

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 11-30**

**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**

The applicability of the Tennessee sales and use tax industrial machinery exemption to software, software maintenance agreements, and various welding supplies, parts, and equipment.

**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**

[TAXPAYER] is a [STATE – NOT TENNESSEE] company that is registered in Tennessee for sales and use tax purposes. The Taxpayer is in the business of manufacturing [TYPES OF PRODUCTS] for resale.

The Taxpayer purchases computer software from a major computer software company that specializes in [TYPE OF] software. The software is installed on each of the [EMPLOYEE'S] computers and used in the design process of the products manufactured. Included with the [TYPE OF] software is a maintenance contract that provides system administration support, unlimited support via the telephone and the Internet, and free upgrades to the software as they become available. There is no breakdown on the purchase invoice between the software and the

maintenance services. The Taxpayer pays a one-time charge upfront and then a yearly maintenance fee.

The Taxpayer also purchases a variety of welding supplies, parts, and equipment from [COMPANY 1]. All of these items are used directly in the welding of the Taxpayer's product. The Taxpayer currently is paying sales tax on its purchase of each item. The Taxpayer provided a list of [NUMBER] items that it purchases from [COMPANY 1].<sup>1</sup> The following is a list of general categories into which these items fall.

1.	Gases used for the welding of [PRODUCT] parts
2.	Cylinders that contain the gases
3.	Hoses used to transfer the gases
4.	Labor, materials, and repair parts for repair of the production welder
5.	Safety equipment used by production workers
6.	Grinding discs used in welding
7.	Welding wire that becomes part of the product
8.	Welding equipment used in production
9.	Caster on production carts used to transfer product during welding
10.	Aerosol used to prep product during welding that comes in direct contact with the product and is consumed within 25 days
11.	Miscellaneous tools used during production

The Taxpayer also purchases a large number of items from [COMPANY 2]. Each of these items is used in the production process, although not necessarily used directly in the welding of the

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<sup>1</sup> This letter ruling will not discuss each item on the list individually but instead will discuss the general categories into which each of the items falls.

product. A list of [NUMBER] such items was supplied by the Taxpayer; many of these items fall into one of the above categories.<sup>2</sup>

## QUESTIONS

1. Is the purchase of the computer software together with the software maintenance contract subject to the Tennessee sales and use tax? If so, do any exemptions from the sales and use tax apply?
2. Are the Tennessee sales and use tax industrial machinery exemption and the gas and energy fuel special tax rate, found at TENN. CODE ANN. § 67-6-206(a) and (b) (Supp. 2010), and the industrial materials exemption, found at TENN. CODE ANN. § 67-6-329(a)(12) (Supp. 2010), applicable to the welding supplies, parts, and equipment supplied by [COMPANY 1]?

## RULINGS

1. Yes. The purchase of the computer software and the software maintenance contract is subject to the Tennessee sales and use tax. No exemptions apply.<sup>3</sup>
2. All of the items supplied by [COMPANY 1], qualify as industrial machinery or industrial materials and are thus exempt for purposes of Tennessee sales and use taxation under TENN. CODE ANN. § 67-6-206(a) and (b) (Supp. 2010) or TENN. CODE ANN. § 67-6-329(a)(12) (Supp. 2010), with the following exceptions:
  - a. Gases used in the welding process are taxed at a reduced rate of 1.5 percent. However, the gases are exempt for purposes of sales and use taxation if they meet specific qualifications under TENN. CODE ANN. § 67-6-206(b)(3).
  - b. Safety equipment used by the Taxpayer's production workers is not "industrial machinery" and therefore does not qualify for the industrial machinery exemption, unless the safety equipment comes in direct contact with the manufactured product and is consumed within twenty-five days, or unless the safety equipment is an associated part, appurtenance, or accessory to the machinery, apparatus, or equipment that is necessary to and primarily for the fabrication of the items manufactured by the Taxpayer.

