TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 95-05

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Attribution of sales of tangible personal property for purposes of the sales factor numerator of the seller's corporate franchise, excise tax apportionment formula, when the goods sold are picked up by the customer at the seller's place of business, or shipped to the customer by common carrier from the seller's place of business.

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

FACT SCENARIO ONE

ABC Company, a Tennessee wholesaler, sells tangible personal property to an out-of-state retailer. The retailer may pick up the goods at ABC Company's Tennessee warehouse in it's own trucks and immediately ship the goods to its retail outlets in other states, or the goods may be shipped directly from the warehouse to the retail outlets via common carrier.

FACT SCENARIO TWO

ABC Company, an out-of-state wholesaler doing business in Tennessee, sells tangible personal property to a Tennessee retailer. The retailer may pick up the goods at ABC Company's out-of-state warehouse in its own trucks and immediately ship the goods to its retail outlets in Tennessee, or the goods may be shipped directly to the retail outlets from the warehouse via common carrier.

QUESTIONS

1. In fact scenario one, would ABC Company be required to include the described sale in its sales factor numerator for Tennessee corporate franchise, excise tax apportionment formula purpose?

2. In fact scenario two, would ABC Company be required to include the described sale in its sales factor numerator for Tennessee corporate franchise, excise tax apportionment formula purpose?

RULINGS

1. No.

2. Yes.

ANALYSIS

TENNESSEE LAW AND FRANCHISE EXCISE TAX RULES

T.C.A. § 67-4-811(g)(1) and (h)(1) provides as follows with regard to inclusion of sales of tangible personal property in the apportionment formula for corporate excise tax purposes. T.C.A. § 67-4-910(g)(1) and (h)(1) sets forth the same requirements for corporate franchise tax purposes.

> "(g)(1) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period."
>
> "(h) Sales of tangible personal property are in this state if:
>
> > (1) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the F.O.B. point or other conditions of the sale; . . ."

Departmental Rule 1320-6-1-.33(1)(a) through (d), including examples, contains the following provisions with regard to sales of tangible personal property and the Tennessee apportionment sales factor numerator.

> (a) Gross receipts from the sales of tangible personal property (except sales to the United States Government; see Rule 1320-6-1-.33(2)) are in this state if the property is delivered or shipped to a purchaser within this state regardless of the F.O.B. point or other conditions of sale.

(b) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

Example: The taxpayer, with inventory in State A sold $100,000 of its products to a purchaser having branch stores in several states including this state. The order for the purchases was placed by the purchaser's central purchasing department located in State B. $ 25,000 of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the "purchaser within this state" with respect to
$25,000 of the taxpayer's sales.

(c) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

Example: The taxpayer makes a sale to a purchaser who maintains a central warehouse in this state at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of taxpayer's products shipped to the purchaser's warehouse in this state is property "delivered or shipped to a purchaser within this state."

(d) The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

Example: A taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer directed the manufacturer or supplier of the merchandise in State B to ship the merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is "in this state."

(e) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while enroute to a purchaser in this state, the sales are in this state.

Example: The taxpayer, a produce grower in State A, begins shipment of perishable produce to the purchase's place of business in State B. While enroute the produce is delivered to the purchaser's place of business in this state in which state the taxpayer is subject to tax. The sale by the taxpayer is attributed to this state.

The language in T.C.A. § 67-4-811(h)(1) is taken directly from Section 16(a) of the Uniform Division of Income for Tax Purposes Act (UDITPA) and Departmental Rule 1320-6-1.33 and its examples contain language similar to Multistate Tax Compact (MTC) Regulations. UDITPA is a model act drafted by the National Conference of Commissioners on Uniform State Laws and approved at their 66th Annual Conference in July, 1957. It was intended to reduce diversity among states in allocation and apportionment methods used to determine their respective shares of a corporation's taxable income.

Currently, UDITPA, or UDITPA like statutes, have been adopted by the majority of states imposing a corporate income tax. *Multistate Corporate Income Tax Guide,* (CCH) paragraphs 145 and 401 (1994). The Multistate Tax Compact created the Multistate Tax Commission in the interest of uniform corporate income taxation. Member states may subscribe to the Compact and its joint audit program. The Compact adopts UDITPA as an optional method of apportionment by member states. Currently there are 17 member states and the District of Columbia. Twenty-four other states have adopted some of the MTC regulations or have similar provisions. *Id.* Tennessee is not a member of the Multistate Tax Compact, but is an associate member of the Compact and has adopted rules similar to the Compact's Rules on UDITPA Allocation and Apportionment. Id. at paragraphs 426 and 4162.01.

