STATE OF TENNESSEE
OFFICE OF THE ATTORNEY GENERAL

March 5, 2018

Opinion No. 18-06

Exemption of Whiskey Barrels from Taxation

Question

Is a barrel comprised of the timber of Tennessee and used by a whiskey producer to age whiskey a "manufactured article" within the meaning of article II, section 30, of the Tennessee Constitution, so that it may be exempt from taxation while it is being used to age whiskey?

Opinion

No. Under article II, section 30, and the relevant case law, an article being used to manufacture another product—such as a barrel being used by a whiskey maker to age whiskey—is not entitled to an exemption from taxation.

ANALYSIS

Senate Bill 2076/House Bill 2038, 110th Tenn. Gen. Assem. (2018), as amended, would add a new subsection (c) to Tenn. Code Ann. § 67-5-216 to provide an exemption from ad valorem tax for "all barrels comprised of the timber" of Tennessee or any other State and "used to age whiskey." The exemption would apply "during the time in which the barrels are so used and owned by a person that produces or manufactures whiskey in such barrels." The proposed legislation is premised on a finding by the General Assembly that a barrel so comprised and so used is "a manufactured article within the meaning and intent of the Constitution of Tennessee, Article II, § 30."

Article II, section 28, of the Tennessee Constitution generally subjects all property to taxation with certain limitations and permitted exceptions. Article II, section 30, establishes the following specific, mandatory exception: "No article, manufactured of the produce of this State shall be taxed otherwise than to pay inspection fees."[1] The purpose of this constitutional exemption from taxation is "to encourage manufacture." *Neuhoff Packing Co. v. Sharpe*, 146 Tenn. 293, 240 S.W. 1101, 1103 (1922).

The question is, therefore, whether wooden barrels being used by whiskey makers to age whiskey are "manufactured articles" within the scope of article II, section 30. As the Tennessee

[1] Although the tax exemption in article II, section 30, refers only to "produce of this State," the federal Commerce Clause prohibits States from "impos[ing] upon the products of other states, brought therein for sale or use, . . . more onerous public burdens or taxes than it imposes upon the like products of its own territory." *I.M. Darnell & Son Co. v. City of Memphis*, 208 U.S. 113, 121 (1908) (discussing article II, section 30, of the Tennessee Constitution). Thus, section 30 must be read to include articles manufactured of the produce of this or any other State.

Supreme Court has long since recognized, that question is one of the proper construction and interpretation of the constitutional exemption for "manufactured articles." *Benedict v. Davidson County*, 67 S.W. 806, 807 (1902).

The proposed legislation attempts to answer or pretermit that question with the legislative finding that the barrels at issue are "manufactured article[s] within the meaning and intent of the Constitution of Tennessee, Article II, § 30." This poses a threshold question: whether a specific legislative finding that the barrels at issue are "manufactured articles" is sufficient to bring the proposed legislation within the scope of the section 30 tax exemption. As a general rule, "the legislative determination of facts is conclusive, and the courts cannot reopen the question or make new findings." *Peay v. Nolan*, 157 Tenn. 222, 7 S.W.2d 815, 818 (1928). The rule "has been often applied in opinions involving the validity of legislative classification for purpose of taxation" . . . but "in cases of that character, the presumption is prima facie, not conclusive." *Id.* "The court is not required to assume the existence of any fact that cannot be reasonably conceived." *Id.*

Because the legislative determination that the barrels at issue are "manufactured articles" within the meaning and intent of article II, section 30, is inconsistent with Tennessee Supreme Court precedent discussed below, a court would be unlikely to sustain it.

The Supreme Court's opinion in *Benedict* provides an analytical starting point and a partial answer as to whether barrels being used by whiskey producers to age whiskey are "manufactured articles" within the scope of article II, section 30. A mill-operating manufacturer claimed that the logs and lumber in its possession were tax-exempt under section 30. The court had to decide when, in the course of a multi-stage manufacturing process, an article becomes "manufactured" within the meaning of article 30. On the facts of the case, the court held that the section 30 tax exemption attached at the beginning of the manufacturing process; the logs became "manufactured articles" when they were "upon the [miller's] yard" ready to be sawed and continued to be "manufactured articles" until the milling process was complete in the hands of miller. *Benedict*, 67 S.W. at 808.

