

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 04-07**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of Tennessee Sales & Use Tax laws to certain purchases and uses of supplies.

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

[THE TAXPAYER] is a clothing retailer with retail locations throughout the United States. The Taxpayer owns several subsidiaries, such as [SUB 1] and [SUB 2] (“related entities”), which are also clothing retailers. The Taxpayer and its related entities maintain retail locations within Tennessee and in numerous states across the United States (“other states”).

The Taxpayer has a warehouse where it maintains its inventory of store supplies. The warehouse is currently located outside of Tennessee. However, the Taxpayer is contemplating relocating this warehouse and Tennessee is one of the likely considerations. At the time of purchase, the Taxpayer cannot determine which supplies will be consumed by the Taxpayer and which supplies will be resold to its related entities. Nor can the Taxpayer determine which supplies will be used within the state where the warehouse is located, or will be shipped to Taxpayer stores in other states. As such, the Taxpayer purchases these supplies by issuing a resale certificate to its vendors, and thus does not pay sales or use tax at the point of purchase.

Supplies are stored in the warehouse and distributed, as needed, to all Taxpayer locations inside and outside of the state where the warehouse is located. The Taxpayer also resells some supplies to its related entities, delivering them to the related entities’ retail locations inside and outside of the state where the warehouse is located. Store supplies are ultimately used and consumed at various retail locations of the Taxpayer or its related entities.

QUESTIONS

1. Can the Taxpayer properly issue a resale certificate to its vendors for the purchase of store supplies shipped to a warehouse in Tennessee?
2. Does Tennessee use tax apply to store supplies that are shipped to the Taxpayer and used at Taxpayer locations within Tennessee?
3. Does Tennessee sales tax apply to store supplies resold by the Taxpayer to related entities and shipped to store locations within Tennessee?
4. Does Tennessee use tax apply to store supplies withdrawn from inventory by the Taxpayer and shipped to Taxpayer locations for use in other states?
5. Does Tennessee use tax apply to store supplies that are resold by the Taxpayer to related entities and shipped to stores located in the other states?

RULINGS

1. Yes, provided the Taxpayer fully complies with the Department’s rule relative to the use of resale certificates (i.e., TENN. COMP. R. & REGS. 1320-5-1-.68).

2. Yes, Tennessee sales or use tax applies.
3. Yes.
4. If title and possession passed to the Taxpayer in a state other than Tennessee, no sales or use tax is applicable since the import-for-export exemption provision applies. However, if title or possession passed to the Taxpayer in Tennessee, the Taxpayer must pay a sales tax on the cost price of the supplies acquired.
5. No.

ANALYSIS

1. Tenn. Code Ann. § 67-6-102(25) (A) defines “retail sales” or “sale at retail” as:

[a] taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose other than for resale. “Retail sales” or “sales at retail” means and includes all such transactions as the commissioner, upon investigation, finds to be in lieu of sales. Any sales for resale must, however, be in strict compliance with rules and regulations promulgated by the commissioner. Any dealer making a sale for resale which is not in strict compliance with rules and regulations shall be personally liable for and pay the tax.

- TENN. COMP. R. & REGS. 1320-5-1-.62 defines “sales for resale” as:

[t]hose whereby a supplier of materials, supplies, equipment and services makes such tangible personal property or services available to legitimate dealers actually selling such property or services as such, or which becomes an industrial material or supply in a manufacturing or processing operation.

TENN. COMP. R. & REGS. 1320-5-1-.68 provides specific guidance with respect to the use of resale certificates, including the requirement that such certificates must be available at the establishment of the dealer for ready inspection and comparison with the deductions claimed on the taxpayer’s monthly sales and use tax returns.

In the facts presented, where the Taxpayer does not know at the time of purchase what portion, if any, of the supplies will be used by them or will be resold to a related entity, the Taxpayer would be permitted to use a resale certificate to purchase the supplies without payment of Tennessee sales tax provided it fully complies with the Department’s rule relative to the use of resale certificates (i.e., TENN. COMP. R. & REGS. 1320-5-1-.68).

2. Tenn. Code Ann. § 67-6-203(a) provides generally that a tax is levied on the cost price of each item or article of tangible personal property when the same is not sold but is used or consumed in this state. TENN. COMP. R. & REGS. 1320-5-1-.95 provides that when no sales or use tax is paid when a person purchases tangible personal property and the property is used or consumed as tangible personal property subject to the sales or use tax, the use must be reported and a tax paid thereon for the month in which the taxable use arose.

