

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 17-06

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 and excise taxes to a unitary group of financial institutions that includes exempt entities.

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

[TAXPAYER] (the "Taxpayer") is a savings association that has represented that it meets the definition of a financial institution in TENN. CODE ANN. § 67-4-2004(17) (Supp. 2016) for Tennessee franchise and excise tax purposes. As such, pursuant to TENN. CODE ANN. § 67-4-2006(a)(3) (Supp. 2016), the Taxpayer files on a combined basis with its unitary, financial institution affiliates. The Taxpayer's

affiliated group has elected to calculate and report taxable net worth for franchise tax purposes on a consolidated basis pursuant to TENN. CODE ANN. 67-4-2103(d) (2013).

The Taxpayer has represented that among the Taxpayer's unitary financial institution affiliates are [REDACTED—TRUSTS] (the "Trusts").¹

The Trusts are [REDACTED]. The owner trustee of the Trusts is [REDACTED], which is commercially domiciled in [REDACTED—STATE]. The sole business purpose of the Trusts is the asset-backed securitization of debt obligations. Accordingly, for purposes of this ruling, it is assumed that the Trusts are exempt under TENN. CODE ANN. § 67-4-2008(a)(10) (Supp. 2016).²

RULINGS

1. Should the Taxpayer include the Trusts in its financial institution affiliated group for Tennessee excise tax purposes, even though the Trusts are exempt from the Tennessee excise tax? If so, how should the Taxpayer report the Trusts' net earnings?

Ruling: Although the Trusts are exempt from Tennessee excise tax pursuant to TENN. CODE ANN. § 67-4-2008(a)(10), the Taxpayer should include the Trusts in its financial institution affiliated group for Tennessee excise tax purposes, as the Taxpayer has represented that the Trusts are financial institutions that are unitary with the Taxpayer. The Trusts' net earnings, however, should be excluded from the net earnings of the financial institution affiliated group, and the receipts of the Trusts should be excluded from both the numerator and the denominator of the group's apportionment formula.

2. Should the Taxpayer include the Trusts in the financial institution affiliated group for purposes of its consolidated net worth election, even though the Trusts are exempt from the Tennessee franchise tax? If so, how should the Taxpayer report the Trusts' net worth for the purpose of calculating consolidated net worth pursuant to TENN. CODE ANN. 67-4-2103(d)?

Ruling: Although the Trusts are exempt from Tennessee franchise tax, they are included in the financial institution affiliated group for purposes of the consolidated net worth election. However, the Trusts' assets and liabilities should be excluded from the consolidated net worth calculation, and the Trusts' receipts should be excluded from both the numerator and the denominator of the financial institution affiliated group's apportionment formula because the Trusts are exempt from the Tennessee franchise tax under TENN. CODE ANN. § 67-4-2105(a).

ANALYSIS

¹ This ruling does not address whether the Taxpayer and the Trusts are financial institutions for franchise and excise tax purposes, and it is inapplicable in the event that the Taxpayer or its affiliates do not meet the definition of a financial institution.

² An entity that qualifies for an exemption under TENN. CODE ANN. § 67-4-2008 is also exempt from the Tennessee franchise tax pursuant to TENN. CODE ANN. § 67-4-2105(a) (Supp. 2016).

Tennessee imposes an excise tax at the rate of 6.5% on the net earnings of all persons doing business in Tennessee.³ 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.⁴ Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, business trusts, state-chartered or national banks, and state-chartered or federally chartered savings and loan associations.⁵ 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.⁶ One such exception is unitary groups of financial institutions.⁷ Financial institutions must file a combined return for franchise and excise tax purposes and pay tax based on the combined net worth⁸ and apportioned combined net earnings of the entire unitary group.⁹ A financial institution affiliated group can also elect to calculate net worth on a consolidated basis.¹⁰

I. Excise Tax Affiliated Group

Although the Trusts qualify for the exemption from excise tax set forth in TENN. CODE ANN. § 67-2008(a)(10), the Taxpayer should include the Trusts in its financial institution affiliated group for Tennessee excise tax purposes, as the Taxpayer has represented that the Trusts are financial institutions and members of the unitary group under TENN. CODE ANN. § 67-4-2007(e)(2)(A). The Trusts' net earnings, however, should be excluded from the net earnings of the financial institution affiliated group, and the receipts of the Trusts should be excluded from both the numerator and the denominator of the group's apportionment formula.

"Financial institutions subject to tax in this state, that are members of a unitary group,¹¹ shall file a combined return and pay tax based on the apportioned combined net earnings of the entire unitary group."¹²

³ TENN. CODE ANN. § 67-4-2007(a) (Supp. 2016).

⁴ TENN. CODE ANN. §§ 67-4-2105(a), -2106(a) (2013).

⁵ TENN. CODE ANN. § 67-4-2004(38).

⁶ TENN. CODE ANN. §§ 67-4-2007(e)(1), -2106(c).

