

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 00-47**

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 Tennessee sales and use tax to property transferred from a parent corporation and its subsidiaries to a single-member LLC. Application of Tennessee sales and use tax to sales of used business equipment.

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 the taxpayer's detriment.

FACTS

[TAXPAYER, ALSO REFERRED TO AS "P"] is a [STATE OTHER THAN TENNESSEE] corporation that owns and operates [RETAIL] stores and distribution centers in Tennessee and surrounding states under the [RETAIL] name. The taxpayer leases most of its retail locations, but owns its distribution centers, truck fleets, and administrative offices. The taxpayer is a Tennessee registered dealer and collects and remits sales and/or use tax on those items deemed to be taxable under T.C.A. § 67-6-101 *et seq.*

Currently, the taxpayer is the parent corporation of three wholly owned subsidiaries, [SUBSIDIARY 1], a [STATE OTHER THAN TENNESSEE CORPORATION], ("S1"), [SUBSIDIARY 2], a [STATE OTHER THAN TENNESSEE CORPORATION], ("S2"), and [SUBSIDIARY 3], a [STATE OTHER THAN TENNESSEE CORPORATION], ("S3"). All management functions over the taxpayer's business are currently conducted by P. S1 performs claims administration services as a risk management corporation for P and the other subsidiaries. S2 consists solely of a single retail store. S3 is a holding company which has two wholly owned subsidiaries, [HOLDING COMPANY 1], a [STATE OTHER THAN TENNESSEE CORPORATION], ("SS1"), and [HOLDING COMPANY 2], a [STATE OTHER THAN TENNESSEE CORPORATION] ("SS2"). SS1 and SS2 are composed solely of retail stores located outside of Tennessee.

For valid, non-tax, business reasons, a tax free reorganization is contemplated in which P will contribute substantially all of its assets and liabilities to [LLC] ("the LLC"), a newly formed [STATE OTHER THAN TENNESSEE] single member Limited Liability Company, in return for one hundred percent (100%) of the ownership interests in the newly formed LLC, pursuant to Section 721 of the Internal Revenue Code. The assets to be transferred consist of business assets such as furniture, fixtures, equipment and supplies used by the taxpayer and its subsidiaries in their business, inventory held by the taxpayer and its subsidiaries for resale, and vehicles used by the taxpayer and the subsidiaries in their business. No consideration (apart from the controlling membership interest in the LLC) will be given by the LLC to P in exchange for this contribution of assets and liabilities. For federal income tax purposes, the LLC will be treated as a division of P, and the contribution of the assets from P to the LLC will have no federal income tax effect.

In addition to equipment and fixtures, P will transfer to the LLC inventory that it purchased for resale, under a valid resale certificate. Prior to receiving this inventory, the LLC will have applied for and obtained a registration certificate from the Department of Revenue and will be capable of issuing a valid resale certificate.

It is anticipated that only a small number of retail stores (less than four) located outside Tennessee and one retail store located in Tennessee, and their related assets, will not be contributed to the LLC. It is currently anticipated that the only situation in which stores will not be contributed to the LLC will be when difficulties regarding lease approval or business license conveyances would prohibit the contribution of the store to the LLC.

Following the formation of the LLC and the contribution to it of substantially all of the P's assets and liabilities, there will be a continuation of the business of the taxpayer. No changes in the P's officers, ownership structure, or the ownership of its subsidiaries is contemplated. The ultimate ownership interest of P in the transferred assets will be the same both before and after the reorganization.

It is expected that the contribution of all or substantially all of the taxpayer's assets and liabilities to the LLC will take place over a twelve-month or thirteen-month period, on a state-by-state basis, in each of the states in which the taxpayer does business. For any given state, all assets located in that state will be transferred to the LLC in a single month. Thus, all or substantially all of the taxpayer's assets in Tennessee will be transferred to the new LLC in a single month. Possibly, all of the inventory owned by the taxpayer may be transferred to the LLC in a single month, regardless of its physical location, in order to simplify accounting matters, such as inventory valuations. Additionally, all employees of the taxpayer, regardless of location, may be transferred to the new LLC at one time as well.

