TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 10-01

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether a limited liability company formed to hold and invest assets of a simplified employee pension plan is subject to the Tennessee franchise and excise taxes.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

(A) The taxpayer must not have misstated or omitted material facts involved in the transaction;

(B) Facts that develop later must not be materially different from the facts upon which the ruling was based;

(C) The applicable law must not have been changed or amended;

(D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and

(E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

TAXPAYER is a Tennessee limited liability company whose single member is the [NAME], a simplified employee pension plan (the "SEP IRA"). The Taxpayer was formed for the sole purpose of giving the beneficiary of the SEP IRA control over the investments within the SEP IRA (*i.e.*, the SEP IRA is a self-directed individual retirement account).

The SEP IRA is an exempt individual retirement account for purposes of federal income taxation and is generally not required to file federal tax returns.[1] The Taxpayer is classified as a disregarded entity for federal income tax purposes in accordance with Treas. Reg. § 301.7701-3(b)(1)(ii).

The Taxpayer uses the funds received from the purchase of its membership units by the SEP IRA to acquire investment assets. The Taxpayer buys and sells real estate and other investments, and earns interest on funds not yet invested in real estate or other assets. The Taxpayer is prohibited from distributing assets outside the normal course of business to any party other than the SEP IRA, its single member.

QUESTION

Is the Taxpayer subject to the Tennessee franchise and excise taxes?

RULING

No.

ANALYSIS

The Taxpayer is not subject to the Tennessee franchise and excise taxes because the Employee Retirement Income Security Act of 1974 ("ERISA") precludes the application of the franchise and excise tax laws to the Taxpayer.

Tennessee imposes an excise tax at the rate of 6.5 percent on the net earnings of certain taxpayers doing business within Tennessee, pursuant to Tenn. Code Ann. § 67-4-2007(a) (Supp. 2009). Tennessee also imposes a franchise tax at the rate $0.25 per $100, or major fraction thereof, on the net worth of a taxpayer doing business in Tennessee, pursuant to Tenn. Code Ann. §§ 67-4-2105(a) (Supp. 2009) and 67-4-2106(a) (2006). Taxpayers subject to the franchise and excise taxes include, but are not limited to, corporations, limited partnerships, and limited liability companies. Tenn. Code Ann. § 67-4-2004(34) (Supp. 2009) (defining the terms "person" and "taxpayer").

Tenn. Code Ann. §§ 67-4-2007(d) and 67-4-2106(c) provide that, for purposes of Tennessee franchise and excise taxation, a business entity shall be classified as a corporation, partnership,

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[1] The only exception to this rule is if the retirement account has unrelated business taxable income or unrelated debt-financed income. If the retirement plan does have such income, it must file federal Form 990-T, Exempt Organization Business Income Tax Return. SEP IRA has not been required to file Form 990-T in the past and does not anticipate that it will with respect to future taxable years.

or other type of business entity, consistent with the way the entity is classified for federal income tax purposes. Tenn. Code Ann. §§ 67-4-2007(d) and 67-4-2106(c) further provide that "entities that are disregarded for federal income tax purposes, except for limited liability companies whose single member is a corporation, shall not be disregarded" for Tennessee franchise and excise tax purposes. Accordingly, a single member limited liability company that is wholly owned by a corporation and that is disregarded for federal income tax purposes will be disregarded for Tennessee franchise and excise tax purposes as well. All other entities are taxed for Tennessee franchise and excise tax purposes on a separate entity basis. Tenn. Code Ann. §§ 67-4-2007(e)(1) and 67-4-2106(c).

The Taxpayer is a limited liability company doing business within Tennessee. Because the Taxpayer is not wholly owned by a corporation, it is taxed for franchise and excise tax purposes on a separate entity basis.

Accordingly, the Taxpayer will be subject to Tennessee franchise and excise taxation unless an exemption or exclusion from taxation applies. As explained below, ERISA preempts the application of the franchise and excise taxes to the Taxpayer. Accordingly, the Taxpayer is not subject to taxation under the franchise and excise tax laws.

Subject to certain limited exceptions that do not apply here, 29 U.S.C. § 1003(a)(1) extends the protections afforded by ERISA to employee benefit plans. An individual retirement account, including a SEP IRA,[2] is considered an "employee benefit plan" as the term is defined for purposes of ERISA under 29 U.S.C. § 1002(3). *See Garratt v. Walker*, 164 F.3d 1249, 1251 (10th Cir. 1998) (finding that SEP IRA is a pension plan within the meaning of ERISA). Specifically, 29 U.S.C. § 1003(a) provides that ERISA applies to "employee benefit plans." There are three types of such plans: employee welfare benefit plans, employee pension benefit plans, and plans that are both of the foregoing. 29 U.S.C. § 1002(3). An "employee pension benefit plan" is defined as "any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer ... to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program (i) provides retirement income to employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond." 29 U.S.C. § 1002(2)(A). SEP IRAs clearly fit within this definition because such plans are funded by employers to provide retirement income to employees and often result in the deferral of income for periods extending to the termination of covered employment or beyond. *See* I.R.C. § 408(k)(2).

