



Administrative Hearing Office

FY2022 Annual Report & Informal Conference Summaries

Administrative Hearing Office - Mission and Role

The Tennessee Department of Revenue (the “Department”) has an Administrative Hearing Office (the “Hearing Office”) where taxpayers can work with Hearing Office personnel to resolve disputes about tax assessments and tax refund claim denials. Hearing officers are required to exercise independent judgment and render decisions on individual issues based on the facts and the law. The Hearing Office is currently comprised of three hearing officers, all of whom are licensed attorneys with significant tax experience, and a legal assistant with an extensive state tax background.

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.

For Fiscal Year 2022, the Hearing Office received 317 requests for informal conferences, 97 of which were resolved without a conference. Information and frequently asked questions about the informal conference process are available on the Department’s website at <https://www.tn.gov/revenue/tax-resources/compliance-information/request-an-informal-conference.html>.

Conference Decisions in Fiscal Year 2022: Topics of Interest

The Department has selected several topics of interest summarized below. Each topic of interest also includes overviews of related conference decisions issued over the past fiscal year.

Please be aware that Tennessee law protects 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 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 conference decision was issued. Furthermore, each case is based upon the facts and circumstances presented, some of which may have been pertinent to the decision but not included in the summary below for confidentiality concerns. Therefore, **taxpayers should consult with a tax professional before relying on any information contained in the following summaries.**

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's liabilities. This protection from liability is not complete, however. So-called "trust fund taxes" are taxes collected on behalf of the government and 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, such as sales tax, may be personally liable for any sales tax collected but not remitted (plus associated penalties and interest),¹ 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 unsuccessful, it will attempt to identify officers or employees responsible for collecting sales tax and issue proposed assessments to those people individually. In addition to holding conferences about a business's underlying tax liability, the Hearing Office hears challenges to proposed personal tax assessments.

Examples:

- the Hearing Office adjusted proposed assessments made by the Department against two different officers of a taxpayer entity as persons responsible for the accounting for and payment of taxes collected from customers. While the hearing officer agreed that both individuals qualified, at certain times, as responsible persons, both individuals provided documentation establishing when those periods began and ended. The hearing officer thus adjusted each assessment to remove periods outside those timeframes and also removed time-barred assessment periods.
- The Hearing Office abated a proposed assessment against the minority owner of a business who was an officer of the company, a member of its board of directors, and possessed check-writing authority for the business. These indicia notwithstanding, the evidence at conference supported the individual's assertion that they did not participate in the business's financial decision-making, and there was no evidence of willful failure to remit collected taxes on the part of the assessed individual.
- The Hearing Office upheld a proposed assessment against an individual who acknowledged themselves to have borne responsibility for paying a company's taxes and to have communicated with a Department officer regarding payment plans and other business operations, set up the company's TNTAP account, and possessed check-writing authority for the business and access to company bank accounts. Even though the company's tax returns were ultimately filed by a third-party accounting firm, the foregoing authority and consequent decisions qualified the individual as a responsible person who had willfully failed to remit the company's taxes owed.
- The Hearing Office upheld a proposed assessment against an individual who managed a business, registered the company with the Department, was the master account holder for

¹ Tenn. Code Ann. § 67-1-1443 (2013).

the company's TNTAP account, and communicated with the Department about moving funds between accounts. This individual insisted that the owner of the company—a relative—dictated all financial decisions, but the hearing officer found them to be a person responsible for remitting unpaid taxes because they were the only person registered to interact with the Department on behalf of the company.

- The Hearing Office abated a proposed personal liability assessment against a landlord who leased property to a business. Although the landlord was listed as one of the business's authorized representatives with the Department, the landlord did not work at the business, did not manage its accounts, was not authorized to write checks on the business's bank accounts, and had no control over the business's staff. The business had authorized the landlord to receive information about the hotel's tax liability on one occasion with no authority to do anything on the business's behalf. The hearing officer agreed the landlord could not have been a person responsible for the hotel's taxes under these circumstances and abated the assessment.

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. The buyer must provide the affidavit to the Department to be protected from liability by the seller's affidavit. The Department has 15 days to notify the buyer if the affidavit is incorrect.

