RULES
OF
DEPARTMENT OF REVENUE
FRANCHISE AND EXCISE TAX DIVISION

CHAPTER 1320-06-01
FRANCHISE AND EXCISE TAX RULES AND REGULATIONS

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1320-06-01-.01 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a) and Acts 1999, Ch. 406, §2; effective July 1, 1999.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed May 14, 2003; effective July 28, 2003.*

1320-06-01-.02 DUE DATE.

The franchise and excise tax return shall be filed with the Commissioner of Revenue on or before the fifteenth (15th) day of the fourth month following the close of the taxpayer's taxable year. The return shall coincide with the accounting period covered by the federal return and the appropriate tax must be paid to the department at the time of filing the return. Returns that are based on a 52-53 week year will be due on or before the fifteenth (15th) day of the fourth month following the end of the month closest to the 52-53 week year end.

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4-806, 67-44-817, 67-4-907, 67-4-915, 67-4-2007, 67-4-2015, and 67-4-2119.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.03 REPEALED.

Authority: *T.C.A. §§ 67-102(a).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed April 3, 1997; effective August 28, 1997.*

1320-06-01-.04 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a), 67-4-817, 67-4-907, and 67-4-915.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.05 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a) and 67-4-817.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.06 REPEALED.

Authority: *T.C.A. § 67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.07 REPEALED.

Authority: *T.C.A. § 67-102(a).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed April 3, 1997; effective August 28, 1997.*

1320-06-01-.08 REPEALED.

Authority: *T.C.A. §§ 67-1-1-02(a), 67-4-819, and 67-4-916.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment filed April 5, 1990; effective July 29, 1990. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.09 REPEALED.

Authority: *T.C.A. § 67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.10 REPEALED.

Authority: *T.C.A. § 67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.* Repeal filed June 28, 2016; effective September 26, 2016.

1320-06-01-.11 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a), 48-1001, 48-1001, 48-1007, and 48-1108.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled June 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.12 REPEALED.

Authority: *T.C.A. § 67-1-102(a) and Acts 1999, Ch. 406, §2; effective July 1, 1999.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12,*

(Rule 1320-06-01-.12, continued)

1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed May 14, 2003; effective July 28, 2003.

1320-06-01-.13 REPEALED.

Authority: *T.C.A. § 67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.14 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a) and 67-4-904.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.15 INDEBTEDNESS-ADEQUACY OF CAPITAL.

The amount of indebtedness to be included pursuant to T.C.A. § 67-4-2107 shall not exceed the greater of the following amounts: (1) Excess of indebtedness over quick assets (cash, receivables, marketable investments), (2) Excess of book value (cost less accumulated depreciation) of capital assets (including inventories) per ending balance sheet of the return over net worth (including surplus reserves). If quick assets exceed the indebtedness to an affiliated corporation and the net worth exceeds the capital assets, the capital is adequate and no part of such indebtedness need be included.

Authority: *T.C.A. §§ 67-1-102 (a), 67-1-102, 67-4-905(c), and 67-4-2107.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.16 REPEALED.

Authority: *T.C.A. § 67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.17 REPEALED.

Authority: *T.C.A. § 67-1-102(a) and Acts 1999, Ch. 406, §2; effective July 1, 1999.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6. 1984. Repeal filed May 14, 2003; effective July 28, 2003.*

1320-06-01-.18 MINIMUM MEASURE OF FRANCHISE TAX.

(1) Rentals included in the minimum measure of the franchise tax may be offset by subrentals only to the amount of rentals paid. To qualify as subrental, the sublessee must have the same rights as the lessee with respect to use of the property.

(2) If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for such property shall be determined on the basis of a reasonable market rental rate for such property.

(3) Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of the franchise tax. Property in transit between the

(Rule 1320-06-01-.18, continued)

buyer and seller and shown on the books and records of the taxpayer in accordance with its regular accounting practices shall be included in the minimum measure of the franchise tax if it is destined to a Tennessee location.

(4) The value of any property while under construction must be included in the minimum measure of the franchise tax if there is actual utilization of such property by the taxpayer either in whole or in part. Actual utilization of the construction in progress will depend upon whether or not the construction in progress is utilized in the particular business conducted by the corporation.

Example 1: A manufacturer is in the process of building or expanding its facilities. The construction in progress would not actually be utilized in conducting the business of manufacturing until put in service by the corporation.

Example 2: A corporation is in the business of building and selling homes and the construction in progress will ultimately be for sale or rental. All of the construction in progress is utilized in conducting the business of home building.

Example 3: A corporation is in the business of operating motels and has a facility under construction. The construction in progress would not actually be utilized in conducting the business of operating motels until put in service by the corporation.

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4-906, and 67-4-2108.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.19 REPEALED.

Authority: *T.C.A. §§ 67-1-102, 67-4-803, and 67-4-805.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment filed March 9, 1990; effective April 23, 1990. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.20 ACTUAL CHARITABLE CONTRIBUTIONS.

In determining net earnings for the purpose of computing the excise tax, T.C.A. § 67-4-2006 requires the charitable contributions deduction claimed under Section 170 of the Internal Revenue Code to be added to federal taxable income; whereas, § 67-4-2006 permits a deduction for actual charitable contributions made by the taxpayer during the fiscal year. The term "actual charitable contributions" means all bona fide contributions expensed and paid in a given year without regard to any percentage as required under federal law. The same criteria used for federal purposes in determining whether or not a contribution is a bona fide contribution is used by this state; however, only the book basis of property donated to charity is allowed as a deduction in determining net earnings for the purpose of computing the excise tax.

Authority: *T.C.A. §§67-1-102(a), 67-1-102, 67-4-805, 67-4-2006, and 67-4-2108.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.21 LOSS CARRYOVERS.

(1) Net operating losses may be carried forward fifteen (15) years as net operating loss carryovers.

(Rule 1320-06-01-.21, continued)

(2) The term "net operating loss" is defined by T.C.A. § 67-4-2006 of the excise tax law as the excess of allowable deductions over total income allocable to this state for the year of the loss. The loss is the same as that reported for federal income tax purposes before any operating loss adjustment and special deductions provided for in the Internal Revenue Code, and the loss is subject to the adjustments (additions and subtractions) provided for in § 67-4-2006. The amount of the loss that may be carried forward will be subject to the following adjustments:

(a) There shall be added to the net loss as determined for excise tax purposes all nonbusiness earnings, all interest, dividends excluded from net earnings pursuant to § 67-4-2006 and any other income excluded from net earnings pursuant to § 67-4-2006.

(b) With respect to taxpayers doing business both within and without Tennessee, adjustment shall be made to reflect the apportionment of the loss on the basis of business done within and without the State of Tennessee during the loss year. After making the adjustment as provided in subparagraph (a) hereof, the loss deductible for Tennessee excise tax purposes shall be that portion of the total loss apportioned to this state by the applicable statutory apportionment formula.

(c) The net loss so determined must be offset against the net earnings from business done within the state for the succeeding year, and if not completely offset by the net earnings from business done within the state for such year, the remainder of such net loss may be offset against the net earnings from business done within the state during the following year. In no case may any portion of such loss be carried forward and used to offset net earnings for any period beyond the applicable net loss carryover period as provided in paragraph (1) above, and in applying the loss carryovers where losses for more than one year are involved, the most remote year will be applied first.

Authority: *T.C.A. §§ 67-1-102, 67-4-805, and 67-4-2006.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment filed March 9, 1990; effective April 23, 1990. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.22 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a), 67-4-808, and 56-4-217.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.23 BUSINESS AND NONBUSINESS EARNINGS.

(1) (a) Business earnings are defined by T.C.A. §§ 67-4-2004 as earnings arising from transactions and activities in the regular course of the taxpayer's trade or business or earnings from tangible and intangible property, if the acquisition, use, management, or disposition of the property constitutes an integral part of the taxpayer's regular trade or business operations. In essence, all earnings which arise from the conduct of the trade or business operations of a taxpayer are business earnings. For purposes of administration of T.C.A. § 67-4-2001 et seq., the income of the taxpayer is business earnings unless clearly classifiable as nonbusiness earnings.

(b) Nonbusiness earnings means all income other than business earnings.

(Rule 1320-06-01-.23, continued)

(c) The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is not determinative of whether income is business or nonbusiness earnings. Income of any type or class and from any source is business earnings if it arises from transactions and activity occurring in the regular course of trade or business. Accordingly, the critical element in determining whether income is "business earnings" or "nonbusiness earnings" is the identification of the transactions and activity which are elements of a particular trade or business. In general, all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business.

(d) A taxpayer may have more than one regular trade or business in determining whether income is business earnings.

(2) Business and Nonbusiness Earnings – Application of Definitions. The following are rules and examples for determining whether particular income is business or nonbusiness earnings. (The examples used throughout these regulations are illustrative only and do not purport to set forth all pertinent facts.)

(a) Rents from Real and Tangible Personal Property. Rental income from real and tangible property is business income if the property with respect to which the rental income was received is used in the taxpayer's trade or business or if the rental income from the use or management of the property constitutes an integral part of the taxpayer's regular trade or business operations.

Example 1: The taxpayer operates a multi-state car rental business. The income from car rentals is business earnings.

Example 2: The taxpayer is engaged in the heavy construction business in which it uses equipment such as cranes, tractors, and earthmoving vehicles. The taxpayer makes short-term leases of the equipment when particular pieces of equipment are not needed on any particular project. The rental income is business earnings.

Example 3: The taxpayer constructed a plant for use in its multi-state manufacturing business, and twenty (20) years later the plant was closed and put up for sale. The plant was rented for a temporary period from the time it was closed by the taxpayer until it was sold eighteen (18) months later. The rental income is business income and the gain on the sale of the plant is business earnings.

Example 4: The taxpayer is a heavy machinery manufacturer. The taxpayer enters into a complicated multi-million dollar deal to acquire the manufacturing assets of another, similar business. As a result of the acquisition, the taxpayer becomes the owner of a small, roadside market in Tennessee. The market is being leased by a third party lessee for $1,000 per month. The taxpayer acquired the assets of the other company solely to expand its manufacturing operations. It had never operated the market and has no intent to engage in the business of leasing commercial real estate. The Taxpayer does not own any other similar property that it leases to others. The taxpayer intends to sell the market as soon as the current lease expires. The rental income from the market is de minimis in relation to that derived from the taxpayer's manufacturing operations. Under these circumstances, the rental income is nonbusiness earnings. The acquiring taxpayer would also exclude the market in the property factor for purposes of the apportionment formula, and would not claim the expenses relative to the market as business expenses.

(Rule 1320-06-01-.23, continued)

(b) Gains or Losses from Sales of Assets. As a general rule, gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes business earnings if the property while owned by the taxpayer was used in the taxpayer's trade or business operations, or if the income from the disposition of the property constitutes an integral part of the taxpayer's regular trade or business operations.

Example 1: In conducting its multi-state manufacturing business, the taxpayer systematically replaces automobiles, machines, and other equipment used in the business. The gains or losses resulting from those sales constitute business earnings.

Example 2: The taxpayer constructed a plant for use in its multi-state manufacturing business and twenty (20) years later sold the property at a gain while it was in operation by the taxpayer. The gain is business earnings.

Example 3: Same as two (2), except that the plant was closed and put up for sale but was not in fact sold until a buyer was found eighteen (18) months later. The gain is business earnings.

Example 4: Same as two (2), except that the plant was rented while being held for sale. The rental income is business income and the gain on the sale of the plant is business earnings.

(c) Interest. Interest income is business earnings where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where income from the use or management of the intangible constitutes an integral part of the taxpayer's regular trade or business operations.

Example 1: The taxpayer operates a multi-state chain of department stores, selling for cash and on credit. Service charges, interest, or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts are business earnings.

Example 2: The taxpayer conducts a multi-state manufacturing business. During the year the taxpayer receives a federal income tax refund and collects a judgment against a debtor of the business. Both the tax refund and the judgment bore interest. The interest income is business earnings.

Example 3: The taxpayer is engaged in a multi-state manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, rain and storm damage, machinery replacement, etc. The moneys in those accounts are invested at interest. Similarly, the taxpayer temporarily invests funds intended for payment of federal, state and local tax obligations. The interest income is business earnings.

Example 4: The taxpayer is engaged in a multi-state money order and traveler's checks business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the taxpayer earns interest income by the investment of the funds pending their redemption. The interest income is business earnings.

(d) Dividends. Dividends are business earnings where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the dividend income from the use or

management of the stock constitutes an integral part of the taxpayer's regular trade or business operations.

Example 1: The taxpayer operates a multi-state chain of stock brokerage houses. During the year the taxpayer receives dividends on stock it owns. The dividends are business earnings.

Example 2: The taxpayer is engaged in a multi-state manufacturing and wholesaling business. In connection with that business the taxpayer maintains special accounts to cover such items as workmen's compensation claims, etc. A portion of the moneys in those accounts is invested in interest bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business earnings.

Example 3: The taxpayer and several unrelated corporations own all of the stock of a corporation whose business operations consist solely of acquiring and processing materials for delivery to the corporate owners. The taxpayers acquired the stock in order to obtain a source of supply of materials used in its manufacturing business. The dividends are business earnings.

Example 4: The taxpayer is engaged in a multi-state heavy construction business. Much of its construction work is performed for agencies of the federal government and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity, the taxpayer holds various stocks and interest bearing securities. Both the interest income and any dividends received are business earning.

