

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING #99-21**

WARNING

Revenue rulings are not binding on the Department. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

Application of business tax to the sale of overnight lodging in a chalet, cottage, or condominium and to management services provided by third-party management companies.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

Various individuals who own property in Tennessee in and around the [REGION] offer their chalets, cottages, and condominiums to the public for a nightly fee. Linens, dishes, and cookware are provided by the property owner as part of this service. Some owners will also provide a small supply of toiletries, dishwashing liquid, trash bags, etc., for the customer's use. Housecleaning is included in the nightly fee.

This overnight lodging is provided through and operated by management companies located in [COUNTY], Tennessee. For their services, the management companies receive a management fee based on a percentage of the property owner's gross proceeds, usually 40%. The management companies collect the nightly fee from the customers. At the end of each month the management company reports total sales to the property owner and sends a check for the total receipts minus the management company's fee.

QUESTIONS

1. Are property owners who provide lodging in their chalets, cottages, and condominiums for a nightly fee subject to business tax? If so, does the tax apply to 100% of the amount charged to their customers or to the amount charged minus the fee paid to the management company?

2. Are the management companies subject to business tax based on the amount of their management fee?

RULINGS

1. The property owners are subject to business tax based on 100% of the amount charged to their customers.
2. The management companies are subject to business tax based on the amount of their management fee.

ANALYSIS

The Business Tax Act, T.C.A. § 67-4-701 *et seq.*, is a component of Tennessee's privilege and excise taxes. It allows counties and incorporated municipalities to tax the privilege of making sales in Tennessee by engaging in any of the business activities enumerated in the Act. T.C.A. § 67-4-704(a); *Westinghouse Electric Corp. v. King*, 678 S.W.2d 19, 23 (Tenn. 1984).

T.C.A. § 67-4-708 classifies the businesses which are subject to the tax. Classification 3 businesses include every person engaged in the business of rendering services except for fifteen specifically listed exceptions. The statute provides in pertinent part as follows:

Businesses, vocations and occupations which are taxable are set forth in the following classifications; provided, that each person shall be classified according to the dominant business activity:

t t t

(3) CLASSIFICATION 3

t t t

(C) Each person making sales of services or engaging in the business of furnishing or rendering services, except those described below. It is the legislative intent that the exceptions shown below shall include the sales of services by those businesses or establishments so described in the Standard Industrial Classification Index of 1972, including all supplements and amendments prepared by the bureau of the budget of the federal government, except where otherwise provided:

t t t

(viii) Accounting, auditing and bookkeeping services;

t t t

(xii) Operators of residential and nonresidential buildings except hotels, motels and rooming houses;

T.C.A. § 67-4-708(3)(C).

T.C.A. § 67-4-702(a) defines the terms used in T.C.A. § 67-4-708(3)(C) as follows:

(1) "Business" includes any activity engaged in by any person, or caused to be engaged in by the person, with the object of gain, benefit, or advantage, either direct or indirect. . . .

(15) "Services" means and includes every activity, function or work engaged in by a person for profit or monetary gain except as otherwise provided in this part. "Services" does not include sale of tangible personal property.

Applying these definitions to the present case, it is clear the property owners and the management companies are each separately engaged in the business of providing services for profit or monetary gain. The property owners provide lodging and accommodations to members of the public for a nightly fee. The management companies provide management services to various property owners and act as their agent for a fee¹.

Therefore, these businesses fall under Classification 3 unless specifically excluded under T.C.A. § 67-4-708(3)(C). To be exempt under that provision a business must fall directly within one of the expressly excepted categories as illustrated in the applicable standard industrial classification index. See Op. Att’y. Gen. 94-98; 1994 Tenn. AG LEXIS 101 (September 7, 1994). The statute refers to the Standard Industrial Classification Index (“SIC”) of 1972, including supplements and amendments thereto. The SIC of 1972 underwent a major revision in 1987. Office of Management and Budget, Executive Office of the President, Standard Industrial Classification Manual of 1987, at 3 (1987). In 1997, the Office of Management and Budget decided to replace the SIC with a new system rather than further amending the SIC. Office of Management and Budget, Executive Office of the President, North American Industry

¹ Tenn. Comp. R. & Regs. 1320-4-5-.02 provides that “[a] person who acts as a broker or an agent for another in making sales of tangible personal property or services. . . and who receives a commission or fee for his service is performing a taxable service and. . . is taxable under classification 3 at the retail service rate on his total commissions and fees.”

