

**TENNESSEE DEPARTMENT OF REVENUE  
REVENUE RULING # 96-34**

**WARNING**

**Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.**

**SUBJECT**

Whether, under the facts presented, Company X will be considered a financial institution for Tennessee franchise, excise tax purposes, whether it will be required to file a combined franchise, excise tax return with its parent and how it will compute its franchise, excise tax apportionment formula.

**SCOPE**

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

**FACTS**

Corporation Z is a [STATE A - NOT TENNESSEE] corporation with multistate activities. Its headquarters are located in [STATE B - NOT TENNESSEE]. The stock of Corporation Z is publicly held and actively traded over the New York and regional stock exchanges. The tax year of Corporation Z is a calendar year and it files a consolidated federal income tax return with its subsidiaries.

Corporation Z is a manufacturer whose primary business operations include:

- (1) The production and marketing of products ([CONTENT OF PRODUCTS]) for [PURPOSE AND USE OF PRODUCTS] and other uses in the home and in business and industry.
- (2) The production and marketing of [PRODUCT] requiring specialized technology in development or application, as well as traditional [PRODUCT] and related products for [TYPE BUSINESS] and other [BUSINESS] needs.

Corporation Z sells its products to commercial wholesalers and generates more than 50% of its income from its manufacturing operations. It is an accrual method taxpayer that records sales under various payment and credit terms that create accounts receivable.

Corporation Z typically does not require collateral to secure its accounts receivable and does not retain a security interest in the products it sells. Accounts receivable that are past due are subject to an interest charge.

Corporation Z is considering forming Company X which will be a wholly owned Tennessee corporation with multistate operations which give it tax nexus in other states as well. Company X will be responsible for servicing Corporation Z's accounts receivable. Periodically, Company X will purchase, without recourse, Z's accounts receivable generated from the sale of goods. Accordingly, Company X will bear the risks and rewards of ownership of the receivables and will be responsible for collection and maintenance of the receivables.

Company X will maintain its principal place of business in Tennessee. Company X's employees will perform the servicing, administration and collection of the receivables. Corporation Z may engage Company X to provide credit approval services. Additionally, Company X may service the accounts receivable generated by Z and held by Z prior to their sale to Company X.

The income Company X receives from its factoring business will be classified as ordinary income on its federal income tax return and will generate more than fifty percent of its gross income.

### **QUESTIONS PRESENTED**

1. For Tennessee corporate franchise, excise tax purposes, is Company X a financial institution?
2. Will Corporation X be required to file a combined Tennessee corporate franchise, excise tax return with Company Z?
3. How will the income Company X earns from the collection of receivables be apportioned for Tennessee corporate franchise, excise tax purposes?

### **RULINGS**

1. Yes.
2. No.
3. Company X will use a single factor gross receipts apportionment formula. All interest income from the accounts receivable purchased from Corporation Z will be included in the denominator of Company X's apportionment formula. Interest income from such accounts receivable will be included in the numerator of Company X's apportionment formula to the extent that sale property related to the accounts receivable was delivered or shipped by Corporation Z to a purchaser or recipient located in Tennessee.

## ANALYSIS

### 1. *COMPANY X IS A FINANCIAL INSTITUTION*

For purposes of the Tennessee corporate franchise, excise tax, T.C.A. §67-4-804(a)(7) defines a financial institution as follows:

“Financial Institution” means a holding company, any regulated financial corporation, a subsidiary of a holding company or regulated financial corporation, or any other corporation organized under the laws of the United States or any other taxing jurisdiction that is carrying on the business of a financial institution. However, “financial institution” does not include insurance companies subject to tax under §§56-4-201 - 56-4-214.

T.C.A. § 67-4-804(a)(2)(A) defines the meaning of the phrase “business of a financial institution”. Under Subparagraph (iii) of subitem (A), the “business of a financial institution” can be defined as:

Otherwise making, acquiring, selling or servicing loans or extensions of credit including, but not limited to, the following:

- (a) Secured or unsecured consumer loans;
- (b) Installment loans;
- (c) Mortgage or deeds of trust or other secured loans on real or tangible personal property;
- (d) Credit card loans;
- (e) Secured or unsecured commercial loans of any type;
- (f) Letters of credit and acceptance of drafts;
- (g) Loans arising in factoring; and
- (h) Any other transaction of a comparable economic effect;

However, T.C.A. § 67-4-804(2)(B) provides that, if the business of a financial institution conducted by a corporation generates less than 50% of the corporation’s gross income, it will not be considered a financial institution.