Example 5: The taxpayer received dividends from the stock of its subsidiary or affiliate which acts as the marketing agency for products manufactured by the taxpayer. The dividends are business earnings.

(e) Patent and Copyright Royalties. Patent and copyright royalties are business income where the patent or copyright with respect to which the royalties were received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the royalty income from the use or management of the patent or copyright constitutes an integral part of the taxpayer's regular trade or business operations.

Example 1: The taxpayer is engaged in the multi-state business of manufacturing and selling industrial chemicals. In connection with that business the taxpayer obtained patents on certain of its products. The taxpayer licensed the production of the chemicals in foreign countries, in return for which the taxpayer receives royalties. The royalties received by the taxpayer are business earnings.

Example 2: The taxpayer is engaged in the music publishing business and holds copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company, including music copyrights. These acquired copyrights are thereafter used by the taxpayer in its business. Any royalties received on these copyrights are business earnings.

(3) Proration of Deductions. As a general rule, the allowable deductions for expenses of a taxpayer are related to both business and nonbusiness earnings. Such items as administrative costs, taxes, insurance, repairs, maintenance, and depreciation are to be

(Rule 1320-06-01-.23, continued)

considered. In the absence of evidence to the contrary, it is assumed that the expenses related to nonbusiness rental earnings will be an amount equal to 50% of such earnings and that expenses related to other nonbusiness earnings will be an amount equal to 5% of such earnings.

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4-804, 67-4-809, 67-4-2004, and 67-4-2010.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment by Public Chapter 575; effective July 1, 1986. Amendment filed February 14, 1991; effective March 31. 1991. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.24 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a), 67-4-806, 67-4-810, 67-4-811, 67-4-814, 67-4-815, 67-4-816, and 67-4-903.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1977. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.25 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a), 67-4-804, and 67-4-809.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.26 REPEALED.

Authority: *T.C.A. § 67-1-102(a) and Acts 1999, Ch. 406, §2; effective July 1, 1999.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed May 14, 2003; effective July 28, 2003.*

1320-06-01-.27 PROPERTY FACTOR.

(1) In General. The property factor of the apportionment formula for the trade or business of the taxpayer shall include all real and tangible personal property owned or rented by the taxpayer and used during the tax period in the regular course of such trade or business. The term “real and tangible personal property” includes land, buildings, machinery, stocks of goods, equipment, and other real and tangible personal property but does not include coin or currency. Property used in connection with the production of nonbusiness earnings shall be excluded from the property factor. Property used both in the production of business earnings and in the production of nonbusiness earnings shall be included in the property factor only to the extent the property is used in the production of business earnings. The method of determining that portion of the value to be included in the factor will depend upon the facts of each case. The property factor shall include the average value of property includable in the factor. See Rule 1320-06-01-.29.

(2) Property Factor – Property Used for the Production of Business Earnings. Property shall be included in the property factor if it is actually used or is available for use or capable of being used during the tax period for the production of business earnings. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor. Property or equipment under construction during the tax period (except inventoriable goods in process) shall be excluded from the factor until such

(Rule 1320-06-01-.27, continued)

property is actually used to produce business earnings. If the property is partially used to produce business earnings while under construction, the value of the property to the extent used shall be included in the property factor. Property used to produce business earnings shall remain in the property factor until its permanent withdrawal is established by an identifiable event such as its conversion to the production of nonbusiness earnings or its sale.

Example 1: Taxpayer closed its manufacturing plant in State X and held such property for sale. The property remained vacant until its sale one year later. The value of the manufacturing plant is included in the property factor until the plant is sold.

Example 2: Same as above except that the property was rented until the plant was sold. The plant is included in the property factor until the plant is sold.

(3) Property Factor – Numerator. The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period to produce business earnings. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination. The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which are located within and without this state during the tax period shall be determined for purposes of the numerator of the factor on the basis of total time within the state during the tax period. An automobile assigned to a traveling employee shall be included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed.

(4) Zero Denominator. In the use of any apportionment formula, where the denominator of a factor is zero, such factor must be eliminated entirely and the average then computed from the remaining factor or factors.

Authority: *T.C.A. §§ 67-101(2), 67-1-102, and 67-4-2012.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.28 PROPERTY FACTOR — VALUATION.

(1) Valuation of Owned Property.

(a) Property owned by the taxpayer shall be valued at its original cost. As a general rule "original cost" is deemed to be the basis of the property for federal tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, etc. If original cost of property is unascertainable, the property is included in the factor at its fair market value as of the date of acquisition by the taxpayer.

Example 1: The taxpayer acquired a factory building in this state at a cost of $500,000 and 18 months later expended $100,000 for major remodeling of the building. Taxpayer files its return for the current taxable year on the calendar-year basis. Depreciation deduction in the amount of $22,000 was claimed on the building for its return for the current taxable year. The value of the building includable in the numerator and denominator of the property factor is $600,000 as the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

(Rule 1320-06-01-.28, continued)

Example 2: During the current taxable year, X Corporation merges into Y Corporation in a tax-free reorganization under the Internal Revenue Code. At the time of the merger, X Corporation owns a factory which X built five years earlier at a cost of $1,000,000. X has been depreciating the factory at the rate of two percent per year, and its basis in X's hands at the time of the merger is $900,000. Since the property is acquired by Y in a transaction in which, under the Internal Revenue Code, its basis in Y's hands is the same as its basis in X's, Y includes the property in Y's property factor at X's original cost, without adjustment for depreciation, i.e., $1,000,000.

(b) Inventory of stock of goods shall be included in the factor in accordance with the valuation method used for federal income tax purposes.

(c) Property acquired by gift or inheritance shall be included in the factor at its basis for determining depreciation for federal income tax purposes.

(2) Valuation of Rented Property.

(a) Property rented by the taxpayer is valued at eight times the net annual rental rate. The net annual rental rate for any item of rented property is the annual rental rate paid by the taxpayer for such property, less the aggregate annual subrental rates paid by subtenants of the taxpayer. Subrents are not deducted when the subrents constitute business earnings.

Example 1: The taxpayer receives subrents from a bakery concession in a food market operated by the taxpayer. Since the subrents are business earnings they are not deducted from rent paid by the taxpayer for the food market.

(b) "Annual rental rate" is the amount paid as rental for property for a 12-month period (i.e., the amount of the annual rent). Where property is rented for less than a 12-month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the tax period. However, where a taxpayer has rented property for a term of 12 or more months and the current tax period covers a period of less than 12 months (due, for example, to a reorganization or change of accounting period), the rent paid for the short tax period shall be annualized. If the rental term is for less than 12 months, the rent shall not be annualized beyond its term. Rent shall not be annualized because of the uncertain duration when the rental term is on a month to month basis. If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for such property shall be determined on the basis of a reasonable market rental rate for such property.

Example 1: Taxpayer A which ordinarily files its returns based on a calendar year is merged into Taxpayer B on April 30. The net rent paid under a lease with five (5) years remaining is $2,500 a month. The rent for the tax period January 1 to April 30 is $10,000. After the rent is annualized the net rent is $30,000 ($2,500 X 12).

Example 2: Same facts as in Example 1, except that the lease would have terminated on August 31. In this case the annualized net rent is $20,000 ($2,500 X 8).

(c) "Annual rent" is the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:

1. Any amount payable for the use of real or tangible personal property, or any part thereof whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise.

(Rule 1320-06-01-.28, continued)

Example: A taxpayer, pursuant to the terms of a lease, pays a lessor $1,000 per month as a base rental and at the end of the year pays the lessor one percent of its gross sales of $400,000. The annual rent is $16,000 ($12,000 plus one percent of $400,000 or $4,000).

2. Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative values of the rent and the other items.

Example (i): A taxpayer, pursuant to the terms of a lease, pays the lessor $12,000 a year rent plus taxes in the amount of $2,000 and interest on a mortgage in the amount of $1,000. The annual rent is $15,000.

Example (ii): A taxpayer stores part of its inventory in a public warehouse. The total charge for the year was $1,000 of which $700 was for the use of storage space and $300 for inventory insurance, handling and shipping charges, and C.O.D. collections. The annual rent is $700. “Annual rent” does not include incidental day-to-day expenses such as hotel or motel accommodations, daily rental of automobiles, etc.

(d) Leasehold improvements shall, for the purposes of the property factor, be treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements shall be included in the factor.

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4-811, and 67-4-2012.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.29 PROPERTY FACTOR: AVERAGING PROPERTY VALUES.

(1) As a general rule the average value of property owned by the taxpayer shall be determined by averaging the values at the beginning and ending of the tax period. However, the Commissioner of Revenue may require or allow averaging by monthly values if such method of averaging is required to properly reflect the average value of the taxpayer’s property for the tax period.

(2) Averaging by monthly values will generally be applied if substantial fluctuations in the values of the property exist during the tax period or where property is acquired after the beginning of the tax period or disposed of before the end of the tax period.

Example: The monthly value of the taxpayer’s property was as follows:

January	$2,000
February	2,000
March	3,000
April	3,500
May	4,500
June	10,000
	$25,000

(Rule 1320-06-01-.29, continued)

July	15,000
August	17,000
September	23,000
October	25,500
November	13,000
December	2,000
	$95,000

TOTAL $120,000

The average value of the taxpayer's property includable in the property factor for the income year is determined as follows:

$$\$120,000 \div 12 = \$10,000$$

(3) Averaging with respect to rented property is achieved automatically by the method of determining the net annual rental rate of such property as set forth in Rule 1320-06-01-.28 (b).

Authority: *T.C.A. §§ 67-101(2), 67-1-102, and 67-4-2012.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.30 PAYROLL FACTOR.

(1) In General.

(a) The payroll factor of the apportionment formula shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the tax period.

(b) The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the taxpayer's method of accounting, at the election of the taxpayer, compensation paid to employees may be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under such method for unemployment compensation purposes. The compensation of any employee on account of activities which are connected with the production of nonbusiness earnings shall be excluded from the factor.

Example 1: The taxpayer used some of its employees in the construction of a storage building which, upon completion, is used in the regular course of taxpayer's trade or business. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of such wages is included in the payroll factor.

Example 2: The taxpayer owns various securities which it holds as an investment separate and apart from its trade or business. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

(c) The term "compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or any other person not properly classifiable as an employee are excluded. Only amounts paid directly to employees are included in the payroll

(Rule 1320-06-01-.30, continued)

factor. Amounts considered paid directly include the value of board, rent, housing, lodging, and other benefits or services furnished to employees by the taxpayer in return for personal services provided that such amounts constitute income to the recipient under the federal Internal Revenue Code. In the case of employees not subject to the federal Internal Revenue Code, e.g., those employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the federal Internal Revenue Code.

(d) The term "employee" means any officer of a corporation, or any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be considered to be an employee if he is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employees" in the Federal Insurance Contributions Act who would not be employees under the usual common law rule, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of this regulation.

(2) Denominator. The denominator of the payroll factor is the total compensation paid everywhere during the tax period. Accordingly, compensation paid to employees whose services are performed entirely in a state where the taxpayer is immune from taxation, for example, by Public Law 86-272, is included in the denominator of the payroll factor.

Example: A taxpayer has employees in its state of legal domicile (State A) and is taxable in State B. In addition, the taxpayer has other employees whose services are performed entirely in State C where the taxpayer is immune from taxation by Public Law 86-272. As to these latter employees, the compensation will be assigned to State C where their services are performed (i.e., included in the denominator - but not the numerator - of the payroll factor) even though the taxpayer is not taxable in State C.

(3) Numerator. The numerator of the payroll factor is the total amount paid in this state during the tax period by the taxpayer for compensation. The tests in T.C.A. §67-4-2012 to be applied in determining whether compensation is paid in this state are derived from the Model Unemployment Compensation Act. Accordingly, if compensation paid to employees is included in the payroll factor by use of the cash method of accounting or if the taxpayer is required to report such compensation under such method for unemployment compensation purposes, it shall be presumed that the total wages reported by the taxpayer to this state for unemployment compensation purposes constitute compensation paid in this state except for compensation excluded under Rule 1320-06-01-.30. The presumption may be overcome by satisfactory evidence that an employee's compensation is not properly reportable to this state for unemployment compensation purposes.

(4) Zero Denominator. In the use of any apportionment formula, where the denominator of a factor is zero, such factor must be eliminated entirely and the average then computed from the remaining factor or factors.

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4-811, 67-4-2012.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.31 PAYROLL FACTOR — COMPENSATION PAID IN THIS STATE.

(1) Compensation is paid in this state if any one of the following tests, applied consecutively, are met:

(a) The employee's service is performed entirely within the state.

(b) The employee's service is performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

(c) If the employee's services are performed both within and without this state, the employee's compensation will be attributed to this state:

1. if the employee's base of operations is in this state; or

2. if there is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this state; or

3. if the base of the operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed but the employee's residence is in this state.

(2) The term "base of operations" is the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points. The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

Authority: *T.C.A. §§ 67-101(2), 67-1-102, and 67-4-2012.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.32 SALES FACTOR.

(1) In General.

(a) T.C.A. § 67-4-2004 defines the term "sales" to mean all gross receipts of the taxpayer not allocated under § 67-4-2011. Thus, for the purposes of the sales factor of the apportionment formula, the term "sales" means all gross receipts derived by the taxpayer from transactions and activity producing business earnings. The following are rules for determining "sales" in various situations:

1. In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers. Gross receipts for this purpose means gross sales, less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales

(Rule 1320-06-01-.32, continued)

taxes) shall be included as part of such receipts if such taxes are passed on to the buyer or included as part of the selling price of the product.

