

Tennessee Franchise and Excise Tax Guide



August 2016

Franchise And Excise Taxes

Dear Tennessee Taxpayer,

This franchise and excise tax guide is intended as an informal reference for taxpayers who wish to gain a better understanding of Tennessee franchise and excise tax requirements. It is not an all-inclusive document or a substitute for Tennessee franchise and excise tax statutes or rules and regulations. The information in this guide is current as of the date of publication. Tax laws, their interpretation, and their application can change due to legislative action, reviews, and court decisions.

Periodically, registered taxpayers are mailed information letters with updates on tax laws and policies. Be sure to read any letter you receive carefully; this information may save you time and money. Informational publications are also available for specific industries. Contact the Taxpayer Services Division to obtain these publications.

Frequently asked questions and answers are located on our website at www.TN.gov/revenue. If you cannot locate your answer, feel free to submit an electronic help ticket for an email response to your specific question. The Department of Revenue also offers a toll-free franchise and excise tax information line for Tennessee residents. The number is (800) 397-8395. If calling from Nashville or outside Tennessee, you may call (615) 253-0700. The Department of Revenue also offers a telecommunications device for the deaf (TDD) line at (615) 741-7398.

Finally, if you have questions, please do not hesitate to contact any of the offices listed below.

Sincerely,

Taxpayer Services Division

Tennessee Department of Revenue
Taxpayer Services Division
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500 Deaderick Street
Nashville, Tennessee 37242-1099

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Regional Offices

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Franchise And Excise Taxes

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Johnson City:
204 High Point Drive
Johnson City, TN 37601
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Knoxville, TN 37902
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Legislative Changes Included in the 2016 Franchise and Excise Tax Guide

- (1) Effect of “Rural Economic Opportunity Act of 2016” on the number of qualified jobs that must be created in order to receive certain job tax credits in Tier 3 and Tier 4 Enhancement Counties. (Page 45)
- (2) Franchise and excise job tax credits for part-time and seasonal adventure tourism jobs created in adventure tourism districts. (Page 47).
- (3) Reforms to Tennessee’s franchise and excise estimated payment requirements. (Page 51)

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Franchise And Excise Taxes

The Franchise And Excise Taxes

The excise tax is a tax imposed on the privilege of doing business in Tennessee. General partnerships and sole proprietorships are not subject to the tax. The tax is based on net earnings or income for the tax year. [Tenn. Code Ann. Section 67-4-2007]

The franchise tax is also levied upon the privilege of doing business in Tennessee and is based on the greater of net worth or the book value of real or tangible personal property owned or used in Tennessee. For this purpose, net worth or property values at the end of the taxable period are used. [Tenn. Code Ann. Section 67-4-2104]

Both taxes are state taxes for state purposes only. No county, municipality, or taxing district shall have power to levy like taxes.

Although the franchise and excise taxes are two separate taxes, the intention of the state legislature, and the policy of the Department of Revenue, is that they are part of the same taxing scheme. Generally, any taxpayer that is liable for one will be liable for both. The use of the terms "franchise and excise tax" or "the tax" in this publication will indicate applicability to both taxes. Persons liable for the tax will register for both on one form and must file returns on one form. The taxable periods for both the franchise and excise taxes are always coincidental. A return is required for every fiscal closing of the corporate books of each taxpayer and must be filed coincidentally with each federal return filing period.

Who Is Liable?

Any person doing business in Tennessee is liable for the franchise and excise tax. In this regard, "person" or "taxpayer" means every corporation, subchapter S corporation, Limited Liability Company, professional limited liability company, registered limited liability partnership, professional registered limited liability partnership, limited partnership, cooperative, joint-stock association, business trust, regulated investment company, real estate investment trust, state-chartered or national bank, or state-chartered or federally chartered savings and loan association. [Tenn. Code Ann. Section 67-4-2004]

A person doing business in Tennessee without incorporating, domesticating, qualifying, or otherwise registering in Tennessee, or doing business in Tennessee while its charter or other registration is forfeited, revoked, or suspended, will not be relieved from filing a return and paying the tax for each tax year that it does business in Tennessee. [Tenn. Code Ann. Sections 67-4-2105(c), 2007(b)]

If a taxpayer dissolves without settling its franchise and excise tax obligations, the officers, stockholders, partners, members, principals, or employees may be held liable for the tax to the extent that they received any of the entity's corporate property in the liquidation process. [Tenn. Code Ann. Sections 67-4-2016, 2117]

Not-for-profit Status

Franchise and excise taxes are not applicable to nonprofit persons as defined by law. They must file an annual report

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The Franchise And Excise Taxes

(continued)

with the Secretary of State and pay the filing fee. However, any nonprofit entity with income from activities that are not related to the reason it was granted nonprofit status is liable for the franchise and excise taxes on that income. [Tenn. Code Ann. Sections 67-4-2007(a) and 67-4-2105(a)]

Registration

All persons subject to the franchise and excise tax will register with the Department of Revenue by completing and filing the registration form prescribed by the Department. This form will be filed within 15 days after the date the person becomes subject to the tax. [Tenn. Code Ann. Section 67-4-2003(c)]

Secretary of State Requirements

To obtain a corporate charter, articles of organization, a certificate of limited partnership, or a certificate of authority for out-of-state corporations, the appropriate forms and fees must be filed with the Tennessee Secretary of State. Any amendments must also be filed with the Secretary of State's office. All corporations, limited liability companies, and limited partnerships qualified with the Tennessee Secretary of State must file an annual report and pay a filing fee with that office. The report is due on the first day of the fourth month following the corporation's fiscal closing.

How to Apply

The franchise and excise tax registration form should be filed online. There is no fee. Taxpayers that need additional information concerning this tax may visit

or call one of the Department of Revenue offices listed on the first page of this publication. Trained personnel are available there to explain Tennessee's tax system and to answer your questions. If online filing is not possible, taxpayers may mail the Application for Franchise, Excise Tax Registration form to the address shown on the instructions.

Nexus of Out-of-State Businesses

[Tenn. Code Ann. Section 67-4-2004]

Out-of-state businesses must register with the Department of Revenue for payment of the franchise and excise taxes if they have "nexus" in Tennessee.

For tax years beginning on or after January 1, 2016, all nonexempt entities are subject to the tax if they are "doing business in the state and having substantial nexus in the state."

"Substantial nexus in the state" means any direct or indirect connection of the taxpayer to this state such that the taxpayer can be required under the Constitution of the United States to remit the tax. Such connection includes, but is not limited to, any of the following:

- + The taxpayer is organized or commercially domiciled in Tennessee;
- + The taxpayer owns or uses its capital in Tennessee;
- + The taxpayer has a systematic and continuous business activity in this state that has produced gross receipts attributable to customers in Tennessee; or
- + The taxpayer has a bright-line presence in the state. A person has a bright-line presence in this state for a tax period if any of the following applies:

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(continued)

- Receipts: > \$ 500,000 or 25% of total receipts from sales in TN
- Property: > \$ 50,000 or 25% of total property by value in TN
- Payroll: > \$ 50,000 or 25% of compensation paid in TN

For tax year beginning prior to January 1, 2016, a business has nexus and is subject to the franchise and excise taxes if it is “doing business within the state.” “Doing business within the state” means an activity purposefully engaged in within Tennessee by a person with the object of gain, benefit, or advantage consistent with the intent of the general assembly to subject such persons to the tax to the fullest extent permitted by the Constitution. The following list is not all inclusive, but shows examples of activities that would generally create nexus:

- + Having an office, distribution point, sales room, warehouse, or any other temporary or permanent place of business in Tennessee, or
- + Conducting any business activities in Tennessee that go beyond the mere solicitation of orders for sales of tangible personal property that are accepted, approved, and shipped from outside Tennessee, provided there is a physical presence in Tennessee. (If the only activity is solicitation of orders for sales of tangible personal property to be accepted, approved, and shipped from outside Tennessee, excise tax would not apply; however, nexus would exist for franchise tax through order solicitation.)

The above named activities are not intended to be all-inclusive, and it would be possible for a business engaged in any activity not listed above to have sufficient nexus in Tennessee to be subject to Tennessee franchise and excise taxes.

The law provides some exceptions to the general nexus rule, and they are found at Tenn. Code Ann. Section 67-4-2004(14)(E).

Classifications of Businesses

[Tenn. Code Ann. Section 67-4-2007]

Businesses will be classified as corporations, partnerships, or other types of business entities consistent with the way they are classified for federal income tax purposes and taxed accordingly. Entities disregarded for federal income tax purposes, except limited liability companies whose single member is a corporation, will not be disregarded for Tennessee franchise and excise tax purposes. Except for unitary groups of financial institutions, captive REIT affiliated groups, or business entities that have been required or permitted to file franchise and excise tax returns on a combined, consolidated, or separate accounting basis, each taxpayer will be considered an separate and single business entity for Tennessee franchise and excise tax purposes. Each entity will file its Tennessee franchise and excise tax return reflecting only its own business activities.

Financial Institutions

[Tenn. Code Ann. Sections 67-4-2004 and 2105]

For franchise and excise tax purposes, a “financial institution” is defined as a holding company, any regulated financial corporation, a subsidiary of a holding

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The Franchise And Excise Taxes

(continued)

company or a regulated financial corporation, an investment entity that is indirectly more than 50% owned by a holding company or a regulated financial corporation, or any other entity that is carrying on the business of a financial institution. "Financial institution" does not include insurance companies subject to tax under Tenn. Code Ann. Sections 56-4-201 through 56-4-214.

A financial institution is not considered to be conducting the business of a financial institution in this state if its only activity is the ownership of an interest in one or more of the following types of property, including activities that are required to acquire or dispose of the property, to service the property, to collect income from the property, or to acquire or liquidate collateral relating to the property.

- + A real estate mortgage investment conduit, real estate investment trust, or regulated investment company as defined by the Internal Revenue Service.
- + A loan-backed security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments, or reasonable projections of payments, on the notes or certificates.
- + A loan, lease, note, or other asset attributed to this state in which the payment obligations were solicited and entered into by an independent person not acting on behalf of the owner.

- + The right to service or collect income from a loan or other asset from which interest on the loan or other asset is attributed to this state and in which the payment obligations were solicited and entered into by an independent person that is not acting on behalf of the owner.
- + Demand deposit clearing accounts, federal funds, certificates of deposit, and other similar wholesale banking instruments issued by other financial institutions.
- + Securities.
- + Any intangible, tangible, real, or personal property acquired in satisfaction, fully or in part, of any a payment obligation that is in default, secured or unsecured, if the ownership of the interest would be exempt otherwise.

Captive Real Estate Investment Trusts

[Tenn. Code Ann. Sections 67-4-2004, 2006, 2007, 2013, 2106, and 2111]

"Captive real estate investment trust" or "captive REIT" means an entity with an election in effect under Section 856(c)(1) of the Internal Revenue Code, compiled in 26 U.S.C. Section 856(c)(1), in which any other entity or individual, directly or indirectly, has at least eighty percent (80%) ownership interest by value determined in accordance with generally accepted accounting principles and whose shares are not traded on a national stock exchange. [Tenn. Code Ann. Section 67-4-2004]

"Captive REIT affiliated group" means a captive REIT and any entity in which the captive REIT, directly or indirectly, has more than fifty percent (50%) ownership interest; provided, however, that a

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“captive REIT affiliated group” does not include a group in which the captive REIT is owned, directly or indirectly, by a bank, a bank holding company, or a public REIT. [Tenn. Code Ann. Section 67-4-2004]

“Real estate investment trust” means an entity that has an election in effect under Section 856(c)(1) of the Internal Revenue Code. [Tenn. Code Ann. Section 67-4-2004]

Captive REIT affiliated groups required to file a combined return: Persons subject to tax in this state that are members of a captive REIT affiliated group shall file a combined return and pay tax based on the apportioned combined net earnings of the entire captive REIT affiliated group, as defined in Tenn. Code Ann. Section 67-4-2006(a). The members of the group shall designate one member that is subject to tax in this state to file the combined return. Each member subject to tax in this state shall be jointly and severally liable for the tax imposed by this part with regard to the affiliated group. [Tenn. Code Ann. Section 67-4-2007(e)(3)]

Net Worth defined for a captive REIT affiliated group: For a captive REIT affiliated group, “net worth” is defined as the difference between the total assets less the total liabilities of the affiliated group at the close of business on the last day of the tax year, as shown by a pro forma consolidated balance sheet including all members of the group. The pro forma consolidated balance sheet shall be prepared in accordance with generally accepted accounting principles wherein transactions and holdings between members of the group and

holdings in non-domestic persons have been eliminated. [Tenn. Code Ann. Section 67-4-2106(b)]

Net Worth Apportionment for a captive REIT affiliated group: Except as may be otherwise provided in this part, the net worth of a taxpayer doing business both in and outside Tennessee shall be apportioned to this state by multiplying such values by a fraction, the numerator of which shall be the property factor plus the payroll factor plus twice the receipts factor and the denominator of such fraction shall be four. [Tenn. Code Ann. Section 67-4-2111(b)]

“Net earnings” and “net loss” defined for a captive REIT affiliated group: Captive REIT affiliated group; “Net earnings” or “net loss” is defined as the combined net earnings or net loss, for all members of the affiliated group, with all dividends, receipts, and expenses resulting from transactions between members of the affiliated group excluded when computing combined net earnings, and subject to the adjustments in Tenn. Code Ann. Sections 67-4-2006(b) and (c) on a combined basis, even if some of the members would not be subject to taxation if considered apart from the affiliated group. [Tenn. Code Ann. Section 67-4-2006(a)(9)]

Dividends Paid Deduction required to be added to Net Earnings: There shall be added to net earnings any deduction by a captive REIT for dividends paid, as defined under 26 U.S.C. Section 561, that is allowed and taken under 26 U.S.C. Section 857(b)(2)(B); however, this add-back does not apply to a captive REIT that is owned, directly or indirectly, by a bank, a bank holding company, or a public REIT. [Tenn. Code Ann. Section 67-4-2006(b)(1)]

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Net earnings apportionment for a captive REIT affiliated group: The net earnings of a captive REIT affiliated group shall be apportioned to Tennessee based on property, payroll, and double weighted receipts as provided in Tenn. Code Ann. Section 67-4-2012, including the factors of those members of the affiliated group that would not be subject to taxation in this state if considered apart from the affiliated group; however, dividends, receipts, and expenses resulting from transactions between members of the affiliated group shall be excluded for purposes of apportionment. [Tenn. Code Ann. Section 67-4-2013(d)] For all tax years beginning on or after July 1, 2016, the sales factor is triple weighted instead of double weighted.

