

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 10-28**

**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 [TYPE] testing services provided by the Taxpayer are properly classified as wholesale sales or retail sales 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;
- (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**

The [TAXPAYER] is a [STATE OF INCORPORATION] analytical [TYPE] laboratory corporation engaged in the business of testing and analyzing [TYPE OF] samples. The Taxpayer's services are primarily provided to [TYPE] firms throughout the continental United States, which then resell the Taxpayer's services to their clients (including individuals, private

industry, government, and other entities). Typically, the [TYPE] firms will subcontract with the Taxpayer for required testing; the Taxpayer will bill the [TYPE] firms for the services; and then the [TYPE] firms will pass along the Taxpayer's charges, most often at a marked-up rate, to their clients as part of the master billing for services rendered.

### QUESTION

Are the [TYPE] testing services provided by the Taxpayer properly classified as wholesale sales or as retail sales for purposes of the Tennessee business tax?

### RULING

The [TYPE] testing services offered by the Taxpayer are classified as wholesale sales, and not as retail sales, for purposes of the Tennessee business tax.

### ANALYSIS

The Business Tax Act was amended by 2009 Tenn. Pub. Acts, Chapter 530, effective July 1, 2009. The analysis provided below for the sale of [TYPE] testing services is divided into two sections, the first discussing the Tennessee business tax laws in effect through June 30, 2009, and the second discussing the Tennessee business tax laws in effect beginning July 1, 2009.

#### *1. The Business Tax Laws in effect through June 30, 2009*

The [TYPE OF] testing services offered by the Taxpayer are classified as wholesale sales, and not as retail sales, under the business tax laws effective through June 30, 2009.

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 & Supp. 2008).

TENN. CODE ANN. § 67-4-709(a) imposes a fifteen dollar minimum tax on each taxpayer that exercises one of the privileges described under TENN. CODE ANN. § 67-4-708. TENN. CODE ANN. § 67-4-723 (2006) requires that a license be issued to all taxpayers that pay the minimum tax prescribed by the Business Tax Act.

Businesses are classified under TENN. CODE ANN. § 67-4-708 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 gross sales at retail and the major and principal source of gross sales at wholesale of the business." TENN. CODE ANN. § 67-4-702(a)(5) (2006). The tax base is determined by the amount of taxable sales made by the business. *Aabakus, Inc.*, 1996 WL 548148, at 5; TENN. CODE ANN. § 67-4-709(b) (2006). Services are grouped under Classification 3, found at TENN. CODE ANN. § 67-4-708(3)(C). The term "services" under TENN. CODE ANN. § 67-4-702(a)(19) includes in pertinent part "every activity, function or work engaged in by a person for profit or monetary gain." Furthermore, all persons engaged in the

business of rendering services are liable for the business tax unless specifically exempted under the provisions of TENN. CODE ANN. § 67-4-708(3)(C)(i)-(xvi).

The Taxpayer describes itself as a provider of [TYPE] testing services. Clearly, TENN. CODE ANN. § 67-4-708(3)(C) places the Taxpayer under Classification 3, since its dominant business activity is the rendering of services. Additionally, there are no exemptions listed under TENN. CODE ANN. § 67-4-708(3)(C) for the services rendered by the Taxpayer. Therefore, the Taxpayer is subject to the Tennessee business tax imposed under TENN. CODE ANN. § 67-4-709(a) and (b)(3).

The rate of tax imposed under TENN. CODE ANN. § 67-4-709(b)(3) depends on whether the Taxpayer's sales of services are classified as "retail" sales or "wholesale" sales under the Tennessee Business Tax Act.<sup>1</sup>

"Retail sales" as defined by TENN. CODE ANN. § 67-4-702(a)(14)(A) include, in pertinent part, sales of services "to any person for any purpose other than for resale," and all sales for resale "must be in strict compliance with rules and regulations." The term "wholesale sale" includes the sale of "services rendered in the regular course of business to a licensed retailer for resale, lease or rental as tangible personal property in the retailer's regular course of business to a user or consumer." TENN. CODE ANN. § 67-4-702(a)(22)(A).

TENN. CODE ANN. § 67-4-702(a)(22)(A) is further explained by TENN. COMP. R. & REG 1320-4-5-47(1) (1974) ("Rule 47(1)"), which states in pertinent part that "sales for resale include those whereby a supplier of ... services makes such ... services available for further processing as a component part of a product to legitimate dealers engaged in and actually reselling or leasing such ... services to a user or consumer."

Accordingly, in order for the Taxpayer's services to be classified as wholesale sales and not as retail sales: 1) the Taxpayer must sell its services in the regular course of business 2) to a licensed retailer 3) for resale 4) in the retailer's regular course of business to a user or consumer.

