

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING #00-03**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Application of the use tax when a dealer uses tangible personal property in the performance of a contract, and such contract is for improvements to a housing development for students of a private nonprofit university.

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

The Developer is an out-of-state corporation formed for the purpose of developing student-housing communities. The General Contractor is an out-of-state corporation.

The Foundation is an out-of-state nonprofit corporation. The Foundation is exempt from Federal taxation under § 501(a) of the Internal Revenue Code of 1986, as amended, as an organization described in § 501(c)(3). It was organized and is operated for the purpose of building, providing, and maintaining affordable on-campus residential housing facilities and properties for students at colleges and universities.

The University is a private nonprofit corporation organized and existing under the laws of the State of Tennessee and is located in Tennessee.

The Board is a public nonprofit corporation organized under the laws of the State of Tennessee. It is authorized pursuant to Tenn. Code Ann. §§ 48-101-301 through 48-101-318, inclusive, to issue revenue bonds payable from the revenues and receipts from a project in order to assist educational institutions and to provide facilities for the improvement and maintenance of their living conditions.

The Board issued bonds to provide funds to finance the cost of acquiring, constructing, furnishing, and equipping a multiple-unit student housing facility (the "Project"),

including the buildings, furniture, fixtures, and equipment, to be located on the campus of the University.

The land on which the Project has been constructed is being leased to the Foundation pursuant to a ground lease agreement between the University, as lessor, and the Foundation, as lessee. Pursuant to the agreement, the University leases the Project site to the Foundation for a forty-year term, subject to certain termination rights.

The lease provides that the Foundation will construct and operate the Project. The rent paid to the University is variable. The Foundation must obtain all financing required for the design, construction and furnishing of the student housing facility, including the issuance of the bonds. The University has the right to prior approval of such plans, which approval cannot be withheld unreasonably. The University has the right to approve various aspects of the construction of the Project, which approval cannot be withheld unreasonably.

The Foundation must pay all bills for labor, materials, insurance, bonds, architects, engineers, contractors, subcontractors, and all other costs and expenses incident to any construction on the Project.

The title to all improvements located on the Project site is vested in the Foundation until the termination or expiration of the ground lease agreement, at which time the title to the improvements automatically vests in the University. The change of title occurs without the necessity of any further action being taken by the Foundation or the University or any instrument being executed and delivered by the Foundation to the University.

The Foundation is required to operate the Project, upon completion of the construction, as a housing complex for the students of the University. The Foundation remains liable for its contracts made pursuant to the ground lease agreement to the same extent as if the ground lease agreement had not been made. The University is not liable to perform any such contracts entered into by the Foundation. The Foundation cannot assign its interest in the ground lease agreement without the approval of the University. The University has the option to purchase the Foundation's interest in the housing complex.

There are contractual relationships among the parties other than the ground lease agreement. There is a separate agreement in which the University agrees to be the agent of the Foundation for purposes of managing the housing complex. The University has a contract with the Developer in which the Developer guarantees the performance and payment by the Foundation to the University. The Foundation has a contract with the Developer for the design and development of the Project. The Developer has a contract with the General Contractor for construction of the Project. The General Contractor has contracts with subcontractors for various aspects of the Project. The University does not have a direct contractual relationship with the General Contractor or with the subcontractors.

The Foundation authorized the Developer to serve as paying agent for all expenses related to the construction and development of the Project. Purchases of tangible personal property for use on the Project were made free of Tennessee sales tax based upon the Foundation's certificate of exemption from Tennessee sales and use taxes, pursuant to Tenn. Code Ann. § 67-6-322.

The ruling request claims that the exemption from the use tax found in Tenn. Code Ann. § 67-6-209(b) should apply, because the University is the real owner of the tangible personal property. While not specifically mentioning the word "agency," the ruling request's focus on the University's alleged control over the Project implies that the Foundation may have held title to the tangible personal property as agent for the University.

QUESTION

Are the Developer, the General Contractor, and the subcontractors exempt from the use tax established by Tenn. Code Ann. § 67-6-209(b), because a private nonprofit university held the title to the tangible personal property used in the construction of the student-housing complex?

RULING

No. Because the University did not hold the title to the tangible personal property at the time it was used, the exemption from the use tax does not apply.

ANALYSIS

Tennessee taxes the use of tangible personal property in the performance of a contract, pursuant to the following statute:

Where a contractor or subcontractor hereinafter defined as a dealer uses tangible personal property in the performance of the contract, or to fulfill contract or subcontract obligations, whether the title to such property be in the contractor, subcontractor, contractee, subcontractee, or any other person, or whether the title holder of such property would be subject to pay the sales or use tax, except where the title holder is a church, private nonprofit college or university and the tangible personal property is for church, private nonprofit college or university construction, such contractor or subcontractor shall pay a tax at the rate prescribed by § 67-6-203 measured by the purchase price of such property, unless such property has been previously subjected to a sales or use tax, and the tax due thereon has been paid. The exemption provided for herein for private nonprofit colleges or universities shall apply only to the state portion of the sales tax. Tenn. Code Ann. § 67-6-209(b).

