

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 04-22**

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

Whether the Taxpayer qualifies for the Tennessee franchise, excise job tax credit.

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

The Taxpayer's address is [OUTSIDE TENNESSEE]. It has a location in [COUNTY], Tennessee and operates an auto auction facility in [CITY]. Its employees are involved in the actual sales of vehicles and in administration related to processing of

sales documentation as well as the operation of a repair and conditioning shop. All sales of vehicles are made to automobile dealerships. Sales are never made to an ultimate consumer at retail.

According to the Taxpayer, an auto auction is merely a place where buyers and sellers of motor vehicles can meet to sell or purchase inventory. All vehicles in inventory are strictly on consignment. As an auto auction operator, the Taxpayer provides the facility to store vehicles and assist automobile owners in offering their vehicles for sale in an open market arena.

Owners of vehicles are referred to as “consignors” by the Taxpayer and are broken down into three broad categories. The first category is comprised of auto dealers that make their living from buying and selling vehicles. The second category includes banks and leasing companies who use auctions to help them dispose of repossessed vehicles and leased vehicles that are returned by customers. The third category consists of automobile manufacturers. The last two of the above referenced categories account for about 60% of the Taxpayer’s business and the Taxpayer actively assists these consignors in managing their inventories.

The Taxpayer states that its primary function is to store vehicles for their owners until such time as an owner decides to make a vehicle available for sale. The Taxpayer also provides services to assist owners in preparing their vehicles for sale. The Taxpayer lists the following sequence of events for its handling of these types of vehicles:

1. The consignor notifies the auction that a vehicle is ready for processing.
2. Either the auction or the consignor will arrange transportation of the vehicle to the auction premises through a third party vendor.
3. The vehicle is stocked into inventory upon arrival to the auction and an evaluation of the condition of the vehicle is prepared at this time.
4. All information about the vehicle is communicated to the customer who then makes a determination as to whether or not to have additional services rendered on the unit.
5. Upon approval from the consignor, various value-added services may be provided by the auction or by a third party vendor under the direction of the auction on behalf of the consignor. These services may include the following:
 - (a) Paintless dent removal.
 - (b) Body and paint work.

- (c) Mechanical repairs.
 - (d) Inspection and certification.
 - (e) Auto detailing.
 - (f) Windshield repair or replacement.
 - (g) Title processing.
6. In most cases, once work on the vehicle has been completed and the title has been sent to the auction, the consignor will give the auction approval to offer the vehicle for sale.
 7. When the vehicle is sold, the auction will disburse to the seller the sales price less any applicable fees due for services performed by the auction.
 8. The auction will then collect funds from the buyer to pay for the vehicle and transfer the vehicle's title to the buyer. The auction never takes title to the vehicle, but merely assists in the direct transfer of the title from the consignor to the buyer.
 9. At this point, the auction may or may not assist the buyer in arranging transportation of the vehicle from the auction premises.
 10. The transaction is complete.

In the case of the auto dealer, the process is basically the same except that the amount of time the vehicle is stored on the auction property is generally much shorter, and many of the value-added services are not performed by the auction.

The Taxpayer states that, as of December 31, [YEAR 2], it employed [NUMBER] full-time employees. This included an increase of [NUMBER] full-time employees from December 31, [YEAR 1] through December 31, [YEAR 2] and this increase can be attributed to the construction of a larger facility that was completed in 2002 at a cost of [\$ X MILLION]. The Taxpayer expects to maintain these new full-time employee jobs in future years and may create additional new full-time jobs in future years. These employees are involved in the actual sales of vehicles, administration as it relates to processing documentation on such sales and the operation of a repair and conditioning shop.

QUESTION PRESENTED

Does the Taxpayer qualify for the Tennessee franchise, excise job tax credit?

RULING

No.

ANALYSIS

APPLICABLE TENNESSEE LAW AND FRANCHISE, EXCISE TAX RULES

Tenn. Code Ann. § 67-4-2109(c) provides that, if certain conditions are met, a taxpayer subject to Tennessee's franchise, excise tax may take a job tax credit against such taxes amounting to \$2,000 (\$4,500 for business enterprises located in economically distressed counties) for each net new full-time employee job created.

