

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 99-12**

**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 sale and installation of flooring materials.

**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] has several locations in Tennessee which sell and install floor coverings in Tennessee. The floor coverings include, but are not limited to, carpet, tile, linoleum, sheet vinyl, vinyl tile, terrazzo, marble, hardwood floors, and cove base. Each location operates independently from other locations and

maintains an autonomous controller and/or operations manager as well as distinct financial statements. In some cases, locations may even compete with one another. A location engages in either retail/residential floor covering services (“Retailers”) or commercial floor covering services (“Contractors”).

Retailers sell floor coverings within the state primarily to residential customers. Retailers maintain sales facilities in the state. Although customers may arrange for installation themselves, Retailers usually provide installation services. Retailers install floor coverings primarily through independent contractors and occasionally through employees. In all cases, Retailers are contractually obligated to perform installation services. The contracts for installed floor coverings may be either lump-sum or separated-fee contracts. Retailers maintain inventories of pads, limited subflooring supplies, and minor amounts of carpet and noncarpet floor coverings. Most materials are ordered on a per job basis. These inventories may be maintained either on site or by a local distribution facility.

The Taxpayer has Contractors in bordering states that primarily act as general contractors for installation services in commercial structures and sometimes as subcontractors for contracts solicited by general contractors. Occasionally, contracts for installation in residential structures are accepted, but generally they are for new residential communities. Upon contract acceptance, Contractors provide and install the floor coverings.

Contractors generally do not maintain sales facilities. They may maintain a small amount of inventory, but they primarily order materials on a per job basis. The contracts for installation services may be either on a lump-sum basis or a separated-fee basis.

Wall-to-wall carpet can be installed by two methods, tack strips or glue. Under the tack strip method, the installer staples or glues a carpet pad to the subfloor. The carpet is then attached over the pad to a tack strip which is nailed to the edges of the subfloor. Under the glue method, the carpet is glued directly to the subfloor. Removing tacked down carpet usually tears the carpet and damages the subfloor. To remove glued carpet, the customer must cut the carpet and rip it up. The carpet is not reusable, and the surface floor may need repair before a new floor is installed.

Carpet tile can be installed by two methods, glue or release adhesive. Under the glue method, the tile is glued directly to the subfloor. It may be removed after installation but is generally only removed and replaced when damaged or worn. Thus, glued down carpet tile is not normally reusable. Further, the subfloor may need repair due to residual glue. Under the release adhesive method, carpet tile is attached to the floor by an adhesive which allows for easier removal and/or movement. As a practice, carpet tiles are not moved until they are damaged or worn. Again, the subfloor may need repair due to residual adhesive.

To install sheet vinyl and vinyl tile floors, the installer creates a smooth subsurface over the subfloor and underlayment. The installer then glues vinyl to the underlayment. Vinyl is usually removed with a hammer and chisel or like instruments. Sometimes heat is used to soften the glue. Removing sheet vinyl destroys the flooring and damages the subfloor.

Ceramic tile generally requires the installer to trowel a thin bead of mortar on the floor and then set a durock board into the mortar. The durock board is secured by nails. The ceramic tile is then glued to the durock board. To remove the ceramic tile, a jackhammer or crowbar is required to break up the ceramic tiles and durock layer, thus destroying the tile and damaging the subfloor. Ceramic tile can also be installed on a recessed floor by setting the tiles in a bed of concrete. Using this method, there is no way to remove the tile without destroying the tile and/or subfloor.

Terrazzo is installed in a mud process similar to that employed in laying concrete. The installer pours, smooths, and hardens the material onto the subfloor. There are no tiles laid. Removal destroys the terrazzo and subfloor.

Marble is installed by precasting the marble in blocks and setting it in mortar. The installation process is similar to installing bricks. Removing the marble floor would destroy the marble and the subfloor.

Hardwood floors are generally installed over an existing underlayment. The underlayment is attached through the board with ring-shanked nails. The installer trowels out glue and sets the wood floor. Boards are then nailed together on the subfloor. The hardwood floor could be removed with a hammer and chisel or like instruments. The removal would generally damage the hardwood floor, destroy the underlayment, and damage the subfloor.

Cove base is a transition piece of rubber material used to finish or cover the edges of walls. Removing cove base requires stretching and bending it out of shape. Cove base is not reusable after removal.

