

The Administrative Hearing Office's Mission and Role

The Tennessee Department of Revenue offers the Administrative Hearing Office as a forum where taxpayers can work with informal conference personnel to resolve disputes about tax assessments and tax refund claim denials. Hearing Office personnel are required to exercise independent judgment and to render decisions on individual issues based on the facts and the law.

The Hearing Office's mission is to resolve disputes on behalf of the Commissioner of Revenue in an informal, expeditious, consistent, and cost effective manner. The Hearing Office may also make determinations about the correct amount of tax due. To that end, the Hearing Office conducts informal conferences with taxpayers to discuss their legal positions, ask questions, request additional information or documentation, and make a determination as to how the dispute should be resolved.

Sometimes, the answer to how a tax dispute should be resolved is not always clear. In these situations, the Hearing Office is authorized to recommend compromises to the Commissioner of Revenue. The Commissioner may consider compromising a tax liability for less than the full amount owed if it is in the best interests of the state to do so.

The Informal Conference Process: Overview

Information and frequently asked questions about the informal conference process are also available on the Department's website at <http://www.tn.gov/revenue/article/request-an-informal-conference>.

An informal conference is available to any taxpayer that has received a proposed assessment of tax who timely requests a conference. A conference request is timely if it is sent to the Hearing Office within 30 days from the date of the notice of proposed assessment.¹ Additionally, Hearing Office personnel, as the Commissioner's designees, may in their discretion grant an untimely conference request or a request to review a refund claim denial.

A taxpayer is not required to request an informal conference to challenge a proposed tax assessment, but the conference process is an inexpensive way to resolve a tax dispute without going to court. The Department does not charge taxpayers to have a conference, and a taxpayer may participate in a conference without representation.

The process begins with the taxpayer submitting a written request for an informal conference to the Hearing Office. Taxpayers requesting a conference should complete the conference request form available on the Department's website.² The written request can be submitted electronically on the

¹ Tenn. Code Ann. § 67-1-1438(b) (Supp. 2016).

² The form is called "Request for Informal Conference to Review Proposed Assessment or Refund Denial" and is available on the Department's website at: <http://www.tn.gov/revenue/article/request-an-informal-conference>.

Department's website or sent to the Administrative Hearing Office by mail, email, fax.³ Conference requests for the following tax types may be submitted through the Tennessee Taxpayer Access Point⁴ ("TNTAP"): sales and use tax, consumer use tax, liquor-by-the-drink tax, tobacco tax, television and telecommunication sales tax and professional privilege tax.

When requesting a conference, the taxpayer should include a copy of the notice of proposed assessment and a power of attorney form (if applicable). The taxpayer should also provide a statement outlining the issues to be discussed during the conference and an explanation of why the taxpayer believes that the proposed assessment is incorrect.

The Hearing Office will contact the taxpayer or taxpayer's representative within 10 days after receiving the timely conference request to schedule the conference. Conferences are held either by telephone or in person in the Department's Nashville office, at the preference of the taxpayer.

While waiting for the conference to be held, taxpayers are encouraged to work with the division that issued the proposed assessment. For example, a taxpayer might locate additional documents that were unavailable during an audit. The taxpayer does not need to wait until the conference to provide the documentation to the Department; instead, the taxpayer can contact the auditor directly to discuss whether the assessment should be adjusted based on the additional documents. The Department and taxpayers are often able to resolve an issue this way without going to conference.

After the informal conference is held, the hearing officer reviews all documentation provided, conducts any necessary legal research and issues a written conference decision to the taxpayer.

Information about the taxpayer's rights and the procedure for challenging an assessment after it becomes final is available on the Department's website at:
<http://www.tn.gov/assets/entities/revenue/attachments/billofrights.pdf>.

Informal Conferences: Fiscal Year 2017

The Hearing Office handles a large number of requests for informal conferences each year.⁵ During fiscal year 2017, taxpayers submitted 394 requests for informal conferences. The actual number of assessments involved is higher, because some taxpayers combine more than one assessment into a single conference request. For example, a taxpayer might have received one assessment for business tax and a separate assessment for sales and use tax. Taxpayers are welcome to combine assessments into one request at their convenience.

