

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 02-14**

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 sales and use tax to sales of aircraft by a subchapter S corporation to its wholly owned subsidiary (QSSS) or single member limited liability company (LLC).

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

[THE TAXPAYER] requested this letter ruling through its representative. The Taxpayer is a Tennessee corporation established in [YEAR], and is a subchapter S corporation for federal income tax purposes. The Taxpayer's business is the sale and rental of heavy

machinery. The Taxpayer's corporate headquarters are located in [CITY], Tennessee. It maintains sales and rental offices throughout [AREA] Tennessee. The Taxpayer has acquired and operates two small aircraft. The aircraft are used to fly the Taxpayer's officers, managers and sales personnel between the Taxpayer's various offices in Tennessee. The aircraft are also used for routine business trips to [STATE – NOT TENNESSEE]. The Taxpayer paid the appropriate Tennessee sales or use taxes on its purchase of these aircraft.

The Taxpayer intends to transfer these aircraft to a new business entity that it will establish for this purpose. For purposes of this ruling, it is assumed the transfer of the aircraft will take place in Tennessee. Also, the aircraft will be based and used in Tennessee. The Taxpayer is considering the use of either of two different business entities for the purpose.

The Taxpayer may establish a qualified subchapter S subsidiary ("QSSS"), and transfer the aircraft to it. Taxpayer explains that the QSSS would elect for federal purposes to have its operations taxed as part of the operations of the parent subchapter S corporation. In the alternative, the Taxpayer may establish a limited liability company ("LLC") and transfer the aircraft to the LLC in exchange for its membership interest. The Taxpayer would be the sole member of this LLC, and the single member LLC would also elect for federal purposes to have operations taxed as part of the operations of the parent subchapter S corporation.

QUESTIONS

1. Would the transfer of the aircraft by the Taxpayer, a subchapter S corporation, to its wholly owned subsidiary (QSSS) be subject to sales or use taxes?
2. Would the transfer of the aircraft by the Taxpayer, a subchapter S corporation, to a single member LLC in which the Taxpayer is the sole member be subject to sales or use taxes?
3. Would the Taxpayer's use of the aircraft after either proposed transfer be subject to sales or use taxes?

RULINGS

1. Yes.
2. No. For sales or use tax purposes, Tennessee does not view the LLC to be an entity separate from the Taxpayer. Therefore, the proposed transfer from the Taxpayer to the LLC would not be recognized.
3. (a) The Taxpayer's use of the aircraft after its transfer to the QSSS would not subject the Taxpayer to any further sales or use taxes absent some additional taxable event.

(b) Since the Taxpayer's transfer of the aircraft to the LLC is not recognized for sales

or tax purposes, and the Taxpayer has previously paid the appropriate Tennessee sales or use tax due on its purchase of the aircraft, the Taxpayer's continued use of its own aircraft after the proposed transfer to the LLC would not result in any further sales or use taxes.

ANALYSIS
Transfer to the Taxpayer's QSSS

In the first factual circumstance presented, the Taxpayer, a subchapter S corporation, proposes to transfer its two small aircraft to a wholly owned subsidiary. The subsidiary will be a qualified subchapter S subsidiary (QSSS) under the Internal Revenue Code.

(3) Treatment of certain wholly owned subsidiaries. --

- (A) In general.--Except as provided in regulations prescribed by the Secretary, for purposes of this title--
 - (i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and
 - (ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.
- (B) Qualified subchapter S subsidiary.--For purposes of this paragraph, the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation (as defined in paragraph (2)), if--
 - (i) 100 percent of the stock of such corporation is held by the S corporation, and
 - (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

26 U.S.C. § 1361(b)(3). It can be seen from the above quoted statute that the Taxpayer's QSSS will not be treated as a separate entity from the Taxpayer for federal tax purposes. Instead, the QSSS is taxed as if it were part of the parent subchapter S corporation.