## ANALYSIS

### 1. Computer Software

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<sup>2</sup> The Taxpayer has also asked which of the [NUMBER] listed items purchased from [COMPANY 2] would be exempt from the Tennessee sales and use tax under the industrial machinery exemption. While many of the listed items could be included in the categories discussed in this ruling, the list provided is too comprehensive to analyze each item. It is the intent of this ruling to discuss the industrial machinery exemption under TENN. CODE ANN. §§ 67-6-206 (Supp. 2010) and 67-6-102(47) (Supp. 2010) and the rules related to this exemption, as well as provide basic guidelines that the Taxpayer can use in determining the applicability of the exemption to the items that it purchases from [COMPANY 2].

<sup>3</sup> Computer software can potentially qualify for the industrial machinery exemption. For a complete discussion on why the Taxpayer's computer software does not qualify for this exemption, see sub-part (a) under the analysis of Question #2.

The sale to the Taxpayer of the computer software, together with the software maintenance contract, is subject to the Tennessee sales and use tax.

Retail sales of tangible personal property in Tennessee are subject to the sales and use tax under TENN. CODE ANN. § 67-6-101 *et seq.*, unless specifically exempted from taxation. TENN. CODE ANN. § 67-6-102(79) (Supp. 2010) defines a “retail sale” as any “sale, lease, or rental for any purpose other than for resale, sublease, or subrent.” The term “sale” is defined under the Tennessee sales and use tax laws in pertinent part as “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.” TENN. CODE ANN. § 67-6-102(81)(A). Additionally, TENN. CODE ANN. § 67-6-102(92)(A) defines “tangible personal property” in pertinent part as “personal property that can be seen, weighed, measured, felt, or touched,” and specifically includes prewritten computer software.<sup>4</sup> Finally, TENN. CODE ANN. § 67-6-231(a) (Supp. 2010) provides that the retail sale, lease, licensing or use of computer software in Tennessee is subject to the sales and use tax, regardless of whether the software is delivered electronically, delivered by use of tangible storage media, loaded or programmed into a computer, created on the premises of the consumer, or otherwise provided.

Thus, a sale of tangible personal property has occurred if there is 1) a transfer of title or possession to the property 2) for a consideration. The computer software purchased by the Taxpayer is prewritten computer software and as such is tangible personal property under TENN. CODE ANN. § 67-6-102(92)(A). The software is installed on the Taxpayer’s computers; thus, a transfer of possession of the software occurs. Additionally, there is consideration because the Taxpayer pays a one-time fee up-front for the possession of this software. Accordingly, the sale to the Taxpayer of the computer software is subject to the Tennessee sales and use tax.

The maintenance contract is also subject to the Tennessee sales and use tax. Maintenance contracts such as those provided to the Taxpayer are taxable pursuant to TENN. CODE ANN. § 67-6-231(b)(1)(A) (Supp. 2010), which provides in pertinent part that the retail sale of computer software maintenance contracts are taxable if “[t]he computer software maintenance contract is sold as part of or in connection with a sale of computer software that is subject to the tax levied by this chapter.”<sup>5</sup> Thus, any charges for support services or any other goods or services offered as part of the maintenance contract are also subject to the Tennessee sales and use tax.

Computer software could potentially qualify as industrial machinery and thus be exempt from sales and use taxation under TENN. CODE ANN. § 67-6-206(a) (Supp. 2010). However, as discussed under the analysis of Question #2, the software as purchased and used by the Taxpayer does not qualify for this exemption. There are no other exemptions under the Tennessee sales and use tax laws that would be applicable to the sale of the computer software to the Taxpayer.

Therefore, the computer software purchased by the Taxpayer is subject to the Tennessee sales and use tax. The maintenance contract is also subject to the Tennessee sales and use tax as part

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<sup>4</sup> “Prewritten computer software” is “computer software ... that is not designed and developed by the author or other creator to the specifications of a specific purchaser” and includes prewritten upgrades. TENN. CODE ANN. § 67-6-102(71).