## **ISSUES**

1. Whether the sale and installation of each of the floor coverings, installed by the methods outlined above, is a sale of tangible personal property or an improvement to real estate.
2. Whether the form of contract used (separated fee, cost-plus, time and materials with upset/guaranteed price, or lump-sum) for the installation of floor coverings impacts the classification as tangible personal property or as an improvement to real estate.

3. Whether the Taxpayer is exempt from sales or use tax on the purchase or use of materials for installation in a church.
4. What are the type of structures referred to in Tenn. Code Ann. § 67-6-209(b) with respect for the exemption for materials used in “church, nonprofit college or university construction” and “carpet installed for a church”?

### **RULINGS**

1. The sale and installation of each of the floor coverings is deemed an improvement to real estate unless the parties intend otherwise.
2. The form of the contract used does not impact the classification of the floor covering unless it reflects the intent of the parties that the floor coverings are tangible personal property.
3. The Taxpayer’s use of materials for installation in a church is exempt from use tax provided that the materials are purchased by the church for church construction. Carpet installed for a church is specifically exempt.
4. The structures to which the exemption applies are those buildings on church, private, nonprofit college or university property in which commonly recognized functions of the church, private, nonprofit college or university are carried on, which are exempt from property tax, and used for noncommercial purposes, but not any other building or improvement to real property. The exemption for carpet installed for a church applies to any church structure.

### **ANALYSIS**

Contractors who install tangible personal property are deemed the users and consumers of that property and generally must pay sales or use tax on the purchase price. Tenn. Code Ann. § 67-6-209(b). If tangible personal property is installed by a contractor as an improvement to realty, the transaction is not a taxable sale. Tenn. Code Ann. § 67-6-209(c).

1. Whether a fixture remains personal property or becomes realty is a mixed question of law and fact. *Fuson v. Whitaker*, 28 Tenn. App. 338, 341, 190 S.W. 2d 305, 307 (1945). 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 Co. 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, 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.

Intent may be shown by examining both objective and subjective factors. *Hubbard v. Hardeman County Bank*, 868 S.W. 2d 656 (Tenn. App. 1993). The objective factors include the type of structure, the mode of attachment and the use and purpose of the property. The subjective factor is the expressed intent, if any, of the parties. The court in *Hubbard* determined that branch bank buildings were not realty but remained tangible personal property. The court found that the buildings were constructed to be portable, such that they could be moved or sold as market conditions or a need for the buildings changed. If the land upon which the buildings were located was sold, the owner of the land would not own the buildings. The ground leases for the buildings expressly provided that the buildings were not to become fixtures.

In the present case, each type of floor covering sold is affixed to the subfloor or floor. The intent of the Taxpayer and customer appears to be that the various flooring materials are installed as permanent improvements to realty and will remain attached thereto for the length of its useful life to the owner of such realty. If the intent is that the items remain tangible personal property, that intent will override any assumption based on the method of installation. Accordingly, the Taxpayer must pay tax on its cost of the materials but need not collect tax on the amount charged for installation.

2. The form of contract used will not affect the determination of whether the materials are improvements to realty as opposed to tangible personal property unless there are terms expressing any intent that the floor coverings remain tangible personal property. The forms of contract listed by the Taxpayer differ only in pricing method: separated-fee, cost-plus, time and materials with upset/guaranteed price, or lump-sum. The Taxpayer will pay sales or use tax on the cost of the materials used, but is not required to charge sales tax on any installation charges.

3. Tenn. Code Ann. § 67-6-209 (b) provides in relevant part that

Where a contractor . . . uses tangible personal property in the performance of his contract . . . except where the title holder [of the tangible personal property] is a church . . . and the tangible personal property is for church . . . construction, such contractor

or subcontractor shall pay a tax at the rate prescribed by § 67-6-203 measured by the purchase price of such property . . .The sales or use tax levied by this chapter shall not apply to carpet installed for a church when the church is exempt from sales or use taxes under § 67-6-322.

The rule construing this statute states that

(2) Any tangible personal property or taxable service which is furnished by a church to a contractor or subcontractor for use in church construction is exempt from the provisions of this regulation, but the exemption does not apply to any materials which may be furnished and used in constructing any other building or improvement to real property even though it may be for a church supported hospital, school, orphanage, etc.

