



# **Franchise and Excise Tax Guide**

**December 2011**

## FRANCHISE AND EXCISE TAXES

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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 business tax requirements. It is not an all-inclusive document or a substitute for Tennessee business 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 and Vehicle Services Division to obtain these publications.

The Department of Revenue offers a toll-free tax information line for Tennessee residents. The number is (800) 342-1003. If calling from Nashville or outside Tennessee, you may call (615) 253-0600. The Department of Revenue also offers a telecommunications device for the deaf (TDD) line at (615) 741-7398.

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

Sincerely,

Taxpayer and Vehicle Services Division

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## **FRANCHISE AND EXCISE TAXES**

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### **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]

#### **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. Persons registered prior to the 1999 revision of the franchise and excise tax, or who have filed a return under prior law, are not required to register again for 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 most efficient method of applying for franchise and excise tax registration is to visit one of the Department of Revenue offices listed on

## FRANCHISE AND EXCISE TAXES

### THE FRANCHISE AND EXCISE TAXES (cont'd)

the first page of this publication. Trained personnel are available there to explain Tennessee's tax system and to answer your questions. If you are unable to visit one of the offices, you may mail the Application for Franchise, Excise Tax Registration form to any of the offices listed.

Whether you complete the Application for Registration form in person or by mail, you will need the following information to complete it:

- + The name, address, and phone number of the business, principal owners, officers, members, or partners, and the person making the application.
- + The Social Security Numbers of the principal owners, partners, members, or officers.
- + The Federal Employer's Identification Number (FEIN) issued by the U.S. Internal Revenue Service if you pay wages to anyone other than yourself.
- + A description of the business, the type of ownership, a brief explanation of the nature of the business, and, if the business is a corporation, the date of incorporation or domestication in Tennessee.
- + The Secretary of State control number if the business is registered with the Secretary of State.
- + The signature of an owner, office, member, or partner on the application.

#### **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. Generally, businesses are considered to have nexus if they:

- + Have an office, distribution point, sales room, warehouse, or any other temporary or permanent place of business in Tennessee, or
- + Conduct 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 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 an 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. These exceptions include:

- + The presence of employees, product samples, or promotional materials at trade shows or conventions, for no more than 20 days each calendar year, providing the employees' activities are limited to taking orders, purchasing goods, or maintaining the show.
- + Activities by book and magazine publishers with Tennessee printers, when limited to activities having to do with the printing, storage, labeling, or delivery by mail or common carrier of their materials; maintenance of raw materials; production; or quality control. This exception doesn't apply if the publisher and printer are affiliated.
- + The physical presence of equipment, tooling, inventory, and employees when the taxpayer's employees are not engaged in the pursuit of a market in Tennessee; the equipment and tools are not used by an affiliated entity; the taxpayer does not have control over the work done by the in-state entity; and the extent of the value of the property, the number of employees, and the number of days the employees are in Tennessee is minimal.
- + The temporary presence of employees solely for the purpose of purchasing goods from Tennessee vendors for out-of-state use. This presence shall not exceed 30 days per calendar year, and the out-of-state employer shall not provide an office for these employees.

Out-of-state corporations doing business in Tennessee are subject to franchise and excise taxes even if they are not incorporated or domesticated in Tennessee.

#### **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

## FRANCHISE AND EXCISE TAXES

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### THE FRANCHISE AND EXCISE TAXES (cont'd)

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 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 – 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 “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

## FRANCHISE AND EXCISE TAXES

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### THE FRANCHISE AND EXCISE TAXES (cont'd)

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)]

**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)]

### 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 schedule of liquidation, distribution, or disposition of all assets must accompany the final return. The final franchise tax will be determined by using the balance sheet values immediately preceding liquidation. [Rule 1320-6-1-.11]

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 issuance.

## **FRANCHISE AND EXCISE TAXES**

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### **THE FRANCHISE AND EXCISE TAXES (cont'd)**

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]

If a taxpayer goes out of business or otherwise ceases to exist during a year, the taxpayer is not entitled to prorate the franchise or excise tax liabilities due.

## FRANCHISE AND EXCISE TAXES

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### EXEMPT ENTITIES

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)]

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. 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.

