

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 16-06**

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. 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 the Tennessee sales and use tax to the fabrication of tangible personal property and the provision of technical support and warranty support services.

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] (the "Taxpayer") is a Tennessee [REDACTED – ENTITY] that assembles and supports [REDACTED – PRODUCTS]. The Taxpayer contracts with [REDACTED – SELLER], a [REDACTED]

company that sells [REDACTED – PRODUCTS], as [REDACTED – SELLER’S] North American assembly and support partner.

To fulfill its sales obligations to customers in the United States and Canada, [REDACTED – SELLER] ships the necessary parts for assembling (the “Assembly Stock”) its [REDACTED – PRODUCTS] to the Taxpayer at no cost. The Taxpayer assembles the parts into functioning [REDACTED – PRODUCTS] and tests and packages the [REDACTED – PRODUCTS] on [REDACTED – SELLER’S] behalf. [REDACTED – SELLER] retains title to both the Assembly Stock and the [REDACTED – PRODUCTS]. The Taxpayer occasionally purchases its own parts or packaging from a third party and uses those items instead of the parts and packaging supplied by [REDACTED – SELLER]. The Taxpayer bills [REDACTED – SELLER] for those additional items either at cost or with the addition of a markup (the “Materials Fees”), depending on the circumstances.

After the Taxpayer assembles and packages the [REDACTED – PRODUCTS], it ships the [REDACTED – PRODUCTS] directly to [REDACTED – SELLER’S] North American customers, who are both end-users and resellers. The Taxpayer charges [REDACTED – SELLER] a flat fee for each the [REDACTED – PRODUCT] it assembles as compensation for these services.¹ The Taxpayer charges [REDACTED – SELLER] for the costs incurred to ship the assembled [REDACTED – PRODUCTS] to [REDACTED – SELLER’S], plus either a per-unit flat fee or a percentage markup on the fees (the “Shipping Fees”), depending on the nature of the shipment.

The Taxpayer contracts with [REDACTED – SELLER] to provide lifetime technical support to [REDACTED – SELLER’S] end-customers in its United States market. Technical support involves the Taxpayer communicating with the end-customers through various channels, such as online chat, telephone calls, web-based forms, and e-mail. The Taxpayer charges [REDACTED – SELLER] a flat fee for every [REDACTED – PRODUCT] that the Taxpayer is obligated to support, which may include [REDACTED – PRODUCTS] that the Taxpayer did not itself assemble.

The Taxpayer further contracts with [REDACTED – SELLER] to provide warranty support as part of [REDACTED – SELLER’S] manufacturer’s limited, one-year warranty on its [REDACTED – PRODUCTS]. If a support incident requires the provision of spare parts under warranty, the Taxpayer sends those parts to the end-customer on [REDACTED – SELLER’S] behalf. To this end, the Taxpayer maintains a separate stock of spare parts for fulfilling warranty obligations (the “Warranty Stock”) that [REDACTED – SELLER] provides to the Taxpayer at no cost. Alternatively, if a [REDACTED – PRODUCT] under warranty needs repair, the end-customer sends the [REDACTED – PRODUCT] to the Taxpayer’s factory. The Taxpayer evaluates, repairs, and tests the [REDACTED – PRODUCT] as necessary and sends the repaired [REDACTED – PRODUCT] back to the end-customer. The Taxpayer charges [REDACTED – SELLER] a flat fee for every [REDACTED – SELLER] [REDACTED – PRODUCT] in the United States market for which the Taxpayer is contracted to support. The Taxpayer also charges [REDACTED – SELLER] for shipping costs, plus a percentage markup on its shipping costs associated with this support.

¹ The Taxpayer invoices [REDACTED – SELLER] at the start of the assembly, when the parts are received, and again when the work is completed.

RULINGS

1. Are the fees that the Taxpayer charges for assembling [REDACTED – SELLER’S] [REDACTED – PRODUCTS], including any Shipping Fees and any Materials Fees, subject to the Tennessee sales and use tax?

Ruling: Under TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2015) a taxable sale includes charges for fabrication of tangible personal property for consumers who furnish materials used in fabrication work. Thus, when the Taxpayer drop ships [REDACTED – PRODUCT] that it fabricates to an [REDACTED – SELLER] customer located inside of Tennessee, the Taxpayer is required to collect and remit Tennessee sales and use tax on its fee for assembling the [REDACTED – PRODUCT] as well as any associated Materials Fees and Shipping Fees as part of the sales price of a [REDACTED – PRODUCT] unless [REDACTED – SELLER] provides to the Taxpayer a valid resale and/or exemption certificate in accordance with TENN. COMP. R. & REGS. 1320-5-1-.68 (2008) and 1320-5-1-.96 (1974), as more fully described in the Analysis section below.