Applying the limited holding of *Benedict* to a barrel, it is clear that a barrel maker—a cooper—who begins with timber and goes through the multi-stage process of cutting that timber and joining it with hoops to create a barrel would be entitled to an exemption under article II, section 30. That exemption would attach from the beginning of the barrel-making process to its completion in the hands of the cooper.

But the *Benedict* Court expressed "no opinion" about the "taxability of the finished article *after it has left the hands of the manufacturer, and gone into the hands of the dealer or consumer*." *Id.* (emphasis added). That question, which *Benedict* had left open, was answered by the Supreme Court in *Morgan & Hamilton Co. v. City of Nashville*, 151 Tenn. 382, 70 S.W. 75 (1925), when a manufacturer of cotton, burlap, and paper bags claimed a section 30 exemption for cotton bales and burlap fabric it had purchased from other manufacturers and was holding in storage.

Citing long-standing judicial interpretation of article II, section 30, the Court denied the exemption. Because "[m]anufactured articles are not exempt as commodities of commerce, but as articles of manufacture in the hands of the manufacturer," "the immunity from taxation of the article of manufacture assured by the Constitution does not follow after the article has passed from

the manufacturer of the particular article he produces or designs." *Id*. at 76. Rather, the exemption, which is "intended to encourage domestic manufacture[,] is an exemption of the article manufactured, not of the commodities which the manufacturer may buy, store, and resell upon a favorable market, or use for manufacturing purposes, according to the dictates of interest." *Id.*; *see also Alcoa, Inc. v. Tenn. State Bd. of Equalization*, No. E2010-00001-COA-R3-CV, 2011 WL 598435 (Tenn. Ct. App. Feb. 18, 2011) (holding raw materials purchased by aluminum manufacturer not exempt under article II, section 30).

The section 30 tax exemption, in other words, is dependent on the conversion of the produce into an article which the manufacturer himself makes—i.e., "an article different from the original product which he bought for use in manufacturing." *Morgan & Hamilton Co.*, 70 S.W. at 77. Accordingly, the burlap cloth and cotton bales were not tax exempt while they were held in storage, but would become exempt in the hands of the purchasing manufacturer when it began to convert them into "the article which [it] as a manufacturer produced." *Id.* at 76–77.

Based on this precedent and reasoning, a barrel purchased from a cooper by a furniture maker would be exempt under article II, section 30, once that furniture maker, as an artisan, begins to convert the barrel into a table or chair, because the furniture maker would be manufacturing an article different from the barrel that he bought. But a barrel that is used by a producer of whiskey to hold and age whiskey would not be tax-exempt under section 30. The whiskey maker is not converting the barrel into an article different from the barrel that the whiskey maker bought; thus, the barrel in the hands of the whiskey maker is not a "manufactured article" within the scope of section 30 as construed by the Tennessee Supreme Court. The whiskey maker may sell used whiskey barrels to a third party after the whiskey has been emptied from it, but that does not change the fact that a whiskey maker is a manufacturer of whiskey, not a manufacturer of barrels. The used barrels are merely byproducts of the whiskey-aging process, just as sawdust and tree bark were byproducts of the miller's manufacturing process of finished wood products in *Benedict.*

Thus, it would be contrary to long-standing judicial construction of article II, section 30 to exempt by statute wooden barrels that have passed to the whiskey maker and are being used to age whiskey. And even when a whiskey producer makes its own barrels, once the barrel-making process is complete and the whiskey maker begins to use those barrels in its whiskey-production process to hold and age the distillates, the barrels cease to be "manufactured articles" under article II, section 30. The barrels instead become articles "use[d] for manufacturing purposes," to which the section 30 exemption does not apply. *See Morgan & Hamilton Co.*, 270 S.W. at 76.

In sum, the proposed legislation would exempt from taxation wooden barrels while the barrels are used to produce whiskey. But those barrels are not within the scope of the exemption allowed for "manufactured articles" under article II, section 30. The legislative finding to the contrary notwithstanding, barrels used by a whiskey maker to age whiskey are not "manufactured articles" as that term has long been construed by the Tennessee Supreme Court. A statute exempting such barrels from taxation would not comport with article II, section 30, of the Tennessee Constitution.

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