

TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 19-07

Revenue rulings are not binding on the Department. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The application of the Tennessee sales and use tax to [SPECIALIZED FARMING] equipment.

SCOPE

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

FACTS

[TAXPAYER] (the "Taxpayer") is [REDACTED] that is developing [SPECIALIZED FARMING EQUIPMENT]. The Taxpayer plans to sell [SPECIALIZED FARMING EQUIPMENT] systems (the "Systems") to farmers in Tennessee. The Taxpayer does not sell directly to end users; the Taxpayer sells to dealers (the "Dealers") who then sell, install, and provide maintenance for the Systems to end users who are primarily farmers. The purpose of the Systems is to allow farmers to [REDACTED].

A System typically includes the following [REDACTED] equipment:

1. [REDACTED]
2. [REDACTED]
3. [REDACTED]
4. [REDACTED]
5. [REDACTED]

The Taxpayer's [REDACTED] equipment is portable and modular. Each System can be customized to fit various farm locations and sizes. The component items of equipment, however, are standardized and can be removed and reused in other locations on the farm or on other farms without any injury to the real property.

When selling a System, Dealers customize the System based on the customer's needs. Dealers then itemize the necessary individual components and charge a separate installation fee for the entire System. Each System also includes a [TIME PERIOD] warranty. Upon expiration of the initial warranty, Dealers may offer repair services and/or an additional warranty or service contract.

The initial System purchase also includes software that has been installed on the hardware and that can be downloaded and installed on customers' computers and mobile devices. The software allows a customer to monitor and control the System remotely. The software can also set up automation

to turn [SYSTEM COMPONENTS] on or off based on data received by the System. The initial download of the software to customers' computers and mobile devices is included with purchase of a System. Software runs on the System equipment and customers' devices; the software is not cloud-based.

Customers are currently provided annual software updates at no additional charge. In the future, Dealers will offer optional annual software updates for direct download for additional fees. The software updates will be offered in the form of a maintenance agreement. These annual software updates are not required for continued operation of the System once it is installed.

RULINGS

1. Are the Dealer's sales and installations of [SPECIALIZED FARMING] equipment sales of tangible personal property or improvements to real property?

Ruling: The sales and installations of [SPECIALIZED FARMING] equipment are sales of tangible personal property because the Dealer sells and installs tangible personal property that remains tangible personal property after installation.

2. Does the sale and installation of [SPECIALIZED FARMING] equipment, qualify for the farm equipment and machinery exemption under TENN. CODE ANN. § 67-6-207(a)(1) (2018) if the buyer is a qualified farmer or nurseryman?

Ruling: The sale of [SPECIALIZED FARMING] equipment, to a buyer who is a qualified farmer or nurseryman as defined in TENN. CODE ANN. § 67-6-207(e), qualifies for the farm equipment and machinery exemption in TENN. CODE ANN. § 67-6-207(a)(1) because the buyer is using the [SPECIALIZED FARMING] equipment directly and principally for the purpose of producing agricultural products for sale and use or consumption off the premises. Charges for installation of exempt [SPECIALIZED FARMING] equipment are also exempt from Tennessee sales and use tax when the Dealer both sells and installs the exempt [SPECIALIZED FARMING] equipment.

3. Are the Dealer's sales of additional warranty or service contracts covering the equipment in the system subject to the Tennessee sales and use tax?

Ruling: Yes. The Dealer's sales of additional warranty or service contracts covering the equipment in the system are subject to the Tennessee sales and use tax pursuant to TENN. CODE ANN. § 67-6-208 (2018).

4. Are the Dealer's sales of optional annual software updates subject to the Tennessee sales and use tax?

Ruling: No. While sales of software updates are generally subject to the Tennessee sales and use tax, the Dealer's sales of optional annual software updates are exempt from the Tennessee sales and use tax pursuant to TENN. CODE ANN. § 67-6-207(a)(1) (2018) because the software is used to operate equipment that is used directly and principally for the purpose of producing agricultural products for sale and use or consumption off the premises.

