

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 11-44**

WARNING

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

SUBJECT

The application of the Tennessee franchise and excise taxes to certain tax attributes of a corporation that has received a discharge of its prepetition debts under Chapter 11 of the United States Bankruptcy Code.

SCOPE

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

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

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[PARENT CORPORATION] is a Delaware corporation formed on [DATE OF FORMATION] to facilitate the combination of the following two previously unrelated, publicly traded corporations and their subsidiaries: 1) [CORPORATION A], a [LOCATION] corporation; and 2) [CORPORATION B], a [LOCATION] corporation. The combination occurred on [DATE OF COMBINATION], with [CORPORATION A] and [CORPORATION B] each becoming wholly-owned subsidiaries of [PARENT CORPORATION].¹ Beginning with the taxable year ending [FINAL DAY OF YEAR OF COMBINATION], and for each taxable year since, [PARENT CORPORATION] has filed a federal consolidated income tax return with its subsidiaries.

On [DATE], the Taxpayer and certain of its United States affiliated debtors and debtors-in-possession filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq.*² The Taxpayer's Plan of Reorganization was confirmed on [DATE OF CONFIRMATION]; the bankruptcy court also discharged the Taxpayer's prepetition debts on or about that date.

Only two members of the Taxpayer's federal consolidated group file Tennessee franchise and excise tax returns: [CORPORATION B] and its wholly-owned subsidiary, [CORPORATION B SUBSIDIARY]. [PARENT CORPORATION] and certain subsidiaries, including [CORPORATION B] and [CORPORATION B SUBSIDIARY], recognized discharge of indebtedness income as a result of the Chapter 11 discharge of prepetition debts. The Taxpayer filed an extension for its [YEAR OF DISCHARGE] federal consolidated income tax return, which is due on [DATE]. For federal income tax purposes, the Taxpayer will exclude the entire amount of discharge of indebtedness income pursuant to I.R.C. § 108(a) when the federal return is filed. Additionally, the Taxpayer expects that its federal net operating losses and capital losses will significantly exceed the amount of excluded discharge of indebtedness income for federal income tax purposes; as a result, the Taxpayer will likely not be required to reduce the basis in its property under I.R.C. § 108(b).

Because the Plan of Reorganization included the issuance of [PARENT CORPORATION] stock to certain creditors, the group's emergence from bankruptcy resulted in an ownership change for [PARENT CORPORATION] on [DATE OF OWNERSHIP CHANGE]. For federal income tax purposes, this stock ownership change triggered the limitation on the use of certain losses under I.R.C. § 382. No change occurred in the direct ownership of [CORPORATION B] and [CORPORATION B SUBSIDIARY].

QUESTIONS

1. For Tennessee excise tax purposes, does Tennessee conform to I.R.C. § 108(a) and thereby exclude discharge of indebtedness income from net earnings in the year in which the Taxpayer's debts are discharged under Chapter 11 of the United States Bankruptcy Code?
2. For Tennessee excise tax purposes, does Tennessee follow the provisions outlined in I.R.C. § 108(b) and require the reduction of Tennessee net operating losses in the year of discharge under Chapter 11 of the United States Bankruptcy Code?

¹ This letter ruling will collectively refer to [PARENT CORPORATION], [CORPORATION A], [CORPORATION B], and any subsidiaries identified in this ruling as the "Taxpayer."

² The case was filed in the United States Bankruptcy Court in [JURISDICTION]. [REDACTED INFORMATION].

3. If the application of I.R.C. § 108(b) results in a reduction to the Taxpayer's basis in certain assets for federal income tax purposes, is the Taxpayer also required to reduce the basis of those same assets following discharge under Chapter 11 of the United States Bankruptcy Code for Tennessee franchise and excise tax purposes?
4. For Tennessee excise tax purposes, does Tennessee adopt I.R.C. § 382 or impose similar rules that limit the use of certain losses, including net operating losses, after undergoing a change in ownership where more than 50% of the taxpayer's stock has changed owners within a three-year period?

