S T A T E O F T E N N E S S E E
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Opinion No. 09-57

Sales Tax Exemption for Trailers Used in Agriculture

QUESTION

Do trailers (such as grain trailers, cotton trailers, hopper bottom trailers, gooseneck trailers, etc.) that are used to transport farm commodities and production supplies to and from the field and to and from the point of storage and/or sale qualify for the sales and use tax exemption provided by Tenn. Code Ann. § 67-6-207(a) when purchased by a qualified farmer as defined in Tenn. Code Ann. § 67-6-207(b) and (e)?

OPINION

To qualify for the exemption provided by Tenn. Code Ann. § 67-6-207(a), the trailers must be used on the farm more than 50% of the time for the purpose of producing agricultural products. Use of the trailers on the road to transport farm commodities and production supplies to and from the point of storage or sale is not part of the production process. Use of the trailers on the farm to transport farm commodities and production supplies to and from the field is part of the production process.

ANALYSIS

Tenn. Code Ann. § 67-6-207(a) provides that "[t]he sale at retail, lease, rental, use, consumption, distribution, repair, storage for use or consumption in this state" of certain enumerated tangible personal property is exempt from sales and use taxes when sold to a qualified farmer or nurseryman. The list of tangible personal property that is exempt from sales and use taxes when sold to a qualified farmer or nurseryman includes:

> (1) 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;
>
> . . .

> (5) Trailers used to transport livestock, as defined in § 44-18-101[.]

Tenn. Code Ann. § 67-6-207(a)(1).[1]

A "qualified farmer or nurseryman" is statutorily defined as a person who meets one 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 [of Revenue] 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).

Tenn. Code Ann. § 67-6-207(e).

Persons seeking to become qualified farmers or nurserymen must apply to the Commissioner of Revenue for authority to make purchases exempt from tax. *See* 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

[1] Previous versions of the statute included an exemption or reduced tax rate for "farm equipment and machinery." Although the statute no longer uses the term "farm equipment and machinery," the current exemption of Tenn. Code Ann. § 67-6-207(a) is similar to the definition of "farm machinery and equipment" contained in previous versions of the statute.

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. *See id.*

The question that we are called upon to answer in this opinion is whether trailers that are used to transport farm commodities and production supplies to and from the field and to and from the point of storage and/or sale qualify for the sales and use tax exemption provided by Tenn. Code Ann. § 67-6-207(a) when they are sold to a qualified farmer or nurseryman. The only trailers that are specifically addressed in the statute are livestock trailers, which are specifically exempt from sales and use taxation by Tenn. Code Ann. § 67-6-207(a)(5). Since other types of trailers are not specifically addressed by the statute, the question of whether they are subject to sales and use taxation depends upon whether they are "used directly and principally for the purpose of producing agricultural products . . . for sale and use or consumption off the premises." Tenn. Code Ann. § 67-6-207(a)(1).

Two cases in Tennessee have addressed the issue of whether an appliance was used directly and principally for the purpose of producing agricultural products for sale and use or consumption off the premises. In *Whelchel v. King*, 610 S.W.2d 710 (Tenn. 1980), the Tennessee Supreme Court held that a grain bin used to dry and store grain prior to sale was used directly and principally in producing an agricultural product for sale and use or consumption off the premises. The Court reasoned that "a farmer uses a grain bin to 'produce' low moisture content grain for sale at the top market price and at a time selected by the farmer, as distinguished from producing a high moisture content grain that must be sold at harvest time, at a sacrificial price." *Id.* at 713. The Court further reasoned that the drying function could not be accomplished without the grain bin structure and "[t]he fact that the grain bin provides a simultaneous storage function does not negate its drying function, which qualifies as a process directly and principally involved in the production of agricultural products for sale." *Id.*

