

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING #95-42**

**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**

Whether [CORPORATION I]'s contribution of appreciated manufacturing operations to a newly formed wholly owned subsidiary and the subsequent contributions of such property by the subsidiary and cash by [CORPORATION II] to a Tennessee limited partnership are subject to Tennessee taxation and whether the subsidiary will be subject to Tennessee corporate franchise, excise taxes if its only activity in Tennessee is the holding of a limited partnership interest in the partnership.

**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**

[CORPORATION I] is a [STATE A] corporation qualified to do business in Tennessee. It is a manufacturer with operations in [STATE B] and Tennessee. [CORPORATION II] is a [STATE A] corporation with no significant assets and no nexus in Tennessee. Both are members of the same affiliated group with [CORPORATION III] being their common parent. [CORPORATION III] is a [STATE C] corporation qualified to do business in Tennessee. It has sales to Tennessee customers, but has no property or payroll in Tennessee.

[CORPORATION I] and [CORPORATION II] are contemplating the formation of a Tennessee limited partnership (TLP). [CORPORATION I] would first form a wholly-owned subsidiary (Newco) by contributing its appreciated Tennessee manufacturing operations to Newco in exchange for Newco's stock. Newco would be incorporated under the laws of [STATE C] and would have its principal place of business there. Newco would then form TLP with [CORPORATION II]. Newco would receive a 99% limited partnership interest in exchange for its contribution of appreciated Tennessee manufacturing operations. [CORPORATION II] would become a 1% general partner in exchange for a cash contribution to TLP.

Contribution of assets by [CORPORATION I] to Newco will be made under the provisions of I.R.C. § 351 of the Internal Revenue Code and thus, will be tax free for federal income tax purposes since the transfer will be solely in exchange for Newco stock and [CORPORATION I] will control Newco. Contribution of assets by Newco and cash by [CORPORATION II] to TLP will also be tax free for federal purposes since I.R.C. § 721 recognizes no gain or loss for federal income tax purposes when assets are contributed to a partnership in exchange for a partnership interest. TLP would be an operating entity that would own tangible and intangible income-producing assets, have employees, and conduct business within Tennessee.

All of the contributions involved in the above transaction would take place and be effective on the last day of the common fiscal year of the entities involved. At the conclusion of the above transaction, Newco's only business activity in Tennessee would be the holding of a limited partnership interest in TLP and the only significant asset of [CORPORATION II] would be its general partnership interest in TLP.

## **QUESTIONS**

1. Will [CORPORATION I]'s contribution of appreciated manufacturing operations to Newco and the subsequent contributions of such manufacturing operations by Newco and cash by [CORPORATION II] to TLP be subject to Tennessee taxation?
2. For years subsequent to the transaction, will Newco have sufficient nexus in Tennessee to be subject to Tennessee corporate franchise, excise taxes?

## RULINGS

1. Except to the extent aircraft, vessels or motor vehicles are involved in the transaction, [CORPORATION I]'s contribution of appreciated manufacturing operations to Newco will be considered an occasional and isolated transaction not subject to Tennessee sales tax. Aircraft, vessels or motor vehicles involved in the transaction will be purchased by Newco for resale to TLP and will be exempt from sales tax provided [CORPORATION I] obtains a Resale Certificate from Newco. [CORPORATION II]'s contribution of cash to TLP will not be subject to Tennessee sales tax .

If TLP provides Newco with an Industrial Machinery Authorization Certificate and a Resale Certificate with regard to any industrial machinery or property, such as inventories, purchased for resale, Newco's contribution to TLP of appreciated manufacturing operations will be subject to Tennessee sales tax only to the extent the transaction involves tangible personal property which is not industrial machinery or property for resale.

The contributions of appreciated Tennessee manufacturing operations by [CORPORATION I] and Newco and the contribution of cash by [CORPORATION II] will not be subject to Tennessee corporate franchise, excise taxes.

2. No.

## ANALYSIS

### *Applicable Statutes and Departmental Rule For Sales Tax Purposes*

T.C.A. § 67-6-202(a) imposes the Tennessee sales tax as follows:

“For the exercise of the privilege of engaging in the business of selling tangible personal property at retail in this state, a tax is levied at the rate of six percent (6%) of the sales price of each item or article of tangible personal property when sold at retail in this state; . . .”

The word “business” is defined for sales tax purposes by T.C.A. § 67-6-102(1) as follows:

“ ‘Business’ includes any activity engaged in by any person, or caused to be engaged in by such person, with the object of gain, benefit, or advantage, either direct or indirect.

‘Business’ does not include occasional and isolated sales or transactions by a person not regularly engaged in business . . .”

“ ‘Business’ includes occasional and isolated sales or transactions of aircraft, vessels, or motor vehicles between corporations and their members or stockholders and also includes such transactions caused by the merger, consolidation, or reorganization of corporations.”

“ ‘Business’ also includes occasional and isolated sales or transactions of aircraft, vessels, or motor vehicles between partnerships and the partners thereof . . .”