Terminating a Business

Before a taxpayer can terminate its charter, articles of organization, or certificate of limited partnership, or withdraw its certificate of authority or other similar document, a tax clearance certificate must be issued by the Department of Revenue. In order to receive a tax clearance certificate, a taxpayer must file all returns to date and a final franchise and excise tax return through the date of liquidation or the date the taxpayer ceased operations in Tennessee.

A taxpayer in the process of liquidating and ceasing business operations will be considered in a "Final Return Status." If the liquidation occurs all on one day, the franchise tax will be determined by the balance sheet values immediately preceding liquidation. If the liquidation occurs over more than one day, then the

taxpayer will use monthly average values to compute the franchise tax bases for any return(s) in a "Final Return Status." A schedule of liquidation, distribution, or disposition of all assets must accompany these return(s). [Tenn. Code Ann. Section 67-4-2115]

When these requirements have been met, the Department of Revenue will issue the tax clearance certificate for termination or withdrawal. The certificate will be mailed to the taxpayer's mailing address unless otherwise specified. To complete the termination or withdrawal process, the taxpayer must contact the Tennessee Secretary of State's office for that office's requirements. The tax clearance certificate is valid for 45 days from the date of issue.

It is the Commissioner's responsibility to collect the franchise and excise tax due, plus any penalties and interest, from any officer, stockholder, partner, member, principal, or employee of a taxpayer that has ceased business without paying the tax, if such person has received property of the defunct business. The amount of tax that may be collected in this situation may not exceed the value of the property received by the person from whom collection is sought. [Tenn. Code Ann. Sections 67-4-2016 and 67-4-2117]

Franchise And Excise Taxes

Exempt Entities

Entities Specifically Exempt Under Statute

The law exempts a number of entities from the franchise and excise tax:

- + Corporations organized in Tennessee, whose sole purpose is furthering industrial development in Tennessee communities, whose stockholders receive no income other than interest on money invested in the corporation, and whose officers receive no compensation. [Tenn. Code Ann. Section 67-4-2008(a)(1)]
- + Corporations organized for the purpose of erecting or owning a meeting place for more than one Masonic lodge, lodge of Odd Fellows, or similar lodge; which could obtain general welfare charters; and whose stock is owned by lodges participating in the common meeting place. Commercial rental income received by such corporations is not tax exempt. [Tenn. Code Ann. Section 67-4-2008(a)(2)]
- + Regulated investment companies or funds organized as unit investment trusts, taxable as grantor trusts under federal law, and whose investment value consists of at least 75% government bonds of the United States, the state of Tennessee, or any county, municipal, or political subdivision of the state. [Tenn. Code Ann. Section 67-4-2008(a)(3)]
- + Federal and state credit unions, production credit associations, and investment companies organized under state law. [Tenn. Code Ann. Section 67-4-2008(a)(4)]
- + Certain venture capital funds dealing primarily in trading securities in non-publicly traded companies on its own behalf. The capital of the fund may be derived from investments by one or more affiliates if such affiliates also qualify as venture capital funds. [Tenn. Code Ann. Section 67-4-2008(a)(5)]
- + Certain limited liability companies, limited partnerships, and limited liability partnerships, the activities of which are at least 66.67% farming or holding personal residences where one or more of its partners or members reside. [Tenn. Code Ann. Section 67-4-2008(a)(6)]
- + Limited liability companies, limited liability partnerships, or limited partnerships existing on May 1, 1999, that:
 - + were at least 98% owned by corporate members of an affiliated group defined in 26 USC Section 1504(a);
 - + were formed and operated for the purpose of acquiring notes and other evidence of indebtedness from its members;
 - + the assets of which serve as security for third party borrowings or indebtedness;
 - + had at least 80% of the income from these instruments included in the income of a corporation doing business in Tennessee; and
 - + were subject to apportionment rules. [Tenn. Code Ann. Section 67-4-2008(a)(7)]

Franchise And Excise Taxes

Exempt Entities *(continued)*

- + Limited partnerships and limited liability companies organized exclusively for the purpose of providing affordable housing are exempt from franchise and excise taxes if the entity receives an allocation of low-income housing tax credits pursuant to Section 401 of the Internal Revenue Code (IRC) of 1986 and has in effect an "extended low-income housing commitment" as defined in Internal Revenue Code Section 42(h)(6)(B) with respect to each residential building owned by the entity for the period covered by the return. Effective for tax period ending on or after June 20, 2003. [Tenn. Code Ann. Section 67-4-2008(a)(8)]
- + Limited liability companies, limited liability partnerships, or limited partnerships, all of whose members or partners are fully liable for the debts, obligations, and liabilities of the entity, and who have filed appropriate documentation with the office of the Secretary of State prior to the first day of the taxable year for which a return is filed. However, in some instances, a secondary level of limited liability entities may be formed between the initial limited liability entity and the individual owners in an attempt to avoid the franchise and excise taxes while still providing limited liability to the individual owners or partners. Members or partners of a limited liability entity may make an election for the entity to be treated as an exempt "obligated entity." The members or partners making this election must file the required documentation with the Secretary of State to become fully liable for the debts, obligations, and liabilities of the entity and are referred to as "obligated members." In the event that any obligated member or any owner of an obligated member, whether such ownership is in whole, in part, direct, or indirect, provides limited liability protection, the obligated member entity is liable for franchise and excise taxes on the portion of income and equity attributable to such obligated member. This is effective for tax periods ending on or after July 1, 2005.
- + Entities, classified as partnerships or trusts under 26 USC Section 7701, or that have elected to be treated as a REMIC or FASIT entity, whose sole purpose is the asset-backed securitization of debt obligations. [Tenn. Code Ann. Section 67-4-2008(a)(10)]
- + Non-corporate entities that are at least 95% family owned. At least 66.67% of the entity's income must be derived from activities that produce passive investment income, or from a combination of the production of passive investment income and farming as defined by statute. Effective July 1, 2009, the definition of "rents" relative to passive investment income was revised to include only rental income from residential or farm property. "Residential property" includes only property leased or rented for residential purposes and includes not more than four separate residential properties for property

Franchise And Excise Taxes

Exempt Entities (continued)

- tax purposes. "Farm property" does not include acreage used for recreational purposes by clubs, including golf course playing hole improvements. Additionally, ownership units held in trust are not treated as owned by members of the family unless the ownership units are property of a trust described in Tenn. Code Ann. Section 67-4-2008(a)(11)(B)(i)(e) (namely, a testamentary trust). [Tenn. Code Ann. Section 67-4-2008(a)(11)]
- + Diversified investing funds are exempt from franchise and excise taxes if the fund is a limited partnership, limited liability company, or limited liability partnership that is formed and operated for the purpose of buying, holding, or selling qualified investment securities on its own behalf. The capital of the fund must be primarily derived from investments by entities or individuals that are not affiliated with the fund. At least 90% of the fund's income must consist of interest, dividends, and gains from the sale or exchange of such investment securities. [Tenn. Code Ann. Section 67-4-2008(a)(12)]

"Affiliated" means entities that are affiliates or part of an affiliated group. As applied to individuals, "affiliates" means any natural person who, directly or indirectly, has more than 50% ownership interest in any entity. Indirect ownership by an individual includes ownership by any family member of the individual. A "family member" of the individual can be:

- + An ancestor of the individual;
- + The spouse or former spouse of the individual;
- + A lineal descendant of the individual, the individual's spouse, or a parent of the individual;
- + The spouse or former spouse of a lineal descendant as described above, or
- + The estate or trust of a deceased individual who, while living, would have fallen into one of the previous categories. [Tenn. Code Ann. Section 67-4-2008(a)(12)(B)]

A corporation or limited liability company is exempt from the franchise and excise taxes if it is directly or indirectly owned and controlled by a nonprofit entity, is organized for the purpose of preserving or rehabilitating a historic property listed on the National Register of Historic Places, and the controlling nonprofit entity has received approval from the U.S. Department of the Interior National Park Service. In order to qualify for exemption, the nonprofit entity must directly or indirectly hold not less than 51% of the corporation or limited liability company's ownership interest and voting control, and the historic property must be used in the performance of the exempt activity or function of the controlling nonprofit entity. Effective for tax periods ending on or after September 1, 2003.

Effective June 3, 2008, an exemption was specifically provided in the franchise and excise tax statutes for insurance companies. [Tenn. Code Ann. Section 67-4-2008(a)(14)]

Any qualified TNInvestco, as defined in Tenn. Code Ann. Section 4-28-102, that has received an allocation of investment tax credits and continues to participate in

Franchise And Excise Taxes

Exempt Entities (continued)

the program established by the Tennessee Small Business Investment Company Credit Act. Effective date June 30, 2010. [Tenn. Code Ann. Section 67-4-2008(a)(15).

Effective for tax periods ending on or after June 30, 2011, an exemption is available for facilities owned directly, in whole or in part, by a branch of the United States Armed Forces. The entity must derive more than 50% of its gross income from the operation of facilities that are located on property owned or leased by the federal government and are operated primarily for the benefit of members of the United States Armed Forces. [Tenn. Code Ann. Section 67-4-2008(a)(16)]

Effective for tax periods ending on or after July 1, 2015, a franchise and excise tax exemption is available for certain interests in qualified low-income community historic structures. The credit is available to:

- + Any qualified low-income community historic structure owner;
- + Any qualified low-income community historic structure lessee; or
- + Any entity that directly or indirectly owns an interest in a qualified low-income community historic structure owner, a qualified low-income community historic structure lessee, or both, and that has no business operations or assets other than:
 - (a) Its investment in the qualified low-income community historic structure owner, the qualified low-

- income community historic structure lessee, or both;
- (b) Business operations and assets incidental to its investment in the qualified low-income community historic structure owner, the qualified low-income community historic structure lessee, or both; and
- (c) De minimis other operations and assets.

"Qualified low-income community historic structure" means a "certified historic structure," as defined in Section 47 of the Internal Revenue Code, together with any associated contiguous real estate, located in a "low-income community," as defined in Section 450 of the Internal Revenue Code, and with respect to which more than \$100,000,000 of "qualified rehabilitation expenditures," as defined in Section 47 of the Internal Revenue Code are incurred after January 1, 2015.

"Qualified low-income community historic structure owner" means a limited liability company that owns a qualified low-income community historic structure and that has no business operations or assets other than:

- + Its investment in the qualified low-income community historic structure;
- + Business operations and assets incidental to the ownership, financing, and leasing of the qualified low-income community historic structure; and
- + De minimis other operations and assets.

"Qualified low-income community historic structure lessee" means a limited liability company that leases or subleases

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Exempt Entities (continued)

substantially all of a qualified low-income community historic structure and that has no business operations or assets other than:

- + Its lease or sublease of the qualified low-income community historic structure;
- + Operations and assets incidental to leasing and subleasing of the qualified low-income community historic structure; and
- + De minimis other operations and assets. [Tenn Code Ann. Section 67-4-2008(a)(17)]

Publicly Traded Real Estate Investment Trusts

Any entity treated as a partnership for federal tax purposes that directly or indirectly distributes 100 percent of its net earnings or net losses to a publicly traded real estate investment trust is exempt from the excise tax. A "publicly traded real estate investment trust" is defined as an entity that has an election in effect under Section 856 of the Internal Revenue Code, and that files with the Securities and Exchange Commission and whose shares are traded on a national stock exchange. For an entity that does not directly or indirectly distribute 100 % of its net earnings or net losses to a publicly traded real estate investment trust, the entity is exempt only to the extent of the distribution to the publicly traded real estate investment trust. [Tenn. Code Ann. Sections 67-4-2019]

Annual Certification

Each entity claiming exemption from franchise and excise taxes under Tenn. Code Ann. Section 67-4-2008, except as

indicated below, must file an application for exemption on the form provided by the Commissioner of Revenue. The application must be filed within 60 days of the beginning of the first tax year for which the exemption is claimed.

Every person claiming exemption under Tenn. Code Ann. Section 67-4-2008 that has previously filed the statutorily required application for exemption must file an application for renewal of the exemption, on a form provided by the Commissioner of Revenue (FAE 183) on or before the fifteenth day of the fourth month following the close of the person's tax year.

Persons claiming exemption under Tenn. Code Ann. Section 67-4-2008(a)(11) must also file the Franchise and Excise Tax Disclosure of Activity form with the initial application or annual renew application.

No person will be exempt from the franchise and excise taxes until the proper exemption initial application or renewal form has been filed, as required. When a person fails to file the appropriate initial application or renewal form in a timely manner, a statutory penalty of \$1,000 will be imposed for the delinquent filing.

Any person who claims exemption under Tenn. Code Ann. Section 67-4-2008 but who fails to meet the criteria for exemption will be assessed all due tax, penalty, and interest.

These requirements do not apply to persons qualified for exemption under Tenn. Code Ann. Section 67-4-2008, subsections (1), (2), (3), (4), (13), (14), and (15).

