

## Contents

Chapter 5: Classifications .....	43
Classifications Generally.....	43
1. Classification 1.....	43
2. Classification 2.....	44
3. Classification 3.....	44
4. Classification 4.....	48
5. Classification 5.....	48
6. Antique Malls, Flea Markets, Gun Shows, Etc.....	48
7. Transient Vendors.....	49
8. Miscellaneous Industry Specific Classifications.....	49
Retailer vs. Wholesaler .....	56
1. Retail Sales.....	57
2. Wholesale Sales.....	58
3. Sales for Resale .....	59
4. Wholesaler to Wholesaler Sales.....	60
5. Retailer to Retailer Sales .....	61
Tax Rates .....	61

## Chapter 5: Classifications

### Classifications Generally

Businesses subject to Tennessee business tax must be classified to determine the correct amount of business tax due. Business tax rates vary based on the type of business and, in many cases, whether the business sells at wholesale or retail.

Each taxpayer is classified by its “dominant business activity” pursuant to Tenn. Code Ann. § 67-4-708 on a per location basis. “[D]ominant business activity” is defined as “the business activity that is the major and principal source of taxable gross sales.”<sup>1</sup> In other words, the business classification is based on the *activity* that generates the largest portion of a business’s taxable sales.

A taxpayer’s classification determines its tax rate.<sup>2</sup> There are five different classifications for taxable activities as well as a separate category for antique malls, flea markets, and the like. A taxpayer must choose only one classification per location. Taxpayers should look to the Standard Industrial Classification Index of 1987 (“SIC”) to aid in determining their business tax classification.

#### 1. Classification 1

Classification 1 activities are subdivided into five distinct groups:<sup>3</sup>

- Classification 1(A) includes sales of food and beer for home preparation and consumption (except for delicatessens and candy at retail) and food brokerage services.
- Classification 1(B) includes sales of lumber, building materials, tools, builders’ hardware, paint and glass, electrical supplies, roofing materials, farm equipment, plumbing, heating and air conditioning equipment, and other basic lines of hardware, and sales by service station operators (except for sales under Classification 1(D)).
- Classification 1(C) includes sales of hay, grain, feed, fertilizer, seeds, bulbs, nursery stock, and other farm, lawn, and garden supplies and tools. Products produced by farmers sold directly from the farm are not included in Classification 1(C).

- Classification 1(D) includes sales of gasoline, diesel fuel, and motor oils at retail.
- Classification 1(E) includes sales of gasoline and diesel fuel at wholesale.

## 2. Classification 2

Classification 2 activities include the sale of:<sup>4</sup>

- Motor vehicles
- Clothing (excluding custom, made-to-order items)
- Home furnishings (excluding antiques)
- Prescription drugs
- Prepared food, (e.g., cooked food meant to be consumed on or off the premises)
- Coal, wood, ice, fuel oil, and liquefied petroleum gas
- Cut flowers
- Advertising specialties

**⚠ This classification also includes a “catch-all” for the sale of any tangible personal property that is not specifically classified. Therefore, taxpayers selling products not listed in any other classification will be Classification 2.**

## 3. Classification 3

Classification 3 includes the sales of more specialized items of tangible personal property. These include, but are not limited to:

- Delicatessens and candy
- Made-to-order clothing, i.e. custom-made clothing

- Antique furniture, furnishings, and art objects
- Artwork
- Books, magazines, stationery (including office supplies and writing supplies), accounting and legal forms, office forms and supplies, pens and pencils, school supplies, and writing supplies
- Sporting goods and equipment, bicycles, bicycle parts, and accessories
- Jewelry
- Tobacco products
- Toys, games, and hobby kits
- Cameras, film, and other photographic supplies
- Fireworks
- Hearing aids
- Luggage
- Artist paints and supplies
- Non-prescription eye-ware
- Pet food
- Above-ground swimming pools (in-ground swimming pools are considered improvements to real property)
- Pawn shops

For a complete list of items, please see Tenn. Code Ann. § 67-4-708(3).

**⚠ Classification 3 also includes the sale of services.**

### *Sale of Services*

Unlike sales and use tax law, the sales of all services are subject to business tax unless specifically exempt. Classification 3 provides 16 different exempt services, which utilize the SIC descriptions to define the service, from business tax.<sup>5</sup> Although discussed in more detail later in Chapter 8 of this Manual, below is a brief list of exempt services.