Company X will periodically purchase accounts receivable from Corporation Z without recourse and will service, collect and maintain such accounts. Company X may also be engaged to provide credit approval services for Corporation Z and to service accounts receivable generated and held by Corporation Z prior to their sale to Company X.

The activities in which Company X will engage are among those enumerated in T.C.A. § 67-4-804(a)(2)(A)(iii) and they generate more than 50% of the corporation’s income. Therefore, for Tennessee franchise, excise tax purposes, Company X is a financial institution under T.C.A. §67-4-804(a)(7).

### 2. *COMPANY X WILL NOT BE REQUIRED TO FILE A COMBINED FRANCHISE, EXCISE TAX RETURN*

T.C.A. §§ 67-4-805(a)(3) and 67-4-919(b) require unitary businesses to file Tennessee corporate franchise, excise tax returns on a combined basis in the manner specified by the law. T.C.A. § 67-4-804(a)(16) defines a unitary business as follows:

"Unitary business" means business activities or operations of financial institutions that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution. "Unitary business" may be applied within a single legal entity or between multiple entities. "Unitary group" includes those entities that are engaged in a unitary business wholly within or within and without this state;

(A) Unity is presumed whenever there is unity of ownership, operation and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting or other controlled interaction among entities that are engaged in the business of a financial institution. The absence of these centralized activities does not, however, necessarily evidence a nonunitary business;

(B) Unity of ownership does not exist unless the corporation is a member of two (2) or more business entities and more than fifty percent (50%) of the voting stock of each member is directly or indirectly owned by:

- (i) A common owner or common owners, either corporate or noncorporate; or
- (ii) One (1) or more of the members of the group;

Under Tennessee law, a corporation that is a financial institution can not be unitary with a corporation that is not a financial institution because the term "unitary business" is defined by T.C.A. § 67-4-804(a)(16) as the ". . . business activities or operations of financial institutions . . .". Company X, a financial institution, can not be unitary with Corporation Z, a manufacturer. Since Tennessee law permits only unitary businesses to file combined franchise, excise tax returns, Company X will not be permitted or required to file a combined franchise, excise tax return with its parent, Company Z. The Tennessee corporate franchise, excise tax return of Company X must be filed on a separate entity basis to include only its own operations.

3. *APPORTIONMENT PROVISIONS  
APPLICABLE TO COMPANY X*

Company X makes no loans, but it does have interest income from assets in the form of accounts receivable it has purchased from Corporation Z. T.C.A. § 67-4-815(a) and (d)(2)(A) make the following provisions concerning excise tax apportionment by a financial institution not filing a combined franchise, excise tax return and having interest income and other receipts from assets in the nature of loans or installment sales contracts that deal with tangible personal property.

- (a) A financial institution which is not filing a combined return and which has earnings from business activity both within and without this state shall apportion its business earnings by multiplying such earnings by the quotient of the

institution's total receipts attributable to the transaction of business in Tennessee, as determined under subsection (d), divided by the institution's total receipts attributable to transacting business in all taxing jurisdictions, as determined under subsection (d).

(d)(2)(A) 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 shall be attributed to Tennessee if the security or sale property is 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 without 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.

T.C.A. § 67-4-919(a) and (d)(2)(A) make similar provisions for franchise tax apportionment by a financial institution not filing a combined franchise, excise tax return and having interest income and other receipts from assets in the nature of loans or installment sales contracts that deal with tangible personal property.

Company X will use a single factor gross receipts apportionment formula to apportion net earnings for excise tax purposes and outstanding stock, surplus and undivided profits for franchise tax purposes. All interest income from the accounts receivable purchased by Company X from Corporation Z will be included in the denominator of Company X's apportionment formula. The accounts receivable purchased by Company X are unsecured. Accordingly, interest income from the accounts receivable purchased by Company X from Corporation Z will be included in the numerator of Company X's apportionment formula to the extent that sale property related to the accounts receivable was delivered or shipped by Corporation Z to a purchaser or recipient located in Tennessee. For purposes of Company X's apportionment formula, receipts other than the interest described, if any, will be attributed to Tennessee in accordance with the provisions of T.C.A. §§ 67-4-815 and 67-4-919.

Arnold B. Clapp, Senior Tax Counsel

APPROVED: Ruth E. Johnson, Commissioner

DATE: 11/14/96