

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #97-38**

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

Application of sales and use tax to the installation of water pipe for a municipal water treatment system.

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 TAXPAYER] is involved in contracts with [NUMBER] different municipalities to install water lines as part of their water treatment systems.

The taxpayer installs water lines for the purpose of taking water from a municipal treatment plant to one or two storage tanks. More specifically, potable water leaves the city's water treatment plant and flows through an existing water line toward a water tank. The pipeline which the taxpayer is installing will intercept some of the water prior to its reaching the first storage tank. The taxpayer's pipeline then takes the water to one or two additional storage tanks. However, along the way a portion of the water will be diverted into one or more "feeder lines." This water eventually goes to residential homes. It is estimated that 80-85% of the water in the pipeline goes first to the storage tanks, and only 15-20% flows into the feeder lines before reaching the tanks. There is no separate pipeline to take water away from the storage tanks. Therefore, water in the tank must eventually come back down the pipeline in order to reach the consumers. Other pipelines supply water to these homes as well.

Additionally, one of the cities involved sells water to a neighboring city. The water is sold before it reaches the storage tank, and all the water in the tank belongs to the purchasing city.

ISSUE

Whether the pipelines installed by the taxpayer are subject to sales and use tax.

RULING

Any pumps or other machines used in the pipeline are exempt from sales and use tax. Otherwise, the pipeline is taxable.

ANALYSIS

TENN. CODE ANN. §67-6-209 imposes a contractor's use tax on tangible personal property used by a contractor in the fulfillment of a contract. Therefore, the pipeline installed by the taxpayer will be subject to sales and use tax unless an exemption applies.

The first area in which an exemption may be found is the contractor's use section itself. Tangible personal property sold to a municipality is exempt from sales or use tax. As a general rule, however, the sale to a contractor for the later benefit of a municipality is not. TENN. COMP. R. & REGS. 1320-5-1-.55. Additionally, the contractor must pay tax on property it uses, even if furnished by the municipality. TENN. CODE ANN. §67-6-209(b). However, the contractor's

use statute provides a limited exemption for the repair and maintenance of certain water systems:

There is exempt from the tax imposed by this section or any other provision of this chapter pipes, fittings and materials used to repair or maintain a water utility system owned by a utility district created pursuant to title 7, chapter 82. This exemption applies only to pipes, fittings and materials which become an integral part of the water utility system. This exemption does not apply to any installation of pipes, fittings or materials for any reason other than repair or maintenance of an existing system.

TENN. CODE ANN. §67-6-209(f). The taxpayer installs a new line which will take water to a storage tank and eventually distribute that water into various feeder lines. The facts provided do not support a finding that the waterline installed by the taxpayer is for the repair or maintenance of an existing system.

Turning to the other possible exemption, TENN. CODE ANN. §67-6-206 provides an exemption for industrial machinery, defined in TENN. CODE ANN. §67-6-102(12) as follows:

(A) Machinery, apparatus and equipment with all associated parts, appurtenances and accessories, including hydraulic fluids, lubricating oils, and greases necessary for operation and maintenance, repair parts and any necessary repair or taxable installation labor therefor, which is necessary to, and primarily for the fabrication or processing of tangible personal property for resale and consumption off the premises, 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 or municipality or a contractor pursuant to a contract with such county or municipality for use in water pollution control or sewage systems...

...(iv) As used in this chapter, "pollution control facilities" means 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...

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(D) Such industrial machinery necessary to and primarily for the fabrication and processing of tangible personal property for resale or used primarily for the control of air pollution or water pollution includes, but is not limited to:

- (i) Machines used for generating, producing, and distributing... treated or untreated water;
- (ii) Equipment used in transporting...finished goods from the end of the manufacturing process to storage;

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(F) Such industrial machinery...does not include machinery, apparatus and equipment used prior to or after equipment exempted by subdivision (12)(D)(ii)....

TENN. CODE ANN. §67-6-102(12)(A), (D) and (F).

The provisions contained in TENN. CODE ANN. §67-6-102(12)(A) are not sufficient to exempt the pipeline. While potable water is tangible personal property for resale and consumption off the premises, the pipeline is not used in the actual fabrication or processing of potable water at the plant. With respect to pollution control, in 1980 the Tennessee Supreme Court held that water pollution control “does not include water distribution systems which are designed and used to remove water from streams or underground wells for use as potable water.” *King Construction Company, Inc. v. Tollett*, 599 S.W.2d 797, 798 (Tenn. 1980).

The Court in *King Construction Company* went on to find that no exemption applied to water pipe installed by a contractor for a municipality. However, in 1984 the legislature enacted Public Chapter 762 which expanded the definition of industrial machinery by adding the language found in TENN. CODE ANN. §67-6-102(12)(D) and (F).

TENN. CODE ANN. §67-6-102(12)(D)(i) expanded industrial machinery to include machines used for generating, producing, and distributing treated or untreated water. Water pipe, then, would be exempt if it qualified as a “machine.” Although, pipe has been included under the broad category of “machinery, apparatus and equipment,” under the rules of statutory construction it is assumed that the Legislature used each of these words purposely and that each word has a meaning and purpose. *Locust v. State*, 912 S.W.2d 716, 718 (Tenn. Ct. App. 1995). Therefore, the term “machines” is necessarily more narrow than “machinery, apparatus and equipment.” More importantly however, as noted above, the sales and use tax code was amended in 1993 to exempt pipes, fittings, and materials used to repair or maintain a water utility system owned by a utility district created under title 7, chapter 82. TENN. CODE ANN. §67-6-209(f) (1993 Public Chapter 477). In the discussion surrounding the passage of §67-6-209(f) Representative Head pointed out that the amendment was intended to grant an exemption to small utilities which do not have the equipment to do their own maintenance. H.B. 1407, 98th General Assembly,

House Session, 3rd and final reading, tape #H-101 at 942 (May 13, 1993). Prior to this amendment, while larger utilities could buy pipe tax exempt and install it themselves, smaller utilities would lose the benefit of the exemption when a contractor was hired to install the pipe. Under 367-6-209(f) small utilities can hire a contractor to install the pipe and still retain the benefit of their exemption. *Id.* If 367-6-102(12)(D)(i), which predates 367-6-209(f), included water pipe, then 367-6-209(f) would have been unnecessary. The items exempted by 367-6-209(f) would have already been exempt. Statutes are to be construed so that no part will be inoperative, superfluous, void, or insignificant. *City of Caryville v. Campbell County*, 660 S.W.2d 510, 512 (Tenn. Ct. App. 1983). Therefore, water pipe is not exempt under TENN. CODE ANN. 367-6-102(12)(D)(i). If there are any pumps or other machines which are part of the contract, those items would be exempt as industrial machinery.

It appears at first that TENN. CODE ANN. 367-6-102(12)(D)(ii) may be applicable. Approximately 80% of the water flowing through the pipeline is taken to the storage tank. However, the pipeline serves as more than just a vehicle for taking the product to storage. It is also a major part of the distribution system. Every gallon that goes up the pipe to the storage tank, must come back down the pipe on its way to the consumer. Clearly, the pipeline is used after the storage of the product. Under TENN. CODE ANN. 367-6-102(12)(F), it cannot be considered industrial machinery for the purpose of applying this exemption. The one line which delivers water to a purchaser's water tank is not taking the product to storage. Therefore, the pipeline is not exempt under TENN. CODE ANN. 367-6-102(12)(D)(ii).

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APPROVED: _____

Ruth E. Johnson
Commissioner

DATE: 9-5-97