### *Exempt Services*

Receipts derived from the sale of the following services are exempt from business tax:

- Accounting, auditing, and bookkeeping services;
- Architecture;
- Banks, building and loan associations, mortgage bankers, securities, brokers, investment companies, and other similar organizations;
- Camps and trailer parks where charges are made only for rental of real property. Persons who rent trailers to transients or sell tangible personal property or make separate charges for specific services furnished are not exempt;
- Services performed by charitable and religious organizations;
- Domestic services performed in private households;
- Educational services offered by elementary and secondary schools, colleges, universities, professional schools and junior colleges, library and information centers, correspondence schools, vocational schools, and specialized non-degree granting schools;
- Services furnished by educational nonprofit research agencies;
- Engineering;

- Services furnished by insurance companies and holding companies;
- Land surveying;
- Legal services;
- Lessors of agricultural, forestry, mining, oil, public utility, and airport properties;
- Medical, dental, and allied health services to human beings, except services of persons engaged in making dentures and artificial teeth;
- Nonprofit membership organization services that are for the promotion of the interests of the members;
- Operators of residential and non-residential buildings other than hotels, motels, and rooming houses;
- Public utilities as defined in Tenn. Code Ann. § 65-4-101; and
- Veterinary services.

No business license is needed, and no tax is due, unless the business is also making sales of tangible personal property and/or other taxable services. Even if a taxpayer qualifies for one of these exemptions, it still must register and pay business tax on any sales that do not qualify for the exemption (e.g. a chiropractor that sells food supplements and ergonomic devices, etc.).<sup>6</sup>

**⚠ Audit Note: Taxpayers should be aware that in the case of a business tax audit, if the business sells a group of services for a lump sum, the taxpayer is not allowed to segregate out nonexempt services. If the business sells the services together and the services cannot be purchased separately, they should be categorized together and only exempted if the entire group falls under one of the exempt service categories.**

For more information on exempt services, please see Chapter 8 of this manual.

#### **4. Classification 4**

Classification 4 activities include all persons contracting, performing a contract, or engaging in the following:

- Constructing or improving real property (e.g. constructing, building, erecting, repairing, grading, excavating, drilling, exploring, testing, or adding to any building, highway, street, sidewalk, bridge, culvert, sewer, irrigation or water system, drainage, or dredging system);
- Installing tangible personal property;
- Providing exterminating services;
- Selling livestock, poultry, or other farm products not exempted under Tenn. Code Ann. § 67-4-712 (discussed in more detail in Chapter 8 of this Manual); and
- Receiving commissions from the sale of farm products belonging to others.<sup>7</sup>

Classification 4 does not include landscaping and lawn care services – these services fall under Classification 3. See the subsection titled Landscapers in the section titled Miscellaneous Industry Specific Classifications in this chapter.

#### **5. Classification 5**

Classification 5 has two subparts:

- Classification 5(A) includes industrial loan and thrift companies certified and licensed under title 45, chapter 5. For a current listing of these companies, see the website for the Department of Financial Institutions; and
- Classification 5(B) includes natural gas marketers.<sup>8</sup>

#### **6. Antique Malls, Flea Markets, Gun Shows, Etc.**

Antique malls, flea markets, craft shows, antique shows, gun shows, and auto shows are not included under one of the five specified classifications. Instead, any county and/or municipality may impose a fee on such businesses by resolution or ordinance. If the fee is imposed (\$1per booth per day), it must be paid directly to and retained by the county or municipality.<sup>9</sup> This fee is in lieu of any business tax that would have otherwise been due.

The per day fee does not apply to a business that sells antiques at least five days a week from a permanent location.<sup>10</sup> Such business will be subject to business tax as a Classification 3 vendor. This also applies to antique malls with separate booths but one common cash register. Under these circumstances, only the mall operator is subject to the business tax on all receipts from that location.

## 7. Transient Vendors

Transient vendors are also excluded from the business tax but are subject to a \$50 fee paid directly to the county and/or municipality for each 14-day period they are licensed to sell their goods.<sup>11</sup> For example:

- A seller of tangible personal property based in Kentucky comes to Nashville, Tennessee for a weeklong trade show, where it will display and sell its merchandise. The Kentucky seller will have to obtain a transient vendor license directly from the local city recorder or county clerk and pay a \$50 fee.

