

In The News

Susan Sample Secures Significant Exemption Certificate Ruling for Client

12.29.20

Texas Comptroller of Public Accounts

RE: Private Letter Ruling No. PLR20200210084524

Dear *****:

We issue this private letter ruling in accordance with Rule 3.1, Private Letter Rulings and General Information Letters. [ENDNOTE 1] We are responding to your request dated Feb. 4, 2020, and supplemental information dated Feb. 26, 2020. Detrimental reliance relief is provided in accordance with Rule 3.10, Taxpayer Bill of Rights.

You requested guidance on the taxability of the development, construction, operation, and maintenance of a public container yard and related infrastructure.

Facts Presented

The Port of Houston Authority of Harris County, Texas (Port) was created and established under Article 3, Section 52, of the Texas Constitution. The Port is a navigation district promoting maritime commerce and economic development. The Port is also exempt from Texas sales and use tax pursuant to Section 151.309(5) (Governmental Entities) and Rule 3.322(c)(5) (Exempt Organizations).

The Port has entered into an Amended and Restated Lease Agreement (Lease) effective Oct. 22, 2019, with respect to **** acres of unimproved land (Property) at the ***** Terminal (Terminal). On Dec. 18, 2019, the Port entered into a First Amendment to Lease Agreement (Lease Amendment) for a term of 30 years.

The lessee on the Lease and the Lease Amendment is ***** (Taxpayer). Taxpayer entered into a joint venture between COMPANY A and COMPANY B, an indirect affiliate of COMPANY C. COMPANY C was formed for the purpose of operating a marine terminal and providing container stevedoring, terminal, and related services in the Port of Houston, Texas. The Taxpayer's Cooperative Working Agreement among Taxpayer, COMPANY A, COMPANY B, and COMPANY C, effective as of Aug. 9, 2008, is filed with the Federal Maritime Commission (FMC) as FMC Agreement No. *****.

A port generally describes the location where ships berth and conduct activity. Within a port there can be multiple terminals through which cargo passes from sea to land. A terminal refers to the specific part of a port dedicated to a certain type of activity, such as containers or bulks. A container port or container terminal is a facility where cargo containers are moved between different transport vehicles for onward transportation. The transshipment may be between container ships and land vehicles, for example trains or trucks.

The Terminal is owned by the Port of Houston. Taxpayer is a tenant of AREA 1 in Bayport but is also a stevedoring operator on the Terminal. The Port is a 25-mile- long complex of nearly 200 private and public

industrial terminals along the 52-mile-long Houston Ship Channel. The eight public terminals are owned, operated, managed, or leased by the Port and include the general cargo terminals at the Turning Basin, Care, Jacintoport, Woodhouse, Barbours Cut, and Bayport container terminals.

The Port charges tariffs for a variety of services to shipping companies sending vessels through the terminal. At the Terminal, dockage charges are applicable on all commercial vessels and the daily rates are determined by multiplying the overall length by the rate in cents per foot or per meter. Dockage is charged on the vessel length. The income from dockage charges for the Port is substantial, as there are over 8,200 vessels and 215,000 barges that pass through the Port each year.

The Terminal also assesses a charge for each vessel loading and/or discharging cargo on, to, or across wharves for the cleaning of berth assignments. The Port assesses loading, unloading, and wharfage charges in cents per short ton of 2,000 pounds or metric ton of 1,000 kilos. The charges apply to all shipments at actual weight. Tariffs paid to the Port for a fully loaded vessel docked at the Terminal can approach \$1,000,000. The Port's Certified Annual Financial Report (CAFR) for 2018 shows revenues from vessel and cargo services at \$344,272,000. The same CAFR shows revenue of only \$18,079,000 for rental of equipment and facilities.

There are two parts to the whole construction project required by the Lease: AREA 1 and AREA 2. Both projects are at the same location and will be performed during the same period and by the same contractor. AREA 1 and AREA 2 are part of the Terminal. AREA 2 are the Port's improvements to the Terminal that Taxpayer will perform on the Port's behalf, including necessary drainage, security, and other infrastructure improvements on the Port's property adjacent to and underneath the Property. Taxpayer shall provide Port with a cost estimate for AREA 2, which costs shall be subject to approval by the Port. The Port is only liable to reimburse Taxpayer for the amount approved in the cost estimate.