RULINGS

1. For Tennessee excise tax purposes, Tennessee neither conforms to nor disallows the exclusion from federal gross income of gain arising from the discharge of indebtedness, as set forth in I.R.C. § 108(a). TENN. CODE ANN. § 67-4-2006(b)(1) (Supp. 2010) does not require that the Taxpayer add to its Tennessee net earnings any income that is excluded from federal taxable income by operation of I.R.C. § 108(a). The Taxpayer's net earnings will therefore not include any discharge of indebtedness income excluded from federal taxable income in the year in which the Taxpayer's debts are discharged under Chapter 11 of the United States Bankruptcy Code.
2. For Tennessee excise tax purposes, Tennessee neither conforms to nor disallows the federal rules regarding the reduction of net operating losses as set forth in I.R.C. § 108(b). The Taxpayer's Tennessee net operating loss for the year of discharge must be computed without taking into account any discharge of indebtedness income that is not included in net earnings in that year. The Taxpayer is not required to reduce any Tennessee net operating loss carryovers from prior years.
3. The Tennessee franchise and excise tax laws neither adopt nor disallow the federal rules regarding the reduction of the Taxpayer's basis in its property under I.R.C. § 108(b). The Tennessee franchise and excise tax laws contain no provision requiring a reduction in the Taxpayer's basis in its property as a result of the exclusion of discharge of indebtedness income from federal gross income. Accordingly, the Taxpayer is not required to make a corresponding reduction to the basis in its property for franchise and excise tax purposes.
4. For Tennessee excise tax purposes, Tennessee neither conforms to nor disallows the rules under I.R.C. § 382 limiting the use of certain losses, including net operating losses, after undergoing a change in ownership where more than 50% of the taxpayer's stock has changed owners within a three-year period. TENN. CODE ANN. § 67-4-2006(c) contains no limitation on the use of net operating losses upon a mere change in stock ownership, where the entity that generated the losses remains in existence as a separate entity. The Taxpayer will therefore continue to be entitled to claim its net operating loss carryforwards for Tennessee excise tax purposes.

ANALYSIS

Tennessee imposes an excise tax on the net earnings of all persons, as defined under TENN. CODE ANN. § 67-4-2004(37) (Supp. 2010), doing business within Tennessee. TENN. CODE ANN. § 67-4-2007(a) (Supp. 2010). Tennessee also imposes a franchise tax at the rate of \$0.25 per \$100, or major fraction thereof, on the net worth of a taxpayer doing business in Tennessee, pursuant to TENN. CODE

ANN. §§ 67-4-2105(a) (Supp. 2010) and 67-4-2106(a) (Supp. 2010).³ Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, corporations such as the Taxpayer and its subsidiaries. TENN. CODE ANN. § 67-4-2004(37).

1. Computation of net earnings

For Tennessee excise tax purposes, Tennessee neither conforms to nor disallows the exclusion from federal gross income of gain arising from the discharge of indebtedness, as set forth in I.R.C. § 108(a). TENN. CODE ANN. § 67-4-2006(b)(1) does not require that the Taxpayer add to its Tennessee net earnings any income that is excluded from federal taxable income by operation of I.R.C. § 108(a). The Taxpayer's net earnings will therefore not include any discharge of indebtedness income excluded from federal taxable income in the year in which the Taxpayer's debts are discharged under Chapter 11 of the United States Bankruptcy Code.

For federal income tax purposes, I.R.C. § 61(a)(12) defines "gross income" to include "income from discharge of indebtedness." However, I.R.C. § 108(a) provides that gross income "does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if-- (A) the discharge occurs in a title 11 case." I.R.C. § 108(d)(2) defines the term "title 11 case" as "a case under title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court." Thus, in accordance with I.R.C. § 108(a), the Taxpayer will exclude from the computation of its federal taxable income any gain arising from the discharge of indebtedness under Chapter 11 of the United States Bankruptcy Code.⁴

The Tennessee excise tax laws neither adopt nor disallow the exclusion from federal gross income of gain arising from the discharge of indebtedness, as set forth in I.R.C. § 108(a). Rather, each taxpayer must calculate its individual Tennessee excise tax liability in accordance with the applicable excise tax provisions.

