

IN THE CHANCERY COURT FOR THE STATE OF TENNESSEE  
TWENTIETH JUDICIAL DISTRICT, DAVIDSON COUNTY, PART IV

EXEL, INC.,

Plaintiff,

vs.

RICHARD ROBERTS,<sup>1</sup>  
Commissioner of Revenue,  
State of Tennessee,

Defendant.

FD9, II  
CASE NO. 06-2869-IV

MEMORANDUM AND FINAL ORDER

This is a tax case. A third-party logistics provider sued the state taxing authority asserting that its services fell within the public utility exemption to the business tax. The taxpayer also relied on other grounds. The taxing authority disagreed, filing a counterclaim seeking to recover the business tax and related relief.

On November 29, 2006, Plaintiff Exel, Inc. ("Plaintiff" or "Exel") sued Loren L. Chumley, Commissioner of Revenue, State of Tennessee ("Defendant" or "the Department"). Exel's Complaint challenges the business tax the Department assessed against it for the period of July 1, 1999 to June 30, 2004, and attendant penalties and interest. *See* Complaint, ¶¶ 3 & 6. On May 9, 2007, the Department filed an Answer and Counterclaim. The potential business tax liability, penalty, and interest at issue here amounted to \$243,966.20 as of February 23, 2006. *See* Answer and Counterclaim, Exhibit A. This matter is before the Court on cross-motions for summary judgment.

In November 2005, the Department assessed Exel for business tax liability, penalties and interest. *See* Notice of Assessment, Exhibit A to Complaint. The parties participated in an informal conference on May 31, 2006. On September 13, 2006, an

<sup>1</sup> When Richard Roberts became Tennessee's Commissioner of Revenue, he was automatically substituted, in this official capacity, as a party. *See* Tenn. R. Civ. P. 25.04.

Administrative Hearing Officer upheld the Department's position in all respects. *See* Complaint, ¶¶ 7 & 8, and Exhibit C to Complaint. Exel sued on November 29, 2006.

### **Summary of Issues**

Exel is a third-party logistics provider with operations at seven commercial sites in Tennessee. Exel's services often include a transportation component, among other things. Businesses operating in Tennessee are subject to the Tennessee Business Tax on sales of services unless the taxpayer falls under one of sixteen statutory exemptions. The threshold issue here is whether the taxpayer and the services it renders within Tennessee fall under one particular exemption: the public utility exemption. Similarly, although several types of public utilities are exempt, the only question presented here is whether the taxpayer owns, operate, manages, or controls "common carriers" in Tennessee within the meaning of the public utility exemption. *See* Tenn. Code Ann. §§ 67-4-708(3)(C)(ix); 65-4-101(b).

Alternatively, Exel contends that any potential business tax liability it might have is negated (or substantially decreased) because its sales are from one wholesaler to another and/or because any potential business tax liability is properly calculable at the wholesale rate. Additionally, Exel claims that any business tax liability it has should be calculated on net profit and not gross receipts. Also, Exel claims that application of the business tax to the sales of services at issue here has an impermissible extraterritorial reach in violation of the Commerce Clause of the United States Constitution. Exel also challenges whether the Department was authorized to assess penalties against it under the circumstances of this case.

### **Applicable Standard**

Tennessee Rule of Civil Procedure 56, which was adopted in 1970, allows parties to obtain a partial or full judgment before trial if the moving party is able to "show that

there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.” Tenn. R. Civ. P. 56.04. The summary judgment mechanism was designed to fill a then-existing procedural gap “for disposition of a case in the trial courts without an actual trial on the merits if the case could not be disposed of on demurrer or plea in abatement.” Tenn. R. Civ. P. 56 advisory commission comment. The Commission, therefore, described the rule as “a substantial step forward to the end that litigation may be accelerated, insubstantial issues removed, and trial confined only to genuine issues.”<sup>2</sup> *Id.* Rule 56, consistent with corresponding rules adopted for the federal system and by other states, contemplates that litigants would have an adequate opportunity to develop the evidentiary record (through discovery and other means) before the case, or issues in a case, may properly be decided by summary judgment. *See* Tenn. R. Civ. P. 56.03, 56.04, 56.06, 56.07; *Craven v. Lawson*, 534 S.W.2d 653, 655 (Tenn. 1976).

It is now well-settled that a court may grant summary judgment if it determines that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. *See Bain v. Wells*, 936 S.W.2d 618, 622 (Tenn. 1997); *Byrd v. Hall*, 847 S.W.2d 208, 210 (Tenn. 1993). In the summary judgment context, the court’s consideration of the facts is record driven. *See McClung v. Delta Square Ltd. P’ship*, 937 S.W.2d 891, 894 (Tenn. 1996). The parties, therefore, should not attempt to establish or refute liability under Tenn. R. Civ. P. 56 by merely resting on general allegations in the pleadings. *See* Tenn. R. Civ. P. 56.06; *Byrd*, 847 S.W.2d at 215; *McCarley v. West Quality Food Serv.*, 948 S.W.2d 477 (Tenn. 1997). On the question of

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<sup>2</sup> Although frivolous claims would appear to be necessarily included in the Rule 56 policy of summarily adjudicating “insubstantial” issues or claims failing to raise “genuine issues of material fact,” the Rule and its Advisory Commission Comments do not mention frivolous claims. Consequently, even though courts sometimes refer to frivolous claims when discussing the summary judgment standard, it appears that this is merely a shorthand reference to the actual standard set forth in Rule 56 and the case law. This Court, therefore, does not require that a claim be frivolous before it can be disposed of by summary judgment.

burden-shifting, the Tennessee Supreme Court recently held that “a moving party who seeks to shift the burden of production to the nonmoving party who bears the burden of proof at trial must either: (1) affirmatively negate an essential element of the nonmoving party’s claim; or (2) show that the nonmoving party cannot prove an essential element of the claim at trial.” *Hannan v. Alltel Publ’g Co.*, 270 S.W.3d 1, 9 (Tenn. 2008). In determining whether there are genuine issues of material fact, the court is required to construe the facts in the light most favorable to the nonmoving party. *See Blair v. West Town Mall*, 130 S.W.3d 761, 763 (Tenn. 2004); *Staples v. CBL & Assocs., Inc.*, 15 S.W.3d 83, 89 (Tenn. 2000).

### Facts<sup>3</sup>

Exel is a Massachusetts corporation doing business in the State of Tennessee. *See* Complaint ¶ 1. Exel is a third-party logistics and transportation management company with operations throughout the world. The Department audited Exel for the period beginning July 1, 1999 through June 30, 2004 (the “Audit Period”). *See* Complaint ¶ 5; Answer ¶ 5. In the suit before the Court, therefore, Exel challenges only the business tax assessed against it for the period of July 1, 1999 to June 30, 2004, and related penalties and interest.

Most of Exel’s customers are large manufacturing or retail companies. These companies have expertise in making quality products and in marketing their products to the public. Some manufacturing and retail companies, however, do not have expertise in the process and logistics required to reliably and efficiently manage the transportation and delivery of raw materials and other products used in the manufacturing process or, once that manufacturing process is complete, to distribute manufactured products to the ultimate consumers. Certain companies, therefore, outsource responsibility for managing

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<sup>3</sup> These facts are not in dispute for summary judgment purposes.

the transportation of their raw materials and manufactured products to companies like Exel that have extensive expertise in that area. *See Verdino Aff.* ¶¶ 3, 5; *Greer Aff.* ¶¶ 4, 6, 8-9.