2. In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, "sales" include the entire reimbursed cost, plus the fee.

3. In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency, or the performance of equipment service contract, research and development contracts, "sales" includes the gross receipts from the performance of such services including fees, commissions, and similar items.

4. In the case of a taxpayer engaged in renting real or tangible property, "sales" includes the gross receipts from the rental, lease, or licensing the use of the property.

5. In the case of a taxpayer engaged in the sale, assignment, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.

6. If a taxpayer derives receipts from the sale of equipment used in its business, such receipts constitute "sales." For example, a truck express company owns a fleet of trucks and sells its trucks under a regular replacement program. The gross receipts from the sales of the trucks are included in the sales factor.

(b) In some cases certain gross receipts should be disregarded in determining the sales factor in order that the apportionment formula will operate fairly to apportion to this state the business earnings of the taxpayer's trade or business. For example, where substantial amounts of gross receipts arise from the sale of fixed assets used in the trade or business, such as the sale of a factory or plant, gross receipts will be excluded from the sales factor. In order to give proper recognition to the apportionment of business earnings (loss) in such instances, the net gain arising from the transaction or activity will be included in the sales factor.

(2) Zero Denominator. In the use of any apportionment formula, where the denominator of a factor is zero, such factor must be eliminated entirely and the average then computed from the remaining factor or factors.

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4-804, 67-4-810, 67-4-2004, and 67-4-2011.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.33 SALES FACTOR — SALES OF TANGIBLE PERSONAL PROPERTY.

(1) Sales Of Tangible Personal Property Are In This State.

(a) Gross receipts from the sales of tangible personal property (except sales to the United States Government; see Rule 1320-06-01-.33(2)) are in this state if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale.

(b) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

(Rule 1320-06-01-.33, continued)

Example: The taxpayer, with inventory in State A, sold $100,000 of its products to a purchaser having branch stores in several states including this state. The order for the purchase was placed by the purchaser's central purchasing department located in State B. $25,000 of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the "purchaser within this state" with respect to $25,000 of the taxpayer's sales.

(c) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

Example: The taxpayer makes a sale to a purchaser who maintains a central warehouse in this state at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of taxpayer's products shipped to the purchaser's warehouse in this state are property "delivered or shipped to a purchaser within this state".

(d) The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

Example: A taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer directed the manufacturer or supplier of the merchandise in State B to ship the merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is "in this state".

(e) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while en route to a purchaser in this state, the sales are in this state.

Example: The taxpayer, a produce grower in State A, begins shipment of perishable produce to the purchaser's place of business in State B. While en route the produce is diverted to the purchaser's place of business in this state where the taxpayer is subject to tax. The sale by the taxpayer is attributed to this state.

(2) Sales Factor – Sales of Tangible Personal Property to United States Government in this State. Gross receipts from the sales of tangible personal property to the United States Government are in this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. For the purposes of this regulation, only sales for which the United States Government makes direct payment to the seller pursuant to the terms of a contract constitute sales to the United States Government. Thus, as a general rule, sales by a subcontractor to the prime contractor, the party to the contract with the United States Government, do not constitute sales to the United States Government. However, sales made to a prime contractor will be considered sales to the United States Government where the prime contractor is authorized to act as agent for the United States Government and for this reason qualifies to purchase only under Federal Supply Contracts entered into between the taxpayer and the United States Government.

Example 1: A Taxpayer contracts with General Services Administration to deliver X number of trucks which were paid for by the United States Government. The sale is a sale to the United States Government.

Example 2: The taxpayer as a subcontractor to a prime contractor with the National Aeronautics and Space Administration contracts to build a component of a rocket for

(Rule 1320-06-01-.33, continued)

$1,000,000. The sale by the subcontractor to the prime contractor is not a sale to the United States Government

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4- 811, and 67-4-2012.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.34 SALES FACTOR – QUALIFIED MEMBER OF A QUALIFIED GROUP.

(1) In General. T.C.A. § 67-4-2012(j) states that for any qualified member of a qualified group, the numerator of the sales factor equals the receipts from all sales of tangible personal property attributed to Tennessee under the sourcing rules for tangible personal property plus the arithmetical average of receipts from all sales other than sales of tangible personal property that are in Tennessee as determined under (1) market-based sourcing, and (2) where the earnings producing activity is performed (a) in this state or (b) both in and outside of Tennessee and a greater proportion of the earnings-producing activity is performed in Tennessee than any other state, based on cost of performance.

(2) Earnings Producing Activity; Defined. The term "earnings producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, the earnings producing activity includes but is not limited to the following:

(a) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.

(b) The sale, rental, leasing, or licensing or other use of real property.

(c) The rental, leasing, licensing or other use of tangible personal property.

(d) The sale, licensing or other use of intangible personal property. The mere holding of intangible personal property is not, of itself, an earnings producing activity.

(3) Costs of Performance; Defined. The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4-811, 67-4-2012.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.35 VARIANCES.

(1) T.C.A. §§ 67-4-2112 and 67-4-2014 provide that if the allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Commissioner of Revenue may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting;

(b) The exclusion of any one or more of the factors;

(Rule 1320-06-01-.35, continued)

(c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's capital and net earnings for purposes of computing franchise and excise taxes. §§ 67-4-2112 and 67-4-2014 permit a departure from the allocation and apportionment provisions only in limited and specific cases. §§ 67-4-2112 and 67-4-2014 may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results under the apportionment and allocation provisions contained in the Franchise and Excise Tax Laws.

(2) As provided by law, the Commissioner is given authority to require combined reports covering members of an affiliated group of corporations. In the event of inter-company activity in the manufacture, production or sales of products, the Commissioner may require a combined report if such is necessary to obtain an equitable and appropriate result.

(3) Application for relief must be addressed to the Commissioner with the filing of a petition, in writing, setting forth the reasons why application of the statutory allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in this state. It must be shown by clear and cogent evidence that peculiar or unusual circumstances exist which would cause application of the said statutory provisions to work a hardship or injustice. Such application must also include a proposed alternative method of allocation or apportionment to be used by the corporation, and be submitted by the taxpayer on or before the statutory due date of the return. In the event that a variation from the statutory provisions is adopted, then such method shall continue in effect so long as the circumstances justifying the variation remain substantially unchanged. It shall be the duty of the taxpayer to furnish each subsequent year such information with the filing of its return as will establish the fact that the circumstances remain substantially unchanged.

Authority: *T.C.A. §§ 67-1-102(a), 67-1-102, 67-4-905, 67-4-811, 67-4-812, 67-4-814, 67-4-815, 67-4-816, 67-4-910, 67-4-2012, 67-4-2013, 67-4-2014, and 67-4-2111.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.36 REPEALED.

Authority: *T.C.A. §§ 67-1-102(a), 13-28-11, and 67-4-808.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed April 3, 1997; effective August 28, 1997.*

1320-06-01-.37 REPEALED.

Authority: *T.C.A. §§ 67-1-102 and 67-4-817.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment filed March 9, 1990; effective April 23, 1990. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.38 CONSTRUCTING OR IMPROVING REAL PROPERTY — SPECIAL APPORTIONMENT RULES.

Earnings from construction contracts must be apportioned to Tennessee pursuant to the property, payroll, and sales apportionment factors set forth in T.C.A. § 67-4-2012. Property, payroll, and sales apportionment factors for the apportionment of income from construction contracts shall be determined as follows:

(Rule 1320-06-01-.38, continued)

(1) Property Factor. In general, the numerator and denominator of the property factor shall be determined as set forth in T.C.A. § 67-4-2012(b), (c) and (d), and Rules 1320-06-01-.27 through .29, inclusive. However, the following special rules are also applicable.

(a) Rents paid for the use of equipment are included in the property factor at eight times the net annual rental rate even though such rental expense may be capitalized into the costs of construction.

(b) "Rents paid" shall include rent expense in the income year for which it is deductible under the taxpayer's method of accounting for federal income tax purposes.

(c) Rent expense which is capitalized to a particular construction project shall be attributed to the state in which the construction project is located.

(2) Payroll Factor. In general, the numerator and denominator of the payroll factor shall be determined as set forth in T.C.A. § 67-4-2012 (e) and (f) and Rules 1320-06-01-.30 and .31. However the following special rules are also applicable.

(a) Compensation paid to employees which is attributable to a particular construction project is included in the payroll factor even though capitalized into the costs of construction.

(b) The payroll factor is computed by including compensation in the income year for which it is deductible under the taxpayer's method of accounting for federal income tax purposes.

(c) Compensation paid to employees which is capitalized to a particular construction project shall be attributed to the state in which the construction project is located.

(3) Sales Factor. In general, the numerator and denominator of the sales factor shall be determined as set forth in T.C.A. § 67-4-2012(g), (h) and (i), Rules 1320-06-01-.32 through .34, inclusive, and Rule 1320-06-01-.42. However, the following special rules are also applicable:

(a) The sales factor is computed by including gross receipts in the income year for which it is includable under the taxpayer's method of accounting for federal income tax purposes.

(b) Gross receipts derived from the performance of a contract are attributable to Tennessee if the construction project is located in Tennessee. If the construction project is located partly within and partly without Tennessee, the gross receipts, payroll and property factors attributable to Tennessee are based upon the ratio which construction costs for the project in Tennessee bear to the total of construction costs for the entire project or any other method, such as engineering cost estimates, which will provide a reasonable apportionment.

Authority: *T.C.A. §§ 67-1-102, 67-1-811, and 67-4-2012.* ***Administrative History:*** *Original rule filed March 9, 1990; effective April 23, 1990. Amendments filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.39 REPEALED.

Authority: *T.C.A. §§ 67-1-102 and 67-4- 905(b).* ***Administrative History:*** *Original rule filed September 4, 1992; effective December 29, 1992. Repeal filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.40 DISREGARDED ENTITIES.

(1) Disregarded Limited Liability Companies. A limited liability company is disregarded for franchise and excise tax purposes only if it is disregarded for federal income tax purposes and its single member is classified as a corporation for federal income tax purposes. If a limited liability company does not meet both of these requirements, it will be treated separately for franchise and excise tax purposes and must file its own separate franchise and excise tax return.

(2) Other Federally Disregarded Entities. Only a limited liability company meeting the requirements of (1) will be disregarded for franchise and excise tax purposes. All other taxpayers subject to the franchise or excise tax will be treated separately, regardless of whether they are otherwise disregarded for federal income tax purposes.

(3) Tiered Ownership of Limited Liability Companies. To determine whether a limited liability company is disregarded for franchise and excise tax purposes when it is only indirectly owned by a corporation, the analysis must take a "top down" approach and begin with the corporation and all directly-owned entities that directly or indirectly own the limited liability company.

Example 1: Corporation X is the single member of LLC1. LLC1 is the single member of LLC2. Corporation X is classified as a corporation for federal income tax purposes. Both LLC1 and LLC2 are disregarded for federal income tax purposes. LLC1 is disregarded for franchise and excise tax purposes to Corporation X. As a disregarded entity, LLC1 is treated as a division of Corporation X and not as a separate entity. As a result, the ownership interest held by LLC1 in LLC2 is treated as owned directly by Corporation X. LLC2 is disregarded for franchise and excise tax purposes to Corporation X because its single member for tax purposes is Corporation X, a corporation.

Example 2: Corporation X is the single member of LLC1 and LLC2, each of which has a 50% ownership interest in LLC3. Corporation X is classified as a corporation for federal income tax purposes. LLC1, LLC2, and LLC3 are each disregarded for federal income tax purposes. LLC1 and LLC2 are each disregarded for franchise and excise tax purposes to Corporation X. As disregarded entities, LLC1 and LLC2 are each treated as a division of Corporation X and not as separate entities. As a result, the ownership interests held by LLC1 and LLC2 in LLC3 are treated as owned directly by Corporation X. LLC3 is disregarded to Corporation X for franchise and excise tax purposes because Corporation X is treated as its single member.

(4) Not-For-Profit Subsidiaries. Except as provided in T.C.A. §§ 67-4-2007 and -2105, a not-for-profit entity is generally exempt from franchise and excise taxes. T.C.A. § 67-4-2004 defines a "not-for-profit" entity as "any person described in §401, §408, §408A, §409, §501, §526, §527, §528, §529 or §530 of the Internal Revenue Code, codified in 26 U.S.C. §401, §408, §408A, §409, §501, §526, §527, §528, §529 or §530." If a taxpayer is disregarded for federal income tax purposes to an entity meeting the definition of a not-for-profit, the taxpayer also meets the definition of a not-for-profit and is exempt from franchise and excise taxes to the extent provided by T.C.A. §§ 67-4-2007 and -2105, regardless of whether the taxpayer is treated as a separate or disregarded entity for franchise and excise tax purposes.

Authority: *T.C.A. §§ 67-1-102, 67-4-2004, 67-4-2007, 67-4-2105, 67-4-2106, and 48-249-1003.*
Administrative History: *New rules filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.41 SERIES LIMITED LIABILITY COMPANIES.