Prior to and following the reorganization described above, the taxpayer and/or the LLC may, from time to time, remodel or refurbish retail stores, or close retail stores. When such refurbishing, remodeling, or closing takes place, the taxpayer and/or the LLC may transfer used equipment and fixtures to another of its retail stores, or may sell such equipment and fixtures to an unrelated purchaser. It is anticipated that such sales or equipment and fixtures to third parties may occur two or more times per year.

QUESTIONS

1. Is the tangible personal property transferred under the proposed reorganization of the company exempt from the sales and use tax as an occasional and isolated sale?
2. Is the sale or the transfer of used store equipment and fixtures to unrelated purchasers exempt from the sales and use tax as an occasional and isolated sale?
3. Under the provisions of TENN. COMP. R. & REGS. 1320-5-1-09(4), will any of the transactions described in Questions 1 and 2 above become taxable

if the transfers take place more than twice a year or if they take place in a period exceeding 30 days?

RULINGS

1. Except for motor vehicles, aircraft, vessels, and inventory held for resale, the transfers are occasional and isolated and not subject to tax. Motor vehicles transferred from P to the LLC are not subject to tax. Transfers of motor vehicles between the various entities other than from P to the LLC are subject to tax. Transfer of inventory is exempt from tax if the transferee entity issues a properly executed resale certificate to the transferor.
2. These sales are occasional and isolated and exempt from tax.
3. TENN. COMP. R. & REGS. 1320-5-1-09(4) does not cause any of the transactions described in this ruling to become subject to tax.

ANALYSIS

Law Regarding Occasional and Isolated Sales

Generally, the sales tax is applicable to the sale of tangible personal property at retail. However, the language which levies the tax on such sales states: "For the exercise of the privilege of engaging in the **business** of selling tangible personal property at retail in this state, a tax is levied ..." T.C.A. § 67-6-202(a) (Emphasis supplied.) If a taxpayer is not engaging in "business", the sale is deemed to be occasional and isolated, and is not subject to tax. "Business" is defined in T.C.A. § 67-6-102(2) which states:

"Business" includes any activity engaged in by any person, or caused to be engaged in by such person, with the object of gain, benefit, or advantage, either direct or indirect. "Business" does not include occasional and isolated sales or transactions by a person not regularly engaged in business, or the occasional and isolated sale at retail or use of services sold by or purchased from a person not regularly engaged in business as a vendor of taxable services, or from one who is such a vendor but is not normally a vendor with respect to the services sold or purchased in such occasional or isolated transaction. "Business" includes occasional and isolated sales or transactions of aircraft, vessels, or motor vehicles between corporations and their members or stockholders and also includes such transactions caused by the merger, consolidation, or reorganization of corporations. "Business" also includes occasional and isolated sales or transactions of aircraft, vessels, or motor

vehicles between partnerships and the partners thereof and transfers between separate partnerships. Transfers caused by the dissolution of a partnership due solely to a partner, in a partnership composed of three (3) or more persons, voluntarily ceasing to be associated in the carrying on of business of the partnership, as provided in § 61-1-128, is not included in "business." "Business" shall be construed to include occasional and isolated sales or transactions by such a person involving aircraft, vessels or motor vehicles (which terms include trailers and special motor equipment sold in conjunction therewith), as defined by and required to be registered under the laws of Tennessee with an agency of this state or under the laws of the United States with an agency of the federal government, unless such sales or transactions are otherwise exempt under this chapter or are sales between persons who are: married, lineal relatives or spouses of lineal relatives, or siblings. Such sales or transactions involving aircraft based in this state shall be presumed to be made and taxable in this state; and any registration reflecting such aircraft which are so based shall constitute evidence thereof. "Business" does not include those occasional or isolated sales or transactions by such a person involving mobile homes or house trailers, as defined by § 55-4-111, when the consummation of such exclusively involves the assumption by the purchaser of a previously existing finance contract and no other consideration is received by the seller. "Business" does not include any sales or use tax of tangible personal property of any type sold directly to consumers by any person, including, but not limited to, the Girl Scouts or county fairs; provided, that the tangible personal property is not regularly sold by such person or is regularly sold by such person only during a temporary sales period which occurs on a semiannual, or less frequent, basis;