In T.C.A. § 67-4-804(b) Tennessee has declared that, with regard to business and nonbusiness earnings, its law implements UDITPA as generally interpreted by states adopting the act. In 1976 Tennessee adopted apportionment provisions similar to UDITPA for corporate franchise, excise tax purposes. Id. at paragraph 4162.01. In applying its apportionment statutes and rules in matters not previously considered by Tennessee courts, Tennessee will be guided by case law in other states which have similar allocation and apportionment statutes and rules.

RECEIPTS FROM SALE OF TANGIBLE PERSONAL PROPERTY ARE ATTRIBUTED TO TENNESSEE BY USE OF THE "DESTINATION TEST"

There are no Tennessee court decisions under current law concerning attribution of sales for purposes of the franchise, excise tax apportionment formula receipts factor. There is one unpublished Tennessee Supreme Court decision under prior law which, although not now applicable, gives some insight with regard to the questions presented. It should be noted that the old statutory terms ". . . customers within Tennessee . . ." are similar to the present statutory terms " . . . purchaser . . . within this state . . .".

Prior law stated that the sales factor of the manufacturer's apportionment formula would consist of "The ratio of the gross sales to customers within Tennessee to total gross sales from all sources." (See T.C.A. § 67-2707 under prior law) *In Woods v. Jack Daniel Distillery,* slip op. S. Ct. (Tenn. April 16, 1977), the Tennessee Supreme Court upheld the Chancellor's ruling that sales destined to purchasers located outside Tennessee should be excluded from the sales factor numerator because earnings from such sales are derived

from markets outside Tennessee. The state conceded that shipments from Tennessee by common carrier to customers outside Tennessee were properly excluded from the numerator of the sales factor. The Chancellor had reasoned that it made no difference whether the products sold were transported out of Tennessee by common carrier or by the customer himself. In upholding the Chancellor's decision, the Tennessee Supreme Court said that the word "within" contained in the statute modifies "customers", not "sales", and therefore, the location of the customer determines whether the sale is to an out-of-state customer and is thus excluded from the sales factor numerator.

Today, most states employ UDITPA's "destination test" in determining the attribution of receipts from sales of tangible personal property. Under the destination test, in-state sales are defined as sales with a destination point in that state. Sales delivered to out-of-state purchasers are included in the sales factor of the destination state. W. Raabe and K. Boucher, *Multistate Corporate Tax Guide,* I 413-414 (1994). There is a split of authority as to how the destination test is applied when an out-of-state purchaser comes into the taxing state to pick up goods at the taxpayer's dock. *Multistate Corporate Income Tax Guide,* (CCH) paragraph 1042 (1994). However, most states apply the destination test to dock sales in the same manner as it is applied to other sales. Thus, when the seller makes dock sales to a purchaser that returns with the product to his out-of-state location, the sale is assigned to the state in which the purchaser delivers the goods. W. Raabe, *supra* at I 414.

The state of Colorado is a UDITPA state which subscribes to the Multistate Tax Compact. In *Lone Star Steel Company v. Dolan,* 668 P.2d 916 (Colo. 1983), the Colorado Supreme Court applied a UDITPA provision identical to T.C.A. § 67-4-811(h)(1). In *Lone Star,* the taxpayer manufactured oil and gas pipe in Colorado. Many of the taxpayer's customers want the pipe they purchase coated and wrapped with tar and paper to prevent rust. For this work the taxpayer recommends an unaffiliated company near its plant and the pipe is transferred there by Lone Star's employees and equipment. Lone Star has a practice of replacing pipe damaged by the unaffiliated company, although it has no legal obligation to do so. In such a case, Lone Star bills the customer for the price of the pipe and the unaffiliated company bills the customer for its services. The question presented to the court was whether sales to out-of-state purchasers are Colorado sales if the pipe is first taken to the unaffiliated company for coating and wrapping and then, by arrangement of the unaffiliated company or the customer, shipped out of Colorado to the customer by common carrier.

The court held that the out-of-state purchaser did not take delivery of the pipe in Colorado because both the unaffiliated company and the common carrier are not the purchaser, but instead are merely intermediaries. For a Colorado sale to result, the statute required the pipe to be ". . . delivered or shipped to a purchaser . . . within this state [Colorado] regardless of the F.O.B. point or other conditions of the sale; . . .". There was no Colorado sale because the pipe was neither delivered nor shipped to a purchaser in Colorado.