2. Are the fees that the Taxpayer charges [REDACTED – SELLER] for technical support subject to the Tennessee sales and use tax?

Ruling: No, technical support is not a specifically enumerated taxable service under Tennessee law.

3. Are the fees that the Taxpayer charges [REDACTED – SELLER] to provide warranty support to end-users of [REDACTED – SELLER’S] [REDACTED – PRODUCTS] in the United States, including any associated shipping fees, subject to the Tennessee sales and use tax?

Ruling: Generally, the fees for providing warranty support are subject to the Tennessee sales and use tax as the sale of a warranty or service contract if the fees meet one of the criteria under TENN. CODE ANN. § 67-6-208 (Supp. 2015). Any associated shipping fees are part of the sale price of the contract. However, if [REDACTED – SELLER] provides the Taxpayer with a properly completed resale certificate, any fees that are otherwise subject to tax as the sale of a warranty or service contract in Tennessee, including any associated shipping fees, are exempt from the Tennessee sales and use tax as the sale of a warranty or service contract for resale.

ANALYSIS

1. CHARGES FOR FABRICATION OF TANGIBLE PERSONAL PROPERTY, INCLUDING SHIPPING FEES AND MATERIALS FEES

Fabrication

Under the Retailers’ Sales Tax Act,² the retail sale in Tennessee of tangible personal property is subject to the sales and use tax. TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2015) defines the term

² Tennessee Retailers’ Sales Tax Act, ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts Ch. 22, 22-54 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2013 & Supp. 2015)).

“sale,” in pertinent part, to mean “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, and includes the fabrication of tangible personal property for consumers who furnish, either directly or indirectly, the materials used in fabrication work.”³ TENN. COMP. R. & REG. 1320-5-1-.41 (1983) adds that “[w]here persons contract to fabricate articles of tangible personal property from materials selected or furnished by customers, the total proceeds from the sale are subject to the Sales or Use Tax.” The term “fabricate” is not defined by the Tennessee Code or the Tennessee courts for Tennessee sales and use tax purposes, so it must be given its natural and ordinary meaning.⁴ A common definition of the term “fabricate” is “to construct from diverse and usually standardized parts.”⁵

For a sale to be subject to Tennessee sales and use tax, the sale must be made “in this state.”⁶ As previously stated, with regard to tangible personal property, a sale takes place upon the transfer of title or possession, or both of tangible personal property.⁷

Sales for resale are not subject to Tennessee sales and use tax.⁸ The term “sale for resale” means “the sale of property, services, or taxable item intended for subsequent resale by the purchaser.”⁹ Any sale for resale must be in strict compliance with the rules and regulations promulgated by the Commissioner.¹⁰ TENN. COMP. R. & REGS. 1320-5-1-.68 (2008) (“Rule 68”) requires that any sale for resale must be supported by a valid resale certificate. TENN. COMP. R. & REGS. 1320-5-1-.29 (1974) (“Rule 29”) provides that a foreign dealer may present a valid resale certificate showing that the dealer is located outside of Tennessee and would be entitled to purchase the property on a Tennessee resale certificate if the dealer were located in Tennessee.¹¹ However, when the property is sold to a foreign dealer for resale, but drop shipped to the foreign dealer’s customer who is a user and consumer in Tennessee, TENN. COMP. R. & REGS. 1320-5-1-.96 (1974) (“Rule 96”) adds certain additional requirements:

³ TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2015).

⁴ The Tennessee Supreme Court has stated that when a statute does not define a term, it is proper to look to common usage to determine the term's meaning. *See, e.g., Beare Co. v. Tenn. Dep't of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993); *see also Tenn. Farmers Assurance Co. v. Chumley*, 197 S.W.3d 767, 782-83 (Tenn. Ct. App. 2006).

⁵ MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 447 (11th ed. 2007).

⁶ *See* TENN. CODE ANN. §§ 67-6-201, -202 (2013).