Exel provides its customers with design, logistics, and transportation management services necessary to transport raw materials or other products on a fully integrated basis through a manufacturing process and, once those products are manufactured, to transport, distribute, and deliver the manufactured products to their ultimate destinations, typically retailers or consumers. *See Verdino Aff.* ¶¶ 3-4, 10, 13, 16-27; *Greer Aff.* ¶¶ 4, 6, 8-9. There are two sides to every supply and distribution chain – the supply side and the distribution side. *See Verdino Aff.* ¶ 7. The supply side includes all steps necessary to transport raw materials or other products to manufacturers for use in the manufacturing process or, typically, several such processes, the result of which is a finished manufactured product. In many cases, there are multiple manufacturers of a finished product. In those circumstances, the supply side includes all stages of transporting raw materials or other products to each manufacturer involved in the production of the finished product. *See Verdino Aff.* ¶ 7. The distribution side includes all steps necessary to transport a manufactured product from the final manufacturer of that product to its ultimate destination, which is typically a retailer or consumer. As there are on the supply side of the chain, there are also often multiple stages involved in the process of transporting a manufactured product through the distribution side. For instance, a manufactured product is often transported from the manufacturer of that product to one or more wholesalers who ultimately transport the finished product to a retailer's distribution center before the product is transported to a retailer's stores or directly to the ultimate consumer. *See Verdino Aff.* ¶ 8.

Exel's services include use of its own vehicles and subcontracts with other third-party carriers to physically deliver manufactured products from a manufacturer to a wholesaler, retailer, retail distribution center, or the ultimate consumer. *See Verdino Aff.* ¶¶ 10, 18-22; *Greer Aff.* ¶ 8. Exel also provides warehouse management services at warehouse facilities at the various locations where the starts and stops commonly involved in the free flow of manufactured products through the supply and distribution chain take place. *See Verdino Aff.* ¶¶ 10, 23-26; *Greer Aff.* ¶ 8. Exel provides a large range of transportation and logistics services, including supply chain analysis and design, supply chain management, in-plant services, warehousing and order fulfillment, assembly and packaging, transportation management, service parts logistics and reverse logistics. *See Anthony Verdino Deposition* ("Verdino Deposition"), pp. 27-55; Exhibit 3 to Deposition. In connection with its analysis and design services, Exel often redesigns or reorganizes a customer's current supply and distribution chain to reduce inefficiencies or costs. After making those kinds of recommendations or changes, Exel often takes over management of a customer's supply and distribution chain or at least a portion of that chain and, in that way, continues to use its expertise to reliably and efficiently transport the customer's products through the supply and distribution chain. *See Verdino Aff.* ¶ 17.

When Exel is hired to provide third-party logistics and transportation management services for a customer, Exel sometimes takes over the management of a customer's in-house fleet of trucks or other vehicles used to deliver raw materials or other products through the manufacturing process or to deliver the manufactured products to their ultimate destination. *See Verdino Aff.* ¶ 14; *Greer Aff.* ¶ 10. When Exel is hired to provide third-party logistics and transportation management services for its customer, Exel sometimes takes over physical possession and management of a warehouse facility

or a portion of a manufacturing facility the customer had previously operated and managed internally and often hires a customer's former employees to perform services for that customer at those facilities. *See Verdino Aff.* ¶ 14; *Greer Aff.* ¶ 10. One of the services Exel provides to its customers – both at the time of the summary judgment hearing and during the Audit Period – is the physical delivery of raw materials or products from one point in the supply and distribution chain to another. This service is Exel's transportation and delivery management service. *See Verdino Aff.* ¶¶ 18-22. Exel's transportation and delivery management service can include the physical delivery of raw materials or component parts from a supplier, warehouse facility, or parts distribution center to the customer's manufacturing facility. It can also include the delivery of manufactured products from a customer's manufacturing facility to a warehouse facility, from a warehouse facility to a wholesaler, a retailer, or the ultimate consumer, or in the case of a return from a consumer back to the dealer, warehouse facility, or manufacturer. Exel's transportation and delivery management service include the delivery of raw materials or manufactured products to and from various locations within the supply and distribution chain – such as from one warehouse facility to another – as necessary to reliably, efficiently, and cost-effectively transport a customer's product through the supply and distribution chain. *See Verdino Aff.* ¶ 18.

The following amounts are at issue in this suit, as outlined in the adjusted business tax assessment letter from the Department of Revenue dated February 23, 2006:

|           |                    |
|-----------|--------------------|
| Tax:      | \$157,700.00       |
| Penalty:  | \$21,619.00        |
| Interest: | <u>\$64,647.20</u> |
| TOTAL:    | \$243,966.20       |

Deposition of Rob Gray ("Gray Deposition"), p. 13, and adjusted assessment letter in Exhibit 5 to deposition. Plaintiff requested and received an informal conference, which was held on May 31, 2006. In a letter dated September 13, 2006, the hearing officer

upheld the Business tax assessment. *See* Complaint, ¶¶ 7-8, and Exhibit C attached to Complaint. Aforestated, Exel filed suit in November of 2006 challenging the assessment of business tax. *See* Compl. During the Audit Period at issue, Exel provided its transportation management services to seven different customers with Tennessee locations. Those customers were: Eastman Chemical Company, DaimlerChrysler Corporation, Williams-Sonoma, Inc., Goodyear Tire & Rubber Company, Owens-Corning Corporation, Johnson & Johnson, and Bayer Corporation. *See* Verdino Aff. ¶ 31; Greer Aff. ¶¶ 13, 15-39. The Department did not assess Exel any business tax liability for the Daimler-Chrysler location during the Audit Period; the Department determined that the services provided by Exel at this location were predominantly transportation related and qualified for the public utility/common carrier exemption from business tax. *See* Revised Audit Report, p. TN 0917, attached to Affidavit of Susan L. Sagash.

Mr. Anthony P. Verdino ("Mr. Verdino"), Vice President for Latin America and Special Projects, described Exel Inc. as a "global supply chain solutions provider" that provides "analysis of networks" for customers who have their own supply chain operations and offers supply chain solutions for those customers who choose to outsource this service to Exel. Verdino Deposition, pp. 14-15. Mr. Verdino described the supply chain solutions Exel provides to its customers to include: freight movement, warehousing, consulting and design of networks, design of racking and conveyor systems in the customer's facilities, packaging, paletization, inventory management, and the arrangement of a "transportation solution" through subcontracting with transportation carriers or using its own trucks. *See* Verdino Deposition, pp. 15-16. Nationwide, Exel owns a fleet of trucks and tractor trailers and uses those vehicles to provide transportation and delivery services to its customers. At the time of the hearing, Exel had a fleet of



2,674 tractors trailers it uses to provide transportation and delivery services to its customers. Exel has a number of employees who drive these vehicles to perform delivery services for Exel's customers. *See Verdino Aff. ¶ 19.* During the Audit Period, Exel had in all of Tennessee only: 2 yard trucks, 22 trailers, 19 daycabs, and 9 straight trucks. *See Gray Deposition, pp. 37-38; Exhibit 8 to Deposition.* In the ordinary course of business doing the Audit Period, that Exel subcontracted with third-party carriers. *See Verdino Deposition, pp. 15-16.*

The services that Exel provides its customers can be categorized into the following ten service descriptions: 1) supply chain analysis and design, 2) supply chain management, 3) inbound to manufacturing, 4) in-plant services, 5) manufacturing services, 6) warehousing and order fulfillment, 7) assembly and packaging, 8) transportation management, 9) service parts logistics, and 10) reverse logistics. *See Verdino Deposition, pp. 27-55; Exhibit 3, attached to Deposition.* During the Audit Period, Exel offered and provided its customers warehouse management services in moving raw materials or manufactured products through the supply and distribution chain. *See Verdino Aff. ¶¶ 23-26.* The warehouse management services Exel provided during the Audit Period included all activities necessary to receive raw materials or manufactured products at a warehouse facility, to manage and track the inventory within a warehouse, to prepare raw materials or manufactured products for deliveries from a warehouse, and to coordinate deliveries of raw materials of manufactured products to and from a warehouse, all in an effort to efficiently transport raw materials and products through the supply and distribution chain. *See Verdino Aff. ¶¶ 23-26.*