⁷ TENN. CODE ANN. §§ 67-4-2006(a)(3). A "financial institution" is defined for franchise and excise tax purposes as "a holding company, any regulated financial corporation, a subsidiary of a holding company or a regulated financial corporation, an investment entity that is indirectly more than fifty percent (50%) owned by a holding company or a regulated financial corporation, or any other person that is carrying on the business of a financial institution." TENN. CODE ANN. § 67-4-2004(17)

⁸ TENN. CODE ANN. § 67-4-2114(c)(1) (2013).

⁹ TENN. CODE ANN. § 67-4-2007(e)(2)(A); TENN. CODE ANN. § 67-4-2106(b).

¹⁰ TENN. CODE ANN. § 67-4-2103(d) (2013).

¹¹ The terms "unitary business" or "unitary group" are defined to mean "business activities or operations of financial institutions that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution." The unitary group "includes those entities that are engaged in a unitary business transacted wholly in, or in and out of the state of Tennessee, even if some of the entities would not be subject to tax in this state, if considered apart from their unitary group." TENN. CODE ANN. § 67-4-2004(52).

Because the Taxpayer has represented that the Trusts are financial institutions and engage in activities that are of mutual benefit, dependent upon, or contributory to its affiliated entities, the Trusts should be included on the Taxpayer's combined FAE 174, Franchise and Excise Financial Institution and Captive Real Estate Investment Trust Tax Return (the "FAE 174") by listing each Trust on Schedule SF.¹³ The Trusts, however, are exempt from the excise tax under TENN. CODE ANN. § 67-4-2008(a)(10). Tennessee excise tax law does not require such entities to either be included in the combined group or utilize the exemption. The two are not mutually exclusive. Accordingly, the Trusts are part of the financial institution's unitary group and included in the Taxpayer's combined FAE 174, but their net earnings should not be included in determining the unitary group's excise tax liability on FAE 174 Schedule J because the entities are exempt from Tennessee excise tax under TENN. CODE ANN. § 67-4-2008(a)(10). Moreover, the Trusts' receipts should be excluded from both the numerator and the denominator of the combined group's apportionment formula on FAE 174 Schedule S-E pursuant to TENN. CODE ANN. § 67-4-2013(b).

II. Consolidated Net Worth Election

Because the Taxpayer has represented that the Trusts are financial institutions and engage in activities that are of mutual benefit, dependent upon, or contributory to its affiliated entities, the Taxpayer should include the Trusts in the financial institutions affiliated group for purposes of the consolidated net worth election; however, the Trusts' net worth should not be included in the consolidated net worth calculation because the Trusts are exempt from the Tennessee franchise tax under TENN. CODE ANN. § 67-4-2105(a).

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.¹⁴

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.¹⁵ 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.¹⁶

¹² TENN. CODE ANN. § 67-4-2007(e)(2)(A).

¹³ Although the Trusts should be listed on Schedule SF, it is not necessary to include their financial information. Listing the Trusts on Schedule SF allows the Taxpayer to provide the Department with a complete picture of the Taxpayer's corporate structure. Listing the Trusts does not affect the tax consequences of any entities subject to Tennessee franchise and excise tax.

¹⁴ Consolidated net worth for financial institutions is reported on Schedule F2 of FAE 174.

¹⁵ 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/assets/entities/revenue/attachments/f1308301.pdf>.

¹⁶ *Id.*

Once made, the consolidated net worth election remains in effect for a minimum of five years.¹⁷ 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.¹⁸

Following the consolidated net worth election, as a financial institution affiliated group in TENN. CODE ANN. § 67-4-2004(18), the group must file a combined return and compute its net worth on a consolidated basis. Each member must close its taxable year on the same date as all other members of the group.¹⁹

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.”²⁰ For this purpose, a non-corporate taxable entity is more than 50% owned if upon liquidation 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.²¹

Because the Taxpayer has represented that the Trusts are part of its affiliated group as defined in TENN. CODE ANN. § 67-4-2004(2)(A), the group made a consolidated net worth election. The Trusts should be listed on FAE 174 Schedule SF because they are part of the affiliated group. Furthermore, the Taxpayer states that the Trusts are exempt from the franchise tax under TENN. CODE ANN. § 67-4-2105(a). Tennessee franchise tax law does not require such entities to either be included in the affiliated group or utilize the exemption. The two are not mutually exclusive. Accordingly, the Trusts’ assets and liabilities should not be included when reporting the consolidated net worth on FAE 174 Schedule F2 because the Trusts are exempt from the franchise tax under TENN. CODE ANN. § 67-4-2105(a). Moreover, the Trusts’ receipts should be excluded from both the numerator and the denominator of the combined group’s apportionment formula on FAE 174 Schedule SC pursuant to TENN. CODE ANN. § 67-4-2118.

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¹⁷ TENN. CODE ANN. § 67-4-2103(h).

¹⁸ *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.

¹⁹ TENN. CODE ANN. § 67-4-2103(d).

²⁰ TENN. CODE ANN. § 67-4-2004(2)(A).

²¹ TENN. CODE ANN. § 67-4-2004(2)(B).

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 4/19/17