ANALYSIS

Tangible Personal Property

Under the Retailers' Sales Tax Act,¹ the retail sale in Tennessee of tangible personal property and specifically enumerated services are subject to the sales tax, unless an exemption applies.² One specifically enumerated service taxable at retail is the installing of "tangible personal property that remains tangible personal property after installation . . . where a charge is made for the installation."³ Thus, the Dealer's sale and installation of [SPECIALIZED FARMING] equipment will be subject to the Tennessee sales and use tax if the [SPECIALIZED FARMING] equipment remains tangible personal property following installation, unless an exemption applies.⁴ If, on the other hand, the [SPECIALIZED FARMING] equipment becomes affixed to realty upon installation, the sale and installation of the [SPECIALIZED FARMING] equipment will not be subject to the Tennessee sales and use tax.⁵

The issue of whether an item of tangible personal property becomes part of realty depends upon the application of the law of fixtures to the particular factual circumstances.⁶ The question of when an item is considered a fixture is resolved by ascertaining the intent of the parties.⁷ "Only those chattels are fixtures which are so attached to the freehold that, from the intention of the parties and the uses to which they are put, they are presumed to be permanently annexed, or a removal thereof would cause serious injury to the freehold."⁸ Therefore, if the property is "intended to be removable

¹ Tennessee Retailers' Sales Tax Act, ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts 22, 22-54 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2018)).

² "Retail sale" is defined as "any sale, lease, or rental for any purpose other than for resale, sublease, or subrent." TENN. CODE ANN. § 67-6-102(76) (2018). TENN. CODE ANN. § 67-6-102(78)(A) defines "sale" in pertinent part to mean "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."

³ TENN. CODE ANN. § 67-6-205(c)(6) (2018). "Tangible personal property" includes "property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses." TENN. CODE ANN. § 67-6-102(89)(A).

⁴ Installation charges are subject to sales and use tax as part of the sales price. See TENN. CODE ANN. § 67-6-102(79)(A) (defining "sales price" to include installation charges); TENN. COMP. R. & REGS. 1320-05-01-.27(2) (2016) (providing that installation services provided with the sale of tangible personal property are a part of the sales price of the tangible personal property sold).

⁵ However, the Dealer would be liable for use tax with respect to all tangible personal property used in the performance of its contract, unless the Dealer had already paid sales and use tax on the purchase of such items or such items are otherwise exempt from the sales and use tax. See TENN. CODE ANN. § 67-6-209(b) (2018); TENN. COMP. R. & REGS. 1320-05-01-.07(1) (2000) ("contractors engaged in constructing or improving real property, whether on a lump sum or a cost-plus basis, are purchasers and consumers of the materials used by them, and are required to pay the Sales or Use Tax on such materials or equipment purchased or imported into this State for use in connection with their contracts.").

⁶ See, e.g., *Gen. Carpet Contractors, Inc. v. Tidwell*, 511 S.W.2d 241 (Tenn. 1974) (holding that for sales and use tax purposes, the dispositive issue regarding whether a contractor is improving realty is whether the property being installed becomes a fixture to the realty).

⁷ *Id.* at 242-43.

⁸ *Magnavox Consumer Electronics v. King*, 707 S.W.2d 504, 507 (Tenn. 1986) (quoting *Hickman v. Booth*, 173 S.W. 438 (Tenn. 1914)).

at the pleasure of the owner, it is not a fixture.”⁹ However, when property is installed upon real property pursuant to a non-ownership interest in the real property, such as a lease or easement, Tennessee courts have determined that the key question becomes whether the parties intend that the owner of the property being installed has the ability to remove the property from the land, asking whether the installed property remains “separate and apart from the freehold.”¹⁰

Therefore, if the property is intended to be removable at the pleasure of the owner, it is not a fixture.¹¹ Both objective and subjective factors may show such intent.¹² Objective factors include the type of structure, the mode of attachment, and the use and purpose of the property.¹³ The subjective factor is the expressed intent, if any, of the parties.¹⁴

Courts have also found that tangible personal property becomes a part of realty if removing the personalty would seriously damage the building to which it is affixed.¹⁵ Further, courts have held that tangible personal property is more akin to a fixture if removal would destroy its essential character as personalty.¹⁶

For example, the Tennessee Supreme Court in *Harry J. Whelchel Co.* analyzed both the stated intent and the objective factors noted above of farmers who purchased and installed grain bins on their farms. The Court reached the conclusion that the grain bins at issue were personalty.¹⁷ Although the bins were large in size and bolted to a concrete base, the court found that they were attached to the concrete base solely for the purpose of preventing them from blowing over in a high wind when empty.¹⁸ Additionally, the bins were financed as personal property, sold at foreclosure as personal property, and installed by lessees on leased farms.¹⁹ Likewise, the Tennessee Court of Appeals in *Keenan* found that a large ornamental gate remained personalty despite having a substantial concrete foundation poured for its support that would leave craters were it removed.²⁰ The court

⁹ *Id.*

¹⁰ *ANR Pipeline Co., et al. v. Tenn. Bd. of Equalization*, Nos. M2001-01098-COA-R12-CV, M2001-01117-COA-R12-CV, M2001-01119-COA-R12-CV, 2002 WL 31840689, at *3 (Tenn. Ct. App. Dec. 19, 2002), *perm. app. denied*, June 30, 2003.