Classification System, at 11 (1997). Because the statute refers only to the SIC, the SIC of 1987 remains applicable under T.C.A. § 67-4-708(3)(C).

T.C.A. § 67-4-708(3)(C)(xii) exempts “operators of residential and nonresidential buildings except hotels, motels and rooming houses.” Neither the property owners nor the management companies fall within this category. Operators of residential and nonresidential buildings are classified under SIC group number 651 - Real Estate Operators (Except Developers) and Lessors; and more specifically under industry numbers 6512, 6513 and 6514. See Op. Att’y. Gen. 88-13, 1988 Tenn. AG LEXIS 10 (January 13, 1988).

In contrast, the property owners at issue in this ruling fall under SIC group number 701 - Hotels and Motels. Cabins and cottages are expressly included in industry number 7011 along with hotels and motels. Furthermore, the industry description includes establishments “primarily engaged in providing lodging, or lodging and meals, for the general public.” As noted above, the property owners are in the business of providing lodging to the general public for a nightly fee and therefore clearly fall within this industry. Accordingly, they do not fall within the exemption provided by T.C.A. § 67-4-708(3)(C)(xii).

The management companies at issue also fall within industry number 7011 if they both manage the properties and provide the operating staff. The SIC directs that businesses which provide management as well as operating staff are classified according to the activity of the establishment managed. Office of Management and Budget, Executive Office of the President, Standard Industrial Classification Manual of 1987, at 403 (1987). That appears to be the case under the facts provided. If the management companies did not provide the operating staff, they would fall under SIC industry number 8741 - Management Services. Either way, they are not included within the exemption.

T.C.A. § 67-4-708(3)(C)(viii) exempts “accounting, auditing and bookkeeping services.” To qualify for this exemption the management company would have to fall within SIC industry number 8721 - Accounting, Auditing, and Bookkeeping Services. While it is not expressly indicated in the facts, it is possible the management companies perform some accounting or bookkeeping functions in providing its services to the property owners. However, it is clear the management companies’ service includes much more than simple accounting or bookkeeping functions. Accordingly, their service does not fall within industry number 8721. *Aabakus, Inc. v. Huddleston*, No. 01-A-01-9505-CH-00215, 1996 Tenn. App. LEXIS 601 (Tenn. Ct. App. September 25, 1996). Instead, as stated above, the management companies fall within industry 7011 or 8741 depending on whether they provide the operating staff.

The remaining thirteen exemptions found in T.C.A. § 67-4-708(3)(C) are inapplicable to these facts. Because none of the exemptions apply, the services provided by the property owners as well as those provided by the management companies are subject to business tax.

The remaining issue is the tax base. Business tax applies to the amount of sales made by the business subject to the tax. *Aabakus, Inc., supra*. To determine the amount of tax, it is necessary to look at the sales price of the services sold. *Id.* T.C.A. § 67-4-702(a)(13) defines “sales price” as “the total amount for which . . . services rendered is sold. . . *without any deduction therefrom on account of the . . . labor or service cost. . . or any other expense whatsoever.*” *Id.* (emphasis added). The property owners are engaged in the business of providing lodging and accommodations to the public. The sales price of this service is the amount charged to the customer. Thus, the property owners are subject to business tax based on 100% of the amount charged to the customers. In determining their business tax liability the property owners cannot deduct the cost of operating their business, whether it be through a management company or otherwise.

Likewise, the management companies are engaged in the business of providing management services to various property owners and acting as their agent for a fee. The sales price of this service is the fee they charge the property owners. The management companies are subject to business tax on their commissions or fees. Tenn. Comp. R. & Regs. 1320-4-5-.02.

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APPROVED: Ruth E. Johnson, Commissioner

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