Examples:

- The Hearing Office upheld a proposed assessment against a taxpayer who operated a restaurant in a location for which the lease to a previous restaurant operator was transferred to the taxpayer. The taxpayer asserted that they operated a separate, new business in this location. The evidence at conference indicated that the taxpayer had, in fact, not only taken over the lease but had purchased the business of the previous restaurant. The hearing officer thus determined that the taxpayer was the previous business's successor even if the seller had failed to acknowledge outstanding tax liabilities during the sale process.
- The Hearing Office abated a proposed assessment against a company that operated a restaurant in the same space as a previous restaurant. Rather than execute a purchase agreement with the operator of the first restaurant, the company entered into a lease for the restaurant space directly with the third-party lessor and was thus not a purchaser of the previous business.

- The Hearing Office upheld but adjusted a proposed assessment against a taxpayer that purchased the assets of a business with substantial tax liabilities. The taxpayer insisted it purchased the assets from the other company's owner, who had acquired them directly, rather than from the company that incurred the tax itself. The hearing officer upheld the assessment on the grounds that the statute does not limit successor liability to the immediate purchaser and that it does not turn on whether liabilities are expressly transferred. The hearing officer did adjust the assessment to limit it to the purchase price paid by the taxpayer.
- The Hearing Office upheld but adjusted a proposed assessment against a company that purchased another company with outstanding tax liabilities. The purchase agreement provided that the seller agreed to pay all taxes associated with the business before the sale, but the seller did not honor the agreement. The purchaser was liable as a successor because it had not obtained a tax clearance letter or filed with the Department an affidavit from the seller respecting its tax liability. Nevertheless, the assessment was reduced to the amount the purchaser had paid for the business.
- The Hearing Office upheld a proposed assessment against a taxpayer that purchased a company's assets. A Department audit subsequently resulted in a determination of additional tax liability. Although the assessment was not issued until after the date of the sale, because the liabilities were incurred in periods before the sale, the hearing officer held that the purchasing company remained liable as successor, having failed to either obtain a tax clearance letter or filed with the Department an affidavit from the seller respecting its tax liability.

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 the Department can verify returns and determine a dealer's tax liability.² If an assessment is 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.³ If a taxpayer fails to keep sufficient records, the Department may make an assessment using the best information available.⁴ 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.

In the absence of sufficient records, auditors often must perform a purchase markup audit. This 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 in these cases has no basis on which to make an adjustment.

² Tenn. Code Ann. §§ 67-6-523 and 67-1-113.

³ TENN. COMP. R. & REGS. 1320-05-01-.80(2).

⁴ Tenn. Code Ann. § 67-1-113(b).

Examples:

- The Hearing Office upheld a proposed sales tax assessment based upon a convenience store's bank deposits for months where the store had discarded its cash register tapes. The Hearing Office agreed the bank deposits were the best information available as to the taxpayer's sales and upheld the assessment.
- The Hearing Office upheld a proposed sales tax assessment against a convenience store. The z-tapes from the store's register were incomplete, and the taxpayer was unable to provide sales or bank records to corroborate the available tapes. Because of the incomplete nature of the records, the auditor performed a purchase markup audit, relying on records of purchases to estimate the store's complete sales for the period. Though the taxpayer asserted that it made sales under the Supplemental Nutrition Assistance Program ("SNAP"), it had no records to support such sales and the resulting assessment could not be adjusted to remove any such sales.
- The Hearing Office upheld a proposed business tax assessment against a taxpayer that did not provide sales records to contest its business tax assessment. The taxpayer challenged both the amount of sales ascribed to it and the Department's characterization of it as primarily a retailer rather than a wholesaler. Without direct records of its sales, the Hearing Office declined to adjust the assessment.
- The Hearing Office upheld a proposed sales tax assessment where the auditor calculated a restaurant's sales by marking up its purchases. The restaurant did not provide the auditors with point-of-sale system reports, sales journals, or general ledgers. The auditors were unable to determine the restaurant's sales from its bank statements, profit and loss statements, and federal tax returns because of the discrepancies among these sources of information.
- The Hearing Office upheld a proposed assessment against a dealer of used vehicles that claimed, for repossessed vehicles whose sales it had financed, a sales credit equal to the balance due on the repossessed vehicle. The Department disallowed the credit because the taxpayer did not keep records of the vehicles repossessed. Without these records the taxpayer could not identify the repossessed vehicles or the payments that were made toward them.