In *Essary v. Huddleston*, No. 02A01-9408-CH-00179, 1995 WL 384985 (Tenn. Ct. App. June 29, 1995) (unpublished), the Tennessee Court of Appeals held that a tractor used to prevent erosion of the soil around trees on a timber farm was an appliance used directly and principally for the purpose of producing an agricultural product for sale and use or consumption off the premises. The Court held that the plaintiff's unrefuted testimony that he intended to sell the trees upon harvesting established that the trees were being produced for the purpose of sale. 1995 WL 384985, at *3. The Court reasoned that "there is no requirement that the taxpayer demonstrate that he has actually sold the agricultural products produced, but instead what is required is that the products be *produced* for the *purpose of* sale or use." *Id.* (emphasis in original). The Court further held that "the plain language of the statute does not limit uses of farm equipment or machinery to planting or harvesting." *Id.* Rather, the statutory requirement is "that the equipment or machinery be used in the *production* of agricultural products." *Id.* (emphasis in original). The Court held that the plaintiff's use of the tractor to prevent erosion of the soil around the trees satisfied the requirement that the tractor be used "directly" in the production of the trees. The Court also held that the statute does not require that the appliance be used exclusively for the purpose of producing agricultural products, and the plaintiff's unrefuted testimony that he used the tractor primarily for work on the farm satisfied the "principally" requirement.

Before livestock trailers were specifically added to the statutory text, this Office was asked for an opinion on the question of whether livestock trailers qualified for the reduced sales and use tax rate for farm equipment and machinery. This Office opined that

> not all appliances which come to be used in a farming operation fall within the definition. Instead, the tax reduction [now an exemption] is meant to apply only to items that are *principally designed for agricultural use*. Items that have many possible uses do not become exempt merely because they are bought by a farmer and used in agriculture.

Op. Tenn. Atty. Gen. No. 81-66 (Jan. 30, 1981) (emphasis added).

This Office concluded that trailers that were sold to farmers and generally used to haul livestock were designed for use directly and principally in the production of agricultural products. This Office also concluded that the rationale for excluding motor vehicles did not apply to livestock trailers because the livestock trailers at issue were "more specifically designed for and limited to agricultural uses than automobiles or trucks would be." *Id.*

In 2001, the Tennessee Department of Revenue issued a letter ruling which addressed the question of whether trailers other than livestock trailers qualified for the sales and use tax exemption for farm equipment and machinery. *See* Tenn. Dept. of Revenue, Letter Ruling No. 01-26. The Department concluded that "a trailer can only qualify if it is being used by a farmer or nurseryman more than 50% of the time in the *production* of an agricultural product that the farmer intends to sell off the premises." *Id.* at 3 (emphasis in original). The Department noted that it had found that "very few" trailers actually qualified for the exemption. *Id.* The Department explained that

> Wagons and similar items designed for and used within the confines of the farm to move the harvested product to storage or for use in feeding the farm animals or poultry are exempt. However, tax should be collected on trailers that will be used principally before or after production (such as for hauling harvested products to market), or during times in which no production activity is occurring (such as traveling on-road to acquire products [e.g. seed, fertilizer] or to transport equipment which is destined to be used in the actual production activity).

Id. at 3-4.

In a previous letter ruling, the Department explained its reasoning for the requirement that to qualify for the exemption appliances must be used more than 50% of the time in the production of agricultural products. The Department relied on the case of *Tennessee Farmers' Coop. v. State ex rel. Jackson*, 736 S.W.2d 87 (Tenn. 1987), in which the Tennessee Supreme Court applied a "51% test" in deciding the applicability of a definition which included the term "principal." *See* Tenn. Dept. of Revenue, Letter Ruling No. 97-34, at 3-4. In that letter ruling,

the Department concluded that the equipment used to construct a mash feed mill was exempt from sales and use taxation because the production of feed for the chickens was a step in the farmer's integrated egg production process. The Department reasoned that the "directly" requirement was met because the machinery was used by a farmer in the production of an agricultural product. *Id.* at 3. The Department reasoned that the "principally" requirement was met because more than half of the output of the feed mill was used in the taxpayer's egg farming operation.

In 2007, the Department published two notices addressing the agricultural exemption certificates that must be presented to sellers in order for qualified farmers and nurserymen to make tax-exempt purchases. In those notices, the Department provided a list of items that qualify for the exemption, including:

> Hay wagons, silage wagons, trailers used directly and principally in producing agricultural and nursery products for sale and consumption off the premises. Trucks, flat-bed trailers, and semi-trailers that are used to transport farm products over the road to market, to transport machinery over the road between farms, or to pick up and carry supplies over the road <u>do not</u> qualify as farm machinery equipment and <u>cannot</u> be purchased without the payment of tax.

