

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 12-32**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.**

**SUBJECT**

Whether the discount charged on trade accounts receivable arising in the ordinary course of business from the sale of a company's products constitutes an "intangible expense" for purposes of determining net earnings or loss under TENN. CODE ANN. § 67-4-2006(b)(1)(K), -(b)(2)(N) (Supp. 2012).

**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**

[TAXPAYER] is a [REDACTED] company that produces [PRODUCTS]. [REDACTED].

In [YEAR], [TAXPAYER] [REDACTED - DESCRIPTION OF TRANSACTION] in order to obtain access to a line of credit at favorable interest rates. [TAXPAYER'S] trade accounts receivable (the "Accounts Receivable") constituted the collateral for the line of credit. [REDACTED]. [TAXPAYER] established [SUBSIDIARY] to [HOLD THE COLLATERAL].

[SUBSIDIARY] was initially capitalized with a contribution of Accounts Receivable from [TAXPAYER]. The Accounts Receivable originated in the normal course of [TAXPAYER'S] business operations from the sale of [TAXPAYER'S] products.

[SUBSIDIARY] regularly replenishes its stock of Accounts Receivable so as to maintain the loan collateral [REDACTED]. Accordingly, [SUBSIDIARY] periodically acquires Accounts Receivable from [TAXPAYER] in a factoring transaction by using the cash [SUBSIDIARY] receives from the payment of existing receivables. These Accounts Receivable are purchased by [SUBSIDIARY] at a discount (the "Discount") equal to the discount that would be charged in a similar transaction between unrelated parties.

Both [TAXPAYER] and [SUBSIDIARY] file Tennessee franchise and excise tax returns. [REDACTED].

## RULING

Is the Discount charged on the Accounts Receivable an "intangible expense" as that term is defined in TENN. CODE ANN. § 67-4-2004(23) (Supp. 2012), for purposes of determining net earnings or loss under TENN. CODE ANN. § 67-4-2006(b)(1)(K), -(b)(2)(N) (Supp. 2012)?

Ruling: No. The Discount charged on the Accounts Receivable is not considered an "intangible expense" as defined in TENN. CODE ANN. § 67-4-2004(23) (Supp. 2012). Accordingly, the application requirements set forth under TENN. CODE ANN. § 67-4-2006(b)(2)(N)(i) (Supp. 2012) do not apply with respect to the deduction of the Discount by [TAXPAYER] for Tennessee excise tax purposes.

## ANALYSIS

Tennessee imposes an excise tax at the rate of 6.5% on the net earnings of all persons, as defined under TENN. CODE ANN. § 67-4-2004(37) (Supp. 2012), doing business within Tennessee. TENN. CODE ANN. § 67-4-2007(a) (2011). Tennessee also imposes a franchise tax at the rate of \$0.25 per \$100, or major fraction thereof, on the net worth of a person doing business in Tennessee, pursuant to TENN. CODE ANN. §§ 67-4-2105(a), -2106(a) (2011). Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, corporations such as [TAXPAYER] and [SUBSIDIARY]. *See* TENN. CODE ANN. § 67-4-2004(37).

TENN. CODE ANN. § 67-4-2006(a)(1) (Supp. 2012) provides in pertinent part that, for a corporation, the term "'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)(K) requires the taxpayer to add to its net earnings or loss "[a]ny intangible expense, or portion thereof, that is paid, accrued or incurred in connection with a transaction with one (1) or more affiliates." The intangible expense can be deducted on the

same return if the Commissioner determines, upon application by the taxpayer, that the intangible expense did not have as its principal purpose the avoidance of the excise tax.<sup>1</sup>

For purposes of determining net earnings or loss under TENN. CODE ANN. § 67-4-2006(b)(1)(K), -(b)(2)(N), TENN. CODE ANN. § 67-4-2004(23)(A) defines the term “intangible expense” as “an expense related to, or in connection with, the acquisition, use, maintenance, management, ownership, sale, exchange, license, or any other disposition of *intangible property*, to the extent such amounts are allowed or allowable as deductions or costs in determining federal taxable income on a separate entity basis.”<sup>2</sup> TENN. CODE ANN. § 67-4-2004(23)(B) further defines “intangible expense” to mean “interest expenses directly or indirectly allowed as deductions or costs in determining federal taxable income on a separate entity basis to the extent such interest expenses are directly or indirectly for, related to, or in connection with the direct or indirect acquisition, use, maintenance, management, ownership, sale, exchange, license, or any other disposition of *intangible property*.”<sup>3</sup>

Thus, for the Discount charged on the Accounts Receivable to be considered an “intangible expense” for these purposes, it must be an expense related to the acquisition, use, maintenance, management, ownership, sale, exchange, license, or any other disposition of *intangible property*.

“Intangible property” is defined as “patents, patent applications, trade names, trademarks, service marks, franchise rights, copyrights, licenses, research, formulas, designs, patterns, processes, formats, and similar types of intangible assets.” TENN. CODE ANN. § 67-4-2004(25).

Here, the Accounts Receivable are the property sold by [TAXPAYER] to [SUBSIDIARY]. To constitute “intangible property” as defined under TENN. CODE ANN. § 67-4-2004(25), the Accounts Receivable must be properly considered patents, patent applications, trade names, trademarks, service marks, franchise rights, copyrights, licenses, research, formulas, designs, patterns, processes, formats, or similar types of intangible assets.

The facts indicate that the Accounts Receivable are trade accounts receivable that originate in the normal course of [TAXPAYER’S] business operations from the sale of [TAXPAYER’S] products. Because trade accounts receivable arising in the ordinary course of business from the sale of a taxpayer’s products are clearly none of the types of property described under TENN. CODE ANN. § 67-4-2004(25), the Accounts Receivable cannot be considered “intangible property” for purposes of determining net earnings or loss under TENN. CODE ANN. § 67-4-2006(b)(1)(K), -(b)(2)(N).

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<sup>1</sup> See 2012 Public Chapter 842, effective April 27, 2012, and applicable to tax years ending on or after July 1, 2012. If the Commissioner approves the taxpayer’s application to deduct the intangible expense, such determination shall remain in effect so long as the taxpayer submits an annual certification that the transaction remains substantially unchanged. The Commissioner is authorized to require that the taxpayer reapply for the deduction beginning no sooner than five years following the most recent application. **For more information about the intangible expense add-back and deduction, including exceptions to the application requirement, see Franchise and Excise Tax Notice #12-16, available on the Department’s website at <http://tn.gov/revenue/notices/fae/12-16fe.pdf>.**

<sup>2</sup> (Emphasis added).

<sup>3</sup> (Emphasis added).

Because the Accounts Receivable are not intangible property, it follows that the Discount charged on the Accounts Receivable is not considered an “intangible expense” for purposes of determining net earnings or loss under TENN. CODE ANN. § 67-4-2006(b)(1)(K), -(b)(2)(N). Since the Discount is not considered an intangible expense, the application requirements set forth under TENN. CODE ANN. § 67-4-2006(b)(2)(N)(i) do not apply with respect to the deduction of the Discount by [TAXPAYER] for Tennessee excise tax purposes.

Kristin Husat  
General Counsel

APPROVED: Richard H. Roberts  
Commissioner of Revenue

DATE: December 19, 2012