<sup>5</sup> TENN. CODE ANN. § 67-6-231(b)(1)(B) and (C) (Supp. 2010) also provides that computer software maintenance contracts are subject to the Tennessee sales and use tax if the contract applies to computer software installed on computers located in Tennessee or if the location of the software is unknown but the purchaser’s residential or business address is in Tennessee.

of the sale of the software. The tax is based on the sales price of the entire transaction, including the monthly maintenance fees. TENN. CODE ANN. § 67-6-202(a) (Supp. 2010).

## 2. Software, welding supplies, parts, and equipment

Under the Retailers' Sales Tax Act, TENN. CODE ANN. § 67-6-101 *et seq.*, the sale of tangible personal property, which includes computer software, welding supplies, parts, and equipment, is generally subject to the Tennessee sales and use tax. However, TENN. CODE ANN. § 67-6-206 exempts "industrial machinery" from the sales and use tax, providing that "[a]fter June 30, 1983, no tax is due with respect to industrial machinery."<sup>6</sup> "Industrial machinery" is defined in pertinent part as "machinery, apparatus and equipment with all associated parts, appurtenances and accessories, including hydraulic fluids, lubricating oils, and greases necessary for operation and maintenance, repair parts and any necessary repair or taxable installation labor therefor, that is necessary to, and primarily for, the fabrication or processing of tangible personal property for resale and consumption off the premises ... where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one's principal business." TENN. CODE ANN. § 67-6-102(47)(A)(i).

Equipment used to transport raw materials from storage to the manufacturing process and to transport the finished product to storage after completion of the manufacturing process is treated as industrial machinery pursuant to TENN. CODE ANN. § 67-6-102(47)(D)(ii). However, TENN. CODE ANN. § 67-6-102(47)(F) specifically excludes from the definition of "industrial machinery" any machinery, apparatus, or equipment used prior to or after the use of the equipment described above; equipment used for maintenance; and equipment used for the convenience or comfort of the workers. Additionally, items, including tanks, used primarily to store raw materials before fabrication or processing begins are not industrial machinery. *Woods v. General Oils, Inc.*, 558 S.W.2d 433, 436 (Tenn. 1977).

Therefore, in order for the Taxpayer's software, welding supplies, parts, and equipment to be exempt from the Tennessee sales and use tax as industrial machinery, four requirements must be met. First, the Taxpayer must be a manufacturer. Second, the software and welding items must be machinery, apparatus or equipment. Third, the software and welding items must be necessary to the fabrication or processing of the products sold by the Taxpayer. Fourth, the software and welding items must be primarily for the fabrication of the products sold by the Taxpayer.

Under the facts presented, the taxpayer qualifies as a manufacturer. A manufacturer is defined under TENN. CODE ANN. § 67-6-102(47)(A)(i) as "one who engages in [the] fabrication or processing [of tangible personal property for resale and consumption off the premises] as one's

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<sup>6</sup> The burden is on the Taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that "[a]lthough the rule is well-established that taxing legislation should be liberally construed in favor of the taxpayer and strictly construed against the taxing authority, it is an equally important principle of Tennessee tax law that 'exemptions from taxation are construed against the taxpayer who must shoulder the heavy and exacting burden of proving the exemption.'" *Am. Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn. Ct. App. 2000) (quoting *Rogers Group, Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn. Ct. App. 1995)). The Tennessee Supreme Court has also stated that the burden is on the taxpayer to establish the exemption, and any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *Am. Airlines*, 56 S.W.3d at 506 (citing *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)).

principal business.” Manufacturing is a taxpayer’s principal business if more than fifty percent of its revenues at a given location are derived from fabricating or processing tangible personal property for resale. *Tenn. Farmers’ Coop. v. State ex rel. Jackson*, 736 S.W.2d 87, 91-92 (Tenn. 1987). The Taxpayer has indicated that it is principally engaged in the fabrication of [TYPES OF PRODUCTS], and these [TYPES OF PRODUCTS] are sold to others for use and consumption off the premises. The Taxpayer is therefore a manufacturer that may be entitled to the exemption provided in TENN. CODE ANN. § 67-6-206(a). Whether the Taxpayer meets the remaining three requirements of the industrial machinery exemption is discussed below in the analysis for each listed category.