Tennessee imposes the excise tax on the net earnings of all persons doing business within the state. TENN. CODE ANN. § 67-4-2006(a)(1) provides in pertinent part that for a corporation, "net earnings" or "net loss" is defined as "federal taxable income or loss before the operating loss deduction and special deductions provided for in 26 U.S.C. §§ 241, 242 [repealed], 243-247" and as adjusted by TENN. CODE ANN. § 67-4-2006(b) and (c). In particular, TENN. CODE ANN. § 67-4-2006(b)(1) does not require that the Taxpayer add to its net earnings any income that is excluded from federal taxable income by operation of I.R.C. § 108(a).

The Taxpayer has stated that the bankruptcy court approved its Plan of Reorganization on [DATE OF CONFIRMATION], and discharged the Taxpayer's prepetition debts. The Taxpayer accordingly will

³ However, under TENN. CODE ANN. § 67-4-2108(a)(1) (Supp. 2010), the franchise tax base "shall in no case be less than the actual value of the real or tangible property owned or used in Tennessee, excluding exempt inventory and exempt required capital investments." For purposes of this section, "property" is to be "valued at cost less accumulated depreciation in accordance with generally accepted accounting principles." TENN. CODE ANN. § 67-4-2108(a)(3).

⁴ For federal income tax purposes, the taxpayer must first compute its gross income, which it then adjusts to arrive at federal taxable income. An item excluded from gross income will therefore not be included in federal taxable income.

exclude the resulting discharge of indebtedness income from its [YEAR OF DISCHARGE] federal taxable income, pursuant to I.R.C. § 108(a).

Because TENN. CODE ANN. § 67-4-2006(b)(1) does not require that the Taxpayer add to its net earnings any discharge of indebtedness income that is excluded from federal taxable income by operation of I.R.C. § 108(a), the Taxpayer's [YEAR OF DISCHARGE] net earnings will not include any such discharge of indebtedness income.

2. Reduction of net operating losses under I.R.C. § 108(b)

For Tennessee excise tax purposes, Tennessee neither conforms to nor disallows the federal rules regarding the reduction of net operating losses in the year of discharge as set forth in I.R.C. § 108(b). The Taxpayer's Tennessee net operating loss for the year of discharge under Chapter 11 must be computed without taking into account any discharge of indebtedness income that is not included in net earnings in that year. The Taxpayer is not required to reduce any Tennessee net operating loss carryovers from prior years.

For federal income tax purposes, I.R.C. § 108(b) requires that the amount excluded from gross income under I.R.C. § 108(b) be applied to reduce various tax attributes of the taxpayer, including net operating losses and loss carryovers. Pursuant to I.R.C. § 108(b)(3), such reductions "shall be one dollar for each dollar excluded by" I.R.C. § 108(a). In particular, I.R.C. § 108(b)(2)(A) requires the reduction of "[a]ny net operating loss for the taxable year of the discharge, and any net operating loss carryover to such taxable year." The reduction in tax attributes is made after the determination of the tax imposed for the taxable year of the discharge, pursuant to I.R.C. § 108(b)(4)(A). Finally, I.R.C. § 108(b)(4)(B) provides that reductions to net operating losses "shall be made first in the loss for the taxable year of the discharge and then in the carryovers to such taxable year in the order of the taxable years from which each such carryover arose."

Thus, for federal income tax purposes, the Taxpayer must first reduce its net operating loss of the taxable year of the discharge. The Taxpayer must then reduce any net operating losses from prior years that are carried forward to the year of discharge. The reduction in tax attributes is made after the determination of the tax imposed for the taxable year of the discharge; in other words, with respect to the year of discharge, the Taxpayer may utilize its net operating losses without taking into account the required reduction.

The Tennessee excise tax laws neither adopt nor disallow the federal rules regarding the reduction of net operating losses under I.R.C. § 108(b). Rather, each taxpayer must calculate its individual Tennessee excise tax liability in accordance with the applicable excise tax provisions.