One of the conditions that must be met in order to take the credit is that the taxpayer must make a sufficient capital investment in a "qualified business enterprise". Tenn. Code Ann. § 67-4-2109(c)(B)(1), set forth in pertinent part below, defines the term "qualified business enterprise" for purposes of the job tax credit as follows:

"Qualified business enterprise" means:

(i) An enterprise in which a business has made the required capital investment necessary to permit the creation or expansion of manufacturing, warehousing and distribution, processing tangible personal property, research and development, computer services, call centers, headquarters facilities as defined in § 67-6-224(b), or convention or trade show facilities[.]

The Taxpayer claims that it has made the "required capital investment" and its construction of a larger facility meets the "qualified business enterprise" requirement because the Taxpayer qualifies as a warehousing facility. The Taxpayer claims that the activities described in the facts presented are no different from the following activities that normally occur at a large regional warehousing facility with the exception that, in such a case, the taxpayer owns the inventory:

1. The taxpayer's staff unloads incoming merchandise received from outside vendors.
2. The taxpayer stocks the merchandise at its warehouse facility.
3. The taxpayer maintains and accounts for all merchandise (inventory) stored at the facility.
4. The taxpayer retrieves merchandise from stock as requested by its retail locations.
5. The taxpayer prepares merchandise for shipment to its retail locations.

The Taxpayer believes that its new facility qualifies as a warehousing facility and is properly classified in the Standard Industrial Classification Manual of 1987 within Industry Group Number 50, Industry Number 5012, which is "Wholesale Trade-Durable Goods."

Tenn. Code Ann. § 67-4-2109(c)(B)(i) states that when a business has made the "required capital investment" in Tennessee real or tangible personal property necessary to permit the creation or expansion of "warehousing and distribution", the resulting facility will be considered a "qualified business enterprise".

For purposes of the franchise, excise job tax credit, the term "warehousing and distribution" is not defined in the franchise, excise tax statutes. Therefore, the words "warehousing" and "distribution" must be given their ordinary and common meanings, since words employed by the legislature in the enactment of tax statutes are to be taken in their natural and ordinary sense. *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132 at 135 (Tenn. 1992) and *Western Pipeline Construction, Inc. v. Dickinson*, 310 S.W.2d 455 at 458 (Tenn. 1958). Words and language used by the General Assembly must be taken in their natural and ordinary sense and read in the context of the entire statute without any forced or subtle construction. *Freedom Broadcasting of Tennessee, Inc., et al. v. Tennessee Department of Revenue*, 83 S.W.3d 776 at 781 and 782 (Tenn. Ct. App. 2002) citing *Eusco, Inc. v. Huddleston*, and *Nuclear Fuel Services, Inc. v. Huddleston*, 920 S.W.2d 659 (Tenn.Ct.App.1995)

The word "warehouse" is defined by *BLACK'S LAW DICTIONARY* 1587 (7th ed. 1999) as; "A building used to store goods and other items. A "warehouser" is defined as "One who, as a businessman, keeps or stores the goods of another for a fee." *Id.* The word "distribution" is defined as "The act or process of apportioning or giving out." *Id.* at 488.

The *AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE, NEW COLLEGE EDITION* 1444 (1978) defines the word "warehouse" as "A place in which merchandise is stored. "Distribute" is defined as "To deliver or pass out." *Id.* at 383.

CONCLUSION

When applied to a type of business, the term "warehousing" and the term "distribution" apply to the service of storing property for a fee and distributing it as directed by the owner.

In almost all situations, a business that sells tangible personal property at wholesale will find it necessary to store such merchandise prior to sale and to distribute it upon sale. This is especially true when the merchandise is being sold on consignment. Such storage and distribution may involve a "warehouse". However, it does not follow that all wholesalers of tangible personal property are in the business of

warehousing and distribution. The storage of goods in a warehouse or other storage facility and distribution of such goods upon sale may be incidental to the wholesale business in which the seller is engaged.

For example, X Business may be engaged in the wholesale sales, at auction or otherwise, of antique furniture on consignment. For a commission, it sells antiques that estates of deceased persons and others leave with it on consignment. The antiques are stored by X Business in its warehouse and sold to antique retailers for a commission. Although an estate may need to clear the deceased's house of all its antique furnishings prior to the house being sold, they do not bring the antiques to X Business for the purpose of storage. They bring the antique furniture to X Business for the purpose of having it sold.

