

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 12-23**

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 Tennessee business tax applies to sales of automotive parts to a party that assembles the parts into products that are sold for resale.

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

[TAXPAYER] (the "Taxpayer") is legally domiciled in [COUNTRY]. The Taxpayer supplies automotive parts to an unrelated corporation located in Tennessee ("T-Co"). T-Co assembles various parts, including parts from the Taxpayer, at its facility in Tennessee. T-Co sells its parts to automobile manufacturers.

The Taxpayer does not have any fixed place of business, such as a branch or an office, in Tennessee. In order to facilitate its sales of parts to T-Co, the Taxpayer leases warehouse space in Tennessee to store automotive parts that T-Co has committed to purchase. The warehouse is operated by an independent third party that is unrelated to the Taxpayer. When T-Co requires parts, it sends its employees to the Tennessee warehouse to obtain the needed parts.

After removing the parts from the Tennessee warehouse, T-Co reports to the Taxpayer which parts were obtained. The Taxpayer then invoices T-Co for the parts. T-Co has a contractual duty to purchase excess automotive parts if there is a significant change in its long-term order planning. This arrangement reflects the intention of the parties that all of the parts shipped to Tennessee and temporarily stored at the warehouse will be purchased by T-Co.

RULING

Are the Taxpayer's receipts from sales of automotive parts to T-Co subject to the Tennessee business tax?

Ruling: Yes. The Taxpayer's receipts from sales of automotive parts to T-Co are subject to the Tennessee business tax, at the rate applicable to wholesalers under Classification 2.

ANALYSIS

The Tennessee Business Tax Act, TENN. CODE ANN. §§ 67-4-701 through -730 (2011), is a component of Tennessee's scheme of privilege and excise taxes. TENN. CODE ANN. § 67-4-704 (2011) 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)-(4) (2011).¹

For Tennessee business tax purposes, businesses are classified under TENN. CODE ANN. § 67-4-708 (2011) according to their dominant taxable business activity, and these statutory classifications determine the rate and due date of the tax. *Aabakus, Inc. v. Huddleston*, No. 01A-01-9505-CH-00215, 1996 WL 548148, at *2 (Tenn. Ct. App. Sept. 25, 1996). "Dominant business activity" is defined as "the business activity that is the major and principal source of taxable gross sales of the business." TENN. CODE ANN. § 67-4-702(a)(5) (2011).

TENN. CODE ANN. § 67-4-708(2)(A) includes under "Classification 2" any business engaged in the sale of "[n]ew or used motor vehicles, parts and accessories." Assuming that the Taxpayer's dominant business activity in Tennessee is in fact the sale of automotive parts, the Taxpayer would come within Classification 2.

TENN. CODE ANN. § 67-4-709 (2011) sets forth the tax rates applicable to each classification.² The tax rate for Classification 2 (as well as for Classifications 1 and 3) is based on whether a taxpayer is a retailer or a wholesaler. If a taxpayer is a retailer, then it will pay the retailer rate on all of its taxable sales, and if a taxpayer is a wholesaler, then it will pay the wholesaler rate on all of its taxable sales. *See* TENN. CODE ANN. § 67-4-709(2) (setting forth the rates for Classification 2).

¹ The Business Tax Act was amended by 2009 Tenn. Pub. Acts, Chapter 530. Effective July 1, 2009, the Commissioner of Revenue is responsible for the collection and administration of all business taxes levied by local governments. *See* TENN. CODE ANN. § 67-4-703 (2011).

² For all taxpayers except those under Classification 5, the minimum tax due is \$22 per year. TENN. CODE ANN. § 67-4-714(a) (2011). Additionally, TENN. CODE ANN. § 67-4-706(a) (2011) provides that, prior to engaging in business, a taxpayer must register with the county clerk, in the case of businesses located within a county, and with the city official designated as the register by city charter or ordinance, in the case of businesses located within a municipality.

“Retailer” is defined as “any person primarily³ engaged in the business of making retail sales.” TENN. CODE ANN. § 67-4-702(a)(16) (2011) (footnote added). A “retail sale” is “any sale other than a wholesale sale.” TENN. CODE ANN. § 67-4-702(a)(15). “Wholesaler” is defined as “any person primarily⁴ engaged in the business of making wholesale sales.” TENN. CODE ANN. § 67-4-702(a)(25) (footnote added). A “wholesale sale” is defined as “any sale to a retailer for resale.” TENN. CODE ANN. § 67-4-702(a)(24)(A).⁵ Additionally, TENN. CODE ANN. § 67-4-702(a)(24)(B) provides that the terms “wholesale sale” or “sale at wholesale” include the sale of industrial materials for future processing, manufacture or conversion into articles of tangible personal property for resale where the industrial materials become a component part of the finished product.”⁶