Franchise And Excise Taxes

The Franchise Tax

The Measure of the Tax

The franchise tax rate is 25 cents per \$100, or major fraction thereof, of a taxpayer's net worth at the close of the tax year covered by the required return. The minimum franchise tax payable each year is \$100. A taxable business that is inactive or has had its charter or other registration forfeited, revoked, or suspended, but has not been dissolved or otherwise properly terminated, is not relieved from filing a return and paying the minimum franchise and excise tax. [Tenn. Code Ann. Sections 67-4-2106 and 2119]

The measure of the tax levied will not be less than the actual **book value** (cost less accumulated depreciation) of the real and tangible property owned or used in Tennessee, excluding exempt inventory and two thirds of the capital investment used to qualify for the additional annual jobs tax credit for higher level investments under Tenn. Code Ann. Section 67-4-209(b)(2)(B). The value of any property under construction and not actually utilized by the taxpayer will not be included in the tax base. [Tenn. Code Ann. Section 67-4-2108(a)]

Property that is used primarily for air or water pollution control or treatment of hazardous waste, certified by the appropriate government authority as necessary to meet the requirements of state, federal, or local law, will not be included in the franchise tax minimum measure. [Tenn. Code Ann. Section 67-4-2108(5)]

The value of **rental property** will be determined by multiplying the net annual rental by the following multiples: real

property - 8; machinery and equipment that is used in manufacturing - 3; furniture and office machinery and equipment - 2; delivery or mobile equipment - 1. [Tenn. Code Ann. Section 67-4-2108(a)(3)]

The value of owned or **leased mobile property**, located both in and outside Tennessee during a tax period, will be determined on the basis of the total percentage of time this property is in the state during the tax period. The value of an automobile or truck assigned to a traveling employee will be considered in Tennessee if the vehicle is licensed in Tennessee or if the employee's compensation is assigned to Tennessee for purposes of the taxpayer's apportionment formula payroll factor. [Tenn. Code Ann. Section 67-4-2108(a)(4)]

A unitary group of financial institutions may take any qualified credit generated by any group member in existence as a member of the group at the end of the year provided that the credit has not previously been taken. [Tenn. Code Ann. Section 67-4-2109(e)(5)]

Net Worth

For taxpayers filing on a separate entity basis, "net worth" is defined as the difference between a taxpayer's total assets less its total liabilities. If the taxpayer does not maintain its books and records in accordance with generally accepted accounting principles, net worth will be computed according to the accounting method used by the taxpayer for federal tax purposes, so long as the method fairly reflects the taxpayer's net worth for purposes of the franchise tax. For taxpayers required by this part to file as a unitary group on a combined basis, "net worth" is defined as the difference between each such taxpayer's total assets

Franchise And Excise Taxes

The Franchise Tax *(continued)*

less its total liabilities computed in accordance with generally accepted accounting principles. [Tenn. Code Ann. Section 67-4-2106(b)]

Effective for tax periods beginning on or after January 1, 2004, the deduction from a taxpayer's net worth base for the value of stock held in companies doing business in Tennessee was repealed and replaced with a voluntary election to calculate the net worth base for franchise tax purposes on a consolidated basis. Once made, the election is binding for a minimum of 5 years. Taxpayers continue to pay on the greater of apportioned net worth or the value of real and tangible personal property in Tennessee regardless of the method that is used to arrive at the apportioned net worth. [Tenn. Code Ann. Section 67-6-2103(d)]

For tax years beginning on or after January 1, 2004, a taxpayer that is a member of an affiliated group or a financial institution affiliated group may elect to compute its net worth on a consolidated basis, provided that, upon election, each member of the consolidated group will be required to compute its worth on a consolidated basis. Such taxpayers must file a group registration on a consolidated basis for a minimum of five years. A Franchise and Excise Tax Consolidated Net Worth Election Registration Application is available on the Department's website. [Tenn. Code Ann. Section 67-4-2103(d)]

An affiliated group will generally not be allowed to elect to compute net worth on a consolidated basis unless all members of the group close their taxable year on the same date. If a member exits the

consolidated group during a tax year because of a change in ownership, merger, or liquidation of the member, the member exiting the group will be excluded from the group and will compute its net worth individually.

Effective April 27, 2012, the Commissioner of Revenue is authorized, upon written request from the taxpayer, to exclude one or more persons from the taxpayer's affiliated group if it is determined that the persons are so remote from the taxpayer that it cannot obtain the information necessary to calculate the net worth of the group, and either that the person is included in the group only because of a direct or indirect interest or that the person has a direct or indirect interest in both the taxpayer and another person that is remote from the taxpayer. In any case, excluding such persons from the affiliated group must result in a fair representation of the affiliated group's net worth. If the exclusion is granted, all members of the affiliated group are bound by it. The Commissioner may require information to substantiate a request, due on or before the due date of the return when the exclusion is to be applicable, and may for good cause accept a late filed request. [Tenn. Code Ann. Section 67-4-2103(d)]

Tenn. Code Ann. Section 67-4-2004(1) provides a uniform definition of an "affiliate" for franchise tax and excise tax purposes. An "affiliate" is: (1) an entity in which the taxpayer, directly or indirectly, has more than a 50% ownership interest; (2) an entity that, directly or indirectly, has more than a 50% ownership interest in the taxpayer; or (3) an entity in which an entity described in (2) directly or indirectly has more than a 50% ownership interest. A noncorporate entity is more than 50%

Franchise And Excise Taxes

The Franchise Tax *(continued)*

owned if, upon liquidation, more than 50% of the assets of the noncorporate entity directly or indirectly accrue to the entity having the ownership interest.

For purposes of calculating the value of real and tangible personal property for Schedule G, railroad companies may value such property in accordance with the method used for federal tax purposes so long as the method used for federal tax purposes fairly reflects the property's actual value. [Tenn. Code Ann. Section 67-4-2108(a)(3)]

The franchise tax imposed on any manufacturer, one whose principal business is fabricating or processing tangible personal property for resale and use or consumption off the premises, will be assessed only on the first \$2 billion of apportioned net worth or real and tangible personal property owned or used in Tennessee. [Tenn. Code Ann. Section 67-4-2121]

Effective June 3, 2008, Tenn. Code Ann. Section 67-4-2118(d) was revised to eliminate, over a four-year period, the 25% deduction that had been allowed in computing consolidated net worth for financial institution affiliated groups that elect to compute their net worth on a consolidated basis.

For tax years beginning on or after January 1, 2008, a financial institution affiliated group may deduct 20% of its securities classified as held to maturity or available for sale. For tax years beginning on or after January 1, 2009, the deduction is reduced to 12.5%. For tax years beginning on or after January 1, 2010, the deduction is reduced to 5%. For tax years

beginning on or after January 1, 2011, the deduction is eliminated. [Tenn. Code Ann. Section 67-4-2118(d)]

Classification of Finished Goods Inventory

Effective for tax years beginning on or after January 1, 2004, the definition of finished good inventory for franchise tax purposes was clarified. In 1995, a provision was enacted to encourage the development of manufacturing, warehousing, and distribution facilities in Tennessee by setting a cap on the value of finished goods inventory included in the taxpayer's franchise tax base minimum measure. The new provision clarifies the incentive by providing that such inventory must be held at a manufacturing, warehousing, or distribution facility rather than at a facility where retail sales are made to customers. [Tenn. Code Ann. Section 67-4-2108(a)(6)(C)]

Adjustments

For tax periods beginning on or after January 1, 2004, the provision under which the value of an interest, determined in accordance with generally accepted accounting principles, which is held by one taxpayer in any other taxpayer paying the franchise tax, or the gross premiums tax levied under either Tenn. Code Ann. Sections 56-4-205 or 56-4-206, and doing business in this state, could be deducted from the franchise tax of the first taxpayer was repealed. This provision was replaced with the option to voluntarily elect to calculate the net worth base for franchise tax purposes on a consolidated basis. [Tenn. Code Ann. Section 67-4-2107(b)]

Franchise And Excise Taxes

The Franchise Tax *(continued)*

If a corporation whose capital stock is inadequate for its business needs is extended credit or has indebtedness to, or guaranteed by, a parent or affiliated corporation, the indebtedness must be included in computation of the corporation's net worth franchise tax base. [Tenn. Code Ann. Section 67-4-2107(c)(1)]

Exemptions

Exempt inventory may be excluded from the minimum measure of the franchise tax. "Exempt inventory" means that portion of a taxpayer's finished goods inventory in excess of \$30 million, for fiscal years beginning on or after July 15, 1998, that would otherwise be included in the minimum measure of the taxpayer's franchise tax. [Tenn. Code Ann. Section 67-4-2108(a)(6)(B)]

Exempt required capital investments may also be excluded from the minimum measure of the franchise tax. "Exempt required capital investments" means two thirds of the value of all capital investments that are the basis for the taxpayer's entitlement to the job tax credit under Tenn. Code Ann. Sections 67-4-2109(c)(2)(G) and (H). Under these provisions, certain capital investments in excess of \$1 billion or \$500 million, as the case may be, qualify taxpayers to take tax credits for certain qualifying jobs created as a result of such investment enterprises. [Tenn. Code Ann. Section 67-4-2108(a)(1)(G)]

The Excise Tax

The Measure of the Tax

All persons, except those with nonprofit status or otherwise exempt, are subject to a 6.5% corporate excise tax on the net earnings from business done in Tennessee for the fiscal year. This tax is in addition to any other taxes assessed under state law. Nonprofit persons and other exempt entities will be subject to the excise tax on net earnings in Tennessee from all activities unrelated to and outside the scope of the activities that give them exempt status.

Except for unitary groups of financial institutions, captive REIT affiliated groups, and business entities that have been required or permitted to file excise tax returns on a combined, consolidated, or separate accounting basis, each taxpayer is treated as a separate entity and must file its excise tax return on a separate entity basis, reflecting only its own business activities even though it may have filed a consolidated federal income tax return. [Tenn. Code Ann. Section 67-4-2007]

In the case of consolidations, mergers, or like events, no carryover loss by the previous taxpayer will be allowed as a deduction against the net earnings of the succeeding taxpayer. However, if the previous taxpayer merges out of existence and into a surviving successor taxpayer that has no income, expenses, assets, liabilities, equity, or net worth, the survivor of the merger may take any qualified loss carryover incurred by the predecessor. [Tenn. Code Ann. Section 67-4-2006(c)(3)]

In order to determine the loss carryover from the current year, there is an add back on Schedule K of all nonbusiness earnings and any other income that was excluded from net earnings on Schedule J in determining the excise tax base. In addition, there is an add back on Schedule K of any "discharge of indebtedness" in the current year that was not included in federal taxable income, and then any excess amount applies to an offset of the prior year's NOL carryover available, applied to the oldest year first. [Tenn. Code Ann. Section 67-4-2006(c)(5&8)]

A unitary group of financial institutions may take qualified loss carryovers of any group member that is in existence as a member of the group at the end of the tax year if such loss has not been previously taken by the member itself or by another unitary group of financial institutions entitled to the loss when the member was part of its unitary group. [Tenn. Code Ann. Section 67-4-2006(c)(4)]

Net Earnings

Net earnings (losses) are defined as federal taxable income (loss), before the net operating loss deduction and special deductions provided for in the Internal Revenue Code, plus or minus certain additions and deductions provided by state law. Some examples of adjustments are:

Additions to Federal Taxable Income before the Net Operating Loss Deduction and Special Deductions (The list is not all inclusive.) [Tenn. Code Ann. Section 67-4-2006(b)(1)]

Franchise And Excise Taxes

The Excise Tax (continued)

- + Tennessee excise tax deducted on the federal tax return. (Refunds of Tennessee excise taxes are excluded from net income to the extent they have been included in federal taxable income in the year of the refund.)
- + Interest income from state and local obligations to the extent not taxable under federal law. The interest income so added back may be reduced by allowable amortization and any interest expense not deductible for federal tax purposes.
- + Gains on sales of assets not already included in the net earnings computations for federal tax purposes. (Capital gains are subject to the excise tax in the tax year incurred.)
- + Federal capital loss carrybacks or carryovers. (Capital losses may be deducted for excise tax purposes in the tax year incurred, and carryovers or carrybacks are not permitted.)
- + Percentage depletion in excess of cost depletion. (Only cost depletion is deductible for excise tax purposes.)
- + Charitable contribution carryovers. (Charitable contributions may be deducted for excise tax purposes in the tax year that they are made. Carryovers are not permitted.)
- + Non-business losses net of related expenses.
- + Any gain realized by an S corporation attributable to a IRC Section 338(h)(10) election. [Tenn. Code Ann. Section 67-4-2006(b)(1)]
- + Any gain on the sale of an asset based on the asset's federal tax basis without any adjustment as a result of the taxpayer not having been subject to Tennessee excise tax during any portion of the period during which the taxpayer took depreciation on the asset for Federal income tax purposes. [Tenn. Code Ann. Section 67-4-2006(b)(2)(C)]
- + Any amount in excess of reasonable rent (2% per month of the appraised value of the property) that is paid, accrued, or incurred for the rental, leasing, or comparable use of industrial and commercial real property (not tangible personal property) owned by an affiliate, whether or not the affiliate is subject to the franchise and excise taxes. [Tenn. Code Ann. Section 67-4-2006(b)(1)(N)]

Deductions from Federal Taxable Income before the Net Operating Loss Deduction and Special Deductions (The list is not all inclusive.) [Tenn. Code Ann. Section 67-4-2006(b)(2)]

- + Dividends earned by a taxpayer that owns 80% or more of the outstanding capital stock of a corporation. (Expenses incurred in earning the dividends need not reduce this deduction.)
- + Amounts included in federal taxable income but not taxable under state law.
- + Actual charitable contributions made by the taxpayer during the tax year but not deducted for federal purposes. (Contributions may be deducted for excise tax purposes in the tax

Franchise And Excise Taxes

The Excise Tax (continued)

- year that they are made. Carryovers are not permitted.) (Real property contributed must be valued at book value rather than fair market value.)
- + Capital losses incurred during the tax year not deducted for federal purposes. (Capital losses may be deducted for excise tax purposes in the tax year incurred. Capital loss carryovers or carrybacks are not permitted.)
- + Net operating losses carryovers. (The carryover period for losses allocable to Tennessee is 15 years for losses incurred in fiscal years ending on or after January 15, 1984. Net operating losses can be claimed only by the entity that suffered the loss. Taxpayers are not entitled to use net operating losses that occurred before they became subject to the excise tax.)
- + Non-business earnings. (Non-business earnings directly allocated to Tennessee under Tenn. Code Ann. Section 67-4-2011 are taxed in Tennessee at 100%.)
- + Effective for tax years beginning on or after July 1, 2004, 75% of the amount donated to a qualified public school support group. The school support group must be registered with the Department of Revenue for sales and use tax purposes, must spend the donated funds on goods or services subject to the sales and use tax, and must certify to the taxpayer making the donation that the sales and use tax has actually been paid. [Tenn. Code Ann. Section 67-4-2006(b)(2)(N)]
- + Effective for tax years beginning on or after July 1, 2005, 75% of the value of charitable donations made to IRC 501(c)(3) exempt nonprofit corporations, associations, and organizations; to IRC 501(c)(4) exempt nonprofit civic leagues or organizations; and to IRC 501(c)(5) and 501(c)(6) exempt associations and organizations. The receiving exempt organization must be registered with the Department of Revenue for sales and use tax purposes, must spend the donated funds on goods or services subject to the sales and use tax, and must certify to the taxpayer making the donation that the sales and use tax has actually been paid. Effective June 27, 2006, the exemption for donations made to organizations exempt under IRC 501(c)(6) is eliminated. [Tenn. Code Ann. Section 67-4-2006(b)(2)(Q)]
- + Any loss realized by an S corporation attributable to a IRC Section 338(h)(10) election. [Tenn. Code Ann. Section 67-4-2006(b)(1)]
- + Any loss on the sale of an asset based on the asset's federal tax basis without any adjustment as a result of the taxpayer not having been subject to Tennessee excise tax during any portion of the period during which the taxpayer took depreciation on the asset for federal income tax purposes. [Tenn. Code Ann. Section 67-4-2006(b)(2)(C)]
- + Any amount in excess of reasonable rent (2% per month of the appraised value of the property) that is received for the rental, leasing, or comparable use of industrial and commercial real property (not

The Excise Tax *(continued)*

tangible personal property) by the affiliated owner subject to the franchise and excise taxes. [Tenn. Code Ann. Section 67-4-2006(b)(1)]

Permanent Decoupling from Federal Bonus Depreciation

For tax periods ending on or after July 15, 2002, Tennessee has permanently decoupled from federal bonus depreciation for excise tax purposes. Depreciation should be calculated using the schedules that existed immediately prior to the federal Job Creation and Worker Assistance Act of 2002. The Internal Revenue Code Section 179 expense election will be allowed.