The rule construing this statute states:

The Sales Tax does not apply to casual and isolated sales by persons who are not, or who have been deemed by the Commissioner not to be engaged in the business of selling tangible personal property or furnishing any of the services subject to the Sales or Use Tax. The Sales Tax, likewise, does not apply to sales of tangible personal property or taxable services not normally sold by a dealer and which has been used by the dealer prior to the sale; this exemption however, does not apply to any sales of tangible personal property or taxable services bought upon a resale certificate for resale by those persons who hold themselves out as engaged in business, notwithstanding the fact that the sales may be few and infrequent. The exemption also does not apply to the

casual and isolated sale of aircraft, vessels and motor vehicles which are required to be registered by the State of Tennessee or the U.S. Government.

TENN. COMP. R. & REGS. 1320-5-1-.09(1).

Transfers of Business Property Other Than Motor Vehicles, Aircraft, and Vessels

The question presented in the ruling request involves goods that previously have been used by the transferor entity in the conduct of its business. Except for the transfer of aircraft, vessels or motor vehicles, and the transfer of inventory of goods held for resale, each of which is subject to a different analysis which will follow, these transactions fall squarely within the occasional and isolated sale exemption. Business assets such as furniture, fixtures, equipment, and supplies used in the transferor's business operations are not the type of goods typically sold by the transferor. In an early sales tax case, Liberty Cash Grocers, Inc. v. Atkins, 202 Tenn. 448, 304 S.W.2d 633 (1957), the Tennessee Supreme Court found similar transfers of store fixtures and equipment, warehouse fixtures and equipment, office fixtures and equipment, and automotive and truck equipment that had been acquired and held by complainant for use in the taxpayer's business to fall within the exemption for occasional and isolated sales as it existed at the time. Here, the proposed transfers are not subject to tax, whether the transferee is a related entity as a part of a corporate reorganization, or an unrelated entity to which the goods are sold. With respect to some of the transfers that will take place as a result of the corporate reorganization, there is additional support for finding the transfers are not subject to sales tax. The additional analysis will be discussed later in this ruling.

Transfers of Motor Vehicles, Aircraft, or Vessels from P to the LLC

The exemption from sales tax of occasional and isolated sales does not apply to "sales of aircraft, vessels, or motor vehicles between corporations and their members or stockholders and also includes such transactions caused by the merger, consolidation, or reorganization of corporations .. " Tenn. Code Ann. § 67-6-102(1). This provision clearly applies to the taxpayer's transfer of motor vehicles unless the transaction is not deemed a sale. However, with respect to the transfers from P to the LLC, for Tennessee state and local tax purposes, no sale takes place.

T.C.A. § 48-211-101, enacted by the Tennessee legislature in 1994, makes the following provisions concerning the classification of a Limited Liability Company for Tennessee tax purposes:

For purposes of all state and local Tennessee taxes, a foreign or domestic LLC shall be treated as a partnership or an association taxable as a corporation as such classification is determined for

federal income tax purposes. The members of a foreign LLC treated as a partnership are subject to all state and local Tennessee taxes in the same manner and extent as partners in a foreign partnership. The members of a domestic LLC are subject to all state and local Tennessee taxes in the same manner and extent as partners in a domestic partnership.