For the reasons discussed below, the [TYPE OF] testing services offered by the Taxpayer are classified as wholesale sales, and not as retail sales, for purposes of the Tennessee business tax.

The first and fourth elements of a wholesale sale are clearly present. The Taxpayer's regular business is to perform the testing and sell the test results to engineering and consulting firms. Thus, it sells its services in the regular course of business. Additionally, these engineering and consulting firms are in the business of selling reports to their clients with the test results provided by the Taxpayer incorporated into the reports. Thus, the Taxpayer's customer sells the test results provided by the Taxpayer as such or as a component part of its report in its regular course of business to a user or consumer.

The second element of a wholesale sale is also present, *i.e.*, the Taxpayer makes sales to licensed retailers. The engineering and consulting firms are clearly "retailers" for purposes of the

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<sup>1</sup> The tax imposed by TENN. CODE ANN. § 67-4-709(b)(3) (2006) is at the rate of three sixteenths of one percent (3/16 of 1%) of all the retail sales of the business and three eightieths of one percent (3/80 of 1%) of all the wholesales sales of the business.

Tennessee business tax. The term “retailer” is defined as “every person engaged in the business of making sales at retail.” TENN. CODE ANN. § 67-4-702(a)(15). The term “sale at retail” is defined in turn under TENN. CODE ANN. § 67-4-702(a)(14)(A) in pertinent part as “a sale of tangible personal property or services rendered to a consumer or to any person for any purpose other than for resale.” The firms make retail sales of their services to consumers and are therefore retailers.

Furthermore, as stated previously, Rule 47(1) helps explain the statutory definition of wholesale sale. Rather than restate the term “licensed retailer,” the rule instead refers to sales to “*legitimate dealers* engaged in and actually reselling or leasing such ... services to a user or consumer.” (Emphasis added.) The term “legitimate” is not defined in the Business Tax Act, but commonly means accordant with or complying with the law. *See* BLACK’S LAW DICTIONARY 732 (7<sup>th</sup> ed. 2000); MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY, ELEVENTH EDITION 710 (2007).<sup>2</sup>

It can be presumed that some of the firms that purchase the Taxpayer’s services will have received a business tax license upon payment of the fifteen dollar minimum business tax due under TENN. CODE ANN. § 67-4-709(a),<sup>3</sup> and thus are clearly accordant with or compliant with the law. However, other firms will be exempt from the business tax under TENN. CODE ANN. § 67-4-708(3)(C)(xv) as providers of engineering services.<sup>4</sup>

Such exempt engineering and consulting firms are not required to obtain a business tax license in order to exercise the privilege of making sales of services in Tennessee. Nevertheless, these firms also are “legitimate dealers” as required by Rule 47(1). Accordingly, the second element of a “wholesale sale” is met.

Finally, the third element of a wholesale sale is present as well; namely, the Taxpayer’s services are sold for resale for Tennessee business tax purposes. Neither the Tennessee Code nor the Tennessee courts have defined the term “resale” for purposes of Tennessee business taxation.<sup>5</sup> 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., Tenn. Farmers Assur. v. Chumley*, 197 S.W.3d 767, 782-83 (Tenn. Ct. App. 2006); *Beare Co. v. Tenn. Dept. of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993). The term “resale,” while not defined under the Business Tax Act, is defined under the Retailers’ Sales Tax Act as “a subsequent, bona fide sale of the

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<sup>2</sup> The term “dealer” also is not defined in the Business Tax Act, but it is commonly interchangeable with the term “retailer.” BLACK’S LAW DICTIONARY 328 (7<sup>th</sup> ed. 2000). As established previously, the engineering and consulting firms are clearly “retailers” for purposes of the Tennessee business tax.

<sup>3</sup> As noted above, TENN. CODE ANN. § 67-4-709(a) imposes a fifteen dollar minimum tax on each taxpayer that exercises one of the privileges described under TENN. CODE ANN. § 67-4-708. TENN. CODE ANN. § 67-4-723 requires that a license be issued to all taxpayers that pay the minimum tax prescribed by the Business Tax Act.

<sup>4</sup> Specifically, TENN. CODE ANN. § 67-4-708(3)(C)(xv) exempts “[s]ervices furnished by persons engaged in the practice of architecture, engineering or land surveying.”

<sup>5</sup> Note that TENN. COMP. R. & REGS. 1320-4-5-.47 (1974) (“Rule 47”) provides in pertinent part that “sales for resale include those whereby a supplier of ... services makes such ... services available for further processing as a component part of a product to legitimate dealers engaged in and actually *reselling or leasing such ... services* to a user or consumer.” (Emphasis added.) Rule 47, which is intended to clarify resale and wholesale sales in the business tax context, clearly contemplates services becoming part of a “product” and then resold as services. The term “product” is broad enough to encompass services as well as tangible personal property.

property, services, or taxable item by the purchaser,” and a “sale for resale” is defined as “the sale of the property, services, or taxable item intended for subsequent resale by the purchaser.” TENN. CODE ANN. § 67-6-102(67) (Supp. 2007). While the sales and use tax definitions are not controlling for business tax purposes, the definitions for “sale” and “retail sale” in both the Business Tax Act and the Retailers’ Sales Tax Act are nearly identical; it is therefore reasonable to conclude that the definition of “resale” under the Retailer’s Sales Tax Act is indicative of what the Tennessee General Assembly intended as the meaning for the term under the Business Tax Act.