For tax periods ending on or after July 1, 2005, 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 exemption shall not apply to any of the eligible limited liability entities that are owned in whole or in part, directly or indirectly, by a corporation other than a non-profit corporation. For tax years beginning on or after July 1, 2008, but before October 1, 2009, the appropriate documentation required for this exemption must be filed on with the Tennessee Secretary of State on or before October 1, 2009. For all other tax years, the appropriate documentation required for this exemption must be filed on or before the

## FRANCHISE AND EXCISE TAXES

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### EXEMPT ENTITIES (cont'd)

first day of the taxable year for which a return is filed. [Tenn. Code Ann. Section 67-4-2008(a)(9)]

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 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)]

Franchise and excise taxes are not applicable to nonprofit corporations as defined by law. Nonprofit corporations must file an annual report with the Secretary of State and pay the corporate 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 and 67-4-2105]

Effective for tax periods ending on or after June 30, 2003, 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 42 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. [Tenn. Code Ann. Section 67-4-2008(a)(8)]

Effective for tax periods ending on or after September 1, 2003, 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. [Tenn. Code Ann. Section 67-4-2008(a)(13)]

Diversified investing funds are exempt from franchise and excise taxes if the fund is a limited partnership, limited liability partnership, or limited liability company 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 an 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;

## FRANCHISE AND EXCISE TAXES

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### EXEMPT ENTITIES (cont'd)

- + 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)]

One business entity can also be an affiliate of another business entity if an individual owns, directly or indirectly, more than 50% interest in both business entities. Indirect ownership by an individual includes ownership by any family member of the individual. [Tenn. Code Ann. Section 67-4-2004]

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)]

### Publicly Traded Real Estate Investment Trusts

Prior to June 27, 2006, to the extent owned by real estate investment trusts, entities treated as partnerships for federal income tax purposes were exempt from the franchise tax.

Effective June 27, 2006, the franchise tax exemption for an entity that is treated as a partnership for federal income tax purposes and that is wholly owned, directly or indirectly, by a real estate investment trust was removed. The minimum franchise tax measure is extended based on the actual value of real or tangible property owned or used in Tennessee to an entity treated as a partnership for federal tax purposes and in which a real estate investment trust directly or indirectly owns a majority interest.

Also eliminated are the provisions relating to the computation of the net earnings or net loss of pass-through entity that is directly or indirectly owned by a real estate investment trust. 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 renewal 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.

## **FRANCHISE AND EXCISE TAXES**

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### **EXEMPT ENTITIES (cont'd)**

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), or (14).

### **Insurance Companies**

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

Prior to 2002, the insurance laws provided insurance companies a credit for the net amount of gross premiums tax paid in the corresponding tax year.

To the extent any franchise and excise tax liability remained after the application of the gross premiums tax credit, the remaining franchise and excise tax liabilities were reduced by an increasing percentage each year until elimination in 2002.

## FRANCHISE AND EXCISE TAXES

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### 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 jobs tax credit. 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)]

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)]

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 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)]

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)]

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 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 has been 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)]

## FRANCHISE AND EXCISE TAXES

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### THE FRANCHISE TAX (cont'd)

However, an affiliated group will 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. [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% 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) is revised to eliminate, over a four-year period, the 25% deduction that has 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)]

### Clarification 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 has been 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)]

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)]

## **FRANCHISE AND EXCISE TAXES**

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### **THE FRANCHISE TAX (cont'd)**

#### **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)]

Entities treated as partnerships for federal income tax purposes that are wholly owned, directly or indirectly, by a real estate investment trust, will be exempt from the payment of the franchise tax. Such entities partially owned by a real estate investment trust will be exempt from the tax imposed by this part to the extent that they are owned by the real estate investment trust. These entities will file franchise and excise tax returns as required and compute the franchise tax as though they were not partially exempt. The franchise tax will then be multiplied by the percentage of ownership by entities that are not real estate investment trusts; the result will be the franchise tax owed. [Tenn. Code Ann. Section 67-4-2108(b)]

## FRANCHISE AND EXCISE TAXES

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### 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)]

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 [Tenn. Code Ann. Section 67-4-2006(b)(1)] (The following is not all inclusive.)**

- + 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)]

## FRANCHISE AND EXCISE TAXES

### THE EXCISE TAX (cont'd)

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

- + 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 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 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 Accelerated Depreciation**

For tax periods ending on or after July 15, 2002, Tennessee has permanently decoupled from federal accelerated 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)]

## FRANCHISE AND EXCISE TAXES

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### THE EXCISE TAX (cont'd)

#### 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 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 a state 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]

#### Disclosure Requirements for Intangible Expense Deductions

For tax periods beginning on or after January 1, 2004, taxpayers are required to disclose, on their excise tax return, any intangible expenses paid to an affiliate company. The department will use this information to examine such transactions on a case-by-case basis to determine if such expenses are allowable as deductions in determining net earnings for excise tax purposes.

Intangible expenses are expenses related to intangible property, such as patents, trademarks, and franchise rights. An affiliated company is one in which the taxpayer has more than a 50% ownership interest, one that has more than a 50% ownership interest in the taxpayer,

## FRANCHISE AND EXCISE TAXES

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### THE EXCISE TAX (cont'd)

or one in which the taxpayer's parent company has more than 50% ownership interest. [Tenn. Code Ann. Sections 67-4-2004(1), (20), (21), and (22); 67-4-2006(b)(1)(L); and 67-4-2006(b)(2)(O)]

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)]

### Capital Gain Realization on Distribution of Assets

Effective for asset sales occurring on or after July 1, 2004, a gain on the sale of an asset distributed to a nontaxable entity or individual must be recognized if the asset is sold within 12 months of being distributed to such entity or individual.

