

This Week in State Tax (TWIST)

January 21, 2025



Tennessee: DoR Rules Drop Shipments Sourced to Ultimate Destination

In a recently issued Revenue Ruling, the Tennessee Department of Revenue (Department) clarified that, for purposes of the Tennessee franchise and excise tax, a drop shipment sale delivered to a warehouse in Tennessee is sourced to Tennessee only if the “ultimate recipient” (i.e., the end user) is in Tennessee. The taxpayer was an out-of-state manufacturer that sold its products using both a third-party merchant and a third-party logistics service. Orders were taken from end users by a merchant and transmitted to the taxpayer for review, approval and fulfillment. The taxpayer then delivered the products pre-packaged and pre-labeled to the temperature-controlled facility of the logistics service in Tennessee, where they were held for up to six weeks before being shipped on to end users. The taxpayer retained title to the products for the duration of this process, which culminated with the recording of two sales transactions – taxpayer to merchant and merchant to end user (with flash title conveying to the end user.)

Under Tennessee law, a multistate business must compute its receipts factor by sourcing sales of tangible personal property to the state which the property is delivered or shipped to a purchaser. Regulations specify that property is shipped to a purchaser in Tennessee if the shipment terminates in Tennessee, even though the property is subsequently transferred by the purchaser to another state. Regulations define “purchaser within this state” to 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.” The ruling notes that a drop shipment to an ultimate recipient outside Tennessee would not be sourced to Tennessee, even if the actual purchaser is within Tennessee. Applying the facts at hand, the Department determined that the taxpayer’s sales were drop shipment transactions in which the end user of the taxpayer’s products was the “ultimate recipient.” In the Department’s view, the purchaser (the merchant) directed the supplier (the taxpayer) to ship goods directly to the purchaser’s customer (the end user). Accordingly, receipts from the sale should be sourced based on the delivery to the end user. The Department noted that the outcome would be different if the merchant purchased the product and stored it with the logistics service in Tennessee prior to placement of an order by the end user. In that case, the transaction would not be treated as a drop shipment, and the delivery to the logistics service facility in Tennessee would have been delivery to the purchaser. Please contact [Taylor Sorrells](#) with questions about [Ruling 24-12](#).

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