Tennessee has also decoupled from the provisions of the 2004 American Jobs Creation Act that allow a deduction from federal income taxes for a specified portion of "Qualified Production Activity Income." The new law requires that any deduction taken under 26 U.S.C. Section 199 to be added back to the taxpayer's net earnings for Tennessee excise tax purposes. [Tenn. Code Ann. Section 67-4-2006(b)(1)(M)]

Business and Non-business Earnings and Losses

For excise tax purposes, earnings (losses) are considered to be business earnings (losses) if they arise from activities in the regular course of the taxpayer's business (the transactional test) or from tangible or intangible personal property, the acquisition, use, management, or disposition of which constitutes an integral part of the taxpayer's business (the functional test). All earnings (losses) that are not specifically defined as

business earnings (losses) are considered to be non-business earnings (losses).

The classification of earnings (losses) as business or non-business makes no difference to a taxpayer that is not doing business outside Tennessee so as to be entitled to apportion because, for such a taxpayer, both business and non-business earnings (losses) are taxed at 100% in Tennessee. However, some taxpayers are entitled to apportion their business earnings because they are doing business both within and outside Tennessee. Those taxpayers pay excise tax on their apportioned business earnings or carry forward their business losses. They then allocate their non-business earnings (losses) to either Tennessee or to another state in accordance with the provisions of Tenn. Code Ann. Section 67-4-2011.

Generally, when both the transactional and functional tests are applied, income (losses) from such items as dividends, interest, rents, royalties, capital gains, patents, and copyrights will be business income (losses) because they arise either in the regular course of the taxpayer's business or from tangible or intangible personal property, the acquisition, use, management, or disposition of which constitutes an integral part of the taxpayer's business. [Tenn. Code Ann. Sections 67-4-2004(1) and 2011]

Allocation of Non-business Earnings (Losses)

In the event that income (losses) from such items as dividends, interest, rents, royalties, capital gains, patents, and copyrights are non-business in nature, they are not included in apportionable income but

The Excise Tax *(continued)*

are directly allocated either to Tennessee or to another state as follows:

- + Dividends and interest are allocated to Tennessee if the taxpayer is domiciled in Tennessee.
- + Rents and royalties from real property sited in Tennessee are allocable to Tennessee.
- + Rents and royalties from tangible personal property are allocable to Tennessee to the extent that the property was utilized in Tennessee or in their entirety if the taxpayer's domicile is in Tennessee and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.
- + Capital gains and losses from the sale of real property are allocated to Tennessee if the situs of the property is in Tennessee.
- + Capital gains and losses from sales of tangible personal property are allocated to Tennessee if the property had situs in Tennessee at the time of sale or the taxpayer is domiciled in Tennessee and is not taxable in the state where the property had situs.
- + Capital gains from sales of intangible property are allocable to Tennessee if the taxpayer's domicile is in Tennessee.
- + Patent and copyright royalties are allocable to Tennessee to the extent utilized by the payer in Tennessee or if utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer is domiciled in Tennessee.

Non-business income that has been directly allocated to Tennessee is 100% subject to the excise tax. [Tenn. Code Ann. Section 67-4-2011]

Intangible Expense Add-back and Disclosure Requirements

Tenn. Code Ann. Section 67-4-2006(b)(1)(K) requires that intangible expenses paid to an affiliate be added back to net earnings. They may be deducted only after the Department's disclosure requirements have been met. If the taxpayer fails to make the disclosure, intangible expense items deducted will be added back to net earnings. If, as a result of adding back such undisclosed intangible expenses, a taxpayer underpays its excise tax liability, a 50% negligence penalty will be levied on the amount of underpayment. [Tenn. Code Ann. Section 67-1-804(b)(2)]

"Intangible expenses" are expenses related to, or in connection with, the acquisition, use, maintenance or management, ownership, sale, exchange, license, or any other disposition of intangible property, to the extent such amounts are allowed or allowable as deductions or costs in determining federal taxable income. Intangible expenses also include interest expenses directly or indirectly allowed as deductions or costs in determining federal taxable income for federal purposes to the extent such interest expenses are directly or indirectly for, related to, or in connection with the direct or indirect acquisition, use, maintenance, management, ownership, sale, exchange, license, or any other disposition of intangible property. [Tenn. Code Ann. Section 67-4-2004(24)]

Franchise And Excise Taxes

The Excise Tax (continued)

All intangible expenses paid to an affiliated entity that were deducted on the respective federal income tax return must be added back for excise tax purposes. "Affiliate" means any entity in which the taxpayer, directly or indirectly, has more than a 50% ownership interest; that directly or indirectly has more than a 50% ownership interest in the taxpayer, or in which such entity, directly or indirectly, has more than a 50% ownership interest. [Tenn. Code Ann. Section 67-4-2004(1)]

After making the add-back discussed above, a deduction may be subsequently taken if certain requirements are met. The code regarding this deduction has been amended several times since its inception for tax years beginning on or after January 1, 2004. It changed for tax periods ending on or after June 30, 2012, and again for tax periods beginning on or after July 1, 2016. [Tenn. Code Ann. Section 67-4-2006(b)(2)(N)]

Tax Period 1/1/2004 – 6/30/12:

Any intangible expense paid, accrued or incurred in connection with a transaction with an affiliate that has been disclosed and deducted on the federal income tax return may be deducted from the excise tax base. In order to properly take the deduction, the intangible expense paid to an affiliate must have been added-back as discussed above and an Intangible Expense Disclosure Form submitted with the return.

Tax Period 7/1/2012 – 6/30/16:

The Intangible Expense Disclosure Form mentioned above was discontinued and replaced by two new forms (IE-A and IE-N) to reflect changes in the law.

For filings falling within this tax period, there is automatic approval of the deduction in certain situations involving affiliates in (1) foreign nations that are signatories to comprehensive income tax treaties with the United States; (2) that during the same tax year, have directly or indirectly paid such portion to an entity that is not an affiliate; or (3) doing business in or deriving income from a state that imposes an income tax on the net income of the affiliate but does not include those states under whose laws the taxpayer and the affiliate file or are included in a combined or consolidated income tax return that includes the taxpayer and the affiliate. When one or more of these safe harbors applies, a taxpayer should deduct such expenses on its franchise, excise tax return, complete Form IE-N Intangible Expense Notice of Deduction and file it with the return each year the safe harbor applies. [Tenn. Code Ann. Section 67-4-2006((b)(2)N)(i)]

A taxpayer with an expense not meeting the criteria for one of the safe harbors listed above may make application with the Commission of Revenue and request approval of the deduction of intangible expenses paid, accrued, or incurred to an affiliate. This application should be made on form IE-A Application for Approval to Deduct. The Department will evaluate the application and issue a letter to the taxpayer approving or denying the intangible expense deduction. Approval will be granted if the Commissioner determines that the intangible expense did not have as its principal purpose the avoidance of the Tennessee excise tax.

If the application is approved, it will remain in effect so long as the taxpayer submits an annual certification that the

The Excise Tax (continued)

transaction remains substantially unchanged. The Commissioner is authorized to require that the taxpayer reapply for the deduction beginning no sooner than five years following the most recent application. [Tenn. Code Ann. Section 67-4-2006((b)(2)N)(ii) and (iii)]

Tax Periods on or after 7/01/2016:

Tenn. Code Ann. Section 67-4-2006(b)(2)(N), which provided guidance on when an intangible expense paid to an affiliate may be deducted, was deleted in its entirety and replaced, effective for tax years beginning on or after July 1, 2016. This amendment allows a deduction of intangible expense only if it is disclosed and;

- + The affiliate to whom the expense has been paid, accrued, or incurred is registered for and paying the excise tax or
- + The expense was paid, accrued, or incurred to an affiliate in a foreign nation that is a signatory to a comprehensive income tax treaty with the United States or to an affiliate that is otherwise not required to be registered for or to pay the excise tax.

Intangible Income

For all tax periods, a taxpayer may deduct intangible income included in the computation of net earnings that is accrued or earned in connection with a transaction with one or more affiliates, to the extent that the corresponding intangible expense is included in the computation of the affiliate's net earnings or loss and is not deducted by the affiliate.

Gain or Loss Recognition on Distribution of Assets

A gain on the sale of an asset that was previously distributed by a taxpayer to a nontaxable entity or individual must be recognized by the distributing taxpayer if the asset is sold within 12 months of being distributed to such entity or individual. [Tenn. Code Ann. Section 67-4-2006((b)(1(I))]

If the distributing entity liquidates prior to the asset sale, the otherwise nontaxable entity or individual is liable for the excise tax on the gain. If the entity merges into a nontaxable entity that then sells the asset, the nontaxable entity is liable for the excise tax on the sale. If the entity executes a document forfeiting its limited liability protection or its taxable status within the 12-month period immediately prior to the sale, the entity itself remains liable for the excise tax on the gain. [Tenn. Code Ann. Section 67-4-2007(f)(1(I))]

In no case shall a gain from the same transaction be taxed twice. The tax does not apply to an entity having not-for-profit status. The 50% penalty for failure to disclose a transaction may be applied for failure to report this gain. [Tenn. Code Ann. Section 67-4-2007(f)]

A loss may be deducted for excise tax purposes on the sale of an asset not already included in the taxpayer's net earnings or loss distributed by a taxpayer treated as a partnership for federal excise tax purposes, by an S corporation or by a business trust, to a member, partner, shareholder, or certificate holder when such asset is sold within 12 months of the date of distribution. Thus, in such a case, the loss for excise tax purposes is

Franchise And Excise Taxes

The Excise Tax *(continued)*

recognized by the entity making the asset distribution rather than by the seller.

[Tenn. Code Ann. Section 67-4-2006(b)(2)(K)]

Disclosure Requirement Dividends Received from Captive Real Estate Investment Trusts

Any financial institution that receives dividends, directly or indirectly, from one or more captive REITs must complete the Captive REIT Disclosure Form and file it with their franchise and excise tax return.

Failure to file this disclosure will result in a disallowance of the deduction for dividends earned by financial institutions that own at least 80% of the outstanding stock of a captive real estate investment trust and will also result in a 50% penalty on the amount of any underpayment arising from the adjustment to the financial institution's net earnings.

A captive real estate investment trust is an entity with an election in effect under IRS Code Section 856(c)(1) in which the taxpayer, directly or indirectly, has at least 80% ownership interest by value determined in accordance with generally accepted accounting principles and whose shares are not traded on a national stock exchange.

Franchise And Excise Taxes

Apportionment To Tennessee

Apportionment by Multi-State Corporations [Tenn. Code Ann. Sections 67-4-2010, 2011, 2012, 2110, and 2111] [Franchise and Excise Tax Rule 1320-6-1-.25]

A taxpayer doing business in Tennessee, and also doing business outside Tennessee so as to be subject to the taxation of another state, may apportion its net worth for Tennessee franchise tax purposes and net earnings for Tennessee excise tax purposes.

For tax years beginning prior to July 1, 2016, this is done by multiplying net worth and net earnings by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the receipts factor and the denominator is the number four.

For tax years beginning on or after July 1, 2016, this is done by multiplying net worth and net earnings by a fraction, the numerator of which is the property factor plus the payroll factor plus three times the receipts factor and the denominator is the number five.

The Property Factor

In computing the property factor, all property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. The total used for the formula is the average of the total value of property owned or used at the beginning of the year and at the end of the year. Taxpayers having interests in general partnerships must include their proportional share of the partnership's real and tangible personal property in the

formula. [Tenn. Code Ann. Sections 67-4-2012(b) and 2111(b)]

The value of owned or leased movable property, located both within and outside Tennessee during a tax period, will be determined on the basis of the total percentage of time this property is in the state during the tax period. The value of an automobile or truck assigned to a traveling employee will be considered in Tennessee if the employee's compensation is assigned to Tennessee for purposes of the taxpayer's apportionment formula payroll factor or if the vehicle is licensed in Tennessee. [Tenn. Code Ann. Sections 67-4-2012(b)-(d) and 2111 (b)-(d)]

The Payroll Factor

The payroll factor includes wages, salaries, commissions, and any other compensation for personal services of employees. A taxpayer's ownership share of the compensation paid by an entity treated as a general partnership for federal income tax purposes must be included in the payroll factor.

Compensation is included in the numerator of the factor if it is paid to an individual whose service is performed entirely in Tennessee or when only an incidental part of the employee's service is performed outside Tennessee. Compensation is also included in the numerator of the factor if some of the employee's service is performed in Tennessee and the employee has a Tennessee base of operations or, if there is no base of operations, the employee is directed or controlled from Tennessee. If an employee lives in Tennessee and the base of operations or place from which

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Apportionment To Tennessee

(continued)

the service is directed is not in a state where some of the service is performed, then the compensation is included in the numerator of the factor. [Tenn. Code Ann. Sections 67-4-2012(e), 2111(e), and 2111(f)]

The Receipts Factor

Tennessee is a destination sales state for purposes of the apportionment formula receipts factor. Generally, sales of tangible personal property are considered to be Tennessee sales or sales outside Tennessee depending on the location of the purchaser regardless of the FOB point or other conditions of sale. Sales to the U.S. Government are Tennessee sales if the merchandise is shipped from Tennessee. A taxpayer's ownership share of the receipts of an entity treated as a general partnership for federal income tax purposes must be included in the receipts factor. [Tenn. Code Ann. Sections 67-4-2012(g)-(h) and 2111(g)-(i)]

Market-based Sourcing

For tax years beginning prior to July 1, 2016, sales of other than tangible personal property are allocable to Tennessee if a greater proportion of the earnings-producing activities are performed in Tennessee. Effective for all tax years beginning on or after July 1, 2016, sales, other than sales of tangible personal property, are in this state if the taxpayer's market for the sale is in this state. The taxpayer's market for a sale is in this state:

- + In the case of sale, rental, lease, or license of real property, if and to the extent the property is located in Tennessee;
- + In the case of rental, lease, or license of tangible personal property, if and to the extent the property is located in this state;
- + In the case of sale of a service, if and to the extent the service is delivered to a location in this state;
- + In the case of intangible property:
 - (i) That is rented, leased, or licensed, if and to the extent the intangible property is used in this state, provided, that intangible property utilized in marketing a good or service to a consumer is considered used in this state if that good or service is purchased by a consumer that is in this state; and
 - (ii) That is sold, if and to the extent the property is used in this state, provided that:
 - (a) A contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is considered used in this state if the geographic area includes all or part of this state;
 - (b) Receipts from intangible property sales tax are contingent on the productivity, use, or disposition of the intangible property shall

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Apportionment To Tennessee *(continued)*

- be treated as receipts from the rental, lease, or licensing of such intangible property; and
- (c) All other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the receipts factor.

