

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 06-26**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

The availability of a qualified Tennessee net operating loss carryover to a corporation that is the single member of a previously uncapitalized limited liability company, where the loss was generated by an affiliated corporation that merged out of existence and into the limited liability company.

**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 his detriment.

**FACTS**

[HOLDING COMPANY] is a holding company that owns 100 percent of the common stock of [COMPANY A] and [Company B]. Holding Company, Company A and Company B are all managed from within Tennessee. For federal income tax purposes, Holding Company, Company A and Company B join in the filing of a federal consolidated income tax return.

Holding Company has no active business operations and its activities are limited to the ownership of the common stock of Company A and Company B. Company A is a [STATE-NOT

TN] corporation that does business both within and without the State of Tennessee. Thus, for purposes of its Tennessee franchise and excise tax return, Company A is subject to excise tax based on income apportioned to the state. For the current tax year, it is anticipated that Company A will have Tennessee taxable income. Company A does not have a Tennessee net operating loss carryover. Company B is a [STATE – NOT TN] corporation that does business solely within the State of Tennessee. Company B has incurred taxable losses since calendar year 2000 (the “Tennessee NOL”). Company B has loss carryovers available to be used in its 2005 Tennessee franchise and excise tax return. Neither Holding Company, Company A nor Company B are engaged in the business of a financial institution for Tennessee tax purposes as defined in Tenn. Code Ann. § 67-4-2004(4)(A).

As part of its plan to simplify its corporate structure, Holding Company desires to combine the operations of Company A and Company B into a single tax-paying entity for state income tax purposes, including Tennessee franchise and excise tax purposes. To accomplish this, Company A will form a [STATE – NOT TN] single member limited liability company (“SMLLC”) and, prior to the capitalization of SMLLC, Company B will be merged into SMLLC, with SMLLC remaining as the survivor of the merger. As used in the previous sentence, “prior to capitalization” means that prior to the merger of Company B, SMLLC will have no income, expenses, assets, liabilities, equity or net worth, as referenced in Tenn. Code Ann. § 67-4-2006(c)(3). It is intended that SMLLC be treated as a disregarded entity for federal and Tennessee income tax purposes. Thus, subsequent to the merger, Company A’s federal taxable income will include the activity of SMLLC.

### **ISSUES**

1. Will SMLLC, as the survivor of the merger with Company B, be disregarded for Tennessee franchise and excise tax purposes?
2. Will the Tennessee NOL incurred by Company B transfer to SMLLC when Company B merges out of existence?
3. Will the Tennessee NOL be available to offset the income of Company A in tax periods subsequent to the merger?

### **RULINGS**

1. Yes.
2. No.
3. No.

### **ANALYSIS**

1. SMLLC will be disregarded for Tennessee franchise and excise tax purposes.

SMLLC will at all times be disregarded for Tennessee franchise and excise tax purposes pursuant to Tenn. Code Ann. §§ 67-4-2007(d) and 67-4-2106(c). As a disregarded entity, SMLLC will be treated as a division of Company A for Tennessee franchise and excise tax purposes.

Tenn. Code Ann. §§ 67-4-2007(d) and 67-4-2106(c) provide that, for purposes of Tennessee franchise and excise taxation, a business entity shall be classified as a corporation, partnership, or other type of business entity, consistent with the way the entity is classified for federal income tax purposes. Tenn. Code Ann. §§ 67-4-2007(d) and 67-4-2106(c) further provide that “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 franchise and excise tax purposes. In other words, a single member limited liability company that is disregarded for federal income tax purposes and that is wholly owned by a corporation will be disregarded for Tennessee franchise and excise tax purposes.

The taxpayer has represented that SMLLC will be treated as a disregarded entity for federal income tax purposes. Additionally, SMLLC will at all times be a single member limited liability company wholly owned by Company A, a corporation. Accordingly, SMLLC will at all times be disregarded for Tennessee franchise and excise tax purposes pursuant to Tenn. Code Ann. §§ 67-4-2007(d) and 67-4-2106(c). If a business entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of its owner. *See* Treas. Reg. § 301.7701-2(a). SMLLC will therefore be treated as a division of Company A for Tennessee franchise and excise tax purposes.

2. The Tennessee NOL will not transfer to SMLLC upon merger.

The Tennessee NOL of Company B will not transfer to SMLLC upon the merger of Company B. The taxpayer has represented that Company B will merge out of existence and into SMLLC. As a disregarded entity, SMLLC will be treated as a division of Company A for Tennessee franchise and excise tax purposes. Company B will therefore be treated as having merged out of existence and into Company A.

Because the merger takes place between Company A and Company B, the Tennessee NOL will not transfer to SMLLC.

3. The Tennessee NOL will not be available to offset the income of Company A.

The Tennessee NOL of Company B will not be available for carryover and deduction from the net earnings of Company A in tax periods subsequent to the merger.

Tennessee imposes an excise tax at the rate of 6.5 percent on the “net earnings” of certain persons doing business within Tennessee. Tenn. Code Ann. § 67-4-2007(a). Persons subject to the excise tax include, but are not limited to, corporations and limited liability companies. Tenn. Code Ann. § 67-4-2004(29). Tenn. Code Ann. § 67-4-2006(a)(1) defines “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.”

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 forward and deducted for up to fifteen years. Tenn. Code Ann. § 67-4-2006(c)(2) provides that in the case of mergers, consolidations, and like transactions, no loss carryovers incurred by the predecessor taxpayer are allowed as a deduction from net earnings on the excise tax return filed by the successor taxpayer, with the exception set forth in Tenn. Code

Ann. § 67-4-2006(c)(3). Tenn. Code Ann. § 67-4-2006(c)(3) provides that 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.

The taxpayer has represented that Company B will merge out of existence and into SMLLC. As a disregarded entity, SMLLC will be treated as a division of Company A for Tennessee franchise and excise tax purposes. Company B will therefore be treated as having merged out of existence and into Company A.

Pursuant to Tenn. Code Ann. §§ 67-4-2006(c)(2) and 67-4-2006(c)(3), Company B's loss carryover will not be allowed as a deduction from the net earnings of Company A unless Company A is a successor taxpayer that has no income, expenses, assets, liabilities, equity or net worth. According to the facts presented by the taxpayer, Company A is actively engaged in business in Tennessee and has Tennessee taxable income. Accordingly, the Tennessee NOL of Company B will not be available for carryover and deduction from the net earnings of Company A in tax periods subsequent to the merger.

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APPROVED: Loren L. Chumley  
Commissioner of Revenue

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