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 Tennessee and brought or shipped into the state and the seller did not collect sales tax on the purchase.⁵ Purchases made from outside the state include, but are not limited to, mail-order catalog purchases, purchases made

⁵ Tennessee gives credit for legally imposed sales or use tax paid to another state and the purchaser may claim such payment as a credit against any Tennessee use tax liability. Tenn. Code Ann. § 67-6-507(a) (2018); Tenn. Comp. R. & Regs. 1320-05-01-.91.

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, trailers, off-highway vehicles, and boats that occur between people who are not motor vehicle or boat dealers.⁶ These kinds of occasional and isolated sales are generally subject to sales or use tax.

Examples:

- The Hearing Office upheld a proposed assessment against a single-member LLC taxpayer that purchased an airplane and on the same day as the sale entered an agreement to lease to another LLC with two members (one of whom was the single member of the taxpayer). The lease agreement required that the lessee pay the taxpayer a monthly amount for use of the airplane, but it was not until the Department assessed sales tax on the purchase price of the airplane that the lessee began making the payments. The taxpayer also did not apply for a sales and use tax registration with the Department until after receiving the notice of assessment. The hearing officer determined the taxpayer failed to strictly comply with the rules and regulations governing a sale for resale and was thus not entitled to the sale-for-resale exemption.
- The Hearing Office abated a proposed assessment against a collector of antique coins whose primary residence was outside the United States. The collector imported coins into the United States and had them shipped to a relative's house in Tennessee for safekeeping. The individual then collected the property during their periodic visits to the Tennessee relative. The hearing officer determined these activities fell under the "import for export" exemption for sales and use tax found at Tenn. Code Ann. § 67-6-313(a) because the collector's intention to remove the property from Tennessee meant it had never "come to rest" in Tennessee as required by case authority construing the exemption.
- The Hearing Office abated a proposed assessment against a company that purchased an airplane. The company registered for sales and use tax with the Department and entered into a lease agreement before purchasing the airplane under its resale certificate. Following the purchase, the company collected sales tax on lease payments, filed returns reporting the lease payments, and remitted the tax collected. The Hearing Office agreed the airplane had been purchased as a sale for resale because it was for leasing and not used by the company.
- The Hearing Office adjusted a proposed assessment made on the fair market value of three boats. The taxpayer had separately purchased and paid sales tax on outboard motors for each boat. The hearing officer thus gave the taxpayer a use tax credit toward the liabilities for the boats in the amount of the sales tax paid on the price of the motors. The hearing officer also removed the negligence penalty from the assessment because it was imposed as a result of the taxpayer's failure to respond to a subpoena from the Department for records pertaining to the sale, which is not a relevant consideration for the statutory negligence penalty.

⁶ Tenn. Code Ann. § 67-6-102(8)(C).

- The Hearing Office adjusted a proposed assessment on several vehicles. The auditor determined that the taxpayer deliberately understated the purchase prices of the vehicles when registering them and assessed tax based on the fair market value of the vehicles and assessed a 100% fraud penalty. The taxpayer challenged the fraud penalty and the timeliness of the assessment. The hearing officer determined that the sales price was not fraudulently understated on each of the vehicles at issue and that the "Report of Casual or Isolated Sale" provided by the taxpayer when registering the vehicles constituted a "return" for purposes of the statute of limitations for assessments established by Tenn. Code Ann. § 67-1-1501(b). The hearing officer abated the assessment on those vehicles for which the hearing officer found the fraud penalty unsupported because the assessments were made more than three years after the end of the year in which the reports or sale were filed.

Sales and Use Tax

The Hearing Office conducts conferences on a wide variety of sales and use tax issues. Below are examples of some topics the office addressed in conference in fiscal year 2022.