If the state/states of assignment cannot be determined, the state/states of assignment shall be reasonably approximated. If the state/states of assignment cannot be determined or reasonably approximated, the sale will be excluded from the numerator and denominator of the sales factor.

If this application to a tax year results in a lower apportionment factor than under the apportionment method in effect prior to January 1, 2016, the taxpayer may annually elect the apportionment method in effect prior to January 1, 2016. However, the election must result in a higher apportionment factor for the tax year, and the taxpayer must have net earnings rather than a net loss for that tax year. [Tenn. Code Ann. Section 67-4-2012(i)]

For any qualified member of a qualified group (see Tenn. Code Ann. Section 67-4-2012(j) for definitions), total receipts in this state shall equal the receipts from all sales of tangible personal property that are in this state as determined under Tenn. Code Ann. Section 67-4-2012(h), plus the arithmetical average of the receipts from all sales other than sales of tangible personal property that are in this

state as determined under each of the following alternative methods:

- + All sales that are in this state as determined under Tenn. Code Ann. Section 67-4-2012(i); and
- + All sales, other than sales of tangible personal property, where the earnings-producing activity is performed:
 - (i) In this state; or
 - (ii) Both in and outside this state and a greater proportion of the earnings-producing activity is performed in this state than in any other state, based on costs of performance. [Tenn. Code Ann. Section 67-4-2012(j) as amended by Public Chapter 514, Acts of 2015]

Distribution Incentive

Effective January 1, 2016, a taxpayer that meets the gross sales threshold and the receipts factor threshold during the tax period qualifies for the application of a new distribution incentive and may elect the incentive by filing an election form with the Department and providing such information as may be required by the Commissioner on or before the due date of the tax return for the period for which such election is to take effect. The election shall remain in effect until revoked by the taxpayer or until the taxpayer no longer qualifies for the election.

Franchise And Excise Taxes

Apportionment To Tennessee *(continued)*

For purposes of this incentive, the following shall apply:

- 1) A taxpayer meets the gross sales threshold if the taxpayer's sales of tangible personal property made in this state during the tax period to all distributors exceed one billion dollars (\$1,000,000,000), as determined under § 67-4-2012 without regard to this section;
- 2) A taxpayer meets the receipts factor threshold if the taxpayer's receipts factor, as determined under § 67-4-2012 without regard to this section, exceeds ten percent (10%); and
- 3) "Certified distribution sales" means sales of tangible personal property made in this state by the taxpayer to any distributor, whether or not affiliated with the taxpayer, that is resold for ultimate use or consumption outside the state; provided, that the distributor has certified that such property has been resold for ultimate use or consumption outside this state. Such certification shall be made in the manner prescribed by the Commissioner.

A taxpayer that has made the election shall, so long as such election is in effect, apportion net earnings and net worth in the manner prescribed elsewhere in the franchise and excise tax law; provided, however, that the total amount derived from certified distribution sales shall be excluded from the numerator of the receipts factor, as that term is defined in the franchise and excise tax law.

A taxpayer that has made the election shall, so long as such election is in effect, pay to the Commissioner, annually, an excise tax on the total amount of certified distribution sales excluded from the numerator of the taxpayer's receipts factor. The amount of such tax shall be computed on a graduated scale depending on the amount of certified distribution sales excluded by the taxpayer. The tax will be due in addition to all other taxes.

Any person doing business in Tennessee, who licenses the use of patents, trademarks, trade names, copyrights, know-how, or other intellectual property to another person in Tennessee, and who is paid royalties or other income based on the sale of products or other activity in Tennessee by the licensee, shall source such income to Tennessee for purposes of its apportionment formula receipts factor. Non-business receipts and receipts from the sale of goodwill are not considered in the receipts factor. [Tenn. Code Ann. Sections 67-4-2012(j), 67-4-2012(k), 67-4-2111(j), and 67-4-2111(k)]

Variations from the Standard Apportionment Formula

In some instances, the statutory tax computation, allocation, or apportionment provisions may not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer's net worth, or the taxpayer's net earnings. In such a case, the taxpayer may petition for, or the Department may require, separate accounting; the exclusion or addition of one or more apportionment formula factors, or the use of other methods to determine receipts for purposes of the apportionment

Franchise And Excise Taxes

Apportionment To Tennessee *(continued)*

formula. The taxpayer may also petition for, or the Department may require, the use of any other tax computation method necessary to fairly reflect the extent of the taxpayer's activities that are subject to the Tennessee franchise and excise tax. [Tenn. Code Ann. Sections 67-4-2014 and 2112]

When two or more business entities (whether incorporated or affiliated or not) are, directly or indirectly, owned or controlled by the same interests, the Commissioner, using appropriate federal guidelines, may make the appropriate adjustments to distribute, apportion, or allocate income, deductions, credits, allowances, or net worth among such business entities if necessary to prevent evasion of taxes, excessive use or abuse of exemptions, or to clearly reflect the income or net worth of such business entities. The Commissioner may also require combined reports utilizing a common apportionment formula covering members of an affiliated group of corporations. [Tenn. Code Ann. Sections 67-4-2014(c)(1), 2014(c)(2), 2112(c)(1), and 2112(c)(2)]

The Commissioner may disregard any entity created or transaction made that has no business purpose or is created or made with the primary purpose of evading either the federal income tax or the franchise and excise tax. [Tenn. Code Ann. Section 67-4-2014(c)(4) and 2112(c)(4)]

Once another method of tax computation or apportionment has been established, it will remain in effect as long as the circumstances justifying the variation remain substantially unchanged, or until

changed or discontinued by the Department, whichever occurs first. Should the Department change or discontinue a variation that has been granted to, or required of, a taxpayer, the taxpayer will be given reasonable notice. The change or discontinuation will then apply to the first, and subsequent, tax periods that begin on or after the date of the notice. [Tenn. Code Ann. Sections 67-4-2014(d) and 2112(d)]

Apportionment of Net Earnings and Net Worth of Common Carriers

When a taxpayer's principal business in Tennessee is that of common carrier, the following ratios will be used to apportion the taxpayer's net earnings and net worth to Tennessee.

Railroads: The ratio obtained by taking the arithmetical average of the following ratios: (A) the gross receipts from railway business operations beginning and ending entirely within this state as compared with its gross receipts from such operations within and without the state; and (B) the mileage owned and operated within Tennessee plus mileage leased and operated within Tennessee as compared with the total of such mileage within and outside this state. [Tenn. Code Ann. Sections 67-4-2013(a)(1) and 2113(a)(1)]

Motor Carriers: The ratio obtained by taking the arithmetical average of the following ratios: (A) the gross receipts from business operations beginning and ending entirely within this state as compared with its entire gross receipts from such operations within and without Tennessee; and (B) the ratio of the total franchise miles, or odometer miles if there are no franchise miles, which it holds or

Franchise And Excise Taxes

Apportionment To Tennessee *(continued)*

uses under lease, contract, or certificate of convenience and necessity from the Interstate Commerce Commission or the Department of Safety within Tennessee, to the total franchise or odometer miles which it holds or uses, inside or outside Tennessee, under such certificates from this or other states, as shown by the annual reports made by the corporation to the various commissions from which it holds certificates. [Tenn. Code Ann. Sections 67-4-2013(a)(2) and 2113(a)(2)]

Rail and Motor Carriers: When the taxpayer is engaged in transporting passengers and property by both rail and motor, then the apportionment ratio is the sum of the miles within Tennessee as computed under both the formula for railroads and the formula for motor carriers compared to the sum of the miles under such formulas within and without the state. [Tenn. Code Ann. Sections 67-4-2013(a)(3) and 2113(a)(3)]

Pipelines: The ratio obtained by taking the arithmetical average of the following ratios: (A) the gross receipts from operations on business beginning and ending entirely within Tennessee as compared with its entire gross receipts from such operations within and without Tennessee; and (B) the ratio of the pipeline miles owned and/or operated within Tennessee, to the miles of pipelines owned and/or operated within and without Tennessee. [Tenn. Code Ann. Sections 67-4-2013(a)(4) and 2113(a)(4)]

Air Carriers: The ratio obtained by taking the arithmetical average of the following ratios: (A) the originating revenue within Tennessee as compared with the entire originating revenue within and without

Tennessee; and (B) the ratio of the total air miles flown within Tennessee to the total air miles flown within and without Tennessee. Air miles flown within Tennessee shall only include miles in Tennessee from flights originating from or ending in Tennessee, or both originating from and ending in Tennessee. [Tenn. Code Ann. Sections 67-4-2013(a)(5) and 2113(6)]

Air Express Carriers: The ratio obtained by taking the arithmetical average of the following ratios: (A) the originating revenue within Tennessee as compared with the entire originating revenue within and without Tennessee; and (B) the ratio of the total air miles flown and ground miles traveled within Tennessee to the total air miles flown and ground miles traveled within and without Tennessee.

Air miles flown within Tennessee only includes miles in Tennessee from flights originating from, or ending in, Tennessee, or both originating from and ending in Tennessee. Ground miles traveled within Tennessee or traveled within and without Tennessee shall only include miles traveled with respect to the actual common carriage of persons or property for hire. [Tenn. Code Ann. Sections 67-4-2013(a)(6) and 2113(7)]

Barges: The ratio obtained by taking the arithmetical average of the following ratios: (A) the revenue from the transportation of cargo loaded in Tennessee as compared with the entire revenue from the transportation of cargo loaded inside and outside Tennessee, and (B) the ratio of the total miles operated inside Tennessee to the total miles operated inside and outside Tennessee. Miles operated in Tennessee shall be 50%

Franchise And Excise Taxes

Apportionment To Tennessee *(continued)*

of the miles operated on the Mississippi River adjacent to the Tennessee shoreline, plus all miles operated on inland waterways in Tennessee. "Miles operated" means one mile of movement of each barge. [Tenn. Code Ann. Sections 67-4-2013(a) and 2113]

Apportionment of Financial Institutions

For excise tax purposes, a financial institution not filing a combined return, that has business activities both within and outside Tennessee so as to be entitled to apportion, computes its apportionment ratio using total receipts attributable to the transaction of business in all taxing jurisdictions. A unitary group of financial institutions computes its apportionment ratio in the same manner using the combined receipts of the group with receipts from transactions between group members eliminated. The ratio so computed is then applied to the financial institution's net earnings or combined net earnings in the case of a unitary group filing on a combined basis. [Tenn. Code Ann. Section 67-4-2013(b)]

For franchise tax purposes, a financial institution, not filing a combined return, that has business activities both within and without Tennessee so as to be entitled to apportion, computes its apportionment ratio using total receipts attributable to the transaction of business in Tennessee divided by total receipts attributable to the transaction of business in all taxing jurisdictions. The ratio so computed is then applied to the financial institution's net worth to obtain the franchise tax base.

A unitary group of financial institutions computes its apportionment ratio in the same manner for each business entity in the group. In the case of a financial institution not filing a combined return, the ratio so computed is then applied to the financial institution's net worth. Each member of a unitary group of financial institutions filing a combined return applies its own apportionment ratio to its own net worth, and the results are then combined to obtain the net worth franchise tax base for the unitary group. [Tenn. Code Ann. Sections 67-4-2118(a) and 2118(b)]

For the purpose of computing the apportionment ratios of financial institutions, receipts includes net taxable gain on disposition of assets such as securities and money market transactions, when derived from transactions and activities in the regular course of business. Gross receipts of a financial institution and the basis on which they will be attributed to Tennessee are as follows:

- + Receipts from the lease or rental of real or tangible personal property located in Tennessee.
- + Interest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property located in Tennessee. If any part of the sale property or property standing as security for the payment of the debt is located part within and part outside the state, only such proportion of the interest income or other receipts shall be attributed to Tennessee as the value of the property within the state bears to the whole property.

Franchise And Excise Taxes

Apportionment To Tennessee *(continued)*

- + Interest income and other receipts from consumer loans, not secured by real or tangible personal property, made by any means to a resident of Tennessee.
 - + Interest income and other receipts from commercial loans and installment obligations, not secured by real or tangible personal property, to be applied in Tennessee. If it cannot be determined where the funds are to be applied, the receipts are to be attributed to the state in which the business applied for the loan. The term "loan" does not include demand deposit accounts, federal funds, certificates of deposit, and other similar wholesale banking instruments issued by other financial institutions.
 - + All receipts and fee income from the issuance of letters of credit, acceptance of drafts, and other devices for assuring or guaranteeing a loan or credit shall be attributed in the same manner as interest income and other receipts from the loan are attributed.
 - + Interest income, merchant discount, other receipts (including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders), and fees shall be attributed to the state to which the card charges and fees are regularly billed.
 - + Receipts from the sale of tangible or intangible assets will be attributed in the same manner that the income from the asset would be attributed.
 - + Receipts from the performance of fiduciary and other services shall be attributed in accordance with the apportionment formula for persons doing business both within and outside the state.
 - + Receipts from the issuance of traveler's checks, money orders, or United States savings bonds shall be attributed to the state where such items are purchased.
 - + Receipts from a participating financial institution's portion of participation loans shall be attributed as otherwise provided. A participation loan is any loan in which more than one lender is a creditor to a common borrower. [Tenn. Code Ann. Sections 67-4-2013(b) and 2118]
 - + Any other receipts not specifically attributed to Tennessee or to another taxing jurisdiction will be attributed to Tennessee in the same proportion as all other receipts enumerated here are attributed to Tennessee. [Tenn. Code Ann. Section 67-4-2013(b)(3)(K)]
- For tax periods beginning on or after January 1, 2006, a taxpayer may apportion its net earnings or net losses and its net worth if it has business activities that are taxable both inside and outside Tennessee. A taxpayer is considered taxable in another state only if the taxpayer is conducting activities in that state that, if conducted in Tennessee, would constitute doing business in Tennessee and would subject the taxpayer to the franchise or excise tax. [Tenn. Code Ann. Sections 67-4-2010 and 67-4-2110]

Franchise And Excise Taxes

Apportionment To Tennessee *(continued)*

Business and Non-business Earnings (Losses)

For franchise and excise tax purposes, apportionment applies only to business earnings (losses). Non-business earnings are not included in the apportionment formula and are instead allocated 100% to one state. Earnings (losses) are considered to be business earnings (losses) if they arise from activities in the regular course of the taxpayer's business or from tangible or intangible personal property, the acquisition, use, management, or disposition of which constitutes an integral part of the taxpayer's business.