Exel did not provide any manufacturing services in any of its seven Tennessee locations during the Audit Period. *See Verdino Deposition, p. 41; Gray Deposition, p. 18.* Exel's transportation management solutions include the provision of freight

transportation through either its own trucks or subcontracts with transportation providers, the arrangement of transportation, provision of traffic control, tariff assistance, arrangement of freight-forwarding, provision of yard management, fulfillment work, and management of internet traffic. Exel also provides software for transportation management. *See Verdino Deposition*, pp. 47-49. Exel uses its propriety inventory management and tracking software and technology to provide its warehouse management services. This technology is typically connected to our customer's technology and to technology on trucks or other carriers making deliveries to and from a warehouse facility. In this way, the inventory management technology allows Exel to manage and track inventory on a real-time basis and to coordinate deliveries of raw materials or products to and from a warehouse. *See Verdino Aff.* ¶ 24. Exel coordinates traffic at the warehouse and provides staff preparation and preparation of inventory. *See Verdino Deposition*, pp. 42-46. During the Audit Period, Exel provided some basic packaging services for some of its customers. *See Verdino Aff.* ¶ 27. The nature and scope of Exel's services were negotiated with each customer. *See Verdino Aff.* ¶ 27.

The precise services Exel provided to each of its customers with Tennessee locations during the Audit Period varied according to the needs of the customer and the contractual agreements between Exel and those customers. *See Verdino Aff.* ¶ 32; *Greer Aff.* ¶¶ 14, 40. For many of Exel's customers with locations in Tennessee during the Audit Period, the services Exel provided in Tennessee were provided pursuant to a nationwide contract, under which Exel provided the customer with a variety of supply and distribution chain services throughout the country. *See Verdino Aff.* ¶ 32; *Greer Aff.* ¶¶ 14, 16-26, 35-39. Exel's two biggest competitors during the Audit Period were United Parcel Services ("UPS") and Federal Express ("FedEx"). *See Verdino Aff.* ¶ 11.

The purpose of any warehouse located within a customer's supply and distribution chain is to provide a place to temporarily store raw materials, components of manufactured products, or finished manufactured products as they move through the various stages of the manufacturing and distribution process. On the supply side of the supply and distribution chain, those warehouse facilities allow raw material or other products to be temporarily stored awaiting transportation to a manufacturing facility at a time when those raw materials or products are needed as part of the manufacturing process. On the distribution side of the supply and distribution chain, warehouse facilities allow manufactured products to be temporarily stored awaiting transportation to a retailer, to a retailer's distribution center, or to the ultimate consumer as needed to fill consumer need or orders for those products. *See Verdino Aff.* ¶ 26.

Exel Transportation Services is a "related entity" to the Plaintiff. Both Exel Inc. and Exel Transportation Services are one of the eight entities wholly owned by DPWN Holdings (USA) Inc. *See Verdino Deposition*, p. 49; Exhibit 4, attached to Deposition. Exel Transportation Services provides transportation services and transportation brokerage; Exel Transportation Services does not provide logistics services or third party supply chain management services. *See Verdino Deposition*, pp. 50-51, 76. Exel Direct is a separate but related entity to the Plaintiff and predominantly handles furniture and appliance deliveries. *See Verdino Deposition*, p. 51; Exhibit 4, attached to Deposition. It is admitted that Exel sold Allied Van Lines prior to the Audit Period. *See Verdino Deposition*, p. 60.

Of the seven locations in Tennessee, Exel filed business tax returns during the Audit Period for only three locations; in these three locations the business tax on the gross sales of services was calculated by Exel at the retail rate, not wholesale rate, and the gross sales of services reported for the three locations was based on "operating income,"

which Exel defined as "gross income minus any administrative costs." Gray Deposition, pp. 15-16; Exhibit 6 to Deposition.

The operating costs Exel deemed "pass-through" costs, and obtained reimbursement for from its customers, for each of the seven sites in Tennessee during the Audit Period are as follows:

- a. Johnson & Johnson: hourly and salaried labor, clerical labor, payroll taxes and benefits, rents and real estate taxes, utilities, building services and insurance, depreciation, equipment rental/lease, fuel, vehicle maintenance, supplies, MIS charges, cleaning, and telephone. *See* Greer Deposition, pp. 23-24; page A-7 of Exhibit 9 to Deposition;
- b. Bayer: hourly and salaried labor, clerical labor, benefits and taxes, rent, building services, equipment and supplies expenses, office, telephone, MIS, professional fees and administrative overhead. *See* Greer Deposition, pp. 24-25; page A-7 to A-8 of Exhibit 9 to Deposition;
- c. Daimler Chrysler: hourly and salaried labor, clerical labor, benefits and payroll taxes, equipment lease and rental, fuel, vehicle maintenance, equipment maintenance and insurance and administrative expenses such as telephone, MIS, and general insurance. *See* Greer Deposition, p. 25; p. A-8 of Exhibit 9 to Deposition;
- d. Goodyear: hourly and salaried labor, clerical labor, benefits and payroll taxes, building security and insurance, equipment lease and rental, supplies and administrative expenses such as general

insurance and MIS charges. *See* Greer Deposition, pp. 25-26; p. A-9 of Exhibit 9 to Deposition;

- e. Owens Corning: hourly and salaried labor, clerical labor, benefits and payroll taxes, equipment lease, fuel, vehicle maintenance, supplies and administrative expenses. *See* Greer Deposition, pp. 26-27; p. A-9 of Exhibit 9 to Deposition;
- f. Eastman: personnel costs and benefits, rent, office supplies. *See* Greer Deposition, p. 27; p. A-b of Exhibit 9 to Deposition;
- g. Williams-Sonoma: leased equipment, fuel, repairs and insurance on the equipment.

Greer Deposition, p. 28; p. A-b of Exhibit 9 to Deposition.

Exel performed warehouse management services for Goodyear during the Audit Period at a Memphis, Tennessee distribution facility. At that facility, Exel was responsible for receiving, storing, tracking, and shipping an inventory of tires manufactured by Goodyear. To facilitate the tracking of that inventory, Exel "branded" tires by stamping a number on the tires and then repackaged the tires and prepared them for later distribution. At the Memphis facility, Exel was also responsible for managing yard operations, including coordinating the receipt of Goodyear tires at the facility, unloading trucks delivering those tires, and subsequently loading trucks to deliver the tires to end users, to another distribution location, or to a retail establishment. Exel was also responsible for selecting, monitoring, and managing the carriers that delivered tires to and from the facility and for scheduling and tracking the progress of the vehicles making those tire deliveries. *See* Greer Aff. ¶ 17.

As is clear in Appendix I to the Logistics Services Agreement between Exel and Goodyear, Goodyear hired Exel to provide logistics services to "receive, store and ship

tires.” PP. TN 0171 and TN 0175, Exhibit B to Greer Affidavit. As stated in Section 1.2C of Appendix I to the Logistics Services Agreement between Exel and Goodyear in effect during the Audit Period, Exel was expressly responsible for ensuring the on-time delivery of Goodyear products delivered from the Memphis facility. *See* Greer Aff. ¶ 19; *see also* Exh. B to Greer Aff. Additionally, Exel was also responsible for services such as: operating the Logistics Center, maintaining high quality standards, on-time unloading, maintaining the facility and grounds, making sure the Logistics Center is safe, and measuring activities and costs throughout the facility. *See* § 1.2.C of Appendix I, Exhibit B to Greer Affidavit.