Please see Chapter 11 for more in-depth analysis of transient vendors.

## 8. Miscellaneous Industry Specific Classifications

### *Home Healthcare Providers*

Businesses engaged in home health services providing non-medical personal care services to seniors and other people with physical, intellectual, and developmental disabilities are Classification 3.

Non-medical personal care services include, but are not limited to, homemaker services, monitoring for safety (including providing reminders to take prescription medication), companionship, grocery shopping, meal preparation, hospital sitter services, 24-hour care, light housekeeping, household laundry, bath and grooming assistance, and transportation.

### *Landscapers*

Businesses engaged in landscaping activities such as planting, mulching, mowing, and the like are subject to business tax under Classification 3. However, businesses engaged in installing irrigation systems and hardscapes (such as patios, retaining walls, ponds, or other

similar structures) are subject to business tax under Classification 4. Businesses engaged in both activities are classified based upon their dominant business activity.

### *Storage Unit Operators*

The rental of storage units is exempt under Tenn. Code Ann. § 67-4-708(3)(C)(xii) as a service provided by an operator of a residential or nonresidential building, and as such, is not subject to the business tax. TENN. COMP. R. & REGS. 1320-04-05-.41 further clarifies that the rental of real property is not taxable.

However, if warehousing and storage services are provided, those services are subject to tax under Classification 3 (see the explanation below). Also, if the storage unit business sells tangible personal property, such as boxes, it should be registered and paying business tax on those sales, even if otherwise only leasing space.

### *Warehousemen*

Warehousemen are subject to business tax as Classification 3 service providers. SIC Major Group 42 includes warehousing. Industry number 4226 is "special warehousing and storage, not elsewhere classified" and includes "warehousing and storage of special products, not elsewhere classified, such as household goods..." TENN. COMP. R. & REGS. 1320-04-05-.38 further clarifies that "warehousing and storage of any tangible personal property belonging to others for a charge or fee are rendering services and are taxable under the Business Tax Act." Such services may involve activities such as handling, securing, and storing goods.

Note that warehousing does not include the lease of designated space within a warehouse with no other services provided.

### *Software Programmers and Consultants*

Software programmers and consultants are subject to business tax as Classification 3 service providers. Even though prewritten software is treated as tangible personal property for sales and use tax purposes, there is no provision in the business tax to deem it tangible personal property. (Custom software is separately and expressly subject to sales and use tax.)<sup>12</sup> Thus, regardless of whether sales of software and services necessary to the sale of software are taxed as part of the sales price of tangible personal property for sales tax, software vendors would fall within Classification 3 for business tax as service providers. This is also consistent with their SIC Classification.

### *House Painters*

House Painters making improvements to real property are subject to business tax as Classification 4 service providers.

### *Electrical Inspectors*

Electrical inspectors are subject to business tax as Classification 3 service providers. While Classification 4 includes references to testing in the SIC descriptions, SIC code 1731 (electrical work) does not include electrical inspectors.

### *Home Warranty Companies*

Services related to insurance provided by insurance carriers or insurance agents are exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(xi). Home warranty companies offer extended warranties, or warranty insurance, on items of tangible personal property within a home. The SIC indicates that a seller of home warranties is considered an insurance carrier. Major Group 63 is described as “carriers of insurance of all types” and includes Industry Number 6351 Surety Insurance. One of the examples listed under 6351 is Warranty Insurance, Home. Therefore, sales of home warranties are services exempt from business tax.

### *Photographers*

Photographers are subject to business tax as Classification 3 service providers. Although customers may purchase photographs from the photographer upon completion of the service or may receive photographs on a disc from the photographer, it has been determined that the photographer is primarily offering a service. This is reiterated by the SIC, which categorizes photographers under Major Group 72 (Personal Services).

### *Real Estate Management Companies*

If a taxpayer sells or manages real estate it owns, the taxpayer is not subject to business tax on sales or rental income.<sup>13</sup> However, taxpayers selling and managing real estate for others are subject to business tax under Classification 3 as providers of taxable services. Management fees are also subject to tax. Managers of short-term rentals and overnight lodgings are liable for tax on the total amount collected for the rental.