Credits

Income Tax Credit

A taxpayer may take a credit against its excise tax for any Tennessee individual income tax that it pays. [Tenn. Code Ann. Section 67-4-2009(7)]

Industrial Machinery Tax Credit

A credit equal to 1% of the cost of industrial machinery purchased or leased during the tax year and located in Tennessee may be taken against both the franchise and excise tax liability.

The credit and any carryover thereof may not exceed 50% of the combined franchise and excise tax liability for the year in which it is taken and may be carried over for no more than 15 years. If any industrial machinery purchased is removed from the state, sold, or otherwise disposed of during its useful life, the state may recover a portion of the credit given. If industrial machinery is leased for less than 80% of its useful life, the amount of the credit will be determined by multiplying the purchase price by the percent of the useful life for which the machinery is leased.

As an alternative to the 1% credit, taxpayers that have filed a business plan with the Commissioner of Revenue and have made the required capital investment during the investment period qualify for a tiered credit of 3%, 5%, 7%, or 10% based on the level of capital investment. The credit percentage is applied against industrial machinery purchased; not the capital investment. The investment period during which the required capital investment must be made cannot exceed three years from the

filing of the business plan related to the required capital investment.

If the taxpayer makes a required capital investment in excess of \$1 billion during the investment period, the credit allowed equals 10% of the purchase price of industrial machinery located in Tennessee.

If the taxpayer makes a required capital investment in excess of \$500 million, the credit allowed equals 7%. If the taxpayer makes a required capital investment in excess of \$250 million, the credit allowed equals 5%. If the taxpayer makes a required capital investment in excess of \$100 million, the credit allowed equals 3%.

The definition of "Industrial Machinery" is lengthy and is found in the sales tax section of the law, Tenn. Code Ann. Section 67-6-102(44). Industrial machinery also includes computer hardware, software and peripheral devices purchased by a taxpayer in the process of making the required capital investment for the jobs tax credit, if all other requirements of the jobs tax credit are met. [Tenn. Code Ann. 67-4-2009(1)(3)(A)(ii)]

"Required capital investment" means an increase of a business investment in real property, tangible personal property, or computer software owned or leased in Tennessee valued in accordance with generally accepted accounting principles. A capital investment will be deemed to have been made as of the date of payment or the date the taxpayer enters into a legally binding commitment or contact for purchase or construction.

Credits (continued)

Provisions requiring Commissioner authorization:

- + A taxpayer that has established its international or national headquarters in Tennessee, or a taxpayer that has established an international, national, or regional warehousing or distribution hub in Tennessee may be permitted to offset up to 100% of its combined franchise and excise tax liability if authorized by the Commissioner of Revenue and the Commissioner of Economic and Community Development. [Tenn. Code Ann. Section 67-4-2009(3)(H)]
- + A taxpayer that qualifies for the 10% credit provided in Tenn. Code Ann. Section 67-4-2009(3)(I)(i) will not be subject to the 15-year carry-forward limitation otherwise applicable to the of an unused credit; provided, that the Commissioner of Economic and Community Development and the Commissioner of Revenue have determined that the allowance of the additional carry-forward is in the best interest of the state. [Tenn. Code Ann. Section 67-4-2009(3)(C)(ii)]
- + The 3-year investment period may be extended by the Commissioner of Economic Development for a period not to exceed a maximum of four years for taxpayers investing more than \$1 billion and for two years for other taxpayers. [Tenn. Code Ann. Section 67-4-2009(3)(I)(vii)(b)]

Job Tax Credit

[Tenn. Code Ann. Section 67-4-2109]

General Provisions

Standard Credit: A qualified business enterprise that makes the required capital investment may obtain a jobs tax credit equal to \$4,500 for each net new qualified job created during the investment period. (See key terms defined below.)

A business plan must be filed with the Commissioner of Revenue in order to qualify for the described jobs tax credit. It will describe the investment to be made, the number of jobs the investment will create, the expected dates such jobs will be filled, and the effective date of the plan. The form may be found at <http://tn.gov/assets/entities/revenue/attachments/f1308601.pdf>.

To qualify for the credit, the qualified business enterprise must make the required capital investment and create at least 25 qualified jobs within the investment period. Effective for tax years ending on or after July 1, 2016, the "Rural Economic Opportunity Act of 2016" reduces the number of qualified jobs that must be created in order to receive a job tax credit from 25 to 20 for an enterprise located in a "Tier 3 Enhancement County" and from 25 to 10 for an enterprise located in a "Tier 4 Enhancement County."

The credit will apply against both the franchise tax and the excise tax. The credit, together with any carryforward credit amount taken on any franchise and excise tax return, cannot exceed 50% of the combined franchise and excise tax liability shown on the return before any credit is taken. Any unused credit may be

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CREDITS *(continued)*

carried forward in any tax period until the credit is taken, up to a maximum of 15 years.

The Commissioner of Revenue has the authority to conduct audits or require the filing of additional information necessary to substantiate or adjust the findings contained within the business plan, and to determine that the business enterprise has complied with all statutory requirements so as to be entitled to the credit.

The taxpayer is not required to establish its commercial domicile in this state in order to receive the jobs tax credit.

Key Terms Defined

“Enhancement County” means a county that meets one of the following criteria for any month during the 24 months immediately prior to the creation of any qualified job for which a job tax credit is sought, based on monthly statistics from the Department of Labor and Workforce Development:

- + The average number of dislocated workers in the county exceeds the average number of dislocated workers in Tennessee; or
- + The per capita income of the county is less than Tennessee’s average per capita income.

On July 1 of each year, the Commissioner of Economic and Community Development may determine that a county qualifies as an enhancement county if the county experiences substantial characteristics of economic distress, including, but not limited to,

major loss of employment, recent high unemployment rates, traditionally low levels of family incomes, high levels of poverty and high concentrations of employment in declining industries.

Upon determining that a county qualifies as an enhancement county, the Department of Economic and Community Development shall designate the county as a Tier 1, Tier 2, Tier 3, or Tier 4 enhancement county based on unemployment, per capita income, and poverty levels of all Tennessee counties using statistical data prepared by any agency of the state or federal government no later than July 1 of each year. The Tier 4 designation was established by the Rural Economic Opportunity Act of 2016 effective for years ending on or after July 1, 2016.

A list of all Tier 1, Tier 2, Tier 3, or Tier 4 enhancement counties shall be published annually by the Department of Economic and Community Development.

“Qualified business enterprise” is an enterprise:

- + In which the business has made the required capital investment necessary to permit the creation or expansion of manufacturing, warehousing and distribution, processing tangible personal property, research and development, computer services, call centers, headquarters facilities as defined in Tenn. Code Ann. Section 67-6-224(b), back office operations, convention or trade show facilities, or tourism related businesses, including, but not limited to, restaurants, lodging

Franchise And Excise Taxes

CREDITS *(continued)*

- establishments, or other tourism-related attractions;
- + In which the business has made the required capital investment necessary to permit the creation or expansion of a repair service facility primarily engaged in providing repairs for aircraft owned by unrelated commercial, governmental or foreign persons; or
- + That promotes high-skill, high-wage jobs in high-technology areas, emerging occupations or skilled manufacturing jobs in which the business has made the required capital investment necessary to permit an increase in the number of qualified jobs.

“Required capital investment,” except for convention or trade show enterprises, means an investment of \$500,000 in real property, tangible personal property, or computer software owned or leased in Tennessee valued in accordance with generally accepted accounting principles.

For businesses engaged in convention or trade show enterprises, “required capital investment” means an investment of \$10 million in such property in the same manner described for other enterprises.

A capital investment shall be deemed to have been made as of the date of payment or the date the business enterprise enters into a legally binding commitment or contract for purchase or construction.

“Qualified job” means a job that meets all of the following criteria:

- + The job position is a permanent, rather than seasonal or part-time, employment position providing employment in a qualified business enterprise for at least 12 consecutive months to a person for at least 37.5 hours per week with minimum health care, as described in Tennessee Code Annotated Title 56, Chapter 7, Part 22; or effective with applications submitted on or after July 1, 2017 and applicable to jobs created on or after July 1, 2017, a qualified job includes a job position entailing adventure tourism, created by an enterprise located in adventure tourism district, that is a permanent employment position providing employment in a qualified business enterprise for at least 12 consecutive months to a person for at least 37.5 hours per week without minimum health care, as described in Tennessee Code Annotated Title 56, Chapter 7, Part 22; or + effective with applications submitted on or after July 1, 2017 and applicable to jobs created on or after July 1, 2017, a qualified job includes jobs that are part-time and seasonal adventure tourism jobs created in an adventure tourism district. These jobs will count as one-half of a job for the purpose of calculating the number of jobs that a qualified business has created. “Part-time” and “seasonal” employment are defined in the statute. [Tenn. Code Ann. Section 67-4-2109(a)(6) as amended by Public Chapter 759, Acts of 2016.];

Franchise And Excise Taxes

CREDITS *(continued)*

- + The job position is newly created in Tennessee and, for at least 90 days prior to being filled by the taxpayer, did not exist in Tennessee as a job position of the taxpayer or of another business entity; or for at least 36 months for a part-time or seasonal position or permanent full-time position not offering health insurance entailing adventure tourism located in an adventure tourism district created on or after July 1, 2017 - Public Chapter 759;
- + The job position is filled; provided, however, that a position will be deemed filled if it subsequently becomes vacant but is refilled within a period of not more than 90 days; and
- + Back office operations job positions must meet the definition of "industrial wage job."

"Investment period" means the period during which qualified jobs are created as a result of the required capital investment. The investment period shall not exceed three years from the effective date of the business plan.

"Industrial wage job" means a qualified job with wages equal to or greater than the state's average occupational wage, as defined in Tenn. Code Ann. Section 67-4-2004, for the month of January of the year during which the job was created.

Additional Annual Credit

In addition to the \$4,500 standard credit, taxpayers may also obtain one of three possible additional annual job tax credits, under the conditions described, providing

the taxpayer meets all of the criteria to qualify for the standard \$4,500 jobs tax credit previously described.

Additional Annual Credit Tier 2, 3, or 4 Enhancement County

If the qualified business enterprise is located in a Tier 2, Tier 3, or Tier 4 enhancement county, an additional annual credit in the amount of \$4,500 shall be available for each qualified job, provided that the job remains filled by employees during the year in which the credit is being taken.

This annual credit may be used to offset up to 100% of the taxpayer's franchise and excise tax liability for that year. Any unused annual credit cannot not be carried forward beyond the year in which the credit originated. The annual credit may first be taken after all of the requirements of the standard and additional annual credit have been met, provided, however, that the taxpayer must begin to apply the annual credit no later than the first tax year following the end of the investment period.

If the qualified business enterprise is located in a Tier 2 enhancement county, the additional annual credit shall be allowed for a period of three years.

If the qualified business enterprise is located in a Tier 3 or 4 enhancement county, the additional annual credit shall be allowed for a period of five years.

Additional annual credit involves a higher level of investment and job creation:

If the qualified business enterprise involves a higher level of investment and

Franchise And Excise Taxes

Credits *(continued)*

job creation, as described below, an annual credit shall be allowed as follows:

- + If the investment exceeds \$1 billion and at least 500 industrial wage jobs are created, the additional annual credit shall be allowed for a period of 20 years.
- + If the investment exceeds \$500 million and at least 500 industrial wage jobs are created, the additional annual credit shall be allowed for a period of 12 years.
- + If the investment exceeds \$250 million and at least 250 industrial wage jobs are created, the additional annual credit shall be allowed for a period of six years.
- + If the investment exceeds \$100 million and at least 100 industrial wage jobs are created, the additional annual credit shall be allowed for a period of three years.
- + If the investment exceeds \$10 million and at least 100 qualified jobs are created that also meet the definition of "headquarters staff employees" under Tenn. Code Ann. Section 67-6-224 and pay at least 150% of the state's average occupational wage for the month of January of the year in which the jobs are created, the additional annual credit shall be allowed for a period of three years.

The Commissioners of Revenue and Economic and Community Development may lower the number of jobs required to qualify for this additional tax credit but by no more than 50%. The credit amount will

also be lowered in direct proportion to the decrease in the number of jobs required.

The additional annual credit shall equal \$5,000 for each of these jobs if the jobs remain filled during the year in which the credit is being taken. This annual credit may be used to offset up to 100% of the taxpayer's franchise and excise tax liability for that year. Any unused annual credit cannot be carried forward beyond the year in which the credit originated.

The taxpayer will be allowed a period not to exceed three years from the effective date of the business plan in which to make the required capital investment necessary to qualify for the additional annual credit.

The annual credit may first be taken after all of the requirements of the standard and additional annual credit have been met. The taxpayer must begin to apply the credit no later than the first tax year following the end of the investment period.

If determined to be in the best interests of the state, the three-year period for making the required investment may be extended by the Commissioner of Economic and Community Development for a reasonable period not to exceed two additional years, or four additional years if the investment exceeds \$1 billion.

A taxpayer is not entitled to more than one additional annual credit. For example, a taxpayer may not claim both the additional annual credit for Tier 2, Tier 3, or Tier 4 enhancement counties and the additional annual credit for the enhanced capital investment and job creation thresholds.

Credits *(continued)*

Additional annual credit for enterprises located in an adventure tourism district: If the qualified business enterprise is in an area designated as an adventure tourism zone [Tenn. Code Ann. Section 11-11-204(c)], an annual credit will be available if the business creates at least 25 new jobs in a Tier 1 enhancement county; at least 19 new jobs in a Tier 2 enhancement county; or at least 13 new jobs in a Tier 3 enhancement county; or at least 10 new jobs in a Tier 4 enhancement county. The Tier 4 county provisions are from the Rural Economic Opportunity Act of 2016 with an effective date of tax years ending on or after July 1, 2016. The annual credit will be allowed for a period of three years if the business is in a Tier 1 or Tier 2 enhancement county and for a period of five years if the business is in a Tier 3 or Tier 4 enhancement county.

