

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #98-32**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of jobs franchise tax credit to a product service center.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the Taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

[THE TAXPAYER] is considering locating a product service center ("PSC") in [CITY A - IN TENNESSEE]. The PSC is described in the ruling request as a light manufacturing, distribution, and processing center for tangible personal property. The Taxpayer anticipates

filing a 1998 franchise, excise tax return¹ and intends to apply the jobs tax credit against its franchise tax liability in the amount of \$2,000.00 for each new, full-time job created in the fiscal year covered by the franchise, excise tax return.² In addition, the Taxpayer anticipates filing a tax return for the excise tax credit applicable to purchases of industrial machinery in the amount of 1% of the equipment purchase price, as set forth in Tenn. Code Ann. § 67-4-808(4).³

The Taxpayer plans to spend approximately [OVER \$500,000.00] in real and personal property to purchase and make operational the proposed facility. Specifically, the Taxpayer plans to purchase [OVER \$500,000.00] in capital assets and to spend an additional [DOLLAR AMOUNT] (minimum) to upgrade and retrofit the facility to adapt it to the specific needs and requirements of the PSC. The capital assets will include site improvements, machinery, and equipment. The purchase of the tangible personal property will be made after January 1, 1993, and all the tangible personal property will be used at the PSC.

The repair process begins with a customer delivering an item of “eligible equipment”⁴ in need of repair to one of the Taxpayer’s [STORES] within the region for shipment to the PSC. The [CITY A] regional PSC will serve Tennessee and all states that adjoin Tennessee. After the equipment is received at one of the Taxpayer’s stores, it is then shipped to the PSC that services the particular region. Once the equipment is received by the appropriate PSC facility, it is then sorted by material handlers and is categorized based upon the type of equipment to be repaired. The equipment is then distributed to one of seven service lines at the PSC, with each segment of the line having a specific and defined function. The seven service lines are:

- (1) Floorcare Line
- (2) Microwave Line
- (3) Sewing Machine Line
- (4) VCR Line
- (5) Camcorder Line
- (6) TV Repair Line
- (7) Audio Line

¹ The Department’s files indicate the taxpayer’s year end is December 31.

² The Taxpayer has not filed a “business plan” with the Department , as required by Tenn. Code Ann. § 67-4-908(c)(2)(C).

³ The taxpayer has not requested a ruling on whether or not it is entitled to the industrial machinery excise tax credit, and, accordingly, this ruling does not address that question.

⁴ The Taxpayer has defined eligible equipment to include the following: air compressors, air cleaners, air conditioners, alternators, audio equipment, bench power tools, bicycles, camcorders, cameras, carpet cleaners, chainsaws, compactors, computers, cooktops, copiers, dehumidifiers, dishwashers, disk drives, disposals, distillers, dryers, fax machines, fishing motors, floor polishers, freezers, floor care equipment, generators, heaters, leaf blowers, lawn mowers, microwaves, printers, refrigerators, scanners, sewing appliances, snow blowers, space heaters, telephones, televisions, tillers, vacuums, video cassette recorders, washers, water filter systems and word processors. This list is not exhaustive and is intended to serve as an illustration of products to be serviced at the proposed PSC.

Each service line is arranged with specialists and generalists and the work is performed in teams. (Attachment 1 to ruling request). The leadership structure at each PSC will be comprised of a plant manager, floor supervisor (1 per 2.5 operating lines), and one team leader. Sixty percent (60%) of all the repair work to be performed involves moderate to substantial modification of the equipment to be repaired, and each repair involves a significant amount of disassembly, diagnosis, part installation, cleaning, reassembly, and quality assurance review. (Attachment 2 to ruling request).

Each service line will transform the form of the equipment from broken, non-functioning and non-salable into repaired, functioning, and salable. Once the equipment is transformed into a functioning item, the equipment is then distributed from the PSC back to the Taxpayer's location where it was originally taken to begin the repair process. Approximately 70% of all repaired items will be shipped to out of state locations.

In addition to equipment repair, the process of reconditioning appliances will take place at the PSC. The primary value added to the equipment coming to the PSC will be disassembly, diagnosis, part installation, cleaning, reassembly, quality assurance review, and distribution.

In order to accomplish the tasks enumerated above, employees will be trained to increase efficiency in their assembly and repair of equipment via the manufacturing task process developed for the Taxpayer.

The Taxpayer intends to implement manufacturing task processes with respect to the repair and transformation of equipment at the PSC. In addition to high-quality repair, manufacturing and distribution, the PSC will create and promote new, high-paying skilled positions to maintain the Taxpayer's standard of excellence.

The PSC will employ [MORE THAN 25] new, full-time employees and [NUMBER] new, part-time employees. The average wage of the full-time employees will be [DOLLAR AMOUNT] per hour with the highest paying jobs peaking at [DOLLAR AMOUNT] per hour. In addition to the hourly wage, a cash reward structure will also be implemented as well as a non-cash reward and recognition program. (Attachment 3 to the ruling request). All the jobs at the PSC will be newly created positions.

ISSUE

Whether the Taxpayer's PSC constitutes a "qualified business enterprise" for purposes of obtaining the Tennessee franchise tax jobs tax credit to be applied against the Taxpayer's franchise tax liability.