Of course, the federal statute does not purport to control the tax treatment of the QSSS for purposes of the Tennessee Sales Tax Law. To determine the correct treatment of the QSSS under the Tennessee law, the Tennessee statutes on this subject must be applied. In Tennessee, each "person" is treated as a separate legal entity for sales or use tax purposes. "Person" is defined in relevant part as follows:

"Person" includes any individual, firm, co-partnership, joint venture, association, corporation, estate, trust, business trust, receiver, syndicate, any governmental agency whose services are essentially a private commercial concern, or other group or combination acting as a unit, in the plural as well as the singular number.

Tenn. Code Ann. § 67-6-102(21). Each corporation is treated as a separate “person” for purposes of applying the sales or use tax. Unlike the federal law, the Tennessee statute does not provide that a subchapter S corporation and its subsidiary should be treated as a single entity for sales tax purposes. Instead, any “person” who engages in the “business” of selling tangible personal property at retail in Tennessee is liable for the sales tax. Tenn. Code Ann. § 67-6-201(1). Furthermore, sales of aircraft between closely affiliated corporations are not exempted under any provision of the sales tax law.¹ Indeed, a corporation’s occasional and isolated sales or transactions involving aircraft are specifically included in a portion of the definition of taxable “business” activity:

.... *"Business" includes occasional and isolated sales or transactions of aircraft, vessels, or motor vehicles between corporations and their members or stockholders and also includes such transactions caused by the merger, consolidation, or reorganization of corporations.... "Business" shall be construed to include occasional and isolated sales or transactions by such a person involving aircraft, vessels or motor vehicles (which terms include trailers and special motor equipment sold in conjunction therewith), as defined by and required to be registered under the laws of Tennessee with an agency of this state or under the laws of the United States with an agency of the federal government, unless such sales or transactions are otherwise exempt under this chapter or are sales between persons who are: married, lineal relatives or spouses of lineal relatives, or siblings. Such sales or transactions involving aircraft based in this state shall be presumed to be made and taxable in this state; and any registration reflecting such aircraft which are so based shall constitute evidence thereof....*

Tenn. Code Ann. § 67-6-102(2) (Emphasis mine).

In *D. Canale & Co. v. Celauro*, 765 S. W. 736 (Tenn. 1989), the Tennessee Supreme Court considered the application of this sales tax statute to occasional and isolated transactions involving the transfer of motor vehicles from a parent corporation to its two newly created subsidiaries. The Court said:

Persons in the business of selling tangible personal property at retail in this state are subject to the sales tax. T.C.A. §§ 67-6-201, 67-6-202. Since 1984, for the purpose of the Sales Tax Act, "business" has been defined so as to include occasional and isolated sales or transactions of aircraft, vessels, or motor vehicles between corporations and their members or stockholders and shall also include such transactions caused by the merger, consolidation, or reorganization of corporations.

...

In the instant case... new subsidiary corporations were created... and title to vehicles was transferred to the new corporations. Following the transaction there was an entity to receive consideration, i.e., the parent corporation, which accepted stock or securities in the subsidiaries based, at least in part, on the transfer of ownership of the motor vehicles in question. *Further, ...the legislature amended the definition of "business," for the purpose of the Sales Tax Act, so as to include the "occasional and*

¹ *But cf.* Tenn. Code Ann. §67-6-350 that exempts from the sales taxes the sale of services between certain affiliated corporations.

isolated sale or transaction of ... motor vehicles ... caused by the ... reorganization of corporations," and made such transactions taxable.

Id. p. 737,738 (Emphasis mine). This decision applies the applicable sales and use tax statutes to facts that are extremely close to those presented by this ruling. The transfer of the aircraft will no doubt increase the value of the Taxpayer's stock interest in the QSSS. Furthermore, these proposed occasional and isolated transactions of aircraft caused by a "reorganization of corporations" are specifically taxable under Tenn. Code Ann. § 67-6-102(2). Accordingly, the sales tax applies if the aircraft are sold in Tennessee. The compensating use tax applies even if the aircraft are not sold in Tennessee since they will be based and used in this state. Since the Taxpayer is a Tennessee business, it is primarily liable for the sales or use tax due on the transfer and/or use of the aircraft in Tennessee.² The QSSS would be secondarily liable. The use tax is complementary to the sales tax and is applicable with respect to tangible personal property, including aircraft, imported from outside the state and used by the importer within the state. *Vector Company, Inc. v. Benson*, 491 S.W.2d 612 (Tenn. 1973); See also, Tenn. Code Ann. § 67-6-210.