Examples:

- Sales tax applies to sales of tickets and charges for admission to places of amusement or recreation. The Hearing Office adjusted a proposed assessment by removing sales tax assessed against a marina's launch fees because the fees were not charges for admission to the lake. Instead, the hearing officer reasoned that the charges were licenses to use a boat ramp to launch boats into the lake and licenses constitute permission to use an area without taking possession of it.
- The Hearing Office adjusted a proposed assessment against a business that administered the hiring and retention of temporary employees for third-party staffing companies. Although the services the workers performed were subject to sales tax, the taxpayer was not purchasing the services of the workers and reselling them to its customers. Instead, it was selling only its own administrative services, which are not subject to sales tax.
- Absent an exception, the statute of limitations for the Department to assess unpaid taxes closes three years after the end of the year in which a return is filed. The Hearing Office adjusted a proposed assessment on items of tangible personal property imported for use in Tennessee because some of the items were imported before the period open under the statute of limitations. The hearing officer determined that the tax was due on the items when imported and removed from the assessment those items that were time-barred by that standard.
- The Hearing Office adjusted an assessment against a business with two locations that had incorrectly attributed all its sales to one of the locations. As a result of this, amounts attributable to the second location were treated as delinquent, and interest was applied to those amounts in the assessment. Because the sales tax is not imposed on a location-by-location basis and because the error had resulted in overpayments for the other location, the

hearing officer determined that interest should be recalculated after offsetting the underpayments for one location by the overpayments for the other.

- The Hearing Office upheld a proposed sales tax assessment on a company that built custom cars. The company had paid sales tax on the parts it used but did not charge sales tax on sales to out-of-state customers though the customers picked up their custom cars in Tennessee. Because a taxable sale occurs when title or possession of an object passes in Tennessee, the sales were not exempt sales made in interstate commerce.
- Sales of farm products—including livestock and produce—are exempt from sales tax only if they are sold by a farm or nursery directly to consumers. The Hearing Office upheld a proposed assessment on a store that sold produce grown by a farm. While in this instance the retail store and the supplying farm shared a common owner, they were separate legal entities, and the exemption did not apply.

Business Tax

The Hearing Office conducts conferences on a wide variety of business tax issues. Below are examples of some topics the office addressed in fiscal year 2022.

Examples:

- The Hearing Office upheld a proposed assessment against a company that provides services at several Tennessee locations, including warehousing and distribution on behalf of customers and the packing and labeling of shipments. The hearing officer agreed with the Department that the taxpayer's customers—whose goods the taxpayer stored, packed, labeled, and shipped—were the end user of these logistics services. The taxpayer's customers were selling their own goods to their own customers and not reselling the taxpayer's logistics services. As a result, the sale of these services were properly characterized as retail sales under the business tax.
- Services delivered to customers outside the state are not subject to business tax. The Hearing Office adjusted an assessment against a company that performed services (primarily repairs) on tangible personal property located in Tennessee. Delivery outside the state occurs if the item on which the service was performed is shipped to a customer location outside the state. But if the service is performed at the customer's Tennessee location, or the customer picks up or receives the item at such a location, the service is taxable. The hearing officer adjusted the assessment based on these criteria.
- Under Tenn. Code Ann. § 67-4-702(22)(A), companies delivering tangible personal property or services with annual receipts in Tennessee exceeding \$500,000.00 or 25% of its total receipts everywhere have "substantial nexus" with Tennessee and are subject to business tax. The Hearing Office upheld a proposed assessment against a company selling a subscription streaming service to Tennessee customers. The taxpayer argued it did not deliver these services into Tennessee but simply provided access to them. The hearing officer disagreed,

relying upon a dictionary definition of “deliver” that included “to send, provide, or make accessible to someone electronically.”

- Under the business tax, sales by wholesalers and retailers are taxed at different rates; generally, the wholesaler rate is lower. And sales from one wholesaler to another are beyond the scope of the business tax.⁷ The Hearing Office adjusted a proposed assessment against a produce distribution facility originally taxed at the retail rate. Although the facility did not have records of the previous owner’s sales, it had a list of the previous owner’s customers. Because those customers were all retailers, the taxpayer’s sales were wholesale sales. But the hearing officer declined to make any further adjustment for the taxpayer’s claims that it was making wholesaler-to-wholesaler sales outside the scope of the business tax because the taxpayer did not provide records to substantiate such a characterization.

Franchise and Excise Taxes

A corporation, limited partnership, limited liability company, or business trust 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 (minimum franchise tax base) 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 fiscal year 2022.

