

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #08-33**

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 sale of services by a nonprofit corporation is exempt for purposes of the Tennessee business tax.

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;
- (G) 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] is a Tennessee nonprofit corporation, organized under Tennessee's Nonprofit Corporation Act, found in Tenn. Code Ann. § 48-51-101, *et seq.* The Taxpayer has also received a determination of tax-exempt status for federal income tax purposes pursuant to IRC § 501(a), as an organization described in IRC § 501(c)(3). The Taxpayer's primary mission is, and remains, as stated in its Charter, as follows:

The purposes for which this corporation is organized are as follows:

- (a) The Corporation has been organized and shall be operated exclusively for charitable, scientific, literary or educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"), including but not limited to, promoting the social welfare, lessening the burdens of government and making distributions to and support of other organizations that qualify as exempt organizations described in Section 170(c) of the Code; provided, however, that such activities, distributions and support must further the purposes, missions and/or activities specifically identified elsewhere in this Charter.
- (b) The Corporation is irrevocably dedicated to and operated exclusively for nonprofit purposes, and no part of the income or assets of the Corporation shall be distributed to or inure to the benefit of any individual.
- (c) Some non-exclusive examples of the charitable and/or educational purpose(s) for which the Corporation is organized are:
 - (i) [INFORMATION DELETED].
 - (ii) [INFORMATION DELETED].
 - (iii) Any other activities reasonably determined by the Corporation's board of directors to be consistent with the purposes set forth in of this Charter which further, directly or indirectly, any of the Corporation's purposes or activities identified herein, and do not violate any of the prohibitions set forth in this Charter.
- (d) The Corporation is not being formed for any purpose for which there are other specific statutory provisions in the State of Tennessee concerning its formation and is not being organized for a purpose or purposes which require authorization under the laws or statutory regulations of the State of Tennessee.

No substantial part of the activities of the Taxpayer will consist of carrying on propaganda, or otherwise attempt to influence legislation. Nor will the Taxpayer participate in any political campaign in any manner on behalf of any candidate for public office.

All of the Taxpayer's gross receipts arise from activities which are related to and fully within the scope of the activities upon which the IRS based its determination that the Taxpayer qualified as an exempt organization under I.R.C. § 501(c)(3) (as a charitable organization).

QUESTION

Is the Taxpayer exempt for purposes of the Tennessee business tax?

RULING

The Taxpayer is exempt for purposes of the Tennessee business tax as a charitable organization with respect to its sales of services.

ANALYSIS

The Business Tax Act, Tenn. Code Ann. § 67-4-701 *et seq.*, is a component of Tennessee's scheme of privilege and excise taxes. Tenn. Code Ann. § 67-4-704(a) (2006) allows counties and incorporated municipalities to tax the privilege of making sales by engaging in any business activity described in Tenn. Code Ann. § 67-4-708(1)-(3) (2006). In particular, Tenn. Code Ann. § 67-4-708(3)(C) applies the business tax to the "making of sales of services or engaging in the business of furnishing or rendering services." The term "services" is defined under Tenn. Code Ann. § 67-4-702(19) (2006) in pertinent part to mean and include "every activity, function or work engaged in by a person for profit or monetary gain except as otherwise provided in this part."¹ Tenn. Code Ann. § 67-4-708(3)(C) provides a number of exemptions from the business tax. In particular, Tenn. Code Ann. § 67-4-708(3)(C)(vii) (2006) exempts from the business tax sales of "services by religious and charitable organizations."²

Tenn. Code Ann. § 67-4-708 sets forth five classes of business activities. A taxpayer's dominant business activity is used to determine under which of the five classifications the taxpayer belongs, for the purposes of determining the appropriate tax rate and the due date of the return. *See Hermitage Memorial Gardens Mausoleum and Memorial Chapel, Inc. v. Dunn et al.*, 541 S.W.2d 147 at 149 (Tenn. 1976) (rejecting taxpayer's argument that only business enterprises whose dominant business activity is defined in the Business Tax Act are subject to the business