During the Audit Period, Exel performed delivery and transportation services for Goodyear pursuant to a Non-Exclusive Master Transportation Contract (the “Goodyear Transportation Contract”). In accordance with the Goodyear Transportation Contract, Exel delivered Goodyear tires between three facilities Exel managed for Goodyear during the Audit Period. *See* Greer Aff. ¶¶ 20-22; *see also* Exh. C to Greer Aff. The three facilities Exel managed for Goodyear during the Audit Period were located in Tennessee, Pennsylvania and Ohio. Under the Goodyear Transportation Contract, Exel used its own fleet of trucks or other vehicles – or vehicles leased from third-parties – to physically deliver Goodyear’s tires from one of those facilities to another. *See* Greer Aff. ¶ 21; *see also* Exh. C to Greer Aff. Pursuant to the Goodyear Transportation Contract, Exel delivered products manufactured by Goodyear at Goodyear’s instruction and to the locations specified and directed by Goodyear. Specifically, the Goodyear Transportation Contract provide that Exel “will, upon acceptance and receipt of the goods of [Goodyear], transport and carry such goods with reasonable dispatch, expedite shipments of such goods when necessary under the direction of [Goodyear], and deliver them in like good order and condition to the consignee” at the destinations chosen by Goodyear. *See*

Greer Aff. ¶ 22; *see also* Exh. C to Greer Aff. At its Tennessee Goodyear site, Exel was “predominantly dealing with warehouse logistics services.” Rob Gray Deposition, p. 24.

The Memphis facility Exel managed for Johnson & Johnson during the Audit Period was one of the three warehouses Exel managed for Johnson & Johnson. *See* Greer Aff. ¶ 23. Exel managed the Memphis facility for Johnson & Johnson from the beginning of the Audit Period until the time the facility closed in December of 2002. At that facility, Exel was responsible for receiving products from over 100 different manufacturing locations around the country and for distributing those products to retailers or retailer distribution centers throughout the Southeastern United States. *See* Greer Aff. ¶ 24. Although Exel did not use its own trucks or other vehicles to physically deliver orders to Johnson & Johnson’s customers during the Audit Period, Exel was responsible for: “(c) selection and monitoring of carrier performance.” Johnson & Johnson Agreement, p. TN 0188, Exhibit D to Greer Affidavit. Under Sections 3.1 and 3.3 of the Johnson & Johnson Agreement (“the J&J Agreement”), Exel was required to maintain 99.5% accuracy in delivering products to customers by specified delivery dates. Greer Aff. ¶ 26; *see also* Exh. D to Greer Aff. The J&J Agreement expressly states that the “ultimate measure” of Exel’s performance under the J&J Agreement was the “total distribution cycle measured by the total days from order receipt at the warehouse to accurate delivery to the customer.” Greer Aff. ¶ 26; *see also* Exh. D to Greer Aff. Exel was also charged with ensuring inventory was not damaged and this was measured based on the requirement of not exceeding inventory damage or shrinkage of “1/10 of 1% of annual case thruput at the facility.” Johnson & Johnson Agreement, p. TN 0195, Exhibit D to Greer Affidavit.

As provided in the J&J Agreement, Exel had led the handling of the flow of customer orders from the time those orders were placed at the Memphis facility until the

time the orders were received by Johnson & Johnson's customers. In connection with this responsibility and as specifically set forth in the J&J Agreement, Exel was responsible for unloading an inventory of products as they arrived at the facility, ensuring those products complied with the anticipated deliveries, entering those products into Exel's inventory management system, tracking and safely storing those products while they were temporarily stored at the facility awaiting further transportation, receiving and processing customer orders for those products, and preparing products to be delivered in fulfillment of each customer order. *See Greer Aff. ¶ 25; see also Exh. D to Greer Aff.*

Exel's services provided to Williams-Sonoma during the Audit Period were limited to yard and transportation management services and associated delivery services at two Memphis, Tennessee locations, as well as two nearby locations in Mississippi. *See Greer Aff. ¶¶ 27-29.* The focus of Exel's yard management services provided at the Williams-Sonoma locations in Tennessee and Mississippi during the Audit Period was coordinating deliveries of Williams-Sonoma merchandise – which was temporarily stored at those facilities awaiting further transport – into and out of those facilities by, among other things, tracking coordinating, and physically placing trailers in preparation for deliveries to and from the facilities, all of which was done as necessary in order to control the free flow of Williams-Sonoma's merchandise to and from those facilities in order to complete consumer orders and receive consumer returns. *See Greer Aff. ¶ 28.* Although Exel did not use its own trucks or other vehicles to deliver orders to consumers from the yards it managed for Williams-Sonoma during the Audit Period, Exel was responsible for coordinating those deliveries which were made by third-party carriers. *See Greer Aff. ¶ 28.*

During the Audit Period, Exel was responsible for performing "shuttle runs" as necessary to transport and deliver Williams-Sonoma merchandise within the yards at the



facilities it managed or between the various yards it managed for Williams-Sonoma in Tennessee and Mississippi. To perform these "shuttle runs," Exel used "yard tractors" or other vehicles it owned or leased to pull trailers loaded with Williams-Sonoma merchandise and to deliver that Williams-Sonoma merchandise to another location within the yard or from one yard to another and often across state lines. This service enabled the Williams-Sonoma merchandise that was delivered on the "yard tractor" to be in the proper location to be loaded onto a trailer at one of the facilities Exel managed and ultimately delivered to a consumer. *See Greer Aff.* ¶ 29.

With regard to coordinating the delivery of products for Eastman to use in its Kingsport, Tennessee manufacturing facility, during the Audit Period, Exel ordered, tracked, managed, and controlled the deliveries of those products as those products arrived at the Kingsport facility from an Eastman facility it also managed in South Carolina. *See Greer Aff.* ¶ 32; *see also* Exh. F to Greer Aff. With regard to transporting goods Eastman had manufactured at the Kingsport, Tennessee facility away from the facility and to customers located throughout the world, during the Audit Period, Exel provided a variety services at the Kingsport facility, including receiving the products Eastman manufactured at that facility, storing and tracking those products in the warehouse located at the facility, and shipping the products in accordance with customer orders and, in many instances, for export from a United States port. *See Greer Aff.* ¶ 33; *see also* Exh. F to Greer Aff. Although Exel did not use its own trucks or other vehicles to deliver products to or from the Kingsport, Tennessee facility it managed for Eastman during the Audit Period, Exel was responsible for coordinating those delivery services, typically though the use of trucks and trains. *See Greer Aff.* ¶ 33; *see also* Exh. F to Greer Aff.

The services provided to Owens-Corning Corporation ("Owens-Corning") in Tennessee during the Audit Period were provided as part of a nationwide relationship between Exel and Owens-Corning pursuant to which Exel provided Owens-Corning a variety of supply and distribution chain services in several states. *See Greer Aff.* ¶¶ 35-36; *see also* Exh. G to Greer Aff. The services Exel provided at its Tennessee Owens-Corning site were "mainly warehouse logistics services." Rob Gray Deposition, p. 25; Exhibit 7 to Deposition. In connection with Exel's services provided at Owens-Corning's Jackson, Tennessee facility during the Audit Period, Exel was responsible for receiving the roofing materials Owens-Corning manufactured directly from the manufacturing line, recording, tracking, and temporarily storing those materials in a warehouse located at the manufacturing facility, managing that temporary storage on a first-in first-out basis, receiving and processing orders for the building materials, preparing the materials for delivery to other manufacturers or customers, and ultimately shipping those materials to other manufacturers or customers. *See id.*; *see also* Exh. G to Greer Aff. Although Exel did not use its own trucks or other vehicles to deliver roofing materials to Owens-Corning's customers during the Audit Period, Exel was responsible for scheduling, coordinating, and monitoring the delivery of those materials, which was typically performed by third-party carriers. *See Greer Aff.* ¶ 35; *see also* Exh. G to Greer Aff.

