

TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 18-08

**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**

The application of Tennessee sales and use tax to gift cards imported into Tennessee and distributed both inside and outside of the State.

**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 company. The rulings herein are binding upon the Department, and are applicable only to the individual company 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 company 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 company directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the company's detriment.

**FACTS**

[TAXPAYER] (the "Taxpayer") is the wholly-owned subsidiary of [COMPANY]. The Taxpayer oversees the acquisition and distribution of gift cards for all [PARENT COMPANY] restaurants, including [AFFILIATED RESTAURANTS] (the "Affiliated Restaurants").

The Taxpayer purchases gift cards and related services from an out-of-state third-party vendor (the "Vendor"). The price paid by the Taxpayer to the Vendor for the gift cards depends on various factors, such as the type of gift card stock purchased, the design of the gift cards, and the volume of the gift cards purchased. The Vendor ships the gift cards to an unrelated third-party distribution facility in Tennessee, where they are stored in a warehouse until being shipped to Affiliated Restaurants and third-party retailers located throughout the United States.

The Taxpayer and the Vendor have entered into a contract regarding shipment. Under the terms of the contract, the gift cards are shipped FOB Shipping Point and the freight charges are passed through to the Taxpayer at the invoice amount. Thus, title to the gift cards passes outside of Tennessee. The Taxpayer retains title to the gift cards until the gift cards are purchased by the ultimate consumer. Gift cards are sold to consumers with specific dollar amounts loaded on the cards for use in purchasing food and beverages at the Affiliated Restaurants throughout the United States. Consumers may choose among a variety of gift card options based on design of the card or the special occasion represented on the gift card.

## **RULINGS**

1. Is the Taxpayer liable for Tennessee sales and use tax on gift cards that are imported into Tennessee, temporarily stored in a third-party distribution facility, and later distributed to locations outside of Tennessee?

Ruling: No. The Taxpayer is not liable for the Tennessee sales and use tax on gift cards that are imported into Tennessee, temporarily stored in a third-party distribution facility, and later distributed to locations outside of Tennessee because such gift cards are not subject to the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-313(a) (2018).

2. Do the Taxpayer's purchases of gift cards from the Vendor that are imported into Tennessee, temporarily stored in a third-party distribution facility, and later distributed to locations within Tennessee, qualify as sales for resale?

Ruling: No. The Taxpayer is subject to Tennessee sales and use tax on gift cards that are imported into Tennessee, temporarily stored in a third-party distribution facility, and later distributed to locations within Tennessee. These sales do not qualify as sales for resale because the Taxpayer uses the gift cards as a means to transfer an intangible right to the ultimate consumer.

## **ANALYSIS**

### **IMPORT-FOR-EXPORT**

Under the Retailers' Sales Tax Act,<sup>1</sup> the retail sale or use of tangible personal property and specifically enumerated services are subject to the sales and use tax, unless an exemption applies. "Retail sale" is defined as "any sale, lease, or rental for any purpose other than for resale, sublease, or subrent."<sup>2</sup>

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<sup>1</sup> Tennessee Retailers' Sales Tax Act, ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts 22, 22-54 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2018)).

<sup>2</sup> TENN. CODE ANN. § 67-6-102(76) (2018).

TENN. CODE ANN. § 67-6-102(78)(A) (2018) defines “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.”

TENN. CODE ANN. § 67-6-203(a) (2018) levies a tax on tangible personal property that is “used, consumed, distributed, or stored for use or consumption in this state.” Although “use” is defined broadly to include “the exercise of any right or power over tangible personal property incident to the ownership thereof,”<sup>3</sup> TENN. CODE ANN. § 67-6-313(a) confirms that “[i]t is not the intention of this chapter to levy a tax upon articles of tangible personal property imported into this state or produced or manufactured in this state for export.”

