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## Chapter 4: Determining Gross Sales

### Gross Sales

The business tax is based on a business's gross taxable sales (also referred to as "gross receipts") per location. A business's gross sales are comprised of all the business location's sales without any deduction whatsoever of any kind or character, unless specifically provided by Tennessee law.<sup>1</sup> Gross sales are multiplied by the appropriate state and local tax rate to calculate the amount of tax owed per location.

Generally, all sales of tangible personal property and services made in Tennessee will be subject to business tax. However, there are several specified exemptions and deductions. For more information on exemptions, see Chapter 8 of this Manual. For information on deductions, please see Chapter 9 of this Manual.

### Taxable Sales

Sales include the furnishing of any things or services taxable under the Business Tax Act.<sup>2</sup> To qualify as a sale for business tax purposes, there must be a transfer of title and/or possession in exchange for consideration.<sup>3</sup>

Qualifying transfers may include:

- Exchanges;
- Barters;
- Leases or rentals;
- Conditional transfers;
- Fabrication where raw materials are furnished by the purchaser;
- Furnishing, repairing, or servicing tangible personal property consumed on the premises of the person furnishing, repairing, or servicing the tangible personal property; and

- Transfers of possession of tangible personal property where the seller retains title as security for payment of the price.

Taxable sales **do not** include:

- Sales specifically exempt or excluded under the Business Tax Act (see Chapter 8 for more information on specific exemptions and exclusions).
- Casual and isolated sales by persons who are not engaged in the business of selling tangible personal property or furnishing any services subject to business tax.<sup>4</sup>
- Sales of tangible personal property or services not normally sold by a wholesaler to a retailer if property has been used by the wholesaler prior to sale.<sup>5</sup>
- Transfers of tangible personal property from one wholesaler to another wholesaler or from one retailer to another retailer where the amount paid by the transferee to the transferor does not exceed the transferor's cost including freight in and storage costs, and transportation costs incurred in the transfer from the transferor to the transferee.<sup>6</sup>

## **1. Casual and Isolated Sales**

As mentioned above, casual and isolated sales are not subject to business tax. For business tax purposes, a sale is considered casual and isolated when the sale is made by persons who are not engaged in the business of selling tangible personal property or furnishing services subject to business tax.

A sale is not considered a casual and isolated sale if the sale is of tangible personal property or taxable services and:

- Purchased for resale by persons who hold themselves out as engaged in business although sales may be few and infrequent;

- Sold for use or consumption by a manufacturer, processor, wholesaler, or jobber engaged in the business of distributing personal property or furnishing services subject to business tax;
- Sold by persons regularly engaging in sales of tangible personal property at antique malls, antique shows, flea markets, craft shows, gun shows, and auto shows; or
- Sold regularly by gun shows, antique shows, craft shows, auto shows, flea markets, or antique malls themselves.<sup>7</sup>

In *Hermitage Memorial Gardens Mausoleum and Memorial Chapel, Inc. v. Dunn*, 541 S.W.2d 147 (1976), the Tennessee Supreme Court analyzed the business tax liability of a business that operated memorial gardens and cemeteries and derived more than half of its revenue from the sale of burial lots, which is not subject to business tax. The Court held that business tax statute does not limit the incidence of tax to those entities whose dominant business activity is one of the activities enumerated in Tenn. Code Ann. § 67-4-708.<sup>8</sup> Instead, all entities who make sales by engaging in any of the activities enumerated in Tenn. Code Ann. § 67-4-708 are subject to tax regardless of whether their primary business activities are taxable.<sup>9</sup> It concluded that the mausoleum's other sales of tangible personal property and services were taxable and that the mausoleum owed business tax on those sales.<sup>10</sup>

## **2. Sales of Services**

Generally, each person making sales of services is subject to business tax as a Classification 3 taxpayer (see Chapter 5 for an in-depth discussion of Classifications).<sup>11</sup> Services include every activity, function, or work engaged in by a person for profit or monetary gain.<sup>12</sup> Please note, although sales of services are generally subject to business tax, there are 16 categories of services that are exempt from business tax that are discussed further in Chapters 5 and 8 of this Manual.

