

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 11-66**

**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**

Whether a [COMPANY] is doing business in Tennessee for purposes of the Tennessee franchise and excise taxes and whether it comes within the protections afforded by the Interstate Income Act of 1959, also known as Public Law 86-272.

**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**

[NAME OF TAXPAYER] (the "Taxpayer") is a [TYPE OF ENTITY] that is headquartered in [STATE – NOT TENNESSEE]. The Taxpayer's business involves [REDACTED]. The Taxpayer offers [PRODUCTS].

[REDACTED]. The Taxpayer's manufacturing facilities and inventory warehousing facilities are located in [STATE – NOT TENNESSEE].

The Taxpayer also utilizes relationships with vendors to offer [PRODUCTS]. [ITEMS OFFERED] include a broad range of products and brands, including [EXAMPLES].

The Taxpayer utilizes sales representatives to solicit sales of its products throughout the United States. In a typical transaction, the Taxpayer's customer agrees to purchase [PRODUCTS] from the Taxpayer [REDACTED]. [REDACTED].

The Taxpayer's business activities in Tennessee consist entirely of utilizing sales representatives to solicit orders from companies of [PRODUCTS]. Such orders are sent outside of Tennessee for approval or rejection. If approved, orders for sales of the Taxpayer's products are filled by shipment or delivery from a point outside Tennessee. For certain products, the Taxpayer utilizes a direct shipment process with vendors that warehouse and ship goods directly to the Taxpayer's customers. As a result, certain product orders may be filled from a point inside Tennessee. In such cases, the Taxpayer does not assume title to such goods at any time. The Taxpayer's products are shipped exclusively via the U.S. Postal Service or common carrier.

The Taxpayer does not maintain or make use of any office or place of business in Tennessee. The Taxpayer does not own or lease, as lessee or lessor, any real or tangible personal property in Tennessee. The Taxpayer does not have inventories, including inventories on consignment, in Tennessee. The Taxpayer does not use its own vehicles to ship its products into Tennessee. The Taxpayer does not repair or service any personal or real property within Tennessee. The Taxpayer does not install or assemble any products within Tennessee. The Taxpayer does not engage in collections activity or credit investigation within Tennessee. The Taxpayer does not train personnel in Tennessee. The Taxpayer does not bring any equipment or tangible personal property into Tennessee in the conduct of its business. The Taxpayer does not engage any third parties to perform any of the above activities in Tennessee.

## **RULINGS**

1. For Tennessee franchise and excise tax purposes, do the Taxpayer's activities in Tennessee come within the scope of the definition of "doing business" under TENN. CODE ANN. § 67-4-2004(14) (2011)?

Ruling: Yes. For Tennessee franchise and excise tax purposes, the Taxpayer’s activities in Tennessee come within the scope of the definition of “doing business” under TENN. CODE ANN. § 67-4-2004(14) (2011).

2. Does the Interstate Income Act of 1959 (Public Law 86-272) proscribe the imposition of the Tennessee excise tax on the Taxpayer?

Ruling: No. The Interstate Income Act of 1959 (Public Law 86-272) does not proscribe the imposition of the Tennessee excise tax on the Taxpayer.

### **ANALYSIS**

Tennessee imposes an excise tax on all persons, as defined under TENN. CODE ANN. § 67-4-2004(37) (2011), doing business within Tennessee. TENN. CODE ANN. § 67-4-2007(a) (2011). Tennessee also imposes a franchise tax at the rate of \$0.25 per \$100, or major fraction thereof, on the net worth of a taxpayer doing business in Tennessee, pursuant to TENN. CODE ANN. §§ 67-4-2105(a) (2011) and 67-4-2106(a) (2011).<sup>1</sup> Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, corporations and limited liability companies. TENN. CODE ANN. § 67-4-2004(37).

#### 1. Doing business in Tennessee

For Tennessee franchise and excise tax purposes, the Taxpayer’s activities in Tennessee come within the scope of the definition of “doing business” under TENN. CODE ANN. § 67-4-2004(14).

“Doing business in Tennessee” is defined for franchise and excise tax purposes as “any activity purposefully engaged in, within Tennessee, by a person with the object of gain, benefit, or advantage,” to the extent permitted by the United States Constitution and the Constitution of Tennessee.<sup>2</sup> TENN. CODE ANN. § 67-4-2004(14)(A). Thus, for the Taxpayer to be considered to be doing business in Tennessee, its activities must be (1) purposefully engaged in (2) within Tennessee (3) with the object of gain, benefit, or advantage.

The Taxpayer has indicated that its activities in Tennessee consist entirely of utilizing sales representatives to solicit orders from companies of [PRODUCTS]. Thus, the Taxpayer purposefully engages in sales activities within Tennessee with the object of gain, benefit, or advantage.

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<sup>1</sup> Note that, under TENN. CODE ANN. § 67-4-2108(a)(1) (2011), the franchise tax base “shall in no case be less than the actual value of the real or tangible property owned or used in Tennessee, excluding exempt inventory and exempt required capital investments.” For purposes of this section, “property” is to be “valued at cost less accumulated depreciation in accordance with generally accepted accounting principles.” TENN. CODE ANN. § 67-4-2108(a)(3).