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. The tax does not apply to an entity having not-for-profit status.

Effective for all transactions occurring on or after July 1, 2008, the gain from the sale of assets by an entity not otherwise subject to the excise tax is subject to the excise tax if the assets were owned during the 12-month period immediately prior to the sale by an affiliate of the seller and the affiliate is subject to the excise tax. The seller will be subject to the excise tax on the gain from such a sale.

In no case shall a gain from the same transaction be taxed twice. The 50% penalty for failure to disclose a transaction may be applied for failure report this gain. [Tenn. Code Ann. Section 67-4-2007(f)]

### Captive Real Estate Investment Trusts

Effective June 3, 2008, Tenn. Code Ann. Section 67-4-2004(6) adds a new definition of "captive real estate investment trust."

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 principals and whose shares are not traded on a national stock exchange.

Effective with tax periods ending on and after July 1, 2008, financial institutions are required to disclose dividends received from captive real estate investment trusts. Failure to do so 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. Failure to disclose will also result in a 50% penalty on the amount of any underpayment arising from the adjustment to the financial institution's net earnings.

## FRANCHISE AND EXCISE TAXES

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### RETURNS AND PAYMENT

#### 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 return will contain the taxpayer's name, the state in which chartered or organized, the location of its principal place of business in this state, and the location of its principal or home office; if applicable, the amount of capital stock subscribed and paid in, the amount issued and outstanding, the amount of surplus and undivided profits or, if applicable, the net worth together with the book value of each share of stock as shown by the records of the corporation at the close of its last fiscal year; a comparative balance sheet as of the beginning and close of the last fiscal year as shown by the records of the taxpayer; an income statement with appropriate supporting schedules; and any other information that the Commissioner may require for the reasonable enforcement of the tax. [Tenn. Code Ann. Sections 67-4-2006 and 67-4-2114(a)]

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)]

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 form and must file on a consolidated basis for a minimum of 5 years. A Franchise and Excise Consolidated Net Worth Election Registration Application is available on the Department's web site. [Tenn. Code Ann. Section 67-4-2103(d)]

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)]

At the Commissioner's discretion, any taxpayer may be required to file, with its franchise and excise tax return, a copy of the federal tax forms filed with the Internal Revenue Service for the same tax year. [Tenn. Code Ann. Sections 67-4-2003(b) and 2103(b)]

#### Estimated Tax Payments

Any taxpayer having a combined franchise and excise tax liability of \$5,000 or more for the current tax year must make 4 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 100% 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 5% for each month of underpayment, not to exceed a total of 25%, will be assessed. Interest will also be assessed on the delinquency or deficiency. A taxpayer that has timely made 4 quarterly estimated franchise and excise tax payments, each of at least 25% of the current year's franchise and excise tax liability, will not be assessed a deficiency penalty on any quarterly payment. [Tenn. Code Ann. Section 67-4-2015]

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. Additional information on electronic funds transfer is available in this tax guide on Page 36.

## FRANCHISE AND EXCISE TAXES

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### RETURNS AND PAYMENT (cont'd)

#### Required Estimated Payment Information for Previous Years

For tax years beginning on or after July 1, 1999, and before July 1, 2000, the minimum quarterly payment is the greater of (a) 25% of the prior year's combined franchise and excise tax liability, or (b) 25% of 50% of the current year's combined franchise and excise tax liability. For tax years beginning before July 1, 1999, or after June 30, 2000 to May 19, 2003, the minimum quarterly payment is the lesser of (a) 25% of the prior year's combined franchise and excise tax liability, or (b) 25% of 80% of the current year's combined franchise and excise tax liability; effective May 19, 2003: 25% of 100% of the current year combined rate. [Tenn. Code Ann. Section 67-4-2015]

#### Extension of Filing Time

An extension of 6 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 90% of the liability for the tax year for which the extension is being requested. If the amount paid is not equal to at least 90% or 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)]

#### 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]

#### 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)]

#### Proration of Franchise Tax for Partial Year Returns

For franchise tax purposes, Tenn. Code Ann. Section 67-4-2115 has been amended to allow for prorating the franchise tax in only two instances – if the tax year is closed within less than 12 months of incorporation, domestication, or commencement of business in Tennessee, or if the taxpayer changes its accounting period covered by the federal return. No other prorating of franchise tax will be permitted. Consistent with Department of Revenue policy, Tenn. Code Ann. Section 67-4-2015 has also been amended to state that there is no prorating of excise tax for a return that covers a period of less than 12 months. [Tenn. Code Ann. Section 67-4-2115]