Since the Taxpayer is purchasing the supplies on a resale certificate and no tax will be paid when the supplies are initially purchased, the Taxpayer will be responsible for self-reporting tax on any supplies removed from inventory and consumed at retail locations within Tennessee. If the initial transaction upon which the resale certificate was used was a Tennessee sale, then the Taxpayer's obligation is more correctly classified as a sales tax rather than a use tax obligation. In this case, the obligation to pay sales tax is being delayed through the use of the resale certificate. See Security Fire Protection, Co., Inc. v. Huddleston, No. W2002-01175-COA-R3CV, 2003 WL 23198899, at *8 (Tenn. Ct. App. Dec. 31, 2003). Regardless of its characterization as sales or use tax, the tax obligation remains and both are payable at the same rate.

3. The Taxpayer is required to collect and remit sales tax on store supplies it purchases that are resold to related entities and shipped to store locations within Tennessee.

If either title to or possession of the store supplies passes from the Taxpayer to a related entity in Tennessee, the sale is a Tennessee sale and is subject to the Tennessee sales tax. See Tenn. Code Ann. §§ 67-6-202 and 67-6-102(26)(A).

4. If the sale of the supplies to the Taxpayer takes place in a state other than Tennessee, the Taxpayer imports the supplies and stores them in Tennessee for a period without use and finally exports them, the sale of supplies will be exempt from sales or use tax under the "import-for-export" exemption provision. (Tenn. Code Ann. § 67-6-313(a) states 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 import for export exemption will be lost if the taxpayer performs an act with respect to the property other than mere storage, inspection or repackaging.

The sales tax import-for-export exemption does not apply when the transfer of title or possession is from a vendor located in Tennessee to a purchaser also located in Tennessee even though the purchaser intends to and does export the merchandise. See *Jack Daniel Distillery v. Jackson*, 740 S.W.2d 413, 416 (Tenn. 1987).

Thus, if the Taxpayer's original purchase of the store supplies was a Tennessee sale that would have been subject to Tennessee sales tax but for the utilization of a resale certificate (i.e., title or possession of the supplies passed to the Taxpayer in Tennessee), the Taxpayer owes the Tennessee sales tax on all such supplies that it subsequently uses at its stores, regardless of whether the stores are located inside or

outside of Tennessee. (See Tenn. Code Ann. § 67-6-203.) The resale certificate cannot be utilized to make the purchases exempt from tax for the Taxpayer's own use. Had it not been for the issuance of the resale certificate, the Taxpayer's Tennessee vendor would have been required to collect a sales tax when it sold the tangible personal property. See *Nasco, Inc. v. Jackson*, 748 S.W.2d 193, 196 (Tenn. 1988).

5. A use tax does not apply to inventory held for resale. Tenn. Code Ann. § 67-6-102(25)(A). Temporary storage, inspection or repackaging of tangible personal property pending shipping or mailing of tangible personal property to non-residents of Tennessee is not a taxable use. See Tenn. Code Ann. § 67-6-102(29).¹ Thus, store supplies acquired that are later sold by the Taxpayer to related entities would not be subject to the use tax and the fact that the supplies were temporarily stored in Tennessee until they are sold and shipped to other states does not constitute a taxable use.

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APPROVED: Loren L. Chumley
Commissioner

DATE: 2/18/04

¹ While the primary question relates to use tax, there are other potential sales tax implications to the question. If title to store supplies passes to the Taxpayer's customer in Tennessee, or the Taxpayer's customer takes possession of such supplies in Tennessee, the Taxpayer should collect and remit a *sales tax* on the store supplies that are sold to the related entity regardless if the supplies are shipped outside of Tennessee. If title to the supplies does not pass to the Taxpayer's customer in Tennessee and the Taxpayer's customer does not take possession of the supplies in Tennessee, there is no Tennessee sale and the Taxpayer would not be required to collect and remit a sales tax on the sale.

As explained in the analysis of Question 3 above, Tennessee law provides that a sale occurs where title or possession of tangible personal property first passes to a buyer. See Tenn. Code Ann. § 67-6-102(26)(A). In making that determination, the Department has issued an Important Notice dated October, 2001 titled Sales and Use Taxability of Goods Transferred to a Carrier. This notice can be found on the Department of Revenue website at www.state.tn.us/revenue/notices/sales/.

However, it should be noted that by virtue of Ch. 357, Public Acts of 2003, Tennessee has become a participant in the Streamlined Sales Tax Agreement. Ch. 357 will become effective no earlier than July 1, 2004. Once the Act becomes effective, Tenn. Code Ann. § 67-6-902(a)(2) would indicate that supplies purchased by the Taxpayer that are resold to a related entity and shipped to another state would be sales tax sourced to the other state rather than to Tennessee.