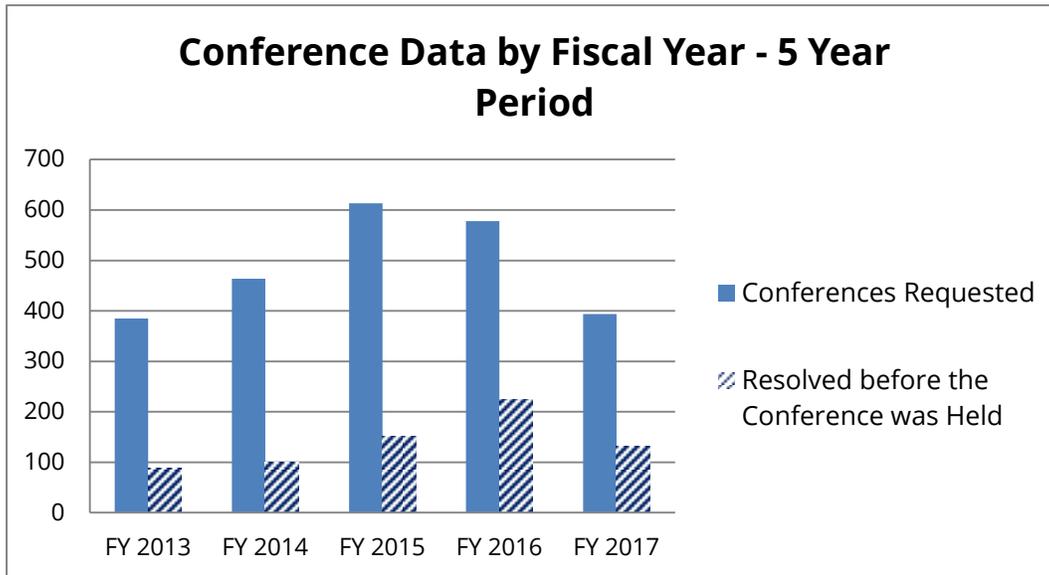
As mentioned previously, taxpayers are also encouraged to continue working with the division that issued the proposed assessment during the time leading up to the scheduled conference.

³ **Mail:** Tennessee Department of Revenue, Administrative Hearing Office, Andrew Jackson Bldg., 11th Floor, 500 Deaderick St., Nashville, TN 37242; **Email:** DORConference.Request@tn.gov; **Fax:** 615-741-6463.

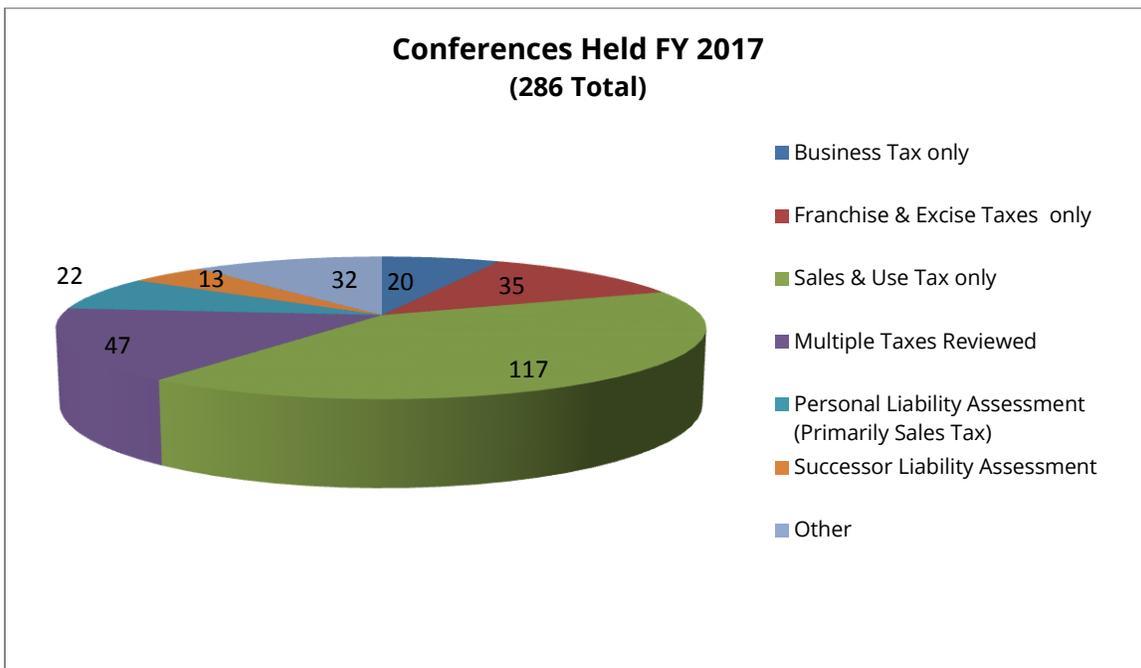
⁴ <https://tntap.tn.gov/eservices/>

⁵ Conference statistics are kept by fiscal year. A fiscal year starts on July 1st of one year and ends on June 30th of the following year.