Although Florida does not claim to be a UDITPA state, its statute concerning the attribution of sales receipts to Florida for the sales factor of its corporate income tax apportionment formula is identical to the UDITPA statute and T.C.A. § 67-4-811(h)(1). In *Department of Revenue v. Parker Banana Co.,* 391 So.2d 762 (Fla. App. 1980), the Florida Court had opportunity to consider the issue of pickup sales. Parker Banana is a Florida corporation that imported bananas to Tampa in refrigerated ships for sale to wholesalers, some of whom are out-of-state. Bananas are transferred by conveyer belt from the ship's hold directly into refrigerated trucks sent to Tampa by, or on behalf of, the purchasers. Some purchasers send trucks owned or rented by them, while others use common carriers or contract carriers.

The Florida Court of Appeals held that the statutory words " . . . within this state . . ." refer to the " . . . purchaser . . .". Thus, for apportionment purposes, Florida sales result only if made to a Florida purchaser, and that depends on the destination of the goods sold. It makes no difference whether delivery or shipment occurs in Florida or elsewhere. Under the destination test, a purchaser from outside the state does not become a " . . . purchaser . . . within this state . . ." by merely sending a representative to pick up the goods in Florida. However, if the destination of the goods is a point within Florida, then the purchaser is within Florida and the sale goes in the numerator of the apportionment formula sales factor. *Id*. at 764.

Minnesota has a sales factor apportionment statute identical to the UDITPA statute and T.C.A. § 67-4-811(h)(1). The Minnesota Supreme Court has held that beer picked up at a taxpayer's Minnesota brewery by out-of-state purchasers in their own trucks for transportation and resale outside Minnesota did not constitute sales within Minnesota. See *Olympia Brewing Co. v. Commissioner,* 326 N.W.2d 642 (Minn. 1982). The court referenced a Multistate Tax Commission regulation and example identical to our Departmental Rule 1320-6-1-.33(c) and example. The rule states: "Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state". In the example to the Rule, the purchaser has a warehouse in the same state as the supplier from which it purchases merchandise. The purchaser ships goods purchased to such warehouse and then transfers them to its own purchasers in another state.

The court held that under the rule, if a shipment terminates in Minnesota, there is a delivery or shipment in Minnesota and a Minnesota sale for apportionment purposes. However, since the purchaser of the beer had no Minnesota warehouses but was transferring the beer out of Minnesota in his own trucks, the shipments terminated outside the state and there was no delivery or shipment within Minnesota and thus no Minnesota sale for apportionment purposes. The matter turns on where the initial purchaser is located, not the location of the final consumer after resale upon resale. The statutory term " . . . within this state . . ." does not modify " . . . delivered or shipped . . ." and the triggering event is not the purchaser's taking physical possession in Minnesota. *Id.* at 647.

The “destination” or “place of market” theory correctly recognizes the contribution of the consumer state to the realization of corporate income. In addition, the “destination test,” as opposed to the “transfer of physical possession” theory, is easy to apply and is not so subject to manipulation by taxpayers. *Strickland v. Patcraft Mills, Inc.,* 302 S.E.2d 544 (Ga. 1983). A taxpayer may be able to structure a delivery or transfer of physical possession in the state that affords the greatest tax savings, but the purchaser’s business location is not likely to be changed solely for the benefit of the seller. *Olympia Brewing, Id.* at 645. If physical possession or passage of title were the controlling factor, an out-of-state taxpayer could structure sales transactions with Tennessee customers so that transfer of title or physical possession always occurred outside Tennessee.

Thus, an out-of-state seller could have Tennessee nexus for franchisee, excise tax purposes, and have sales to customers in Tennessee, but have no Tennessee sales to include in the numerator of its apportionment formula sales factor.

CONCLUSION

Tennessee uses the destination test, or market theory, to determine sales of tangible personal property that must be included in the numerator of the receipts factor of a taxpayer’s apportionment formula for corporate franchise, excise tax purposes. It makes no difference whether the merchandise is shipped by common carrier from the seller’s Tennessee location to the initial out-of-state purchaser, or whether the initial out-of-state purchaser sends his own truck to Tennessee to pick up the merchandise at the Tennessee seller’s place of business and takes it to the purchaser’s out-of-state location. Such sales are not includible in the seller’s Tennessee apportionment sales factor numerator.

Likewise, an out-of-state seller having corporate tax nexus in Tennessee must include in his apportionment Tennessee sales factor numerator, sales to initial purchasers located in Tennessee. It makes no difference that the Tennessee purchaser sends his trucks to pick up the merchandise at the seller’s out-of-state place of business, or that the merchandise was shipped to the Tennessee customer by common carrier, F.O.B. shipping point, from the seller’s out-of-state location.

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APPROVED: Ruth E. Johnson, Commissioner

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