

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 01-03**

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 Tennessee sales and use tax to a company that sells or installs various [SYSTEMS].

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] is in the business of providing various [SYSTEMS] to its customers. These systems include [VARIOUS PRODUCT SYSTEMS]. Each of these systems is ultimately attached to and becomes a permanent part of real property upon installation.

As discussed below, in some instances the taxpayer will sell the system to a contractor who installs the system. In other cases, the taxpayer will sell part of the system to a

contractor and will subcontract to install a portion of the system itself. In either case, the taxpayer will program, test and certify the system after it has been installed.

The taxpayer provides these systems by way of one of the following scenarios:

1. The taxpayer purchases the system from one of its suppliers and then sells it to [CONTRACTOR "A"]. The [CONTRACTOR "A"] installs the system. The taxpayer subsequently programs, tests, and certifies the system. The taxpayer invoices [CONTRACTOR "A"] a lump sum bid price. The taxpayer's bid price includes a charge for the materials and a charge for programming, testing, and certifying of the system. These charges are not separately stated.
2. This scenario is the same as scenario #1 except that [CONTRACTOR "A"]'s customer is exempt from the payment of Tennessee sales and use tax because it is either an exempt non-profit organization or an exempt federal, state or local governmental entity.
3. A [CONTRACTOR "B"] has a contract to install a complete [Z SYSTEM]. The [CONTRACTOR "B"] plans to install [PART ONE] of the system. The [CONTRACTOR "B"] hires the taxpayer as a subcontractor to install [PART TWO] of the system. The taxpayer purchases the entire system from one of its suppliers. The taxpayer then sells the [MATERIALS] to [CONTRACTOR "B"] for it to install. The taxpayer installs [PART TWO] (or hires a subcontractor to perform the installation on its behalf). The taxpayer subsequently programs, tests, and certifies the system. The taxpayer invoices [CONTRACTOR "B"] a lump sum bid price. The taxpayer's bid price includes a charge for all the materials (both those installed by [CONTRACTOR "B"] and those installed by the taxpayer), a charge for installing [PART TWO], and a charge for programming, testing, and certifying the system. These charges are not separately stated.
4. [CONTRACTOR "A"] has a contract to install the entire system. It plans to install [PART ONE] of the system only. It hires the taxpayer as a subcontractor to install [PART TWO]. The taxpayer purchases the entire system from one of its suppliers. It then sells [PART ONE] of the system to [CONTRACTOR "A"] to install. The taxpayer installs [PART TWO]. The taxpayer subsequently programs, tests, and certifies the system. The taxpayer invoices [CONTRACTOR "A"] a lump sum bid price. The taxpayer's bid price includes a charge for all of the materials (both those installed by [CONTRACTOR "A"] and those installed by the taxpayer), a charge for installation of [PART TWO], and a charge for programming, testing and certifying the system. These charges are not separately stated.

In every case, the taxpayer knows at the time it purchases the system whether it will install any portion of the system itself or will sell the entire system to a contractor. While

most of the systems are sold and installed in Tennessee, occasionally the taxpayer will provide a system to be installed outside Tennessee.

QUESTION

Does Tennessee sales tax apply to the bid price charged by the taxpayer in each of the described scenarios?

RULING

Under the specific facts presented, Tennessee sales tax does apply to the entire bid price charged by the taxpayer in each of the four scenarios, if either title to or possession of the system passes to the purchaser in Tennessee. The contractor is the purchaser. If neither title to nor possession of the system passes to the purchaser in Tennessee, Tennessee sales tax does not apply.

ANALYSIS

Generally, the manner in which sales tax applies depends on whether the property is sold at retail as tangible personal property or is installed pursuant to a contract for the improvement of real property.

A sale at retail in Tennessee is subject to sales tax. T.C.A. § 67-6-202; *Alford v. Butler*, 367 S.W.2d 281 (Tenn. 1963). The elements necessary to constitute a sale are (1) transfer of title or possession, or both of (2) tangible personal property, for (3) a consideration. T.C.A. § 67-6-102(25)(A); *Volunteer Val-Pak v. Celauro*, 767 S.W.2d 635, 636 (Tenn. 1989). If either title to or possession of the tangible personal property passes in Tennessee, the sale is subject to Tennessee sales tax even if the purchaser immediately exports the item. *Jack Daniel Distillery v. Jackson*, 740 S.W.2d 413 (Tenn. 1987). Conversely, if both title to and possession of the property pass to the purchaser outside Tennessee, the sale has not occurred in this state and Tennessee sales tax does not apply. *Eusco, Inc. v. Huddleston*, 835 S.W.2d 576, 582 (Tenn. 1992).