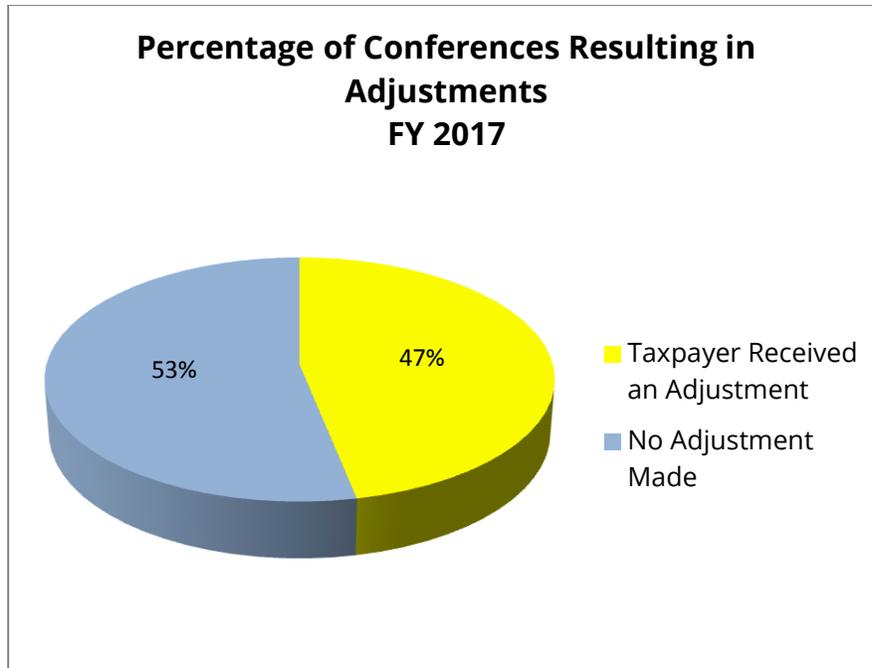
Significantly, taxpayers who made timely requests for conferences during Fiscal Year 2017 were able to resolve their disputes almost 35% of the time before the informal conference was held.



Hearing officers hold conferences on a wide variety of topics. The most common issues involve sales and use tax, business tax, liquor-by-the-drink tax, and the franchise and excise taxes. The Department's hearing officers are licensed attorneys, each with several years of experience working with Tennessee tax laws.



The Department's hearing officers have the authority to make adjustments to a proposed assessment when doing so is legally correct. During fiscal year 2017, a full 47% of taxpayers having an informal conference received a partial or full adjustment to their assessments. This number does not include the taxpayers who resolved their disputes before the conference was held.



In many cases, an adjustment is the result of the taxpayer providing additional information or documentation that was not made available during an audit. In other instances, the hearing officer determined that an adjustment was appropriate after applying the law to the taxpayer's facts.

Conferences Held in Fiscal Year 2017: Topics of Interest

As a service to the public, the Department has selected several topics of interest to taxpayers, which are summarized below with overviews of related conference decisions.

Please be aware that Tennessee has laws that protect the identity and information of individual taxpayers. The Department is required by law to maintain a taxpayer's information as confidential, unless the taxpayer gives the Department permission to disclose information. The unauthorized disclosure of taxpayer information is in fact a criminal offense.

Because the Department takes taxpayer confidentiality very seriously, the following summaries of conference decisions do not contain any details that could lead to an individual taxpayer being identified.

Please also be aware that the summaries are of actual cases and the applicable law might have changed since the time the conference decision was issued. Taxpayers should consult with a tax professional before relying on any information contained in the following summaries.

Sales Tax

The Hearing Office conducts conferences on a wide variety of sales and use tax issues. Below are examples of some topics addressed in conference in FY 2017.

Examples:

Just as sales tax is due on sales of tangible personal property, sales tax is due on lease payments from the rental of tangible personal property. The Hearing Office upheld a proposed sales tax assessment against a business that rented tangible personal property and collected sales tax on rental fees but not on late payment fees. Sales tax is due on the "sales price," which includes the total amount of consideration for which property is leased. The late fees were an obligation that the renter agreed to pay under the lease and did not represent interest, financing, or carrying charges.

The Hearing Office abated a portion of a proposed sales tax assessment against a company that rented portable storage units where the auditor determined that the company should have charged tax on late payment fees, repossession fees, and attorney's fees. The Hearing Office concluded that while late payment fees could be considered part of a taxable lease payment, the repossession and attorney's fees did not represent consideration given for control or possession of the units; these fees were removed from the proposed assessment.

Tennessee taxes sales that occur in Tennessee but does not tax sales of goods that are delivered to purchasers outside the state. The Hearing Office abated a proposed sales tax assessment on items that a Tennessee store delivered to out-of-state customers using its own trucks. The store was able to provide sufficient documentation of the out-of-state deliveries to establish that those sales had not occurred in Tennessee because title and possession of the items were transferred to the purchasers outside of Tennessee.

Industrial machinery used in the manufacture of tangible personal property is exempt from sales/use tax. The Hearing Office upheld a proposed sales tax assessment against a manufacturer who claimed that scales it used to weigh finished products were exempt industrial machinery. Because the scales were not used in manufacturing the product, they did not qualify as exempt industrial machinery.

Sales of certain services are subject to the sales tax. The Hearing Office upheld a proposed sales tax assessment against a company that performed roadside repairs because repairing tangible personal property is a taxable service.

The Hearing Office upheld a proposed sales tax assessment where a store sold equipment tax free to individuals who used exemption certificates from charitable entities, but paid for their purchases using personal funds. Tennessee law exempts sales made directly to exempt organizations.⁶ Purchases made with a charitable entity's exemption certificate, but paid for by an individual's personal check, credit card, or financing agreement cannot qualify as sales to an exempt organization.

⁶ Tenn. Code Ann. § 67-6-322(d) (2013).