The Taxpayer sells its services to firms, which subsequently sell those same services to end-users. These firms are selling something that they purchased from someone else, thus the sales are clearly “resales” as defined above. Accordingly, the Taxpayer’s sales of its services meet the four elements of a wholesale sale listed above and thus come within the intended meaning of “wholesale sale” under the Tennessee business tax.

Thus, the [TYPE OF] testing services offered by the Taxpayer are classified as wholesale sales, and not as retail sales, for purposes of the Tennessee business tax.

A final issue concerning statutory construction must be addressed. As noted above, TENN. CODE ANN. § 67-4-702(a)(22)(A) defines “wholesale sale” as “the sale of *tangible personal property or services* rendered in the regular course of business to a licensed retailer for resale, lease or rental as *tangible personal property* in the retailer’s regular course of business to a user or consumer.” (Emphasis added.) Because it is impossible to resell services as tangible personal property, one might conclude based on the literal language of this definition that a service can never be sold at wholesale. However, for the reasons discussed below, this conclusion is erroneous.

The Tennessee Supreme Court has stated that legislative intent is to be ascertained whenever possible “without forced or subtle construction that would limit or extend the meaning of the language.” *Boarman v. Jaynes*, 109 S.W.3d 286, 290-291 (Tenn. 2003). Similarly, the Tennessee Court of Appeals has stated that “courts must give effect to the ‘plain import of the language of the act’ and must not use the strict construction rule to thwart ‘the legislative intent to tax.’” *Saturn Corp. v. Johnson*, 197 S.W.3d 273, 276 (Tenn. Ct. App. 2006) (citing *Int’l Harvester Co. v. Carr*, 466 S.W.2d 207, 214 (Tenn. 1971)).

However, Tennessee courts have concluded that when a statute is ambiguous, the legislative history and the entire statutory scheme may be considered for interpretive guidance. See *Eastman Chem. Co. v. Johnson*, 151 S.W.3d 503, 507 (Tenn. 2004); *Perrin v. Gaylord Entm’t Co.*, 120 S.W.3d 823, 826 (Tenn. 2003); *Walker v. Sunrise Pontiac-GMC Truck, Inc.*, 249 S.W.3d 301, 309 (Tenn. 2008). Statutes relating to the same subject or that have a common purpose are to be construed together, “and the construction of one such statute, if doubtful, may be aided by considering the words and legislative intent indicated by the language of another statute.” *Lyons v. Rasar*, 872 S.W.2d 895, 897 (Tenn. 1994) (citing *Belle-Aire Vill., Inc. v. Ghorley*, 574 S.W.2d 723, 725 (Tenn. 1978)); *Spence v. Miles Labs., Inc.*, 810 F.Supp. 952 (E.D.Tenn. 1992). Additionally, the Tennessee Supreme Court has stated that a statute should not be interpreted in a manner 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 N Am., 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)).

As stated previously, TENN. CODE ANN. § 67-4-702(a)(22)(A) defines “wholesale sale” as “the sale of *tangible personal property or services* rendered in the regular course of business to a licensed retailer for resale, lease or rental *as tangible personal property* in the retailer’s regular course of business to a user or consumer.” (Emphasis added.) A literal reading of TENN. CODE ANN. § 67-4-702(a)(22)(A) would allow the sale of a service to be treated as a wholesale sale only if the service were resold as tangible personal property. Obviously, services cannot be resold as tangible personal property; it is impossible to even imagine how a service could be converted into tangible personal property in the first place. Thus, if the definition of “wholesale sale” were interpreted literally, *no* service could ever be sold at wholesale, even though the definition of the term “wholesale” clearly contemplates wholesale sales of services. Because the plain language of the definition of the term “wholesale sale” is ambiguous, it is proper to look to the legislative history and the entire statutory scheme in order to determine the legislative intent.

The Business Tax Act was enacted under Chapter 387 of the Public Acts of 1971. An examination of the legislative history does not reveal what the Tennessee General Assembly intended by the definition of “wholesale sale.”