Transfer to the LLC

It may first appear that the authorities relied upon to determine that the Tennessee sales or use tax applies to the transfer of an aircraft from the Taxpayer to its subsidiary corporation should also apply to tax transfers from the Taxpayer to its single member LLC. However, the Tennessee Legislature has specifically established the tax treatment of an LLC. Tenn. Code Ann. § 48-211-101 provides:

For purposes of all state and local Tennessee taxes, a foreign or domestic LLC shall be treated as a partnership or an association taxable as a corporation as such classification is determined for federal income tax purposes. The members of a foreign LLC treated as a partnership are subject to all state and local Tennessee taxes in the same manner and extent as partners in a foreign partnership. The members of a domestic LLC are subject to all state and local Tennessee taxes in the same manner and extent as partners in a domestic partnership.

(Emphasis mine) While this provision infers that LLCs will have more than one member³, it also clearly states that the federal tax treatment of an LLC as a corporation or partnership is controlling for state tax purposes. The Taxpayer, a subchapter S corporation, has stated the LLC will be disregarded for federal tax purposes and treated as a part of the Taxpayer. Applicable federal regulations support the Taxpayer's contention the LLC would be treated as part of the subchapter S corporation.

(a)... A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same

² There is no indication from the facts presented that any statutory exclusion or exemption from the tax [e. g. "sale for resale" pursuant to Tenn. Code Ann. 67-6-102(24)(A)] would apply.

³ This statute was enacted before 1999 Tenn. Pub. Acts 346 extended Tennessee's recognition of LLCs to single member LLCs.

manner as a sole proprietorship, branch, or division of the owner.

...

(c) Other business entities. For federal tax purposes--

...

(2) Wholly owned entities--(i) In general. A business entity that has a single owner and is not a corporation under paragraph (b) of this section is disregarded as an entity separate from its owner.

26 C.F.R. § 301.7701-2.

The elements necessary to constitute a sale in Tennessee are (1) transfer of title or possession, or both of (2) tangible personal property, for a (3) consideration. *Volunteer Val-Pak v. Celauro*, 67 S.W.2d 635, *636 (Tenn. 1989); Tenn. Code Ann. § 67-6-102(25)(A). It is axiomatic that there can be no transfer of title or possession for sales and use tax purposes without two separate entities, both a buyer and a seller. In this case, applicable federal law incorporated by Tenn. Code Ann. § 48-211-101 treats the Taxpayer and its single member LLC as one. Accordingly, the proposed transfer of an aircraft from the Taxpayer to the LLC would not be recognized as a taxable event for sales or use tax purposes.

Taxpayer's Use after the Transfer

Since the Tennessee sales or use taxes due on the Taxpayer's purchase price of the aircraft have been previously paid, the Taxpayer would have no additional use tax liability arising from its proposed transfer of the aircraft to the LLC or its subsequent use of the aircraft.

The Taxpayer may have further sales or use tax liability resulting from its use of the aircraft transferred to the QSSS. Since the Taxpayer will no longer own the aircraft, an agreement with the QSSS whereby the Taxpayer continues to use the aircraft may be taxable. While the facts presented do not indicate that the Taxpayer will later lease the aircraft, this seems likely. If the Taxpayer should enter into a lease that is subject to the sales taxes imposed pursuant to Tenn. Code Ann 67-6-204(a), the Taxpayer and/or the QSSS would be liable for sales or use taxes upon the gross proceeds or agreed rental price of the lease.

Charles T. Moore
Special Tax Counsel

APPROVED: Ruth E. Johnson
Commissioner

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