

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 14-03**

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

The application of the Tennessee franchise tax to a group of affiliated entities making a consolidated net worth election.

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

A multinational group of legal entities has a tiered structure containing corporations, limited partnerships ("LPs"), and limited liability companies ("LLCs").

[PARENT] ("Parent"), a U.S. corporation, owns [COMPANY A] ("Company A"), an LLC classified as a corporation for federal income tax purposes. Company A owns [COMPANY B]

(“Company B”) and [COMPANY C] (“Company C”), which are LLCs classified as corporations for federal income tax purposes; multiple domestic LLCs disregarded for federal income tax purposes; domestic corporations; and foreign corporations. Company B owns several domestic and foreign LLCs disregarded for federal income tax purposes; a domestic corporation; foreign corporations; foreign LLCs federally classified as corporations; and foreign limited partnerships (“LPs”). Company C owns a domestic LLC disregarded for federal income tax purposes.

For federal income tax purposes, the income and attributes of Parent, Company A, Company B, Company C, various other domestic subsidiaries, and each of the federally disregarded entities owned by these entities are included in a U.S. Consolidated Corporation Income Tax Return. The federal income tax treatment of each entity and its position in the legal entity structure is illustrated in Appendix A.

For purposes of this ruling, the single-member LLCs (“SMLLCs”) owned by Company A, Company B, or Company C that are disregarded entities for federal income tax purposes and not characterized as corporations for federal income tax purposes are referred to as “Federally Disregarded SMLLCs.”

RULINGS

1. Are the Federally Disregarded SMLLCs also disregarded entities for Tennessee franchise and excise tax purposes?

Ruling: Yes. The Federally Disregarded SMLLCs are also disregarded for purposes of the Tennessee franchise and excise taxes.

2. May Parent, Company A, Company B, Company C, and all domestic entities owned by Company A or Company B that are not disregarded for Tennessee franchise and excise tax purposes make a consolidated net worth election for purposes of computing the Tennessee franchise tax?

Ruling: All entities that are included in the affiliated group may make a joint election to compute net worth on a consolidated basis for purposes of calculating the Tennessee franchise tax. The facts indicate that the affiliated group includes Parent, Company A, Company B, Company C, and all domestic entities owned by Company A, Company B, or Company C that are not disregarded for Tennessee franchise and excise tax purposes. Any entity that is disregarded for Tennessee franchise and excise tax purposes to a member of the affiliated group is covered by the consolidated net worth election by virtue of being disregarded to the affiliated group member. If the affiliated group makes a consolidated net worth election, all entities that are part of the group and subject to the Tennessee franchise tax must compute net worth on a consolidated basis.

3. For Tennessee franchise tax purposes, may the affiliated group making the consolidated net worth election exclude from net worth the holdings of members of the affiliated group in foreign entities, which are statutorily excluded from the affiliated group?

Ruling: In calculating consolidated net worth for Tennessee franchise tax purposes, members of the affiliated group may exclude from net worth the holdings of members of the group in any entity that does not come within the TENN. CODE ANN. § 67-4-2004(15) (2013) definition of a “domestic person.” When a member of the affiliated group invests in a foreign Federally Disregarded SMLLC that qualifies as a disregarded entity for Tennessee franchise and excise tax purposes, the foreign Federally Disregarded SMLLC is treated as a division of its owner. The net worth of a foreign Federally Disregarded SMLLC is therefore treated as the net worth of its corporate parent and, thus, is part of the consolidated net worth computation.

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(38) (2013), doing business within Tennessee.¹ 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) (2013).² Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, corporations, limited liability companies, and limited partnerships.³ With certain limited exceptions, each taxpayer is considered a “separate and single business entity” for Tennessee franchise and excise tax purposes and must file its Tennessee franchise and excise tax return on a separate entity basis.⁴

(1) DISREGARDED ENTITIES

The Federally Disregarded SMLLCs are disregarded for purposes of the Tennessee franchise and excise taxes.

TENN. CODE ANN. §§ 67-4-2007(d), -2106(c) (2013) provide that, for Tennessee franchise and excise tax purposes, 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. However, TENN. CODE ANN. §§ 67-4-2007(d), -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. Thus, to be disregarded for Tennessee franchise and excise tax purposes, an

¹ TENN. CODE ANN. § 67-4-2007(a) (2013).

² Note that, under TENN. CODE ANN. § 67-4-2108(a)(1) (2013), the franchise tax base “shall in no case be less than the actual value of the real or tangible property owned or used in Tennessee, excluding exempt inventory and exempt required capital investments.” According to TENN. CODE ANN. § 67-4-2108(a)(3), for purposes of this section, “property” is to be “valued at cost less accumulated depreciation in accordance with generally accepted accounting principles.”

³ TENN. CODE ANN. § 67-4-2004(38) (2013).