Consumer Use Tax

Use Tax is the counterpart to the sales tax. All Tennessee residents, as well as businesses operating in the state, must pay use tax when goods are purchased from outside the state of Tennessee and brought or shipped into the state and the seller did not collect sales tax on the purchase. Purchases made from outside the state include, but are not limited to, mail-order catalog purchases, purchases made online, over-the-phone purchases, and purchases made from a store located in another state. Use tax does not apply to the purchase of services.

Use tax is also due on occasional and isolated sales of items such as aircraft, motor vehicles, off-highway vehicles, and boats that occur between people who are not motor vehicle or boat dealers.⁷ These kinds of occasional and isolated sales are generally subject to sales or use tax. Generally, each time there is a change of ownership that change of ownership results in sales or use tax being due.

Examples:

The Hearing Office upheld a proposed consumer use tax assessment against a woman who had purchased jewelry on eBay because she had imported the jewelry from another country for personal use and had not paid sales/use tax to Tennessee or any other state.

The Hearing Office abated a proposed consumer use tax assessment against a company that purchased a cargo trailer from an out-of-state dealer because at the time of the purchase, the company met the definition of a "qualified farmer," subsequently registered with the Department as a qualified farmer, and used the trailer in a manner that was consistent with the agricultural exemption.

The Hearing Office upheld a proposed consumer use tax assessment against a man who underreported the purchase price of a boat. The man paid cash, and traded livestock and equipment for the boat. When he registered the boat, he reported that the purchase price was only the amount of cash paid, instead of including the value of the items he also traded. He then used the boat as collateral for a considerably larger loan. Because the bill of sale did not provide a sales price, the Department researched the value of the boat using the NADA Guide⁸ and issued a proposed assessment of tax for the difference between the NADA value and the amount the man reported he paid. The Department uses an item's market value as the basis for an assessment when the purchase price of an item cannot be established and the Hearing Office agreed this was proper in this case.

The Hearing Office abated a proposed consumer use tax assessment issued to a Tennessee resident who received items imported from outside the United States⁹ after the sender confirmed in writing to the Department that the items were sent to the recipient as a gift.

⁷ Tenn. Code Ann. § 67-6-102 (8)(C) (Supp. 2016).

⁸ <http://www.nadaguides.com/Boats>

⁹ The Department routinely receives information from the U.S. Customs Department about items that are imported into Tennessee.

The Hearing Office upheld a proposed consumer use tax assessment on a son's purchase of a drone that he gave to his father, who operated a farm. The Department considers unmanned aircraft systems (drones) to qualify for the agricultural equipment exemption when they are used to monitor and manage farms; the father had an agricultural exemption certificate and could have bought the drone himself free of tax. However, the assessment was upheld because the son, who purchased the drone, did not have his own agricultural exemption certificate.

The Hearing Office upheld a proposed consumer use tax assessment against a contractor that had not paid sales tax or accrued use tax on purchases of construction materials from out-of-state. Because contractors that repair or construct real property are considered to be the users of the materials used in those projects, they owe sales/use tax on those materials and are required to pay use tax on materials when they don't pay sales tax at time they purchase them.

Retail Accountability Program

The Department's Retail Accountability Program helps ensure that the sales tax collected by retailers from consumers is remitted properly to the state of Tennessee. The Department receives purchase information electronically from wholesalers of beer, tobacco, food, candy and/or non-alcoholic beverages.¹⁰ The Department uses this information to compare a taxpayer's purchases to its reported sales. If a discrepancy is found, the Department may issue a proposed assessment.

A taxpayer who receives a proposed assessment is encouraged to contact the Department's Retail Accountability Program and work with one of that program's personnel. Many taxpayers who work directly with the Retail Accountability Program group are able to resolve the issues regarding their proposed assessments and eliminate the need to have a conference.

Examples:

Although a convenience store claimed that the cost of inventory used by the Department was overstated because one of its vendors had reported the suggested retail price instead of the cost price of goods it had purchased, the Hearing Office was unable to adjust the proposed assessment. Because only vendors can change purchase data that they reported to the Department, the Hearing Office suggested that the store contact the vendor to request that the reported information be changed, and then to contact the Department to make appropriate adjustments if the vendor agreed to make the changes.

The Hearing Office upheld various proposed assessments where retail stores claimed that their purchases exceeded their reported sales because they were increasing their inventories. In no case did the stores provide requested inventory records, and in each case the stores' purchases were fairly consistent for each month, suggesting that the stores had not been building up inventory.

When a convenience store challenged a proposed assessment on the grounds that the 11% cigarette markup that the Department used to calculate its tax liability was greater than the 8% markup that the store actually used, the Hearing Office upheld the proposed assessment because the store was

¹⁰ Tenn. Code Ann. § 67-6-410 (Supp. 2016).

required to markup cigarettes by 11% under the Unfair Cigarette Sales Law.¹¹ The Law requires that retailers markup cigarettes by a specific percentage and imposes fines for violations of the law that increase depending on the number of violations.