¹ Regulations add to this definition by stating that a person exempt under the provisions of Tenn. Code Ann. § 67-4-708, Classification 3, from paying the tax on receipts from services rendered is, nevertheless, liable for the tax on receipts from sales of tangible personal property. TENN. COMP. R. & REGS. 1320-4-5-.48(1). However, any institution operated for religious or charitable purposes is exempt from paying business tax on any profits that are earned from the sale of items contributed to the institution or articles produced by the institution from such contributed items. Tenn. Code Ann. § 67-4-712(b)(5) (2006).

² The Business Tax Act provides several additional exemptions; however, none apply to the Taxpayer. Note that the burden is on the taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that "[a]lthough the rule is well-established that taxing legislation should be liberally construed in favor of the taxpayer and strictly construed against the taxing authority, it is an equally important principle of Tennessee tax law that 'exemptions from taxation are construed against the taxpayer who must shoulder the heavy and exacting burden of proving the exemption.'" *American Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn.Ct.App. 2000) (quoting *Rogers Group, Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn.Ct.App. 1995)). The Tennessee Supreme Court has also stated that the burden is on the taxpayer to establish the exemption, and any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *American Airlines, Inc. v. Johnson*, 56 S.W.3d at 506 (citing *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)).

tax). *See also* TENN. COMP. R. & REGS. 1320-4-5-.15. “Dominant business activity” is defined as “the business activity which is the major and principal source of gross sales at retail and the major and principal source of gross sales at wholesale of the business.” Tenn. Code Ann. § 67-4-702(5) (2006).

The Taxpayer provides numerous services to [NAME OF ENTITY]. The Taxpayer is therefore exercising the taxable privilege of making sales by engaging in a business activity described in Tenn. Code Ann. § 67-4-708. More specifically, Tenn. Code Ann. § 67-4-708(3)(C) places the Taxpayer under Classification 3, since the Taxpayer’s dominant business activity is the rendering of services. Accordingly, the Taxpayer will be subject to the business tax with respect to its sales of services, unless it qualifies for the “charitable organization” exemption under Tenn. Code Ann. § 67-4-708(3)(C)(vii).

A preliminary question is whether the Taxpayer must be specifically described in the Standard Industrial Classification Index (the “SIC Index”) in order to qualify for the “charitable organization” exemption under Tenn. Code Ann. § 67-4-708(3)(C)(vii). Tenn. Code Ann. § 67-4-708(3)(C) expressly provides that it is the legislative intent that the exceptions under that subsection “shall include the sales of services by those businesses or establishments so described in the Standard Industrial Classification Index of 1972, including all supplements and amendments.”³ Importantly, however, the Tennessee Attorney General has stated that the sale of a particular service may be exempt from the business tax even though it is not specifically listed in the SIC Index. *See* Tenn. Op. Atty. Gen. No. 82-203 (Tenn. A.G. April 5, 1982) (opining that audiology comes within the exemption for allied health services, even though audiology is not listed anywhere in the SIC Index).⁴

The SIC Index does not contain a general classification for charitable organizations.⁵ Additionally, while the SIC Index contains Industry Group classifications for certain types of entities that may be exempt for federal income tax purposes under IRC § 501(c)(3), such as religious and educational organizations, a charitable organization such as the Taxpayer does not come under any of these Industry Groups. As a result, if inclusion in the SIC Index were a requirement, no charitable organization could possibly qualify for the “charitable organization” exemption under Tenn. Code Ann. § 67-4-708(3)(C)(vii). Such an interpretation would thus impermissibly render Tenn. Code Ann. § 67-4-708(3)(C)(vii) inoperative and meaningless. The Tennessee Supreme Court has stated that a statute should not be interpreted in a manner

³ The SIC Index classifies business establishments by the type of economic activity they perform; the SIC classifications are based on the “primary” or “predominant” activity of the subject industries. Not all business types are included in the SIC Index; rather, the SIC Index classifies only those types of business establishments representing a significant part of the economy. *See Aabakus, Inc. v. Huddleston*, 1996 WL 548148 at *3 (Tenn.Ct.App. 1996).

