

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 97-13**

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

Whether construction materials purchased or used in Tennessee for use in other states are subject to sales or use tax.

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 a construction company based in Tennessee with offices in [STATE X]. The Taxpayer has construction projects in 7 - 10 different states at any given time. Approximately ninety-five percent of the Taxpayer's construction projects involve new construction of or additions to buildings. At its [CITY], Tennessee location, the Taxpayer operates a prefabrication shop where pipes, valves, and fittings are received from both Tennessee and out of state vendors. The Taxpayer's employees weld and perform other procedures to produce installable piping units which are then shipped to the Taxpayer's job sites throughout the country for installation by the Taxpayer's employees. For example, the Taxpayer prefabricates all the pipes, joints, and required parts for bathroom plumbing to specification in [TENNESSEE CITY], where the machinery and experienced labor are located. The Taxpayer then sends the prefabricated units to the construction site where the installation work crew simply installs the units in the bathrooms by connecting them to the existing plumbing integrated in the building.

ISSUES

1. Whether prefabrication component materials purchased from Tennessee vendors and assembled in state for ultimate installation in buildings in other states is subject to Tennessee sales or use tax as well as sales or use tax imposed in the state in which the material is installed.
2. Whether prefabrication component materials purchased from out of state vendors and assembled in state for ultimate installation in buildings in other states would be subject only to the sales or use tax imposed by the state in which the material is installed.
3. Whether, if a separate company performed the same function as the Taxpayer's [TENNESSEE CITY] location, it would qualify for a resale certificate or for the manufacturer's exemption with respect to its prefabrication activities in [TENNESSEE CITY]; and if so, whether the purchase of the prefabricated material, its sale to a construction company out of state, and the delivery of the material to a job site out of state would then be exempt from Tennessee sales or use tax.

RULINGS

1. The purchase of these materials in Tennessee for assembly in Tennessee is subject to sales and/or use tax regardless of whether the assembled units are installed in other states. This Department cannot give a ruling concerning the law of other states.
2. The purchase of materials from out of state vendors for assembly in Tennessee prior to shipping the units to an out of state construction site is subject to use tax on the cost of the materials brought into Tennessee. The assembled items, however, will be exempt from sales or use tax in Tennessee provided that the units are for use out of state. This Department cannot give a ruling concerning the law of other states.
3. If a separate company performed the Taxpayer's prefabrication activities in Tennessee and constructed piping units for sale to an out of state purchaser with delivery out of state, sales tax would not be due on the transaction. The separate company would be entitled to purchase prefabrication materials with a resale certificate, regardless of the separate company's status as a manufacturer, provided that the company properly registered with the Department for sales and use tax.

ANALYSIS

Tenn. Code Ann. § 67-6-201 states that a person exercises a taxable privilege who "uses or consumes in this state any item of tangible personal property . . . [or] stores for use or consumption in this state any item or article of tangible personal property." A taxable use includes "the exercise of any rights or power over tangible personal property incident to ownership thereof, except that it does not include the sale at retail of that property in the regular course of business." Tenn. Code Ann. § 67-6-102(30)(A).

This Ruling pertains to the units manufactured and installed in buildings as opposed to other improvements to realty.

1. The Taxpayer purchases materials from Tennessee vendors and uses them to produce piping units at its Tennessee location for installation in buildings out of state. TENN. COMP. R. & REGS. 1320-5-1-1.03 (2) states that

[c]ontractors and subcontractors 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.

The Taxpayer is a contractor and does not sell the piping units, but uses them at its construction sites as a component part of a building. Accordingly, when the Taxpayer purchases the component parts from Tennessee vendors, it must pay sales tax to the Tennessee vendor.

The tax paid in Tennessee, however, is based on the sales price of the component items and not on the value of the piping unit as a whole. Tenn. Code Ann. § 67-6-313(a) excludes from sales or use tax “tangible personal property imported into this state or produced or manufactured in this state for export.” The Taxpayer would not be assessed Tennessee use tax on the fair market value of the finished product if the piping units are manufactured for export and are actually exported for the Taxpayer’s use in other states. Accordingly, the value of the completed piping units which are exported from Tennessee for use in other states is not taxed by Tennessee, although the purchase of the component parts in Tennessee is subject to tax.