(1) The Tennessee Revised Limited Liability Company Act, T.C.A. §§ 48-249-101 et. seq., generally permits the establishment of one or more designated "series" within a limited liability company, commonly referred to as the "Master LLC." The Master LLC and each

(Rule 1320-06-01-.41, continued)

series is treated as a separate entity and must determine its tax classification as though it were a separate limited liability company. The Master LLC and each series will generally be classified as a corporation, partnership, or other type of business entity, consistent with the way it is classified for federal income tax purposes. A Master LLC or a series that is wholly owned by a corporation and that is disregarded for federal income tax purposes will be disregarded for franchise and excise tax purposes. All other federally disregarded Master LLCs or series are treated as separate entities for franchise and excise tax purposes.

(2) A Master LLC and each series doing business in and having substantial nexus with Tennessee must separately register with the department and set up separate tax accounts. A series must provide on its application for franchise, excise tax registration information about the Master LLC under whose organization documents the series was authorized.

(3) Unless a series is classified as a disregarded entity for franchise and excise tax purposes, each series must file a separate tax return. The Master LLC must also file a separate return unless disregarded. The Master LLC and each series will be treated as separate entities for purposes of assessments, refunds and taxpayer remedies, unless disregarded.

(4) The Master LLC and each series must apply separately to qualify for any applicable franchise and excise tax exemption. On any application for exemption, the series should state that it is a limited liability company. Because each series is treated as a separate entity under state law, only that series' activities, income, and other attributes will be considered in any applicable exemption determination.

(5) If a series terminates its existence, it must obtain a separate tax clearance.

Authority: *T.C.A. §§ 67-1-102, 67-4-2004, 67-4-2007, 67-4-2106, 48-29-101, 48-249-309, and 48-249-1003.* ***Administrative History:*** *New rules filed June 28, 2016; effective September 26, 2016.*

1320-06-01-.42 SALES FACTOR — SALES OTHER THAN SALES OF TANGIBLE PERSONAL PROPERTY IN THIS STATE.

(1) General Rules.

(a) Market-Based Sourcing. Sales, other than sales of tangible personal property, are in Tennessee if and to the extent that the taxpayer's market for the sales is in Tennessee. In general, the provisions in this section establish uniform rules for (1) determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Tennessee, (2) reasonably approximating the state or states of assignment where such state or states cannot be determined, and (3) excluding the sale where the state or states of assignment cannot be determined or reasonably approximated.

(b) Outline of topics. The provisions in this regulation are organized as follows.

1. General Rules.

a. Market-Based Sourcing

b. Outline of Topics

c. Definitions Market-Based Sourcing

d. General Principles of Application; Contemporaneous Record

(Rule 1320-06-01-.42, continued)

e. Rules of Reasonable Approximation

f. Exclusion of Sales from the Sales Factor

2. Sale, Rental, Lease or License of Real Property.

3. Rental, Lease or License of Tangible Personal Property.

4. Sale of a Service.

a. General Rule

b. In-Person Services

c. Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer

d. Professional Services

e. Broadcast Advertising

5. License or Lease of Intangible Property.

a. General Rules

b. License of a Marketing Intangible

c. License of a Production Intangible

d. License of a Broadcasting Intangible

e. License of Mixed Intangible

f. License of Intangible Property where Substance of the Transaction Resembles a Sale of Goods or Services

g. Examples

6. License of Intangible Property.

a. Assignment of Sales

b. Examples

7. Special Rules.

a. Software Transactions

b. Sales or Licenses of Digital Goods and Services

c. Enforcement of Legal Rights

(c) Definitions. For the purposes of this regulation the following terms have the following meanings.

(Rule 1320-06-01-.42, continued)

1. "Billing address" means the location indicated in the books and records of the taxpayer as the primary mailing address relating to a customer's account as of the time of the transaction as kept in good faith in the normal course of business and not for tax avoidance purposes.

2. "Broadcast customer" means a person, corporation, partnership, limited liability company, or other entity, such as an advertiser or a platform distribution company, that has a direct connection or contractual relationship with the broadcaster under which revenue is derived by a broadcaster.

3. "Broadcaster" means a taxpayer that is a television broadcast network, a cable program network, or a television distribution company. The term "broadcaster" does not include a platform distribution company.

4. "Business customer" means a customer that is a business operating in any form, including an individual who operates a business through the form of a sole proprietorship. Sales to a non-profit organization, to a trust, to the U.S. Government, to any foreign, state or local government, or to any agency or instrumentality of such government shall be treated as sales to a business customer and shall be assigned consistent with the rules that apply to such sales.

5. "Commercial domicile" means the principal place from which the trade or business of a business entity is directed or managed.

6. "Film programming" means one or more performances, events, or productions (or segments of performances, events, or productions) intended to be distributed for visual and auditory perception, including but not limited to news, entertainment, sporting events, plays, stories, or other literary, commercial, educational, or artistic works.

7. "Individual customer" means any customer who is not a business customer.

8. "Place of order," means the physical location from which a customer places an order for a sale other than a sale of tangible personal property from a taxpayer, resulting in a contract with the taxpayer.

9. "Platform distribution company" means a cable service provider, a direct broadcast satellite system, an Internet content distributor, or any other distributor that directly charges viewers for access to any film programming.

10. "State where a contract of sale is principally managed by the customer," means the primary location at which an employee or other representative of a customer serves as the primary contact person for the taxpayer with respect to the implementation and day-to-day execution of a contract entered into by the taxpayer with the customer.

(d) General Principles of Application; Contemporaneous Records. In order to satisfy the requirements of this regulation, a taxpayer's assignment of sales of other than tangible personal property must be consistent with the following principles:

1. A taxpayer's application of the rules set forth in this regulation shall be based on objective criteria and shall consider all sources of information reasonably available to the taxpayer at the time of its tax filing including, without limitation, the taxpayer's books and records kept in the normal course of business. A

taxpayer's method of assigning its sales shall be determined in good faith, applied in good faith, and applied consistently with respect to similar transactions and year to year. A taxpayer shall retain contemporaneous records that explain the determination and application of its method of assigning its sales, including its underlying assumptions, and shall provide such records to the Commissioner of Revenue upon request.

2. The provisions of Rule 1320-06-01-.42(4)-(7) provide for various assignment rules that apply sequentially in a hierarchy. For each sale to which a hierarchical rule applies, a taxpayer must make a reasonable effort to apply the primary rule applicable to the sale before seeking to apply the next rule in the hierarchy (and must continue to do so with each succeeding rule in the hierarchy, where applicable). For example, in some cases, the applicable rule first requires a taxpayer to determine the state or states of assignment, and where the taxpayer cannot do so, the rule then requires the taxpayer to reasonably approximate such state or states. In such cases, the taxpayer must in good faith and with reasonable effort attempt to determine the state or states of assignment (i.e., apply the primary rule in the hierarchy) before it may reasonably approximate such state or states.

3. A taxpayer's method of assigning its sales, including the use of a method of approximation, where applicable, must reflect an attempt to obtain the most accurate assignment of sales consistent with the regulatory standards set forth in this regulation, rather than an attempt to lower the taxpayer's tax liability. A method of assignment that is reasonable for one taxpayer may not necessarily be reasonable for another taxpayer, depending upon the applicable facts.

(e) Rules of Reasonable Approximation.

1. In General. In general, the provisions of Rule 1320-06-01-.42(4)-(7) establish uniform rules for determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Tennessee. The provisions of the regulation also set forth rules of reasonable approximation, which apply where the state or states of assignment cannot be determined. In some instances, the reasonable approximation must be made in accordance with specific rules of approximation prescribed by this regulation. See, e.g., Rule 1320-06-01-.42(4)(d) (pertaining to professional services). In other cases, the applicable rule in this regulation permits a taxpayer to reasonably approximate the state or states of assignment, using a method that reflects an effort to approximate the results that would be obtained under the applicable rules or standards set forth in this regulation.

2. Approximation Based Upon Known Sales. In any instance where, applying the applicable rules set forth in Rule 1320-06-01-.42(4) (pertaining to sales of services), a taxpayer can ascertain the state or states of assignment of a substantial portion of its sales of substantially similar services ("assigned sales"), but not all of such sales, and the taxpayer reasonably believes, based on all available information, that the geographic distribution of some or all of the remainder of such sales generally tracks that of the assigned sales, it shall include those sales which it believes track the geographic distribution of the assigned sales in its sales factor in the same proportion as its assigned sales. This rule also applies in the context of licenses and sales of intangible property where the substance of the transaction resembles a sale of goods or services. See 1320-06-01-.42(5)(f) and (6)(a)4.

(Rule 1320-06-01-.42, continued)

(f) Exclusion of Sales from the Sales Factor. In any case in which a taxpayer cannot ascertain the state or states to which a sale is to be assigned pursuant to the applicable rules set forth in this regulation (including through the use of a method of reasonable approximation, where relevant) using a reasonable amount of effort undertaken in good faith, the sale shall be excluded from the numerator and the denominator of the taxpayer's sales factor.

(2) Sale, Rental, Lease or License of Real Property. In the case of a sale, rental, lease or license of real property, the sale is in Tennessee if and to the extent that the property is in Tennessee.

(3) Rental, Lease or License of Tangible Personal Property. In the case of a rental, lease or license of tangible personal property, the sale is in Tennessee if and to the extent that the property is in Tennessee. If property is mobile property that is located both within and without Tennessee during the period of the lease or other contract, the receipts assigned to Tennessee shall be the receipts from the contract period multiplied by the fraction used by the taxpayer for property factor purposes (as adjusted when necessary to reflect differences between usage during the contract period and usage during the taxable year).

(4) Sale of a Service.

(a) General Rule. The sale of a service is in Tennessee if and to the extent that the service is delivered at a location in Tennessee. In general, the term "delivered" shall be construed to refer to the location of the taxpayer's market for the service provided and is not to be construed by reference to the location of the property or payroll of the taxpayer as otherwise determined for corporate apportionment purposes. The rules to determine the location of the delivery of a service in the context of several specific types of service transactions are set forth at Rule 1320-06-01-.42(4)(b)-(e).

(b) In-Person Services.

1. In General. Except as otherwise provided in this subsection, in-person services are services that are physically provided in person by the taxpayer, where the customer or the customer's real or tangible property upon which the services are performed is in the same location as the service provider at the time the services are performed. This rule includes situations where the services are provided on behalf of the taxpayer by a third-party contractor. Examples of in-person services include, without limitation, warranty and repair services; cleaning services; plumbing services; carpentry; construction contractor services; pest control; landscape services; medical and dental services, including medical testing and x-rays and mental health care and treatment; child care; hair cutting and salon services; live entertainment and athletic performances; and in-person training or lessons. In-person services include services within the description above that are performed at (1) a location that is owned or operated by the service provider or (2) a location of the customer, including the location of the customer's real or tangible personal property. Various professional services, including legal, accounting, financial and consulting services, and other such services as described in Rule 1320-06-01-.42(4)(d), although they may involve some amount of in-person contact, are not treated as in-person services within the meaning of this section.

2. Assignment of Sales. Except as otherwise provided in this subsection, where the service provided by the taxpayer is an in-person service, the delivery of the service is at the location where the service is received. Therefore, the sale is in

Tennessee if and to the extent the customer receives the in-person service in Tennessee.

(i) Rule of Determination. In assigning its sales of in-person services, a taxpayer shall first attempt to determine the location where a service is received, as follows:

(I) Where the service is performed with respect to the body of an individual customer in Tennessee (e.g. hair cutting or x-ray services) or in the physical presence of the customer in Tennessee (e.g. live entertainment or athletic performances), the service is received in Tennessee.

(II) Where the service is performed with respect to the customer's real estate in Tennessee or where the service is performed with respect to the customer's tangible personal property at the customer's residence or in the customer's possession in Tennessee, the service is received in Tennessee.

(III) Where the service is performed with respect to the customer's tangible personal property and the tangible personal property is to be shipped or delivered to the customer, whether the service is performed in Tennessee or outside Tennessee, the service is received in Tennessee if such property is shipped or delivered to the customer in Tennessee.

(ii) Rule of Reasonable Approximation. In any instance in which the state or states where a service is actually received cannot be determined, but the taxpayer has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, the taxpayer shall reasonably approximate such state or states.

(c) Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer.

1. In General. Where the service provided by the taxpayer is not an in-person service within the meaning of Rule 1320-06-01-.42(4)(b) or a professional service within the meaning of Rule 1320-06-01-.42(4)(d) and the service is delivered to or on behalf of the customer, or delivered electronically through the customer, the sale is in Tennessee if and to the extent that the service is delivered in Tennessee. For purposes of this section, a service that is delivered "to" a customer is a service in which the customer and not a third party is the recipient of the service. A service that is delivered "on behalf of" a customer is one in which a customer contracts for a service but one or more third parties, rather than the customer, is the recipient of the service, such as fulfillment services (see Rule 1320-06-01-.42(4)(c)2(i) or the direct or indirect delivery of advertising to the customer's intended audience (see Rule 1320-06-01-.42(4)(c)2(iii)). A service that is delivered electronically "through" a customer is a service that is delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to an end user or other third-party recipient. Except in the instance of a service that is delivered through a customer (where the service must be delivered electronically), a service is included within the meaning of this section, irrespective of the method of delivery, e.g., whether

such service is delivered by a physical means or through an electronic transmission.

2. Assignment of Sales. The assignment of a sale to a state or states in the instance of a service that is delivered to the customer or on behalf of the customer, or delivered electronically through the customer, depends upon the method of delivery of the service and the nature of the customer. Separate rules of assignment apply to services delivered by physical means and services delivered by electronic transmission. (For purposes of this section, a service delivered by an electronic transmission shall not be considered a delivery by a physical means). In any instance where, applying the rules set forth in this section, the rule of assignment depends on whether the customer is an individual or a business customer, and the taxpayer acting in good faith cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer.