During the Audit Period, Exel managed a warehouse facility located in Memphis, Tennessee that was one of several warehouses Exel managed for Bayer across the country for the purpose of distributing Bayer products throughout the United States. The locations of warehouses Exel managed for Bayer during the Audit Period were chosen based on Exel's analysis of Bayer's supply and distribution chain and the redesign of that chain to make the nationwide interstate flow and distribution of Bayer products more efficient, cost-effective, and reliable. *See Greer Aff.* ¶¶ 37-38. With regard to the

Memphis facility Exel managed for Bayer during the Audit Period, manufacturers of Bayer products shipped those products directly to the Memphis facility. Exel was responsible for receiving those products, recording, tracking, and managing the inventory of Bayer products temporarily stored at the facility, receiving and processing orders for those products, and then loading and shipping the products to retailers or retail distribution centers. *See* Greer Aff. ¶ 38; *see also* Exh. H to Greer Aff. Although Exel did not use its own trucks or other vehicles to deliver Bayer products to retailers or retail distribution centers during the Audit Period, Exel was responsible for acting as Bayer's agent to coordinate those deliveries. *See* Greer Aff. ¶ 38; *see also* Exh. H. to Greer Aff.

Exel used a variety of different methods to set the pricing for services it provided to customers during the Audit Period. *See* Verdino Aff. ¶¶ 33-39; Greer Aff. ¶¶ 41-49. Typically, under explicit cost-plus contracts, the management fee for Exel's service was set at ten to twelve percent of the costs for which Exel was reimbursed. *See* Verdino Aff. ¶ 33; Greer Aff. ¶ 41. The Logistics Services Agreement between Exel and Goodyear in effect during the Audit Period is an example of a "cost-plus" contract Exel had with a customer during the Audit Period. Section 2.1 of Appendix I to the Logistics Services Agreement between Exel and Goodyear sets forth certain costs Exel incurred and paid for on Goodyear's behalf in connection with performing its services for Goodyear and for which it would be reimbursed. Separate from those reimbursement payments, under Section 2.4 in Appendix I to the Logistics Services Agreement, Goodyear was also required to pay Exel a management fee to be determined by applying an agreed upon percentage to the total amount of reimbursed costs. *See* Greer Aff. ¶ 42; *see also* Exh. B to Greer Aff.

Some customers for whom Exel performed services in Tennessee during the Audit Period paid Exel on a "fixed variable" basis. *See* Verdino Aff. ¶ 34; Greer Aff. ¶

43. Under the "fixed variable" pricing method, Exel received one payment from its customers on a per unit basis that it separated into two categories for its own accounting purposes: 1) funds it used to pay of its business expenses, and 2) funds it labeled management fees which represented Exel's profit after expenses were paid. *See* Rob Gray Deposition, pp., 43, 57. The J&J Agreement governing the services Exel provided to Johnson & Johnson in Tennessee during the Audit Period is an example of "fixed variable" pricing. Under the J&J Agreement, Johnson & Johnson paid Exel a "handling rate" of 34 cents per case and a "storage rate" of 48 cents per square foot. These rates were determined based on an analysis of the costs Exel would incur providing its services to Johnson & Johnson and were set at a price that would reimburse Exel for those costs and provide Exel with an additional fee of approximately ten percent of those costs as payment for its services. *See* Verdino Aff. ¶¶ 35-36; Greer Aff. ¶ 44; *see also* Exh. D to Greer Aff.

In many instances, when Exel and a customer lacked certainty with regard to the costs Exel would incur and pay on its customers' behalf in connection with providing its services, the customer and Exel agreed to begin a contractual relationship under a "cost-plus" arrangement and then, after a specified period of time, transition the contract to a "fixed variable" contract. Under contracts that called for this kind of transitional payment system, during the initial "cost-plus" phase of the contract, Exel was reimbursed directly for its costs and received an additional management fee at a specified percentage of those costs, typically ten to twelve percent, to compensate Exel for its services. Then, after Exel performed its services for the specified period of time and, thereby, could more precisely estimate the costs that would be incurred and paid by Exel on its customer's behalf in connection with providing its services to that customer, the payment method switched to a "fixed variable" method, pursuant to which Exel received payment of a per

unit price established by adding the typical costs Exel had incurred while performing under the contract plus a specified percentage – typically ten to twelve percent – of those costs. *See Verdino Aff.* ¶¶ 37-38; *Greer Aff.* ¶¶ 45-48.

The contract between Owens-Corning and Exel governing the services Exel performed for Owens-Corning in Tennessee during the Audit Period (the “Owens-Corning Contract”) is an example of a transitional pricing scheme. As provided in the Owens-Corning Contract, during the first six months of Exel’s performance under the contract, Owens-Corning reimbursed Exel on cost-plus basis. Then, after that initial cost-plus phase, Exel and Owens-Corning agreed to a fixed variable payment structure for Exel’s services. *See Greer Aff.* ¶¶ 46-47; *see also* Exh. G to *Greer Aff.*

The agreed upon fixed variable pricing for Exel’s services to Owens-Corning in Tennessee during the Audit Period was established in various amendments to the Owens-Corning Contract. As stated in those amendments, the variable pricing Exel and Owens-Corning agreed upon for Exel’s services in Tennessee was determined based on the actual costs Exel had incurred providing those services during the first several months of performance under the contract. *See Greer Aff.* ¶ 47; *see also* Exh. G to *Greer Aff.* The transitional pricing system – consisting of an initial “cost-plus” phase followed by the establishment of more permanent “fixed variable” pricing – Exel had with Owens-Corning and some of its other customers during the Audit Period allowed both the customer and Exel to have more confidence that their contract was priced correctly. That is, the transitional pricing allowed both the customer and Exel to have confidence that the payments made pursuant to the contract would accurately reimburse Exel for costs incurred providing its services and would also include a management fee to compensate Exel for its services at approximately ten to twelve percent of those costs. *See Verdino Aff.* ¶ 38; *Greer Aff.* ¶ 48.

During the Audit Period, Exel provided to Chrysler in Tennessee transportation services limited to physically delivering Chrysler products from a Memphis parts distribution center to Chrysler dealers located in six surrounding states. Exel owned or leased the fleet of trucks that provided this delivery service and played no role in loading the trucks at the parts distribution center. Exel's role in the process of transporting parts for Chrysler was to use its fleet of trucks and drivers to deliver the parts from the distribution center to the dealers. *See Greer Aff.* ¶ 15; *see also* Exh. A to Greer Aff.

### **Analysis and Statement of Legal Grounds for Rulings**

At the outset, the Court recognizes its duty to follow basic tenets of statutory construction as announced by our appellate courts:

Our duty in construing statutes is to ascertain and give effect to the intention and purpose of the legislature. Legislative intent is to be ascertained whenever possible from the natural and ordinary meaning of the language used, without forced or subtle construction that would limit or extend the meaning of the language.

When the statutory language is clear and unambiguous, we must apply its plain meaning in its normal and accepted use, without a forced interpretation that would limit or expand the statute's application. Where an ambiguity exists, we must look to the entire statutory scheme and elsewhere to ascertain the legislative intent and purpose. The statute must be construed in its entirety, and it should be assumed that the legislature used each word purposely and that those words convey some intent and have a meaning and a purpose. The background, purpose, and general circumstances under which words are used in a statute must be considered, and it is improper to take a word or a few words from its context and, with them isolated, attempt to determine their meaning.

*Eastman Chem. Co. v. Johnson*, 151 S.W.3d 503, 507 (Tenn. 2004) (internal quotations and citations omitted). This Court, therefore, looks to the statutory language as its first order of business. *See CAO Holdings, Inc. v. Trost*, 333 S.W.3d 73, 85-86 (Tenn. 2010). After that, if other rules of construction apply, the Court follows them.