⁴ TENN. CODE ANN. §§ 67-4-2007(e)(1), -2106(c) (2013).

entity must be (1) a single member limited liability company; (2) disregarded for federal income tax purposes; and that is (3) wholly owned by a corporation.

For purposes of TENN. CODE ANN. §§ 67-4-2007(d), -2106(c), the term “corporation” includes an entity formed as a corporation under state law; a non-corporate entity whose default classification for federal tax purposes is to be treated as a corporation; an entity formed under another country’s laws whose default classification for federal tax purposes is to be treated as a corporation;⁵ and an entity that makes an election on federal Form 8832 (Entity Classification Election) to be classified as a corporation for federal tax purposes.⁶

TENN. CODE ANN. § 48-249-1003 (2013) provides that, “[f]or purposes of all state and local Tennessee taxes, a domestic or foreign LLC shall be treated as a partnership or an association taxable as a corporation, as such classification is determined for federal income tax purposes.”⁷ Thus, for Tennessee franchise and excise tax purposes, a limited liability company will be treated as a corporation, partnership, or disregarded entity in the same manner as it is for federal purposes.

Company A, Company B, and Company C are LLCs taxed as corporations for federal income tax purposes. Each of these LLCs is the sole member of a Federally Disregarded SMLLC. Thus, each such Federally Disregarded SMLLC is also disregarded for Tennessee franchise and excise tax purposes.

(2) CONSOLIDATED NET WORTH ELECTION

All entities that are included in the affiliated group may make a joint election to compute net worth on a consolidated basis for purposes of calculating the Tennessee franchise tax.⁸ The facts indicate that the affiliated group includes Parent, Company A, Company B, Company C, and all domestic entities owned by Company A, Company B, or Company C that are not disregarded for Tennessee franchise and excise tax purposes. All entities that are disregarded for Tennessee franchise and excise tax purposes to a member of the affiliated group are covered by the consolidated net worth election by virtue of being disregarded to an affiliated group member. If the affiliated group makes a consolidated net worth election, all entities that are part of the group and subject to the Tennessee franchise tax must compute net worth on a consolidated basis.

⁵ See Treas. Reg. § 301.7701-2(b)(8) (West, Westlaw through Apr. 24, 2014) (listing foreign entities that are classified federally as corporations).

⁶ See TENNESSEE DEPARTMENT OF REVENUE, NOTICE 13-16 (Nov. 2013), available at <http://tn.gov/revenue/notices/fae/13-16fe.pdf> (last visited May 5, 2014).

⁷ This provision was enacted in 1994 as part of the Tennessee Limited Liability Company Act, see Tennessee Limited Liability Company Act, ch. 868, §1, 1994 Tenn. Pub. Acts 654, 654-752 (originally codified at TENN. CODE ANN. § 48-211-101, codified as amended at TENN. CODE ANN. § 48-249-1003 (2013)), before the publication of the federal “check-the-box” regulations in late 1996. As a result, the provision does not specifically reference the “disregarded” entity option now available under the federal regulations.

⁸ The computation of consolidated net worth includes the financial information of all entities that are part of the affiliated group regardless of whether an entity must individually file a franchise and excise tax return.

For tax years beginning on or after January 1, 2004, TENN. CODE ANN. § 67-4-2103(d) (2013) allows a taxpayer that is a member of an affiliated group to elect to compute its net worth for Tennessee franchise tax purposes on a consolidated basis. Each affiliated group member computing its net worth on a consolidated basis must file a separate Tennessee franchise and excise tax return.⁹

To compute net worth on a consolidated basis, all members of an affiliated group must file a group consolidated net worth registration form on or before the due date of the tax return for the period for which the election is to take effect.¹⁰ If a member enters or leaves the group at any time during the tax year, the group must file an amended group registration form on or before the due date of the return for the period in which the event takes place.¹¹

Once made, the consolidated net worth election remains in effect for a minimum of five years.¹² After the initial five years, the consolidated net worth computation election will continue unless the group revokes its election by filing a group revocation election form.¹³

Following the consolidated net worth election, each member of the group that is subject to the franchise and excise taxes must file its own franchise and excise tax return. Each member must compute its net worth on a consolidated basis and must close its taxable year on the same date as all other members of the group.¹⁴

An “affiliated group” is defined as (1) “[a] taxpayer that, standing alone, is subject to the Tennessee franchise tax”; (2) “[a]ll other domestic persons in which the taxpayer, directly or indirectly, has more than 50% ownership interest”; (3) “[a]ll other domestic persons that, directly or indirectly, have more than 50% ownership interest in the taxpayer”; and (4) “[a]ll other domestic persons in which a person described in [(3), above,] directly or indirectly, have more than 50% ownership interest, regardless of whether such persons do business in Tennessee.”¹⁵ For this purpose, a non-corporate taxable entity is more than 50% owned if upon liquidation

⁹ Consolidated net worth is reported on Schedule F2 of the franchise and excise tax return, FAE 170.

