

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 06-20**

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 a parent corporation's wholly owned corporate subsidiary will lose its net operating loss carryovers by converting into a limited liability company or merging out of existence into a newly formed limited liability company.

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

Parent is a corporation organized under the laws of a state other than Tennessee that holds interests in several first-tier operating subsidiaries. One of these subsidiaries (the "Subsidiary") is a former Delaware corporation that was converted to a limited liability company (the "LLC") pursuant to Delaware law. Parent is the sole member of the LLC.

The Subsidiary/LLC conducts business activities both within and without Tennessee. Prior to the conversion, the Subsidiary maintained a separate Tennessee franchise, excise tax reporting obligation and incurred a net operating loss carryforward ("NOL"). Subsequent to the conversion, the LLC defaulted to disregarded entity status for federal income tax purposes and is treated as a disregarded entity for Tennessee excise tax purposes pursuant to Tenn. Code Ann. § 67-4-2007(d). As such, all of the LLC's operating results are attributed to the Parent when determining the total Tennessee excise tax liability for both entities. However, the LLC remains a legal entity, separate and distinct from the Parent.

QUESTIONS PRESENTED

1. For Tennessee excise tax purposes, will the Subsidiary's NOL carryforward survive its conversion into an LLC with the corporate Parent as its single member and be

available to offset the net income ultimately reported by the Parent and the disregarded LLC for Tennessee excise tax purposes?

2. Would the answer to question one above be the same if the Subsidiary had merged out of existence and into a newly formed LLC that subsequently defaulted to disregarded status for federal tax purposes?

RULINGS

1. No.
2. Yes, the answer would be the same as in question one.

ANALYSIS

Applicable Statutes

Tenn. Code Ann. § 67-4-2007(d) makes the following provisions concerning limited liability companies for Tennessee excise tax purposes. Similar provisions are made by Tenn. Code Ann. § 67-4-2106(c) for franchise tax purposes.

For purposes of the excise tax levied by this part, a business entity shall be classified as a corporation, partnership, or other type business entity consistent with the way the entity is classified for federal income tax purposes, and subject to tax in accordance with this part. Notwithstanding any provision of law to the contrary, entities that are disregarded for federal income tax purposes, except for limited liability companies whose single member is a corporation, shall not be disregarded for Tennessee excise tax purposes.

Because Parent, the single member of the LLC, is a corporation, Tenn. Code Ann. §§ 67-4-2007(d) and § 67-4-2106(c) require the LLC to be disregarded and to be included as a division of the Parent in its franchise, excise tax return.

Tenn. Code Ann. § 67-4-2006(c)(1), set forth in pertinent part below, permits a qualified NOL to be carried forward for up to 15 years from the year in which the NOL occurred.

Qualified net operating losses may be carried forward and deducted in the next succeeding tax year or years in which the taxpayer has net income until fully utilized, but in no case for more than fifteen (15) years after the taxable year in which the net operating loss occurs.

A NOL may be taken only by the entity that generated it. The successor of the entity that generated an NOL has no right to its predecessor's NOL or any carryover thereof. Tenn. Code Ann. § 67-4-2006(c)(2) makes this clear:

Except for unitary groups of financial institutions, each taxpayer is considered a separate entity; therefore, in the case of mergers, consolidations, and like transactions, no loss carryovers incurred by the predecessor taxpayer shall be allowed as a deduction from net earnings on the excise tax return filed by the successor taxpayer. With the exception set forth in subdivision (c)(3), a loss carryforward may be taken only by the taxpayer that generated it.

Tenn. Code Ann. § 67-4-2006(c)(3) makes an exception when, for purposes of changing its state of incorporation or for other reasons, a taxpayer merges out of existence and into a shell entity that has no income, expenses, assets, liabilities, equity or net worth. In such a situation, the entity that generated the credit is exactly the same after the merger as it was before the merger, except that it may be a different type of entity, have a different name or a different state of incorporation.

Notwithstanding the provisions contained in subdivision (c)(2), 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 carryover and deduction from the net earnings of the surviving successor in accordance with the provisions of this subsection (c).

Application of Tax Statutes to Facts Presented

1. The Subsidiary's NOL Carryforward Will Not Survive Its Conversion Into An LLC with the Corporate Parent as Its Single Member

In the context of the facts presented, the conversion results in the Subsidiary ceasing to exist as a corporation for franchise, excise tax purposes and becoming a division of the Parent. Prior to the transaction, Subsidiary was treated as a separate entity corporation for franchise, excise tax purposes. After the transaction, the LLC is disregarded and treated as a division of the corporate Parent. For franchise, excise tax purposes, this is tantamount to the Subsidiary having undergone a merger, consolidation or like transaction.

However, the Subsidiary has not undergone a merger, consolidation or like transaction with a shell entity that has no income, expenses, assets, liabilities, equity or net worth. After the transaction, the Subsidiary no longer exists. The LLC is disregarded and considered a division of the Parent, a corporation that already has its own assets, liabilities and net worth. Thus, Tenn. Code Ann. § 67-4-2006(c)(3) does not apply and the Subsidiary/LLC loses its NOL carryovers as a result of the transaction.

2. The Subsidiary's NOL Carryforward Will Not Survive Merger Out of Existence and Into a Newly Formed LLC with the Corporate Parent as Its Single Member

In this transaction, the Parent forms a new single member LLC and the Subsidiary merges out of existence and into the LLC.

After the transaction, the LLC is disregarded and treated as a division of the corporate Parent. The Subsidiary has not merged out of existence and into a shell entity that has no income, expenses, assets, liabilities, equity or net worth. For franchise, excise tax purposes, the newly formed LLC is disregarded and treated as a division of the Parent, a corporation that already has its own assets, liabilities and net worth. Thus, Tenn. Code Ann. § 67-4-2006(c)(3) does not apply and the Subsidiary loses its NOL carryovers as a result of the transaction.

Arnold B. Clapp
Special Counsel to the Commissioner

APPROVED: Loren L. Chumley, Commissioner

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