¹¹ *Id.*

¹² *Hubbard v. Hardeman Cnty. Bank*, 868 S.W.2d 656, 660 (Tenn. Ct. App. 1993).

¹³ *Harry J. Whelchel Co. v. King*, 610 S.W.2d 710, 713-14 (Tenn. 1980).

¹⁴ *Id.*

¹⁵ *See Process Sys., Inc. v. Huddleston*, No. 101801-I, 1996 WL 614526, at *3 (Tenn. Ct. App. Oct. 25, 1996) (citing *Memphis Hous. Auth. v. Memphis Steam Laundry-Cleaner, Inc.*, 463 S.W.2d 677, 679 (Tenn. 1971)).

¹⁶ *See id.* (finding that conveyor system’s essential character would be destroyed upon removal, which required cutting system components into pieces with an acetylene torch) (citing *Green v. Harper*, 700 S.W.2d 565, 567 (Tenn. Ct. App. 1985)).

¹⁷ 610 S.W.2d at 714.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Keenan v. Fodor*, No. M2011-01475-COA-R3CV, 2012 WL 3090303, at *8-9 (Tenn. Ct. App. July 30, 2012).

lent greater significance to the person's stated intention that the gate would be moveable and that it was designed so as to be moveable if necessary.²¹

On somewhat different facts, the Tennessee Court of Appeals in *Hubbard* reached a similar conclusion in holding that two one-story branch bank buildings were personal property.²² The court based its ruling on the fact that the leased buildings were constructed to be portable, such that they could be moved or sold as market conditions or need for the buildings changed, and the leases expressly provided the buildings were not to become fixtures.²³

In contrast, the Tennessee Supreme Court in *General Carpet Contractors* examined carpet that was laid using the tackless strip method and was therefore easily removable.²⁴ The court found that the carpet became realty because the parties installed it with the intent that it remain in place for the length of its useful life. The method of installation simply allowed for easy replacement of the carpet when it was worn out.²⁵ Similarly, the Tennessee Court of Appeals found in *Process Systems, Inc.* that removal of a conveyor system would damage the building in which it was installed and would destroy the system's essential character.²⁶ Accordingly, the court held the conveyor system was an improvement to real property.²⁷

Likewise, the Tennessee Court of Appeals found in *Hermann Holtkamp Greenhouses, Inc.* that a person's greenhouses became realty upon installation based on their enormous square footage, built-in restrooms and lunchrooms, and concrete tunnels.²⁸ The court expressed that each of these facts reflected an intention that the greenhouses remain permanently installed on the property.²⁹

In the Taxpayer's case, the totality of the circumstances indicates that the [SPECIALIZED FARMING] equipment remains tangible personal property following installation. The [SPECIALIZED FARMING] equipment is standardized and is minimally attached to the real estate. It is easily removed and causes little or no damage upon removal. The [SPECIALIZED FARMING] equipment is designed to be moved (it can be removed and relocated within the farm or to other farms as the owner's needs change), modified, reused, and potentially resold. Finally, the [SPECIALIZED FARMING] equipment's removal would not destroy its essential character as personalty.³⁰

²¹ *Id.*

²² 868 S.W.2d at 660.

²³ *Id.*

²⁴ 511 S.W.2d at 243.

²⁵ *Id.*

²⁶ 1996 WL 614526 at *3.

²⁷ *Id.*

²⁸ *Hermann Holtkamp Greenhouses, Inc. v. Metro. Nashville & Davidson Cnty.*, No. M2009-00345-COA-R3-CV, 2010 WL 366697, at *9 (Tenn. Ct. App. Feb. 2, 2010).

²⁹ *Id.*

³⁰ See *Process Sys., Inc.*, 1996 WL 614526, at *3.

For the foregoing reasons, it appears the parties intend for the [SPECIALIZED FARMING] equipment to remain personalty following its installation. Thus, the [SPECIALIZED FARMING] equipment must be treated as tangible personal property and charges for both the sale and installation of the [SPECIALIZED FARMING] equipment are subject to the Tennessee sales and use tax, unless an exemption applies.