An examination of the statutory scheme, on the other hand, reveals that the legislature intended to include sales of services, such as those by the Taxpayer, under the definition of “wholesale sales.” First, the definition of “wholesale sales” under TENN. CODE ANN. § 67-4-702(a)(22)(A) includes in pertinent part the “sale of tangible personal property or *services*” for resale (emphasis added). As noted above, because services cannot be resold as tangible personal property, a strict interpretation of the definition would render the inclusion of the word “services” in the definition meaningless. This would essentially mean that sales of services for resale could never be considered wholesale sales. It must be assumed that the legislature included each word contained within the statute for a purpose, and thus the above interpretation clearly would not be in line with the intent of the legislature. Rather, such an interpretation would impermissibly render the use of the term “services” in the definition of “wholesale sales” inoperative and void. *Nissan N. Am., Inc.*, 155 S.W.3d at 106.

This is further demonstrated by an examination of TENN. CODE ANN. § 67-4-708(3)(C), which includes in pertinent part, as part of taxable Classification 3, “[e]ach person making *sales of services*.” (Emphasis added.) The term “sales” includes both retail sales and wholesale sales. To interpret this provision more narrowly, by limiting sales to mean only retail sales, would contradict the plain language meaning of the statute and render the legislature’s broader choice of terms to be superfluous. *Id.* It is clear that the legislature intended to include wholesale sales of services within taxable Classification 3 and thus intended for wholesale sales of services to be possible.

Because the legislature clearly intended to tax wholesale sales of services, as evidenced by the plain language interpretation of TENN. CODE ANN. § 67-4-708(3)(C) and by the inclusion of the term “services” within the “wholesale sale” definition, a proper interpretation of the definition of “wholesale sale” would be in pertinent part a “sale of tangible personal property or services for

resale as tangible personal property *or services*.” This interpretation is further reiterated by the plain language of Rule 47, which states, as noted above, that sales for resale include those of services to dealers of services who intend to resell such services. Thus, the Taxpayer’s sales of its services to its clients for resale as services to the end users meet the legislature’s intended meaning of the term “wholesale sales.”

Accordingly, the sales of the Taxpayer’s services are wholesale sales for purposes of the Tennessee business tax and are taxed pursuant to TENN. CODE ANN. § 67-4-709(b)(3)(B) at the rate of three eightieths of one percent (3/80 of 1%) of all the wholesale sales of the business.<sup>6</sup>

## 2. *The Business Tax Laws as of July 1, 2009*

The Taxpayer is classified as a wholesaler and thus its sales are subject to the wholesale rate under the business tax laws in effect beginning July 1, 2009.

Under the amended business tax laws, the basic initial analysis remains the same. Businesses are still classified according to their dominant business activity, and these statutory classifications continue to determine the rate and due date of the tax. Furthermore, the Taxpayer remains categorized under Classification 3 as one who renders services.

However, while the rate of tax at which a taxpayer pays is still found under TENN. CODE ANN. § 67-4-709, it is based on whether a taxpayer is a “retailer” or a “wholesaler,” rather than whether a taxpayer’s sales are retail or wholesale sales. 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. “Retailer” is defined as “any person primarily engaged in the business of making retail sales.” TENN. CODE ANN. § 67-4-702(16) (Supp. 2009). “Wholesaler” is defined as “any person primarily engaged in the business of making wholesale sales.” TENN. CODE ANN. § 67-4-702(24). A “retail sale” is “any sale other than a wholesale sale.” TENN. CODE ANN. § 67-4-702(15). A “wholesale sale” is in pertinent part “any sale to a retailer for resale.” TENN. CODE ANN. § 67-4-702(23)(A). “Resale” is now defined by the Business Tax Act as “a subsequent, bona fide sale of the property, services, or taxable item by the purchaser.” TENN. CODE ANN. § 67-4-702(14).

Thus, under the amended business tax laws, the Taxpayer is a wholesaler if more than fifty percent (50%) of the Taxpayer’s taxable gross sales are sales of its services to a retailer that subsequently sells the services. As established previously, the majority of the Taxpayer’s taxable gross sales are sales of [TYPE] testing services to retailers that sell the services to their clients.

Under the amended business tax laws, the Taxpayer is clearly a wholesaler. Accordingly, all of the Taxpayer’s taxable sales will be subject to the Classification 3 wholesaler rate of three eightieths of one percent (3/80 of 1%). TENN. CODE ANN. § 67-4-709(3)(B) (Supp. 2009).

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<sup>6</sup> Note that if the Taxpayer also makes retail sales in addition to its wholesales sales, and such sales make up 20% or less of its total sales, then such sales will also be considered wholesale for purposes of Tennessee business taxation. However, if the Taxpayer’s retail sales make up more than 20% of its total sales, then such retail sales will be taxed at the retail sales tax rate of three sixteenths of one percent (3/16 of 1%). TENN. CODE ANN. § 67-4-702(a)(22)(B) (2006); TENN. COMP. R. & REG. 1320-4-5-.37(1) (1974).

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