

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING #13-02**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. 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 applicability of the Tennessee sales and use tax industrial machinery exemption to racks installed within a freezer of a [FOOD PRODUCTION] facility.

**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] (the "Taxpayer") is a [PRODUCER OF FOOD PRODUCTS]. The Taxpayer has been granted an industrial machinery authorization by the Tennessee Department of Revenue.

The Taxpayer [HAS A] facility in [CITY], Tennessee. The [REDACTED] facility includes a large freezer area (the “freezer area”), which is maintained at [TEMPERATURE]. The freezer area is a single room that encompasses approximately [NUMBER] square feet.

The Taxpayer purchased and installed a rack system (the “Freezer Racks”) in the freezer area. The Freezer Racks are bolted to the freezer area floor and are not used in any other part of the warehouse and distribution facility.

Customers specify that a [FOOD PRODUCT] must be frozen to certain specifications. The [FOOD PRODUCTS] are chilled, but not frozen, and packaged before they enter the freezer area. Once frozen, the [FOOD PRODUCTS] typically remain in the freezer area for approximately 1 to 5 days, and are then shipped to the Taxpayer’s customers. A small percentage of purchased frozen goods may be kept in the freezer area; purchased frozen goods do not exceed 10% of the goods in the freezer area.

### **RULING**

For purposes of the Tennessee sales and use tax, are the Freezer Racks exempt as industrial machinery under TENN. CODE ANN. § 67-6-206(a) (Supp. 2012)?

Ruling: Yes. the Freezer Racks are exempt as industrial machinery under TENN. CODE ANN. § 67-6-206(a) (Supp. 2012).

### **ANALYSIS**

Under the Retailers’ Sales Tax Act, TENN. CODE ANN. §§ 67-6-101 to -907 (2011 and Supp. 2012), retail sales of tangible personal property in Tennessee are generally subject to sales and use tax, unless an exemption applies.<sup>1</sup> TENN. CODE ANN. § 67-6-206(a) (Supp. 2012) 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.”

In order for an item to qualify as exempt industrial machinery, the Taxpayer must qualify as a manufacturer. A manufacturer, for purposes of the industrial machinery exemption, is “one who engages in . . . fabrication or processing as one’s principal business.”<sup>2</sup> Manufacturing is a

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<sup>1</sup> The burden is on the taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that “exemptions are strictly construed against the taxpayer, who has the burden of proving entitlement to the exemption.” *Steele v. Indus. Dev. Bd. of the Metro. Gov’t of Nashville & Davidson Cnty.*, 950 S.W.2d 345, 348 (Tenn. 1997); *see also Am. Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn. Ct. App. 2000) (quoting *Rogers Grp., Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn. Ct. App. 1995)) (“Although 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.’”). The Tennessee Supreme Court has also recognized that any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *See 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)).

<sup>2</sup> TENN. CODE ANN. § 67-6-102(44)(A)(i) (Supp. 2012); *cf.* TENN. CODE ANN. § 67-6-206(b)(2).

taxpayer's principal business if more than 50% of its revenues at a given location are derived from fabricating or processing tangible personal property for resale.<sup>3</sup>

Under the facts presented, the Taxpayer qualifies as a manufacturer. The Taxpayer has in fact been granted an industrial machinery authorization by the Tennessee Department of Revenue.

The term "industrial machinery" is generally defined in pertinent part<sup>4</sup> as

[m]achinery, 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(44)(A)(i) (Supp. 2012).

Therefore, the Taxpayer's Freezer Racks will be exempt from the Tennessee sales and use tax as industrial machinery if the following requirements are met: 1) the Freezer Racks are properly considered machinery, apparatus, and/or equipment, or their associated parts, appurtenances or accessories; 2) the Freezer Racks are necessary to the fabrication or processing of the products sold by the Taxpayer; and 3) the Freezer Racks are primarily for the fabrication of the products sold by the Taxpayer.