(i) Delivery to or on Behalf of a Customer by Physical Means, Whether to an Individual or Business Customer. Services delivered to a customer or on behalf of a customer through a physical means include, for example, product delivery services where property is delivered to the customer or to a third party on behalf of the customer; the delivery of brochures, fliers or other direct mail services; the delivery of advertising or advertising-related services to the customer's intended audience in the form of a physical medium; and the sale of custom software (e.g., where software is developed for a specific customer in a case where the transaction is properly treated as a service transaction for purposes of corporate taxation) where the taxpayer installs the custom software at the customer's site. The rules in this subsection apply whether the taxpayer's customer is an individual customer or a business customer.

(I) Rule of Determination. In assigning the sale of a service delivered to a customer or on behalf of a customer through a physical means, a taxpayer must first attempt to determine the state or states where such services are delivered. Where the taxpayer is able to determine the state or states where the service is delivered, it shall assign the sale to such state or states.

(II) Rule of Reasonable Approximation. Where the taxpayer cannot determine the state or states where the service is actually delivered, but has sufficient information regarding the place of delivery from which it can reasonably approximate the state or states where the service is delivered, it shall reasonably approximate such state or states.

(III) Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Tennessee and is to apportion its income pursuant to T.C.A. §67-4-2012.

Example 1: Direct Mail Corp, a corporation based outside Tennessee, provides direct mail services to its customer, Business Corp. Business Corp transacts with Direct Mail Corp to deliver printed fliers to a list of customers that is provided to it by Business Corp. Some of Business Corp's customers are in Tennessee and some of those customers are in other states. Direct Mail Corp will use the postal service to deliver the printed fliers to Business Corp's

(Rule 1320-06-01-.42, continued)

customers. The sale of Direct Mail Corp's services to Business Corp is assigned to Tennessee to the extent that the services are delivered on behalf of Business Corp to Tennessee customers (i.e., to the extent that the fliers are delivered on behalf of Business Corp to Business Corp's intended audience in Tennessee).

Example 2: Ad Corp is a corporation based outside Tennessee that provides advertising and advertising-related services in Tennessee and in neighboring states. Ad Corp enters into a contract at a location outside Tennessee with an individual customer who is not a Tennessee resident to design advertisements for billboards to be displayed in Tennessee, and to design fliers to be mailed to Tennessee residents. All of the design work is performed outside Tennessee. The sale of the design services is in Tennessee because the service is physically delivered on behalf of the customer to the customer's intended audience in Tennessee.

Example 3: Same facts as Example 2, except that the contract is with a business customer that is based outside Tennessee. The sale of the design services is in Tennessee because the services are physically delivered on behalf of the customer to the customer's intended audience in Tennessee.

Example 4: Fulfillment Corp, a corporation based outside Tennessee, provides product delivery fulfillment services in Tennessee and in neighboring states to Sales Corp, a corporation located outside Tennessee that sells tangible personal property through a mail order catalog and over the Internet to customers. In some cases when a customer purchases tangible personal property from Sales Corp to be delivered in Tennessee, Fulfillment Corp will, pursuant to its contract with Sales Corp, deliver that property from its fulfillment warehouse located outside Tennessee. The sale of the fulfillment services of Fulfillment Corp to Sales Corp is assigned to Tennessee to the extent that Fulfillment Corp's deliveries on behalf of Sales Corp are to recipients in Tennessee.

Example 5: Software Corp, a software development corporation, enters into a contract with a business customer, Buyer Corp, which is physically located in Tennessee, to develop custom software to be used in Buyer Corp's business. Software Corp develops the custom software outside Tennessee, and then physically installs the software on Buyer Corp's computer hardware located in Tennessee. The development and sale of the custom software is properly characterized as a service transaction, and the sale is assigned to Tennessee because the software is physically delivered to the customer in Tennessee.

Example 6: Same facts as Example 5, except that Buyer Corp has offices in Tennessee and several other states, but is commercially domiciled outside Tennessee and orders the software from a location outside Tennessee. The receipts from the development and sale of the custom software service are assigned to Tennessee because the software is physically delivered to the customer in Tennessee.

(Rule 1320-06-01-.42, continued)

(ii) Delivery to a Customer by Electronic Transmission. Services delivered by electronic transmission include, without limitation, services that are transmitted through the means of wire, lines, cable, fiber optics, electronic signals, satellite transmission, audio or radio waves, or other similar means, whether or not the service provider owns, leases or otherwise controls the transmission equipment. In the case of the delivery of a service by electronic transmission to a customer, the following rules apply.

(I) Services Delivered By Electronic Transmission to an Individual Customer.

I. Rule of Determination. In the case of the delivery of a service to an individual customer by electronic transmission, the service is delivered in Tennessee if and to the extent that the taxpayer's customer receives the service in Tennessee. If the taxpayer can determine the state or states where the service is received, it shall assign the sale to such state or states.

II. Rules of Reasonable Approximation. If the taxpayer cannot determine the state or states where the customer actually receives the service, but has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, it shall reasonably approximate such state or states. Where a taxpayer does not have sufficient information from which it can determine or reasonably approximate the state or states in which the service is received, it shall reasonably approximate such state or states using the customer's billing address.

(II) Services Delivered By Electronic Transmission to a Business Customer.

I. Rule of Determination. In the case of the delivery of a service to a business customer by electronic transmission, the service is delivered in Tennessee if and to the extent that the taxpayer's customer receives the service in Tennessee. If the taxpayer can determine the state or states where the service is received, it shall assign the sale to such state or states. For purposes of this section, it is intended that the state or states where the service is received reflect the location at which the service is directly used by the employees or designees of the customer.

II. Rules of Reasonable Approximation. If the taxpayer cannot determine the state or states where the customer actually receives the service, but has sufficient information regarding the place of receipt from which it can reasonably approximate the state or states where the service is received, it shall reasonably approximate such state or states.

III. Secondary Rule of Reasonable Approximation. In the case of the delivery of a service to a business customer by electronic transmission where a taxpayer does not have sufficient information from which it can determine or reasonably approximate the state or states in which the service is

received, such state or states shall be reasonably approximated as set forth in this section. In such cases, unless the taxpayer can apply the safe harbor set forth in Rule 1320-06-01-.42(4)(c)2(ii)(II)IV, the taxpayer shall reasonably approximate the state or states in which the service is received as follows: first, by assigning the sale to the state where the contract of sale is principally managed by the customer; second, if the state where the customer principally manages the contract is not reasonably determinable, by assigning the sale to the customer's place of order; and third, if the customer's place of order is not reasonably determinable, by assigning the sale using the customer's billing address; provided, however, that in any instance in which the taxpayer derives more than 5% of its sales of services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by that customer.

IV. Safe Harbor. In the case of the delivery of a service to a business customer by electronic transmission a taxpayer may not be able to determine, or reasonably approximate under Rule 1320-06-01-.42(4)(c)2(ii)(II)II, the state or states in which the service is received. In these cases, the taxpayer may, in lieu of the rule stated at Rule 1320-06-01-.42(4)(c)2(ii)(II)III, apply the safe harbor stated in this section (Rule 1320-06-01-.42(4)(c)2(ii)(II)IV). Under this safe harbor, a taxpayer may assign its sales to a particular customer based upon the customer's billing address in any taxable year in which the taxpayer (1) engages in substantially similar service transactions with more than 250 customers, whether business or individual, and (2) does not derive more than 5% of its sales of services from such customer. This safe harbor applies only for purposes of Rule 1320-06-01-.42(4)(c)2(ii)(II) to services delivered by electronic transmission to a business customer, and not otherwise.

(III) Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Tennessee and is to apportion its income pursuant to T.C.A. § 67-4-2012. Assume where relevant, unless otherwise stated, that the safe harbor set forth at Rule 1320-06-01-.42(4)(c)2(ii)(II)IV does not apply.

Example 1: Support Corp, a corporation that is based outside Tennessee, provides software support and diagnostic services to individual and business customers that have previously purchased certain software from third-party vendors. These individual and business customers are located in Tennessee and other states. Support Corp supplies its services on a case-by-case basis when directly contacted by its customer. Support Corp generally provides these services through the Internet but sometimes provides these services by phone. In all cases, Support Corp verifies the customer's account information before providing any service. Using the information that Support Corp verifies before performing a service, Support Corp can determine where its services are received, and therefore must assign its sales to these locations. The sales made to Support Corp's individual and business customers are in Tennessee

to the extent that Support Corp's services are received in Tennessee. See Rule 1320-06-01-.42(4)(c)2(ii)(I) and (II).

Example 2: Online Corp, a corporation based outside Tennessee, provides web-based services through the means of the Internet to individual customers who are residents of Tennessee and other states. These customers access Online Corp's web services primarily in their states of residence, and sometimes, while traveling, in other states. For a substantial portion of its sales, Online Corp either can determine the state or states where such services are received, or, where it cannot determine such state or states, it has sufficient information regarding the place of receipt to reasonably approximate such state or states. However, Online Corp cannot determine or reasonably approximate the state or states of receipt for all of such sales. Assuming that Online Corp reasonably believes, based on all available information, that the geographic distribution of the sales for which it cannot determine or reasonably approximate the location of the receipt of its services generally tracks those for which it does have this information, Online Corp must assign to Tennessee the sales for which it does not know the customers' location in the same proportion as those sales for which it has this information. See Rule 1320-06-01-.42(1)(e)2.

Example 3: Same facts as in Example 2, except that Online Corp reasonably believes that the geographic distribution of the sales for which it cannot determine or reasonably approximate the location of the receipt of its web-based services do not generally track the sales for which it does have this information. Online Corp must assign the sales of its services for which it lacks information as provided to its individual customers using the customers' billing addresses. See Rule 1320-06-01-.42(4)(c)2(ii)(I)II.

Example 4: Net Corp, a corporation based outside Tennessee, provides web-based services to a business customer, Business Corp, a company with offices in Tennessee and two neighboring states. Particular employees of Business Corp access the services from computers in each Business Corp office. Assume that Net Corp determines that Business Corp employees in Tennessee were responsible for 75% of Business Corp's use of Net Corp's services, and Business Corp employees in other states were responsible for 25% of Business Corp's use of Net Corp's services. In such case, 75% of the sale is received in Tennessee, and therefore 75% of the sale is in Tennessee. See Rule 1320-06-01-.42(4)(c)2(ii)(II). Assume alternatively that Net Corp lacks sufficient information regarding the location or locations where Business Corp's employees used the services to determine or reasonably approximate such location or locations. Under these circumstances, if Net Corp derives 5% or less of its sales from Business Corp, Net Corp must assign the sale under Rule 1320-06-01-.42(4)(c)2(ii)(II)III to the state where Business Corp principally managed the contract, or if that state is not reasonably determinable, to the state where Business Corp placed the order for the services, or if that state is not reasonably determinable, to the state of Business Corp's billing address. If Net Corp derives more than 5% of its sales of services from Business Corp, Net Corp is required to identify the state in which its contract of sale is principally

managed by Business Corp and must assign the receipts to that state.

Example 5: Net Corp, a corporation based outside Tennessee, provides web-based services through the means of the Internet to more than 250 individual and business customers in Tennessee and in other states. Assume that for each customer Net Corp cannot determine the state or states where its web services are actually received, and lacks sufficient information regarding the place of receipt to reasonably approximate such state or states. Also assume that Net Corp does not derive more than 5% of its sales of services from any single customer. Net Corp may apply the safe harbor stated in Rule 1320-06-01-.42(4)(c)2(ii)(II)IV and may assign its sales using each customer's billing address.

(iii) Services Delivered Electronically Through or on Behalf of an Individual or Business Customer. A service delivered electronically "on behalf of" the customer is one in which a customer contracts for a service to be delivered electronically but one or more third parties, rather than the customer, is the recipient of the service, such as the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience. A service delivered electronically "through" a customer to third-party recipients is a service that is delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to end users or other third-party recipients.

(I) Rule of Determination. In the case of the delivery of a service by electronic transmission, where the service is delivered electronically to end users or other third-party recipients through or on behalf of the customer, the service is delivered in Tennessee if and to the extent that the end users or other third-party recipients are in Tennessee. For example, in the case of the direct or indirect delivery of advertising on behalf of a customer to the customer's intended audience by electronic means, the service is delivered in Tennessee to the extent that the audience for such advertising is in Tennessee. In the case of the delivery of a service to a customer that acts as an intermediary in reselling the service in substantially identical form to third-party recipients, the service is delivered in Tennessee to the extent that the end users or other third-party recipients receive such services in Tennessee. The rules in this subsection apply whether the taxpayer's customer is an individual customer or a business customer and whether the end users or other third-party recipients to which the services are delivered through or on behalf of the customer are individuals or businesses.

(II) Rule of Reasonable Approximation. If the taxpayer cannot determine the state or states where the services are actually delivered to the end users or other third-party recipients either through or on behalf of the customer, but has sufficient information regarding the place of delivery from which it can reasonably approximate the state or states where the services are delivered, it shall reasonably approximate such state or states.

(III) Select Secondary Rules of Reasonable Approximation.