A “person” is defined by T.C.A. § 67-6-102(20) as follows:

“ ‘Persons’ includes any individual, firm . . . corporation . . .”

For Tennessee sales tax purposes, T.C.A. § 67-6-102(24)(A) defines a “sale” as follows:

“ ‘Sale’ means any transfer of title or possession, or both, in exchange, barter, lease or rental, conditional, or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration . . .”

Under T.C.A. § 67-6-102(23)(A), “Retail sales” or “sale at retail” is defined as follows:

“ ‘Retail sales’ or ‘sale at retail’ means a taxable sale of tangible personal property . . . to a consumer or to any person for any purpose other than resale.”

Departmental Rule 1320-5-1-.68 makes the following provision concerning sales for resale:

“Dealers shall require certificates of resale for all tangible personal property sold . . . in this state, for the purpose of resale, and such certificates must be available at the establishment of the dealer for ready inspection and comparison with the deductions claimed on monthly Sales and Use Tax Returns.”

T.C.A. § 67-6-206(a) exempts purchases of industrial machinery, which is defined in T.C.A. § 67-6-102(12), from the Tennessee sales tax as follows:

“. . . no tax is due with respect to industrial machinery.”

Departmental Rule 1320-5-1-1-.06(2), (4) and (6), set forth in part below, requires taxpayers purchasing industrial machinery to obtain an Industrial Machinery Authorization Certificate from this Department in order for the property purchased to be exempt from Tennessee sales and use taxes.

“(2) Persons who wish to make purchases . . . of industrial machinery shall apply to the commissioner for authority to make such purchases exempt from tax. . . . Any misrepresentation made on the application by the taxpayer will subject the taxpayer to any applicable tax, penalty and interest.”

“(4) Persons who have obtained authority from the commissioner to make purchases of industrial machinery shall provide their vendors with a copy of their authority and such purchases shall then be exempt from tax.”

“(6) Persons seeking to purchase industrial machinery must comply with the provisions of this rule in order to obtain the exemption provided at T.C.A. §67-6-206(a). Failure to do so shall subject such purchases to tax.”

1. *Contribution of Tangible Personal Property  
By [CORPORATION I] to Newco and Cash by [CORPORATION II] To TLP  
Are Not Retail Sales Subject To Tennessee Sales Tax*

In the described transaction, the title and possession of appreciated Tennessee manufacturing operations will be transferred from [CORPORATION I] to Newco in exchange for the stock of Newco. The same property will then be transferred by Newco to TLP in exchange for a 99% limited partnership interest. In addition, [CORPORATION II] will contribute cash to TLP in exchange for a 1% general partnership interest.

The Tennessee sales tax imposed by T.C.A. § 67-6-202(a) is applicable only when tangible personal property is involved. The sales tax will not apply to the cash contributed to TLP by [CORPORATION II] or to any part of the manufacturing operations transferred by [CORPORATION I] to Newco which do not constitute tangible personal property.

T.C.A. § 67-6-102(1) has the effect of exempting occasional and isolated sales from the Tennessee sales tax unless aircraft, vessels, or motor vehicles are involved. [CORPORATION I] is a manufacturer and does not normally transfer or sell manufacturing operations. Therefore, manufacturing operations, consisting of tangible

personal property other than aircraft, vessels, or motor vehicles, transferred by [CORPORATION I] to Newco are not subject to Tennessee sales tax because the transaction is occasional and isolated.

Any aircraft, vessels, or motor vehicles included in the appreciated manufacturing operations transferred by [CORPORATION I] are “sales” under T.C.A. § 67-6-102(24)(a) because title and possession of such property is being transferred to Newco for consideration of Newco stock. However, the transfer is not a “sale at retail” under T.C.A. § 67-6-102(23)(A) because the manufacturing operations will be transferred to Newco for the purpose of resale to TLP. Thus, the Tennessee sales tax is not applicable to any part of the transfer of manufacturing operations from [CORPORATION I] to Newco.

If any aircraft, vessels, or motor vehicles are included in the appreciated manufacturing operations transferred by [CORPORATION I] to Newco, [CORPORATION I] will not be required to collect sales tax from Newco on such items if, in accordance with Departmental Rule 1320-5-1-.68, it obtains a Resale Certificate from Newco.

*Contribution of Tangible Personal Property  
Other Than Industrial Machinery Or Property for Resale  
By Newco to TLP are Retail Sales Subject To Tennessee Sales Tax*

Newco will purchase the appreciated manufacturing operations from [CORPORATION I] for the purpose of reselling them to TLP. Therefore, transfer of the property to TLP is the “business” of Newco as defined by T.C.A. § 67-6-102(1) and can not qualify as an occasional and isolated transaction. Using the same analysis set forth above, Newco’s transfer of the appreciated manufacturing operations to TLP in exchange for a 99% limited partnership interest, to the extent tangible personal property not for resale is involved, would be a “sale” under T.C.A. § 67-6-102(24)(A) and a “retail sale” under T.C.A. § 67-6-102(23)(A) because the transfer is being made for a purpose other than for resale. However, since TLP is purchasing the property for use in manufacturing operations, to the extent the property qualifies as “industrial machinery” under T.C.A. § 67-7-102(12), it will be exempt from the Tennessee sales tax under T.C.A. § 67-6-206(a), provided TLP obtains an Industrial Machinery Authorization Certificate from this Department and provides it to Newco under the provisions of Departmental Rule 1320-5-1-1.06(2),(4) and (6).