The Taxpayer purchases gift cards in bulk from a Vendor outside of Tennessee. Title to the gift cards passes outside of Tennessee. The gift cards are then shipped to an unrelated third-party distribution facility in Tennessee where they are temporarily stored and later shipped to the Affiliated Restaurants and third-party retailers. The gift cards that are subsequently distributed outside of Tennessee are not subject to Tennessee sales and use tax under TENN. CODE ANN. § 67-6-313(a) because they are imported into Tennessee for export.<sup>4</sup>

#### **SALE FOR RESALE**

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.<sup>5</sup> “Tangible personal property” includes “property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses.”<sup>6</sup> Conversely, the sale of an intangible right, even if embodied in tangible personal property, is generally not subject to the Tennessee sales and use tax.<sup>7</sup>

The term “retail sale” means “any sale, lease, or rental for any purpose *other than for resale*, sublease, or subrent.”<sup>8</sup> Thus, sales for resale are not subject to the Tennessee sales and use tax. TENN. CODE ANN. § 67-6-102(75) defines a “sale for resale” as “the sale of the property, services, or taxable item intended for subsequent resale by the purchaser” and requires any sales for resale to be “in strict compliance with rules and regulations promulgated by the commissioner.” The term “resale” means “a subsequent, bona fide sale of the property, services, or taxable item by the purchaser,”<sup>9</sup> and only applies when sold to “legitimate dealers actually selling such property or services as such.”<sup>10</sup>

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<sup>3</sup> TENN. CODE ANN. § 67-6-102(94)(A).

<sup>4</sup> TENN. CODE ANN. § 67-6-313(a) (2018).

<sup>5</sup> TENN. CODE ANN. § 67-6-102(78)(A).

<sup>6</sup> TENN. CODE ANN. § 67-6-102(89)(A).

<sup>7</sup> See generally *Barnes & Noble Superstores, Inc. v. Huddleston*, No. 01A01-9604-CH-00149, 1996 WL 596955, at \*2 (Tenn. Ct. App. Oct. 18, 1996).

<sup>8</sup> TENN. CODE ANN. § 67-6-102(76) (emphasis added).

<sup>9</sup> TENN. CODE ANN. § 67-6-102(75)(A).

<sup>10</sup> TENN. COMP. R & REGS. 1320-05-01-.62(1) (2016).

Not all transactions readily lend themselves to classification for sales tax purposes. In order to resolve the tension in these difficult transactions, Tennessee courts have developed a line of inquiry that focuses on what is the “true object”<sup>11</sup> of the transaction.<sup>12</sup> In applying this test, the courts look at the totality of the facts and circumstances<sup>13</sup> to determine what objective is really being accomplished by the transaction.<sup>14</sup>

When a transaction involves taxable and nontaxable components and the transaction’s true object or a “crucial,”<sup>15</sup> “essential,”<sup>16</sup> “necessary,”<sup>17</sup> “consequential,”<sup>18</sup> or “integral”<sup>19</sup> element of the transaction is subject to tax, the entire transaction is subject to sales tax.<sup>20</sup> Only if the true object of the transaction is not independently subject to sales tax and the items that would be subject to sales tax are “merely incidental” to the true object of the transaction will the transaction not be subject to sales tax.<sup>21</sup>

Transfers of tangible personal property in association with a sale of intangible property raise characterization issues because intangible property rights are generally not subject to sales tax in Tennessee. For example, in the unreported case of *Barnes & Noble Superstores, Inc. v. Huddleston*,<sup>22</sup> the

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<sup>11</sup> This inquiry is sometimes stated as the “primary purpose” test. See generally *Qualcomm, Inc. v. Chumley*, No. M2006-01398-COA-R3-CV, 2007 WL 2827513, at \*4-5 (Tenn. Ct. App. Sept. 26, 2007) (giving a synopsis of the “true object” or “primary purpose” test in Tennessee).

<sup>12</sup> This analysis is not entirely unique to Tennessee, but the application of the test does vary in other states. See generally 2 JEROME HELLERSTEIN ET AL., *STATE TAXATION: SALES AND USE, PERSONAL INCOME, AND DEATH AND GIFT TAXES AND INTERGOVERNMENTAL IMMUNITIES* ¶ 12.08[1], at 12-108 (3d ed. 1998 & Supp. 2012) (discussing the “true object” test).

