

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 11-39**

**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**

The applicability of the Tennessee sales and use tax industrial machinery exemption.

**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] sells and distributes industrial air compressors and related parts, supplies, and services. The Taxpayer's customers are located throughout the United States, and include [TYPES OF CUSTOMERS].

The Taxpayer has introduced a new venture, [REDACTED], whereby the Taxpayer provides compressed air to the customer's place of business. The Taxpayer anticipates that the majority of its [COMPRESSED AIR] customers will be manufacturers, who typically utilize compressed air to operate tools and production line equipment required for the manufacturing of products for resale.

Upon implementation of a ten-year contract for the [COMPRESSED AIR], the Taxpayer installs and maintains its equipment at the customer's location. The Taxpayer retains full ownership and control over the equipment, which includes an air compressor, spare parts, and accessories. The compressor takes in air from the surrounding environment, which it then compresses and delivers. The Taxpayer invoices the customer a standard monthly fee based upon the anticipated range of consumption of compressed air. If the maximum contractual volume of compressed air is exceeded, the Taxpayer invoices a supplementary charge, which is calculated by a predetermined method. The Taxpayer does not lease or rent the [COMPRESSED AIR] equipment to the customer and does not charge the customer for any lease or rental. Additionally, the Taxpayer remits Tennessee use tax with respect to its [COMPRESSED AIR] equipment located in Tennessee.

The Taxpayer recently installed [COMPRESSED AIR] equipment at the [CITY], Tennessee, plant of [NAME OF PLANT] (the "Customer"). The Customer is in the business of manufacturing [PRODUCT]. The Customer describes its use of the compressed air as follows:

Approximately 80% of the volume of compressed air is used to clean bags for dust collection devices; the compressed air is used by releasing high pressure pulses to recover product from the dust collection units around the Customer's facility.

Approximately 10% of the volume of compressed air is used in tanks that accumulate pressures above 90 psi and that deliver a high impact shock, to remove product build-up and accumulation from the walls of pyro-process vessels.

Approximately 5% of the volume of compressed air is used to operate pneumatic actuators as flow valves, natural gas valves, material conveying gates; and other process flow control mechanisms.

Approximately 5% of the volume of compressed air is used to operate analysis instruments and continuous emissions monitors. Specifically, the compressed air is used to perform cleaning and purging cycles to maintain continuous emissions monitors in a clean state, free from debris and plugs, as well as actuate analyzer valves.

## QUESTION

For Tennessee sales and use tax purposes, does the industrial machinery exemption found under TENN. CODE ANN. § 67-6-206(a) (Supp. 2010) apply to the Taxpayer's sales of [REDACTED] compressed air to the Customer?

## RULING

No. For Tennessee sales and use tax purposes, the industrial machinery exemption found under TENN. CODE ANN. § 67-6-206(a) (Supp. 2010) does not apply to the Taxpayer's sales of [REDACTED] compressed air to the Customer. All such sales are subject to the Tennessee sales and use tax.

## ANALYSIS

Under the Retailers' Sales Tax Act, TENN. CODE ANN. § 67-6-101 *et seq.*, the retail sale of tangible personal property is generally subject to the Tennessee sales and use tax.<sup>1</sup> However, TENN. CODE ANN. § 67-6-206(a) (Supp. 2010) exempts "industrial machinery" from the sales and use tax, providing that "[a]fter June 30, 1983, no tax is due with respect to industrial machinery."<sup>2</sup>

TENN. CODE ANN. § 67-6-102(47)(A)(i) (Supp. 2010) defines "industrial machinery" in pertinent part as "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 [sic], that is necessary to, and primarily for, the fabrication or processing of tangible personal property for resale and consumption off the premises ... where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one's principal business."