Tenn. Dept. of Revenue, Sales and Use Tax Notices, Nos. 07-12 and 07-13 (emphasis in original). The Department explained that qualified farmers and nurserymen who use their exemption certificates to make purchases free of tax will become liable for the sales tax, penalty and interest if "[t]he machinery and equipment . . . are not used *directly and principally* in producing agricultural or horticultural products for sale and consumption off the premises[.]" *Id.* (emphasis added). We take the Department's notices to mean that use of a trailer to transport farm products to market or to carry other items over the road does not necessarily disqualify the trailer from exemption, but that such use does not amount to "producing agricultural products" so as to count in reaching the 51% threshold.

It is clear from the above-referenced authorities that trailers used on the farm can be exempt from sales and use taxation, provided that they are principally used in the production of agricultural products, even if they are also used for other purposes. The statute does not require that the trailers be used exclusively in the production of agricultural products. *See Essary v. Huddleston*, 1995 WL 384985, at *3. We are told that the trailers at issue in this opinion are used to transport farm commodities and production supplies to and from the field and to and from the point of storage and/or sale. Whether these trailers are exempt from taxation depends on whether any of the trailers' uses are part of the production process and whether those uses are the principal uses of the trailers.

The statute does not provide a definition of the term "producing"; a court interpreting the statute would therefore follow the well-established rule that "[w]ords in legislative enactments are generally given their natural and ordinary meaning." *Boles v. City of Chattanooga*, 892 S.W.2d 416, 420 (Tenn. Ct. App. 1994). The relevant definitions of the verb "produce" are "1.

To bring forth : YIELD. 2. To create by physical or mental effort. 3. To manufacture. 4. To give rise to." *Webster's II New College Dictionary* (Houghton Mifflin 2001). The relevant definition of the noun "production" is "An act or process of producing." *Id.* It is clear that production of agricultural products is not limited to planting or harvesting. *See Essary v. Huddleston*, 1995 WL 384985, at *3.

Transportation of farm commodities to market for sale is not part of the production process. By the time it is transported to market for sale, the process of "bringing forth," "creating," "manufacturing," or "giving rise to" the agricultural product is already complete. Transportation of farm commodities to storage prior to sale is likewise not part of the production process. The Tennessee Supreme Court in *Whelchel v. King*, 610 S.W.2d at 713, reasoned that the fact that the grain bins were also used to store grain did not negate their drying function. It was the grain bins' drying function, rather than their storage function, that constituted a phase of the production process. Here, using the trailers to transport farm commodities to the point of storage and/or sale is not part of the production process because the production process is complete once the finished agricultural products are ready to be stored and/or sold.

Transportation of production supplies to and from the point of storage and/or sale is also not part of the production process. While it is necessary to have production supplies in order to produce agricultural products, the act of purchasing and storing these supplies is not part of the production process. It cannot be said that production has begun when production supplies are purchased and/or stored. Production does not begin until those supplies are transported to the field and put to active use.

The instant request also indicates that the trailers are used to transport farm commodities and production supplies to and from the field. It is the opinion of this Office that trailers that are used on the farm to transport farm commodities and production supplies to the field are being used in the production of agricultural products. For example, trailers that are used on the farm to transport feed to the farm animals and poultry are being used in production. Likewise, trailers that are used to transport production supplies to the field for planting, cultivating, irrigating, or harvesting the crops are being used in production.

Now that we have determined that the trailers will be used, in part, in the production of agricultural products, we must address whether this is their principal use. The statute does not provide a definition of the term "principally." The adjective "principal" is defined as "First, highest, or foremost in importance, rank, worth, or degree : CHIEF." *Webster's II New College Dictionary* (Houghton Mifflin 2001). As the Department noted in Letter Ruling No. 97-34, the Tennessee Supreme Court has approved a "51% test" for determining the "principal business" of a taxpayer for purposes of Tenn. Code. Ann. § 67-6-206. *See Tennessee Farmers' Coop. v. State ex rel. Jackson*, 736 S.W.2d 87 (Tenn. 1987). Given these definitions, it is the opinion of this Office that to be exempt from taxation the trailers must be used on the farm more than 50% of the time in activities that constitute part of the production process, as explained above.

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