TENN. CODE ANN. § 67-4-2006(c)(1) permits a taxpayer to deduct a net operating loss from its net earnings in the computation of its Tennessee excise tax liability; qualified net operating losses may be carried forwarded and deducted for up to fifteen years. The term "net operating loss" is defined as "the excess of allowable deductions over total income allocable to this state for the year of the loss."⁵
Id.

⁵ Additionally, TENN. CODE ANN. § 67-4-2006(c)(5) provides that "[t]here shall be added to the net loss as determined for excise tax purposes, all nonbusiness earnings, interest and dividends, excluded from net earnings pursuant to [TENN. CODE ANN. § 67-4-2006], and any other income excluded from net earnings pursuant to" TENN. CODE ANN. § 67-4-2006. In other words, the net operating loss is reduced by the amount of any income excluded from net earnings by operation of TENN. CODE ANN. § 67-4-2006. This provision is not applicable in the Taxpayer's

As explained in the response to Question #1, discharge of indebtedness income is not included in net earnings for Tennessee excise tax purposes because it is excluded from federal taxable income under I.R.C. § 108(a). Because such income is not included in net earnings, it does not constitute “income allocable to this state” for purposes of determining the Taxpayer’s net operating loss under TENN. CODE ANN. § 67-4-2006(c)(1). Thus, the Taxpayer’s Tennessee net operating loss for the year of discharge must be computed without taking into account any discharge of indebtedness income that is not included in net earnings in that year.

Because the Tennessee excise tax laws neither adopt nor disallow the federal rules regarding the reduction of net operating losses under I.R.C. § 108(b), the Taxpayer is not required to reduce any net operating loss carryovers from prior years for Tennessee excise tax purposes.

Accordingly, the Taxpayer’s Tennessee net operating loss for the year of discharge must be computed without taking into account any discharge of indebtedness income that is not included in net earnings in that year. The Taxpayer is not required to reduce any Tennessee net operating loss carryovers from prior years.

3. Reduction of basis under I.R.C. § 108(b)

The Tennessee franchise and excise tax laws neither adopt nor disallow the federal rules regarding the reduction of the Taxpayer’s basis in its property under I.R.C. § 108(b). The Tennessee franchise and excise tax laws contain no provision requiring a reduction in the Taxpayer’s basis in its property as a result of the exclusion of discharge of indebtedness income from gross income under I.R.C. § 108(a). Accordingly, the Taxpayer is not required to make a corresponding reduction to the basis in its property for franchise and excise tax purposes.

For federal income tax purposes, I.R.C. § 108(b) requires that the amount excluded from gross income under I.R.C. § 108(b) be applied to reduce various tax attributes of the taxpayer. Pursuant to I.R.C. § 108(b)(3), such reductions “shall be one dollar for each dollar excluded by” I.R.C. § 108(a). In particular, I.R.C. § 108(b)(2)(E)(i) requires the reduction of the “basis of the property of the taxpayer.”⁶ Under I.R.C. § 1017(a), this basis reduction shall apply “at the beginning of the taxable year following the taxable year in which the discharge occurs.” Thus, for federal income tax purposes, the Taxpayer must reduce the basis in its property at the beginning of the taxable year following the taxable year in which the discharge occurs.

The Tennessee franchise and excise tax laws neither adopt nor disallow the federal rules regarding the reduction of the Taxpayer’s basis in its property under I.R.C. § 108(b). Additionally, the Tennessee franchise and excise tax laws contain no provision requiring a reduction in the Taxpayer’s basis in its property as a result of the exclusion of discharge of indebtedness income from federal gross income. Accordingly, the Taxpayer is not required to make a corresponding reduction to the basis in its property for franchise and excise tax purposes.

4. Limitation on use of net operating losses under I.R.C. § 382

case because, as explained in the response to Question #1, net earnings does not include discharge of indebtedness income and TENN. CODE ANN. § 67-4-2006 does not operate to exclude such income from net earnings.

⁶ The reduction to basis occurs after the reduction of net operating losses and certain other tax attributes; thus, basis will be reduced only if discharge of indebtedness income exceeds such other tax attributes. *See* I.R.C. § 108(b)(2).