Therefore, in order for a purchase of tangible personal property to be exempt from the Tennessee sales and use tax as industrial machinery, four requirements must be met. First, the purchaser must be a manufacturer. Second, the tangible personal property purchased must be machinery,

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<sup>1</sup> TENN. CODE ANN. § 67-6-102(79) (Supp. 2010) defines a "retail sale" as any "sale, lease, or rental for any purpose other than for resale, sublease, or subrent." The term "sale" is defined under the Tennessee sales and use tax laws in pertinent part as "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration." TENN. CODE ANN. § 67-6-102(81)(A). Additionally, TENN. CODE ANN. § 67-6-102(92)(A) defines "tangible personal property" in pertinent part as "personal property that can be seen, weighed, measured, felt, or touched."

<sup>2</sup> The burden is on the taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that "[a]lthough the rule is well-established that taxing legislation should be liberally construed in favor of the taxpayer and strictly construed against the taxing authority, it is an equally important principle of Tennessee tax law that 'exemptions from taxation are construed against the taxpayer who must shoulder the heavy and exacting burden of proving the exemption.'" *Am. Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn. Ct. App. 2000) (quoting *Rogers Group, Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn. Ct. App. 1995)). The Tennessee Supreme Court has also stated that the burden is on the taxpayer to establish the exemption, and any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *Am. Airlines*, 56 S.W.3d at 506 (citing *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)).

apparatus or equipment. Third, the tangible personal property must be necessary to the fabrication or processing of the products sold by the purchaser. Fourth, the tangible personal property must be primarily for the fabrication of the products sold by the purchaser.

This letter ruling will not address the first requirement, because none of the other requirements are satisfied.

The second requirement is not satisfied because the Customer does not purchase machinery, apparatus or equipment from the Taxpayer. The facts indicate that the Taxpayer sells compressed air, not equipment. The Tennessee Supreme Court has interpreted the phrase “machinery, apparatus, and equipment” to include “the devices conveying the materials and components from one part of the manufacturing or fabricating process to another.” *Eastman Chemical Co. v. Johnson*, 151 S.W.3d 503, 509-510 (Tenn. 2004). Because compressed air is not machinery, apparatus or equipment, and is not a device used to convey materials from one part of the manufacturing or fabricating process to another, it cannot qualify as exempt industrial machinery.

Note that the Taxpayer does not sell, lease, or rent the [COMPRESSED AIR] equipment to the Customer. TENN. CODE ANN. § 67-6-102(81)(A) defines the term “sale” in pertinent part as “any *transfer of title or possession, or both*, exchange, barter, *lease or rental*, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property *for a consideration*.” (Emphasis added.) Here, the Taxpayer does not transfer title or possession of the [COMPRESSED AIR] equipment to the Customer for a consideration. The Taxpayer retains full ownership and control over the equipment, which includes an air compressor, spare parts, and accessories. The Taxpayer does not charge the customer for any lease or rental of the equipment. Additionally, the Taxpayer remits Tennessee use tax with respect to its [COMPRESSED AIR] equipment located in Tennessee. Rather, the Taxpayer invoices the customer a standard monthly fee based upon the anticipated range of consumption of compressed air. Thus, the Taxpayer sells the Customer compressed air that is generated by the [COMPRESSED AIR] equipment.

Additionally, the third and fourth requirements are not met. To meet these requirements, the compressed air would have to be necessary to the fabrication or processing of the products sold by the Customer and used primarily for the fabrication of the products sold by the Customer.

Here, the facts indicate that the Customer uses approximately 80% of the volume of the compressed air generated by the [COMPRESSED AIR] equipment to clean bags for dust collection devices. Specifically, the compressed air is used by releasing high pressure pulses to recover product from the dust collection units around the Customer’s facility. In other words, at least 80% of the compressed air is used for purposes of cleaning the facility. While such use may benefit the Customer’s manufacturing operations in general, it is not *necessary to or used primarily* for the fabrication of the cement sold by the Customer.

Accordingly, for Tennessee sales and use tax purposes, the industrial machinery exemption found under TENN. CODE ANN. § 67-6-206(a) does not apply to the Taxpayer's sales of [REDACTED] compressed air to the Customer. All such sales are subject to the Tennessee sales and use tax.

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APPROVED: Richard H. Roberts  
Commissioner of Revenue

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