(Rule 1320-06-01-.42, continued)

I. Where a taxpayer's service is the direct or indirect electronic delivery of advertising on behalf of its customer to the customer's intended audience, if the taxpayer lacks sufficient information regarding the location of the audience from which it can determine or reasonably approximate such location, the taxpayer shall reasonably approximate the audience in a state for such advertising using the following secondary rules of reasonable approximation. Where a taxpayer is delivering advertising directly or indirectly to a known list of subscribers, the taxpayer shall reasonably approximate the audience for advertising in a state using a percentage that reflects the ratio of the state's subscribers in the specific geographic area in which the advertising is delivered relative to the total subscribers in such area. For a taxpayer with less information about its audience, the taxpayer shall reasonably approximate the audience in a state using the percentage that reflects the ratio of the state's population in the specific geographic area in which the advertising is delivered relative to the total population in such area.

II. Where a taxpayer's service is the delivery of a service to a customer that then acts as the taxpayer's intermediary in reselling such service to end users or other third-party recipients, if the taxpayer lacks sufficient information regarding the location of the end users or other third-party recipients from which it can determine or reasonably approximate such location, the taxpayer shall reasonably approximate the extent to which the service is received in a state by using the percentage that reflects the ratio of the state's population in the specific geographic area in which the taxpayer's intermediary resells such services, relative to the total population in such area.

(IV) Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Tennessee and is to apportion its income pursuant to T.C.A. § 67-4-2012.

Example 1: Web Corp, a corporation that is based outside Tennessee, provides Internet content to viewers in Tennessee and other states. Web Corp sells advertising space to business customers pursuant to which the customers' advertisements will appear in connection with Web Corp's Internet content. Web Corp receives a fee for running the advertisements that is determined by reference to the number of times the advertisement is viewed or clicked upon by the viewers of its website. Web Corp's sale of advertising space to its business customers is assigned to Tennessee to the extent that the viewers of the Internet content are in Tennessee, as measured by viewings or clicks. See Rule 1320-06-01-.42(4)(c)2(iii)(I). If Web Corp is unable to determine the actual location of its viewers, and lacks sufficient information regarding the location of its viewers to reasonably approximate such location, Web Corp must approximate the amount of its Tennessee sales by multiplying the amount of such sales by a percentage that reflects the Tennessee population in the specific geographic area in which

the content containing the advertising is delivered relative to the total population in such area. See Rule 1320-06-01-.42(4)(c)2(iii)(III).

Example 2: Retail Corp, a corporation that is based outside of Tennessee, sells tangible property through its retail stores located in Tennessee and other states, and through a mail order catalog. Answer Co, a corporation that operates call centers in multiple states, contracts with Retail Corp to answer telephone calls from individuals placing orders for products found in Retail Corp's catalogs. In this case, the phone answering services of Answer Co are being delivered to Retail Corp's customers and prospective customers. Therefore, Answer Co is delivering a service electronically to Retail Corp's customers or prospective customers on behalf of Retail Corp, and must assign the proceeds from this service to the state or states from which the phone calls are placed by such customers or prospective customers. If Answer Co cannot determine the actual locations from which phone calls are placed, and lacks sufficient information regarding the locations to reasonably approximate such locations, Answer Co must approximate the amount of its Tennessee sales by multiplying the amount of its fee from Retail Corp by a percentage that reflects the Tennessee population in the specific geographic area from which the calls are placed relative to the total population in such area. See Rule 1320-06-01-.42(4)(c)2(iii)(III)I.

Example 3: Web Corp, a corporation that is based outside of Tennessee, sells tangible property to customers via its Internet website. Design Co designed and maintains Web Corp's website, including making changes to the site based on customer feedback received through the site. Design Co's services are delivered to Web Corp, the proceeds from which are assigned pursuant to Rule 1320-06-01-.42(4)(c)2(ii). The fact that Web Corp's customers and prospective customers incidentally benefit from Design Co's services, and may even interact with Design Co in the course of providing feedback, does not transform the service into one delivered "on behalf of" Web Corp to Web Corp's customers and prospective customers.

Example 4: Wholesale Corp, a corporation that is based outside Tennessee, develops an Internet-based information database outside Tennessee and enters into a contract with Retail Corp whereby Retail Corp will market and sell access to this database to end users. Depending on the facts, the provision of database access may be either the sale of a service or the license of intangible property or may have elements of both. Assume that on the particular facts applicable in this example Wholesale Corp is selling database access in transactions properly characterized as involving the performance of a service. When an end user purchases access to Wholesale Corp's database from Retail Corp, Retail Corp in turn compensates Wholesale Corp in connection with that transaction. In this case, Wholesale Corp's services are being delivered through Retail Corp to the end user. Wholesale Corp must assign its sales to Retail Corp to the state or states in which the end users receive access to Wholesale Corp's database. If Wholesale Corp cannot determine the state or states where the end users actually receive

access to Wholesale Corp's database, and lacks sufficient information regarding the location from which the end users access the database to reasonably approximate such location, Wholesale Corp must approximate the extent to which its services are received by end users in Tennessee by using a percentage that reflects the ratio of the Tennessee population in the specific geographic area in which Retail Corp regularly markets and sells Wholesale Corp's database relative to the total population in such area. See Rule 1320-06-01-.42(4)(c)2(iii)(III)II. Note that it does not matter for purposes of the analysis whether Wholesale Corp's sale of database access constitutes a service or a license of intangible property, or some combination of both. See Rule 1320-06-1-.42(5)(f).

(d) Professional Services.

1. In General. Except as otherwise provided in Rule 1320-06-01-.42(4)(d)2, professional services are services that require specialized knowledge and in some cases require a professional certification, license or degree. Professional services include, without limitation, management services, bank and financial services, financial custodial services, investment and brokerage services, fiduciary services, tax preparation, payroll and accounting services, lending and credit card services, legal services, consulting services, video production services, graphic and other design services, engineering services, and architectural services.

2. Overlap with Other Categories of Services.

(i) Certain services that fall within the definition of "professional services" set forth in Rule 1320-06-01-.42(4)(d)1 are nevertheless treated as "in-person services" within the meaning of Rule 1320-06-01-.42(4)(b), and are assigned under Rule 1320-06-01-.42(4)(b). Specifically, professional services that are physically provided in person by the taxpayer such as carpentry, certain medical and dental services or child care services, where the customer or the customer's real or tangible property upon which the services are provided is in the same location as the service provider at the time the services are performed, are "in-person services" and are assigned as such, notwithstanding that they may also be considered to be "professional services". However, professional services where the service is of an intellectual or intangible nature, such as legal, accounting, financial and consulting services, are assigned as professional services under Rule 1320-06-01-.42(4)(d), notwithstanding the fact that such services may involve some amount of in-person contact.

(ii) Professional services may in some cases include the transmission of one or more documents or other communications by mail or by electronic means. However, in such cases, despite this transmission, the assignment rules that apply are those set forth in Rule 1320-06-01-.42(4)(d), and not those set forth in Rule 1320-06-01-.42(4)(c), pertaining to services delivered to a customer or through or on behalf of a customer.

3. Assignment of Sales. In the case of a professional service, it is generally possible to characterize the location of delivery in multiple ways by emphasizing different elements of the service provided, no one of which will consistently represent the market for the services. Therefore, for purposes of consistent application of the market-sourcing rule stated in T.C.A. § 67-4-2012, the Commissioner has

(Rule 1320-06-01-.42, continued)

concluded that the location of delivery in the case of professional services is not susceptible to a general rule of determination, and must be reasonably approximated. The assignment of a sale of a professional service depends in many cases upon whether the customer is an individual or business customer. In any instance in which the taxpayer, acting in good faith, cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer. For purposes of assigning the sale of a professional service, a taxpayer's customer is the person who contracts for such service, irrespective of whether another person pays for or also benefits from the taxpayer's services.

(i) General Rule. Sales of professional services other than those services described in Rule 1320-06-01-.42(4)(d)3(ii) (architectural and engineering services) are assigned in accordance with this section.

(I) Professional Services Delivered to Individual Customers. Except as otherwise provided in this section, Rule 1320-06-01-.42(4)(d), in any instance in which the service provided is a professional service and the taxpayer's customer is an individual customer, the state or states in which the service is delivered shall be reasonably approximated as set forth in this section, Rule 1320-06-01-.42(4)(d)3(i)(I). In particular, the taxpayer shall assign the sale to the customer's state of primary residence, or, if the taxpayer cannot reasonably identify the customer's state of primary residence, to the state of the customer's billing address; provided, however, in any instance in which the taxpayer derives more than 5% of its sales of services from an individual customer, the taxpayer is required to identify the customer's state of primary residence and must assign the receipts from the service or services provided to that customer to that state.

(II) Professional Services Delivered to Business Customers. Except as otherwise provided in this section, Rule 1320-06-01-.42(4)(d), in any instance in which the service provided is a professional service and the taxpayer's customer is a business customer, the state or states in which the service is delivered shall be reasonably approximated as set forth in this section, 1320-06-01-.42(4)(d)3(i)(II). In particular, unless the taxpayer may use the safe harbor set forth at 1320-06-01-.42(4)(d)3(i)(III), the taxpayer shall assign the sale as follows: first, by assigning the receipts to the state where the contract of sale is principally managed by the customer; second, if such place of customer management is not reasonably determinable, to the customer's place of order; and third, if such customer's place of order is not reasonably determinable, to the customer's billing address; provided, however, in any instance in which the taxpayer derives more than 5% of its sales of services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by the customer.

(III) Safe Harbor; Large Volume of Transactions. Notwithstanding the rules set forth in Rule 1320-06-01-.42(4)(d)3(i)(I) and (II), a taxpayer may assign its sales to a particular customer based on the customer's billing address in any taxable year in which the taxpayer (1) engages in substantially similar service transactions with more than 250 customers, whether individual or business, and (2) does not derive more than 5% of its sales of services from such customer.

This safe harbor applies only for purposes of Rule 1320-06-01-.42(4)(d)3(i), and not otherwise.

(ii) Architectural and Engineering Services with Respect to Real or Tangible Personal Property. Architectural and engineering services with respect to real or tangible personal property are professional services within the meaning of this section Rule 1320-06-01-.42(4)(d). However, unlike in the case of the general rule that applies to professional services, (1) the sale of such an architectural service is assigned to a state or states if and to the extent that the services are with respect to real estate improvements located, or expected to be located, in such state or states; and (2) the sale of such an engineering service is assigned to a state or states if and to the extent that the services are with respect to tangible or real property located in such state or states, including real estate improvements located in, or expected to be located in, such state or states. These rules apply whether or not the customer is an individual or business customer. In any instance in which architectural or engineering services are not described in this section (Rule 1320-06-01-.42(4)(d)3(ii)), the sale of such services shall be assigned under the general rule for professional services. See Rule 1320-06-01-.42(4)(d)3(i).

Example 1: Architecture Corp provides building design services as to buildings located, or expected to be located, in Tennessee to individual customers who are residents of Tennessee and other states, and to business customers that are based in Tennessee and other states. Architecture Corp's sales are assigned to Tennessee because the locations of the buildings to which its design services relate are in Tennessee, or are expected to be in Tennessee. For purposes of assigning these sales, it is not relevant where, in the case of an individual customer, the customer primarily resides or is billed for such services, and it is not relevant where, in the case of a business customer, the customer principally manages the contract, placed the order for the services or is billed for such services. Further, such sales are assigned to Tennessee even if Architecture Corp's designs are either physically delivered to its customer in paper form in a state other than Tennessee or are electronically delivered to its customer in a state other than Tennessee. See Rule 1320-06-01-.42(4)(d)3(ii).

Example 2: Law Corp provides legal services to individual clients who are residents of Tennessee and other states. In some cases, Law Corp may prepare one or more legal documents for its client as a result of these services and/or the legal work may be related to litigation or a legal matter that is ongoing in a state other than where the client is resident. Assume that Law Corp knows the state of primary residence for many of its clients, and where it does not know this state of primary residence, it knows the client's billing address. Also assume that Law Corp does not derive more than 5% of its sales of services from any one individual client. Where Law Corp knows its client's state of primary residence, it shall assign the sale to that state. Where Law Corp does not know its client's state of primary residence, but rather knows the client's billing address, it shall assign the sale to that state. For purposes of the analysis it is irrelevant whether the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or the litigation or other legal matter that is the underlying predicate for the services is in another state. See Rule 1320-06-01-.42(4)(d)2(ii) and 3(i)(I).

(Rule 1320-06-01-.42, continued)

Example 3: Law Corp provides legal services to several multistate business clients. In each case, Law Corp knows the state in which the agreement for legal services that governs the client relationship is principally managed by the client. In one case, the agreement is principally managed in Tennessee; in the other cases, the agreement is principally managed in a state other than Tennessee. Where the agreement for legal services is principally managed by the client in Tennessee, the sale of the services shall be assigned to Tennessee; in the other cases, the sale is not assigned to Tennessee. In the case of the sale that is assigned to Tennessee, the sale shall be so assigned even if (1) the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or (2) the litigation or other legal matter that is the underlying predicate for the services is in another state. See Rule 1320-06-01-.42(4)(d)2(ii) and 3(i)(II).

Example 4: Consulting Corp, a company that provides consulting services to law firms and other customers, is hired by Law Corp in connection with legal representation that Law Corp provides to Client Co. Specifically, Consulting Corp is hired to provide expert testimony at a trial being conducted by Law Corp on behalf of Client Co. Client Co pays for Consulting Corp's services directly. Assuming that Consulting Corp knows that its agreement with Law Corp is principally managed by Law Corp in Tennessee, the sale of Consulting Corp's services shall be assigned to Tennessee. It is not relevant for purposes of the analysis that Client Co is the ultimate beneficiary of Consulting Corp's services, or that Client Co pays for Consulting Corp's services directly. See Rule 1320-06-01-.42(4)(d)3(i)(II).