Examples:

- Whether earnings are included in the apportionable tax base subject to the Tennessee excise tax is determined by the statutory definition of business earnings that Tennessee courts have construed to include a transactional test and a functional test; nonbusiness earnings are not apportioned. The Hearing Office upheld an assessment against a taxpayer resulting from the Department’s disallowance of a nonbusiness earnings deduction claimed by the taxpayer for that portion of an asset sale attributed to goodwill for federal tax purposes. The hearing officer determined that “goodwill cannot be divorced from the business itself” for purposes of apportionment. Thus, if the sale of business assets produces business earnings, so too does the sale of goodwill associated with those assets. Because the assets at issue were used by the taxpayer to produce business earnings, the gain from their sale and from the sale of the associated goodwill also produced business earnings under the functional test.
- The Hearing Office upheld an assessment resulting from the Department’s disallowance of a deduction for nonbusiness earnings. The taxpayer acquired stock in a company as part of a reorganization to facilitate the sale of assets. As part of this process, the operating company paid dividends that the taxpayer reported as income on its federal return while claiming that the payments passed through it directly to the operating company’s original shareholders. Because the stock transaction was necessary for the reorganization, it was integral to the taxpayer’s business, and the income from the stock dividends—which was recognized by the

⁷ Tenn. Comp. R. & Regs. 1320-04-05-.47(3).

taxpayer at the federal level—was business earnings under the functional test for business earnings as described in cases like *Blue Bell Creameries v. Roberts*, 333 S.W.3d 59 (Tenn. 2011).

- The Hearing Office reviewed the Department's partial denial of an amended return refund claim tied to Job Tax Credits and Additional Annual Job Tax Credits for jobs created during the Investment Period. The taxpayer amended its Job Tax Credit Business Plans. After the informal conference, the Audit Division reviewed the amended plans and approved the refund.
- Federal law (Pub. Law 86-272) prohibits states from imposing a tax measured by net income on businesses whose only activity in the state is soliciting orders for sales of tangible personal property. The Hearing Office upheld a proposed franchise and excise assessment against an out-of-state manufacturer that had annual Tennessee sales exceeding \$500,000.00 per year and three employees in Tennessee, including an engineer working from home. The amount of sales supported a finding of substantial nexus subjecting the company to excise tax, and because the engineer was not engaged in activities involving sales solicitation, the company could not claim the Public Law 86-272 safe harbor and was thus subject to Tennessee's excise tax.
- The franchise tax is imposed on the greater of a taxpayer's net worth or the value of its property, and under Tenn. Code Ann. § 67-4-2103(d), members of consolidated groups may elect to compute net worth on a consolidated basis. The Hearing Office upheld an assessment against a taxpayer that had not made the § 2103(d) election and had excluded from its net worth computation investments in subsidiaries that filed their own franchise and excise tax returns. The hearing officer determined this approach was inconsistent with the statutory definition of net worth (Tenn. Code Ann. § 67-4-2106) as "the difference between the taxpayer's total assets and total liabilities computed in accordance with generally accepted accounting principles." As a separate entity, the taxpayer's investments in its subsidiaries were part of its assets and should have been included in its separate entity net worth computation.

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 fiscal year 2022.

Examples:

- The International Registration Plan (IRP) is a registration reciprocity agreement among the states, the District of Columbia, and the provinces of Canada. The agreement provides for payment of licensing (registration) fees based on the distance traveled in all jurisdictions. Motor carriers that qualify for the IRP must register their vehicles in their home or "base" jurisdiction, which allocates and distributes the fees based on miles traveled in each jurisdiction. If a motor carrier's movement and distance records are inadequate, the base jurisdiction must assess 20% of the fees the carrier paid for the year. The Hearing Office

upheld a proposed IRP assessment when a motor carrier's drivers' logs did not support the reported allocation among jurisdictions.

- The professional privilege tax is on the privilege of maintaining an active license with certain professional licensing boards and is due on June 1 of each year. The Hearing Office upheld a proposed professional privilege tax assessment against a doctor who had retired but whose license was not due to expire until October. Under Tennessee case law, as long as a license is active, the professional privilege tax is due regardless of whether the license holder is practicing in Tennessee. But the hearing officer found good and reasonable cause to waive the associated penalty.
- The Hearing Office abated a proposed professional privilege tax assessment against an individual whose professional license was administered by their employer. Though the individual resigned before June 1, the employer did not file the proper paperwork to terminate the license until June 2. Because the individual resigned from the position before June 1 and did everything in their power to surrender and terminate the license implicating the tax before the operative date, the hearing officer determined the tax was not due.

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>.