#### Delinquent Accounts

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]

#### Return Forms

The appropriate Franchise, Excise Tax Return Form FAE 170 or FAE 174, along with instructions and appropriate schedules, are mailed to all registered franchise and excise taxpayers by the Department of Revenue based on the ending date of the taxpayer's fiscal year. Should there be a change in the taxpayer's filing status, fiscal year dates, or a need for additional forms, the forms may be accessed on the Department of Revenue's Internet web site. The address is [www.tennessee.gov/revenue](http://www.tennessee.gov/revenue). Forms may also be requested by calling the Department at one of the phone numbers listed in this publication.

## **FRANCHISE AND EXCISE TAXES**

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### **RETURNS AND PAYMENT (cont'd)**

#### **Electronic Filing**

Electronic filing for franchise and excise tax minimum payment returns and quarterly estimated payments is now available at <http://www.tennesseeanytime.org/fnetax/>.

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. Additional information on electronic funds transfer is available in this tax guide on Page 36.

Requests for extension of filing time may also be made electronically at this same web site.

## FRANCHISE AND EXCISE TAXES

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### CREDITS

#### 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)]

#### 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(8)]

#### 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.

However, a taxpayer that has established its international, national, or regional 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 percent of its combined franchise and excise tax liability. The increased amount of credit available for offset must be determined by the commissioner of revenue and the commissioner of economic and community development to be in the best interests of the state.

The industrial machinery tax credit was revised to offer tiered levels of credit based on the level of Tennessee investment during the investment period. The taxpayer must file a business plan

with the Commissioner of Revenue in order to qualify for the tiered level credit.

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 and purchases in the process of making the required capital investment.

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%.

“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 contract for purchase or construction.

The investment period during which the required capital investment must be made cannot exceed 3 years from the filing of the business plan related to the required capital investment. The 3-year period may be extended by the Commissioner of Economic Development for a reasonable 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]

#### Job Tax Credit

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

#### General Provisions.

A qualified business enterprise that makes the required capital investment may obtain a jobs tax credit equal to \$4,500 for each qualified job created during the investment period.

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

“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), or convention or trade show facilities;
- + 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;

- + 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;
- + 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
- + The job position is filled prior to January 1, 2016

“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.

The qualified business enterprise shall file a business plan with the Commissioner of Revenue in order to qualify for the described jobs tax credit. The business plan shall be filed in a manner prescribed by the commissioner and 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.

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.

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 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

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

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.

#### Additional Annual Credit

In addition to the \$4,500 credit described previously, taxpayers may also obtain the following job tax credit, under the conditions described, providing the taxpayer meets all of the criteria to qualify for the basic \$4,500 jobs tax credit previously described.

“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, or Tier 3 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.

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

If the qualified business enterprise is located in a Tier 2 or Tier 3 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.

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 beginning with the first tax year after the initial job tax credit is created.

If the qualified business enterprise is located in a Tier 3 enhancement county, the additional annual credit shall be allowed for a period of five years beginning with the first tax year after the initial job tax credit is created.

If the qualified business enterprise involves a higher level of investment and 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 beginning with the first tax year after the initial job tax credit is created.
- + 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 beginning with the first tax year after the initial job tax credit is created.
- + 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 beginning with the first tax year after the initial job tax credit is created. An integrated supplier or integrated customer will qualify for this level of credit regardless of the level of its capital investment or the number of jobs created.

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

- + 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 beginning with the first tax year after the initial job tax credit is created.
- + 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 beginning with the first tax year after the initial job tax credit is created.

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 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 both the additional annual credit for Tier 2 and Tier 3 enhancement

counties and the additional annual credit for the enhanced capital investment and job creation thresholds.

### 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 basic \$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 available for jobs created in Tier 2 and Tier 3 enhancement counties.

If determined to be in the best interests of the state, the Commissioner of Revenue is authorized to allow the 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 shall determine the number of qualified jobs necessary for the taxpayer to receive the credit.

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 enhancement county, the taxpayer shall have five years to create the minimum number of qualified jobs necessary to receive the credit.

The Commissioner of Revenue, with the approval of the Commissioner of Economic and Community Development, is authorized to approve 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 and provided that the Commissioner of Revenue and the Commissioner of Economic

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

and Community Development have determined that allowance of the credit is in the best interests of the state.

A taxpayer that has established its international, national, or regional 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, shall be allowed to offset up to 100% of its franchise and/or excise tax liability by job tax credits or any carryforward of the job tax credits, if the Commissioner of Revenue and the Commissioner of Economic and Community Development determine that increasing the percentage of offset permitted to the taxpayer is in the best interests of the state. The Commissioner of Revenue and the Commissioner of Economic and Community Development shall determine the percentage of franchise and/or excise tax liability allowed to be offset and the period during which the increased offset shall continue.

