

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 95-33**

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

Application of the local sales tax single article cap to a digital central office switching system and/or its components.

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 his detriment.

FACTS

A [NAME OF TAXPAYER] [TRADEMARK] digital central office switching system is telecommunication equipment that uses digital technology and is sold to telephone companies who provide telephone service in the State of Tennessee. Digital technology allows the telecommunications switching systems to be faster, more compact, and able to

provide higher quality voice signal than is possible with the older analog technology. In addition this technology allows the telephone companies to offer a variety of enhanced features to consumers (Call Waiting, Call Forwarding, etc.). The versatility of digital transmission also allows the communications networks to process voice, data, video, and graphic information simultaneously.

A basic [NAME OF TAXPAYER] digital central office switching system's components are housed in cabinets called frames. Some frames are grouped as bays (Exhibit 1) depending on the size of the switching system and the required configuration. The following components of a switching system are housed in frames.

1. **[TRADEMARK] Supernode** - This is the engine of the switch. It incorporates a non-blocking switch matrix and a range of multi-computing processors. (Exhibit 2)
2. **Peripheral Modules** - The peripheral modules provide the interface from the Supernode to the subscriber, handling voice and data traffic to and from trunks and lines. (Exhibit 3 - Line Control Peripheral is in the center of the photo.)
3. **Input/Output Controller** - The prime interface between the switching system and the maintenance subsystem. (Exhibit 4 - 1st frame on left.)
4. **Main Distribution Frame** - Interfaces the switching equipment lines with the outside peripherals. (Exhibit 5)
5. **Power Distribution Cabinet** - Distributes electrical power throughout the system. (Exhibit 6)

Additional components not housed in frames are:

6. **Maintenance and Administration Position** - Enables network-provider personnel to perform general maintenance and administration functions on the switching system, i.e., performance management, security, billing, fault management., etc. (Exhibit 7)
7. **Cable Racks and Cable (FRWK)** - The rack that houses and holds the cable lines that support the system. (Exhibit 8)
8. **Local Test Cabinet** - Used to test the system. (Exhibit 9)
9. **Office Batteries** - Supplies power to the office. Part of the power distribution system. (Exhibit 10)

10. **Spare Parts** - Additional equipment on stock. (Exhibit 11)

11. **Spare Parts Cabinets** - House the spare parts. (Exhibit 12)

Attached to this ruling and incorporated in this statement of facts are the referenced exhibits, which are photographs of the items in question. It is assumed for the purpose of this ruling that none of the items described above become fixtures upon installation.

ISSUE

Whether the digital central office switch or any of its components described above are single articles under T.C.A. § 67-6-702(d).

RULING

The digital central office switch is not a single article. The separate components would be treated for single article purposes as follows:

1. **[TRADEMARK] Supernode** (Exhibit 2) - This is one single article.
2. **Peripheral Modules** (Exhibit 3) - Each module is one single article.
3. **Input/Output Controller** (Exhibit 4 - 1st frame on left) - This is one single article.
4. **Main Distribution Frame** (Exhibit 5) - This is one single article.
5. **Power Distribution Cabinet** (Exhibit 6) - This is one single article.
6. **Maintenance and Administration Position** (Exhibit 7) - This is not a single article.
7. **Cable Racks and Cable (FRWK)** (Exhibit 8) - Each rack and each cable is one single article.
8. **Local Test Cabinet** (Exhibit 9) - This is one single article.
9. **Office Batteries** (Exhibit 10) - Each battery is one single article.
10. **Spare Parts** (Exhibit 11) - Each part is a single article.

11. **Spare Parts Cabinets** (Exhibit 12) - Each cabinet is a single article

ANALYSIS

T.C.A. § 67-6-702(a)(1) provides in relevant part:

Any county . . . is authorized to levy a tax on the same privileges subject to this chapter . . . collected in the same manner and on all such privileges but not to exceed two and three-fourths percent (2 $\frac{3}{4}$ %); provided, that the tax levied shall apply only to the first one thousand six hundred dollars (\$1,600) *on the sale or use of any single article of personal property*. (Emphasis added)

T.C.A. § 67-6-702(4)(d) provides the following definition of the term “single article”:

(d) "Single article" means that which is regarded by common understanding as a separate unit exclusive of any accessories, extra parts, etc., and that which is capable of being sold as an independent unit or as a common unit of measure, a regular billing or other obligation. Such independent units sold in sets, lots, suites, etc., at a single price shall not be considered a single article. Parts or accessories for motor vehicles that are installed at the factory and delivered with the unit as original equipment and/or parts or accessories for motor vehicles that are installed by the dealer and/or distributor prior to sale, at the time of the sale, or which are included as part of the sales price of the vehicle shall be treated as a part of the unit. In addition, all necessary parts and equipment installed by a motor vehicle dealer which are essential to the functioning of the motor vehicle or are required to be installed on the motor vehicle prior to sale to the ultimate consumer pursuant to state or federal statutes relating to the lawful use of the motor vehicle shall be treated as a part of the unit.

The Tennessee Supreme Court has stated that the determination of whether any particular item of tangible personal property should be considered a single article is a question of fact. *Honeywell Information Systems v. King*, 640 S.W.2d 553,554 (Tenn. 1982). Under the facts of *Honeywell*, the court held that a computer system was not a single article.

In *Executone of Memphis v. Garner*, 650 S.W.2d 734 (Tenn. 1983), the court was called upon to apply the single article limitation to the sale of a telephone system. It was the plaintiff's position in that case that the system basically consisted of three parts: a plug to connect to the service provider, a switching system to route calls, and the telephones

themselves. The plaintiff argued that the entire system was a single article since no single part of the system was sufficient of itself. The Court squarely rejected this argument, citing the provision of Local Sales and Use Tax Rule No. 1320-5-2.06 [Rule 6], which provides in relevant part as follows:

(2) A single article of personal property shall mean that which is regarded by common understanding as a separate unit exclusive of any accessories, extra parts, etc., and is capable of being sold as an independent unit or as a common unit of measure, a regular billing, or other obligation. Such independent units sold in sets, lots, suites, etc., at a single price shall not be considered a single article. Parts or accessories for automobiles, tractors, and other similar items that are installed at the factory and delivered with the unit as original equipment shall be treated as a part of the unit.

The court rejected the internal sufficiency test, finding instead that the rule was consistent with the statute and in keeping with the general intent of the legislature. *Id.* at 737. The court then concluded that the components of the plaintiff's system were "commonly understood" to be separate units. *Id.* The court noted that "the separate physical character of each component part, both in the design of the system and in the ultimate benefit to the customer." *Id.*

Therefore, applying the statutes, the rule, and the judicial precedent to the facts at hand, the digital central office switch is not a single article, since it consists of a number of separate components which would be commonly understood to be separate items. Turning to the individual components, based on the pictures and descriptions provided, the [TRADEMARK] Supernode (Exhibit 2), each Peripheral Module (Exhibit 3), the Input/Output Controller (Exhibit 4 - 1st frame on left), the Main Distribution Frame (Exhibit 5), and the Power Distribution Cabinet (Exhibit 6) would each be considered one single article. The Maintenance and Administration Position clearly consists of a number of separate items and cannot be considered a single article. Each cable rack and each cable would be considered one single article. The Local Test Cabinet is one single article. Each Office Battery would constitute one single article. Each Spare Parts Cabinet would be considered a single article, but would not include the Spare Parts themselves, each of which would be considered a separate single article.

Steve Thomas, Senior Tax Counsel

APPROVED: Ruth E. Johnson, Commissioner

DATE:

9/28/95