The apparent legislative intent of T.C.A. § 48-211-101 is to classify limited liability companies for Tennessee state and local tax purposes in the same way that they are classified for federal income tax purposes. T.C.A. § 48-211-101 was enacted in 1994 prior to the adoption of Treas. Reg. § 301.7701-3 (1997), better known as the “check-the-box” provisions, and does not specifically address federal income tax classification elections by eligible limited liability companies under the check-the-box provisions, nor does it address an election by a limited liability company to be disregarded as an entity separate from its owner.

If a single member limited liability company has made a valid election to be disregarded as an entity separate from its owner under Treas. Reg. § 301.7701-3 (1997) or is so classified by the default provisions, it will be disregarded as an entity separate from its owner for Tennessee state and local tax purposes, unless an applicable statute requires otherwise. In cases where the single member is a corporation and the limited liability company doing business in Tennessee is disregarded as an entity separate from its owner, it will be treated as a division of its single corporate member. The election has been made to treat the LLC as a division of P for Federal income tax purposes. Therefore, all transfers of assets between P and LLC, including transfers of motor vehicles, are, for tax purposes, not actually transactions between separate entities and are not considered sales. Therefore, they are not subject to tax.

Transfers of Motor Vehicles, Aircraft, or Vessels Other Than from P to the LLC

However, the ruling request states that property used by the subsidiaries of P in the conduct of their business will be contributed to the LLC. It is not clear whether this will be a transaction where the transfer will be from the owner-subsidary direct to the LLC, or whether the assets will first be transferred to P and then to the LLC. In either event, the transfer of aircraft, motor vehicles, and boats from the subsidiaries, either to P or the LLC, would not be exempt under the analysis above. Rather, there is an actual transaction between two separate entities.

A sale requires an element of consideration to be passed between the parties. Tenn. Code Ann. § 67-6-102(25)(A). D. Canale & Co., et al. v. Celauro, 765 S.W. 2d 736 (Tenn. 1989); Northern Telecom v. Olsen, 679 S.W. 2d 448 (Tenn. 1984). In D. Canale, the taxpayer created subsidiary corporations and transferred vehicles to them in exchange for stock or securities. D. Canale & Co., *supra* at 737. The court held that because the entity that transferred the vehicles received

from the transferee an ownership interest in the transferee, the transfer constituted a taxable sale. Id. at 737-38.

The transferee entity in this case will receive title and possession of the motor vehicles from the transferor entities. A similar situation existed in Northern Telecom v. Olsen, supra. The taxpayer in Northern Telecom was a corporation into which a subsidiary was absorbed, resulting in a transfer of all the subsidiary's property, including an airplane, to the taxpayer. Northern Telecom, supra at 449. The court held that the transfer was not a taxable sale because the subsidiary received no consideration during the transaction as it ceased to exist. Id.

The Northern Telecom case was discussed in D. Canale. The D. Canale court, in holding that the transfer from a company to a new subsidiary was taxable, stated:

Further, after the trial court's decision which was affirmed in Northern Telecom, the legislature amended the definition of "business," for the purpose of the Sales Tax Act, so as to include the "occasional and isolated sale or transaction of . . . motor vehicles . . . caused by the . . . reorganization of corporations," and made such transactions taxable.

D. Canale, supra at 738. The statute clearly states that business includes the transfer of a motor vehicle "caused by the merger, consolidation, or reorganization of corporations." T.C.A. § 67-6-102(1).

As noted in the first paragraph of this section, the ruling request does not specify the exact process by which assets belonging to the subsidiaries will be transferred into the LLC. It is not clear what the transferor entity receives in exchange for the assets, nor whether the transferor will cease to exist as a result of the reorganization. However, the plain language of the statute¹ provides for tax on a transfer of aircraft, vessels, and motor vehicles caused by merger, consolidation, or reorganization of corporations. There is no longer a requirement that a sale take place. The transferee entity will receive motor vehicles as a result of the reorganization of the taxpayer; therefore the tax applies. Accordingly, the sales tax is due on transfers of motor vehicles other than direct transfers from P to the LLC.

