

# PUBLICATION

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## Business Income and Sales/Use Taxes: What Constitutes a Manufacturer for Certain Tax Incentives

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**Manufacturing, as often noted, is the backbone of the American economy. Manufacturers not only innovate and create products that contribute to the betterment of our way of life but are also critically fundamental to our national competitiveness in a global marketplace. Additionally, manufacturers offer excellent wages, and each dollar invested by manufacturers produces a multiplier effect for local economies. No wonder manufacturers are highly sought reportedly and recruited by state governments, oftentimes offering a variety of tax and other incentives associated with new or expanded plant facilities.**

In the areas of state tax incentives, the definition of what constitutes a manufacturer can be critical to understanding the potential availability of such incentives. The purpose of this publication is to address the definition of a manufacturer for selected incentives potentially available with respect to certain state business income taxes as well as and sales and use taxes. While there is a wide variety of state taxes, the scope of this publication is limited to addressing the definition of manufacturing only for particular issues pertinent to business income and sales/use taxes.

## Tennessee

### Franchise and Excise Taxes

These Tennessee taxes are imposed on business entities that operate in this state and offer their owners limited liability protection. The excise tax is this state's business income tax and the franchise tax is this state's net worth tax. In certain circumstances where a business is operating not only in Tennessee but also in other states, that business likely will be allowed to use an apportionment formula in calculating its franchise and excise tax obligations so as to apportion to Tennessee its share of the business income and net worth. Manufacturers under such circumstances are currently allowed to elect to use a single sales factor method of apportionment.<sup>1</sup> A taxpayer is treated as a manufacturer for such purposes if more than 50 percent of a taxpayer's revenue from its activities in Tennessee (excluding passive income) is from manufacturing activities. The numerator of this ratio includes revenues derived from manufacturing activities occurring in Tennessee, and the denominator includes all revenues (excluding passive income) derived from all activities occurring in Tennessee. The ratio is computed from all the activities statewide in Tennessee and is not limited to a location-by-location analysis. While the Tennessee Department of Revenue (TN DOR) has noted that the franchise and excise statutes do not define a "manufacturer," the TN DOR will generally apply the same logic, rulings, and judgment used for sales and use tax purposes in defining a manufacturer for franchise and excise tax purposes – and thus, defining the type of permitted activities within the scope of manufacturing activities.

The TN DOR does, however, undertake a location-by-location analysis when separately determining whether a manufacturer can utilize the industrial machinery credit for franchise and excise tax purposes. In essence, and while a particular taxpayer having multiple locations in Tennessee may be considered as a manufacturer on a statewide basis pursuant to the above-referenced single sales factor election, that taxpayer may not be considered as a manufacturer for the industrial machinery credit at, for example, one of those locations where

the activities at that location are not principally the fabrication or processing of tangible personal property for resale. See reference to the "51% test" below as to sales and use taxes.

Importantly, a manufacturer's franchise tax base is capped at \$2 billion of apportioned net worth. A manufacturer for these purposes means any taxpayer whose principal business is fabricating or processing tangible personal property for resale and ultimate use or consumption off the premises of the taxpayer engaging in such fabrication or processing. The TN DOR has stated that, for purposes of this test, the taxpayer's manufacturing activities are not required to occur in Tennessee.

So, and as just noted, the definition of a manufacturer is different depending on the franchise and excise tax incentive being sought.

## **Sales and Use Taxes**

A "manufacturer" is defined for Tennessee sales and use tax purposes as one whose principal business is fabricating or processing tangible personal property for resale and consumption off the premises. According to the TN DOR, manufacturing is a taxpayer's principal business if more than 50 percent of its revenues at a given location are derived from fabricating or processing tangible personal property for resale. The foregoing analysis is referred to by TN DOR as the "51% test." Application of the 51 percent test is a very fact-specific inquiry according to the TN DOR. Thus, a taxpayer having multiple locations in Tennessee might qualify under the 51 percent test as a manufacturer at some but not all such locations.

"Processing" has been defined by the Tennessee Supreme Court to mean "essentially a transformation or conversion of materials or things into a different state or form from that in which they originally existed – the actual operation incident to changing them into marketable products." "Fabrication" on the other hand, has been referenced by the TN DOR as the transformation of tangible personal property into another state.