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.

### Call Center Credits

The job tax credits may be computed by a general partnership that establishes and operates a call center in Tennessee, placed in service by such general partnership on or after June 30, 2003, that would otherwise qualify for the job tax credit. The credit shall first apply in the tax year in which the qualified business enterprise increases net full-time employment by 400 or more jobs, and shall then apply in subsequent fiscal years in which further net increases occur above the level of employment established when the credit was last taken.

The credit may also be computed by a general partnership that has established an international, national, or regional headquarters in this state that meets the definition of a qualified headquarters facility under Tenn. Code Ann. Section 67-6-224 and would otherwise qualify for the job tax credits. The amount of the credit shall be computed under the provisions of this subsection as if the general partnership were subject to the franchise and excise taxes.

With respect to the general partnership tax year during which a credit is so computed, a partner in such general partnership that is subject to Tennessee franchise and excise tax and that directly holds a first tier ownership interest in the general partnership may take a percentage of the credit that equals the total amount of the credit for the general partnership multiplied by the partner's percentage interest in the general partnership on the last day of such general partnership tax year against the partner's franchise and excise tax liability for the partner's tax year that includes the last day.

The job tax credit passed through from the general partnership to the first tier partner shall, in the hands of the first tier partner, be subject to applicable provisions and limitations, including carry forward provisions. In no case shall the credit or a carryover of the credit be taken by a business entity, unless it was a partner in the general partnership and subject to franchise and excise tax at the time the credit was earned by the general partnership.

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

#### **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 1 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 employment begins and must state the number of persons with disabilities newly employed. [Tenn. Code Ann. Section 67-4-2109(g)]

#### **Qualified Headquarters Relocation Credit**

There is a credit for qualified headquarters relocation expenses incurred during the investment period for establishing a qualified headquarters facility provided that the taxpayer establishes and is eligible for the qualified headquarters credit and can qualify for the job tax credit in connection with a required capital investment in excess of \$1 billion.

Effective June 28, 2007, the relocation credit is a tiered level credit based on the level of jobs created. The credit is equal to any qualified headquarters relocation expenses incurred by the taxpayer during the investment period for establishing a qualified headquarters facility, but is limited to a specific dollar amount (based on the number of jobs created) multiplied by the number of headquarters staff employee positions relocated by the taxpayer.

- + If the taxpayer creates at least 100 but less than 250 net new full-time employee jobs that pay at least 150% of Tennessee's average occupational wage, the credit available is \$10,000 per job.
- + If the taxpayer creates at least 250 but less than 500 net new full-time employee jobs that pay at least 150% of Tennessee's average occupational wage, the credit available is \$20,000 per job.
- + If the taxpayer creates at least 500 but less than 750 net new full-time employee jobs that pay at least 150% of Tennessee's average occupational wage, the credit available is \$30,000 per job.
- + If the taxpayer creates at least 750 net new full-time employee jobs that pay at least 150% of Tennessee's average occupational wage, the credit available is \$40,000 per job.
- + If the taxpayer creates at least 500 net new full-time employee jobs in connection with a capital investment in excess of \$1 billion, the relocation credit will equal \$100,000 per job.

Any amount allowed as a credit that exceeds the taxpayer's liability will be refunded to the taxpayer as an overpayment. [Tenn. Code Ann. Section 67-4-2109(h)]

If the qualified headquarters facility is not utilized as a headquarters facility for at least 10 years from the beginning date of substantial completion of the headquarters facility, the taxpayer will be assessed for tax, plus applicable interest. The amount of tax will equal the total credit and/or refund taken multiplied by a fraction, the numerator of which is the number of years the facility is not utilized as a headquarters facility and the denominator of which is ten. The amount of interest will be calculated in accordance with current statutory requirements from the date the facility is no longer utilized as a headquarters facility until the date paid.

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

The taxpayer is not required to establish its commercial domicile in Tennessee to receive this credit. [Tenn. Code Ann. Section 67-4-2109(g)]

A taxpayer that has established its international, national, or regional headquarters in Tennessee, or a taxpayer that has established an international, national, or regional warehousing or distribution hub in Tennessee, is allowed to convert unused net operating losses to a credit against its franchise tax liability. The credit is available only if the taxpayer is unable to use the net operating loss or loss carryover to offset net income during the current tax year. If a net operating loss is converted to a credit against the franchise tax, it is no longer available as a deduction for excise tax purposes. The credit is available only if it is determined by the Commissioner of Revenue and the Commissioner of Economic and Community Development to be in the best interests of the state. [Tenn. Code Ann. Section 67-4-2109]

Effective for tax periods beginning on or after January 1, 2006, if the headquarters staff employee position does not remain filled in Tennessee for a period of at least five years, beginning from the date such employee position was initially filled in Tennessee, the taxpayer shall be subject to an assessment of the total amount of credit or refund taken relating to such employee position, plus interest.

