

Intangible Expense Add-back and Deduction

Notice #12-16

Franchise and Excise Tax

October 2012



Highlights

➤ *Effective for tax periods ending on or after July 1, 2012, IE-N or IE-A must be filed in order to deduct affiliated intangible expenses*

➤ *Deduction allowed under certain "safe harbors"*

➤ *Application required for all other situations*

INTRODUCTION

This notice provides information regarding the new approval process to allow for the deduction of intangible expenses paid to an affiliated entity for excise tax purposes.

DISCUSSION

Effective for tax periods ending on or after July 1, 2012, Public Chapter 842 (2012) amended Tenn. Code Ann. § 67-4-2006 to allow specific types of intangible expenses to be deducted from the excise tax base.

I. Safe Harbor Deductions

The statute allows for the deduction of intangible expenses paid to affiliated entities when the intangible expenses come within one of the following safe harbors:

- a) the affiliate is in a foreign nation that is a signatory to a comprehensive income tax treaty with the United States;
- b) the affiliate, during the same tax year, has directly or indirectly paid such portion to an entity that is not an affiliate, or
- c) the affiliate is subject to a state's income tax and computes the appropriate portion using the allocation or apportionment rules of that state.

Notice of Deduction ([Form IE-N](#))

Form IE-N is the form that should be filed in instances where a taxpayer is deducting intangible expenses paid to an affiliate that come within the safe harbors listed above. When one or more of these safe harbors applies, a taxpayer should deduct such expenses on its franchise, excise tax return, complete Form IE-N, and file it with the return each year the safe harbor applies.

II. Business Purpose Deductions

The statute also allows for the deduction of intangible expenses paid, accrued, or incurred in connection with a transaction with one or more affiliates, if the Commissioner of Revenue determines upon application by the taxpayer, that the intangible expense, or portion thereof, did not have as its principal purpose the avoidance of the Tennessee excise tax.

Application for Approval to Deduct ([Form IE-A](#))

Form IE-A should be completed by any taxpayer that is requesting approval to deduct from net earnings or losses an intangible expense not meeting the criteria for one or more of the safe harbors. The Department will evaluate the application and issue a letter to the taxpayer approving or denying the intangible expense deduction.

If the taxpayer does not receive an approval or denial letter prior to filing their return, they may deduct the intangible expense on the proper line and complete the appropriate box (Line 25, check box B) on Schedule J of the return. The taxpayer will be assessed for any additional excise tax due if the deduction is subsequently denied. When the application is filed at least sixty (60) days prior to

the original or extended due date of the return and the Department has neither approved nor denied the application by the due date or extended due date, there will be no penalty assessed based on the disallowance of the deduction and no interest accrues on any tax due as a result of the disallowance until 30 days after the date upon which the Department issues a denial notice.

If the Department approves the intangible expense deduction, such determination will remain in effect for at least five years, so long as the taxpayer completes an annual certification that the facts and circumstances surrounding the transaction remain substantially unchanged. This certification will be included on Schedule J of the franchise and excise tax return.

III. Intangible Expense- Add-Back Requirement

Tenn. Code Ann. § 67-4-2006(b)(1)(K) requires all intangible expense paid to an affiliated business entity initially be added to a taxpayer's net earnings or losses on Schedule J of the franchise, excise tax return. These expenses can be subsequently deducted on the same tax return provided the taxpayer files a Form IE-N or obtains approval for the deduction after filing Form IE-A. Failure to add back intangible expenses paid to an affiliate on the initially filed return will subject the taxpayer to a negligence penalty.

➤ *No change to the add back requirement*

➤ *Relevant definitions*

"Intangible expense" means 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.

"Intangible expense" also means 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;

"Intangible income" means income related to, or in connection with, the acquisition, use, maintenance or management, ownership, sale, exchange, license, or any other disposition of intangible property, to the extent such amounts are included or includable in determining federal taxable income;

"Intangible property" means patents, patent applications, trade names, trademarks, service marks, franchise rights, copyrights, licenses, research, formulas, designs, patterns, processes, formats, and similar types of intangible assets;

References:

T.C.A. § 67-4-2004
T.C.A. § 67-4-2006
P.C. 842 (2012)

The information provided here is current as of the date of publication but may change as a result of new statutes, regulations, or court decisions. While this notice is intended to be comprehensive, events and situations unanticipated by this notice may occur. In such cases you should contact the department or your tax professional for further guidance.