



This Week in State Tax (TWIST)

September 25, 2023



To listen to the podcast please [click here](#)

Tennessee: Federal income tax classification affects manufacturer status

The Tennessee Department of Revenue recently addressed how a taxpayer's federal income tax status affects its classification as a manufacturer. The taxpayer at issue was a SMLLC that was formed by its contractor company Parent to fabricate goods at a plant currently owned and operated by the Parent. The Parent intended to transfer all plant machinery and equipment to the taxpayer and the taxpayer planned to enter into a new lease for the space at the plant housing the fabrication operations. The fabricated goods were to be sold to the contractor Parent and unrelated entities. Tennessee's sales and use tax industrial machinery exemption is granted to entities whose principal business is the fabrication or processing of tangible personal property for resale and consumption off the premises. An activity is a taxpayer's principal business if more than fifty percent of its revenues at a given location are derived from fabricating or processing tangible personal property for resale, i.e., the "51 percent test." The taxpayer requested guidance as to whether it would qualify for the industrial machinery sales and use tax exemption and reduced rates for water and energy, as well as whether it would be a manufacturer for Tennessee Business Tax purposes. Rulings were also requested as to whether the Parent would qualify as a manufacturer if the taxpayer elected to be treated as a disregarded entity of the Parent.

Under Tennessee law, if a SMLLC has made a valid election to be taxable as a corporation, then it will be treated as a separate entity for Tennessee state and local tax purposes. If a SMLLC does not make an election or elects to be treated as a disregarded entity on Form 8832, then it will be disregarded as an entity separate from its owner for Tennessee state and local tax purposes, unless an applicable statute requires otherwise. The Department concluded that if the taxpayer elected to be treated as a corporation for federal income tax purposes, its sales of fabricated goods would be included in the principal business test, and it would qualify as a manufacturer for purposes of the sales tax exemption and lower rates on water and fuel. The taxpayer would also qualify as a manufacturer eligible for the manufacturing exemption to the business tax if it elected to be treated as a corporation for federal tax purposes.

In contrast, if the taxpayer was treated as an entity disregarded as separate from its parent, the taxpayer would be treated as a division of the Parent, and the sales to the Parent would essentially not exist and would not count in determining if the 51 percent test was met. To qualify for the industrial machinery exemption, Parent would need to sell fabricated goods to third parties and have more than 50 percent of its revenues from such sales of fabricated items. If the Parent did not meet the 51 percent test, it would not be permitted to obtain the benefit of any exemptions or reduced tax rates available to manufacturers. Please contact [Justin Stringfield](#) with questions on Letter Ruling #23-08.

kpmg.com/socialmedia



© 2023 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. USCS000670-1M

The following information is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.