The Taxpayer questions its tax liability in Tennessee since it intends to pay use tax in the state of the item’s ultimate destination. Sales or use tax is due upon the initial exercise of the taxable privilege. In this case, the taxable privilege is initially exercised when the Taxpayer purchases the items in state or brings the items to Tennessee for use in producing piping units. Sales or use tax is therefore due in Tennessee at that time and cannot be delayed in favor of paying a use tax at a later point in time.

This Ruling cannot address the tax administration or laws of other states.

2. The Taxpayer purchases prefabrication components from out of state vendors for assembly of the piping units in Tennessee. Tenn. Code Ann. § 67-6-210 (a) provides that for

all tangible personal property imported, or caused to be imported from other states . . . and used by a dealer, the dealer . . . shall pay the tax imposed by this chapter on all articles of tangible personal property so imported and used, the same as if the articles had been sold at retail for use or consumption in this state.”

TENN. COMP. R. & REGS. 1320-5-1-1.03 (2) provides that contractors must pay sales or use tax on the purchase price of all component parts installed in buildings. Therefore, the Taxpayer must pay a use tax on the value of the component items it purchases in other states for assembly in Tennessee unless the Taxpayer has previously paid an equivalent amount of tax on the items. Tenn. Code Ann. § 67-6-209(b).

As stated above, because the units are manufactured for export, the Taxpayer would not be assessed tax on the value of the assembled units. Tenn. Code Ann. § 67-6-313(a); *Beecham Laboratories v. Woods*, 569 S.W. 2d 456 (Tenn. 1978). If the component items are brought into the state, stored here, and exported without the Taxpayer using them, the items are not subject to tax under the import for export exemption. Tenn. Code Ann. § 67-6-313(a). This import-for-export exemption from sales tax does not apply when tangible personal property is transferred from a vendor located in Tennessee to a purchaser also located in Tennessee even though the purchaser intends to and does export the merchandise. *Jack Daniel Distillery v. Jackson*, 740 S.W. 2d 413 (Tenn. 1987). The

import for export exemption does not apply to materials used in Tennessee to fabricate items for use outside Tennessee. *Nasco, Inc. v. Jackson*, 748 S.W. 2d 193 (Tenn. 1988).

The Taxpayer uses these component materials in its prefabrication plant in Tennessee. Accordingly, the Taxpayer is required to pay use tax on the materials to the extent they have not been previously taxed.

This Ruling cannot address the tax administration and laws of other states.

3. If a separate company performed the Taxpayer's prefabrication activities in Tennessee and constructed piping units for sale to an out of state purchaser, sales tax would not be due on the value of the completed units because a taxable sale would not occur in Tennessee.

The separate company, once properly registered with the Department, would be entitled to use a resale certificate to purchase the component parts free of tax. Tenn. Code Ann. § 67-6-102(23)(A) defines a retail sale to include a "taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose other than resale." A sale for resale, then, is not a taxable retail sale. Resale of the units, as opposed to the manufacture of the units for the company's own use, is a requirement for the exemption to apply. The purchase of prefabrication materials by the separate company would be exempt from tax if the company resold the completed units.

The company could purchase components on a resale certificate regardless of whether it was deemed a manufacturer. The separate company may qualify as a manufacturer if its primary revenue generating activity involved "the fabrication or processing of tangible personal property for resale and consumption off the premises." Tenn. Code Ann. § 67-6-102(12)(A). Since a separate company would resell the piping units, as opposed to the Taxpayer's construction of the units for its own use, the separate company may be deemed a manufacturer upon application to the Department. If the company were a manufacturer, any items "bought for future processing, manufacturing, or conversion into articles of tangible personal property for resale, where such materials become a component part of the finished products, [would] not [be] subject to Sales or Use Tax." TENN. COMP. R. & REGS. 1320-5-1-.40. The separate company's status as a manufacturer, then, does not affect the company's ability to purchase the components exempt from tax.

If the Taxpayer purchased the units from the separate company in Tennessee, it would be required to pay sales tax on the transaction, even if the Taxpayer intends to and actually does export the units. *Jack Daniels Distillery v. Jackson*, 740 S.W. 2d 413 (Tenn. 1987). If the separate company sold the units to an out of state company by shipping the units out of state without a transfer of title or possession in Tennessee, the transaction would not be subject to tax.

Caroline R. Krivacka
Tax Counsel

APPROVED: Ruth E. Johnson
Commissioner

DATE: 5/23/97