For information on property management companies, see the section titled Sales or Rentals of Real Property in Chapter 8 of this manual.

### *Farrier Suppliers*

The sales of farrier supplies (e.g. horseshoes) are subject to business tax as Classification 2, under the catch-all provision as taxpayers making sales of “[t]angible personal property not specifically listed or described elsewhere[.]”<sup>14</sup>

### *Farriers*

Farriers are subject to business tax as Classification 3 service providers if the services the farriers provide are their dominant taxable business activity.

### *Dentists*

Services performed by dentists are exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(i). However, sales of tangible personal property by a dentist, such as electric toothbrushes, dental water jet oral irrigators (i.e. Waterpik), teeth whitening products, mouth wash, etc., are subject to business tax as Classification 2, under the catch-all provision. Note that the definition of tangible personal property excludes “any materials, substances or other items of any nature inserted or affixed to the human body by duly licensed physicians or dentists or otherwise dispensed by them in the treatment of patients.”<sup>15</sup>

### *Radon Testing*

Radon testing is subject to business tax under Classification 3, service providers. While the Classification 4 description does have language that includes the word “testing” and “building,” radon testing is testing the air quality in the building, not the building itself.

### *Music Lessons, Tutoring, Day Cares/Pre-Ks*

Individuals providing music lessons and private tutoring and day cares/pre-Ks are subject to business tax as Classification 3 service providers.

There is an exemption for “[e]ducational services offered by elementary and secondary schools, colleges, universities, professional schools and junior colleges, library and information centers, correspondence schools, vocational schools and specialized nondegree granting schools.”<sup>16</sup>

Day cares and pre-Ks are not exempt because they are not elementary or secondary schools or one of the others listed. Likewise, individuals who provide instruction of some sort, e.g., individual private tutors and individual piano teachers do not meet the definition of a school within the statute and are not an establishment within the SIC code. However, an actual music school would qualify for the exemption.

### *Veterinarians*

Services furnished by persons engaged in the practice of veterinary medicine, dentistry or surgery are exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(xiv). Sales of services involving the boarding and lodging of animals, if sold by veterinarians, are also exempt from business tax. However, veterinarians are liable for business tax on their sales of grooming services and their sales of animal food and medicine, collars, leashes, and any other tangible personal property sold by them.

Veterinarians should determine their dominant taxable sales for classification purposes. If most of a veterinarian's taxable sales are sales of pet food or grooming, they should pay business tax on all taxable sales as Classification 3 service providers. If most a veterinarian's taxable sales are of animal medications, they should pay business tax on all taxable sales as Classification 2 sellers.

### *Massage Therapists*

Massage services provided by licensed massage therapists are exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(i) as medical or allied health services. These sales would be treated by SIC code 8049 as sales of exempt services provided by health practitioners not elsewhere classified. However, like other medical service providers, massage therapists may become liable for business tax if they make other types of sales that do not fall within this exemption.

### *Acupuncturists*

Acupuncturists are exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(i) as medical or allied health services. Such sales would be treated by SIC code 8049 as sales of exempt services provided by health practitioners not elsewhere classified. However, like other medical service providers, acupuncturists may become liable for business tax if they make other types of sales that do not fall within this exemption.

### *Botox Injections*

Botox injections are exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(i) as medical or allied health services. In general, Botox injections must be administered by a licensed medical professional. According to the state medical board, there is one exception to the rule. If the injections are administered in a doctor's office under the supervision of a licensed doctor, they can be administered by anyone that the doctor has trained. However, because the second scenario must occur in a doctor's office under a doctor's supervision, either scenario would qualify as medical or allied health. See also SIC code 8049.

### *Electrolysis and Laser Spot/Scar Removal*

Electrolysis and laser spot/scar removal are exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(i) as medical or allied health services. Electrolysis must be administered by an electrologist licensed by the Tennessee Electrolysis Health Department board, and laser spot/scar removal must be administered by a licensed medical professional. Such sales are treated under SIC code 8049 as sales of exempt services provided by health practitioners not elsewhere classified.

### *Microdermabrasion*

There are different levels of microdermabrasion services. Estheticians can administer cosmetic microdermabrasion; in which case it is **not** an exempt medical or allied health service. Instead, such services are subject to business tax as Classification 3, service providers.