¹⁰ TENN. CODE ANN. § 67-4-2103(g) (2013). The consolidated net worth registration form is available on the Department’s website at <http://tn.gov/revenue/forms/fae/f1308301Fill-in.pdf>.

¹¹ *Id.*

¹² TENN. CODE ANN. § 67-4-2103(h).

¹³ *Id.* TENN. CODE ANN. § 67-4-2103(i) authorizes the Commissioner of Revenue to accept a late election or a late revocation of an election, or to permit any early revocation of an election to compute net worth on a consolidated basis if the commissioner determines there is reasonable and good cause for such action.

¹⁴ TENN. CODE ANN. § 67-4-2103(d).

¹⁵ TENN. CODE ANN. § 67-4-2004(2)(A).

more than 50% of the assets of the non-corporate taxable entity, directly or indirectly, accrue to a member or members of the affiliated group.¹⁶

A “domestic person” includes any entity “with more than twenty percent (20%) of the average of its property, payroll and receipts factors, as each factor is calculated for a separate entity under § 67-4-2111, in the United States.”¹⁷ Thus, all non-domestic entities are excluded from the affiliated group for purposes of the consolidated net worth election. For purposes of this discussion, entities that do not come within the definition of “domestic person” under TENN. CODE ANN. § 67-4-2004(15) will be referred to as “foreign entities.”

Parent, Company A, Company B, Company C, and their domestic regarded subsidiaries comprise an affiliated group as defined under TENN. CODE ANN. § 67-4-2004(2), and as a group may make a consolidated net worth election. All foreign entities that are part of the organizational structure as described in the Facts are excluded from the affiliated group making the election. Each affiliated group member that is subject to the Tennessee franchise and excise taxes must file its own separate franchise and excise tax return, but the consolidated net worth upon which each entity’s franchise tax is imposed is computed based upon the assets and liabilities of all members of the affiliated group.¹⁸

(3) EFFECT OF INVESTMENTS IN FOREIGN ENTITIES ON CONSOLIDATED NET WORTH COMPUTATION

In calculating consolidated net worth for Tennessee franchise tax purposes, members of the affiliated group may exclude from net worth the holdings of members of the group in any entity that does not come within the definition of a “domestic person.” When a member of the affiliated group invests in a foreign Federally Disregarded SMLLC that qualifies as a disregarded entity for Tennessee franchise and excise tax purposes, the foreign Federally Disregarded SMLLC is treated as a division of its owner. The net worth of a foreign Federally Disregarded SMLLC is therefore treated as the net worth of its corporate parent and, thus, is part of the consolidated net worth computation.

For taxpayers computing net worth on a consolidated basis, net worth is defined as “the difference between the total assets and the total liabilities of the affiliated group at the close of business on the last day of the tax year, as shown by a pro forma consolidated balance sheet including all members of the group.”¹⁹ TENN. CODE ANN. § 67-4-2106(b) states that a taxpayer should prepare its pro-forma consolidated balance sheet “in accordance with generally accepted accounting principles wherein transactions and holdings between members of the group and holdings in non-domestic persons have been eliminated.”

¹⁶ TENN. CODE ANN. § 67-4-2004(2)(B).

¹⁷ TENN. CODE ANN. § 67-4-2004(15).

¹⁸ See TENN. CODE ANN. § 67-4-2106(b).

¹⁹ *Id.*

If the affiliated group makes a consolidated net worth election and a member of the group has a holding in an entity that does not come within the definition of a “domestic person,”²⁰ then the affiliated group must exclude from its consolidated balance sheet any holdings in such entity.

According to the facts presented, certain affiliated group members have holdings in a number of foreign entities including foreign corporations, foreign LLCs classified as corporations for federal income tax purposes, foreign limited partnerships classified as partnerships for federal income tax purposes, and foreign Federally Disregarded SMLLCs.

The foreign corporations, foreign LLCs classified as corporations for federal income tax purposes, and foreign limited partnerships classified as partnerships for federal income tax purposes in which several of the affiliated entities hold an interest are properly characterized as non-domestic persons because, on a separate entity basis, none of these entities has more than twenty percent (20%) of its average of property, payroll, and receipts factors, in the United States.²¹ The pro-forma consolidated balance sheet of the affiliated group must exclude holdings in such foreign entities in accordance with TENN. CODE ANN. § 67-4-2106(b). As such, in calculating consolidated net worth, a taxpayer that is part of the affiliated group must exclude the holdings of group members in the foreign corporations, foreign LLCs classified as corporations for federal income tax purposes, and foreign limited partnerships classified as partnerships for federal income tax purposes that are part of the organizational structure as described in the Facts.