The Hearing Office abated a proposed assessment against a retailer after the retailer provided tobacco buydown documentation and the retailer's wholesalers made changes to the purchase data reported to the Department. The adjustment for both the buydowns and wholesaler data changes resulted in the retailer owing no additional tax.

Franchise and Excise Taxes

A corporation, limited partnership, limited liability company, business trust or other limited liability entity chartered/organized in Tennessee or doing business in this state must register for and pay franchise and excise taxes. The franchise tax is based on the greater of net worth or the book value of real or tangible personal property owned or used in Tennessee. The excise tax is based on net earnings or income for the tax year. The Hearing Office addressed a number of franchise and excise tax issues during FY 2017.

Examples:

As a general rule, one company may not deduct the losses of a predecessor company as the result of mergers, consolidations, and similar transactions, but there is an exception when the predecessor company merges out of existence into a successor that had no income, assets, liabilities, equity, or net worth.¹² The Hearing Office upheld a proposed franchise and excise tax assessment against a company into which a predecessor merged because the successor company was already in existence and had income, assets, liabilities, equity, and net worth prior to the merger.

In two cases, the Hearing Office upheld proposed franchise and excise tax assessments against companies that had sold their businesses and failed to treat their gains as business earnings¹³ subject to excise tax. Business earnings may arise from transactions and activity in the regular course of a taxpayer's business (the transactional test) or from the disposition of property that constituted an integral part of the taxpayer's regular trade or business operations (the functional test). In both cases, the Hearing Office agreed that the sale of the companies' businesses did not occur in the normal course of business, but found that the companies had sold assets that were integral to their businesses. Accordingly, the gains from the sales qualified as business earnings under the functional test.

When a taxpayer's federal tax liability is changed as the result of an audit by the Internal Revenue Service ("IRS"), the Department has two years from the date a taxpayer notifies the Department of a redetermination to assess additional franchise and excise tax based on those changes.¹⁴ The

¹¹ Tenn. Code Ann. § 47-25-302 (Supp. 2016); Tenn. Acts 2015, ch. 347, § 2 (effective July 1, 2015).

¹² Tenn. Code Ann. § 67-4-2006(c)(3) (Supp. 2016).

¹³ Tenn. Code Ann. § 67-4-2004(4) (Supp. 2016).

¹⁴ Tenn. Code Ann. § 67-1-1501 (Supp. 2016).

Hearing Office upheld a proposed franchise and excise tax assessment where a business had failed to respond to the Department's inquiries about the federal revision and the Department issued an estimated assessment as a result. The business argued that the proposed assessment was made outside of the applicable statute of limitations, but the Hearing Office disagreed, reasoning that the statute of limitations had not yet begun to run because the business had not notified the Department of the IRS revisions.

A financial services company and several of its subsidiaries filed Tennessee franchise and excise tax returns on a separate entity basis. Because financial institutions that form a unitary group must file a combined return, the auditor determined the company and subsidiaries meeting the definition of "financial institution" should have filed a combined franchise and excise tax return. The company agreed with the auditor regarding the filing of combined returns, but disagreed with the inclusion of certain subsidiaries in the company's unitary group. In particular, the auditor included a subsidiary that was the parent of two regulated financial corporations, stating that the parent is a holding company, which, by definition, is a financial institution. The Hearing Office determined the subsidiary was not a holding company because it was not registered as a "bank holding company" under the Bank Holding Company Act of 1956 because it did not own or control a bank, as the regulated financial corporations were not banks. Since the subsidiary was not a holding company as defined in the statute, it was not a financial institution. The Hearing Office, therefore, removed the parent and the two regulated financial corporations from the company's unitary group.

Business Tax

The Hearing Office conducts conferences on a wide variety of business tax issues. Below are examples of topics addressed in FY 2017.

Examples:

Businesses are taxed at different rates depending on their classification.¹⁵ The Hearing Office found that a landscape firm was properly classified for business tax purposes as a Classification 3 service provider and not and Classification 4 contractor. Classification 4 contractors construct buildings, roads, and other real property improvements, while Classification 3 service providers are engaged in providing services that are not specifically exempted. Under the Standard Industrial Classification Manual, which Tennessee courts use to determine whether a service is exempt, "Landscape and Horticultural Services" is a specific major group that is not included in the list of exempt services.¹⁶

Businesses are also taxed at different rates depending on whether they are making wholesale or retail sales. The Hearing Office upheld a proposed business tax assessment against the seller of building products and supplies who had reported its sales at the lower wholesale rate. The seller primarily made sales to contractors, who were considered the users and consumers of the products and supplies they purchased because they were not reselling the materials but were using them to make improvements to realty. Consequently, the sales were retail sales and subject to business tax at the retail rate.

¹⁵ Tenn. Code Ann. § 67-4-708 (Supp. 2016).

¹⁶ Tenn. Code Ann. § 67-4-708(3)(C) (Supp. 2016).

