

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 06-25**

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

The inclusion in Tennessee taxable income of a loss arising from a deemed asset sale under IRC § 338(h)(10), and the ability of the taxpayer to carry forward the resulting Tennessee net operating loss to subsequent years for Tennessee excise tax purposes.

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

Buyer, a corporate entity legally and commercially domiciled outside of Tennessee, acquired 100% of the stock of [CORPORATION], another corporate entity, during [YEAR]. [CORPORATION] was a calendar year taxpayer that later switched to a fiscal year and is doing business in Tennessee and filing Tennessee franchise and excise tax returns. Prior to its acquisition by Buyer, [CORPORATION] was wholly owned by another corporate entity, Seller. Buyer, [CORPORATION], and Seller are all treated as Subchapter C corporations for federal tax purposes. None has ever been treated as an S corporation for federal tax purposes.

Although Buyer acquired [CORPORATION] through a stock purchase, Buyer and Seller made a joint election under Section 338(h)(10) of the Internal Revenue Code of 1986, as amended (“Section 338(h)(10)”), which resulted in the transaction being treated as a sale of assets by [CORPORATION] (“deemed asset sale”) for federal income tax purposes rather than a sale of [CORPORATION]’s stock by the Seller.¹ The purchase price paid by Buyer was less than the

¹ For federal income tax purposes, Section 338(a) of the Internal Revenue Code of 1986, as amended, allows a corporation (“P”) that purchases 80% or more of the stock of a corporation (“T”) to elect to have the acquisition treated as a purchase of T’s assets. Following the election, T is treated as if it sold all of its assets at a price determined by P’s basis in T’s stock. The result of the election is that the difference between the purchase price of T’s assets and its basis is recognized as gain or loss to T, and the basis of the assets is stepped up or down, as the case may be.

If T is part of a “selling consolidated group,” P and the sellers of T’s stock may also jointly elect under Section 338(h)(10) to treat the transaction as a deemed asset sale followed by a liquidation. 26 U.S.C. § 338(h)(10); Treas. Reg. § 1.338(h)(10)-1(c)(1). A “selling consolidated group” is the consolidated group of which T is a member on the acquisition date. Treas. Reg. § 1.338(h)(10)-1(b)(2). Under this election, T’s gain or loss on the deemed asset sale is

tax basis of [CORPORATION]'s assets; therefore, the deemed asset sale generated a tax loss for [CORPORATION]. Pursuant to the Federal Consolidated Return Regulations, Seller utilized [CORPORATION]'s loss on the deemed asset sale in its [YEAR] consolidated federal income tax return.

[CORPORATION] filed a Tennessee franchise and excise tax return for the short period ended in [YEAR]. The excise tax base incorporated the loss generated by [CORPORATION]'s deemed asset sale. As a result, for excise tax purposes, [CORPORATION] reported an overall net loss on the [YEAR] short period return. Following its acquisition by Buyer, [CORPORATION] maintained its corporate identity, its Federal Employee Identification Number, its Tennessee account number, and continues to use the assets it owned prior to its acquisition by Buyer. [CORPORATION] has continued to file Tennessee franchise and excise tax returns. [CORPORATION] has not used the net operating losses reported on the [YEAR] short period return to offset taxable income in subsequent years.

QUESTIONS

1. Was the loss stemming from [CORPORATION]'s deemed asset sale under the Section 338(h)(10) election properly reflected in [CORPORATION]'s taxable income on the Tennessee franchise and excise return for the short period ending in [YEAR]?
2. For Tennessee excise tax purposes, may [CORPORATION] carry forward to subsequent years the loss generated on its [YEAR] short period return?

RULINGS

1. Yes. The loss stemming from [CORPORATION]'s deemed asset sale under the Section 338(h)(10) election was properly reflected in [CORPORATION]'s taxable income on the Tennessee franchise and excise return for the short period ending in [YEAR].
2. Yes. For Tennessee excise tax purposes, [CORPORATION] may carry forward to subsequent years the loss generated on its [YEAR] short period return.

ANALYSIS

1. [CORPORATION]'s Tennessee taxable income for the short period ending in [YEAR]

The net operating loss arising from [CORPORATION]'s deemed asset sale under Section 338(h)(10) was properly reflected in [CORPORATION]'s Tennessee taxable income on its franchise and excise tax return for the short period ending in [YEAR]. (This loss will hereafter be referred to as the “[YEAR] NOL.”)

Tennessee imposes an excise tax on the “net earnings” of certain persons, including corporations, doing business within Tennessee. Tenn. Code Ann. §§ 67-4-2007(a) and 67-4-2004(29).² Tenn.

included in the consolidated tax return of the selling group, and no gain or loss is recognized on the sale of T's stock by members of that group.

² The Tennessee franchise and excise tax laws have been recodified since the date of the transaction at issue. The Tennessee Code Annotated references used herein will reflect the current code sections, unless there is a need to note a change in the law that would have an impact on the answers to the questions presented.

Code Ann. § 67-4-2006(a)(1) defines the “net earnings” or “net loss” of a corporation as “federal taxable income or loss before the operating loss deduction and special deductions provided for in 26 U.S.C. §§ 241-247 and 249, and as adjusted by subsections (b) and (c) of this section.” Subsections (b) and (c) of Tenn. Code Ann. § 67-4-2006 require specific addition and subtraction adjustments to federal taxable income to arrive at Tennessee taxable income. Subsections (b) and (c) do not provide, however, for an adjustment to federal taxable income that would require gain or loss arising from a Section 338(h)(10) election to be treated for Tennessee excise tax purposes in a manner that is inconsistent with the federal income tax treatment.

