

**TENNESSEE DEPARTMENT OF REVENUE  
REVENUE RULING # 02-38**

**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**

The appropriate apportionment and sourcing methodology to determine a taxpayer's taxable income and franchise tax base for royalty income received from licensing product and manufacturing-related patents and know-how.

**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**

Taxpayer is a corporation organized and commercially domiciled outside of Tennessee. It has offices and employees outside of Tennessee and holds a [X - MAJORITY]% interest in several manufacturing facilities located outside of Tennessee.

In addition to other sources of income, Taxpayer has income from licensing product and manufacturing-related patents and know-how to both affiliated and non-affiliated corporations ("licensees") engaged in the manufacture and sale of tangible personal property. While many of the licensees are limited to the grant of rights under a single patent, others grant access to patented and non-patented inventions, drawings, designs, technical information, and know-how related to the design and production of entire products. The royalty calculations are generally based on a percentage of the licensees'/manufacturer's wholesale revenue.

**QUESTION**

For purposes of Tennessee's apportionment formula, should the Taxpayer's royalty income from licensing product and manufacturing-related patents and know-how be sourced to the location of the licensees' manufacturing facilities?

## **RULING**

Yes, so long as the Taxpayer is doing business in Tennessee and licenses product and manufacturing-related products and know-how to another person in Tennessee and is paid royalties or other income based on the sale of products or other activity by the licensee.

## **ANALYSIS**

With respect to the sourcing of royalty income, Tenn. Code Ann. § 67-4-2012(j) provides as follows:

. . . any person doing business in Tennessee, who licenses the use of patents, trademarks, tradenames, copyrights, or know-how, or other intellectual property to another person in Tennessee, and who is paid royalties or other income based on the sale of products or other activity in Tennessee by the licensee, shall source such income to Tennessee for purposes of its apportionment formula receipts factor.

Tenn. Code Ann. § 67-4-2012(j).

Tennessee's apportionment formula receipts factor is defined in Tenn. Code Ann. § 67-4-2012(g) as follows:

The receipts factor is a fraction, the numerator of which is the total receipts of the taxpayer in this state during the tax period, and the denominator of which is the total receipts of the taxpayer everywhere during the tax period. For this purpose, "gross receipts" includes a taxpayer's ownership share of the gross receipts of any general partnership, or entity treated as a general partnership for federal income tax purposes, in which such taxpayer has an ownership interest. A return being filed by a limited liability company that has a general partnership as its single member shall include in its receipts factor only the gross receipts attributed to the limited liability company. "Gross receipts" also includes a taxpayer's ownership share of gross receipts of any limited partnership, subchapter S corporation, limited liability company, or other entity treated as a partnership for federal income tax purposes, in which the taxpayer has an ownership interest, directly or indirectly through one (1) or more such entities, and which is not doing business in Tennessee and thus is not subject to Tennessee excise tax.

Tenn. Code Ann. § 67-4-2012(g).

Based on the foregoing, if the Taxpayer is doing business in Tennessee and licenses product and manufacturing-related products and know-how to another person in Tennessee and receives royalty or other income based on the sale of products or other activity by the licensee, then such income is required to be sourced to Tennessee for purposes of its apportionment formula receipts factor. To the extent the Taxpayer has

income from other intangible personal property sales, that income will be sourced to Tennessee only if the earnings-producing activity is performed in Tennessee or if it is performed both in and outside Tennessee and a greater proportion of the earnings producing activities is performed in Tennessee than in any other state, based on costs of performance. See, Tenn. Code Ann. § 67-4-2012(i).

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