However, licensed medical professionals administer medical grade microdermabrasion, which is administered in a doctor's office and supervised by a doctor. When microdermabrasion is provided by a licensed medical profession or in a doctor's office, it is exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(i) as medical or allied health services. See also SIC code 8049.

### *Chiropractors*

Chiropractors are exempt from business tax under Tenn. Code Ann. § 67-4-708(3)(C)(i) as medical or allied health services. They are also specifically listed under SIC code 8041. Like other medical service providers, chiropractors may become liable for business tax if they make other types of sales that do not fall within this exemption.

## *Advertising Agencies*

The SIC” defines advertising agencies and advertising consulting services as “establishments primarily engaged in preparing advertising (writing copy, artwork, graphics, or other creative work) and placing such advertising in periodicals, newspapers, radio and television, or other advertising media for clients on a contract or fee basis.” Services provided by advertising agencies are generally subject to business tax as Classification 3 sales of services.

### *Advertising Agencies Purchasing Media on Behalf of Clients*

The amounts that an advertising agency receives for rendering services to plan, budget for, facilitate the purchase of, and verify media placement for the agency’s client are subject to business tax. Additionally, any commissions received by the advertising agency from the media outlet for facilitating sales of media placement to the agency’s client are also subject to business tax.

However, any amounts that an advertising agency receives from a client that the agency uses to purchase media placement from a media outlet, including newspapers, magazines, billboards, television, radio, and online sites (e.g., social media ads, web banners, pop-up ads, links to webpages, etc.), are not subject to business tax. The media placement is not a cost of property sold, cost of materials used, labor or service costs, or other expenses of the advertising agency in providing its advertising materials or services.

Therefore, the charge for the cost of the media placement is not part of the sales price of the advertising agency’s sale of its advertising services or tangible personal property. Additionally, the advertising agency does not hold itself out as a seller or provider of media placement. Instead, the media outlet is the provider of media placement and retains control of the media.

Advertising agencies commonly negotiate to purchase media placement on behalf of their clients. Agencies may charge clients for services and the cost of the media placement in different ways.

For example:

- An agency may charge its client only the same amount for which the media placement was purchased. For example, an agency purchases media placement from a media outlet for \$1,000, and the agency charges its client \$1,000 for the media placement.

- An agency may charge its client a lump sum service fee that includes charges for its services to facilitate the purchase of the media placement and the cost of the media placement. For example, an agency purchases media placement from a media outlet for \$1,000, and the agency charges its client a lump sum of \$1,200 for the media placement. The agency uses \$1,000 of that amount to pay the media outlet and it retains \$200 as a service fee.
- An agency may separately itemize its service fee and the cost of the media placement in the amount that it charges its client. Using the same scenario as the previous example, the invoice the agency gives its client has separate itemized amounts for media placement for \$1,000 and a service fee for \$200.
- A media outlet may charge the advertising agency a lump sum fee that includes the cost of the media placement and a commission paid to the advertising agency. The advertising agency then charges its client the same lump sum. Once paid over to the media outlet, the media outlet will then pay the commission to the advertising agency. For example, an agency charges its client a lump sum of \$1,200 for the media placement. The agency pays the entire \$1,200 to the media outlet, and the media outlet writes a commission check to the agency for \$200.

Regardless of which way an advertising agency charges its client for the media placement, the portion of the amount charged that the agency uses to pay the media outlet for the media placement is not subject to business tax. In other words, the net amount that the media outlet keeps is not taxable. In each of the examples above, the \$1000 that the agency receives from its client for the cost of the media placement is not subject to business tax.<sup>17</sup>

**⚠ To determine the amounts subject to business tax, an auditor may review the agreements between advertising agencies, clients, and media outlets.**

## Retailer vs. Wholesaler

Classifications 1-3 each have separate rates for wholesalers and retailers. If a business qualifies as a wholesaler, then it will be subject to the business tax at the wholesale rate for its classification on all its taxable gross sales. Likewise, if a business qualifies as a retailer, then it will be subject to the business tax at the retailer rate for its classification on all its taxable gross sales.<sup>18</sup>

## 1. Retail Sales

A retail sale is any sale that is not a wholesale sale. In retail sales, the purchaser is generally the end-user of the product or service. For example:

- ABC Company sells sporting goods equipment directly to end-users/consumers. These sales are considered retail sales.