Some of the appreciated manufacturing operations transferred by Newco to TLP may consist of tangible personal property, such as inventories, which TLP is purchasing for the purpose of resale. The transfer of such property for the purpose of resale would not be a “retail sale” under T.C.A. § 68-6-102(23)(A), and thus will not be subject to Tennessee sales tax if TLP provides Newco with a Resale Certificate in accordance with Departmental Rule 1320-5-1-.68.

The transfer by Newco to TLP of appreciated manufacturing operations consisting of tangible personal property which does not qualify as industrial machinery under T.C.A. §

67-6-102(12) and is not purchased by TLP for resale, will be subject to Tennessee sales tax. Newco will be required to collect sales taxes from TLP upon transfer of such property and to remit the taxes collected to this Department.

*Contributions of Manufacturing Operations  
By [CORPORATION I] and Newco and Cash by [CORPORATION II]  
Are Not Subject to Franchise, Excise Taxes*

T.C.A. § 67-4-806 imposes the Tennessee corporate excise tax on “net earnings”. For this purpose, T.C.A. § 67-4-805(a)(1) defines “net earnings” as “. . . federal taxable income before the operating loss deduction and special deductions . . . subject to the adjustments in subsection (b).” Subsection (b)(1) and (2) set forth certain items to be added to or deducted from federal net earnings to compute the excise tax base.

I.R.C. § 351 recognizes no gain or loss if property is transferred to a corporation solely in exchange for the stock of the transferee. I.R.C § 721(a) recognizes no gain or loss to a partnership or its partners when property is contributed to the partnership in exchange for a partnership interest. The transfer of appreciated Tennessee manufacturing operations by [CORPORATION I] to Newco and by Newco to TLP, and the contribution of cash by [CORPORATION II] to TLP, will have no effect on federal net earnings of any of the corporations involved.

Under Tennessee law, items not included in federal net earnings can affect net earnings for Tennessee excise tax purposes only if T.C.A. § 67-4-805(b)(1) and (2) requires them to be added to, or deducted from, federal net earnings to compute the excise tax base. Items required to be added to, or deducted from, federal net earnings under T.C.A. § 67-4-805(b)(1) and (2) do not include gains or losses from the transactions in question, and thus no Tennessee corporate excise tax is applicable.

2. *Newco Does Not Have Sufficient  
Nexus In Tennessee  
To Be Subject to Franchise, Excise Taxes*

After the transactions described, Newco’s only business activity in Tennessee will be the holding of a 99% interest in TLP. Some years ago, the Tennessee Department of Revenue took the position that a foreign corporate limited partner is not doing business in Tennessee so as to be subject to Tennessee corporate franchise, excise taxes if its activities are limited as follows:

- (1) The corporate limited partner’s only business activity in Tennessee is the holding of a limited partnership interest in a partnership(s) with nexus in Tennessee; and

(2) The corporate limited partner exercises no power, management or control over the partnership(s) except such powers or capacities outlined in T.C.A. § 61-3-302 which limited partners may exercise without participating in the management or control of a partnership.

As a limited partner, Newco's involvement with the TLP will be similar to the interest of a foreign corporation whose only Tennessee activity is that of a stockholder in a corporation doing business in Tennessee. Neither a limited partner nor a stockholder has the right to participate in the management or control of the partnership, or corporation, as the case may be, and thus neither are said to be "doing business" in Tennessee so as to be subject to corporate franchise, excise taxes imposed by T.C.A. §§ 67-4-901 et seq. and 67-4-801 et seq.

The Department's position with regard to this matter considers a foreign corporate limited partner in a partnership having nexus in Tennessee as having only a passive investment in Tennessee just as does a foreign corporate stockholder in a corporation having nexus in Tennessee. Such a passive investment would not create sufficient tax nexus for Tennessee to impose corporate franchise, excise taxes.

If, in addition to its limited partnership interest in TLP, Newco were to engage in other activities and transactions in Tennessee, either with TLP itself, or with other parties, it would be subject to Tennessee franchise, excise taxes unless such activities and transactions only involve solicitation of sales in interstate commerce and, as such, are protected from state taxation by Title 15 U.S.C.A. §§ 381-384, better known as Public Law 86-272.

\_\_\_\_\_  
Arnold B. Clapp, Tax Counsel

**APPROVED:** \_\_\_\_\_  
Ruth E. Johnson

**DATE:** 12-12-95