Courts are required to liberally construe statutes that impose a tax in favor of the taxpayer and strictly construe them against the taxing authority. *See Eastman Chem. Co.*,

151 S.W.3d at 507. “[W]here there is doubt as to the meaning of a taxing statute, the doubt must be resolved in favor of the tax payer.” *Commercial Standard Ins. Co. v. Hixson*, 133 S.W.2d 493, 494 (Tenn. 1939). This construction, however, must be fair and give effect to the language of the statute. See *International Harvester Co. v. Carr*, 466 S.W.2d 207, 214 (Tenn. 1971); *United Inter-Mountain Tel. Co. v. Moyers*, 426 S.W.2d 177, 181 (Tenn. 1968). Unless the text of a revenue statute requires otherwise, courts are expected to give the words in the statute their natural and ordinary meaning and to enforce revenue statutes as written. See *Eastman Chem. Co.*, 151 S.W.3d at 507; *Stratton v. Jackson*, 707 S.W.2d 865, 866 (Tenn. 1986).

Courts should consider the natural and ordinary meaning of words in a revenue statute, unless the statutory language requires a different approach. See *Eastman Chem. Co.*, 151 S.W.3d at 507. When the statute’s purpose is clear from the text of the statute, the language should be enforced as written. See *Stratton*, 707 S.W.2d at 866. There are instances, however, when courts should use a more context-sensitive approach:

A statute’s meaning is derived, not from considering the separate meaning of each individual word in a statute, but from considering the entire statute as a whole in light of its general purpose. See *State v. Flemming*, 19 S.W.3d 195, 197 (Tenn. 2000); *First Nat’l Bank of Memphis v. McCanless*, 186 Tenn. 1, 8, 207 S.W.2d 1007, 1009 (1948). Thus rather, than “mak[ing] a fortress out of the dictionary,” *Crown Enters., Inc. v. Woods*, 557 S.W.2d 491, 493 (Tenn. 1997) (quoting *Cabell v. Markham*, 148 F.2d 737, 739 (2d Cir. 1945)); cf. *Western Pipe Line Constructors, Inc. v. Dickinson*, 203 Tenn. 248, 257, 310 S.W.2d 455, 459-60 (1958), the courts’ role is to ascertain and give the fullest possible effect to the General Assembly’s intent and purpose without unduly restricting the statute’s application or to expand its application beyond its intended scope. *In re Estate of Davis*, 308 S.W.3d 832, 837 (Tenn. 2010); *Seals v. H & F, Inc.*, 301 S.W.3d 237, 242 (Tenn. 2010).

*CAO Holdings, Inc. v. Trost*, 333 S.W.3d 73, 86 (Tenn. 2010).

#### Public Utility Exemption

As a threshold matter, Exel is claiming that the services in question are exempt from the business tax under Tenn. Code Ann. § 67-4-708(3)(C)(ix) because they are

“[p]ublic utilities as defined in § 65-4-101.” *Id.* Under Tenn. Code Ann. § 65-4-101(6)(A), public utilities are defined as entities “that own, operate, manage or control, within the state . . . *common carriers* . . .” *Id.* (emphasis added). Under Tennessee law, tax exemptions are strictly construed against taxpayers. Exel, therefore, has the burden of showing that they are entitled to the public utilities exemption. This burden is necessarily exacting, given that every presumption is against exemption and that a well-founded doubt defeats it. *See Hutton v. Johnson*, 956 S.W.2d 484, 488 (Tenn. 1997); *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994).

Generally speaking, common carriers offer to the public, for compensation, the service of transporting persons or property from place to place. *See Brown v. Allright Auto Parks, Inc.*, 456 S.W.2d 660, 665 (Tenn. Ct. App. 1970). In Tennessee, Exel serves companies in several ways, which may vary from location to location. Consequently, even if Exel owns, operates, manages, or controls a common carrier at one Tennessee location, this does not necessarily mean that Exel does not engage in services at the “common carrier” location which fall outside the public utility exemption or that Exel serves in this same “common carrier” capacity at all of its other locations in Tennessee.

Exel asserts that the claimed exemption is designed to treat taxpayers that fall into certain categories a certain way and that the Department was not able to treat particular services as not being exempted services. Exel, therefore, takes the position that once it meets the statutory definition of a common carrier at any location and to any extent, then that ends the inquiry and it is entitled to the full exemption on all of their sales of services in Tennessee regardless of its actual, mixed or differing roles at its Tennessee locations. As pointed out by the Department, such an approach would be counter to the way the business tax is structured and, as well, the proposition that a taxpayer claiming a tax exemption has an exacting burden.



In other words, Exel engages directly in transportation services that are generally exempt from business tax as services rendered in the role of owning, operating, managing or controlling “common carrier.” Exel serves in other business capacities in Tennessee by managing warehouses or serving as a logistics consultant, which are not, in themselves, the kind of transportation services that would warrant common carrier treatment under the public utility exemption to the business tax. Exel asserts that because all of these services are part of an integrated transportation system impacting a customer’s supply and distribution chain, given that it holds a common carrier certificate from the ICC and given that it regularly serves in a direct transportation role that the Department concedes is exempt under the public utilities exemption, that it is entitled to an exemption for all of its Tennessee business activity, especially given that the exemption expressly speaks to categories of businesses.

The Court respectfully disagrees with Exel. The business tax is transactional and services-triggered. The fact that Exel serves in the role of a common carrier regularly does not mean that every sale it has in Tennessee is exempt. Under the circumstances where a company’s sales fall within more than one category, it is appropriate and prudent for the Department to take a particularized, nuanced view of that company’s potential business tax liability as it did here.

To the extent that Plaintiff claims it is exempt from Tennessee business tax on all of its activities because it, as an entity, is a “common carrier,” such assertions are unsupported by Tennessee law. The tax imposed pursuant to Tenn. Code Ann. § 67-4-708(3)(C)(2008) is on all “services,” except those services enumerated “in subdivisions (3)(C)(i)-(xvi).” *Id.* Similarly, the tax exemptions provided apply only to the enumerated services, not entire businesses, types of businesses, or kinds of businesses, or classes of businesses, etc. To find an entire class of businesses exempt from business tax,

regardless of the actual services conducted by that business, would operate to extend the enumerated services exemption provisions beyond plain its meaning and extend the exemption provision's scope beyond that which was intended by the legislature. This expansive interpretation is contrary to the proposition that the tax exemption must be strictly construed against the taxpayer. See *Tibbals Flooring Company v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994).

Similarly, any claim that the majority of Plaintiff's business activities are "common carrier" activities and therefore all of its activities in Tennessee are exempt from business tax is problematic. Tennessee case law does not take an "all or none" approach in the application of business tax exemptions based on a particular business' dominant business activity. The Tennessee Supreme Court has held that a determination of business' "dominant business activity" is significant only to the determination of which classification the business would fall under, and even if the dominant business activity is not subject to business tax, those remaining revenues from activities that are subject to business tax are not exempt but rather accrue business tax. See *National Gas Distributors, Inc. v. State*, 804 S.W.2d 66, 67 (Tenn. 1991). In *Hermitage Memorial Gardens Mausoleum & Memorial Chapel, Inc. v. Dunn*, 541 S.W.2d 147 (Tenn. 1976), the Court determined that in a mixed business activity situation, business tax is to be levied against any revenue generated from a business activity subject to business tax, regardless of what the dominant business activity was. In *Dunn*, a cemetery operator sold burial plots and other burial services. See *Dunn*, 541 S.W.2d at 149. It was undisputed that more than half of the taxpayer's revenue was derived from the sale of plots and that the sale of real estate was not subject to business tax. See *id.* However, the Court declined to find that the business tax was to apply in an "all or none" fashion. Rather, the Court noted that the language of the statutes neither limited "the incidence of the tax to

those entities whose dominant business activity is one of the activities enumerated” nor did the language completely exempt “entities whose dominant business activity is one not enumerated” as subject to business tax. *Id.* The Court held that “[a]ll entities who make sales by engaging in any of the business activities enumerated in § 67-5805 [predecessor to Tenn. Code Ann. § 67-4-708] are subject to the tax.” *Id.* The Court, therefore, upholds the Department’s decision to impose the business tax against Exel for certain of its services.