Example 5: Advisor Corp, a corporation that provides investment advisory services, provides such advisory services to Investment Co. Investment Co is a multistate business client of Advisor Corp that uses Advisor Corp's services in connection with investment accounts that it manages for individual clients, who are the ultimate beneficiaries of Advisor Corp's services. Assume that Investment Co's individual clients are persons that are residents of numerous states, which may or may not include Tennessee. Assuming that Advisor Corp knows that its agreement with Investment Co is principally managed by Investment Co in Tennessee, the sale of Advisor Corp's services shall be assigned to Tennessee. It is not relevant for purposes of the analysis that the ultimate beneficiaries of Advisor Corp's services may be Investment Co's clients, who are residents of numerous states. See Rule 1320-06-01-.42(4)(d)3(i)(II).

Example 6: Design Corp is a corporation based outside Tennessee that provides graphic design and similar services in Tennessee and in neighboring states. Design Corp enters into a contract at a location outside Tennessee with an individual customer to design fliers for the customer. Assume that Design Corp does not know the individual customer's state of primary residence and does not derive more than 5% of its sales of services from the individual customer. All of the design work is performed outside Tennessee. The sale is in Tennessee if the customer's billing address is in Tennessee. See Rule 1320-06-01-.42(4)(d)3(i)(I).

(Rule 1320-06-01-.42, continued)

(e) Broadcast Advertising Services. Notwithstanding anything herein to the contrary, receipts from a broadcaster's sale of advertising services to a broadcast customer are assigned to Tennessee if the commercial domicile of the broadcast customer is in Tennessee. For purposes of this provision, "advertising services" means an agreement to include the broadcast customer's advertising content in the broadcaster's film programming.

(5) Rental, Lease, or License of Intangible Property.

(a) General Rule.

1. The receipts from the rental, lease, or license of intangible property are in Tennessee if and to the extent the intangible is used in Tennessee. In general, the term "use" shall be construed to refer to the location of the taxpayer's market for the use of the intangible property that is being rented, leased, or licensed and is not to be construed to refer to the location of the property or payroll of the taxpayer.

2. In general, a rental, lease, or license of intangible property that conveys all substantial rights in such property is treated as a sale of intangible property for tax purposes. See Rule 1320-06-01-.42(6). Note, however, that for purposes of Rule 1320-06-01-.42(5) and (6), a sale or exchange of intangible property is treated as a license of such property where the receipts from the sale or exchange derive from payments that are contingent on the productivity, use or disposition of the property.

3. Intangible property rented, leased, or licensed as part of the sale or lease of tangible property is treated under Rule 1320-06-01-.42 as the sale or lease of tangible property.

(b) License of a Marketing Intangible. Where a license is granted for the right to use intangible property in connection with the sale, rental, lease, license, or other marketing of goods, services, or other items (i.e., a marketing intangible), the royalties or other licensing fees paid by the licensee for such right are assigned to Tennessee to the extent that the fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by customers in Tennessee. Examples of a license of a marketing intangible include, without limitation, the license of a service mark, trademark, or trade name; certain copyrights and a franchise agreement. In each of these instances the license of the marketing intangible is intended to promote consumer sales. In the case of the license of a marketing intangible, where a taxpayer has actual evidence of the amount or proportion of its receipts that is attributable to Tennessee, it shall assign such amount or proportion to Tennessee. In the absence of actual evidence of the amount or proportion of the licensee's receipts that are derived from Tennessee customers, the portion of the licensing fee to be assigned to Tennessee shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the Tennessee population in the specific geographic area in which the licensee makes material use of the intangible property to regularly market its goods, services or other items relative to the total population in such area. Where the license of a marketing intangible is for the right to use the intangible property in connection with sales or other transfers at wholesale rather than directly to retail customers, the portion of the licensing fee to be assigned to Tennessee shall be reasonably approximated by multiplying the total fee by a percentage that reflects the ratio of the Tennessee population in the specific geographic area in which the licensee's goods, services, or other items are ultimately marketed using the intangible property relative to the total population of such area.

(Rule 1320-06-01-.42, continued)

(c) License of a Production Intangible. Where a license is granted for the right to use intangible property other than in connection with the sale, lease, license, or other marketing of goods, services, or other items, and the license is to be used in a production capacity (a "production intangible"), the licensing fees paid by the licensee for such right are assigned to Tennessee to the extent that the use for which the fees are paid takes place in Tennessee. Examples of a license of a production intangible include, without limitation, the license of a patent, a copyright, or trade secrets to be used in a manufacturing process, where the value of the intangible lies predominately in its use in such process. In the case of a license of a production intangible, it shall be presumed that the use of the intangible property takes place in the state of the licensee's commercial domicile (where the licensee is a business) or the licensee's state of primary residence (where the licensee is an individual) unless the taxpayer or the Commissioner can reasonably establish the location(s) of actual use. Where the Commissioner can reasonably establish that the actual use of intangible property pursuant to a license of a production intangible takes place in part in Tennessee, it shall be presumed that the entire use is in Tennessee except to the extent that the taxpayer can demonstrate that the actual location of a portion of the use takes place outside Tennessee.

(d) License of a Broadcasting Intangible. Where a broadcaster grants a license to a broadcast customer for the right to use film programming, the licensing fees paid by the licensee for such right are assigned to Tennessee to the extent that the broadcast customer is located in Tennessee. In the case of business customers, the broadcast customer's location shall be determined using the broadcast customer's commercial domicile. In the case of individual customers, the broadcast customer's location shall be determined using the address of the broadcast customer listed in the broadcaster's records.

(e) License of a Mixed Intangible. Where a license of intangible property includes both a license of a marketing intangible and a license of a production intangible (a "mixed intangible") and the fees to be paid in each instance are separately and reasonably stated in the licensing contract, the Commissioner will accept such separate statement for purposes of this section if it is reasonable. Where a license of intangible property includes both a license of a marketing intangible and a license of a production intangible and the fees to be paid in each instance are not separately and reasonably stated in the contract, it shall be presumed that the licensing fees are paid entirely for the license of the marketing intangible except to the extent that the taxpayer or the Commissioner can reasonably establish otherwise.

(f) License of Intangible Property where Substance of Transaction Resembles a Sale of Goods or Services.

1. In general. In some cases, the license of intangible property will resemble the sale of an electronically-delivered good or service rather than the license of a marketing intangible or a production intangible. In such cases, the receipts from the licensing transaction shall be assigned by applying the rules set forth in Rule 1320-06-01-.42(4)(c)2(ii) and (iii), as if the transaction were a service delivered to an individual or business customer or delivered electronically through an individual or business customer, as applicable. Examples of transactions to be assigned under this section (1320-06-01-.42(5)(f)) include, without limitation, the license of database access, the license of access to information, the license of digital goods (see Rule 1320-06-01-.42(7)(b)), and the license of certain software (e.g., where the transaction is not the license of pre-written software that is treated as the sale of tangible personal property, see Rule 1320-06-01-.42(7)(a)).

(Rule 1320-06-01-.42, continued)

2. Sublicenses. Pursuant to Rule 1320-06-01-.42(5)(f)1, Rule 1320-06-01-.42(4)(c)2(iii) may apply where a taxpayer licenses intangible property to a customer that in turn sublicenses the intangible property to end users as if the transaction were a service delivered electronically through a customer to end users. In particular, the rules set forth at Rule 1320-06-01-.42(4)(c)2(iii) that apply to services delivered electronically to a customer for purposes of resale and subsequent electronic delivery in substantially identical form to end users or other recipients may also apply with respect to licenses of intangible property for purposes of sublicense to end users, provided that for this purpose the intangible property sublicensed to an end user shall not fail to be substantially identical to the property that was licensed to the sublicensor merely because the sublicense transfers a reduced bundle of rights with respect to such property (e.g., because the sublicensee's rights are limited to its own use of the property and do not include the ability to grant a further sublicense), or because such property is bundled with additional services or items of property.

(g) Examples. Assume in each of these examples that the taxpayer that licenses the intangible property is taxable in Tennessee and is to apportion its income pursuant to T.C.A. § 67-4-2012.

Example 1: Crayon Corp and Dealer Co enter into a license contract under which Dealer Co as licensee is permitted to use trademarks that are owned by Crayon Corp in connection with Dealer Co's sale of certain products to retail customers. Under the contract, Dealer Co is required to pay Crayon Corp a licensing fee that is a fixed percentage of the total volume of monthly sales made by Dealer Co of products using the Crayon Corp trademarks. Under the contract, Dealer Co is permitted to sell the products at multiple store locations, including store locations that are both within and without Tennessee. Further, the licensing fees that are paid by Dealer Co are broken out on a per-store basis. The licensing fees paid to Crayon Corp by Dealer Co represent fees from the license of a marketing intangible. The portion of the fees to be assigned to Tennessee shall be determined by multiplying the fees by a percentage that reflects the ratio of Dealer Co's receipts that are derived from its Tennessee stores relative to Dealer Co's total receipts. See Rule 1320-06-01-.42(5)(b).

Example 2: Network Corp is a broadcaster that licenses rights to its film programming to both platform distribution companies and individual customers. Platform distribution companies pay licensing fees to Network Corp for the rights to distribute Network Corp's film programming to the platform distribution companies' customers. Network Corp's individual customers pay access fees to Network Corp for the right to directly access and view Network Corp's film programming. Network Corp's receipts from each platform distribution company will be assigned to Tennessee if the broadcast customer's commercial domicile is in Tennessee. Network Corp's receipts from each individual broadcast customer will be assigned to Tennessee if the address of the broadcast customer listed in the broadcaster's records is in Tennessee. See Rule 1320-06-01-.42(5)(d).

Example 3: Moniker Corp enters into a license contract with Wholesale Co. Pursuant to the contract Wholesale Co is granted the right to use trademarks owned by Moniker Corp to brand sports equipment that is to be manufactured by Wholesale Co or an unrelated entity, and to sell the manufactured equipment to unrelated companies that will ultimately market the equipment to consumers in a specific geographic region, including a foreign country. The license agreement confers a license of a marketing intangible, even though the trademarks in question will be affixed to property to be manufactured. In addition, the license of the marketing intangible is for the right to use the intangible property in connection with sales to be made at wholesale rather than

(Rule 1320-06-01-.42, continued)

directly to retail customers. The component of the licensing fee that constitutes the Tennessee sales of Moniker Corp is determined by multiplying the amount of the fee by a percentage that reflects the ratio of the Tennessee population in the specific geographic region relative to the total population in such region. See Rule 1320-06-01-.42(5)(b).

Example 4: Formula, Inc and Appliance Co enter into a license contract under which Appliance Co is permitted to use a patent owned by Formula, Inc to manufacture appliances. The license contract specifies that Appliance Co is to pay Formula, Inc a royalty that is a fixed percentage of the gross receipts from the products that are later sold. The contract does not specify any other fees. The appliances are both manufactured and sold in Tennessee and several other states. Assume the licensing fees are paid for the license of a production intangible, even though the royalty is to be paid based upon the sales of a manufactured product (i.e., the license is not one that includes a marketing intangible). Because the Commissioner can reasonably establish that the actual use of the intangible property takes place in part in Tennessee, the royalty is assigned based on the location of such use rather than to location of the licensee's commercial domicile, in accordance with Rule 1320-06-01-.42(5)(c). It is presumed that the entire use is in Tennessee except to the extent that the taxpayer can demonstrate that the actual location of some or all of the use takes place outside Tennessee. Assuming that Formula, Inc can demonstrate the percentage of manufacturing that takes place in Tennessee using the patent relative to such manufacturing in other states, that percentage of the total licensing fee paid to Formula, Inc under the contract will constitute Formula, Inc's Tennessee sales. See Rule 1320-06-01-.42(5)(c).

Example 5: Axel Corp enters into a license agreement with Biker Co in which Biker Co is granted the right to produce motor scooters using patented technology owned by Axel Corp, and also to sell such scooters by marketing the fact that the scooters were manufactured using the special technology. The contract is a license of both a marketing and production intangible, i.e., a mixed intangible. The scooters are manufactured outside Tennessee. Assume that Axel Corp lacks actual information regarding the proportion of Biker Co's receipts that are derived from Tennessee customers. Also assume that Biker Co is granted the right to sell the scooters in a U.S. geographic region in which the Tennessee population constitutes 25% of the total population during the period in question. The licensing contract requires an upfront licensing fee to be paid by Biker Co to Axel Corp and does not specify what percentage of the fee derives from Biker Co's right to use Axel Corp's patented technology. Because the fees for the license of the marketing and production intangible are not separately and reasonably stated in the contract, it is presumed that the licensing fees are paid entirely for the license of a marketing intangible, unless either the taxpayer or Commissioner reasonably establishes otherwise. Assuming that neither party establishes otherwise, 25% of the licensing fee constitutes Tennessee sales. See Rule 1320-06-01-.42(5)(b) and (e).

