

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 02-02**

**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 the Tennessee sales and use tax to certain pallets, some of which are temporarily used for storage of raw material prior to being resold to customers as part of a finished product manufactured and sold.

**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 revocation of the ruling must inure to the taxpayer's detriment.

**FACTS**

At its Tennessee manufacturing facility, [THE TAXPAYER], fabricates or processes for resale the [TYPE OF PRODUCTS] often seen on highly visible areas of [TYPES OF LOCATIONS]. These [PRODUCTS] typically [ARE USED IN ASSOCIATION WITH] products of various companies that are associated with some [TYPE OF SALES PROMOTION]. The Taxpayer [MANUFACTURES] separate [TYPES OF COMPO-

NENTS] in the process of fabricating [THE PRODUCT]. Most of the assembled products produced also require the use of [ADDITIONAL COMPONENTS].

Prior to selling the [PRODUCT] to its customer, the Taxpayer [PERFORMS AN ADDITIONAL SERVICE FOR ITS CUSTOMER] pursuant to instructions provided by the customer. Finally, the [FINAL PRODUCTS] are placed on pallets and stretch-wrapped securely in all directions, and the final product (including the pallet) is shipped to a location specified by the customer. In every instance, ownership of the pallet is transferred to the customer as a necessary part of the sale of the [PRODUCT], and the pallet is not returned to the Taxpayer. No separate charge to the customer is made for any of the pallets.

The Taxpayer needs to continuously purchase pallets on a regular basis to keep up with the demand for its products. Before transferring them to customers as a necessary component of each product sold, the Taxpayer does make use of some<sup>1</sup> of the pallets it purchases by temporarily storing raw materials [SPECIFIC COMPONENTS] on them prior to actual production. In every instance, however, these particular pallets are eventually moved to the end of the manufacturing process where, as originally intended, they become a part of the final product which is transferred and sold to the Taxpayer's customer.

The Taxpayer possesses a valid industrial machinery authorization number and is considered a manufacturer or processor by the Tennessee Department of Revenue.

## **QUESTION**

Is the Taxpayer entitled to purchase all of its pallets exempt from Tennessee sales or use tax pursuant to either the "resale" exemption or the special statutory exemption for packaging materials and containers (or both), even if some of the pallets are temporarily used for raw material storage prior to being resold to customers as part of the finished product manufactured and sold?

## **RULING**

No. While the Taxpayer will not owe sales or use tax on its purchase of pallets used only for the shipping of its product, the Taxpayer will owe sales or use tax on those pallets that are used for storage prior to being shipped to the Taxpayer's customer.

## **ANALYSIS**

Tennessee imposes the sales tax upon "the privilege of engaging in the business of selling tangible personal property at retail in this state." T.C.A. § 67-6-202(a). A "sale at retail" means:

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<sup>1</sup> According to the Taxpayer, the actual percentage of pallets used for storage is well below 50% of all pallets purchased.

a taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose other than for resale. . . . Any sales for resale must, however, be in strict compliance with rules and regulations promulgated by the commissioner . . . .

Tenn. Code Ann. § 67-6-102(24(A)).

The term “sales for resale” is defined to mean:

those whereby a supplier of materials . . . makes such tangible personal property available to . . . dealers actually selling such property or services *as such*, or which becomes an industrial material or supply in a manufacturing or processing operation”. (emp. added).

Tenn.Comp.R. & Reg. § 1320-5-1-.62(1) (1987).

Based on the foregoing, the Taxpayer is not entitled to purchase the pallets exempt from the sales tax pursuant to the resale exemption. First, the Taxpayer makes no separate charge for the pallets. Second, the Taxpayer is not purchasing the pallets for resale *as such* to its [PRODUCT] customers. Instead, the Taxpayer is purchasing the pallets for the dual purpose of raw material storage and as a packaging material for shipment of its [PRODUCTS].

Since the Taxpayer's purchase of the pallets will not be exempt from Tennessee sales and use tax under the resale exemption, the next inquiry is whether or not the Taxpayer can purchase some or all of its pallets exempt from the tax pursuant to the exemption for packaging materials and containers found at Tenn. Code Ann. § 67-6-102(24)(E).

Tenn. Code Ann § 67-6-102(24)(E) states, in pertinent part:

"Sale at retail," "use," "storage," and "consumption" do not include the sale, use, storage or consumption of:

\* \* \*

(ii) Materials, containers, labels, sacks, bags or bottles used for packaging tangible personal property when such property is either sold therein directly to the consumer or when such use is incidental to the sale of such property for resale . . .

Tenn. Code Ann. § 67-6-102(24)(E)(ii).

Tenn. Comp. R. & Regs. 1320-5-1-.11 (hereinafter “Rule 11” or “the Rule”), entitled “Containers, Wrapping and Packaging Materials and Related Products” interprets Tenn. Code Ann. § 67-6-102(24). The first paragraph of the regulation states:

Items actually accompanying the product sold or shipped, without which the delivery of the product is impracticable on account of the character of the contents, and for which there is no separate charge, are not subject to Sales or Use Tax. These items include such things as containers, packing materials, labels or name plate affixed to products manufactured, and printed matter containing only directions for use.