The qualified headquarters relocation credit may be calculated by any general partnership that establishes a qualified headquarters facility in Tennessee, as defined in Tenn. Code Ann. Section 67-6-224, and that qualifies for the job tax credit. [Tenn. Code Ann. Section 67-4-2109(h)]

Effective June 30, 2010, the headquarters facilities credit is extended to an insurance company that has a qualified headquarters facility for sales or use tax purposes.

Effective July 1, 2011, the commissioner is authorized to lower the number of jobs that must be created in order to qualify for the credit. The job creation requirement cannot be lowered by more than 50%. However, the amount of credit will also be reduced in direct proportion to the reduction in the job creation requirement.

### Qualified Production Company Refund

Effective for tax periods ending on or after December 31, 2006, a qualified production company that incurs at least \$1 million in qualified expenses is entitled to a refund equal to 15% of its qualified expenses, provided that the company has established a headquarters facility in Tennessee. If the qualified production company does not have a headquarters facility in Tennessee, then any qualified investor that has a headquarters facility in Tennessee is allowed a refund equal to the amount to which the qualified production company would have been entitled, multiplied by the qualified investor's percentage ownership in the company. "Qualified expenses" are expenses incurred in Tennessee that are determined to be necessary for the production of a movie in Tennessee. [Tenn. Code Ann. Section 67-4-2109]

### Financial Institution Loans to Eligible Housing Entities

Effective for tax years ending on or after July 1, 2005, a financial institution is allowed a credit against the franchise and excise taxes equal to 5% of a qualified loan or long time investment or equal to 10% of a grant, contribution, or qualified low-rate loan made to 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 for any eligible activity.

"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 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. Any

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

unused credit can be carried forward for 15 years from the year in which the credit originated.

The franchise and excise tax credit available to financial institutions for low-rate loans made to non-profit entities that provide affordable housing or to community development financial institutions may be calculated based either on 5% of the original amount of the loan or 3% of the unpaid balance at the end of each year for 15 years. [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)]

#### Green Energy and Carbon Charge Credits

Tenn. Code Ann. Section 67-4-2109(n)

“Certified green energy supply chain manufacturer” means any manufacturer that has made, during the investment period, a required capital investment in excess of \$250 million in constructing, expanding, or remodeling a facility that is certified by the Commissioner of Revenue, the Commissioner of Economic and Community Development, and the Commissioner of Environment and Conservation, in their sole discretion, to be a facility engaged in manufacturing a product that is necessary for the production of green energy.

“Investment period” means a period not to exceed three years from the filing of the business plan related to qualification as a certified green energy supply chain manufacturer, during which the required capital investment must be made.

“Maximum certified rate” means a rate expressed as a price per kilowatt hour for calculating the green energy tax credit and shall be established through the issuance of a private letter ruling by the Commissioner of Revenue, which shall be subject to approval by the Commissioner of Economic and Community Development and the Commissioner of Finance and Administration and any such maximum certified rate established for a green energy supply chain manufacturer shall apply to any campus affiliate.

“Carbon charge” means a tax or fee imposed or levied by the federal or state government, the purpose of which is to reduce the emission of greenhouse gases. Such carbon charge may include, but is not limited to, a tax, emission fee or charge, or required purchase of carbon or emission off-sets or credits, whether incurred by or imposed directly on the certified green energy supply chain manufacturer or campus affiliate or imposed on the Tennessee Valley Authority or other applicable energy provider and billed to the certified green energy supply chain manufacturer or campus affiliate.

“Charge for electricity sold” means the total delivered cost of electricity sold to the certified green energy supply chain manufacturer or campus affiliate at the point of delivery to the facility. The charge for electricity sold shall be the total amount due as shown on the customer's electricity bills over the applicable tax year. Any carbon charge shall be excluded from the charge for electricity sold to the extent such carbon charge is included in the allowed credit.

#### Green Energy Tax Credit

A certified green energy supply chain manufacturer and campus affiliate, integrated customer, or integrated supplier of a green energy supply chain manufacturer will be allowed a green energy tax credit against the total franchise and excise tax liability. The credit amount will be equal to the amount by which the

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

charge for electricity sold to the certified green energy supply chain manufacturer, campus affiliate, integrated customer, or integrated supplier exceeds the charge that would have been made for such total delivered electricity if the maximum certified rate had been applied during the applicable tax year.