Example 6: Same facts as Example 5, except that the license contract specifies separate fees to be paid for the right to produce the motor scooters and for the right to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The licensing contract constitutes both the license of a marketing intangible and the license of a production intangible. Assuming that the separately stated fees are reasonable, the Commissioner will: (1) assign no part of the licensing fee paid for the production intangible to Tennessee, and (2) assign 25% of the licensing fee paid for the marketing intangible to Tennessee. See Rule 1320-06-01-.42(5)(e).

(Rule 1320-06-01-.42, continued)

Example 7: Better Burger Corp, which is based outside Tennessee, enters into franchise contracts with franchisees who agree to operate Better Burger restaurants as franchisees in various states. Several of the Better Burger Corp franchises are in Tennessee. In each case, the franchise contract between the individual and Better Burger provides that the franchisee is to pay Better Burger Corp an upfront fee for the receipt of the franchise and monthly franchise fees, which cover, among other things, the right to use the Better Burger name and service marks, food processes and cooking know-how, as well as fees for management services. The upfront fees for the receipt of the Tennessee franchises constitute fees paid for the licensing of a marketing intangible. These fees constitute Tennessee sales because the franchises are for the right to make Tennessee sales. The monthly franchise fees paid by Tennessee franchisees constitute fees paid for (1) the license of marketing intangibles (the Better Burger name and service marks), (2) the license of production intangibles (food processes and know-how) and (3) personal services (management fees). The fees paid for the license of the marketing intangibles and the production intangibles constitute Tennessee sales because in each case the use of the intangibles is to take place in Tennessee. See Rule 1320-06-01-.42(5)(b)-(c). The fees paid for the personal services are to be assigned pursuant to Rule 1320-06-01-.42(4).

Example 8: Online Corp, a corporation based outside Tennessee, licenses an information database through the means of the Internet to individual customers that are residents of Tennessee and other states. These customers access Online Corp's information database primarily in their states of residence, and sometimes, while traveling, in other states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with Rule 1320-06-01-.42(5)(f). If Online Corp can determine or reasonably approximate the state or states where its database is accessed, then it must do so. Assuming that Online Corp cannot determine or reasonably approximate the location where its database is accessed, Online Corp must assign the sales made to the individual customers using the customers' billing addresses to the extent known. Assume for purposes of this example that Online Corp knows the billing address for each of its customers. In this case, Online Corp's sales made to its individual customers are in Tennessee in any case in which the customer's billing address is in Tennessee. See Rule 1320-06-01-.42(4)(c)2(ii)(I).

Example 9: Net Corp, a corporation based outside Tennessee, licenses an information database through the means of the Internet to a business customer, Business Corp, a company with offices in Tennessee and two neighboring states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with Rule 1320-06-01-.42(5)(f). Assume that Net Corp cannot determine where its database is accessed but reasonably approximates that 75% of Business Corp's database access took place in Tennessee, and 25% of Business Corp's database access took place in other states. In such case, 75% of the receipts from database access is in Tennessee. Assume alternatively that Net Corp lacks sufficient information regarding the location where its database is accessed to reasonably approximate such location. Under these circumstances, if Net Corp derives 5% or less of its receipts from database access from Business Corp, Net Corp must assign the sale under Rule 1320-06-01-.42(4)(c)2(ii)(II) to the state where Business Corp principally managed the contract, or if that state is not reasonably determinable to the state where Business Corp placed the order for the services, or if that state is not reasonably determinable to the state of Business Corp's billing address. If Net Corp derives more than 5% of its receipts from database access from Business Corp, Net Corp is required to identify the state in which its contract of sale is principally managed by Business Corp and must assign the receipts to that state. See Rule 1320-06-01-.42(4)(c)2(ii)(II).

(Rule 1320-06-01-.42, continued)

Example 10: Net Corp, a corporation based outside Tennessee, licenses an information database through the means of the Internet to more than 250 individual and business customers in Tennessee and in other states. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned in accordance with Rule 1320-06-01-.42(5)(f). Assume that Net Corp cannot determine or reasonably approximate the location where its information database is accessed. Also assume that Net Corp does not derive more than 5% of its sales of database access from any single customer. Net Corp may apply the safe harbor stated in Rule 1320-06-01-.42(4)(c)2(ii)(II)IV, and may assign its sales to a state or states using each customer's billing address.

Example 11: Web Corp, a corporation based outside of Tennessee, licenses an Internet-based information database to business customers who then sublicense the database to individual end users that are residents of Tennessee and other states. These end users access Web Corp's information database primarily in their states of residence, and sometimes, while traveling, in other states. Web Corp's license of the database to its customers includes the right to sublicense the database to end users, while the sublicenses provide that the rights to access and use the database are limited to the end users' own use and prohibit the individual end users from further sublicensing the database. Web Corp receives a fee from each customer based upon the number of sublicenses issued to end users. The license is a license of intangible property that resembles a sale of goods or services and shall be assigned by applying the rules set forth in Rule 1320-06-01-.42(4)(c)2(iii). See 1320-06-01-.42(5)(f). If Web Corp can determine or reasonably approximate the state or states where its database is accessed by end users, then it must do so. Assuming that Web Corp lacks sufficient information from which it can determine or reasonably approximate the location where its database is accessed by end users, Web Corp must approximate the extent to which its database is accessed in Tennessee using a percentage that represents the ratio of the Tennessee population in the specific geographic area in which Web Corp's customer sublicenses the database access relative to the total population in such area. See Rule 1320-06-01-.42(4)(c)2(iii)(II).

(6) Sale of Intangible Property.

(a) Assignment of Sales. The assignment of a sale to a state or states in the instance of a sale or exchange of intangible property depends upon the nature of the intangible property sold. For purposes of this section (Rule 1320-06-01-.42(6)), a sale or exchange of intangible property includes a license of such property where the transaction is treated for tax purposes as a sale of all substantial rights in the property and the receipts from transaction are not contingent on the productivity, use or disposition of the property. For the rules that apply where the consideration for the transfer of rights is contingent on the productivity, use or disposition of the property, see Rule 1320-06-01-.42(5)(a) and (6)(a)3.

1. Contract Right or Government License that Authorizes Business Activity in Specific Geographic Area. In the case of a sale or exchange of intangible property where the property sold or exchanged is a contract right, government license or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area, the sale is assigned to a state if and to the extent that the intangible property is used or otherwise associated with the state. Where the intangible property is used in, or otherwise associated with, only Tennessee, the taxpayer shall assign the sale to Tennessee. Where the intangible property is used in or is otherwise associated with Tennessee and one or more other states, the taxpayer shall assign the sale to Tennessee to the

extent that the intangible property is used in, or associated with, Tennessee, through the means of a reasonable approximation.

2. Agreement Not to Compete. An agreement or covenant not to compete in a specified geographic area requires the contract party to refrain from conducting certain business activity in that specified area. In the case of an agreement or covenant not to compete the receipts are to be assigned to a state based upon the percentage that reflects the state's population in the U.S. geographic area specified in the contract relative to the total population in such area.

3. Sale that Resembles a License (Receipts are Contingent on Productivity, Use or Disposition of the Intangible Property). In the case of a sale or exchange of intangible property where the receipts from the sale or exchange are contingent on the productivity, use or disposition of the property, the receipts from the sale shall be assigned by applying the rules set forth in Rule 1320-06-01-.42(5) (pertaining to the license or lease of intangible property).

4. Sale that Resembles a Sale of Goods and Services. In the case of a sale or exchange of intangible property where the substance of the transaction resembles a sale of goods or services and where the receipts from the sale or exchange do not derive from payments contingent on the productivity, use or disposition of the property, the receipts from the sale shall be assigned by applying the rules set forth in Rule 1320-06-01-.42(5)(f) (relating to licenses of intangible property that resemble sales of goods and services). Examples of such transactions include those that are analogous to the license transactions cited as examples in Rule 1320-06-01-.42(5)(f).

5. Except as otherwise provided in this section, the sale of intangible property that is not referenced in Rule 1320-06-01-.42(6)(a)1,2,4, or 5 shall be excluded from the numerator and the denominator of the taxpayer's sales factor.

(b) Examples. Assume in each of these examples that the taxpayer that provides the service is taxable in Tennessee and is to apportion its income pursuant to T.C.A. § 67-4-2012.

Example 1: Airline Corp, a corporation based outside Tennessee, sells its rights to use several gates at an airport located in Tennessee to Buyer Corp, a corporation that is based outside Tennessee. The contract of sale is negotiated and signed outside of Tennessee. The sale is in Tennessee because the intangible property sold is a contract right that authorizes the holder to conduct a business activity solely in Tennessee. See Rule 1320-06-01-.42(6)(a)1.

Example 2: Wireless Corp, a corporation based outside Tennessee, sells a license issued by the Federal Communications Commission (FCC) to operate wireless telecommunications services in a designated area in Tennessee to Buyer Corp, a corporation that is based outside Tennessee. The contract of sale is negotiated and signed outside of Tennessee. The sale is in Tennessee because the intangible property sold is a government license that authorizes the holder to conduct business activity solely in Tennessee. See Rule 1320-06-01-.42(6)(a)1.

Example 3: Same facts as in Example 2 except that Wireless Corp sells to Buyer Corp an FCC license to operate wireless telecommunications services in a designated area in Tennessee and an adjacent state. Wireless Corp must attempt to reasonably approximate the extent to which the intangible property is used in or associated with Tennessee. For purposes of making this reasonable approximation, Wireless Corp may

rely upon credible data that identifies the percentage of persons that use wireless telecommunications in the two states covered by the license. See Rule 1320-06-01-.42(6)(a)1.

Example 4: Sports League Corp, a corporation that is based outside Tennessee, sells the rights to broadcast the sporting events played by the teams in its league in all 50 U.S. states to Network Corp. Although the games played by Sports League Corp will be broadcast in all 50 states, the games are of greater interest in the southeast region of the country, including Tennessee. Because the intangible property sold is a contract right that authorizes the holder to conduct a business activity in a specified geographic area, Sports League Corp must attempt to reasonably approximate the extent to which the intangible property is used in or associated with Tennessee. For purposes of making this reasonable approximation, Sports League Corp may rely upon audience measurement information that identifies the percentage of the audience for its sporting events in Tennessee and the other states. See Rule 1320-06-01-.42(6)(a)1.

Example 5: Business Corp, a corporation based outside Tennessee engaged in business activities in Tennessee and other states, enters into a covenant not to compete with Competition Corp, a corporation that is based outside Tennessee, in exchange for a fee. The agreement requires Business Corp to refrain from engaging in certain business activity in Tennessee and other states. The component of the fee that constitutes a Tennessee sale is determined by multiplying the amount of the fee by a fraction represented by the percentage of the Tennessee population over the total population in the specified geographic region. See Rule 1320-06-01-.42(6)(a)2.

Example 6: Inventor Corp, a corporation that is based outside Tennessee, sells patented technology that it has developed to Buyer Corp, a business customer that is based in Tennessee. Assume that the sale is not one in which the receipts derive from payments that are contingent on the productivity, use or disposition of the property. See Rule 1320-06-01-.42(6)(a)4. Inventor Corp understands that Buyer Corp is likely to use the patented technology in Tennessee, but the patented technology can be used anywhere (i.e., the rights sold are not rights that authorize the holder to conduct a business activity in a specific geographic area). The sale of the patented technology shall be excluded from the numerator and denominator of Inventor Corp's sales factor. See Rule 1320-06-01-.42(6)(a)5.

(7) Special Rules.

(a) Software Transactions. A license or sale of pre-written software for purposes other than commercial reproduction (or other exploitation of the intellectual property rights), when transferred on a tangible medium, is treated as the sale of tangible personal property, rather than as either the license or sale of intangible property or the performance of a service. In such cases, the receipts are assigned to Tennessee as a sale of tangible personal property. In all other cases, the receipts from a license or sale of software are to be assigned to Tennessee as determined otherwise under this regulation (e.g., depending on the facts, as the development and sale of custom software, see Rule 1320-06-01-.42(4)(c), as a license of a marketing intangible, see Rule 1320-06-01-.42(5)(b), as a license of a production intangible, see Rule 1320-06-01-.42(5)(c), as a license of intangible property where the substance of the transaction resembles a sale of goods or services, see Rule 1320-06-01-.42(5)(f), or as a sale of intangible property, see Rule 1320-06-01-.42(6)).

(b) Sales or Licenses of Digital Goods or Services. In the case of a sale or license of digital goods or services, including, among other things, the sale of various video, audio and software products or similar transactions, the receipts from the sale or license shall be

(Rule 1320-06-01-.42, continued)

assigned by applying the same rules as are set forth in Rule 1320-06-01-.42(4)(c)2(ii) or (iii), as if the transaction were a service delivered to an individual or business customer or delivered through or on behalf of an individual or business customer. For purposes of the analysis, it is not relevant what the terms of the contractual relationship are or whether the sale or license might be characterized, depending upon the particular facts, as, for example, the sale or license of intangible property or the performance of a service. See Rules 1320-06-01-.42(5)(f) and (6)(a)5.

(c) Enforcement of Legal Rights. Receipts attributable to the protection or enforcement of legal rights of a taxpayer through litigation, arbitration, or settlement of legal disputes or claims, including the filing and pursuit of claims under insurance contracts, shall be excluded from the numerator and denominator of the taxpayer's sales factor. For purposes of this rule, in the case of a settlement agreement, it shall not be relevant how the parties to the agreement characterize the payment made under the agreement.

Authority: *T.C.A. §§ 67-1-102(a) and 67-4-2012.* ***Administrative History:*** *New rules filed June 28, 2016; effective September 26, 2016.*