The [YEAR] NOL was included in [CORPORATION]’s separate company federal taxable income. In the computation of its Tennessee taxable income, [CORPORATION] is not required to adjust its federal taxable income with respect to gain or loss arising from a Section 338(h)(10) election. Therefore, the [YEAR] NOL was properly included in [CORPORATION]’s Tennessee taxable income.

2. Carry forward of [CORPORATION]’s [YEAR] NOL

[CORPORATION] may carry forward the [YEAR] NOL to subsequent tax periods for Tennessee excise tax purposes.

Tenn. Code Ann. § 67-4-805(c)(i), applicable to [CORPORATION]’s [YEAR] short period return, permitted a corporation to deduct a net operating loss from its net earnings in the computation of its Tennessee excise tax liability; the corporation could carry forward and deduct net operating losses for up to fifteen years. Additionally, Tenn. Comp. R. & Regs. 1320-6-1-.21 (“Rule 21”) (also applicable to [CORPORATION]’s [YEAR] short period return) provides that each corporation is considered a separate entity, and that “in the case of mergers, consolidations, etc., no loss carryovers incurred by the predecessor corporation will be allowed as a deduction from net earnings on the tax return of the successor corporation.”³

Accordingly, [CORPORATION] may carry forward the [YEAR] NOL if, after the transaction that was the subject of the Section 338(h)(10) election, [CORPORATION] is either the same taxpayer or the successor taxpayer for Tennessee franchise and excise tax purposes.

For federal income tax purposes, if a Section 338 election is made, the [CORPORATION] corporation is treated as though it were two separate corporations, Old [CORPORATION] and New [CORPORATION]. 26 U.S.C. § 338(a). In a Section 338(h)(10) election in particular, Old [CORPORATION] is treated as if, before the close of the acquisition date, after the deemed asset sale, and while Old [CORPORATION] is a member of the selling consolidated group, it transferred all of its assets to members of the selling consolidated group and ceased to exist. Treas. Reg. § 1.338(h)(10)-1(d)(4). Members of the selling consolidated group are treated as if, after the deemed asset sale and before the close of the acquisition date, they received the assets transferred by Old [CORPORATION]. Treas. Reg. § 1.338(h)(10)-1(d)(5)(i). In other words, immediately after the deemed asset sale, Old [CORPORATION] is treated as having liquidated

³ The revision and recodification of the excise tax statute after the date of the transaction at issue incorporated Rule 21 into the net operating loss provisions under Tenn. Code Ann. § 67-4-2006(c). 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. Tenn. Code Ann. § 67-4-2006(c)(2) provides that each taxpayer is considered a separate entity, and that in the case of mergers, consolidations and like transactions, a loss carryforward may be taken only by the taxpayer that generated it.

into its parent company or companies. New [CORPORATION] is treated as a separate corporation that acquired the assets of Old [CORPORATION].

The deemed existence of two [CORPORATION] corporations, and the deemed liquidation of the old [CORPORATION] corporation, are a fiction created under federal income tax regulations. The Tennessee Court of Appeals has stated, however, that “rulings of the federal courts in regard to federal tax laws are not binding on Tennessee courts when they are called upon to interpret Tennessee tax laws.” *Little Six Corp. v. Johnson*, 1999 WL 336308 at *3 (Tenn.Ct.App. May 28, 1999); *See Tidwell v. Berke*, 532 S.W.2d 254 (Tenn.1975). Therefore, the federal income tax regulations do not control the determination of whether [CORPORATION] is the same taxpayer or the successor taxpayer for Tennessee franchise and excise tax purposes.

The Tennessee franchise and excise tax laws do not provide for an election to treat a stock sale as a deemed asset sale. Additionally, Tennessee has not adopted Section 338(h)(10) and the accompanying federal regulations for purposes of Tennessee tax law. While it is true that, in the computation of Tennessee taxable income, Tenn. Code Ann. § 67-4-2006(b)-(c) does not require an adjustment to federal taxable income with respect to the Section 338(h)(10) election, the lack of such a requirement is not the equivalent of the adoption of the underlying federal rule.

Because Tennessee has not adopted the federal regulations under Section 338, there is no deemed existence of two [CORPORATION] corporations and no deemed liquidation of the old [CORPORATION] corporation for Tennessee franchise and excise tax purposes. Additionally, [CORPORATION] did not actually terminate its existence and liquidate into its parent as part of the transaction that was the subject of the Section 338(h)(10) election. Finally, [CORPORATION] is not a successor corporation as that term is used in Rule 21 and Tenn. Code Ann. § 67-4-2006(c)(2), because [CORPORATION] did not merge or consolidate into another corporation.

[CORPORATION] is therefore the same corporation before and after the transaction that was the subject of the Section 338(h)(10) election. [CORPORATION] is the corporation that filed the Tennessee franchise and excise tax return that generated the [YEAR] NOL. Accordingly, Tenn. Code Ann. § 67-4-805(c)(i), Tenn. Code Ann. § 67-4-2006(c)(2) and Rule 21 permit [CORPORATION] to carry forward the [YEAR] NOL to subsequent tax years for Tennessee excise tax purposes.

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