Retail sales include sales to contractors because contractors are considered the end-user of the product. A **retailer** is any person whose taxable gross sales are at least 50% retail sales.<sup>19</sup> Taxable gross sales refers to Tennessee sales, therefore, sales made in other states are disregarded in determining whether a business is a retailer. For example:

- Acme Corporation (“Acme”) is located in Kentucky, where it has 10 retail stores. Acme also has a distribution center located in Tennessee, where it sells exclusively to Bravo Corporation (“Bravo”), a related business. Bravo has 5 retail stores in Tennessee. Acme generates 70% of its total gross receipts from retail sales in Kentucky, and 30% of its gross receipts from wholesale sales in Tennessee. Although more than 50% of its total sales are retail sales, such retail sales are not *taxable* gross sales for Tennessee business tax purposes and thus do not apply when determining whether Acme is a retailer or wholesaler. In this case, Acme is a Tennessee wholesaler and subject to business tax on its sales to Bravo.

Taxpayers should carefully note who their customers are and how the customers use the products or services sold. For example, contractors, hospitals, and rest homes are considered end-users of products they purchase for use in providing their respective services. Thus, sales to such entities are retail sales.

### *Packaging*

TENN. COMP. R. & REGS. 1320-04-05-.10 makes it clear that sales of returnable packaging to everyone (“to either retailers or to anyone else”) are retail sales. However, the rule, when addressing sales of nonreturnable packaging, states only that sales to retailers are retail sales. Therefore, sales of nonreturnable packaging to anyone other than retailers are wholesale sales.

### *Sale of Services to Federal, State, Local Governments, or Non-Profit Entities*

*Services* provided to the federal government, Tennessee state and local governments, or non-profit entities should be classified as retail sales for Tennessee business tax purposes.

## **2. Wholesale Sales**

A wholesale sale includes the following:<sup>20</sup>

- A sale to a retailer for resale;
- A sale of industrial materials for future processing that become component parts of a product that is for resale;
  - For example, a Tennessee aluminum smelter sells ingots (pieces of metal) to a Tennessee auto parts maker.
- Sales of *tangible personal property* to the State or other government agencies or to other institutions exempt from paying sales and use tax under Tenn. Code Ann. § 67-6-322 (sales of *services* to governmental or exempt agencies or institutions are sales at retail); or
- A sale by a franchised motor vehicle dealer to a manufacturer or distributor of motor vehicles or an obligor under an extended service contract of parts or repair services, or both, necessary for repairs performed by the dealer under the manufacturer’s, distributor’s or obligor’s warranty, and also includes a manufacturer or distributor of the motor vehicle.

A **wholesaler** is any person whose taxable gross sales are more than 50% wholesale sales.<sup>21</sup> An example of a wholesale sale is as follows:

- Paper manufacturer sells its paper to a business-to-business office products company. The business-to-business office products company sells the paper directly to businesses that use the paper in daily operations. Because the business-to-business office product company is reselling to end-users, the office products company is a retailer. As such, the sale to a retailer for resale is a wholesale sale.

### *Packaging*

There is a special regulation that applies to sales of packaging. All sales of returnable packaging, regardless of the purchaser, are retail sales. Additionally, all sales of nonreturnable packaging to retailers are retail sales. However, all sales of packaging materials to anyone other than a retailer (i.e., manufacturers, wholesalers, distributors, resellers) are wholesale sales.<sup>22</sup>

### **3. Sales for Resale**

The term “resale” is defined as “a subsequent, bona fide sale of the property, services, or taxable item by the purchaser,” and a “sale for resale” is defined as “the sale of the property, services, or taxable item intended for subsequent resale by the purchaser.”<sup>23</sup> Sales for resale may be taxable depending on the underlying facts of the transaction.