A mere storage service could be obtained for a fee at any public warehouse. The estate could then sell the antiques and the public warehouse would make distribution to the various purchasers at the direction of the estate.

In the above example, X Business would be engaged in the service of selling antiques. An establishment, such as a public warehouse, operating a public warehouse where property is stored for a fee and later distributed at the direction of the owner is engaged in the business service of warehousing and distribution.

The determination of whether a business is a "qualified business enterprise" for purposes of the Tennessee franchise, excise job tax credit does not necessarily depend on how the establishment is classified in the Standard Industrial Classification (SIC) Manual, 1987 Edition. The job tax credit statute, Tenn. Code Ann. § 67-4-2109(c), does not mention the SIC Manual. However, the Taxpayer states that its SIC number falls within Major Group 50, which is "Wholesale Trade-Durable Goods."

In its description of the "Wholesale Trade" division as a whole at page 287, the 1987 SIC Manual recognizes that wholesale trade involves other functions besides selling, such as maintaining inventories, which would necessarily involve the storage of goods:

In addition to selling, functions frequently performed by wholesale establishments include **maintaining inventories of goods**; extending credit; physically assembling, sorting, and grading goods in large lots; breaking bulk and redistribution in smaller lots; delivery; refrigeration; and various types of promotion such as advertising and label designing. (*Emphasis supplied*)

Like the storage of the vehicles that the Taxpayer takes on consignment, the repair work that the Taxpayer does on such vehicles is a service incidental to its business as an automobile auction. However, even if the repair work is not incidental to the Taxpayer's auction business, it is not "warehousing and distribution."

As the Taxpayer points out, “Automobile Auction – Wholesale” is listed under “Major Group 50 – Wholesale Trade – Durable Goods,” “Industry Group 501,” “Industry Number 5012 – Automobiles and Other Motor Vehicles.” The 1987 SIC Manual at page 289 describes this classification as follows:

Establishments primarily engaged in the wholesale distribution of new and used passenger automobiles, trucks, trailers and other motor vehicles, including motorcycles, motor homes, and snowmobiles.

The 1987 SIC Manual includes establishments engaged in “general warehousing and storage” in “Major Group 42,” “Industry Group 422,” “Industry No. 4225,” and describes such establishments as follows:

Establishments primarily engaged in warehousing and storage of a general line of goods.

By its own admission, by its SIC code, and by the operations described in the facts presented, the Taxpayer is clearly operating an automobile auction facility and is engaged in the service of auctioning vehicles for a commission. This is not a “warehousing and distribution” business nor is it any of the other businesses named in Tenn. Code Ann. § 67-4-2109(c)(B)(1)(i).

Regardless of whether an establishment is a warehousing and distribution business, almost every business will find it necessary to have a building or area that it uses for storage and from which it makes distributions. However, depending on the facts and circumstances, such a building or area does not necessarily qualify as a “warehousing and distribution” facility for purposes of Tenn. Code Ann. § 67-4-2109(c)(B)(i) and the job tax credit.

The Taxpayer is clearly not operating a “warehousing and distribution” business within the meaning of Tenn. Code Ann. § 67-4-2109(c)(B)(i) and it has not been shown that the Taxpayer has made the “required capital investment” to permit the creation or expansion of a “warehousing and distribution” facility. From the facts presented, it does not appear that the Taxpayer’s accommodations for storage of automobiles awaiting auction is a “warehousing and distribution” facility within the meaning of the franchise, excise job tax credit statutes.

Thus, the Taxpayer’s investment is not in a “qualified business enterprise” for purposes of the franchise, excise job tax credit. Since the Taxpayer’s investment is not in a “qualified business enterprise”, it can not qualify for the job tax credit and it is not necessary for us to examine whether it would meet any of the other job tax credit criteria set forth in Tenn. Code Ann. § 67-4-2109(c).

Arnold B. Clapp

Special Counsel to the Commissioner

APPROVED: Loren L. Chumley, Commissioner

DATE: 7/30/04