Despite the fact that a store sold professional salon and beauty products only to licensed hair stylists and not to the general public, the Hearing Office upheld a proposed business tax assessment based on the auditor's determination that the store was making retail sales. The store had reported its sales at the wholesale rate. However, the stylists purchasing the products used those products to provide hair styling services and did not resell the products to their clients. Therefore the sales were properly classified as retail sales.

Construction contractors are allowed to deduct payments made to subcontractors from their gross sales if those payments are properly documented and the contractor retains a copy of the subcontractor's business license. The Hearing Office reduced a proposed business tax assessment against a contractor who was able to provide additional documentation of payments made to subcontractors after the audit had been completed.

Hall Income Tax – Return of Capital

Although it does not tax income from wages, Tennessee imposes an income tax on stock dividends and bond interest.¹⁷ Returns of capital, however, are not subject to tax.¹⁸ Tennessee's courts have defined what constitutes a dividend quite broadly; it is the recurrent payment to stockholders that does not reduce stock holdings leaving owners in a position to enjoy future returns on the same stock and may come from any source. "Stock" can also include some partnership interests. Similarly, Tennessee's statutory definition of what constitutes a bond is broader for tax purposes than it is in an ordinary financial context and includes all notes that pay interest over a period of more than six months.¹⁹

Through a matching program, the Department compares the federal tax returns of Tennessee residents to Hall income tax returns, and it may issue a proposed assessment for taxable distributions that were not reported to Tennessee.

Examples:

When a married couple made a series of loans to a company that ultimately defaulted on the loans, the Hearing Office upheld a proposed assessment of tax on interest that the company paid to the couple before the default. Even if the principal amount of the loan could be considered capital, the interest payments to the couple could not be treated as a return of capital because their principal was not returned to them.

The Hearing Office abated a proposed assessment where a taxpayer who received distributions of income from a trust's income account and principal account reported only the distribution from the income account and was issued a proposed assessment for unpaid tax on the distributions from the principal account. The income account contained interest from bonds that paid interest, but when the bonds were sold, called, or had matured, the proceeds were placed in the principal account. The

¹⁷ Tenn. Code Ann. § 67-2-102 (2013). The Hall Income Tax will be phased out over the next few years. For more information regarding the phasing out of the Hall Income Tax, see Important Notice #17-09.

¹⁸ Tenn. Code Ann. § 67-2-104(e)(7) (2013).

¹⁹ Tenn. Code Ann. § 67-2-101(1) (2013).

distributions from the principal account represented a return of capital and were not subject to the income tax.

In several conferences, the Hearing Office upheld proposed assessments where taxpayers claimed that the distributions they received were non-taxable returns of capital. Because the taxpayers had the same number of shares after a distribution that they owned before the distribution, the Hearing Office determined that the distribution was a taxable dividend. When taxpayers argued that the distribution affected the basis of their shares, the Hearing Office explained that the change in basis was not relevant if the taxpayer did not sell or redeem shares, and the issuing entity did not liquidate.

Hall Income Tax - Miscellaneous

Persons who are domiciled in Tennessee for at least six months are subject to Tennessee's Hall income tax. The Hearing Office upheld a proposed assessment against a Delaware partnership where a Tennessee resident was the limited partner of the partnership as well as the sole member, owner, and director of a limited liability company that was the partnership's general partner. The Hearing Office determined that given the role of the Tennessee resident in the limited liability company and the company's role in the partnership, the partnership's principal place of business and commercial domicile were in Tennessee.

Lack of Records

Tennessee law requires dealers to keep adequate books and records of sales and purchases for three years from December 31 of the year in which the associated return was filed, so that the Department can verify returns and determine a dealer's tax liability.²⁰ If an assessment was made and a taxpayer challenges the assessment, either to the Department or in court, the taxpayer must keep all records covered by the assessment until the matter is resolved.²¹ If a taxpayer fails to keep sufficient records, the Department may determine the taxpayer's liability using the best information available.²² When a taxpayer has not kept adequate records, auditors will examine available third-party information such as the taxpayer's purchases, bank deposits and federal tax returns. Auditors often must perform a purchase markup audit, which involves applying a percentage markup to the taxpayer's purchases, to calculate taxable sales. Unless a taxpayer can furnish documentation that was unavailable during the audit, the Hearing Office has no basis on which to make an adjustment.

Examples:

The Hearing Office upheld a proposed sales tax assessment against a convenience store that had no sales records. The auditor contacted the store's vendors and calculated its sales by marking up those purchases. The store's owner insisted that the markup percentage the auditor used was too high, but was unable to provide reliable documentation showing the store's selling prices.

²⁰ Tenn. Code Ann. § 67-6-523(a, b) (2013) and Tenn. Code Ann. § 67-1-113 (2013).

²¹ TENN. COMP. R. & REGS. 1320-05-01-.80(2).

²² Tenn. Code Ann. § 67-1-113(b) (2013).