Furthermore, TENN. CODE ANN. § 67-6-329(a)(12) (Supp. 2010) also exempts from the Tennessee sales and use tax industrial materials used “for future processing, manufacture or conversion into articles of tangible personal property for resale where the industrial materials ... become a component part of the finished product or are used directly in fabricating, dislodging, or sizing.” *See also* TENN. COMP. R. & REG. 1320-5-1-.40 (1974) (“Rule 40”) (exempting “[m]aterials and taxable services bought for future processing, manufacturing or conversion into articles of tangible personal property for resale, where such materials become a component part of the finished products” and materials or supplies that come in direct contact with the manufactured product during manufacturing and are consumed within twenty-five days).

a. Software used to design manufactured parts

The software purchased by the Taxpayer, because it is used prior to the transportation of raw materials to the manufacturing process, is not “necessary to” or “primarily for” the manufacturing process and as such is not “industrial machinery” under TENN. CODE ANN. § 67-6-102(47)(A)(i) and (F). Thus, the computer software cannot qualify for the industrial machinery exemption found under TENN. CODE ANN. § 67-6-206(a).

The computer software purchased by the Taxpayer meets the first two requirements for industrial machinery. As discussed above, the Taxpayer is a manufacturer for the purposes of the industrial machinery exemption. The second requirement also is satisfied. Neither the Tennessee Code nor the Tennessee courts have defined the term “apparatus” for purposes of Tennessee sales and use taxation. The Tennessee Supreme Court has stated that when a statute does not define a term, it is proper to look to common usage to determine the term’s meaning. *See, e.g., Tenn. Farmers Assur. Co. v. Chumley*, 197 S.W.3d 767, 782-83 (Tenn. Ct. App. 2006); *Beare Co. v. Tenn. Dept. of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993). WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY 96 (1991) defines the term “apparatus” as “a set of materials or equipment designed for a particular use” or “an instrument or appliance designed for a specific operation.” The software clearly meets this definition.

However, the software is not necessary to or primarily for the manufacturing process. The terms “necessary” and “primarily” are also undefined by the Tennessee Code and the Tennessee courts for Tennessee sale and use tax purposes. The common definition of the term “necessary” is “that which cannot be dispensed with; essential; indispensable; ... inherent in the situation; unavoidable from the premises ... rendering some essential and intimate service.” WEBSTER’S NEW TWENTIETH CENTURY DICTIONARY (2nd ed. 1964). Thus, in order for machinery, equipment, or apparatus to be “necessary” to the manufacturing process, it must be essential to the manufacturing process as engaged in by a taxpayer. Here, the Taxpayer uses the software to design the parts that it manufactures, so it is clearly an important step in the Taxpayer’s business.

The term “primarily” has been defined by the Tennessee Supreme Court for purposes of the industrial machinery exemption as “first of all; principally; or fundamentally” and as “first in rank or importance, chief, principal, basic or fundamental.” *Woods v. General Oils, Inc.*, 558 S.W.2d 433, 436 (Tenn. 1977). (citing WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY (1961); *Breen v. Indus. Acc. Bd.*, 436 P.2d 701 (Mont. 1968); *Twentieth Century Mfg. Co. v. United States*, 444 F.2d 1109 (Ct. Cl. 1971)). The machinery, equipment, or apparatus satisfies this test if more than fifty percent of its use is in the manufacturing operation. The Taxpayer’s software is used solely for the design of the manufactured parts.

However, the manufacturing process is confined by TENN. CODE ANN. § 67-6-102(47)(F), which excludes such machinery, equipment, or apparatus that is used prior to the use of equipment that transports raw materials from storage to the manufacturing process. Therefore, the manufacturing process begins with the delivery of raw materials, and anything that occurs prior to this step is not considered part of the manufacturing. Here, the software is used for the design of the manufactured parts. With respect to the entire manufacturing process, this step takes place before the actual manufacturing begins and before the transportation of raw materials used in the manufacturing process takes place. Accordingly, the computer software is not “necessary to” or “primarily for” the manufacturing process and thus is not industrial machinery for Tennessee sales and use tax purposes. As a result, the software cannot qualify for the industrial machinery exemption found under TENN. CODE ANN. § 67-6-206(a).

b. Gases used for the welding of [PRODUCT] parts

Gases are subject to a reduced Tennessee sales and use tax rate when sold to a manufacturer. However, gases may be exempt from the Tennessee sales and use tax if they meet certain qualifications.