⁴ Note that the Tennessee Attorney General has also opined that persons exempted from paying business tax under Tenn. Code Ann. § 67-4-708(3)(C) must fall within one of the expressly excepted categories, as illustrated in the SIC Index. *See* Tenn. Op. Atty. Gen. No. 94-098 (Tenn. A.G. September 7, 1994). This opinion, however, concerns a service that was in fact included in the SIC Index, but under an Industry Group that was not listed as exempt from the business tax under Tenn. Code Ann. § 67-4-708(3)(C).

⁵ Note that charitable trusts are included under SIC Index Industry Group 673 (Trusts); the Taxpayer does not come within this classification because it is not a trust.

rendering it meaningless or useless. *See Mercy v. Olsen*, 672 S.W.2d 196, 200 (Tenn. 1984) (quoting *Hoyer-Schlesinger-Turner, Inc. v. Benson*, 479 S.W.2d 223, 225 (Tenn.1972)). Similarly, the Tennessee Court of Appeals has stated that the interpretation of a statute must not render any part of the statute “inoperative, superfluous, void or insignificant.” *Nissan North America, Inc. v. Haislip*, 155 S.W.3d 104, 106 (Tenn.Ct.App. 2004) (quoting *State v. Morrow*, 75 S.W.3d 919, 921 (Tenn. 2002)). Accordingly, there is no requirement that the Taxpayer be specifically described in the Standard Industrial Classification Index (the “SIC Index”) in order to qualify for the “charitable organization” exemption under Tenn. Code Ann. § 67-4-708(3)(C)(vii).

Neither the SIC Index, the Tennessee Code nor the Tennessee courts have defined the term “charitable organization” for purposes of Tennessee business taxation. The Tennessee Supreme Court has stated that when a statute does not define a term, it is proper to look to common usage to determine the term’s meaning. *See, e.g., Tennessee Farmers Assur. v. Chumley*, 197 S.W.3d 767, 782-83 (Tenn. 2006); *Beare Co. v. Tennessee Dept. of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993). Black’s Law Dictionary (8th ed. 2004) defines the term “charitable organization” as a “tax-exempt organization that (1) is organized and operated exclusively for religious, scientific, literary, educational, athletic, public-safety, or community-service purposes, (2) does not distribute earnings for the benefit of private individuals, and (3) does not participate in any way in political candidate campaigns, or engage in substantial lobbying.”

The Taxpayer comes within this definition of “charitable organization.” First, the Taxpayer has received a determination of tax-exempt status for federal income tax purposes pursuant to IRC § 501(a), as an organization described in IRC § 501(c)(3). Second, the Taxpayer’s Charter indicates that the Taxpayer is organized exclusively for religious, scientific, literary, educational, athletic, public-safety, or community-service purposes. Third, the Taxpayer is chartered under Tennessee’s Nonprofit Corporation Act, found at Tenn. Code Ann. §§ 48-51-101, *et seq.* Under Tenn. Code Ann. § 48-63-102 (2006), the Taxpayer is prohibited from making distributions for the benefit of private individuals. Furthermore, the Taxpayer’s Charter specifically provides that no income or assets of the Taxpayer may be distributed to, or inure to the benefit of, any individual. Fourth, the Taxpayer has stated that it does not participate in any way in political candidate campaigns, or engage in substantial lobbying. Thus, the Taxpayer is properly characterized as a “charitable organization” for purposes of the Tennessee business tax.

Because the Taxpayer is properly characterized as a charitable organization, the Taxpayer is exempt under Tenn. Code Ann. § 67-4-708(3)(C)(vii) with respect to its sales of services.

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Commissioner

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