⁷ TENN. CODE ANN. § 67-6-102(78)(A)

⁸ *See* TENN. CODE ANN. §§ 67-6-202(a) (providing that “retail sales” in this state are subject to tax) and 67-6-102(78) (defining “retail sale” as “any sale, lease, or rental for any purpose other than for resale, sublease, or subrent”).

⁹ TENN. CODE ANN. § 67-6-102(75)(A).

¹⁰ *Id.*; *see also Upper East Tennessee Distributing v. Johnson*, No. 03A01-9701-CH-00011, 1997 WL 243503 (Tenn. Ct. App. May 13, 1997) *perm. app. denied*.

¹¹ Rule 29 provides, in pertinent part:

(2) Bona fide dealers outside the State of Tennessee, who make purchases of tangible personal property or taxable services in this State which would otherwise be subject to the provisions of the Sales and Use Tax Law, may make purchases of items or services which they normally sell free of the Sales Tax, provided such a dealer will furnish his vendor in this State with a valid certificate of resale showing that he is a dealer located out of this State and would be entitled to purchase such property upon a resale certificate if he were a dealer in this State.

[S]ales of tangible personal property or taxable services made by a dealer to an out-of-state vendor who directs that the dealer act as his (the out-of-state vendor) agent to deliver or ship tangible personal property or taxable services to his (the out-of-state vendor) customer, who is a user or consumer, are subject to the Sales or Use Tax. The dealer so acting as agent for the out-of-state vendor must collect the tax involved on the transaction unless the transaction comes within the conditions indicated herein.

In summary, Rule 68 requires that any sale for resale be supported by a valid resale certificate issued by the purchasing dealer to the supplier. Under Rule 29, ordinarily a foreign dealer may present a valid foreign resale certificate showing that it is a dealer located outside Tennessee and would be entitled to purchase the property on a Tennessee resale certificate if it were a dealer in this state. However when the property is sold to a foreign dealer for resale, but drop shipped to the foreign dealer's customer who is a user and consumer in Tennessee, Rule 96 adds certain additional requirements.

The Taxpayer in this case contracts with [REDACTED – SELLER] to assemble [REDACTED – PRODUCTS] from standardized parts provided by [REDACTED – SELLER]. This transaction constitutes the sale of tangible personal property because as set forth in the definition of a sale in TENN. CODE ANN. § 67-6-102(78)(A), the Taxpayer fabricates tangible personal property from parts furnished by its customer.

Pursuant to the terms of the Taxpayer's contract with [REDACTED – SELLER], title to the Assembly Stock and the assembled [REDACTED – PRODUCTS] never transfers from [REDACTED – SELLER] to the Taxpayer, so the Taxpayer's sales to [REDACTED – SELLER] are "in this state" only to the extent possession passes in Tennessee. Possession of a [REDACTED – PRODUCT] does not transfer in Tennessee on sales in which [REDACTED – SELLER] directs the Taxpayer to ship the [REDACTED – PRODUCTS] outside of Tennessee; however, possession does transfer in Tennessee for sales in which the Taxpayer drop ships the [REDACTED – PRODUCTS] to [REDACTED – SELLER'S] customers located in Tennessee. For these Tennessee sales, if [REDACTED – SELLER] provides the Taxpayer with proper documentation in accordance with Rules 68 and 96, such sales are exempt from the Tennessee sales and use tax.

Thus, if the Taxpayer drop ships the [REDACTED – PRODUCTS] to an [REDACTED – SELLER] customer who is an end user and consumer in Tennessee, unless [REDACTED – SELLER] presents a valid Tennessee resale certificate, the Taxpayer is required to collect and remit tax on its sales to [REDACTED – SELLER]. If [REDACTED – SELLER'S] customer is the end user and consumer of the property but has a valid Tennessee sales and use tax exemption, such as a non-profit or other type of entity or use-based exemption, the Taxpayer may accept [REDACTED – SELLER'S] foreign resale certificate and a copy of its customer's Tennessee exemption certificate. On the other hand, if the Taxpayer drop ships to an [REDACTED – SELLER] customer who is a reseller of the property, the Taxpayer may accept [REDACTED – SELLER'S] foreign resale certificate and a copy of its customer's Tennessee resale certificate to document the third party drop shipment as a sale for resale.