A taxpayer approved by the TN DOR as a manufacturer at a particular location has the opportunity to purchase industrial machinery and industrial supplies for the manufacturing process at that location exempt from the sales and use tax; and the opportunity to purchase energy fuel and water used in the manufacturing process at such location at reduced rates or exempt from tax.

Even if so approved by the TN DOR, a manufacturer is subject to audit by the TN DOR for purposes of proving that the manufacturing definitional requirements have in fact been satisfied and are continuing to be satisfied.

## **Georgia**

### **Corporate Income Tax**

This Georgia tax is imposed on corporate taxpayers, including manufacturers, that own property in Georgia, do business in Georgia, or receive income from Georgia sources that are subject to the tax. Corporations may also have to pay a net worth tax.

Georgia, like many states, seeks to incentivize manufacturers to move to the state and to certain counties. Georgia has done so, as an example, by creating a tax credit such as the new manufacturing facilities property credit which is available to manufacturers that satisfy the various requirements for such credit, with such credit being available to offset income tax liabilities and with any excess available to offset withholding taxes. Separately, and while a job tax credit is available to a wide variety of taxpayers, specific types of manufacturers, such as a "personal protection equipment manufacturer" (as defined by regulations adopted by the Georgia Department of Revenue (GA DOR)), may claim additional job tax credit. Each of these credits for manufacturers are aimed at incentivizing the location or expansion of manufacturing projects in Georgia.

To qualify as a manufacturer, and while the definition of a manufacturer for this tax purpose varies from context to context and can be fact-intensive, the determinations have been similar and are mostly aligned with the definition of a manufacturer for sales and use tax purposes discussed below.

## Sales and Use Taxes

Georgia provides benefits to manufacturers within the state on the "front end" of their business operations. As to sales and use taxes, manufacturers can qualify for exemptions on their input costs, to include machinery integral to their manufacturing process and energy used in the manufacture of tangible property. These exemptions provide strong incentives to reduce the upfront costs of manufacturing operations. Furthermore, these exemption provisions are often broadly construed -- for example, one manufacturer was reportedly able to receive an exemption for a lease of quality control equipment that was "integral" to their manufacturing operations.

In the context of sales and use taxes, the Georgia Legislature has been more explicit with respect to defining a manufacturer, and the GA DOR utilizes such definition in determining qualification as a manufacturer. In that regard, manufacturers are broadly defined to be a person or business that is engaged in the manufacture of tangible personal property for sale or further manufacturing; and, to be considered as a manufacturer, the person or business, or the location of the person or business, must be: (a) classified as a manufacturer under the 2007 North American Industrial Classification System Sectors 21, 31, 32 or 33, or the NAICS industry code 22111 or specific code 511110; or (b) generally regarded as being a manufacturer. The Legislature chose to include the broad national standards, but also went further by including that a person or business could qualify as a manufacturer if "generally regarded as a manufacturer" – that is, engaging in the change or conversion of industrial materials by physical or chemical means into a different form of tangible property, also including assembly and packaging that occurs at a manufacturing plant.

The foregoing tax incentives offered in Tennessee and Georgia are simply just a few of the tools used by these states in recruiting manufacturers to locate or expand in their jurisdictions. With respect to manufacturers that are planning for a new location in a state, or expanding an existing presence in a state, those manufacturers should first consider how those tax and other incentives would apply to their particular activities.

Baker Donelson's state and local tax attorneys are dedicated to providing comprehensive, realistic, and value-added services to assist businesses and other taxpayers across the Firm's footprint. The above information in this newsletter is only intended to be a general overview of the topics addressed. To discuss your specific situation, please contact [Carl E. Hartley](#) (Chattanooga), [Michael M. Smith](#) (Atlanta), [Elizabeth J. Atkinson](#) (Baltimore, Washington, D.C., Falls Church) or any other attorney in the Firm's [State and Local Tax Group](#).

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<sup>1</sup> The single sales factor method of apportionment will be required for most apportioning taxpayers for tax years ending on or after December 31, 2025.