Under TENN. CODE ANN. § 67-6-206(b)(1), a reduced sales tax rate of 1.5% is imposed with respect to gases when they are sold to or used by a manufacturer. However, TENN. CODE ANN. § 67-6-206(b)(3), exempts the above substances from the sales and use tax if it is established to the satisfaction of the Commissioner “that they are exclusively used directly in the manufacturing process, coming into direct contact with the article being fabricated or processed by the manufacturer, and being expended in the course of the contact.” If the gases meet this test, then the manufacturer must obtain an exemption certificate from the Commissioner and must purchase the gases under this certificate.

Because the Taxpayer is a manufacturer under the sales and use tax laws, the gases the Taxpayer uses for the welding of [PRODUCT] parts qualify for the reduced tax rate under TENN. CODE ANN. § 67-6-206(b)(1). Furthermore, if the Taxpayer can show that the gases are used exclusively in the manufacturing process, that they come in direct contact with the [PRODUCT], and that they are expended in the course of such contact, then the gases will be exempt from the Tennessee sales and use tax with a certificate of exemption.

c. Cylinders that contain the gases

The cylinders that contain the gases used for the welding of [PRODUCT] parts are industrial machinery and are exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-206(a).

“Industrial machinery” as defined in pertinent part by TENN. CODE ANN. § 67-6-102(47)(A)(i) includes “[m]achinery, apparatus and equipment *with all associated parts, appurtenances and accessories.*” (Emphasis added.) The production welder is a piece of machinery or equipment that is necessary to and primarily for the fabrication of the items manufactured by the Taxpayer. The definition of industrial machinery specifically includes all associated parts, appurtenances and accessories to equipment or machinery that qualifies under the definition. The cylinders that contain the gases used in the welding process are appurtenant to the welder. Therefore, the cylinders are exempt from the Tennessee sales and use tax under the industrial machinery exemption.

d. Hoses used to transfer the gases to the welder

The hoses that transfer the gases to the welder are industrial machinery and are exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-206(a).

“Industrial machinery” as defined in pertinent part by TENN. CODE ANN. § 67-6-102(47)(A)(i) includes “[m]achinery, apparatus and equipment *with all associated parts, appurtenances and accessories.*” (Emphasis added.) The production welder is a piece of machinery or equipment that is necessary to and primarily for the fabrication of the items manufactured by the Taxpayer. The definition of industrial machinery specifically includes all associated parts, appurtenances and accessories to equipment or machinery that qualifies under the definition. The hoses that transfer the gases used in the welding process are “*appurtenances and accessories.*” (Emphasis added.) The production welder is a piece of machinery or equipment that is necessary to and primarily for the fabrication of the items manufactured by the Taxpayer. The definition of industrial machinery specifically includes all associated parts, appurtenances and accessories to equipment or machinery that qualifies under the definition. The hoses that transfer the gases used in the welding process are appurtenant to the welder. Therefore, the hoses are exempt from the Tennessee sales and use tax under the industrial machinery exemption.

e. Labor, materials, and repair parts for the repair of the production welder

The labor, materials, and repair parts for the repair of the production welder are exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-206(a) as industrial machinery.

“Industrial machinery” as defined in pertinent part by TENN. CODE ANN. § 67-6-102(47)(A)(i) includes “[m]achinery, apparatus and equipment with all associated parts, appurtenances and accessories, including ... *repair parts and any necessary repair or taxable installation labor therefor.*” (Emphasis added.) The production welder is a piece of machinery or equipment that is necessary to and primarily for the fabrication of the items manufactured by the Taxpayer. The definition of “industrial machinery” specifically includes repair parts and repair labor for equipment or machinery that qualifies under the definition. Therefore, the labor, materials, and repair parts are exempt from the Tennessee sales and use tax under the industrial machinery exemption.

f. Safety equipment used by production workers

The safety equipment used by the Taxpayer's production workers generally is not considered industrial machinery and is not exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-206(a).