#### Imposition of the Business Tax

As discussed above, Exel claims that it is exempt from business tax under the public utility exemption because it owns, operates, manages, or controls common carriers in Tennessee. Alternatively, Exel claims that it owes no additional business tax because it is engaged in wholesaler to wholesaler sales. The Department, however, assessed business tax against Exel at the retail rate. Defendant asserts that Exel did not establish in the evidentiary record that its customers are wholesalers. Defendant argues that Exel’s sales were not wholesale sales because Exel’s customers consumed Exel’s services and because Exel’s customers did not hold what Exel sold them for resale.

The Court agrees with the Department that the sales in question were not wholesale sales because it is undisputed that what Exel sold its customers was never held for resale. These services were consumed by Exel’s customers. Additionally, the Court concludes that the record does not support summary judgment in favor of Exel on the question of whether its Tennessee customers were wholesalers.

More significantly, the Plaintiff fails to establish that it is a wholesaler that made “wholesale sales” because the sales of its services were not for “resale.” Plaintiff relies on *Pfizer, Inc. v. Johnson*, No. M2004-00041-COA-R3-CV, 2006 WL 163190, at \*1 (Tenn. Ct. App. Jan. 23, 2006), in which the Tennessee Court of Appeals ruled that sales

of tangible personal property from one wholesaler to another wholesaler were not subject to the “additional” business tax because such sales fit neither the “retail sales” nor “wholesale sales” definitions of the business tax statutes. However, in *Pfizer*, the taxpayer (Pfizer) sold tangible personal property to McKesson Corporation, a wholesaler of pharmaceutical products, who in turn sold the same tangible personal property to “a retailer, who in turn sold them to a consumer.” *Pfizer*, 2006 WL 163190, at \*3. Accordingly, the court found that Pfizer’s sale to McKesson was not subject to additional business tax. *See id.* at \*4.

However, in the case before this Court, the Plaintiff has sold services directly to its Tennessee customers; these Tennessee customers consumed the logistics and management services Exel provided and did not “resell” these services to a retailer who would pass them on to the consumer. Indeed, Plaintiff has failed to demonstrate even conceptually how it is possible for its clients to “resell” its supply chain management services. Accordingly, Exel made no “wholesale sales,” and therefore could not be a “wholesaler.” As such, the Plaintiff fails to qualify for the *Pfizer* wholesaler to wholesaler exclusion from additional business tax.

Secondly, on the question of the applicable tax rate, Exel takes the position that if the Court determines that it owes business tax that any such tax should be imposed at the wholesale rate. The Court concludes that Exel’s sales to its customers should be subject to business tax at the retail rate because Exel’s services are directed at and consumed by its Tennessee customers. With respect to Exel’s sales which do not fall under the public utilities exemption, the record establishes that Exel sells its customers logistics and management services and that Exel did not step into the shoes of its customers and produce their products at its seven Tennessee locations.

Plaintiff's assertion that it owes no "additional" business tax or in the alternative owes the tax only at the reduced wholesale rate also fails. While the Commissioner concedes sales from one wholesaler to another wholesaler for resale are not subject to additional business tax, in this case, Plaintiff's sales of services are not for resale; rather, they are fully consumed by the Plaintiff's Tennessee customer and therefore the sales of these services are subject to the "additional" business tax. Moreover, this tax is owed at the retail rate because, again, Exel's services are not for resale; Exel's services are not part of its customer's inventory. Rather, these services are fully consumed by Exel's clients.

Tenn. Code Ann. § 67-4-709(a)(2008) imposes a minimum \$15 tax on all businesses subject to Tennessee Business tax for each Tennessee location. However, there is also an "additional tax." Tenn. Code Ann. § 67-4-709(b)(2008) mandates that "[i]n addition to the minimum tax, persons shall pay a tax, according to the dominant business activity of such persons[.]" *Id.* Tenn. Code Ann. § 67-4-708 outlines all the business activities subject to business tax and categorizes them into five broad classifications. These classifications are significant because the rate of tax paid on gross receipts is determined by the classification a business falls under. Plaintiff, whose dominant business activity is the sale of services, falls under Classification 3. Classification 3 businesses pay a differing amount of "additional tax" depending on whether they engage in wholesale sales or retail sales. A business falling under Classification 3 would pay an "additional" tax of "[t]hree sixteenths of one percent (3/16 of 1%) of all sales by a retailer[.]" Tenn. Code Ann. § 67-4-709(3)(A). However, Class 3 businesses pay only "[t]hree eightieths of one percent (3/80 of 1%) of all sales by a wholesaler." Tenn. Code Ann. § 67-4-709(3)(B).

Tenn. Code Ann. § 67-4-702(a)(22)(A)(2008) defines “[w]holesale sale” or “sale at wholesale” as “the sale of tangible personal property or services rendered in the regular course of business to a licensed retailer for resale, lease or rental as tangible personal property in the retailer’s regular course of business to a user or consumer.” *Id.* Tenn. Code Ann. § 67-4-702(a)(23)(2008) defines “wholesaler” as “any person engaged in the business of making wholesale sales[.]” *Id.* Tenn. Code Ann. § 67-4-702(a)(14)(A)(2008) defines “retail sales” or “sales at retail” as, in relevant part, “a sale of tangible personal property or services rendered to a consumer or to any person for any purpose other than for resale.” *Id.*

Moreover, the “true object” of the services Exel provided was for the services to be consumed by Exel’s Tennessee customers, not to be resold. *See Weigel v. Commissioner of Revenue*, 566 N.W.2d 79 (Minn. 1977) (holding that the sales of supplies to a dry cleaner was a sale at retail, not wholesale, because the “true object” of the sale was ultimate use of the supplies by the dry cleaner even if the cost of the supplies were passed on to the dry cleaner’s customers). Indeed, the Tennessee Supreme Court has rejected the idea that a service provider whose service’s costs are passed on to the end consumer has provided services for “resale.” In *Nashville Mobilephone Co. v. Woods*, 655 S.W.2d 934 (Tenn. 1983), Melrose provided repair service for Nashville Mobilephone’s customers. Melrose claimed that, because it was performing a service that Nashville Mobilephone was obligated to provide and because Nashville Mobilephone passed the cost of Melrose’s services on to the end customer, its services were sales for resale. *See id.* at 938. However, the Court held that Melrose was providing a taxable service to Nashville Mobilephone directly and was not furnishing the repair service for purposes of resale. *See id.*

*Net Profit v. Gross Receipts*

Plaintiff asserts that “most” of its services provided to Tennessee clients were on a “cost plus” basis whereby the client agreed to reimburse Exel for third-party costs and, in addition, pay a fixed fee to Exel. *See* Complaint, ¶ 32. The record reveals that Exel invoices its Tennessee customers based on several pricing structures that include cost plus, fixed pricing, fixed pricing mixed with a cost plus, and a management fee. *See* Gray Deposition, pp. 38-39; Answer to Interrogatory No. 4, attached as Exhibit 2 to Deposition. However, no matter which pricing structure is used, in all cases Exel determines its “income” or “operating income” to be its “margins,” which are a predetermined percentage of profit above the “costs” of performing its services. Gray Deposition, p. 43.

