

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING 11-18**

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

The application of the Tennessee sales and use tax to sales by a multi-level marketing company.

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

The Taxpayer is a direct selling company that is registered to collect and remit sales tax in Tennessee. As a direct selling company, the Taxpayer has entered into an agreement with the Tennessee Department of Revenue to collect and remit sales tax to the state by the following method. The Taxpayer sells consumer products to independent commissioned business owners (the “Advisors”), who are not registered to collect and remit sales tax in Tennessee. The Advisors purchase the products from the Taxpayer at the wholesale price of the products. At the time of this transaction, the Taxpayer collects sales tax from the Advisors based on the anticipated sales price to the consumer/end-user (*i.e.*, the suggested retail selling price plus any other taxable charges, such as shipping and handling) of its products, which it remits to the state on behalf of the Advisors.

The Advisors generally sell the products using the “party plan” under which the Advisor holds a party at the home of an individual (the “Hostess”). The Hostess invites individuals to her house so that the Advisors can show the invited guests the Taxpayer’s products. The Advisors sell the products to the guests at the suggested retail price plus sales tax. An Advisor’s profit is the difference between her cost (*i.e.*, the wholesale price of the products plus shipping and handling charges) and the retail price of the products.

Hostesses are given the following incentives to hold a party:

- A discount equal to [PERCENTAGE] of the sales at the party is usable by the Hostess toward her purchases made at that party.

- If the party generates a certain volume of sales and a certain number of orders from the guests, the Hostess may pay [DOLLAR AMOUNT] and receive an additional [PERCENTAGE] discount on her own purchases made at that party.
- The Hostess is allowed to purchase any [NUMBER] items at a special hostess price ranging from [DOLLAR AMOUNT] to [DOLLAR AMOUNT] each.
- The Hostess is allowed to purchase [NUMBER] of items at [PERCENTAGE] off the suggested retail price.
- The Hostess is allowed to purchase an additional item at [PERCENTAGE] off the suggested retail price if purchased at a show that was booked by an individual attending her show.

The Taxpayer also has an awards program for its Advisors whereby an Advisor who meets certain sales or recruiting goals will receive an “award product certificate” of a certain dollar value. This certificate can be redeemed by the Advisor on the Advisor’s purchase of sample products.

QUESTIONS

1. When a Hostess purchases the Taxpayer’s products from the Advisor using the discounts she has earned, how is the Tennessee sales tax computed?
2. When the Taxpayer sells sample products to an Advisor who uses an award product certificate, how is the Tennessee sales tax computed?

RULINGS

1. The Tennessee sales tax is based on the price paid by the Hostess, *i.e.*, the retail price minus any discounts. However, the [DOLLAR AMOUNT] paid by the Hostess for an additional twenty percent discount is subject to the sales tax as part of the sales price of the merchandise that she purchases using the discount.
2. The Tennessee sales tax is based on the price paid by the Advisor, *i.e.*, the wholesale price minus the value of the certificate.

ANALYSIS

Retail sales of tangible personal property and specifically enumerated services in Tennessee are subject to sales and use tax under TENN. CODE ANN. § 67-6-101 *et seq.* Specifically, TENN. CODE ANN. § 67-6-202(a) (Supp. 2010) imposes the sales tax on the sales price of each article of tangible personal property that is sold at retail in Tennessee. TENN. CODE ANN. § 67-6-102(79) (Supp. 2010) defines a “retail sale” as any “sale, lease, or rental for any purpose other than for resale, sublease or subrent.” The term “sale” is defined under the Tennessee sales and use tax

laws in part as “any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration.”¹ TENN. CODE ANN. § 67-6-102(81)(A).²

“Sales price” is defined in TENN. CODE ANN. § 67-6-102(82)(A) as “the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise.” However, TENN. CODE ANN. § 67-6-102(82)(B)(i) excludes from the sales price “[d]iscounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale.”

1. Sales tax on discounted purchases by a Hostess

The Tennessee sales tax owed on the discounted purchases by a Hostess is based on the price paid by the Hostess, *i.e.*, the retail price minus any discounts.