Effective June 30, 2010, machinery and equipment for the production of electricity using clean energy technology can be treated just as pollution control equipment for sales tax, franchise and excise tax, and property tax credit. "Clean energy technology" means technology used to create green energy from geothermal, hydrogen, solar, and wind sources. [Public Chapter 1134, Acts of 2010]

The Tennessee Valley Authority, or the applicable energy provider, shall supply such information as deemed necessary by the Commissioner of Revenue to verify the amount of such credit. To the extent that any amount allowed as a credit for any tax year exceeds the combined franchise and excise tax liability after the application of all available credits other than the carbon charge credit, the amount of excess will be deemed an overpayment of tax and will be refunded to the taxpayer. The overpayment and such refund shall not exceed, for any one tax year, an amount equal to \$1.5 million for each \$250 million in capital investments made by the certified green energy supply chain manufacturer.

A claim for refund must be filed within three years from December 31 of the year in which the credit was incurred. Any amount allowed as a credit that is not applied to the taxpayer's liability and is not received by the taxpayer as a refund may be carried forward in perpetuity until it is claimed as a refund or utilized as a credit by the certified green energy supply chain manufacturer.

Except for the purpose of receiving a refund or otherwise utilizing credits that have been carried forward, the green energy tax credit shall cease to be effective on January 1, 2029. No new credit shall be allowed for tax years ending on or after that date.

### Carbon Charge Credit

A certified green energy supply chain manufacturer and any campus affiliates shall be allowed a carbon charge credit against the total franchise and excise tax liability equal to any carbon charges incurred by or imposed directly on the certified green energy supply chain manufacturer, campus affiliate, or imposed on the Tennessee Valley Authority or other applicable energy provider and billed to the certified green energy supply chain manufacturer or campus affiliate during the applicable tax year.

The Tennessee Valley Authority, or the applicable energy provider, shall supply such information as deemed necessary by the Commissioner of Revenue to verify the amount of the carbon charge credit. To the extent any amount allowed as a carbon charge credit exceeds the combined franchise and excise tax liability after the application of all other available credits, the amount of excess will be deemed an overpayment and will be refunded to the taxpayer.

A claim for refund must be filed with the commissioner within three years from December 31 of the year in which the credit was incurred.

The investment period for making the required capital investment may be extended by the Commissioner of Economic and Community Development for a reasonable period, not to exceed two years, for good cause shown. "Good cause" includes, but is not limited to, a determination by the Commissioner of Economic and Community Development that the capital investment is a result of the credit provided.

The green energy tax and carbon tax credits and any other applicable credits, net operating losses, or carryforwards of credits or net operating losses shall be applied in the following order.

- + Any credits, net operating losses, or carryforwards of losses or credits available to the certified green energy supply chain manufacturer, campus affiliate, integrated customer, or integrated supplier, except for the green energy tax credits, shall be applied to the taxpayer's tax liability first;

## FRANCHISE AND EXCISE TAXES

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### CREDITS (cont'd)

- + Any green energy tax credit available shall be applied to the taxpayer's liability second and shall be refundable as provided if the credit exceeds the taxpayer's remaining liability; and
- + Any carbon tax credit available shall be applied to the taxpayer's liability third and shall be refundable as provided if the credit exceeds the taxpayer's remaining liability.

### 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)]

### Brownfield Property Tax Credit

Effective June 30, 2010, 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]

### Qualified Medical Trade Center Credits

Effective June 30, 2010 a refundable franchise and excise tax credit is extended to any key tenant of a qualified medical trade center equal to the amount of relocation expenses incurred by the key tenant. The credit cannot exceed \$10 for each square foot of space leased and occupied

within the facility. To the extent that any amount allowed as a credit to a key tenant for any tax year exceeds the key tenant's combined franchise and excise tax after application of all available credits, the amount of the excess shall be considered an overpayment and be refunded to the key tenant.

Also effective June 30, 2010, a refundable franchise and excise tax credit is available for qualified advertising expenses incurred by an entity for the purpose of co-promoting a qualified medical trade center and the State of Tennessee or the City of Nashville. A credit of 15% of any qualified advertising expenses will be allowed against the combined franchise and excise tax liability of any entity that incurs and pays the qualifying advertising expenses. To the extent that the amount allowed as credit for any tax year exceeds the taxpayer's combined franchise and excise tax after application of all available credits, the amount of excess will be considered an overpayment and be refunded to the taxpayer. [Tenn. Code Ann. Section 67-4-2109]

### Eligibility under Previous Law

Taxpayers not subject to the franchise and excise taxes in 1997 and 1998, and who meet the criteria set forth below, may compute the job tax credit they would have qualified for in 1997 and 1998 under the previous franchise and excise tax law, compute the amount of the credit they would have taken on their returns for 1997 and 1998, and the amount they would have carried forward to subsequent years in which they were not subject to the tax. Any excess credit then may be carried forward to tax years in which they were subject to the tax.