An initial consideration is whether the freezing of the Taxpayer's food products is part of the "fabrication or processing" of those products. If the freezing occurs after the fabrication or processing of the products is completed, then the Freezer Racks cannot qualify as exempt industrial machinery.

In *Beare Co. v. Tenn. Dept. of Revenue*, 858 S.W.2d 906 (Tenn. 1993), the Tennessee Supreme Court considered whether the freezing and preservation of food products constituted "processing" for purposes of TENN. CODE ANN. § 67-6-206.<sup>5</sup> Specifically, the court considered whether The Beare Company engaged in the business of preserving food products through freezing and cold storage and was entitled to the reduced sales tax rate under TENN. CODE ANN. § 67-6-206(b)(1) for retail sales of certain energy fuels, when sold to or used by manufacturers. In making its determination, the court examined the definition of "manufacturer" under TENN. CODE ANN. § 67-6-206(b)(2), which states that a manufacturer is "one whose principal business is fabricating or processing tangible personal property for resale."

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<sup>3</sup> *Tenn. Farmers' Coop. v. State ex rel. Jackson*, 736 S.W.2d 87, 91-92 (Tenn. 1987); see also *Beare Co. v. Tenn. Dep't of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993).

<sup>4</sup> The definition of "industrial machinery" is extensive; this letter ruling will discuss only that portion of the definition that is applicable to the Taxpayer.

<sup>5</sup> The court did not consider whether the taxpayer in *Beare Co.* fabricated products, because the company did not produce the food products that it blast froze and maintained in a frozen state.

The Beare Company's revenues derived from four types of activities: "blast freezing," "handling," "preservation," and "special services."<sup>6</sup> "Blast freezing" was performed on food products received by the company in a fresh or raw condition; these goods were frozen by lowering the temperature of the products to zero degrees Fahrenheit or below within a period of 72 hours.<sup>7</sup> "Preservation" was the storage of previously frozen goods in holding freezers, where the products were maintained in a frozen state. *Id.* The purpose of preservation storage was to maintain the low temperature of the products to prevent deterioration or spoilage. *Id.*

The Tennessee Supreme Court examined different definitions of "processing" as put forth by courts in other states, all of which required a change in the state, form, or condition of the original material in order for "processing" to occur.<sup>8</sup> The court concluded that the change in form of the raw food products to a frozen condition, and the maintenance of such frozen condition, could be considered "processing."<sup>9</sup> Specifically, the court held that the initial blast freezing, together with the maintenance of that frozen condition, constituted "processing" for purposes of TENN. CODE ANN. § 67-6-206(b)(2).<sup>10</sup> Conversely, the court held that, with respect to the "preservation" service whereby the taxpayer stored already frozen goods in holding freezers, "the mere preservation of the prefrozen condition" did not constitute "processing."<sup>11</sup>

The Taxpayer's facts differ slightly from those of *Beare Co.*, in that The Beare Company did not produce the food products that it blast froze and maintained in a frozen state. Rather, The Beare Company received packaged food products from its customers, and then froze those products and maintained them in a frozen state. Here, the Taxpayer produces the [FOOD PRODUCTS], packages them, and then freezes and maintains them in a frozen state. Nonetheless, this difference in the relevant facts is not enough to distinguish *Beare Co.* from the Taxpayer's situation. If the activity of freezing a food product that was fabricated and packaged by a taxpayer's customer qualifies as processing, then it follows that the freezing of a food product that was fabricated and packaged by the taxpayer should also qualify as processing.

Accordingly, the freezing of [FOOD PRODUCTS] and the maintenance of those products in a frozen state is properly considered part of the Taxpayer's [FOOD PRODUCT] fabrication or processing operation.

