

**STATE OF TENNESSEE**

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Opinion No. 04-103

Treatment of Depreciation under the Federal Job Creation and Worker Assistance Act of 2002 in  
Calculating Partnership Earnings for the Tennessee Excise Tax

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**QUESTION**

Does the add-back of depreciation allowed under title 1, § 101, of the federal Job Creation and Worker Assistance Act of 2002 (26 U.S.C. § 168(k)) (JCWAA) in calculating a limited partnership's net earnings for purposes of the Tennessee excise tax negate the deduction of the amount subject to self-employment taxes?

**OPINION**

No. Depreciation allowed under title 1, § 101, of the JCWAA remains an amount added back to a limited partnership's federal ordinary income under Tenn. Code Ann. § 67-4-2006(b)(1)(H) notwithstanding the deduction of the amount subject to self-employment taxes.

**ANALYSIS**

The calculation of a limited partnership's Tennessee excise tax liability derives from its ordinary income for federal tax purposes as listed on its federal partnership tax return. Tenn. Code Ann. § 67-4-2006(a)(4)(A). Both distributions to partners and depreciation under the JCWAA are available as deductions in the calculation of the business's federal ordinary income. 26 U.S.C. § 703. The excise tax provides for distributions to partners, which are reflected in Tennessee law as the amount subject to self-employment taxes, to be subtracted from ordinary income in calculating net earnings. Tenn. Code Ann. § 67-4-2006(a)(4)(A). At the same time, an individual partner may be entitled to a deduction for depreciation under the JCWAA as part of the calculation of his or her personal income for federal income taxation. However, Tennessee law provides that JCWAA depreciation is added back to a partnership's federal ordinary income in calculating its net earnings. Tenn. Code Ann. § 67-4-2006(b)(1)(H).

Thus, the treatment of JCWAA depreciation under Tennessee law may appear to negate the deduction of the amount subject to self-employment taxes. However, this treatment is consistent with the structure of the Tennessee excise tax statutes, the treatment of depletion, and the General

Assembly's intent to "decouple" Tennessee's excise tax calculation from the calculation of federal ordinary income to avoid the loss of revenues that would otherwise result.

Tenn. Code Ann. § 67-4-2007 imposes a tax on a business's net earnings. Tenn. Code Ann. § 67-4-2004(20) lists the types of "persons" or "taxpayers" subject to this tax. Tenn. Code Ann. § 67-4-2006 sets out the method for computing net earnings for the various types of business.

Tenn. Code Ann. § 67-4-2006(a)(4) governs the calculation for a taxpayer treated as a partnership for federal tax purposes. This subsection starts with "[t]he amount of ordinary income or loss determined under the applicable provisions of the Internal Revenue Code, including, but not limited to, guaranteed payments to partners and capital gains," § 67-4-2006(a)(4)(A), as the basis of the partnership's net earnings and then subtracts from this amount "[t]he amount subject to self-employment taxes, without regard to any cap, distributable or paid to each partner or member." Tenn. Code Ann. § 67-4-2006(a)(4)(B).

Distributions to partners, as listed on a partnership's federal tax return, become one component of the amount subject to federal self-employment tax for an individual. This amount is deducted from a partnership's total income to arrive at the amount on which net earnings for Tennessee excise tax purposes are based. Thus, for limited partnerships, Tenn. Code Ann. § 67-4-2006(a)(4)(B) subtracts such payments to arrive at the amount subject to the excise tax.

Tenn. Code Ann. § 67-4-2006(b)(1) provides that certain amounts are to be "added to a taxpayer's net earnings or net losses." The effect of this add-back provision is that certain amounts that a business would be able to deduct to arrive at its ordinary income on its federal tax return, notably depletion, are added back to its ordinary income to arrive at the business's net earnings for the Tennessee excise tax.

Tenn. Code Ann. § 67-4-2006(b)(1)(H), enacted in 2002, operates the same way. This subsection includes in the list of amounts added back to federal ordinary income "[a]ny depreciation permitted as a deduction in computing federal taxable income solely as a result of the provisions of title 1, § 101, of the Job Creation and Worker Assistance Act of 2002." This federal tax provision allows additional depreciation on property acquired after September 10, 2001, and placed in service before January 1, 2005, or, in certain cases, January 1, 2006. Even though a partnership may have deducted such depreciation in calculating its federal taxable income, Tenn. Code Ann. § 67-4-2006(b)(1)(H) still requires the partnership to add the depreciation back to its ordinary income in calculating net earnings for the Tennessee excise tax.

In addition, the potential ability of an individual partner to include depreciation allowed under the JCWAA in preparing his or her federal individual income tax return, such as for property of a separate sole proprietorship maintained by that individual, does not affect the operation of Tenn. Code Ann. § 67-4-2006. Pursuant to Tenn. Code Ann. § 67-4-2004(20), the taxpayer for purposes of the excise tax is the partnership. Therefore, the net earnings or losses being determined pursuant to Tenn. Code Ann. § 67-4-2006 are those of the partnership and not those of the individual partners.

Similarly, any property on which JCWAA depreciation is taken on a federal tax return and added back under § 67-4-2006(b)(1)(H) would be property of the partnership.

The treatment of JCWAA depreciation as an add-back does not deny a partnership or individual taxpayer the benefit of this depreciation for federal tax purposes. The add-back required by Tenn. Code Ann. § 67-4-2006(b)(1)(H) does not mean that the amount is also added back on an individual's federal self-employment tax return. The General Assembly intended this treatment merely to "decouple" a business's net earnings for purposes of the excise tax from its federal ordinary income so as not to deprive Tennessee of the excise tax revenues it would have collected if the JCWAA had not been enacted.

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