The net worth of any foreign Federally Disregarded SMLLC disregarded for purposes of the franchise and excise taxes is included in the net worth of its owner. As stated above in the response to Question #1, a SMLLC owned by an entity classified as a corporation for federal income tax purposes is treated as a disregarded entity for Tennessee franchise and excise tax purposes. Accordingly, the foreign Federally Disregarded SMLLCs owned solely by Company B are disregarded entities for purposes of the Tennessee franchise and excise taxes and are included in Company B’s franchise and excise tax return. The end effect is that the net worth of the foreign Federally Disregarded SMLLCs is treated as the net worth of Company B, and is accordingly included in the consolidated balance sheet.

In summary, if the affiliated group makes a consolidated net worth election, it may exclude from its consolidated balance sheet holdings that affiliated group members have in the foreign regarded entities. The affiliated group may not, however, exclude holdings of its members in foreign Federally Disregarded SMLLCs that are disregarded to affiliated group members for Tennessee franchise and excise tax purposes.

²⁰ As previously stated, for purposes of the Tennessee franchise and excise taxes, a “domestic person” is “any person with more than twenty percent (20%) of the average of its property, payroll, and receipts factors, as each factor is calculated for a separate entity under § 67-4-2111, in the United States.” TENN. CODE ANN. § 67-4-2004(15).

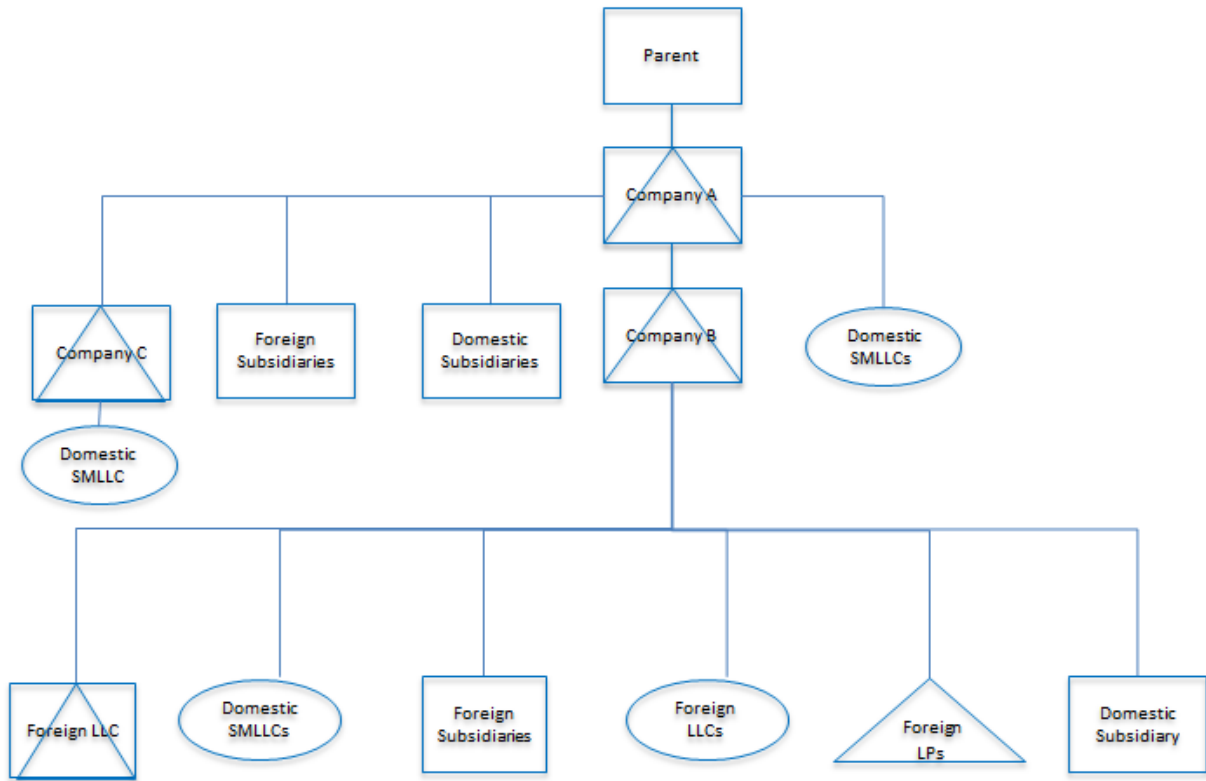
²¹ See TENN. CODE ANN. § 67-4-2004(15).

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APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: June 19, 2014

Appendix A



Legend

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- Corporation for federal income tax purposes
 - LLC taxed as a corporation for federal income tax purposes
 - LLC taxed as a disregarded entity for federal income tax purposes
 - LP taxed as a partnership for federal income tax purposes