TENN. CODE ANN. § 67-6-102(47)(A)(i) requires that the equipment used by a manufacturer be "necessary to, and primarily for, *the fabrication* or processing of tangible personal property." (Emphasis added.) The term "fabrication" is not defined by the sales tax statutes; thus, it must be given its ordinary and commonly accepted meaning. *W. Pipeline Constructors, Inc. v. Dickinson*, 310 S.W.2d 455, 458 (Tenn. 1958). "Fabricate" means "to construct by combining or assembling; to make." WEBSTER'S II NEW COLLEGE DICTIONARY (1995).

Safety equipment used by the Taxpayer's workers, such as gloves, hats, and sleeves, are not used to make or construct the manufactured items. Furthermore, if the safety equipment is used for the convenience or comfort of the workers, then such items are excluded from the definition of "industrial machinery" under TENN. CODE ANN. § 67-6-102(47)(F). Therefore, such safety equipment is subject to the Tennessee sales and use tax.

However, there are two circumstances in which safety equipment may be exempt. First, if the safety equipment used by the Taxpayer comes in direct contact with the manufactured product during the manufacturing process and is consumed within twenty-five days, then the equipment is not subject to the Tennessee sales and use tax. Rule 40(2); *Quaker Oats Co. v. Jackson*, 745 S.W.2d 269, 270-271 (Tenn. 1988). Second, if the safety equipment is an associated part, appurtenance, or accessory to any machinery, apparatus, or equipment that is necessary to and primarily for the fabrication of the items manufactured by the Taxpayer, then such safety equipment is industrial machinery under TENN. CODE ANN. § 67-6-102(47)(A)(i). For example, a guard that is attached to a piece of machinery for safety reasons could become appurtenant to that machinery and could thus qualify as industrial machinery.

g. Grinding discs used in welding

The grinding discs used in welding are industrial machinery and are exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-206(a).

"Industrial machinery" as defined in pertinent part by TENN. CODE ANN. § 67-6-102(47)(A)(i) includes "[m]achinery, apparatus and equipment *with all associated parts, appurtenances and accessories.*" (Emphasis added.) The grinding discs become part of the grinders that are pieces of machinery or equipment that is necessary to and primarily for the fabrication of the items manufactured by the Taxpayer. The definition of industrial machinery specifically includes all associated parts, appurtenances and accessories to equipment or machinery that qualifies under the definition. Therefore, because the grinding discs are part of the grinders, the grinding discs are exempt from the Tennessee sales and use tax under the industrial machinery exemption.

Additionally, if the grinding discs come in direct contact with the manufactured product and are consumed within twenty five days, then Rule 40(2) will also exempt them from the Tennessee sales and use tax.

h. Welding wire that becomes part of the product

Welding wire that becomes part of the product manufactured by the Taxpayer is exempt from Tennessee sales and use tax under Rule 40.

TENN. CODE ANN. § 67-6-329(a)(12) states that “[i]ndustrial materials ... for future processing, manufacture or conversion into articles of tangible personal property for resale where the industrial materials ... become a component part of the finished product” are not subject to the Tennessee sales and use tax. *See also* Rule 40(1). During the manufacturing process, the welding wire is incorporated into and becomes a component part of the finished product. Thus, the welding wire is exempt from the Tennessee sales and use tax.

i. Welding equipment used in production

The welding equipment used in production is industrial machinery and is exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-206(a).

“Industrial machinery” as defined in pertinent part by TENN. CODE ANN. § 67-6-102(47)(A)(i) includes “equipment ... *that is necessary to, and primarily for, the fabrication or processing of tangible personal property.*” (Emphasis added.) The welding equipment is necessary to the welding process and production of the product. The equipment is bought specifically for the welding of the product and is used only for this purpose. Therefore, the items of welding equipment are exempt from the Tennessee sales and use tax under the industrial machinery exemption.

j. Casters on production carts used to transfer product during welding

The casters on the production carts that are used to transfer the product manufactured by the Taxpayer during the welding process are industrial machinery and are exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-206(a).