Farm Equipment and Machinery Exemption

As noted above, under the Retailers' Sales Tax Act,³¹ the retail sale in Tennessee of tangible personal property and specifically enumerated services is subject to the sales tax, unless an exemption applies.³² TENN. CODE ANN. § 67-6-207 (2018) provides various exemptions for sales to qualified farmers or nurserymen³³ of certain farm equipment, machinery, and other agricultural items. In particular, TENN. CODE ANN. § 67-6-207(a)(1) exempts "any appliance used directly and principally for the purpose of producing agricultural products, including nursery products, for sale and use or consumption off the premises, but excluding an automobile, truck, household appliances or property that becomes real property when erected or installed." Thus, to qualify for the exemption the [SPECIALIZED FARMING] equipment purchased by a qualified farmer or nurseryman must be used directly and principally for the purpose of producing agricultural products for sale and use or consumption off the premises.

An item is considered to be used "directly and principally" for the purpose of producing agricultural products if it is used more than 50% of the time by a farmer in the production of agricultural products.³⁴ The terms "produce" and "production" are not statutorily defined for purposes of TENN. CODE ANN. § 67-6-207(a)(1). However, Tennessee's Attorney General has opined that these terms, for

³¹ Tennessee Retailers' Sales Tax Act, ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts 22, 22-54 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2018)).

³² "Retail sale" is defined as "any sale, lease, or rental for any purpose other than for resale, sublease, or subrent." TENN. CODE ANN. § 67-6-102(76) (2018). TENN. CODE ANN. § 67-6-102(78)(A) defines "sale" in pertinent part to mean "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."

³³ TENN. CODE ANN. § 67-6-207(e) provides that the term "qualified farmer or nurseryman" means "a person who meets one (1) or more of the following criteria: (1) The person is the owner or lessee of agricultural land from which one thousand dollars (\$1,000) or more of agricultural products were produced and sold during the year, including payments from government sources; (2) The person is in the business of providing for-hire custom agricultural services for the plowing, planting, harvesting, growing, raising or processing of agricultural products or for the maintenance of agricultural land; (3) The person is the owner of land that qualifies for taxation under the Agricultural Forest and Open Space Land Act of 1976, compiled in chapter 5, part 10 of this title; (4) The person's federal income tax return contains one (1) or more of the following: (A) Business activity on IRS schedule F, profit or loss from farming; and (B) Farm rental activity on IRS form 4835, farm rental income and expenses or schedule E, supplemental income and loss; and (5) The person otherwise establishes to the satisfaction of the commissioner that the person is actively engaged in the business of raising, harvesting or otherwise producing agricultural commodities as defined in § 67-6-301(c)(2)." Persons seeking to become qualified farmers or nurserymen must apply to the Commissioner of Revenue for authority to make purchases exempt from tax. TENN. CODE ANN. § 67-6-207(b). If the Commissioner finds that an applicant is entitled to be a qualified farmer or nurseryman, the Commissioner will issue a certificate granting the authority to make purchases exempt from tax for a period of four years, or until the applicant is no longer operating within the scope of his original application. *Id.*

³⁴ See *Tennessee Farmers' Coop. v. State ex rel. Jackson*, 736 S.W.2d 87, 90-92 (Tenn. 1987); Op. Tenn. Att'y Gen. No. 09-57 (Apr. 16, 2009).

purposes of the exemption, are properly considered to mean “to bring forth;” “to create by physical or mental effort;” “to manufacture;” or “to give rise to,” and the “act or process of producing.”³⁵ Notably, the production of agricultural products is not limited to planting or harvesting.³⁶

The [SPECIALIZED FARMING] equipment is installed to create a functioning System. The System’s purpose is [REDACTED]. As long as the System is used at least 51% of the time by a farmer in the production of agricultural products, for sale and use or consumption off the premises, it will qualify for the exemption.

Charges for the installation of exempt [SPECIALIZED FARMING] equipment are also exempt from Tennessee sales and use tax when the seller both sells and installs the exempt [SPECIALIZED FARMING] equipment.

TENN. CODE ANN. § 67-6-202(a) (2018) imposes the sales tax on the “sales price of each article of tangible personal property when sold at retail in this state.” The term “sales price” is defined in pertinent part as “the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise.”³⁷ TENN. CODE ANN. § 67-6-102(79)(A)(v) (2018) disallows any deduction from the sales price for installation charges.” Thus, installation charges are part of the sales price of tangible personal property.