For Tennessee excise tax purposes, Tennessee neither conforms to nor disallows the rules under I.R.C. § 382 limiting the use of certain losses, including net operating losses, after undergoing a change in ownership where more than 50% of the taxpayer's stock has changed owners within a three-year period. TENN. CODE ANN. § 67-4-2006(c) contains no limitation on the use of net operating losses upon a mere change in stock ownership, where the entity that generated the losses remains in existence as a separate entity. The Taxpayer will therefore continue to be entitled to claim its net operating loss carryforwards for Tennessee excise tax purposes.

For federal income tax purposes, I.R.C. § 382 generally limits a taxpayer's use of certain losses, including net operating losses, after undergoing a change in ownership where more than 50% of the taxpayer's stock has changed owners within a three-year period. The Taxpayer has stated that the Plan of Reorganization caused the issuance of [PARENT CORPORATION] stock to certain creditors. This resulted in an ownership change for [PARENT CORPORATION] that triggered the limitation under I.R.C. § 382. No change occurred in the direct ownership of [CORPORATION B] and [CORPORATION B SUBSIDIARY].

Tennessee neither conforms to nor disallows the rules under I.R.C. § 382 regarding limitations on the use of net operating losses following an ownership change where more than 50% of the taxpayer's stock has changed owners within a three-year period. Rather, each taxpayer must calculate its individual Tennessee excise tax liability in accordance with the applicable and excise tax provisions.

TENN. CODE ANN. § 67-4-2006(c)(1) permits a taxpayer to deduct a net operating loss from its net earnings in the computation of its Tennessee excise tax liability; qualified net operating losses may be carried forwarded and deducted for up to fifteen years.

For Tennessee excise tax purposes, the use of net operating losses is generally limited to the taxpayer that generated the loss.⁷ Specifically, TENN. CODE ANN. § 67-4-2006(c)(2) provides that "a loss carryforward may be taken only by the taxpayer that generated it, with the exception set forth in TENN. CODE ANN. § 67-4-2006(c)(3)." TENN. CODE ANN. § 67-4-2006(c)(3) provides that when a taxpayer merges out of existence and into a successor taxpayer that has "no income, expenses, assets, liabilities, equity or net worth," any qualified Tennessee loss carryover of the predecessor that merged out of existence shall be available for carryforward and deduction from the net earnings of the surviving successor. Unless this exception applies, no loss carryforwards incurred "by the predecessor taxpayer are allowed as a deduction from net earnings on the excise tax return filed by the successor taxpayer." See *AT & T Corporation v. Johnson*, 148 S.W.3d 74 (Tenn. Ct. App. 2004) (holding that taxpayer was not entitled to use of net operating loss incurred by predecessor); *Little Six Corporation v. Johnson*, 1999 WL 336308 (Tenn. Ct. App. No. 01-A-01-9806-CH00285, May 28, 1999) (holding that taxpayer was not entitled under TENN. COMP. R. & REGS. § 1320-6-1-.21(2)(d) to use of net operating loss incurred by predecessor). *Id.*

Importantly, TENN. CODE ANN. § 67-4-2006(c) contains no limitation on the use of net operating losses upon a mere change in stock ownership, where the entity that generated the losses remains in existence as a separate entity.

In the Taxpayer's case, the only entities that file Tennessee franchise and excise tax returns are [CORPORATION B] and [CORPORATION B SUBSIDIARY]. No change has occurred in the ownership of [CORPORATION B] and [CORPORATION B SUBSIDIARY] as a result of the Plan

⁷ TENN. CODE ANN. § 67-4-2006(c)(2) provides that, except for unitary groups of financial institutions, each taxpayer is considered a separate entity.

of Reorganization; neither entity has merged or otherwise consolidated into another company. Thus, in each case, [CORPORATION B] and [CORPORATION B SUBSIDIARY] will continue to be entitled to claim their respective net operating loss carryforwards for Tennessee excise tax purposes. Similarly, if [PARENT CORPORATION] were to file a franchise and excise tax return, it would not be required to reduce its net operating losses as a result of the change in its stock ownership pursuant to the Plan of Reorganization.

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APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: 9/7/11