Tenn. Comp. R. & Regs. 1320-5-1-.1.01. Clearly, then, if a church purchased the flooring materials installed by the Taxpayer in a church building, the Taxpayer would not be liable for use tax on the materials. If the material installed is carpet, the statute clearly exempts the carpet installed for a church from sales or use tax, regardless of where it is installed or who purchases the carpet.

4. The exemption in Tenn. Code Ann. § 67-6-209(b) applies to materials used in “church, private nonprofit college or university construction.” This exemption applies only to the state portion of the sales tax for private nonprofit colleges or universities. *Id.* There are no further guidelines within the statute to determine what constitutes church, private nonprofit college, or university construction.

The word “church” is not defined in either a statute or an administrative rule. The common understanding of a church is a “place where persons regularly assemble for worship.” Black’s Law Dictionary (6th ed.). Tennessee courts have not defined the word in considering this exemption from sales and use tax.

Tangible personal property purchased free of Tennessee sales and use tax by a church under the exemption granted churches under Tenn. Code Ann. § 67-6-322(a)(1) and used by the Taxpayer in performance of a contract to construct a building will be exempt from the use tax imposed by Tenn. Code Ann. § 67-6-203 if the building constructed meets all of the following tests:

1. It qualifies for exemption from property taxes.
2. It is not used for commercial purposes.
3. It is used for commonly recognized church functions.

With regard to the first criterion Tenn. Code Ann. § 67-5-212(a)(1) exempts from property tax any property used purely for religious purposes as follows:

There shall be exempt from property taxation the real and personal property, or any part thereof, owned by any religious . . . institution which is occupied and used by such institution or its officers purely and exclusively for carrying out thereupon one (1) or more of the purposes for which the institution was created or exists . . . provided, however, that no church shall be granted an exemption on more than one (1) parsonage which shall include not more than three (3) acres of land exempt as hereinafter provided; and provided further, that no property shall be totally exempted, nor shall any portion thereof be pro rata exempted unless such property or portion thereof is actually used purely and exclusively for religious, . . . purposes. For the purposes of this section, a church parsonage shall be deemed to be property used purely and exclusively for religious purposes; provided, however, that no church shall be granted an exemption on more than one (1) parsonage.

If a building appears to be exempt from property tax under Tenn. Code Ann. § 67-5-212(a)(1), the first of the three criteria listed will be satisfied.

As to the second criterion, property owned by a religious institution but used to operate a secular business outside the institution's charter will not be exempted from property taxation. *Christian Home for the Aged, Inc. v. Tenn. Assessment Appeals Comm'n*, 790 S.W. 2d 288, 1990 Tenn. App. LEXIS 83 (Tenn. App. 1990); *City of Nashville v. State Board of Equalization, et al.*, 360 S.W.2d 458 at 468 (Tenn. 1962), (religious institution's realty used for operation of commercial parking lots, cafeteria and snack bar in competition with similar tax paying businesses is not exempt from property taxation). The church could not require membership status or fees for use of a building facility or use it as a revenue generating source. To meet to the third criterion, all of the uses which the church plans for the building facility must be within the scope of commonly recognized church functions and appear consistent with purely religious rather than commercial purposes.

As Tenn. Comp. R. & Regs. 1320-5-1-1.01(2) states, however, the exemption from sales and use tax does not apply to any other building aside from a church, notwithstanding the fact that it may be related to or supported by the church, such as a hospital, school, or orphanage. This specific language clearly indicates that the exemption is limited to the common understanding of a church, i.e., the church and associated buildings as opposed to church-supported entities and locations.

To be considered a church, then, the Department considers whether the property is exempt from property tax and used for religious and non commercial

purposes. The Taxpayer would not have to pay use tax on materials purchased by a church and used in the construction of a church, based on the common understanding of a church building, taking into consideration the limitations in Tenn. Comp. R. & Regs. 1320-5-1-1.01(2).

Using the same rationale, materials used for buildings are exempt under the private nonprofit college and university provision of Tenn. Code Ann. § 67-6-209(b) if they can be deemed reasonably related to the functions of the nonprofit college or university. For example, a student bookstore, copy shop, or cafeteria are reasonably related, whereas a grocery store or bank building on college or university property are not.

The exemption for carpet installed for a church applies to any structure as long as the carpet is installed for a church.

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APPROVED: Ruth E. Johnson, Commissioner

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