AREA 1 is a flat surface made of cast-in-place concrete that Taxpayer will use to conduct its business of operating a marine terminal and providing container stevedoring, terminal, and related services. These improvements are consistent with what would be expected for an industrial container yard allowing loading and unloading on a flat surface. All improvements made to AREA 1, including underground utilities, stormwater drainage, concrete pavement structure, light poles and fire hydrants, will be owned by the Port. Improvements are the property of the Port and shall be surrendered with the Leased Premises on the Termination Date of the Lease.

The permitted use as stated in the Lease is for "[t]he development and operation of an empty container depot, including (i) a depot for empty containers and chassis, empty refrigerated containers and generator sets, stevedore/terminal equipment, and other ancillary equipment; (ii) maintenance and repair of all of the above and of loaded and transloaded containers; (iii) ancillary activities that relate to such transportation-related Equipment; and (iv) container freight station (CFS) operations, including the stuffing and/or stripping of containers, that are authorized within a three-acre portion of the Leased Premises (Designated Acres), which portion shall be agreed upon by Taxpayer and Landlord."

The Port is very specific in what it allows Taxpayer to do on its property; consequently, the Lease prohibits any uses not specified as a permitted use.

Questions, Rulings, and Analysis

Our restatement of your questions is shown below, followed by our responses and analysis.

Question One: Can Taxpayer issue an exemption certificate to the contractor under Rule 3.291(c)(4) for incorporated tangible personal property, consumable items, and taxable services used to construct AREA 2?

Ruling One: Yes. The improvements are exempt from Texas sales and use tax under Section 151.311 and Rule 3.291 and Taxpayer may issue an exemption certificate to the contractor under Rule 3.291(c)(4) for incorporated tangible personal property, consumable items, and specified taxable services used to construct AREA 2. Taxpayer's contractors may issue an exemption certificate to their suppliers under Rule 3.291(c)(5).

Question Two: Can Taxpayer issue an exemption certificate to the contractor under Rule 3.291(c)(4) for incorporated tangible personal property, consumable items, and taxable services used to construct AREA 1?

Ruling Two: Yes. The improvements are exempt from Texas sales and use tax under Section 151.311 and Rule 3.291 and Taxpayer may issue an exemption certificate to the contractor under Rule 3.291(c)(4) for incorporated tangible personal property, consumable items, and specified taxable services used to construct AREA 1. Taxpayer's contractors may issue an exemption certificate to their suppliers under Rule 3.291(c)(5).

Analysis: Section 151.311 exempts from sales and use tax certain purchases of taxable items for use in the performance of a contract for an improvement to realty for a governmental entity. This exemption applies even when the contract is between a nonexempt entity and a contractor, if the contract is an "exempt contract." Comptroller's Decision Nos. 44,896 and 47,235 (2009). Rule 3.291(a)(5) defines an "exempt contract" as "a contract with a nonexempt entity to improve real property for the primary use and benefit of an organization exempted under Tax Code, §151.309...."

Texas Water Code, Title 4, Chapter 60, Subchapter E, Section 60.101(a) (Acquisition and Maintenance of Port Facilities) provides the improvement and operation of port facilities is a public purpose. This includes purchasing, leasing, constructing, maintaining, or extending facilities that aid in the navigation and navigation-related commerce in the ports and on the waterways. Texas Water Code, Section 60.005, also provides that the property of a navigation district is public property used for essential public and governmental purposes.

However, the primary use and benefit test requires more than a showing that the improvement may serve a specific public purpose of an exempt entity. See Comptroller's Decision Nos. 44,896 and 47,235 (2009); and 31,770 (1999). In determining whether a contract for an improvement to realty is for the primary use and benefit of an exempt entity that will own the improvement, the Comptroller considers all the facts and circumstances. In situations where the nonexempt entity and contractor execute construction contracts pursuant to some underlying agreement, the agency has evaluated the underlying agreement to determine the primary and use benefit. See STAR Accession Nos. 201405903L (May 9, 2014) and 200108598L (Aug. 20, 2001).