“Industrial machinery” as defined in pertinent part by TENN. CODE ANN. § 67-6-102(47)(A)(i) includes “[m]achinery, apparatus and equipment *with all associated parts, appurtenances and accessories.*” (Emphasis added.) The Tennessee Supreme Court has interpreted the phrase “machinery, apparatus, and equipment” to include “the devices conveying the materials and components from one part of the manufacturing or fabricating process to another.” *Eastman Chemical Co. v. Johnson*, 151 S.W.3d 503, 509-510 (Tenn. 2004).<sup>7</sup> This interpretation would clearly include the production cart that is used to transfer the Taxpayer’s product during the welding process. Additionally, the production cart is necessary to transfer the product during production and is used solely for this purpose. The definition of industrial machinery specifically includes all associated parts, appurtenances and accessories to equipment or machinery that qualifies under the definition. The casters are part of the production cart. Therefore, the casters are exempt from the Tennessee sales and use tax under the industrial machinery exemption.

k. Aerosol used to prep the product during welding

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<sup>7</sup> The Tennessee Supreme Court was quoting the Tennessee Court of Appeals. The Tennessee Supreme Court ultimately reversed the lower court’s decision in *Eastman Chemical Co.* While it agreed with the lower court’s interpretation of the phrase “machinery, apparatus and equipment,” it did not agree with the lower court’s application of the interpretation.

The aerosol used to prep the product during welding is exempt from the Tennessee sales and use tax under Rule 40 and TENN. CODE ANN. § 67-6-329(a)(12).

Rule 40(2) states that “[m]aterials and supplies coming in direct contact with and which are consumed within twenty-five (25) consecutive calendar days, in the processing of manufactured products” are exempt from the Tennessee sales and use tax. Under TENN. CODE ANN. § 67-6-329(a)(12), industrial materials that are used directly in the fabricating process are specifically exempt from sales and use taxation.

The aerosol used during the welding process is consumed within twenty-five days and is used directly on the products manufactured by the Taxpayer. Therefore, the aerosol is exempt from the Tennessee sales and use tax under Rule 40 and the industrial materials exemption.

1. Miscellaneous tools used during production

The miscellaneous tools used during production are industrial machinery and are exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-206(a), if the tools are necessary to and primarily for the fabrication of the Taxpayer’s products.

“Industrial machinery” as defined in pertinent part by TENN. CODE ANN. § 67-6-102(47)(A)(i) includes “apparatus ... *that is necessary to, and primarily for, the fabrication or processing of tangible personal property.*” (Emphasis added.) The tools the Taxpayer uses during production clearly meet the definition of apparatus.<sup>8</sup> Therefore, if the tools the Taxpayer uses are necessary to and primarily for the fabrication of the Taxpayer’s products, then they will be considered industrial machinery. As discussed under the analysis to Question #1, a tool is necessary to the production if it is essential to the manufacturing process as engaged in by a taxpayer, and a tool is primarily for the production if more than fifty percent of its use is in the manufacturing operation.

The circular flared end brush, the clamp 12-inch regular duty, and the standard 18-inch tongs used by the Taxpayer during production are necessary to the manufacturing process and are used only for this purpose. Therefore, these specific tools, and any other tools used during production that qualify as industrial machinery, are exempt from the Tennessee sales and use tax as industrial machinery.

Note that if any of the miscellaneous tools purchased by the Taxpayer are used primarily in the maintenance of the machinery and equipment used in the manufacturing process, then such tools will not qualify for the industrial machinery exemption.

Elizabeth Henderson  
Tax Counsel

APPROVED: Richard H. Roberts  
Commissioner of Revenue

DATE: 06/23/2011

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<sup>8</sup> See the discussion under sub-part (a) under the analysis for Question #2 for the definition of “apparatus.”