Sales Price

TENN. CODE ANN. § 67-6-202(a) (2013) imposes the sales tax on the sales price of each article of tangible personal property sold at retail in Tennessee. The term “sales price” means “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,” without any deduction for the cost of materials used or delivery charges regardless of whether those charges are separately billed.¹²

Thus, when the Taxpayer fabricates and ships the [REDACTED – PRODUCTS] to [REDACTED – SELLER’S] Tennessee customers and those sales are not properly exempt from Tennessee sales and use tax as stated above, the taxable sales price of the [REDACTED – PRODUCTS] includes the Taxpayer’s fee for assembling the [REDACTED – PRODUCTS], as well as associated Materials Fees and Shipping Fees.

2. TECHNICAL SUPPORT

In addition to the transfer of tangible personal property, the term “sale” also includes “the furnishing of any of the things or services” taxable under the Retailers’ Sales Tax Act.¹³ The Tennessee sales and use tax applies to retail sales of services specifically enumerated in the Retailers’ Sales Tax Act.¹⁴

[REDACTED – SELLER] provides lifetime technical support to its customers and contracts with the Taxpayer to provide these support services, which include communicating with customers through various channels, such as online chat, telephone calls, web-based forms, and e-mail. The Taxpayer charges [REDACTED – SELLER] a flat fee for every [REDACTED – PRODUCT] that the Taxpayer is obligated to support. The Taxpayer’s technical support services are not specifically enumerated taxable services pursuant to Tennessee law. Accordingly, the fees the Taxpayer charges [REDACTED – SELLER] for its technical support services are not subject to Tennessee sales and use tax.

3. WARRANTY SERVICE CONTRACT, INCLUDING WARRANTY SERVICE CONTRACT SHIPPING FEES

Pursuant to TENN. CODE ANN. § 67-6-208(a) (Supp. 2015), the retail sale of, use of, or subscription to a warranty or service contract is subject to the Tennessee sales and use tax. A warranty or service contract covering the repair or maintenance of tangible personal property is subject to Tennessee sales and use tax when (1) the contract is sold in connection with the sale of tangible personal property that is subject to the Tennessee sales and use tax, (2) the contract applies to tangible personal property located in Tennessee, or (3) the location of the tangible personal property covered by the contract is unknown but the purchaser’s residential street address or primary business address is in Tennessee.¹⁵

¹² TENN. CODE ANN. § 67-6-102(79)(A)(ii) and (iv). Tenn. Code Ann. § 67-1-102(25)(A) defines delivery charges as “charges by the seller of personal property or services, including, but not limited to, transportation, shipping, postage, handling, crating, and packaging.”

¹³ TENN. CODE ANN. § 67-6-102(78)(C).

¹⁴ The Retailers’ Sales Tax Act imposes the sales tax only on services specifically enumerated in the Act. *See, e.g.*, TENN. CODE ANN. § 67-6-205 (2013); *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Ryder Truck Rental, Inc. v. Huddleston*, No. 91-3382-III, 1994 WL 420911, at *3 (Tenn. Ct. App. Aug. 12, 1994) (providing that sales tax does not apply to all services; rather, it only applies to retail sales of services specifically enumerated by the statute).

¹⁵ TENN. CODE ANN. § 67-6-208(c).

Here, the Taxpayer is selling a warranty or service contract to [REDACTED – SELLER] when it contracts with [REDACTED – SELLER] to repair the [REDACTED – PRODUCTS] or send parts to end users of the [REDACTED – PRODUCTS] in the United States and charges [REDACTED – SELLER] a flat fee for every [REDACTED – SELLER] [REDACTED – PRODUCT] in the United States that it agrees to support. The fees that the Taxpayer charges [REDACTED – SELLER] to [REDACTED – PRODUCTS] and parts are part of the sales price of the warranty or service contract that the Taxpayer sells.¹⁶ [REDACTED – SELLER] provides the same warranty or service contract to its customers as a manufacturer's limited, one-year warranty when it sells the [REDACTED – PRODUCTS]. Thus, when [REDACTED – SELLER] purchases the warranty or service contract from the Taxpayer, it makes such purchase for resale. Therefore, if [REDACTED – SELLER] provides the Taxpayer with a valid Tennessee or foreign resale certificate pursuant to Rule 68 and Rule 29, the flat fee that [REDACTED – SELLER] pays the Taxpayer to support its [REDACTED – PRODUCTS] in the United States, as well as any associated shipping fees, are not subject to the Tennessee sales and use tax.¹⁷

Grant Marshall
Assistant General Counsel

APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: August 30, 2016

¹⁶ See *supra* note 12 and accompanying text.

¹⁷ See *supra* notes 8-11 and accompanying text.