The additional annual credit will be \$4,500 per qualified job provided that the job remains filled during the year for which the credit is being taken. The credit can be used to offset up to 100% of the franchise and excise tax liability for that year but cannot be carried forward beyond the year in which the credit originated. [Tenn. Code Ann. Section 67-4-2109(b)(2)(C)]

Special Provisions

These special provisions are exceptions to the job tax provisions previously described. If a conflict between the provisions described here and those previously described, these provisions will prevail. Otherwise, any provision previously described will also apply to credits provided in these special provisions.

The standard \$4,500 job tax credit available to all qualifying businesses will be increased from \$4,500 to \$5,000 if the qualified business enterprise qualifies for the additional annual credit for higher level of investment and job creation.

If the qualified business enterprise is located in a Tier 2 enhancement county, the taxpayer shall have three years in order to create the minimum number of qualified jobs necessary to receive the credit. If the qualified business enterprise is located in a Tier 3 or 4 enhancement county, the taxpayer shall have five years to create the minimum number of qualified jobs necessary to receive the credit.

The job tax credits shall be allowed for new high-skill, high-wage, qualified jobs in high-technology areas, emerging occupations, or skilled manufacturing, regardless of whether net employment is increased. This provision applies only to new jobs created by a taxpayer who failed to meet the net increase requirement due to worker layoffs or reductions, where such workers have been certified by the federal Department of Labor's Division of Trade Adjustment Assistance, as having been adversely affected by foreign trade, so as to be eligible for assistance in accordance with the federal Trade Adjustment Assistance Reform Act of 2002. A taxpayer seeking qualification for jobs tax credits under this provision shall be required to satisfy all other requirements of this subsection, and shall be required to provide evidence to the Commissioner of Revenue of the Department of Labor's certification of eligibility for assistance for the taxpayer's adversely affected worker group.

Credits *(continued)*

If determined to be in the best interests of the state, the Commissioner of Revenue in conjunction with the Commissioner of Economic and Community Development is authorized:

- + to allow the jobs tax credit to a qualified business enterprise that is located in an enhancement county upon the creation of less than 25 qualified jobs. The Commissioner of Revenue and the Commissioner of Economic and Community Development will determine the number of qualified jobs necessary for the taxpayer to receive the credit.
- + to approve a job tax credit in cases where the newly created position existed in this state as a job position of the taxpayer or of another business entity less than 90 days prior to being filled by the taxpayer, provided that all other requirements to obtain the credit have been satisfied by the taxpayer.
- + to allow an offset up to 100% of the franchise and/or excise tax liability by job tax credits or any carryforward of the job tax credits for taxpayers that have established its international, or national headquarters in this state and has met the requirements to qualify for the credit provided in Tenn. Code Ann. Section 67-6-224, or a taxpayer that has established an international, national, or regional warehousing or distribution hub in this state and has met the requirements to be a

qualified new or expanded warehouse or distribution facility.
[Tenn. Code Ann. Section 67-4-2109(b)(3)]

Jobs Tax Credit for Employing Persons with Disabilities

A jobs tax credit of \$5,000 for each net new full-time employee job and a credit of \$2,000 for each net new part-time employee job is available for employment of persons with disabilities who are receiving Tennessee state services directly related to the disabilities.

Employment of the disabled employee must create a net increase in the number of persons with disabilities employed by the taxpayer within the 90-day period immediately preceding the employment.

The taxpayer must provide the qualifying employment for at least 12 consecutive months for no less than the minimal hours per week as described in the enacting legislation for respective full-time and part-time employment jobs. The taxpayer is not required to make a capital investment in a qualified business enterprise to receive this credit.

The credit for new net employee jobs for persons with disabilities applies initially in the tax year in which the taxpayer increases net new employment of such persons by one or more and in subsequent fiscal years in which additional net increases occur above the level of employment established when the credit was last taken.

The taxpayer must file a plan with the Commissioner of Revenue on or before the last day of the fiscal year in which the

Credits *(continued)*

employment begins and must state the number of persons with disabilities newly employed.

The Commissioner of Revenue will certify the taxpayer's participation in an employment incentive program, as well as the number of qualifying employees hired, based on the plan submitted by the taxpayer. State employment incentive programs must annually provide to the Commissioner of Revenue for approval, on or before July 1, a list of their existing programs promoting the hiring of individuals with disabilities. [Tenn. Code Ann. Section 67-4-2109(g)]

Community Resurgence Jobs Tax Credit

Effective July 1, 2015, in addition to any other job tax credits allowed, there shall be allowed to any qualified business a community resurgence job tax credit equal to \$2,500 for each qualifying job created.

A "qualified business" means a new or existing business located in a high-poverty area according to the most recent decennial determination at the time a business plan is filed with the Commissioner.

A "qualifying job" means: (i) A full-time job with wages equal to, or greater than, the state's average occupational wage, as defined in Tenn. Code Ann. Section 67-4-2004, for the month of January of the year during which the job was created; (ii) The job is newly created in this state and, for at least 90 days prior to being filled by the taxpayer, did not exist in this state as a job of the taxpayer or of another business entity; and (iii) The job is created within a

three-year period from the effective date of the business plan.

The qualified business shall file a business plan with the Commissioner in order to qualify for the community resurgence job tax credit. The business plan shall be filed in a manner prescribed by the Commissioner and shall describe the type of business, the number of jobs to be created, the expected dates the jobs will be filled, and the effective date of the plan.

In order to qualify for the credit, the qualified business shall create at least 10 qualifying jobs. The credit shall first apply in the tax year in which the qualified business first satisfies the job creation requirements and in subsequent tax years in which further net increases occur above the level of employment established when the credit was last taken.

The credit shall apply against the franchise tax and the excise tax. However, the credit, together with any carry-forward thereof, taken on any franchise and excise tax return shall not exceed 50% of the combined franchise and excise tax liability shown on the return before any credit is taken. Any unused credit may be carried forward in any tax period until the credit is taken; provided, however, that the credit may not be carried forward for more than 15 years. [Tenn. Code Ann. Section 67-4-2109]

Legislative Changes to Job Tax Credit Public Chapters 1019 and 759

Rural Economic Opportunity Act of 2016, Public Chapter 1019: The "Rural Economic Opportunity Act of 2016" extends the

Credits *(continued)*

additional annual credit of \$4,500 per qualified job to an enterprise located in a "Tier 4 Enhancement County" for a period of five years, beginning with the first tax year in which the qualified business enterprise applies the credit. The "Rural Economic Opportunity Act of 2016" extends the additional tax credit to an enterprise located in an area designated as an adventure tourism district that is located in a "Tier 4 Enhancement County" for a period of five years, beginning with the first tax year in which the enterprise applies the credit. These provisions are effective for tax years ending on or after July 1, 2016. [Tenn. Code Ann. Section 67-4-2109(a)(6) as amended by Public Chapter 759, Acts of 2016.]

Part-time and Seasonal Adventure Tourism Jobs, Public Chapter 759

Effective with applications submitted on or after July 1, 2017 and applicable to jobs created on or after July 1, 2017, job tax credits are authorized for part-time and seasonal adventure tourism jobs created in adventure tourism districts. These jobs will count as one-half of a job for the purpose of calculating the number of jobs that a qualified business has created.

"Part-time" and "seasonal" employment are defined in the statute. [Tenn. Code Ann. Section 67-4-2109(a)(6) as amended by Public Chapter 759, Acts of 2016.]

Gross Premiums Tax Credit

In accordance with Tenn. Code Ann. Section 56-4-217, a franchise tax credit is available on the net amount of gross premiums tax paid that is measured by a period that corresponds to the franchise

tax period on which the return is based, plus any amount used to offset payment to the Tennessee guaranty association that has not otherwise been recovered, but not including the gross premiums receipts tax paid by fire insurance companies for the purpose of executing the fire marshal law. [Tenn. Code Ann. Section 67-4-2109(c)]

Financial Institution Loans to Eligible Housing Entities

A financial institution is allowed a credit against the franchise and excise taxes equal to either (1) 5% of a qualified loan or long time investment or (2) 3% annually of the unpaid principal balance of a qualified loan made to an eligible housing entity for any eligible activity as of December 31 of each year for the life of the loan or 15 years, whichever is earlier. In addition, a credit is allowed equal to either (1) 10% of a grant, contribution, or qualified low-rate loan made to an eligible housing entity for any eligible activity or (2) 5% annually of the unpaid principal balance of a qualified low-rate loan made to an eligible housing entity for any eligible activity as of December 31 of each year for the life of the loan or 15 years, whichever is earlier.

"Eligible housing entity" is defined as any Tennessee nonprofit corporation with an IRC Section 501(c)(3) status, the Tennessee Housing Development agency, a public housing authority, or a development district.

"Eligible activity" is defined as an activity that creates or preserves affordable housing for low-income Tennesseans, an activity to help low-income Tennesseans obtain safe and affordable housing, an

Credits *(continued)*

activity which builds the capacity of an eligible nonprofit to provide housing opportunities to low income Tennesseans, and any other activities approved by the executive director of the Tennessee Housing Development Agency and the Commissioner of Revenue.

In order to take the credit, the regulated financial institution must maintain a certification from the Tennessee Housing Development Agency establishing credit entitlement and such records as required by the Tennessee Housing Development Agency to ensure that affordable housing opportunities are being provided.

Unused credits described in the first paragraph, that are based on 5% of a qualified loan or long time investment or 10% of a grant, contribution, or qualified low-rate loan made to an eligible housing entity for any eligible activity can be carried forward for 15 years from the year in which the credit originated.

However, unused credits, described in the first paragraph, that are based on 3% or 5% annually of the unpaid principal balance a qualified loan may not be carried forward. [Tenn. Code Ann. Section 67-4-2109(i)]

Tennessee Rural Opportunity Fund Credit

A credit is available in an amount equal to 10% of a financial institution's contribution to the Tennessee Rural Opportunity Fund or the Tennessee small business opportunity fund. The credit is allowed each year for a period of 10 years, beginning with the tax year in which the contribution is made. Any unused credit

cannot be carried forward beyond the year in which the credit originated.

Loaning funds to the Tennessee Rural Opportunity Fund by the taxpayer will constitute a contribution. However, if at the close of the tenth year of the period during which the credit is allowed, the taxpayer or its assignee received repayment, or retains any right to payment, of all or any portion of the amount contributed or any interest accrued on the amount contributed, the credit plus interest will be recaptured in the first tax year following the ten-year period during which the credit is allowed. [Tenn. Code Ann. Section 67-4-2109(m)]

Brownfield Property Tax Credit

Effective June 30, 2010, there is available a franchise and excise tax credit equal to 50% or 75%, depending on the amount of capital investment (\$25 million or \$200 million, respectively) of the purchase price of Brownfield property purchased in Tennessee for the purpose of a qualified development project. The total value of credits authorized is capped at \$10 million per year and allows the credit to be used for development projects using non-prime agricultural properties in any year in which credits remain available.

"Brownfield property" is defined as real property that is the subject of an investigation or remediation as a Brownfield project under a voluntary agreement or consent order pursuant to Tenn. Code Ann. Section 68-212-224. [Tenn. Code Ann. Section 67-4-2009]

Credits *(continued)*

Consolidations, Mergers and Like Events

Except for unitary groups of financial institutions, each taxpayer is treated as a separate entity. In the case of consolidations, mergers, or like events, a tax credit incurred by a predecessor will not be allowed as a deduction on the tax return filed by a succeeding taxpayer. However, if a taxpayer merges out of existence into a successor taxpayer that has no income, expenses, assets, liabilities, equity, or net worth, the successor taxpayer may carry over any qualified credit accrued to the predecessor. [Tenn. Code Ann. Sections 67-4-2109(e)(1) and (e)(2)]

Credits Repealed

The provision for the following credits expired on July 1, 2015; however, any taxpayer that has filed a business plan with the Department prior to July 1, 2015, will continue to be eligible for the credit. [Public Chapter 504, Acts of 2015]

- + Green Energy and Carbon Charge Credits [Tenn. Code Ann. Section 67-4-2109(m)]
- + Call Center Credits [Tenn. Code Ann. Section 67-4-2009(3)(G)(ii) & 67-4-2109(b)(3)(H)(ii)]
- + Qualified Headquarters Relocation Credit [Tenn. Code Ann. Section 67-4-2109(g)]
- + Industrial Machinery Credit of 1.75% for an Investment in a Qualifying Environmental Project [Tenn. Code Ann. Section 67-4-2009(3)(J)(vi)]
- + Qualified Medical Trade Center Credits [Tenn. Code Ann. Section 67-4-2109(n)]

Returns And Payment

Electronic Filing

Beginning January 1, 2014, all franchise and excise tax returns and payments related to form FAE170 Franchise, Excise Tax Return must be filed and paid electronically. All franchise and excise tax extensions (if required) and estimated tax payments and filings are also required to be filed and paid electronically. Taxpayers may file electronically using an approved software vendor or online through our website under the E-file and Pay page.

The only exception to this requirement is if you are required to file a FAE170 return, which includes apportionment schedules, and do not use an approved software vendor, you cannot file the return online through our website. You must instead use paper tax forms. Taxpayers required to file paper forms in this specific situation are not subject to penalty charges for failing to file electronically.

Financial Institutions filing for FAE174 Franchise, Excise Financial Institution and Captive Real Estate Investment Trust Tax Return are currently not included in the electronic filing requirement; however, the returns may be filed electronically through certain approved software vendors.

Any taxpayer owing \$2,500 or more in connection with any quarterly estimated payment must remit that tax payment to the state in funds that are immediately available to the state on the date payment is made. Additional information on electronic funds transfer is available in this tax guide in the General Provisions section. [Tenn. Code Ann. Section 67-1-703(b)]

Filing the Annual Return

Each taxpayer liable for the franchise and excise tax must file an accurate and complete return, signed by its president or other principal officer, under penalty of perjury. The franchise and excise tax return will be filed with the Commissioner not later than the 15th day of the fourth month following the close of the taxpayer's tax year. The return must coincide with the accounting period covered by the federal return. The appropriate tax must be paid to the Department at the time of filing the return. [Tenn. Code Ann. Section 67-4-2015(a)]

Proration of Franchise Tax for All Partial Year Returns

For tax periods ending on or after May 13, 2013, proration of the franchise tax is allowed for any return, including those in "Final Return Status," covering less than a 12-month period, except for federal 52-53 week returns. This includes a return if the tax year closes less than 12 months within incorporation, domestication, or commencement of business in Tennessee. In that case, a domestic entity prorates from the earlier of the date of formation or commencement of business, whereas a foreign entity prorates from the date of commencement of business in the state. The excise tax is not subject to proration. In the event the franchise tax is prorated, rental expenses in Schedule G are to be annualized. Proration and annualization are calculated on a days-method. [Tenn. Code Ann. Section 67-4-2115]

Returns And Payment *(continued)*

Financial Institutions Combined Return

Financial institutions forming a unitary business will file a combined return and pay tax on all operations of the unitary business. Information normally required for the franchise and excise tax return will be included for every member of the unitary group, even if some of the members would not otherwise be subject to the tax. Dividends, receipts, and expenses resulting from transactions between members of a unitary group shall be excluded from the return for purposes of apportionment. [Tenn. Code Ann. Sections 67-4-2006(a)(3) and 2114(c)]

Estimated Tax Payments and Penalties

Effective for tax years beginning on or after January 1, 2016, any taxpayer having a combined franchise and excise tax liability of \$5,000 or more for two consecutive tax years must make four equal quarterly estimated franchise and excise tax payments for its current tax year. The minimum amount of each quarterly payment shall be the lesser of one fourth of the combined franchise and excise tax liability for the preceding tax year, annualized if the preceding tax year was for less than 12 months, or one fourth of 80% of the combined franchise and excise tax liability for the current tax year.

