TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 11-11

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 assets of a commingled trust formed pursuant to Rev. Rul. 81-100, 1981-1 C.B. 326 (Mar. 30, 1981), 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

[BANK] is a national bank with its commercial domicile and principal place of business located outside the State of Tennessee. [BANK] is a broadly diversified financial services company that provides [SERVICES].

As part of its [TYPE OF] business, [BANK] provides institutional trust services through trust offices located [GEOGRAPHIC LOCATION]. [BANK] currently serves as a trustee of a commingled trust formed pursuant to Rev. Rul. 81-100, 1981-1 C.B. 326 (Mar. 30, 1981),[1] and known as the [FUND] [THE "FUND"]. The Fund's participants include pension plans that are exempt for federal income tax purposes under I.R.C. § 501(a) as organizations described in I.R.C. § 401(a) and individual retirement accounts that are exempt for federal income tax purpose under I.R.C. § 408(e). The Fund has received a letter of determination from the Internal Revenue Service stating that the Fund qualifies as exempt for purposes of federal income taxation 1) under I.R.C. § 501(a) as an organization described in I.R.C. § 401(a) with respect to its participants that are pension plans, and 2) under I.R.C. § 408(e) with respect to its participants that are individual retirement accounts.

The Fund owns all of the membership interests in [THE TAXPAYER], a limited liability company. The Taxpayer owns certain rental real estate located in Tennessee. The sole purpose of the Taxpayer is to hold the Tennessee real property and to pay the income therefrom, less expenses, to its sole member, the Fund.

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. 2010). 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. 2010) 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(37) (Supp. 2010) (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, or other type of business entity, consistent with the way the entity is classified for federal income

[1] Rev. Rul. 81-100, 1981-1 C.B. 326 (Mar. 30, 1981), provides that qualified retirement plans and individual retirement accounts may pool their assets in a commingled trust without affecting the federal tax exempt status of the separate qualified retirement plans and individual retirement accounts.

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." There are three types of employee benefit 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).

The Fund's participants include pension plans that are exempt for federal income tax purposes under I.R.C. § 501(a) as organizations described in I.R.C. § 401(a). These types of pension plans are properly considered "employee benefit plans" as the term is defined for purposes of ERISA under 29 U.S.C. § 1002(3). Such pension plans fit within this definition because the plans are generally 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.

The Fund's participants also include individual retirement accounts that are exempt for federal income tax purposes under I.R.C. § 408(e). Whether or not an individual retirement account is considered an "employee benefit plan" as the term is defined for purposes of ERISA under 29 U.S.C. § 1002(3) depends on the type of account; generally speaking, only individual retirement accounts that are used to provide retirement income in the employment context qualify.[2] Traditional and Roth individual retirement accounts are not considered "employee benefit plans" as the term is defined under 29 U.S.C.A. § 1002(3) because they are not established or maintained by an employer to provide retirement income to employees. Additionally, 29 U.S.C.A. § 1051(6) specifically excludes individual retirement accounts from ERISA coverage.

[2] For example, SEP and SIMPLE IRAs generally fit within this definition because such plans are funded by employers to provide retirement income to employees (typically in the context of self-employment).

Regardless of whether the Fund's participants include individual retirement accounts that do not qualify as employee benefit plans, however, all of the assets of the Fund come under the protections afforded by ERISA. 29 C.F.R. § 2510.3-101(h)(1) provides that when an employee benefit plan acquires or holds an interest in an entity listed in the regulation, the plan's "assets include its investment and an undivided interest in each of the underlying assets of the entity." Among the entities listed is a "group trust which is exempt from taxation under section 501(a) of the Internal Revenue Code pursuant to the principles of Rev. Rul. 81-100, 1981-1 C.B. 326." 29 C.F.R. § 2510.3-101(h)(1)(i). Thus, if a commingled trust formed pursuant to Rev. Rul. 81-100 has participants that qualify as employee benefit plans, then all of the commingled trust's assets will be treated as though they were assets of employee benefit plans, even if other participants are not in fact employee benefit plans. Here, the Fund has participants that qualify as employee benefit plans (*i.e.*, the pension plans that are exempt for federal income tax purposes under I.R.C. § 501(a) as organizations described in I.R.C. § 401(a)). Pursuant to 29 C.F.R. § 2510.3-101(h)(1)(i), the assets of such participants are treated as including all assets held by the Fund. Because all of the Fund's assets are treated as being held by employee benefit plans, all of the Fund's assets come under the protections afforded by ERISA.

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 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

[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."

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, 29 U.S.C. § 1144(a) 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 the Fund, which are treated as entirely owned by employee benefit plans pursuant to 29 C.F.R. § 2510.3-101(h)(1)(i). Accordingly, the Taxpayer is not subject to the Tennessee franchise and excise taxes.

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APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: 02/23/11