Transfer of Inventory of Goods Held for Resale

Goods held for sale are not within the exemption for occasional and isolated sales. The sales tax is imposed on sales at retail. T.C.A. §67-6-202. The definition of "sale at retail", T.C.A. §67-6-102, excludes sales for resale,

¹ As amended by Ch. 523, Pub. Acts 1984, subsequent to the decision in Northern Telecom. This amendment is explained in D. Canale, 765 S.W.2d at 738.

providing, however, that sales for resale must be in compliance with rules and regulations promulgated by the commissioner. Therefore, the transfer of items held for resale is not subject to sales tax, if all applicable rules regarding sales for resale are strictly adhered to. The issuance of a resale certificate by a dealer making purchases for resale is required by TENN. COMP. R. & REGS. 1320-5-1-.68. Accordingly, assuming that LLC issues a resale certificate to each transferor entity for the inventory being transferred, no sales tax is due on the transfer, even if that transfer constitutes a sale.

Application of TENN. COMP. R. & REGS. 1320-5-1-09(4)
to Occasional and Isolated Sales

Finally, the taxpayer has stated that some of the transfers which qualify for the occasional and isolated sales exemption might take place more frequently than twice per calendar year, or during a period which exceeds thirty days in duration. It inquires as to whether the provisions of TENN. COMP. R. & REGS. 1320-5-1-09(4) would render such a sale taxable.

TENN. COMP. R. & REGS. 1320-5-1-09(4) states:

Irregular sales of tangible personal property or regular sales of tangible personal property made only during a temporary sales period occurring on a semiannual or less frequent basis are casual and isolated sales not subject to tax. If a person other than a public or private school, grades K-12, or school group has or conducts more than two (2) sales periods during a calendar year, such person shall be liable for sales tax on all sales during that calendar year. Public and private schools, grades K-12, and school support groups having or conducting more than two (2) sales periods during a calendar year, having purchased tangible personal property or taxable services without the payment of tax, shall be liable for the use tax based on the purchase price of the items or services purchased during that calendar year. A sales period shall be presumed to be temporary if it is of 30 consecutive days duration or less. Persons making purchases of tangible personal property or taxable services for resale during temporary semiannual or annual sales periods shall provide their vendor with a written statement indicating that the items or services will be sold during a semiannual or annual sales period.

The purpose of this rule is obviously to interpret the language in T.C.A. § 67-6-102(2) which states:

"Business" does not include any sales or use tax of tangible personal property of any type sold directly to consumers by any person, including, but not limited to, the Girl Scouts or county fairs;

provided, that the tangible personal property is not regularly sold by such person or is regularly sold by such person only during a temporary sales period which occurs on a semiannual, or less frequent, basis;

The occasional and isolated sale exemption was a part of the sales tax law as it was originally enacted. Ch. 3, Pub. Acts 1947, § 2(i). The provision regarding temporary sales periods is of much later origin, having its beginnings with Ch. 779, Pub. Acts 1984. Originally, the provision applied only to certain sales made by non-profit institutions, and allowed only one temporary sales period per year. The enactment placed the provision in the code in a section dealing with other sales and use tax exemptions for eleemosynary institutions. In 1985, the original enactment was replaced with the language in § 67-6-102(2) quoted in the preceding paragraph. Ch. 389, Pub. Acts 1985. While the provision now applies to persons other than non-profit institutions, it is obvious from its history that the exemption was to benefit non-profit institutions making irregular sales of tangible personal property. It was not intended to restrict the already-existing exemption for occasional and isolated sales. Any transfers made by the taxpayer which are exempt due to being occasional and isolated sales are exempt without regard to whether they occur on a semiannual or less frequent basis and without regard to the length of any period during which such transfers take place, so long as such transfers do not become the taxpayer's regular business.

Owen Wheeler
Tax Counsel 3

APPROVED: Ruth E. Johnson
Commissioner

DATE: 11-29-00