RULING

The PSC does not constitute a qualified business enterprise for the purposes of the franchise jobs tax credit.

ANALYSIS

Tenn. Code Ann. § 67-4-908(c)(2)(A) provides that

A job tax credit of two thousand dollars (\$2,000) for each net new full-time employee job, when it is filled during the fiscal year and in existence at the end of the fiscal year, shall be allowed against a business' franchise tax liability for that year; provided, that:

- (i) The business has met the required capital investment in the qualified business enterprise;
- (ii) The credit shall first apply in the fiscal year in which the qualified business enterprise increases net full-time employment by twenty-five (25) or more jobs, and in those subsequent fiscal years in which further net increases occur above the level of employment established when the credit was last taken; and
- (iii) The new full-time employee jobs are filled prior to January 1, 2008.

(Emphasis added). The required capital investment is a minimum of \$500,000 spent on real, personal, and/or leased property in Tennessee after January 1, 1993. The Taxpayer has planned to exceed that amount.

A "qualified business enterprise" is defined as

an enterprise in which a business has made the 'required capital investment' in Tennessee in real or tangible personal property necessary to permit the creation or expansion of manufacturing, warehousing and distribution, processing tangible personal property, research and development, computer services, corporate offices, or convention or trade show facilities.

Tenn. Code Ann. § 67-4-908(c)(1)(B) (emphasis added). The question is whether the PSC is a qualified business enterprise within the definition of Tenn. Code Ann. § 67-4-908(c)(1)(B). Although the facility will include some warehousing and/or distribution, those are not the primary functions occurring at the PSC. The only category of qualified activities in which the Taxpayer may qualify, then, is the "processing of tangible personal property."

"Processing of tangible personal property" is not defined in the statute. It has been discussed extensively, however, in the context of sales and use tax law. Tenn. Code Ann. § 67-6-206, for example, provides certain exemptions and reduced tax rates for manufacturers. A "manufacturer" is defined "as one whose principal business is fabricating or processing tangible

personal property for resale." Tenn. Code Ann. § 67-6-206(b)(2). "Fabricating or processing" is also not defined by the sales tax statutes⁵; consequently, the phrase has been given its ordinary and commonly accepted meaning. *See The Beare Co. v. Department of Revenue*, 858 S.W. 2d 906 (S. Ct. 1993). In *Beare*, the Court quotes the following definition:

["Processing" is] essentially a transformation or conversion of materials or things into a different state or form from that in which they originally existed
- the actual operation incident to changing them into marketable products.

Beare, 858 S.W. 2d at 908, citing *Gressel Produce Co. v. Kosydar*, 297 N.E.2d 532, 535 (Ohio 1973) (cleaning, cooling, sorting, and application of oil to eggs did not constitute "processing" because there was no change in the state or form of the eggs). The Court cited another Ohio case in which the court emphasized that mere enhancement of the value of a product, absent a change in "state or form" from that in which it originally existed, does not constitute "processing." *The Beare Co.*, 858 S.W.2d 906, citing *Sauder Woodworking Co. v. Limbach*, 527 N.E.2d 296, 297 (Ohio 1988) (packaging material in which furniture is shipped and sold is not used during the manufacturing or processing period, and is therefore not exempt from sales and use taxes). *See also Woods v. General Oils, Inc.*, 558 S.W.2d 433, 436 (Tenn. 1977) (blending of several types of oil to create new oil deemed processing).

Applying the law to the facts of the case, the *Beare* court held that a taxpayer engaged in freeze-drying food for storage was entitled to the manufacturer's exemptions under Tenn. Code Ann. § 67-6-206. The food was raw and unprocessed, and was transformed into a different state or form through the freeze drying process.

Under the present facts, giving the phrase "fabricating or processing" its common and ordinary meaning, the Taxpayer is not processing the items received in the PSC. Although the items brought into the PSC will be changed into marketable products, that is what they formerly were prior to their malfunction. The Taxpayer is essentially performing either repair work or at most, a refabrication of the items. Neither repair nor refabrication constitute the processing of tangible personal property.

The activities at the PSC may be deemed remanufacturing. The sales tax law, however, does not equate remanufacturing with the fabrication or processing of tangible personal property. *See Misenheimer Saw & Tool, Inc. v. Huddleston*, 1994 Tenn. App. LEXIS 668 (Ct. App. 1994). There is a separate exemption for the remanufacture of industrial machinery in Tenn. Code Ann. § 67-6-102(12)(B), leading to the conclusion that it is distinct from what is commonly known as manufacturing (also referred to in the sales tax law as fabrication and processing). Accordingly, remanufacturing is not the same as processing under a sales tax

⁵ The phrase "[fabricating or processing tangible personal property for resale]" is defined in Tenn. Code Ann. § 67-6-102(7); however, that definition is concerned with the "for resale" portion of the phrase rather than defining "fabricating or processing of tangible personal property."

analysis. The common understanding of processing, as discussed in the context of sales and use tax, applies to the franchise jobs tax credit. Therefore, the Taxpayer is not entitled to the jobs credit with respect to its PSC operation.

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APPROVED:

Ruth E. Johnson
Commissioner

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