The Sales and Use Tax Rule that is based upon this statute is the following:

- (1) Contractors or sub-contractors using tangible personal property, which has been furnished them for use and which has not been subjected to a Sales or Use Tax at the rate provided for by the Sales and Use Tax Law, and the tax due thereon has not been paid, shall pay the Use Tax provided for by law, measured by the purchase price or fair market value of such property.
- (2) Any tangible personal property or taxable service which is furnished by a church to a contractor or subcontractor for use in church construction is exempt from the provisions of this regulation, but the exemption does not apply to any materials which may be furnished and used in constructing any other building or improvement to real property, even though it may be for a church supported hospital, school, orphanage, etc. Tenn. Comp. R. & Regs. § 1320-5-1-1.01.

A “dealer” is defined to include a person who:

[u]ses tangible personal property, whether the title to such property is in such person or some other entity, and whether or not such other entity is required to pay a sales or use tax, in the performance of such person’s contract or to fulfill such person’s contract obligations, unless such property has previously been subjected to a sales or use tax, and the tax due thereon has been paid Tenn. Code Ann. § 67-6-102(7)(K).

The use tax established by Tenn. Code Ann. § 67-6-209(b) taxes the use of tangible personal property in the performance of a contract, if the tangible personal property has not been subject to the sales or use tax already. Under the facts given, the tangible personal property was purchased using the exemption certificate of the Foundation and therefore was not subject to sales tax at that time. The subsequent use of the tangible personal property in the performance of the construction contracts was taxable under the use tax, unless the titleholder of the tangible personal property was “a church, private nonprofit college or university and the tangible personal property [was] for church, private nonprofit college or university construction” Tenn. Code Ann. § 67-6-209(b).

The Foundation’s ownership of the tangible personal property is shown clearly by the use of the Foundation’s certificate of exemption from the sales and use tax to purchase the tangible personal property. Also, the provision of the lease agreement that establishes the Foundation as the titleholder of the improvements that result from the use of the tangible personal property shows that the Foundation held the title to the tangible personal property. Because the Foundation, rather than the University, was the titleholder to the tangible personal property at the time it was used in the performance of the construction contracts, the use tax applies.

“[A]n exemption from a taxing statute is strictly construed against the taxpayer and such exemption must positively appear by statute and not by implication.” Hall Contracting Corp. v. Tidwell, 507 S.W.2d 697, 698 (Tenn. 1974). The use tax established by Tenn. Code Ann. § 67-6-209(b) “prevents private independent contractors from escaping the

privilege tax merely because the property used in this private capacity was immune from such tax when purchased” United States v. Boyd, 363 S.W.2d 193, 203 (Tenn. 1962).

Because the ruling request implied that the Foundation might have held the title to the tangible personal property at issue as agent for the University, the issue of a potential agency relationship is addressed as follows:

‘Generally the distinction between the relation of principal and agent and employer and independent contractor is based on the extent of the control exercised over the employee in the performance of his work, he being an independent contractor if the will of the employer is represented only by the result, but an agent where the employer’s will is represented by the means as well as the result.’ (Citation omitted). ‘The distinction between an independent contractor and an agent depends upon the intention of the parties as expressed in the contract.’ Id. at 197.

The absence of an agency relationship between the exempt entity and the potential taxpayer defeats the potential taxpayer’s claim to be exempt from the use tax based upon its relationship with the exempt entity. Id. at 205. See also Gehl Corp. v. Johnson, 991 S.W.2d 246 (Tenn. App. 1998) and Tidwell v. Goodyear Tire & Rubber Co., 520 S.W.2d 721 (Tenn. 1975).

The Foundation was not the agent of the University for the purpose of holding title to the tangible personal property at issue. The lease agreement required the Foundation to pay for the materials used on the Project. The Foundation was responsible for obtaining any financing for the Project. The title to the improvements to the housing complex that resulted from the use of the tangible personal property vested in the Foundation. The use of the Foundation’s certificate of exemption from the sales and use tax to purchase the tangible personal property shows that the Foundation purchased the tangible personal property.

The implication in the ruling request that the Foundation might have held the title to the tangible personal property as agent for the University is incorrect. This implication fails to take into account (among other things) the difference between the tangible personal property at the time it was used and the improvements to real property that exist after it was used. The University did not have sufficient control over the Foundation regarding title to the tangible personal property at the time it was used to establish the Foundation as the agent of the University for the purpose of holding title to the tangible personal property.

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APPROVED: Ruth E. Johnson
Commissioner of Revenue

DATE: 1/14/00