Exel determined subtracted its operational costs from its total revenue to arrive at its not profit at a particular site. All operating costs, except overhead, are considered “pass-through” costs that Exel obtains reimbursement for from its customers. Exel deducts these “cost reimbursements” from “total revenue” to arrive at “operating revenue,” the latter of which it asserts is its gross receipts upon which its business tax should be computed. Gray Deposition, p. 57; Answer to Interrogatory No. 12, Exhibit 2 attached to Deposition; Complaint, Count Four. In short, Exel contends that all of its expenses or costs of doing business, except overhead, are “reimbursed” by its clients and therefore are simply “pass-through” costs, while only its “margins” or net profit realized from the predetermined percentage of profit are “gross receipts” subject to the business tax. However, a plain meaning reading of the business tax statutes brings to light the error in Plaintiff’s calculations.

The Business tax has been defined by the Tennessee Supreme Court as a “gross receipts” tax. *See Stalcup v. City of Gatlinburg*, 577 S.W.2d 439, 440 (Tenn. 1978); *see*

also *IBM Credit Corp. v. County of Hamilton*, 830 S.W.2d 77, 78 (Tenn. Ct. App. 1992). To properly calculate the business tax due on “gross receipts” or “all sales” of services the Plaintiff conducted in Tennessee, it is necessary to determine what constitutes the sales price of the services rendered. The business tax statutes clarify that “sale price” means “the total amount for which . . . services rendered is sold . . . without any deduction from the price on account of the cost of the property sold, the cost of materials used, labor or service cost, losses, or any other expense whatsoever[.]” Tenn. Code Ann. § 67-4-702(a)(18); *see also* Tenn. Comp. R. & Regs. 1320-4-5-.09(1).

The business tax statutes and interpreting Tennessee case law clarify that the business tax attaches to “gross receipts” and not net profit after business costs have been subtracted. The definition of “sales price” directly addresses and prohibits the “cost plus” calculation scheme Plaintiff attempts to use to avoid paying business tax on the full price of its services rendered in Tennessee. What Plaintiff attempts to term “reimbursements” or “pass-through costs” are actually nothing more than a part of the total revenue Plaintiff collects from its customers in the course of selling its services. It matters not if Exel’s accounting methodology earmarks portions of the total collected revenue for its own business costs and other portions for profit. Exel, for Tennessee business tax purposes, is not allowed to “deduct” from the “total amount” it receives from its Tennessee customers any “labor or service costs” or “any other expense whatsoever” when calculating its gross receipts upon which the additional business tax is owed. *See* Tenn. Code Ann. § 67-4-702(a)(18).

#### Commerce Clause

Article I, § 8, cl. 3 of the United States Constitution grants Congress the power “[t]o regulate commerce with foreign nations, and among the several states, and with the Indian tribes.” *Id.* In addition to this affirmative grant of power to Congress, the



Commerce Clause, by implication, necessarily contains an inherent “dormant,”<sup>4</sup> “negative” or prohibitory thrust which prevents states from taking action that places an impermissible burden on interstate commerce. *See United Haulers Ass’n, Inc. v. Oneida–Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 338 (2007); *Quill Corp. v. North Dakota*, 504 U.S. 298, 312-13 (1992).

Contrary to Exel’s arguments regarding where its customers’ inventory is sold, the business tax here was imposed on Exel in response to Exel exercising the privilege of engaging in business activity and business transaction in Tennessee. *See Worrall v. Kroger Co.*, 545 S.W.2d 736, 738 (Tenn. 1977). The incident of taxation is Exel’s business activity in Tennessee. Exel’s sale of logistics services in Tennessee, where these services were delivered and consumed, does not implicate interstate commerce in a way that would suggest an impermissible impact on interstate commerce or on unconstitutional extraterritorial reach. *See American Beverage Ass’n v. Snyder*, 700 F.3d. 796 (6<sup>th</sup> Cir. 2012). The Court concludes that the Tennessee business tax, as applied here, does not violate the Commerce Clause or any other constitutional prescription. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

#### Penalties

The Department assessed a 25% penalty for the locations where Exel failed to register and pay the business tax and a 10% discretionary penalty for those locations where Exel registered but remitted business tax on only a portion of its receipts. *See* Complaint, Exhibit C. It appears that the Department was not authorized by law to waive the 25% penalty on those locations, failure to procure a license as required by law. *See* Tenn. Code Ann. § 67-1-803(a)(2)(A). The Court concludes that the Department did not

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<sup>4</sup> The basic idea is that when Congress fails to act in an area of interstate commerce, the constitutional power to do so lies dormant until a state or local government enacts a measure that potentially impacts interstate commerce.

abuse its discretion in declining to waive the 10% penalty for Exel's conduct in underreporting its business tax liability. The record does not indicate that Exel was misled by the taxing authorities or its tax professionals. Additional, there were no mistakes of fact. Although it could be argued that this case presented unsettled questions of law, the Court does not believe that the Department abused its discretion under the circumstances of this case. *See* Tenn. Code Ann. § 67-1-803(c)(1). The Court, therefore, will allow the penalties the Department assessed against Exel to stand. Given the heavy burden that a taxpayer bears in the exemption context, it was within the Department's discretion to assess the 10% penalty here.

### **Conclusion**

The Court determines that there are no genuine issues of material fact and that the Defendant Commissioner of Revenue is entitled to judgment as a matter of law. Accordingly, Defendant's motion for summary judgment is GRANTED; Plaintiff's motion for summary judgment is DENIED. The Court awards judgment in favor of Defendant in all respects; denies Plaintiff's claim for tax exemption as a public utility; and dismisses Plaintiff's Complaint in its entirety, with prejudice. The Court hereby awards judgment in favor of Defendant and against Plaintiff on Defendant's counterclaim in the total amount of \$243,966.20 in principal, interest, and penalty as of February 23, 2006. The Court awards additional interest beginning from February 23, 2006 under Tenn. Code Ann. § 67-1-801(a)(2) and/or the applicable law.

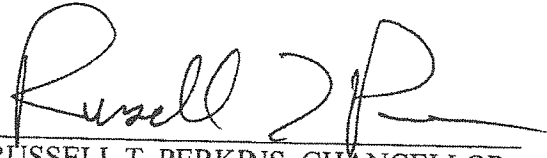
The Court further finds that the Commissioner is the prevailing party in this case within the meaning of Tenn. Code Ann. § 67-1-1803(d) and is entitled to an award of reasonable attorneys' fees and expenses of litigation as provided by that statute. The Court finds, however, that determination of the amount of such fees and expenses to which the Commissioner is entitled should await the outcome of any possible appeals in

this case. Having determined all of the claims of Plaintiff and the counterclaim of Defendant in this matter, the Court finds that there is no just reason for delay in entering a final, appealable judgment as to all the rulings made in this Memorandum and Final Judgment. The Court, pursuant to Tenn. R. Civ. P. 54.02, therefore expressly directs that a final, appealable judgment is hereby entered as stated above.

The Court reserves determination of the amount of attorneys' fees and expenses of litigation to be awarded pursuant to Tenn. Code Ann. § 67-1-1803(d), and any additional award of interest in this case, until all appeals are concluded. The time within which any notice of appeal may be filed in this case shall run from the date of entry of this Memorandum and Final Judgment in accordance with Tenn. R. Civ. P. 54.02. Within sixty (60) days after that date, the Commissioner may file an application for an award of fees and expenses, unless a timely notice of appeal is filed. If the decision of this Court is appealed, the prevailing party may file an application for an award of fees and expenses within sixty (60) days after issuance of the mandate concluding proceedings in the appellate courts.

All costs of this case are taxed against Plaintiff, for which execution may issue if necessary.


**IT IS SO ORDERED.**

  
RUSSELL T. PERKINS, CHANCELLOR

cc: Stephen J. Jasper, Esq.  
Jonathan N. Wike, Esq.

**RULE 58 CERTIFICATION**

A Copy of this order has been served by U. S. Mail upon all parties or their counsel named above.

  
Deputy Clerk and Master  
Chancery Court

6/29/13  
Date

 **MAILED**  
7/1/13