Where an automotive parts and repair shop did not maintain resale and exemption certificates for sales that the shop made free of tax, the Hearing Office upheld a proposed sales tax assessment that resulted in part from the auditor disallowing exempt sales that the shop reported on its sales tax returns. Sales for resale must be in strict compliance with the applicable rules and regulations,²³ which require obtaining a resale certificate before making a sale free of tax, and sales to tax-exempt organizations must be supported by a valid exemption certificate.²⁴

The Hearing Office approved the auditor's use of bank deposits to calculate a store's sales and upheld the resulting proposed sales tax assessment. Bank statements were the only records that the store had after its electronic records were lost due to a computer virus and most of its paper records were destroyed due to water damage. The Hearing Office agreed to adjust the assessment in the future if the store could provide documentation that established the store's claim that certain deposits represented loans and not sales.

When a business had records for only two of the years in the audit period, the Hearing Office upheld a proposed assessment where the auditor calculated the business' out-of-state sales using those two years' records to create an error factor that was applied to the other years of the audit period. The Hearing Office did not accept the business' explanation that only one year was representative of its sales because the records the auditor used were the best information available.²⁵

In two separate matters, the Hearing Office upheld proposed assessments based on an International Fuel Tax Association ("IFTA") audit because the contract carriers did not have the required Individual Vehicle Mileage Records. IFTA requires licensed carriers to keep detailed records showing each vehicle's distance records that include the trip date, origin, destination, route, and beginning and ending odometer reading for each trip. If a licensee does not keep these required records, the auditor may disregard a licensee's reported (but unsubstantiated) mileage and instead estimate a fuel usage of four miles per gallon.

Personal Liability for Taxes (Tenn. Code Ann. § 67-1-1443)

One reason for operating a business in the form of a corporate or other limited liability entity is to avoid personal liability for the business' liabilities. This protection from liability is not complete, however, because "trust fund taxes" collected on behalf of the government are an exception to the protections provided by corporate or other limited liability structures. Individuals who are required to collect and remit tax collected from customers may be personally liable for any sales tax collected but not remitted (plus associated penalties and interest),²⁶ if those individuals had the authority to determine which creditors would be paid and voluntarily chose not to remit the collected taxes to the Department. When a business has an unpaid sales tax liability, the Department's Collection Services Division will first attempt to collect the tax from the business, but if that effort is

²³ Tenn. Code Ann. § 67-6-102(75)(A) (Supp. 2016).

²⁴ Tenn. Code Ann. § 67-6-322(e) (2013).

²⁵ Tenn. Code Ann. § 67-1-113(b) (2013).

²⁶ Tenn. Code Ann. § 67-1-1443 (2013).

unsuccessful, it will attempt to identify officers or employees responsible for remitting collected sales tax and issue proposed assessments to those people individually. In addition to holding conferences about a business' underlying tax liability, the Hearing Office hears challenges to proposed personal tax assessments.

Examples:

The Hearing Office abated a proposed personal liability assessment against a family member who was listed as a co-owner of a business on the business' tax account registration form. The documentation provided allowed the Hearing Office to conclude that the family member was not the individual responsible for overseeing the business' day-to-day operations, collecting taxes from customers, or preparing its tax returns.

Although the owner of a store hired employees to manage the store and did not participate in the store's day-to-day operations, the Hearing Office upheld a proposed personal liability assessment against him. The owner hired an accountant to file the store's tax returns, but the owner was the only individual responsible for providing information to the accountant that was needed to file the returns, including the amount of sales tax reported on the returns.

The Hearing Office abated a proposed personal liability assessment against a company's third party service provider who had a contract with the company to provide financial related services. The service provider documented that he had no access to the company's bank account and no authority over the company's cash management, and therefore had no involvement in the company's payment decisions.

The Hearing Office upheld a proposed personal liability assessment against the manager of a restaurant despite the fact that he had no ownership interest in the restaurant. The documentation provided showed that the manager ran the restaurant, had check writing authority, which he exercised, and was responsible for providing the restaurant's accountant with the sales figures used to complete the restaurant's sales tax returns.

Concluding that he was a passive investor, the Hearing Office abated a proposed personal liability assessment against a man listed as one of two owners of a restaurant. The man provided detailed documentation that led the Hearing Office to conclude that he was simply a passive investor, had no involvement in the day-to-day operations of the restaurant, and was not responsible for collecting, accounting for, or paying over taxes collected from customers.

The Hearing Office abated a proposed personal liability assessment against the former owner of a restaurant because the former owner was able to document that he had sold his interest in the restaurant a number of years before the restaurant failed to remit the tax it collected. There was no indication that the former owner had continued to have any involvement in the restaurant after selling his ownership interest to the current owner.

Successor Liability

After purchasing a business, the buyer may find that in addition to acquiring the business, the buyer has also acquired outstanding tax liabilities of the business. Under Tennessee law, the buyer of the

business is considered the seller's "successor, successors, or assigns." The buyer is required to withhold from the purchase price of the business the amount of unpaid taxes, interest, and penalties, unless the seller has provided a certificate of clearance from the Department stating that no taxes, penalties or interest are due. Alternatively, the seller can provide the buyer with an affidavit stating that it has no past due tax liability; in order to be protected from liability by the seller's affidavit, the buyer must provide the affidavit to the Department. The Department has 15 days to notify the buyer if the affidavit is incorrect.