The facts and circumstances the agency considers include:

- Whether the primary purpose of the improvements contemplated by the underlying agreement is to benefit the exempt entity;
- Whether the improvements are used for a business purpose;
- Whether the operation of the improvements actually serve a public function;
- Whether the exempt entity approves the design and construction of the improvements;
- Whether the exempt entity manages the operation of the new facilities; and
- Whether title to the improvements remains with the taxable entity.

In Comptroller's Decision No. 31,770, for example, the agency evaluated whether a nonexempt entity contracting for improvements owned by a governmental entity would qualify as an exempt contract under a primary use and benefit analysis.

A general construction contractor contracted with an airline, a private corporation, to construct a hangar and

warehouse expansion at the airport, a non-profit governmental entity organized pursuant to the Texas Municipal Airports Act. The improvements were leased to and operated by a nonexempt entity. Specifically, the hangar was used and occupied by an airline to perform aircraft repairs.

The Comptroller ruled that the hangar is necessary for the safe and efficient performance of the airport's specific public and governmental purpose. Additionally, the governmental entity exercised significant control over the construction and operation of the improvements such as approving the construction plans, having the right to enter the facilities to inspect, maintain, or repair, in addition to exercising governmental functions.

AREA 2 includes necessary drainage, security, and other infrastructure improvements on the Port's property. The primary purpose of these improvements is for the benefit of the exempt entity (the Port) and they are necessary to further the Port's public function to operate or develop ports or waterways within the authority. Title to AREA 2 remains with the Port and the improvements are never owned by or leased to Taxpayer. The incorporated tangible personal property, consumable items, and taxable services purchased for AREA 2 are therefore exempted from Texas sales and use tax under Rule 3.291(c)(4) and (c)(5).

The Port will lease to Taxpayer the land on which Taxpayer will construct and conduct the operation of AREA 1. Taxpayer will make improvements to the infrastructure, including improvements to the earthworks, underground utilities (water, electricity), stormwater drainage, concrete pavement structure, light poles, and fire hydrants. All these improvements will remain the Port's property.

The container yard is an integrated part of the Port's operations, providing a platform to provide essential services and generate substantial revenue from the provision of these services. The development of ports and waterways is a specific public purpose and a matter of public necessity. The factors supporting this conclusion are title to the improvements are transferred to the exempt entity, the exempt entity has approval of the design and construction of the improvements, the exempt entity has control over significant aspects of the operation such as hours of operation, the level of service and fees, and the exempt entity can take over operation if Taxpayer does not perform its obligations. Therefore, the primary use and benefit of the improvements are the Port's. The incorporated tangible personal property purchased for AREA 1 is, therefore, exempted from Texas sales and use tax.

The contracts for AREA 1 and AREA 2 are exempt contracts under Section 151.311 and Rule 3.291 because the primary use and benefit is for the Port.

Taxpayer may issue an exemption certificate to the contractor under Rule 3.291(c)(4) for incorporated tangible personal property, consumable items, and taxable services that are performed at the jobsite, expressly required by contract and are integral to the performance of the contract, used to construct AREA 1 and AREA 2. Taxpayer's contractors may issue an exemption certificates to their suppliers under Rule 3.291(c)(5).

Comptroller's Decisions and STAR documents cited can be found on the Comptroller's State Tax Automated Research (STAR) system. The Texas Tax Code, Texas Administrative Code, and the STAR system are accessible at www.comptroller.texas.gov/taxes/.

If you have questions about this private letter ruling, please email us through our website at <https://comptroller.texas.gov/web-forms/tax-help/> and reference Private Letter Ruling No. 20200210084524.

Sincerely,

Tax Policy Division – Indirect Taxes

Texas Comptroller of Public Accounts

ENDNOTE

1 Unless otherwise indicated, all references to “Section” are to the Texas Tax Code, and all references to “Rule” are to Title 34 of the Texas Administrative Code.

The full Private Letter Ruling can also be read [here](#).

Primary Contacts



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Related Practices

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