In those cases where tax applies to the retail sale of tangible personal property, the tax base is the sales price of the item. "Sales price" is defined, in pertinent part, as "the total amount for which...tangible personal property is sold, including any services that are a part of the sale of tangible personal property...." T.C.A. § 67-6-102(26).

In contrast to a retail sale, charges for installing property that becomes a permanent part of the realty upon installation are not subject to sales tax. T.C.A. § 67-6-209(c);¹ Tenn. Comp. R. & Regs. 1320-5-1-.27.² Instead, the property installed as a part of realty is

¹ T.C.A. § 67-6-209(c) provides in pertinent part that "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...."

² Tenn. Comp. R. & Regs. 1320-5-1-.27 states in pertinent part as follows: "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."

used and consumed by the contractor in the performance of its contract, and the contractor must pay sales tax to its supplier or remit use tax directly to the Department of Revenue if the supplier fails to collect the tax. Tenn. Comp. R. & Regs. 1320-5-1-.27.

In each of the four scenarios set out in the facts, the taxpayer sells all or part of the system to a contractor who has contracted to install the property as an improvement to realty. Pursuant to the provisions discussed above, the contractor is the user and consumer of the property. Accordingly, the taxpayer is making a retail sale to the contractor and must collect and remit tax on the total amount for which the property is sold, including any services that are a part of the sale. Under the facts presented, programming, testing and certifying the system constitute services that are part of the sale of the system. Charges for those services, therefore, are part of the sales price. As noted, however, the sale will not be subject to Tennessee sales tax if both title to and possession of the property pass to the contractor outside the state.

In the second scenario, the contractor's customer is exempt from the payment of Tennessee sales and use tax because it is either an exempt non-profit organization or an exempt federal, state or local governmental entity. That fact does not change the manner in which sales tax applies in this case. As noted above, the taxpayer is making a retail sale to the contractor, who is the user and consumer of the property in fulfilling its contract. The contractor is not entitled to the benefit of its customer's status as an exempt entity. *See, e.g., United States v. Boyd*, 378 U.S. 39 (1964); *Tennessee Blacktop, Inc. v. Benson*, 494 S.W.2d 760 (Tenn. 1973).

In the third and fourth scenarios, the contractor hires the taxpayer as a subcontractor to install a portion of the property. That portion of the property is not sold by the taxpayer at retail. Instead, the taxpayer has contracted to install the property as an improvement to realty and is therefore the user and consumer of the property. Accordingly, tax generally would not apply to the charges related to that property. However, the taxpayer has charged a single lump sum price for the retail sale of certain tangible personal property and the installation³ of other property to realty. Taxable and non-taxable charges must be separately stated or the entire amount becomes subject to tax.⁴ Accordingly, the lump sum charge is subject to sales tax.⁵

Whether the charge is separated or not, the taxpayer cannot use a resale certificate to purchase the material that it has contracted to install rather than sell at retail. Tenn. Comp. R. & Regs. 1320-5-1-.27; Tenn. Comp. R. & Regs. 1320-5-1-.68. According to the facts provided, in every case the taxpayer knows at the time that it purchases the system whether it will sell the system as tangible personal property or whether it will install a portion of that system as an improvement to real property. Therefore, the taxpayer cannot issue a blanket resale certificate to any vendor from which it purchases

³ Because the taxpayer does not sell the property it installs, the charge for installation of the property to realty refers to the charge for the materials and the labor to install the materials.

⁴ *See* Tenn. Comp. R. & Regs. 1320-5-1-.22(4), 1320-5-1-.23(1), 1320-5-1-.25(1), 1320-5-1-.41, 1320-5-1-.61(2), 1320-5-1-.99(3) for numerous examples where failure to separately state a nontaxable charge causes the entire charge to be subject to tax.

⁵ If the facts were changed and the taxpayer separately stated the charge for installing real property, then sales tax would not apply to those charges.

items that it will install. The taxpayer can only issue a resale certificate to a vendor if the taxpayer intends to resell the items purchased. If the taxpayer purchases items that it intends to resell at the same time that it purchases items that it intends to install, the taxpayer should issue a resale certificate only for those items that it intends to resell and should tell the vendor to collect sales tax on the items that it intends to install.

If the taxpayer pays tax to its supplier on the purchase of materials and subsequently collects and remits tax from the contractor on the entire charge, the taxpayer should take a credit for the tax previously paid to the supplier.

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APPROVED: Ruth E. Johnson
Commissioner

DATE: 2-14-01