An Advisor, when selling products to a consumer, sells the products at the retail price. As an incentive for hosting a party to showcase the Taxpayer’s products, a Hostess can earn discounts off her own purchase of the products. The Hostess is charged the retail price minus the applicable discount that she receives. As noted above, TENN. CODE ANN. § 67-6-202(a) imposes the sales tax on the “sales price” of each article of tangible personal property that is sold at retail in Tennessee. “Sales price” is defined in TENN. CODE ANN. § 67-6-102(82)(A) as “the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise.” However, TENN. CODE ANN. § 67-6-102(82)(B)(i) excludes from the sales price “discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale.” TENN. COMP. R. & REGS. 1320-5-1-.12 (2008) (“Rule 12”), further clarifying this principle, provides in pertinent part that “[t]he selling price of an article of tangible personal property ... does not include the amount of bona fide cash discounts actually taken by the buyer.” Therefore, the sales price of an item that the Hostess purchases at a discount is the retail price minus the discount.

However, in addition to the given discounts, the Hostess also has an option to pay [DOLLAR AMOUNT] to receive an additional [PERCENTAGE] discount off her purchases made at the party she is hosting. Because the Hostess must use the discount immediately, the [DOLLAR AMOUNT] the Hostess pays for the additional discount is subject to the sales tax as part of the total consideration for the merchandise she purchases with the discount.

¹ TENN. CODE ANN. § 67-6-102(92)(A) defines “tangible personal property” as “personal property that can be seen, weighed, measured, felt, or touched.”

² TENN. CODE ANN. § 67-6-102(78) mandates that all sales for resale be in strict compliance with the rules and regulations. TENN. COMP. R. & REGS. 1320-5-1-.68(2) (2008) (“Rule 68”) provides that “[a]ll sales for resale which are not supported by resale certificates properly executed shall be deemed retail sales, and the dealer held liable for the tax.”

The purpose of the [DOLLAR AMOUNT] payment is to bestow on the Hostess an immediate benefit that must be applied to her concurrent purchases. The [DOLLAR AMOUNT] payment can be contrasted with the purchase of a discount membership card in *Barnes & Noble Superstores, Inc. v. Huddleston*, No. 01A01-9604-CH-001491996, 1996 WL 596955 (Tenn. Ct. App. Oct. 18, 1996). In *Barnes & Noble*, the court held that the taxpayer's sale of cards that entitled its customers to a discount on subsequent purchases of merchandise was not subject to the Tennessee sales tax. The court rejected the state's argument that the purchase of a discount card was the prepayment of merchandise for the sole reason that a purchaser of the card was not obligated to purchase any merchandise. *Id* at 2. The court stated that the "true object" of the discount card transaction was to bestow upon a customer the intangible right to receive a discount on a possible future purchase. *Id*.

Unlike the intangible right to receive a discount on future purchases that the cardholders in *Barnes & Noble* received with the purchase of a discount card, the additional [PERCENTAGE OF] discount that a Hostess receives upon payment of [DOLLAR AMOUNT] must be used immediately. If the Hostess pays the [DOLLAR AMOUNT] but does not make an immediate purchase, the discount is lost. Thus, unlike in *Barnes & Noble*, no intangible right to a future discount is conveyed to the Hostess. Additionally, it is reasonable to assume that a Hostess would not pay the [DOLLAR AMOUNT] without making an immediate purchase. The [DOLLAR AMOUNT] payment is therefore made in conjunction with an actual, immediate sales transaction and thus becomes part of the consideration paid in that transaction. Because the [DOLLAR AMOUNT] payment is part of the sales transaction for purchases that the Hostess makes for which she will receive the additional [PERCENTAGE] discount, it is therefore part of the total consideration for such purchases. Accordingly, the [DOLLAR AMOUNT] is part of the sales price of the purchased merchandise and as such is subject to the sales and use tax.³

2. Sales tax on discounted purchases of samples by an Advisor

The Tennessee sales tax owed on the discounted purchases of samples by an Advisor is based on the amount paid by the Advisor, *i.e.*, the original price minus the value of the award product certificate.

The award product certificate awarded to an Advisor who meets certain goals qualifies as a discount under TENN. CODE ANN. § 67-6-102(82)(B)(i) in the same manner as the discounts discussed in Analysis #1. Accordingly, the sales tax on purchases made by an Advisor purchasing with an award product certificate would be computed based on the total amount paid by the Advisor, *i.e.*, the original price minus the value of the certificate. TENN. CODE ANN. § 67-6-202(a).

³ Note that under the facts provided, the Taxpayer indicates that it has entered into a special written agreement with the Department whereby it collects and remits the sales tax on behalf of the Advisors. Pursuant to this agreement, the Advisors do not register to collect sales tax in Tennessee; rather, the Taxpayer essentially pre-collects the sales tax on the sales transactions. In the absence of such an agreement, the Advisors making sales in Tennessee would be required to collect and remit the applicable tax on sales to consumers in this state.

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