The criteria these taxpayers must meet are:

- + They were formed as business entities after December 31, 1995.
- + They were not subject to the Tennessee franchise and excise tax prior to Chapter 406 of the Public Acts of 1999.
- + They could have qualified for the job tax credit, under the previous franchise and excise tax law repealed by Chapter 406, in the years 1997 and 1998, had they been subject to the provisions of the previous law.

## **FRANCHISE AND EXCISE TAXES**

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### **CREDITS (cont'd)**

The excess job tax credit may be carried forward for a period of 15 years from the tax year in which it originated.

These same entities may compute the amount, if any, of the industrial machinery credit and the net operating loss carryover they would have been eligible for in tax years 1997 and 1998 and the amounts they would have applied in those tax years. Any excesses may be carried forward in the same manner as the excess job tax credit.

[Tenn. Code Ann. Section 67-4-2018]

## FRANCHISE AND EXCISE TAXES

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### 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. 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 4.

#### **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 8 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 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. Sales of other than tangible personal property are allocable to Tennessee if a greater proportion of the earnings-producing activities are performed in 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)-(i) and 2111(g)-(i)]

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)]

## FRANCHISE AND EXCISE TAXES

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### APPORTIONMENT TO TENNESSEE (cont'd)

#### **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.

#### **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 1 or more apportionment formula factors, or the use of other methods to determine receipts for purposes of the apportionment 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 2 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)]

For tax years beginning on or before December 31, 2006, a hospital company must file its franchise and excise tax return on a combined basis with all other corporations or entities subject to these taxes that are members of its controlled group and are doing business subject to taxation in Tennessee. One member of the combined group must sign these returns on behalf of all members. The combined return shall contain all financial statements and schedules that would be required of each member filing a separate franchise and excise tax return.

Each member's net earnings or losses subject to carryover, if applicable, and each member's apportionment ratio, and applicable supporting schedules must be computed separately as would be required by law if no combined return were required. The franchise and excise tax shall be computed for the combined group based on the combined net earnings or net losses of the members. The losses available to each member of the controlled group under current or prior law will be available for offset against the net earnings of the combined group in the first year of filing on a combined basis. Any portion that is not used to offset net earnings of the combined group in the first year may be carried forward, for no more than 15 years, on a combined basis to be available as an offset to future net earnings of the combined group. No member of the

## FRANCHISE AND EXCISE TAXES

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### APPORTIONMENT TO TENNESSEE (cont'd)

combined group may file its franchise and excise tax return on a separate basis without the consent of the commissioner.

#### **Apportionment of Net Worth of Common Carriers and Insurance Companies**

When a taxpayer's principal business in Tennessee is that of common carrier or insurance company, the following ratios will be used to apportion the taxpayer's net earnings and net worth to Tennessee. For the tax year beginning on or after December 15, 2002, and all subsequent years, the franchise and excise tax is no longer applicable to insurance companies that are subject to payment of the gross premiums tax.

**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 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 67-4-20013(a)(6) and 2113(7)]

## FRANCHISE AND EXCISE TAXES

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### APPORTIONMENT TO TENNESSEE (cont'd)

**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% 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.
- + 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.

## FRANCHISE AND EXCISE TAXES

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### APPORTIONMENT TO TENNESSEE (cont'd)

- + 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

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### 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.

The department will notify taxpayers that they are required to file electronically if the taxpayer's average payment is \$10,000 or more. A taxpayer may also choose to participate voluntarily when not required to do so. Voluntary participants are subject to the same rules and regulations as persons required to participate.

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.

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]

The commissioner, with the concurrence of the Attorney General if the amount waived exceeds \$25,000, 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. 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 2 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 who believes that 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 warrant a waiver of the penalty assessed. [Tenn. Code Ann. Section 67-1-803]

## FRANCHISE AND EXCISE TAXES

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### GENERAL PROVISIONS (cont'd)

#### 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 tax returns for the previous 3 years. 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 notice of assessment for any delinquent taxes will be issued. [Tenn. Code Ann. Section 67-1-1301]

#### 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 31<sup>st</sup> of the year in which the tax was paid.

The commissioner may approve refunds of up to \$50,000. 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)]

#### 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]

#### 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.

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 recommences. The 90-day stay for most collection activity is likewise extended. The taxpayer is not required to request an informal

## **FRANCHISE AND EXCISE TAXES**

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### **GENERAL PROVISIONS (cont'd)**

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.

# FRANCHISE AND EXCISE TAXES

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## TENNESSEE TAXPAYER BILL OF RIGHTS

You, as a taxpayer, have certain rights. Your rights are so important that, in 1992, 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  
Fax (615) 741-6463

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.