The sale and installation of tangible personal property that remains tangible personal property is subject to tax when the seller both sells and installs the tangible personal property. Conversely, when the seller both sells and installs exempt tangible personal property that remains tangible personal property upon installation, both the tangible personal property and the installation will be exempt. However, if the seller contracts with a third party to install the exempt [SPECIALIZED FARMING] equipment, the installation charges will be subject to Tennessee sales and use tax.³⁸

Additionally, the sale of repair and replacement parts, including labor to repair the qualified [SPECIALIZED FARMING] equipment, is also exempt from sales tax when purchased by a qualified farmer or nurseryman.³⁹

Additional Warranty or Service Contracts

Pursuant to TENN. CODE ANN. § 67-6-208(a) (2018), the retail sale of, use of, or subscription to a warranty or service contract is subject to the Tennessee sales and use tax. A warranty or service contract covering the repair or maintenance of tangible personal property is subject to Tennessee

³⁵ Tenn. Op. Att’y Gen. No. 09-57 (April 16, 2009).

³⁶ See, e.g., *Essary v. Huddleston*, No. 02A01-9408-CH-00179, 1995 WL 384985 at *3 (Tenn. Ct. App. June 29, 1995) (unpublished) (holding that a tractor was used directly and principally for the purpose of producing timber products where the farmer’s primary use of the tractor was to prevent soil erosion around growing trees).

³⁷ TENN. CODE ANN. § 67-6-102(79)(A).

³⁸ TENN. CODE ANN. § 67-6-205(c)(6) imposes the Tennessee sales and use tax on the service of installing tangible personal property that remains tangible personal property after installation.

³⁹ TENN. CODE ANN. § 67-6-207(a)(8).

sales and use tax when (1) the contract is sold in connection with the sale of tangible personal property that is subject to the Tennessee sales and use tax, (2) the contract applies to tangible personal property located in Tennessee, or (3) the location of the tangible personal property covered by the contract is unknown but the purchaser's residential street address or primary business address is in Tennessee.⁴⁰

Here the purchase of a System includes a [TIME PERIOD] warranty and the Dealer may separately sell additional warranty or service contracts. Such contracts are either sold in connection with the sale of tangible personal property that is subject to the Tennessee sales and use tax⁴¹ or, in the case of sales to qualified farmers or nurserymen, apply to tangible personal property located in Tennessee.⁴²

As noted above, TENN. CODE ANN. § 67-6-207 provides various exemptions for sales to qualified farmers or nurserymen⁴³ of certain farm equipment, machinery, and other agricultural items. The exemptions found in TENN. CODE ANN. § 67-6-207, however, do not extend to sales of warranty or service contracts. Accordingly, the Dealer's sales of additional warranty or service contracts covering the equipment are subject to Tennessee sales or use tax. Because these contracts are taxable on the front-end, any repairs made under the warranty or service contract will not be subject to additional tax.⁴⁴

Software Updates/Maintenance Agreements

As previously stated, under the Retailers' Sales Tax Act,⁴⁵ the retail sale in Tennessee of tangible personal property and specifically enumerated services are subject to the sales and use tax, unless an exemption applies. Tangible personal property includes "prewritten computer software," which is defined in TENN. CODE ANN. § 67-6-102(68) in pertinent part as "computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser."⁴⁶

When Dealers offer annual software updates, they will be selling potentially taxable tangible personal property. However, because the software is used to operate equipment that is used directly and principally for the purpose of producing agricultural products for sale and use or

⁴⁰ TENN. CODE ANN. § 67-6-208(c)(1)-(3) (2018).

⁴¹ TENN. CODE ANN. § 67-6-208(c)(1).

⁴² TENN. CODE ANN. § 67-6-208(c)(2).

⁴³ TENN. CODE ANN. § 67-6-207(e).

⁴⁴ TENN. CODE ANN. § 67-6-208(d).

⁴⁵ Tennessee Retailers' Sales Tax Act, Ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts Ch. 22, §§ 22-54 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2018)).

⁴⁶ TENN. CODE ANN. § 67-6-102(68) further provides that "[p]rewritten computer software' or a prewritten portion of the computer software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software." Note, however, that "where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for the modification or enhancement, the modification or enhancement shall not constitute prewritten computer software." *Id.*

consumption off the premises, it qualifies for the exemption in TENN. CODE ANN. § 67-6-207(a)(1). Accordingly, the Dealer's sales of computer software updates will be exempt from Tennessee sales and use tax.

APPROVED:

David Gerregano
Commissioner of Revenue

DATE:

10/14/19