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<sup>6</sup> *Beare Co.*, 858 S.W.2d at 907.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at 908. The court considered the following cases: *Comm'r of Carroll Cnty. v. B.F. Shriver Co.*, 146 Md. 412, 126 A. 71 (1924) (corn husked, sorted, washed, cut from the cob, and canned); *Stokely-Van Camp, Inc. v. State*, 50 Wash.2d 492, 312 P.2d 816 (1957) (vegetables sorted, cleaned, cut, blanched, packaged, and frozen); *Bornstein Sea Foods, Inc. v. State*, 60 Wash.2d 169, 373 P.2d 483 (1962) (filleting, packaging, and freezing fish); *Perdue Foods, Inc. v. State Dept. of Assessments*, 264 Md. 672, 288 A.2d 170 (1972) (chickens slaughtered, dressed, packaged, and cooled); *Bain v. Dept. of Revenue*, 293 Or. 163, 646 P.2d 12 (1982) (production of fish using "mechanical, chemical and electronic processes"); *Fischer Artificial Ice & Cold Storage Co. v. Iowa State Tax Comm'n*, 248 Iowa 497, 81 N.W.2d 437, 441 (1957).

<sup>9</sup> *Id.* at 909.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

For the reasons explained below, the Freezer Racks qualify as exempt industrial machinery for Tennessee sales and use tax purposes.

The first requirement is met because the Freezer Racks are properly considered equipment. The Tennessee Code Annotated has not defined the term “equipment” for purposes of Tennessee sales and use taxation. When a word or phrase is not defined, the Tennessee Supreme Court has looked to its “usual and accepted meaning” to determine the Legislature’s intent.<sup>12</sup> In applying an earlier version of the industrial machinery exemption,<sup>13</sup> the Tennessee Supreme Court in *Tibbals Flooring Co. v. Olsen*, 698 S.W.2d 60, 62 (Tenn. 1985), consulted WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY (1976), which defined the term “equipment” in pertinent part as “the physical resources serving to equip a person, [such as] the implements . . . used in an operation or activity.” The Freezer Racks are “equipment” for purposes of the industrial machinery exemption because they are properly characterized as physical resources or implements used in the Taxpayer’s [FOOD PRODUCT] processing operation.

The second requirement is met because the Freezer Racks are necessary to the processing of the products sold by the Taxpayer. The term “necessary” is not defined by the Tennessee Code Annotated or the Tennessee courts for Tennessee sales and use tax purposes. A common definition of the term “necessary” is “absolutely needed; required.”<sup>14</sup> Thus, in order for a piece of machinery, equipment, or apparatus to be “necessary” to the taxpayer’s fabrication or processing operation, it must be absolutely needed for that process to work. Stated conversely, for the machinery, equipment, or apparatus to be considered “necessary,” the Taxpayer’s fabrication or processing operation must not be able to function as required in the item’s absence.

For the Freezer Racks to be considered “necessary,” the Taxpayer must be unable to effectuate its fabrication or processing operation in the racks’ absence. It is difficult to conceptualize how the Taxpayer could effectively freeze the [FOOD PRODUCTS] and maintain them in a frozen state in the absence of the Freezer Racks. The racks allow the Taxpayer to freeze as much product as possible. The racks also separate the products, permitting cold air to circulate and freeze the products in the most time and energy efficient manner possible. In the absence of the Freezer Racks, the Taxpayer’s only option would be to place packages of [FOOD PRODUCTS] on the floor; the racks are therefore also essential to the production of hygienic, edible food products. The totality of the circumstances indicates that the Freezer Racks are necessary to the Taxpayer’s fabrication or processing operation.

The third requirement is also met because the Freezer Racks are used primarily for the processing of the products sold by the Taxpayer. The Tennessee Supreme Court, in applying the industrial machinery exemption, found that the term “primarily” means “‘first of all; principally; or fundamentally.’”<sup>15</sup> The Court also noted that the term has been held to mean “‘first in rank or

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<sup>12</sup> See *Byrant v. Genco Stamping & Mfg. Co.*, 33 S.W.3d 761, 765 (Tenn. 2000); *Beare Co.*, 858 S.W.2d at 908; see also *Tenn. Farmers Assurance Co. v. Chumley*, 197 S.W.3d 767, 782 (Tenn. Ct. App. 2006).

