

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 09-42**

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

Application of the Tennessee business tax to mortgage brokers.

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 the taxpayer's detriment.

FACTS

[CITY IN TENNESSEE] as allowed by Tenn. Code Ann. § 67-4-704(a) (2006), imposes a tax on the privilege of engaging in the business activities described in Tenn. Code Ann. § 67-4-708(1)-

(3) (2006) (*i.e.* the business tax). [CITY IN TENNESSEE] has been contacted by [COMPANY], a company that conducts business within [CITY IN TENNESSEE'S] city limits, regarding whether [COMPANY'S] business activities conducted in [CITY IN TENNESSEE] during [YEARS] were exempt from the business tax. [CITY IN TENNESSEE] subsequently requested this letter ruling in order to gain clarification of the issue.

[COMPANY] is a mortgage broker. Under the facts provided, its income consists of commissions and fees derived from its brokerage services.

QUESTION

Are [COMPANY'S] commissions and fees derived from its sales of brokerage services exempt from the Tennessee business tax?

RULING

[COMPANY]'s commissions and fees derived from its sales of brokerage services are exempt from the Tennessee business tax.¹

However, if [COMPANY] also engages in any taxable business activities, the gross sales from such activities would be subject to the Tennessee business tax regardless of whether those sales constitute the principal source of [COMPANY]'s income.

ANALYSIS

The Business Tax Act, Tenn. Code Ann. § 67-4-701 *et seq.*, is a component of Tennessee's 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).

A taxpayer is classified under Tenn. Code Ann. § 67-4-708 according to its 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). The taxpayer's dominant taxable business activity is only relevant with respect to the determination of the taxpayer's classification under Tenn. Code Ann. § 67-4-708. All persons that make sales by engaging in any of the activities enumerated in Tenn. Code Ann. § 67-4-708 are subject to tax, regardless of whether their principal business activities are taxable. *Hermitage Mem'l Gardens v. Dunn*, 541 S.W.2d 147, 149 (Tenn. 1976).

Persons whose dominant taxable business activity is the selling of services are grouped under Classification 3, found at Tenn. Code Ann. § 67-4-708(3)(C), which applies the business tax to

¹ The Business Tax Act has been amended by Chapter 530 of the Public Acts of 2009, effective July 1, 2009. This letter ruling is based on the law in effect during the years in question (*i.e.*, 2007 and 2008). However, the outcome of this letter ruling would remain the same if based on the Business Tax Act as amended in 2009.

“making sales of services or engaging in the business of furnishing or rendering services.”² Thus, with certain specified exceptions that are discussed more fully below, a person whose dominant taxable business activity is the sale of services will be subject to business tax under Classification 3.

[COMPANY] describes itself as a mortgage broker, which is clearly a service activity. Therefore, [COMPANY] will fall within Classification 3 unless an exception applies.

However, Tenn. Code Ann. § 67-4-708(3)(C)(i)-(xvi) specifically excludes sixteen categories of services from the business tax. In particular, Tenn. Code Ann. § 67-4-708(3)(C)(x) provides an exemption for:

Services furnished by institutions which are engaged in deposit banking or closely related functions, including fiduciary activities, services furnished by persons engaged in extending credit or lending money except persons taxable under subdivision (5); services furnished by establishments engaged in the underwriting, purchase, sale or brokerage of securities on their own account or on the account of others; services furnished by exchanges, exchange clearing houses and other services allied with the exchange of securities and commodities; services furnished by investment trusts, investment companies, holding companies and commodity trading companies.

To further describe the services that are exempt from taxation, Tenn. Code Ann. § 67-4-708(3)(C) states that the sixteen exempt services “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 [the “SIC Index”].”³ Accordingly, it is proper to examine the SIC Index to construe exactly which services fall within the exemption.

Industry Group 616 of the SIC Index (Mortgage Bankers and Brokers) includes mortgage brokers using their own money (Industry Number 6162) and mortgage brokers arranging for loans using the money of others (Industry Number 6163). [COMPANY], as a mortgage broker, clearly is included in Industry Group 616. Accordingly, [COMPANY] is covered by Major Group 61 of the SIC Index, which comprises services furnished by persons engaged in extending credit. As a result, the Taxpayer comes within the scope of the exemption found under Tenn. Code Ann. § 67-4-708(3)(C)(x) with respect to its sales of brokerage services. Accordingly, the Taxpayer’s commissions and fees derived from its sales of brokerage services are exempt for purposes of the Tennessee business tax.

Note, however, that [COMPANY] is exempt only with respect to its sales of brokerage services. Sales of services that do not come within the scope of an exemption under Tenn. Code Ann.

² 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” the Business Tax Act.

³ The SIC Index classifies business establishments by the type of economic activity they perform. 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. Sept. 25, 1996). The SIC Index of 1987 is the most recent edition of the index.

§ 67-4-708(3)(C)(i)-(xvi) remain subject to business tax. Additionally, most sales of tangible personal property are likewise subject to business tax. Therefore, while not indicated by the facts provided, if [COMPANY] were in fact engaged in any other business activities apart from its brokerage activities, such activities must be examined separately to determine if they are subject to taxation. As discussed above, any taxable activities remain taxable even if they constitute only a minority of the taxpayer's business.

Elizabeth Henderson
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APPROVED: Reagan Farr
Commissioner of Revenue

DATE: 9/8/09