<sup>13</sup> See, e.g., *AOL, Inc. v. Roberts*, No. M2012-01937-COA-R3-CV, 2013 WL 4067977, at \*6 (Tenn. Ct. App. Aug. 12, 2013) (basing the holding on the “totality of the circumstances”).

<sup>14</sup> Note that it could be possible that there is not a single true object of the transaction, but rather multiple objects of the transaction. In that case, each object of the transaction should be analyzed separately for tax purposes. Cf. *Penske Truck Leasing Co. v. Huddleston*, 795 S.W.2d 669, 670-71 (Tenn. 1990) (holding that a long-term truck lease agreement and a fuel agreement were truly separate agreements and should be treated as separate transactions for sales tax purposes, despite being embodied in a single contract document).

<sup>15</sup> See, e.g., *Thomas Nelson, Inc. v. Olsen*, 723 S.W.2d 621, 624 (Tenn. 1987) (holding that a transaction involving the sale of non-taxable intangible advertising concepts was nevertheless subject to sales tax on the entire amount of the transaction because advertising models, which were tangible personal property, were an “essential,” “crucial,” and “necessary” element of the transaction).

<sup>16</sup> *Id.*; see also *AT&T Corp. v. Johnson*, No. M2000-01407-COA-R3-CV, 2002 WL 31247083, at \*8 (Tenn. Ct. App. Oct. 8, 2002) (holding that a transaction involving the sale of engineering services along with separately itemized tangible telecommunications systems was subject to sales tax on the entire amount of the contract because “equipment, engineering, and installation combine in this instance to produce BellSouth’s desired result: a functioning item of tangible personal property assembled on the customer’s premises,” and further describing the engineering services as “essential” and “integral” to the sale of tangible personal property).

<sup>17</sup> See *supra* note 16.

<sup>18</sup> See *Rivergate Toyota, Inc. v. Huddleston*, No. 01A01-9602-CH-00053, 1998 WL 83720, at \*4 (Tenn. Ct. App. Feb. 27, 1998) (holding that a transaction involving the commission and distribution of advertising brochures was subject to sales tax on the “entire cost of the transaction” because, although the transaction involved a number of services, the brochures themselves “were not inconsequential elements of the transaction but, in fact, were the sole purpose of the contract”).

<sup>19</sup> See *AT&T Corp. v. Johnson*, 2002 WL 31247083, at \*8.

<sup>20</sup> See Tenn. Dept. of Rev. Ltr. Rul. 14-10 (Oct. 14, 2014) (discussing Tennessee law regarding the “true object” test).

<sup>21</sup> See generally *id.*

<sup>22</sup> No. 01A01-9604-CH-00149, 1996 WL 596955, at \*2 (Tenn. Ct. App. Oct. 18, 1996).

Tennessee Court of Appeals held that the sale of a discount card that entitled its bearer to future discounts on merchandise was not subject to sales tax because, even though tangible personal property in the form of the discount card was transferred to the customer, the true object of the transaction was really the purchase of an “intangible right”<sup>23</sup> that was not subject to sales tax.

Like the membership cards in *Barnes & Noble Superstores*, the “true object” of the Taxpayer’s sale of gift cards is not the physical gift card itself, but rather the intangible value the gift card contains. The fact that consumers can choose between various designs on the gift cards does not place an independent value on the actual cards themselves. The underlying value of a gift card is the right to redeem it for food and/or beverages at some future time. Thus, the sales of such intangible rights are not subject to the sales and use tax.

Here, the Taxpayer does not purchase the tangible cards from the Vendor to resell as such. Rather, the Taxpayer uses the gift cards as a means to transfer an intangible right to the ultimate consumer for a future purchase of food and/or beverages. Accordingly, the Taxpayer is subject to Tennessee sales and use tax on gift cards that are imported into Tennessee, temporarily stored in a third-party distribution facility, and later distributed to Affiliated Restaurants and third-party retailers in Tennessee; its transfers to Affiliated Restaurants and third-party retailers in Tennessee do not qualify as sales for resale.

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Commissioner of Revenue

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<sup>23</sup> *Id.*