

TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 20-09

Revenue rulings are not binding on the Department. This ruling is based on the particular facts and circumstances presented and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The sourcing of receipts from sales of tangible personal property for Tennessee franchise and excise tax apportionment purposes.

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 Taxpayer, a manufacturer of custom-built tangible personal property, is headquartered outside Tennessee. The Taxpayer sells the custom-built tangible personal property to customers located both inside and outside Tennessee. The Taxpayer's manufacturing facilities are located outside Tennessee. The Taxpayer does, however, have a Tennessee facility it uses to store the tangible personal property after the manufacturing process is complete.

The custom-built tangible personal property is of a type that is required to be registered. Most purchasers register the property in the state where it will be primarily stored. Regardless of the state of registration, customers register the property at the same time it is being manufactured and before the customer takes title to or possession of the property.

All the Taxpayer's customers take possession of the custom-built tangible personal property at the Taxpayer's Tennessee facility. The customer receives training at the Tennessee facility for two or three days prior to removing the custom-built tangible personal property to its location of registration.

RULING

Will the Taxpayer exclude from the numerator of its Tennessee franchise and excise tax apportionment formula receipts from sales of its custom-built tangible personal property destined for a location outside Tennessee, as evidenced by the place of registration?

Ruling: The Taxpayer should source receipts from the sale of its custom-built tangible personal property according to the location of the purchaser. While the place of registration may be indicative of the purchaser's location, it is not controlling for purposes of the sourcing of receipts under TENN. CODE ANN. §§ 67-4-2012(h)(1) and -2111(h)(1) (Supp. 2019).

The Taxpayer will exclude from the numerator of its Tennessee apportionment formula receipts from the sale of custom-built tangible personal property that is delivered to a purchaser in Tennessee when the purchaser has no location in Tennessee. When the purchaser takes delivery of the custom-built tangible personal property in Tennessee, the Taxpayer must include the receipt in the numerator of its Tennessee apportionment formula if the purchaser of the Taxpayer's custom-built tangible personal property has a location in Tennessee.

ANALYSIS

Tennessee imposes an excise tax at the rate of 6.5% on the net earnings of all persons, as defined under TENN. CODE ANN. § 67-4-2004(38) (Supp. 2019), doing business within Tennessee.¹ Tennessee also imposes a franchise tax at the rate of \$0.25 per \$100, or major fraction thereof, on the net worth of a person doing business in Tennessee, pursuant to TENN. CODE ANN. §§ 67-4-2105(a) (Supp. 2019) and -2106(a) (2013). Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, entities such as corporations, limited partnerships, and limited liability companies.²

TENN. CODE ANN. § 67-4-2010(a) (2013) provides that a taxpayer that has business activities taxable both inside and outside the state of Tennessee shall allocate or apportion its net earnings or losses for Tennessee excise tax purposes. Similarly, TENN. CODE ANN. § 67-4-2110(a) (2013) provides that a taxpayer that has business activities taxable both inside and outside the state of Tennessee shall allocate or apportion its net worth for Tennessee franchise tax purposes. Unless it is a financial institution, a common carrier, or a manufacturer that has made an election to use a single sales factor formula, a taxpayer must use the three-factor apportionment formula set forth under TENN. CODE ANN. §§ 67-4-2012(a)(2) and 67-4-2111(a) (Supp. 2019), which utilizes a property factor, a payroll factor, and a triple-weighted receipts factor. The receipts factor "is a fraction, the numerator of which is the total receipts of the taxpayer in [Tennessee] during the tax period, and the denominator of which is the total receipts of the taxpayer everywhere during the tax period."³

Receipts are sourced to Tennessee based on whether such receipts derive from sales of tangible personal property or from sales other than sales of tangible personal property. Generally, when the

¹ TENN. CODE ANN. § 67-4-2007(a) (Supp. 2019).

² TENN. CODE ANN. § 67-4-2004(38) (Supp. 2019).

³ TENN. CODE ANN. §§ 67-4-2012(g) and 67-4-2111(g).

purchaser is not the United States government, sales of tangible personal property are sourced to Tennessee whenever the property is “delivered or shipped to a purchaser, other than the United States government, inside this state regardless of the F.O.B. point or other conditions of the sale.”⁴

The language of the statute is potentially ambiguous in that the phrase “inside this state” could refer to either the location where the purchaser takes delivery of the property or the place where the purchaser is located. There are no Tennessee court decisions under current law that address this potential ambiguity. However, there is one unpublished Tennessee Supreme Court decision under prior law that provides insight regarding this question.

Prior law stated that the sales factor of a manufacturer’s apportionment formula was based in part on “[t]he ratio of the gross sales to customers *within Tennessee* to the total gross sales from all sources.”⁵ In *Woods v. Jack Daniel Distillery*, slip op. S. Ct. Tenn. (April 16, 1977), the Tennessee Supreme Court held that sales destined to purchasers located outside Tennessee should be excluded from the sales factor numerator because earnings from such sales are derived from markets outside Tennessee. In upholding the trial court decision, the Tennessee Supreme Court explained that the word “within” contained in the statutes modifies “customers” and not “sales,” such that the location of the customer determines whether the sale is excluded from the sales factor numerator.

While not controlling with respect to the current statutory language, the Tennessee Supreme Court’s decision in *Woods v. Jack Daniel Distillery* suggests that the purchaser’s location – as opposed to where the purchaser takes possession of the property – is the critical factor in determining whether a sale of tangible personal property is sourced to Tennessee.

Significantly, neither the applicable statutes, corresponding rule, nor the case discussed above suggest that the determination of whether the purchaser is “inside,” “within,” or “in” Tennessee depends on where the purchaser is headquartered, domiciled, or primarily resides. On the contrary, the use of the broad terms “inside,” “within,” or “in” strongly suggest that the receipt must be sourced to Tennessee if the purchaser has some sort of location in Tennessee and particularly if the purchaser takes possession of the property in Tennessee.

The Taxpayer specifically inquired as to whether it will exclude from the numerator of its Tennessee apportionment formula receipts from the sale of its custom-built tangible personal property when the property is registered by the purchaser in a state other than Tennessee. Where the property is registered or primarily used may be an indication of the purchaser’s location; importantly, however, the state of registration or primary use is not controlling. A purchaser could very well be located in Tennessee but choose to register and use the property in another state. Accordingly, the Taxpayer should not base its sourcing of receipts on the place where the tangible personal property is registered.

⁴ TENN. CODE ANN. § 67-4-2012(h)(1). Note that TENN. COMP. R. & REGS. 1320-06-01-.33(1)(a) (2016) provides that sales of tangible personal property are sourced to Tennessee when the property is delivered or shipped to a purchaser “within this state,” while TENN. CODE ANN. § 67-4-2111(h)(1) uses the language “in this state.”

⁵ See TENN. CODE ANN. § 67-2707(c) (1956) (emphasis added). It should be noted that the old statutory term “customers within Tennessee” is substantially similar to the present statutory terms “purchaser . . . inside this state” and “purchaser . . . in this state” found in TENN. CODE ANN. §§ 67-4-2012(h)(1) and 67-4-2111(h)(1).

Instead, the Taxpayer should exclude from the numerator of its Tennessee apportionment formula receipts from the sale of its custom-built tangible personal property that is delivered to a purchaser in Tennessee when the purchaser has no location in Tennessee. When the purchaser takes delivery of the custom-built tangible personal property in Tennessee, the Taxpayer must include the receipt in the numerator of its Tennessee apportionment formula if the purchaser of the Taxpayer's custom-built tangible personal property has a location in Tennessee.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 10/14/2020