Based on the information provided, the Taxpayer’s receipts from its sales of automotive parts to T-Co are subject to the Tennessee business tax, at the rate applicable to wholesalers under Classification 2.⁷

The Taxpayer’s sales are properly considered wholesale sales for Tennessee business tax purposes under TENN. CODE ANN. § 67-4-702(a)(24)(B). In the Taxpayer’s case, the automotive parts are an industrial material. The Taxpayer sells the automotive parts to T-Co for future processing, manufacture or conversion into articles of tangible personal property for resale. Additionally, the automotive parts become a component part of the finished product.

The Taxpayer has suggested that its business transactions are controlled by the Tennessee Court of Appeals’ decision in *Pfizer, Inc. v. Johnson*, No. M2004-00041-COA-R3-CV, 2006 WL 163190, at *4 (Tenn. Ct. App. Jan. 23, 2006) (holding that sales by one wholesaler to another wholesaler were not subject to the business tax, under a prior version of the law).

However, the Taxpayer’s reliance on *Pfizer, Inc.* is misplaced. The taxpayer in that case was a pharmaceutical manufacturer with a warehouse in Tennessee, which it used to distribute its pharmaceutical products to various wholesalers. *Pfizer, Inc.*, 2006 WL 163190, at *1. In reaching its decision, the Tennessee Court of Appeals correctly looked to the definition of “wholesale sale” contained in TENN. CODE ANN. § 67-6-702(a)(19) (1998) (codified as amended at TENN. CODE ANN. § 67-6-702(a)(24)(A)). See *Pfizer, Inc.*, 2006 WL 163190, at *3.

At that time, TENN. CODE ANN. § 67-4-702(a)(19)(B) (1998) provided, just as TENN. CODE ANN. § 67-4-702(a)(24)(B) (2011) does now, that a “wholesale sale” would “include[] the sale of industrial

³ In this context, “primarily” is defined to mean that “more than fifty percent (50%) of the taxable gross sales of the business are retail sales.” TENN. CODE ANN. § 67-4-702(a)(16).

⁴ In this context, “primarily” is defined to mean that “more than fifty percent (50%) of the taxable gross sales of the business are wholesale sales.” TENN. CODE ANN. § 67-4-702(a)(25).

⁵ TENN. CODE ANN. § 67-4-702(a)(14) provides that the term “resale” means “a subsequent, bona fide sale of the property, services or taxable item by the purchaser.” “Sale for resale” means “the sale of the property, services, or taxable item intended for subsequent resale by the purchaser.” *Id.*

⁶ TENN. COMP. R. & REGS. 1320-4-5-.29(1) (1987) further explains this provision, stating that “[s]ales of industrial materials and services to manufacturers and processors who further process, manufacture or convert such materials as a component part of articles of tangible personal property, or use the services in preparing such product for sale or resale, are considered to be sales at wholesale and, therefore, subject to the business tax.” Note that, although not relevant to this letter ruling, TENN. CODE ANN. § 67-4-702(a)(24)(B) does not apply to raw or unprocessed agricultural products.

⁷ See TENN. CODE ANN. § 67-4-709(2)(B).

materials for future processing, manufacture or conversion into articles of tangible personal property for resale where such industrial materials become a component part of the finished product.” The court did not refer to that subsection, however, because Pfizer, Inc. was not selling industrial materials used for future conversion into articles of tangible personal property. Pfizer, Inc. was instead selling pharmaceuticals that were already completed articles of tangible personal property, with no additional processing necessary. *Cf. Pfizer, Inc.*, 2006 WL 163190, at *1, *3.

The Tennessee Court of Appeals correctly relied upon TENN. CODE ANN. § 67-4-702(a)(19) to reach its decision in *Pfizer, Inc.*. But that holding is inapposite here because, as explained above, the Taxpayer’s products more properly fit into the definition of “wholesale sale” contained in TENN. CODE ANN. § 67-6-702(a)(24)(B) as industrial materials that are processed to become component parts of the finished product. Moreover, subsection (B) does not require that the sale of the products be to a retailer, *compare* TENN. CODE ANN. § 67-6-702(a)(24)(B), *with* TENN. CODE ANN. § 67-6-702(a)(24)(A), so it is irrelevant under subsection (B) that T-Co is not a retailer.

Accordingly, the Taxpayer’s receipts from sales of automotive parts to T-Co are subject to the Tennessee business tax, at the rate applicable to wholesalers under Classification 2.

Kristin Husat
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APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: 10-17-12