Examples:

The Hearing Office abated a proposed assessment against a company that purchased property from a landlord who had previously rented the property to a tenant who closed its business, but failed to pay all taxes before going out of business. The Hearing Office determined that the company had not assumed the unpaid liability by purchasing a business from the previous tenant, but had instead purchased property from the former tenant's landlord. Thus, the purchaser was not responsible for the previous tenant's unpaid taxes.

The Hearing Office upheld a proposed successor liability assessment against a limited liability company ("LLC") that took over a retail store run by a sole proprietor. After the sole proprietor incurred sales and business tax liabilities, she closed her sole proprietorship's account and with a relative formed an LLC that continued to run the store. The Hearing Office determined that the transfer of the sole proprietor's business and its assets to the LLC represented a sale for an amount equal to the sales/use and business tax liabilities of the sole proprietorship, making the LLC responsible for the unpaid taxes.

The Hearing Office abated a proposed assessment against a company that purchased assets from a bank that obtained the assets as a secured creditor through a bankruptcy proceeding. Since the bank was not a successor to the prior owner of the assets (an auto repair business), the business that purchased the assets from the bank could also not be a successor to the prior owner.

The Hearing Office upheld a proposed assessment against the purchaser of a restaurant despite the purchaser's good faith belief that the seller was selling its assets free and clear of any tax liability. The seller had not given the purchaser a certificate from the Department stating that no tax was due or an affidavit from the seller to that effect, as the law requires. Nevertheless, as the law provides, the Hearing Office reduced the proposed assessment to the fair market value purchase price of the transaction, which was less than the tax liability.

The Hearing Office abated a proposed successor liability assessment against an automotive service company that conducted its business at the same location where a used car dealership had previously operated. The service company was able to provide documentation showing that it was formed by different individuals, did not purchase any inventory or accounts from the used car dealership, and was in a different line of business.

The Hearing Office upheld a proposed successor liability tax assessment against the owner of a convenience store property who repossessed the property and evicted his tenant when his tenant stopped paying rent. The tenant had also failed to pay all sales taxes. After the eviction, the owner continued to operate the store to ensure that it was an ongoing business, but did not obtain his own

sales/use tax numbers or accounts. The Hearing Office upheld the proposed assessment because the owner took possession of the store's assets and continued to operate the store using the prior tenant's accounts until a new tenant took over the business.

Miscellaneous other taxes

In addition to the tax categories discussed above, the Hearing Office occasionally conducts conferences on where the tax type is one that is less frequently seen. Below are some examples of topics the office addressed in FY 2017.

Examples:

The professional privilege tax is on the privilege of maintaining an active license with certain professional licensing boards²⁷ and is due on June 1 of each year. The Hearing Office abated a portion of a proposed professional privilege tax against an attorney whose Tennessee license was inactive during certain years in the audit period when she relocated to Florida and failed to maintain her Tennessee license during that time. The remainder of the proposed assessment, which included years where the attorney had an active Tennessee license, was upheld.

The Hearing Office upheld a proposed tire pre-disposal fee²⁸ assessment where a business selling racing tires did not collect the tax. The Hearing Office rejected the business' argument that the fee did not apply to tires to be driven on a dirt track instead of a street or highway because the purpose of the fee is to offset the costs associated with the eventual disposal of tires and not to compensate for damage done to the state's roads and highways.

The Hearing Office upheld a proposed sales tax assessment against a convenience store that claimed to be making wholesale sales of tobacco products. Under Tennessee law, only licensed tobacco wholesalers may sell tobacco products as sales for resale, and any unlicensed sales are Class B misdemeanors and can be subject of a penalty of up to \$250.00 per day of unlicensed activity.²⁹ The convenience store did not have a tobacco wholesale license and could not deduct those sales as exempt.

The Taxation of Unauthorized Substances Act³⁰ levies a tax on unauthorized substances sold or possessed by "merchants," who are defined as persons actually engaged in selling unauthorized substances or persons in possession of unauthorized substances in a quantity sufficient to create a principal tax liability of at least \$10,000.00. The Hearing Office abated a proposed unauthorized substances tax against a man who was found to have six marijuana plants growing on his property because he was not selling the marijuana and any resulting tax liability would be less than \$10,000.00.

²⁷ Tenn. Code Ann. § 67-4-1701 *et seq.* (2013).

²⁸ Tenn. Code Ann. § 67-4-1603(a) (2013).

²⁹ Tenn. Code Ann. § 67-4-1024 (2013).

³⁰ Tenn. Code Ann. § 67-4-2801 *et seq.* (2013).

Conclusion

In addition to the above information and summaries, a wealth of tax information is available on the Department's website found at <http://www.tn.gov/revenue/>. The "contact us" link at the bottom of the page provides links to telephone numbers for the general call center, as well as telephone number hotlines associated with specific tax areas. Questions may also be submitted in writing by clicking on the "Revenue help" link on the "contact us" page.