Tenn. Comp. R. & Regs. 1320-5-1-.11(1).

The Rule must be read in conjunction with the statute. While the Commissioner of Revenue is authorized to prescribe reasonable rules and regulations not inconsistent with the taxing statutes under Tenn. Code Ann. § 67-1-102, such rules and regulations may not enlarge the scope of either a taxing statute or an exemption. See, *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Volunteer Val-Pak v. Celauro*, 767 S.W.2d 635, 637 (Tenn. 1989); *Coca-Cola Bottling Co. v. Woods*, 620 S.W.2d 473, 475-76 (Tenn. 1981).

Furthermore, Tenn. Code Ann § 67-6-102(24) operates to negate in part other provisions of the Retailers' Sales Tax Act that would otherwise impose sales or use taxes. Therefore, the rules of statutory construction that apply to exemptions apply to the construction and application of Tenn. Code Ann. § 67-6-102(24). See *Hutton v. Johnson*, 956 S.W.2d 484 (Tenn. 1997). Tax exemption statutes will be construed against the taxpayers and exemptions will not be implied. *Hyatt v. Taylor*, 788 S.W.2d 554 (Tenn. 1990). Every presumption is against exemption, and any well founded doubt defeats a claimed exemption. *United Cannery, Inc. v. King*, 696 S.W.2d 525 (Tenn. 1985). The burden is upon the taxpayer to establish a claimed exemption. *Woods v. General Oils, Inc.*, 558 S.W.2d 433 (Tenn. 1977).

Under Tenn. Code Ann. § 67-6-102(24) and Rule 11, an item will be exempt if:

- 1) it is a material, container, label, sack, bag or bottle;
- 2) used for packaging tangible personal property when such property is either sold therein directly to the consumer or when such use is incidental to the sale of such property for resale;
- 3) it accompanies the tangible personal property sold or shipped;
- 4) delivery of the tangible personal property is impracticable without the item on account of the character of the tangible personal property; and
- 5) there is no separate charge for the item.

The Taxpayer's pallets satisfy each of the five requirements. The first and second requirement is satisfied because the pallets are materials used to package the [PRODUCTS] that are sold directly to the Taxpayer's customers. While it is true that

pallets are not generally thought of as “packaging”, the Taxpayer’s shrink wrapping of the display cases to the pallets prior to shipment indicates that, with this taxpayer, the pallets are being used as materials for packaging tangible personal property. The third and fourth requirements are satisfied because the pallets accompany the [PRODUCTS] that are sold or shipped and the character of the [PRODUCTS] are such that delivering them to the Taxpayer’s customers without the pallets would be impracticable. Finally, the fifth requirement is satisfied because the Taxpayer does not make a separate charge for the pallets.

Based on the foregoing, the Taxpayer’s purchase of those pallets used solely as packaging materials will be exempt from Tennessee sales and use tax. Those pallets that are also used for temporary storage of the Taxpayer’s raw materials, however, will not qualify for the exemption.

Under the Retailers’ Sales Tax Act, Tenn. Code Ann. § 67-6-101 et. seq., the legislature has declared it a taxable privilege for a person to use or consume in this state any item or article of tangible personal property as defined in Chapter 6 of Title 67 of the Tennessee Code. Tenn. Code Ann. § 67-6-201(2). A tax is levied on the cost price of each item or article of tangible personal property when the same is not sold but is used, consumed, distributed, or stored for use or consumption in this state. Tenn. Code Ann. § 67-6-203(a). Furthermore, Tenn. Comp. R. & Regs. 1320-5-1-.95 (hereinafter “the Rule”), entitled “Use of Property Upon Which No Sales or Use Tax Has Been Paid”, provides as follows:

When a person purchases tangible personal property upon which no Sales or Use Tax is paid, and which is used or consumed as tangible personal property subject to the Sales or Use Tax, such use must be reported and a tax paid thereon for the month in which the taxable use arose. It is the duty of the person to keep accurate records to show what determination is made of such property.

Tenn. Comp. R. & Regs. 1320-5-1-.95.

In the case of the pallets used for storage and later used as a part of the packaging of the [PRODUCTS] that are shipped to customers, it is important to note that there are two taxable events. The first tax event is the use of the pallets for raw material storage. This use is a taxable event under Tenn. Code Ann. § 67-6-203(a) and Tenn. Comp. R. & Regs. 1320-5-1-.95. The second event is the use of the pallets for packaging tangible personal property. The fact that the second event is exempt from sales and use tax under Tenn. Code Ann. § 67-6-102(24)(E)(ii) and Tenn. Comp. R. & Regs. 1320-5-1-.11(1) is immaterial because the pallets have already been used for a taxable event and the taxes have been properly paid accordingly.

Based on the foregoing, to the extent the pallets are used or consumed by the Taxpayer in Tennessee, the pallets are subject to Tennessee’s use tax. Since the Taxpayer does make use of some the pallets it purchases by temporarily storing raw materials on them prior to

actual production, the Taxpayer is obligated to pay the sales or use tax levied by Tenn. Code Ann. § 67-6-203(a) on those pallets.

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APPROVED: Ruth E. Johnson  
Commissioner

DATE: 02-12-02