The quarterly payments will be due on the 15th day of the fourth, sixth, and ninth months of the current tax year and the first month of the next tax year. If any of the quarterly payments become deficient or delinquent, a penalty of 2% for each month of underpayment, not to exceed a total of 24%, will be assessed. Interest will

also be assessed on the delinquency or deficiency. A taxpayer that has timely made four quarterly estimated franchise and excise tax payments, each of at least 25% of 80% of the current year's franchise and excise tax liability or 25% of the prior year's liability, will not be assessed a deficiency penalty on any quarterly payment. [Tenn. Code Ann. Section 67-4-2015]

Any taxpayer owing \$2,500 or more in connection with any quarterly estimated payment must remit that tax payment to the state in funds that are immediately available to the state on the date payment is made. [Tenn. Code Ann. Section 67-1-703(b)]

Extension of Filing Time

An extension of six months in which to file the franchise and excise tax return will be granted provided that, by the original due date of the return, the taxpayer has paid franchise and excise tax equal to the lesser of 90% of the liability for the tax year for which the extension is being requested or 100% of the liability for the year preceding the tax year in which the extension is being requested. If the preceding year was less than 12 months, the tax must be annualized. If there was no liability in the preceding tax year, the taxpayer must pay the \$100 minimum franchise tax. If the amount paid is not equal to the appropriate amount indicated above, or if the return isn't filed by the extended due date, penalties and interest will be added from the original due date as though no extension had been granted. [Tenn. Code Ann. Section 67-4-2015(g)]

Returns And Payment *(continued)*

Filing extension form FAE 173 is not required if you do not need to make a payment because you have already made sufficient payments on or before the original due date of the return. If a payment is needed to meet the payment requirement and you do not file your federal return as part of a consolidated group, either this state form or a copy of your federal extension request can be submitted. In this case, the form FAE173 or copy of your federal extension must be filed with the extension payment on or before the original due date of the return. If a payment is required and you file your federal return as part of a consolidated group, you must use this form or file an extension request electronically. This form or the electronic version of this form must be filed with the extension payment on or before the original due date of the return.

Penalties for Late Filing

Taxpayers failing to file, or filing late, are subject to a penalty of 5% per month, up to 25%, with a minimum penalty of \$15. In addition, interest accrues at a rate set by the Commissioner of Revenue. The \$15 minimum penalty applies even if no tax is due or if an adequate amount of tax was paid before the return was filed. [Tenn. Code Ann. Section 67-1-801]

Penalties for Failure to Disclose Transactions

If the taxpayer fails to make a disclosure and underpays its tax liability, a 50% negligence penalty will be imposed on the amount of any underpayment. [Tenn. Code Ann. Section 67-1-804(b)]

Delinquent Accounts Certified to the Secretary of State

When a taxpayer becomes 90 days delinquent in the payment of the tax, the Commissioner will certify the name of that taxpayer to the Secretary of State. At that time, following notification to the taxpayer, the taxpayer's charter or certificate to do business in Tennessee will automatically be revoked. If the taxpayer subsequently pays all taxes, fees, interest, and penalties, the charter or certificate may be reinstated, unless another taxpayer has taken title. [Tenn. Code Ann. Sections 67-4-2016 and 2116]

Paper Forms

Paper versions of all forms and schedules related to the franchise, excise tax are available online:

[<http://tn.gov/revenue/article/forms-franchise-excise-tax>.]

Even though these paper forms are available online, they should not be filed unless the taxpayer meets one of the electronic filing exceptions discussed in the Returns and Payments – Electronic Filing section.

Miscellaneous general purpose forms available on the Department of Revenue website include: Change of Address, Power of Attorney, Claim for Refund, Installment Payment Agreement Application, Offer in Compromise, Penalty Waiver Form and Report of Debts form. [<http://tn.gov/revenue/article/general-purpose-forms>]

General Provisions

Mailing Date

If the due date for a return falls on Saturday, Sunday, or a state holiday, the due date is automatically extended until the next business day. Returns mailed through the United States mail will be considered filed and received on the date shown in the post office cancellation mark on the envelope. If the cancellation mark is not legible or is missing, then the return will be considered filed on the date the envelope is stamped as "received" by the Department of Revenue. [Tenn. Code Ann. Section 67-1-107]

Electronic Funds Transfer (EFT)

The Tennessee General Assembly has authorized the Commissioner of Revenue to require certain tax payments to be made by funds readily available to the state. Electronic Funds Transfer is a method approved by the Commissioner for accomplishing this. Rules for the administration of this legislation went into effect on January 1, 1992.

Two payment options are available that use the Automated Clearing House (ACH) system to electronically transfer tax payments. The ACH system is a nationwide network designed for this purpose and is the preferred transaction method for many financial institutions and corporations. A third payment option, Federal Wire Transfer, should be used only as an emergency option.

Penalty and interest charges may be incurred if the taxpayer fails to remit by the chosen method. No matter which method is chosen, the taxpayer must complete the Electronic Funds Transfer

Agreement with the Department of Revenue.

Effective June 25, 2009, any taxpayer owing \$2,500 or more in connection with any quarterly estimated payment must remit that tax payment to the state in funds that are immediately available to the state on the date payment is made.

Effective January 1, 2013, all taxpayers filing franchise and excise tax returns using commercial computer software approved by the Tennessee Department of Revenue were required to file those returns electronically and to make the associated tax payments electronically as well.

Beginning January 1, 2014 all franchise and excise tax returns and payments related to Form FAE170 Franchise, Excise Tax Return must be filed and paid electronically.

Additional information on EDI and EFT, and the required forms, may be obtained by contacting the Department of Revenue's Electronic Commerce Unit at (866) 368-6374.

Penalties

A penalty is imposed for the late filing of a tax return and for late payment of taxes owed the state. The penalty is computed at a rate of 5% per month, or any portion of a month, from the due date until the date the taxes are paid. The maximum penalty is 25% of the tax amount due; the minimum penalty is \$15. [Tenn. Code Ann. Section 67-1-804]

Franchise And Excise Taxes

General Provisions *(continued)*

The Commissioner is authorized to waive, in whole or in part, penalties that are not the result of gross negligence or willful disregard of the law if such penalties fall within any of the good and reasonable causes for waiver set forth in the law. Interest may not be waived under any circumstances. The Attorney General must approve a waiver of penalty of \$100,000 or more. Penalties may not be waived in situations where the taxpayer has failed to procure a license required by law unless the taxpayer can prove that failure to procure the required license was the result of erroneous advice or action on the part of officials charged with enforcement of the law.

Among the good and reasonable causes for the waiver of a delinquency penalty is the fact that the taxpayer has timely filed and paid the tax in question for at least the two prior years. Any cause for a delinquency may be accepted as good and reasonable if it appears to the Commissioner that the taxpayer has done everything that it could reasonably be expected to do, as an ordinarily intelligent and reasonably prudent business person, to timely file the return and pay the tax.

Any taxpayer that believes it has good and reasonable cause for waiver of any penalty assessed should petition the Commissioner in writing for a penalty waiver. Such a petition should set forth the facts and circumstances that occasioned the deficiency or delinquency and the good and reasonable causes that the taxpayer believes warrants a waiver of the penalty assessed. A Petition for Waiver of Penalty form is available under the general forms section of our website. Petitions for waiver of penalties should be

submitted in writing to the Department via the email address penalty.waivers@tn.gov. [Tenn. Code Ann. Section 67-1-803]

Reasonable causes are listed in state statute Tenn. Code Ann Sections 67-1-803(c) and (d). Waivers can also be issued in delinquency cases if the taxpayer has a good two-year filing record with the Department, and no willful disregard of the law or gross negligence is involved.

Interest

Interest is imposed on any taxes not paid by the date required by law even though a filing date extension may have been granted. The interest charge on any returns filed late is established each July 1. Interest charges are not subject to waiver. [Tenn. Code Ann. Section 67-1-801]

Audits and Assessments

All tax returns filed with the Department of Revenue undergo some type of office audit or examination to ensure that the correct tax has been paid. This audit could be a computer math audit, a manual examination by a trained auditor, or both. The taxpayer will be contacted if additional information is needed to complete the audit, and will receive written notification if any adjustments are made to the return.

Any taxpayer selected for a field audit will be contacted by the Department of Revenue to set up a convenient time for the audit. The taxpayer will receive advance notification on which records will be needed for the audit. A field audit generally involves an examination of records and documentation used to file

Franchise And Excise Taxes

General Provisions *(continued)*

tax returns for the previous three years. . At the Commissioner's discretion, any taxpayer may be required to provide a copy of the federal tax forms filed with the Internal Revenue Service for the same tax year and any other information that the Commissioner may require for the reasonable enforcement of the tax. [Tenn. Code Ann. Sections 67-4-2003(b), 2103(b), 67-4-2006 and 67-4-2114(a)]

At the completion of the audit, the auditor will leave the taxpayer a written report for review. Once the auditor had made any necessary changes to the report, the proposed notice of assessment for any delinquent taxes will be issued. [Tenn. Code Ann. Section 67-1-1301]

Audits and Overpayments

When an audit of a franchise and excise tax return, for any year not barred by the statute of limitations, discloses an overpayment of the amount of franchise and excise tax due, the taxpayer may apply the amount overpaid as a credit or receive a refund in the amount of the overpayment. [Tenn. Code Ann. Sections 67-4-2009(2) and 2109(d)]

Keeping Records

Every taxpayer is required to establish and maintain records that are adequate for auditors to use in determining that the correct franchise and excise taxes have been paid.

All such records shall be open for inspection, at all reasonable hours, to the Commissioner of the Department of Revenue or authorized representatives of

the Commissioner. [Tenn. Code Ann. Section 67-6-523]

Refunds

The Commissioner of Revenue is empowered to refund taxes collected in error, including excise taxes due a taxpayer because of a decrease in net income divulged by an examination by the Internal Revenue Service. Refund requests must be supported by proper proof and must be filed within 3 years from December 31st of the year in which the tax was paid.

The Commissioner may approve refunds of up to \$100,000. Refunds of greater amounts must go to the Attorney General's office for approval. [Tenn. Code Ann. Section 67-1-1802]

Dishonored Checks

If payment for taxes due is made by a check or money order that is subsequently dishonored, a penalty of 1% of the amount of the check may be imposed on the taxpayer. If a taxpayer presents the Department with three or more dishonored checks in any calendar year, the penalty will increase to 10% of the amount of the check. Regardless, the minimum amount of penalty attached will be \$15. [Tenn. Code Ann. Section 67-1-804(d)]

Franchise And Excise Taxes

Tennessee Taxpayer Bill Of Rights

You, as a taxpayer, have certain rights so important that the Tennessee General Assembly enacted legislation to spell them out. The Tennessee Taxpayer Bill of Rights summarizes state tax laws and revenue rules with which the Department of Revenue must comply while serving you.

Taxpayer Rights [Tenn. Code Ann. Section 67-1-110]

Tennessee guarantees that you, the taxpayer, have the right to:

- Fair and courteous treatment from all employees of the Department of Revenue.
- Tax forms and information written in plain language.
- Prompt and accurate responses to all inquiries and requests for tax assistance.
- Access public records not confidential or otherwise protected by law, and to review such records at an appropriate time and location.
- Obtain all tax information relating to your account, including financial information, which is kept confidential, except to the extent required by law.
- Tax notices that clearly explain the amount being billed.
- Clear rules and procedures to resolve tax problems.
- An informal conference, as provided by law, with the Commissioner of Revenue or her delegate to dispute any tax assessment. (Taxpayers have the right to be represented by an attorney, certified public accountant, or other representative at such conference).
- Assurance that employees of the Department of Revenue are not paid, promoted, or in any way rewarded on the basis of assessments or collections.
- Suggest ways the Department of Revenue may better serve the public.
- Prompt notification of any refund to which you are entitled.
- Assistance through statewide meetings held by the Department of Revenue in convenient locations in which taxpayers are allowed to ask questions and voice opinions.
- Notice and demand for payment 10 days before the Department of Revenue makes any collection effort, except as otherwise provided by law.
- 30 days notice before seized assets are liquidated, except as otherwise provided by law.

Taxpayer Right To A Conference [Tenn. Code Ann. Section 67-1-1801]

Taxpayers are entitled to an **informal conference** to discuss an assessment. If this request is made in writing within 30 days from the date of the Notice of Assessment, the conference must be granted. If it is made beyond the 30 days, the conference may be granted within the discretion of the Commissioner.

Requests for conferences may be sent by mail or fax transmittal to:

Administrative Hearing Office
Tennessee Department of Revenue
500 Deaderick Street, Room 1240
Nashville, TN 37242
Phone (615) 741-3810
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Franchise And Excise Taxes

Taxpayers who wish to contest an assessment without making payment have 90 days to file suit in chancery court, as provided by statute. Interest will continue to accrue at the prevailing rate until payment is received. A lien may be filed against the taxpayer's property during this 90-day period, but the Department generally may not levy on the taxpayer's property to satisfy the assessment.

If the taxpayer timely requests an informal conference, the 90-day period for filing suit stops running until a conference decision is issued in writing. After the decision is issued, the 90-day period resumes running. The 90-day stay for most collection activity is likewise extended. The taxpayer is not required to request an **informal conference** before contesting an assessment in court.

If the taxpayer does not timely file suit to contest the assessment, the taxpayer may pay the assessment, request a refund, and then file suit in chancery court for a refund in accordance with the procedures set forth in Tenn. Code Ann. Section 67-1-1802.