The price charged by the vendor for tangible personal property or services or the quality of such property or services is immaterial in determining whether a sale is one for resale.<sup>24</sup> The determinative factor is the customer’s treatment of his purchase.<sup>25</sup>

Sales for resale include:

- Sales of tangible personal property or taxable services made by a dealer to an out-of-state vendor who directs that the dealer act as the out-of-state vendor’s agent to deliver or ship tangible personal property or taxable services to the out-of-state vendor’s customer, who is a user or customer;<sup>26</sup>
- Sales where a supplier of materials, supplies, equipment, and services makes tangible personal property or services available for further processing as a component part of a product to legitimate dealer engaged in and reselling or leasing such property or services to a user or consumer;<sup>27</sup> and

- Sales to a manufacturer or processor for future processing, manufacture, or conversion into articles of tangible personal property for resale where such industrial materials become a component part of the finished product.<sup>28</sup>

#### *When Sales for Resale are Considered Wholesale Sales*

Sales of tangible personal property and services to a retailer who may make further distributions from a central warehouse or other distribution point to others for resale are considered wholesale sales.

#### **4. Wholesaler to Wholesaler Sales**

Sales made by one wholesaler to another wholesaler (or sales by one retailer to another retailer at cost) are excluded from the definition of sale and thus are not subject to the business tax.<sup>29</sup> This exemption applies even if the sale includes a markup.

Taxpayers, therefore, must determine if their customer is a wholesaler or retailer.

#### *Examples*

- Paper manufacturer sells its paper to a business-to-business stationery company, a paper distributor. The business-to-business stationery company sells the paper directly to businesses, retail stores or printers, that offer the stationery to end-users. Because the business-to-business stationery company is reselling to a reseller, they are making a wholesaler-to-wholesaler sale and the transaction between the paper manufacturer and the business-to-business stationery company, a paper distributor, is not subject to business tax.
- Pharmaceutical drug manufacturer sells its products to a distribution company that sells said pharmaceuticals directly to hospitals who provide patient care. Although the sale from manufacturer to distributor appears to be a wholesaler-to-wholesaler sale, it is not because TENN. COMP. R. & REGS. 1320-04-05-.20 states the hospitals are users and consumers of products sold to them for use in providing healthcare services. Therefore, it is a taxable wholesale sale by the pharmaceutical drug manufacturer and a retail sale by the distribution company.
- Wholesaler A sells products (100%) to Wholesaler B who sells these products to Retailers (70%) and Consumers (30%). 70% of Wholesaler A's sales are exempt

wholesale to wholesale sales and 30% are taxable wholesaler to retailer sales subject to the wholesale rate. Wholesaler A must be aware of its customers' business activities.

## 5. Retailer to Retailer Sales

Retailer to retailer sales are generally subject to business tax. However, transfers of tangible personal property from a retailer to another retailer for consideration that does not exceed the cost of the tangible personal property including freight and storage costs, and transportation costs incurred is not defined as a sale and is not subject to business tax.<sup>30</sup> These type sales are often accommodation sales. For example:

- A customer at a car dealership in Nashville wants a black car with black interior. The Nashville dealership only has a white car with black interior. However, the dealership finds the car at a Memphis dealership. The Memphis dealership sells the car to the Nashville dealership at cost plus transportation. Both dealerships are retailers, but because the sale was made at cost plus transportation, it is not considered a sale for business tax purposes.

## Tax Rates

Each person subject to the business tax as a Classification 1-4 or 5B taxpayer must pay at least \$22 per year per location. If the taxpayer does not have a location within the state, it must pay a minimum tax of \$22 for all its activity in the state. **This minimum tax applies to every person registered in the state, even if no business activity is carried on.**

**⚠ Contractors are required to have a registration in the jurisdiction of their domicile. If all of a contractor's sales in other jurisdictions in this state exceed the \$50,000 threshold amount and the contractor had no sales in its domicile jurisdiction, then the contractor must pay the minimum \$22 tax in its domicile.**

Each taxpayer must pay business tax according to its classification at the rates below:<sup>31</sup>

- Classification 1A, 1B, 1C retailer – 1/10 of 1% (0.001);

- Classification 1A wholesaler – 1/40 of 1% (0.00025);
- Classification 1B and 1C wholesaler – 3/80 of 1% (0.000375);
- Classification 1D retailer – 1/20 of 1% (0.0005);
- Classification 1E wholesaler – 1/32 of 1% (0.0003125);
- Classification 2 retailer – 3/20 of 1% (0.0015);
- Classification 2 wholesaler – 3/80 of 1% (0.000375);
- Classification 3 retailer – 3/16 of 1% (0.001875);
- Classification 3 wholesaler – 3/80 of 1% (0.000375);
- Classification 4 – 1/10 of 1% (of the compensation under the contract or of the gross commissions, margins, or fees) (0.001);
- Classification 5A – 3/10 of 1% of gross income of the business (interest income, earned discounts, earned lease rentals, commission fees, past due charges, contract earnings, collection charges, loan service fees, late fee income) (0.003); and
- Classification 5B – 1/50 of 1% (0.0002).