<sup>13</sup> The court applied a version of the industrial machinery exemption that has since been amended. However, the amendment does not affect the court’s finding as to the meaning of the term “equipment.”

<sup>14</sup> MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 828 (11<sup>th</sup> ed. 2007).

<sup>15</sup> *Woods v. Gen. Oils, Inc.*, 558 S.W.2d 433, 436 (Tenn. 1977) (quoting WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY (1961)).

importance, chief, principal, basic or fundamental.”<sup>16</sup> The machinery, equipment, or apparatus satisfies this test if more than 50% of its use is in the manufacturing operation. Here, the manufacturing operation includes the freezing of the [FOOD PRODUCTS] and their maintenance in a frozen state. The facts indicate that at least 90% of the use of the Freezer Racks is in conjunction with this phase of the manufacturing operation.<sup>17</sup> Thus, the Freezer Racks are primarily for the manufacturing process.

One could argue that the Freezer Racks are used primarily for storage, not for the processing of the products sold by the Taxpayer. This argument, however, cannot be reconciled with the Tennessee Supreme Court’s holding in *Beare Co.*, which states that the freezing of food products, *together with the maintenance of that frozen condition*, constitutes “processing” for purposes of TENN. CODE ANN. § 67-6-206(b)(2).<sup>18</sup> In the Taxpayer’s case, when the [FOOD PRODUCTS] enter the freezer area and are placed on the Freezer Racks, the manufacturing process is not yet completed. Instead, the products undergo further processing, which under the holding of *Beare Co.* includes both the freezing of the [FOOD PRODUCTS] and their maintenance in a frozen state. The maintenance of the products in a frozen state – and thus the manufacturing process – continues until the products are removed from the Freezer Racks. In other words, the use of the Freezer Racks cannot be characterized as being for storage, because the racks are used at least 90% of the time during the manufacturing process.<sup>19</sup>

Because the Freezer Racks meet each requirement set forth above, the racks qualify for the industrial machinery exemption under TENN. CODE ANN. § 67-6-206(a).

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APPROVED: Richard H. Roberts  
Commissioner of Revenue

DATE: 1/9/2013

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<sup>16</sup> *Id.* (quoting *Breen v. Indus. Accident Bd.*, 436 P.2d 701 (Mont. 1968); *20th Century Mfg. Co. v. United States*, 444 F.2d 1109 (Ct. Cl. 1971)).

<sup>17</sup> The facts indicate that a small percentage of purchased frozen goods may be kept in the freezer area; purchased frozen goods do not exceed 10% of the goods in the freezer area.

<sup>18</sup> *Beare Co.*, 858 S.W.2d at 909.

<sup>19</sup> The Tennessee Court of Appeals has observed that the legislature imposed a temporal requirement that the equipment in question must be used *during* the manufacturing process. *Nuclear Fuel Servs., Inc. v. Huddleston*, 920 S.W.2d 659 (Tenn. Ct. App. 1995). By definition, industrial machinery includes equipment used to transport raw materials from storage to the manufacturing process, and equipment used to transport finished goods from the end of the manufacturing process to storage. TENN. CODE ANN. § 67-6-102(a)(44)(D)(ii). Specifically excluded from the definition of industrial machinery is “machinery, apparatus and equipment used prior to or after equipment exempted by subdivision (a)(44)(D)(ii).” TENN. CODE ANN. § 67-6-102(a)(44)(F). This limitation effectively excludes from the definition of “industrial machinery” any equipment that is used prior to the beginning, or after the completion, of the manufacturing process. Here, however, the Freezer Racks are not used prior to or after the completion of the manufacturing process.