### *Sales of Services and Tangible Property*

Services do not include sales of tangible personal property.<sup>13</sup> A person exempt from paying the tax on sales from services rendered is still liable for tax on the sales of tangible personal property.<sup>14</sup> Persons engaged in the business of selling tangible personal property are liable for business tax even if they refer to their business transactions as services.<sup>15</sup> For example:

- In *Auto Glass Co. of Memphis v. Gerregano*, the Tennessee Court of Appeals determined a company in the business of selling and installing automotive glass and making repairs to damaged automotive glass should file under Classification 1(B) as a person engaged in making sales of glass, for business tax purposes.<sup>16</sup> Although the majority of the company's sales transactions included glass (tangible personal property) and installation of glass (a service), the Appellate Court determined Classification 1(B) was the correct classification, rather than Classification 3, because the sale of glass, not the installation, was the major source of the company's taxable gross sales.<sup>17</sup>

### *Services for Affiliated Entities*

Services provided to an affiliated business entity **at cost with no markup** are not included in the definition of taxable services.<sup>18</sup> As such, services provided by a taxpayer to an affiliated business entity are excluded from gross sales when calculating business tax.

An affiliated entity is:

- An entity in which the taxpayer has more than a 50% ownership interest;
- An entity that has more than a 50% ownership interest in the taxpayer; or
- An entity in which a second entity has more than a 50% ownership interest in the second entity that has more than a 50% ownership interest in the taxpayer.<sup>19</sup>

### *Sale of a Group of Services*

If exempt services are sold at the same time as taxable services and/or tangible personal property, the otherwise exempt services will only be exempt if they can be purchased separately and are separately itemized on the invoice.

If a group of services is sold together for one lump sum, and the services are not individually sold, the services will be categorized under the Standard Industrial Classification Index of 1972 ("SIC"), including all supplements and amendments that most appropriately describes the group of services as a whole. The most recent amendment to the 1972 SIC was done in 1987, thus the 1987 SIC should be used. For example:

- A company offers a suite of services that includes bookkeeping, payroll, legal, management billing, human resources, and public relations for a lump sum. A customer cannot choose which individual services it will receive. The cost includes all of the services together. Although legal services are exempt, the company's services will most closely fall under SIC Index number 8741, Management Services.

If the SIC does not fall under one of the exempt service categories, then the lump sum for the group of services will be taxable. This is true even if some of the services offered in the group of services would be exempt if sold separately. Therefore, in the example above, because management services are not included in one of the exempt service categories, the lump sum for the suite of services is subject to the business tax.

If services are sold together and cannot be purchased separately, they should be categorized together and only exempted if the entire group falls under one of the exempt service categories.

### *Sales of Software*

For business tax purposes, sales of software are treated as sales of services. Sales of software are not considered sales of intangible (or tangible) personal property.

The Department relies on the SIC Index to evaluate whether a service is exempt from business tax.<sup>20</sup> Generally, the Department also *considers* the SIC Index to determine the Classification of a taxpayer's business activities.

Software creation and subsequent sales of that software are considered sales of services under the SIC Index. The 1987 SIC identifies businesses that provide "Computer Programming, Data Processing, and Other Computer Related Services" (Industry Group No. 737) are part of Major Group 73, "Business Services."<sup>21</sup>

Industries in Group No. 737 include, in pertinent part:

- 7371: Computer Programming Services, such as custom applications software programing, custom computer programs or systems software development, and custom software programming

- 7372: Prepackaged Software, including application software, games, and operating systems
- 7373: Computer Integrated Systems Design, consisting of developing or modifying computer software and packaging or bundling the software with computer hardware to create and market an integrated system

### *Sale of Services to State or Local Governments*

Services provided to Tennessee state and local governments should be classified as retail sales for Tennessee business tax purposes. Wholesale and retail sales of services subject to Tennessee business tax under Classification 3 of Tenn. Code Ann. § 67-4-708 are taxable at different rates. As such, it is important to determine whether a taxpayer's sales of services are wholesale or retail sales under Tennessee's business tax statutes. For example:

- A taxpayer that provides temporary staffing services to various businesses, such as manufacturers and government agencies is classified as a Classification 3 service provider. This taxpayer's sales of staffing services to manufacturers would be classified as wholesale sales, and its sale of staffing services sold to the government agencies would be classified as retail sales.

### **3. Sales of Intangible Personal Property**

Taxpayers who buy and sell intangible personal property or real property as part of their normal business activities are not liable for business tax on these sales.<sup>22</sup>

"Tangible personal property" is defined as "personal property that may be seen, weighed, measured, felt or touched, or is in any other manner perceptible to the senses."<sup>23</sup> The definition specifically excludes "stocks, bonds, notes, insurance or other obligations or securities."<sup>24</sup>

Examples of non-taxable intangibles include:

- Royalties
- Franchise fees

- Broadcast rights
- Licensing of copyrights
- Transfer of virtual currency
- Renewable Identification Numbers ("RINs")<sup>25</sup>

#### **4. Installation Sales**

Charges for the installation of tangible personal property in connection with a sale of tangible personal property are subject to business tax if the property continues to be personal property after installation.<sup>26</sup>

##### *Property Ordinarily Removed*

Personal property is tangible personal property sold and attached to real property but ordinarily removed by the owner or tenant.<sup>27</sup>

- Examples of personal property include:
  - Air conditioning window units;
  - Curtain and drapery rods; and
  - Gasoline pumps and tanks.