<sup>2</sup> TENN. CODE ANN. § 67-4-2004(14)(E) provides several exceptions to the definition of “doing business.” However, none of these exceptions apply to the Taxpayer under the facts presented.

Accordingly, the Taxpayer's activities in Tennessee come within the scope of the definition of "doing business" for Tennessee franchise and excise tax purposes.<sup>3</sup>

## 2. Public Law 86-272

The Interstate Income Act of 1959, 15 U.S.C. § 381 ("Public Law 86-272") does not proscribe the imposition of the Tennessee excise tax on the Taxpayer.

As discussed in the response to Question #1, the Taxpayer is doing business in Tennessee. Thus, the Taxpayer will be subject to the Tennessee franchise and excise taxes unless an exemption from taxation applies.<sup>4</sup> In the Taxpayer's case, Public Law 86-272 potentially exempts the Taxpayer from the Tennessee excise tax.<sup>5</sup> Public Law 86-272 prohibits a state from taxing the income of a corporation formed under the laws of another jurisdiction<sup>6</sup> whose only business activities within the state consist of "solicitation of orders" for tangible goods, provided that the orders are sent outside the state for approval and the goods are delivered from out of state.

Specifically, Section 101(a)(1) of Public Law 86-272 provides that the state shall not have power to impose a net income tax "on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year" include the following: the "solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State."

Thus, for Public Law 86-272 to proscribe the imposition of the Tennessee excise tax on the Taxpayer, the following requirements must be met: 1) the Taxpayer's sole business activity in Tennessee is the solicitation by its representatives of orders for sales of tangible personal property; 2) orders for the Taxpayer's products are sent outside Tennessee for approval or

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<sup>3</sup> Although the Taxpayer has not requested that this letter ruling address the issue of whether Tennessee's power to tax the Taxpayer is limited by the Due Process Clause of the Fourteenth Amendment or the Commerce Clause of Article I, Section 8, of the United States Constitution, note that the presence of the Taxpayer's salespersons in Tennessee creates sufficient contact and nexus with the state so as to render taxation permissible. See *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992); *Complete Auto Transit, Inc. v. Hewitt*, 430 U.S. 274 (1977).

<sup>4</sup> The burden is on the taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that "[a]lthough the rule is well-established that taxing legislation should be liberally construed in favor of the taxpayer and strictly construed against the taxing authority, it is an equally important principle of Tennessee tax law that 'exemptions from taxation are construed against the taxpayer who must shoulder the heavy and exacting burden of proving the exemption.'" *Am. Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn. Ct. App. 2000) (quoting *Rogers Group, Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn. Ct. App. 1995)). The Tennessee Supreme Court has also stated that the burden is on the taxpayer to establish the exemption, and any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *Am. Airlines*, 56 S.W.3d at 506 (citing *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)).

<sup>5</sup> Public Law 86-272 only exempts a taxpayer from the excise tax; because the franchise tax is not a net income tax, Public Law 86-272 is not applicable to it. See 2004 Tenn. Op. Atty. Gen. No. 04-159 (November 8, 2004).

<sup>6</sup> See Section 101(b) of Public Law 86-272.

rejection; and 3) if approved, such orders are filled by shipment or delivery from a point outside Tennessee.

Based on the facts presented, the Taxpayer does not satisfy all of the requirements under Section 101(a)(1) of Public Law 86-272.

The first and second requirements are met. The Taxpayer has stated that its business activities in Tennessee consist entirely of utilizing sales representatives to solicit orders from companies of [PRODUCTS]. The Taxpayer has described the [PRODUCTS] as including [EXAMPLES]. All such items are tangible personal property. Additionally, orders for sales of the Taxpayer's products are sent outside of Tennessee for approval or rejection.

However, the third requirement is not met, because not all orders for sales of the Taxpayer's products are filled by shipment or delivery from a point outside Tennessee. The facts presented indicate that for certain products, the Taxpayer utilizes a direct shipment process with vendors that warehouse and ship goods directly to the Taxpayer's customers; in such cases, product orders may be filled from a point *inside* Tennessee.

Section 101(a)(1) of Public Law 86-272 expressly requires that orders for products be "filled by shipment or delivery from a point outside" Tennessee. This requirement is not met in the Taxpayer's case, because the Taxpayer on occasion directs a vendor to fill an order and the vendor does so by shipping the product from a location *inside* Tennessee. The United States Supreme Court has held that Public Law 86-272 does not apply when delivery of a product occurs from a point within the taxing state. *Heublein, Inc. v. S. Carolina Tax Comm'n*, 409 U.S. 275, 278-79 (1972). This is the case even when the product is shipped from outside the state to the taxpayer's in-state representative, held for a period of time, and then delivered to the in-state customer. *Id.*

The Taxpayer has stated that when a vendor delivers a product from a point inside Tennessee, the Taxpayer does not take title to the item at any point. However, Public Law 86-272 contains no exception for intrastate deliveries where the taxpayer does not hold title to the merchandise. Rather, the plain language of the statute requires that shipment or delivery take place from a point outside the state, regardless of who holds title.

Accordingly, Public Law 86-272 does not proscribe the imposition of the Tennessee excise tax on the Taxpayer.

Kristin Husat  
Director of Legal Services

APPROVED: Richard H. Roberts  
Commissioner of Revenue

DATE: 12/5/2011