If the taxpayer is an operator of coin-operated machines, it is required to pay a minimum tax of \$22 only for its principal place of business. Each Class 5A taxpayer must pay a minimum tax of \$450 per year but will not be required to pay any more than \$1,500 per year.<sup>32</sup>

### *Municipal-Level Tax Rate*

Any municipality that elects to levy the municipal-level business tax after January 1, 2014, or that elects to change the rate of the tax must do so at the same rates listed above. However, if a municipality elected to levy the municipality business tax prior to this date, then it may continue to levy the tax at its existing rate.<sup>33</sup> See the Department's website for a current list of municipalities that levy a municipal level business tax.

- 
- <sup>1</sup> Tenn. Code Ann. § 67-4-702(a)(5).
- <sup>2</sup> *Aabakus, Inc. v. Huddleston*, 1996 WL 548148 at 2 (Tenn. Ct. App. Sept. 25, 1996).
- <sup>3</sup> Tenn. Code Ann. § 67-4-708(1).
- <sup>4</sup> Tenn. Code Ann. § 67-4-708(2).
- <sup>5</sup> Tenn. Code Ann. § 67-4-708(3)(C)(i)-(xvi).
- <sup>6</sup> *Hermitage Memorial Gardens Mausoleum and Memorial Chapel, Inc. v. Dunn*, 541 S.W.2d 147 (Tenn. 1976).
- <sup>7</sup> Tenn. Code Ann. § 67-4-708(4).
- <sup>8</sup> Tenn. Code Ann. § 67-4-708(5).
- <sup>9</sup> Tenn. Code Ann. §§ 67-4-710 and 67-4-705(c).
- <sup>10</sup> Tenn. Code Ann. § 67-4-710.
- <sup>11</sup> Tenn. Code Ann. § 67-4-710(a)(2).
- <sup>12</sup> Tenn. Code Ann. § 67-6-231(a).
- <sup>13</sup> TENN. COMP. R. & REGS. 1320-04-05-.41(1).
- <sup>14</sup> Tenn. Code Ann. § 67-4-708(2)(F).
- <sup>15</sup> Tenn. Code Ann. § 67-4-702(a).
- <sup>16</sup> Tenn. Code Ann. § 67-4-708(3)(C)(iii).
- <sup>17</sup> See Letter Ruling 18-01 for further examples.
- <sup>18</sup> Tenn. Code Ann. § 67-4-709.
- <sup>19</sup> Tenn. Code Ann. § 67-4-702(a)(17).
- <sup>20</sup> Tenn. Code Ann. § 67-4-702(a)(26). TENN. COMP. R. & REGS. 1320-04-05-.20, 1320-04-05-.47, and 1320-04-05-.50.
- <sup>21</sup> Tenn. Code Ann. § 67-4-702(a)(27).
- <sup>22</sup> TENN. COMP. R. & REGS. 1320-04-05-.10.
- <sup>23</sup> Tenn. Code Ann. § 67-4-702(a)(15).
- <sup>24</sup> TENN. COMP. R. & REGS. 1320-04-05-.47(4).
- <sup>25</sup> *Id.*
- <sup>26</sup> Tenn. Code Ann. § 67-4-702(a)(15).
- <sup>27</sup> TENN. COMP. R. & REGS. 1320-04-05-.47(1).
- <sup>28</sup> *Id.*
- <sup>29</sup> Tenn. Code Ann. § 67-4-702(a)(18)(B). *Pfizer v. Johnson*, 2006 WL 163190 (Tenn. Ct. App. Jan. 23, 2006).
- <sup>30</sup> Tenn. Code Ann. § 67-4-702(a)(18)(B).
- <sup>31</sup> Tenn. Code Ann. § 67-4-709.
- <sup>32</sup> Tenn. Code Ann. § 67-4-714(a).
- <sup>33</sup> Tenn. Code Ann. § 67-4-705(b).