The person making the sale of personal property is responsible for the tax regardless of whether the property is installed by the person selling the property or if another person acting on his behalf installs the personal property.<sup>28</sup>

- Tax should be computed based on the dominant business activity of the person making the sale of the personal property.
- Taxpayers making charges for installing personal property apart from the sale of the tangible personal property shall be taxed under Classification 4 of the business tax. For example:



- A taxpayer purchases flooring and the installation of flooring from a home improvement store. The home improvement store subcontracts with individuals to install the flooring. When the home improvement store pays business tax, the store may deduct the amounts paid to the subcontractors. The subcontractors must be licensed, and the home improvement store must provide the Department with the subcontractors' information on Schedule C.

### *Property Not Ordinarily Removed*

Charges made for installing tangible personal property which becomes a part of real property, and which is not ordinarily removed by the owner or tenant, such as plumbing, electrical wiring, etc., are be deemed to be made by a contractor, and the person installing such property should file and pay the business tax as a contractor.

For more information on business tax for contractors, please see Chapter 11 of this Manual.

## **5. Sales to Employees**

Sales to employees are included in gross sales for business tax purposes. If no specific charge was made to the employee, then either the sales price or the cost of the property or service furnished is included in gross sales.<sup>29</sup>

## **6. Installment and Credit Sales**

Taxpayers making conditional, charge, or installment sales must report the total selling price of such sales and pay the appropriate business tax due in the reporting period in which the contracts of sale are entered.<sup>30</sup> See Chapter 9 related to bad debts and repossessions.

## **7. Lay-Away Sales**

Lay-away, lay-by or will-call sales are considered taxable sales for business tax purposes. Lay-away sales should be included in the business tax base for the taxable period in which the delivery of the property is made.<sup>31</sup> If the property is returned to inventory because of nonpayment for the merchandise and any previously made payments are forfeited because

the sale was not completed, the amounts forfeited should be included in the business tax base at that time.<sup>32</sup> For example:

- Store A is a calendar year taxpayer (tax year ends 12/31). Store A makes a layaway sale to a customer in October of 2018 for \$500 worth of merchandise. Store A receives \$100 payments in October, November, and December of 2018 from the customer. The customer makes no more payments, and the merchandise is returned to inventory in March due to nonpayment in March of 2019.
  - The \$300 in payments Store A received should be reported for business tax during the 2019 tax year.

## Sales Price

For business tax purposes, “sales price” is defined as the total amount paid for the tangible personal property or services rendered without any deduction of the cost of property sold, cost of materials used, labor or services costs, or other expenses.<sup>33</sup> Freight, delivery, or other like transportation charges are subject to business tax if title to the property being transported passes to the vendee at the destination point.<sup>34</sup>

### 1. Exclusions

The following items are not included in the sales price *if* they are separated on the taxpayer’s invoice or bill of sale or if they are billed separately to customers:

- Finance charges;
- Carrying charges;
- Time price differential;
- Interest from credit extended on sales of tangible personal property under installment sales contracts, conditional sale contracts, or other contracts providing deferred payments of the purchase price; and<sup>35</sup>

- Other charges where additional consideration is given by the purchaser for the privilege of making deferred payments.<sup>36</sup>

Sales price does not include:

- Advertising costs paid by a seller to an auctioneer for purpose of advertising an auction. These advertising costs are not included in the sales price when no portion of the payment is retained as profit by the auctioneer, and when the payment has been placed in escrow or a trust account by the auctioneers on behalf of the seller.<sup>37</sup>
- Any amount reasonably allocated as a cost of providing a service when services are sold to an affiliated business entity.<sup>38</sup>
- Additional consideration received by a motor dealer from a lender for the sale or assignment to the lender of a chattel lease or conditional sales contract.<sup>39</sup>
- Freight or other transportation charges when title to the property being transported passes to the customer at the point of origin.<sup>40</sup>

## 2. Expenses Passed Through to the Customer

Expenses that are passed through to the customer are not included in the sales price in *limited circumstances*. In *Aabakus, Inc. v. Huddleston*, the Tennessee Court of Appeals examined the definition of sales price when addressing the business tax liability of a human resource support service. The Court concluded that the fees the agency earned providing personnel management services to small businesses were subject to business tax. The Court also held that expenses that simply passed through the agency were not subject to business tax because they were funds that the agency was required to pay over to third parties on its clients' behalf and the agency was simply acting as a paying agent.