Importantly, 29 U.S.C. § 1144(a) states that ERISA provisions relating to the protection of employee benefit rights and to plan termination insurance "shall supersede any and all State laws[3] insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title." State laws

[2] Generally speaking, a SEP IRA is an individual retirement account (as defined under I.R.C. § 408(a)) that meets the requirements of I.R.C. § 408(k). One requirement is that the employer must make certain contributions to the SEP IRA. I.R.C. § 408(k)(2). Individual retirement accounts, including SEP IRAs, are exempt for purposes of federal income taxation pursuant to I.R.C. § 408(e)(1).

[3] 29 U.S.C. § 1144(c)(1) defines the term "State law" as including "all laws, decisions, rules, regulations, or other State action having the effect of law, of any State."

specifically designed to affect employee benefit plans are accordingly preempted by ERISA. *Mackey v. Lanier Collection Agency & Serv.*, 486 U.S. 825, 829 (1988). Additionally, the United States Supreme Court has held that a state law that is not specifically designed to affect employee benefit plans (*i.e.*, a law of general application) will be preempted by ERISA if the law "relates to" employee benefit plans. *Id.* at 830-831. A state law may "relate to" an employee benefit plan even if its effect on the plan is only indirect. *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 138 (1990). Generally speaking, ERISA will preempt a state law unless the effect of the state law on the employee benefit plan is merely tenuous, remote or peripheral. *Shaw v. Delta Airlines, Inc.*, 463 U.S. 85, 100 (1983).

Thus, ERISA does not preempt generally applicable state taxes where the effect on the employee benefit plan is merely tenuous, remote or peripheral. State taxes on employees' income, for example, are not considered as having a sufficient effect on an employee benefit plan so as to trigger ERISA preemption. *See, e.g., Firestone Tire & Rubber Co. v. Neusser*, 810 F.2d 550 (6th Cir. 1987) (holding that municipal tax on employees' income did not have sufficient effect on employee benefit plan). Similarly, state taxes that include in the employer's tax base compensation paid to employees are not considered as having a sufficient effect on an employee benefit plan so as to trigger ERISA preemption. *See, e.g., Thiokol Corp. v. Roberts*, 76 F.3d 751, 762 (6th Cir. 1996) (holding that value added tax that included employee compensation in tax base did not have sufficient effect on employee benefit plan).

Significantly, however, a tax law of general application that depletes an employee benefit plan's assets is considered to have an effect that "relates to" employee benefit plans, *i.e.*, an effect that is more than tenuous, remote or peripheral. Thus, when a state tax law functions to deplete an employee benefit plan's assets, ERISA will preempt the state tax law. *See, e.g., Morgan Guar. Trust Co. v. Tax Appeals Trib. of New York State Dept. of Taxation and Fin.*, 599 N.E.2d 656, 661 (N.Y 1992) (holding that tax on gain from real estate transaction directly and adversely affected employee benefit plan where real estate was a plan asset, because payment of the tax would deplete the plan's assets).

Here, ERISA preempts the application of the Tennessee franchise and excise taxes to the Taxpayer because subjecting the Taxpayer to taxation would directly result in the depletion of the assets of an employee benefit plan. First, imposition of the franchise and excise taxes on the Taxpayer would result in the depletion of assets ultimately owned by the SEP IRA. Second, the SEP IRA wholly owns the Taxpayer, which is disregarded for federal income tax purposes to the SEP IRA pursuant to Treas. Reg. § 301.7701-3(b)(1)(ii). The Taxpayer, as a disregarded entity, is treated for federal income tax purposes as a division of the SEP IRA, an employee benefit plan covered by ERISA. The Taxpayer therefore comes within the scope of the protections afforded by ERISA to the same extent as the SEP IRA. Because the Taxpayer is itself covered by ERISA, ERISA preempts the application of the franchise and excise tax laws to the Taxpayer.

Accordingly, the Taxpayer is not subject to the Tennessee franchise and excise taxes.

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APPROVED:	Reagan Farr Commissioner of Revenue
DATE:	1/15/10