### *Example*

Company A is a limited liability company with its principle place of business in Tennessee. Company A contracts with businesses ("customers") to provide human resource vendor management services. Company A then contracts with third-party staffing agencies ("suppliers") to meet its customers' workforce needs. Company A compiles all the suppliers' invoices for each customer and sends each customer a consolidated invoice. Customers pay

the invoiced amount to Company A, and Company A pays suppliers on each customer's behalf. Company A receives an administrative fee typically equal to four percent of its customer's consolidated invoice.

- Company A is subject to Tennessee business tax on the administrative fees that it retains as compensation.
- Company A is not subject to Tennessee business tax on the amounts it receives from customers that are transferred to suppliers and not ultimately retained by the Company A. The invoice payments Company A receives, less Company A's administrative fees, are funds that Company A is required to pay over to third parties, the suppliers, on its customers' behalf for wages, payroll taxes, insurances, and other employment related charges that are simply passed through Company A.

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<sup>1</sup> Tenn. Code Ann. § 67-4-702(a)(7).

<sup>2</sup> Tenn. Code Ann. § 67-4-702(a)(15)(B).

<sup>3</sup> Tenn. Code Ann. 67-4-702(a)(18)(A)(i).

<sup>4</sup> TENN. COMP. R. & REGS. 1320-04-05-.05 and 1320-04-05-.53.

<sup>5</sup> *Id.*

<sup>6</sup> Tenn. Code Ann. § 67-4-702(a)(18)(B).

<sup>7</sup> TENN. COMP. R. & REGS. 1320-04-05-.05.

<sup>8</sup> *Id.* at 149.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> Tenn. Code Ann. § 67-4-708(3)(c).

<sup>12</sup> Tenn. Code Ann. § 67-4-702(a)(21).

<sup>13</sup> *Id.*

<sup>14</sup> TENN. COMP. R. & REGS. 1320-04-05-.48(1).

<sup>15</sup> TENN. COMP. R. & REGS. 1320-04-05-.48(2).

<sup>16</sup> *Auto Glass Co. of Memphis v. Gerregano*, No. W2018-01472-COA-R3-CV, 2019 WL 1343987 at \*5 (Tenn. Ct. App. 2019). Tenn. Code Ann. § 67-4-702(19) and (21).

<sup>17</sup> *Id.*

<sup>18</sup> TENN. COMP. R. & REGS. 1320-04-05-.48(2).

<sup>19</sup> Tenn. Code Ann. § 67-4-702(a)(1).

<sup>20</sup> *Aabakus, Inc. v. Huddleston*, 1996 WL 548148 at \*3 (Tenn. Ct. App. 1996).

<sup>21</sup> The 1987 version of the manual can be accessed online at <http://www.osha.gov/pls/imis/sicsearch.html>.

<sup>22</sup> TENN. COMP. R. & REGS. 1320-04-05-.02(3).

<sup>23</sup> Tenn. Code Ann. § 67-4-702(a)(23).

<sup>24</sup> *Id.*

<sup>25</sup> *See* Ruling 17-05.

<sup>26</sup> TENN. COMP. R. & REGS. 1320-04-05-.21(1).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> TENN. COMP. R. & REGS. 1320-04-05-.49.

<sup>30</sup> TENN. COMP. R. & REGS. 1320-04-05-.22.

<sup>31</sup> TENN. COMP. R. & REGS. 1320-04-05-.23.

<sup>32</sup> *Id.*

<sup>33</sup> Tenn. Code Ann. § 67-4-702(a)(19).

<sup>34</sup> TENN. COMP. R. & REGS. 1320-04-05-.18.

<sup>35</sup> TENN. COMP. R. & REGS. 1320-04-05-.08.

<sup>36</sup> Tenn. Code Ann. § 67-4-702(a)(19).

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<sup>37</sup> *Id.* These advertising costs are not included in the sales price when no portion of the payment is retained as profit by the auctioneer, and when the payment has been placed in escrow or a trust account by the auctioneers on behalf of the seller.

<sup>38</sup> *Id.*

<sup>39</sup> Tenn. Code Ann. § 67-4-702(a)(19).

<sup>40</sup> TENN. COMP. R. & REGS. 1320-04-05-.18.