

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 17-07**

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 limited liability company that is disregarded for federal income tax purposes to an entity described in Section 501(a) of the Internal Revenue Code of 1986, as amended.

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

[PENSION TRUST] (the "Pension Trust") is a governmental pension trust that is a qualified trust within the meaning of I.R.C. § 401(a) and exempt from federal income taxes pursuant to I.R.C. § 501(a). The Pension Trust is the sole member of [SMLLC] (the "SMLLC"). The SMLLC is disregarded for federal income tax purposes and is therefore treated as a division of the Pension Trust for federal income tax purposes under Treas. Reg. § 301.7701-2(a).

The Pension Trust formed the SMLLC to [REDACTED] in Tennessee for investment purposes. The SMLLC's sole business activity is [REDACTED]. All income earned by the SMLLC accrues to the Pension Trust for reinvestment or payment of governmental pension obligations. The SMLLC is the sole business entity owned by the Pension Trust operating in the State of Tennessee.

RULING

Is the SMLLC a disregarded entity for Tennessee franchise and excise tax purposes?

Ruling: Yes. The SMLLC is a limited liability company that is wholly-owned by an entity classified as a corporation for federal tax purposes.

ANALYSIS

Tennessee 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.¹ Tennessee also imposes an excise tax at the rate of 6.5% on the net earnings of all persons doing business within Tennessee.² Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, limited liability companies and business entities classified as corporations for federal income tax purposes.³ With certain limited exceptions, each taxpayer is considered a "separate and single business entity" and must file its Tennessee franchise and excise tax return on a separate entity basis.⁴

For Tennessee franchise and excise tax purposes, a business entity is classified as a corporation, partnership, or other type of business entity, consistent with the way the entity is classified for federal income tax purposes.⁵ However, "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.⁶ Thus, to be disregarded for Tennessee franchise and excise tax purposes, an entity must be (1) a single member limited liability company; (2) disregarded for federal income tax purposes; and (3) wholly-owned by a corporation.

For purposes of applying TENN. CODE ANN. §§ 67-4-2007(d), -2106(c), the Department has interpreted the term "corporation" to include 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

¹ TENN. CODE ANN. §§ 67-4-2105(a) and -2106(a) (2013 & Supp. 2016).

² TENN. CODE ANN. § 67-4-2007(a) (Supp. 2016).

³ TENN. CODE ANN. §§ 67-4-2004(38), -2007(d) (Supp. 2016).

⁴ TENN. CODE ANN. §§ 67-4-2106(c) and -2007(d).

⁵ *Id.*

⁶ *Id.*

tax purposes is to be treated as a corporation;⁷ and an entity that makes an election on federal Form 8832 (Entity Classification Election) to be classified as a corporation for federal tax purposes.⁸

With respect to limited liability companies, TENN. CODE ANN. § 48-249-1003 (2013) provides that, “[f]or purposes of all state and local Tennessee taxes, a domestic or foreign limited liability company shall be treated as a partnership or an association taxable as a corporation, as such classification is determined for federal income tax purposes.”⁹ 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, but it will file as a separate entity unless it comes under the exception found in TENN. CODE ANN. §§ 67-4-2007(d), -2106(c).

Here, the SMLLC is a single member limited liability company and is treated as disregarded for federal income tax purposes. It is wholly-owned by the Pension Trust, an entity that is exempt from federal income tax under I.R.C. § 501(a). An entity that is exempt from federal income tax under I.R.C. § 501(a) is treated as having made an election to be classified as a corporation for federal income tax purposes.¹⁰ Therefore, the Pension Trust is classified as a corporation for federal income tax purposes and, consequently, Tennessee franchise and excise tax purposes. Because the SMLLC is a limited liability company wholly-owned by a corporation and disregarded for federal income tax purposes, it is disregarded for Tennessee franchise and excise tax purposes.

Because the SMLLC is disregarded for Tennessee franchise and excise tax purposes, its earnings are considered to be net earnings of the Pension Trust, a not-for-profit entity. However, these net earnings may be subject to the Tennessee excise tax to the extent they constitute unrelated business taxable income, as defined in I.R.C. § 512, or are otherwise subject to income taxes under Subchapter A of the Internal Revenue Code.¹¹ Additionally, as a not-for-profit entity, the Pension Trust is subject to the Tennessee excise tax on all net earnings that are attributable to any activities unrelated to and outside the scope of the activities that give it exempt status.¹²

Similarly, unless it qualifies for an applicable exemption, as a not-for-profit entity, the Pension Trust is subject to the Tennessee franchise tax with respect to its Tennessee net worth, or real or tangible

⁷ See Treas. Reg. § 301.7701-2(b)(8) (West, Westlaw through May 4, 2017) (listing foreign entities that are classified federally as corporations).

⁸ See Tenn. Dep’t of Rev., Notice 14-12 (June 2014), available at <http://tn.gov/assets/entities/revenue/attachments/14-12fe.pdf>.

⁹ 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, before the publication of the federal “check-the-box” regulations in late 1996. As a result, the provision does not specifically reference “disregarded” entity option not available under the federal regulations.

¹⁰ Treas. Reg. § 301.7701-3(c)(1)(v) (West, Westlaw through May 4, 2017) (providing that entity exempt from federal income taxation under I.R.C. § 501(a) is deemed to elect to be classified as an association for federal tax purposes); I.R.C. § 7701(a)(3) (West, Westlaw through May 4, 2017) and Treas. Reg. § 301.7701-2(b)(2) (defining the term “corporation” to include associations); cf. Treas. Reg. § 301.7701-2(b)(6) (defining the term “corporation” to include business entities wholly-owned by a State or any political subdivision thereof).

¹¹ TENN. CODE ANN. § 67-4-2007(a).

¹² *Id.*

personal property owned or used, that is attributable to activities subject to income taxes under I.R.C. § 512 or any other provision of Subchapter A of the Internal Revenue Code.¹³ Additionally, a not-for-profit entity is subject to the franchise tax on all of its Tennessee net worth, or real or tangible personal property owned or used, that is attributable to any activities that are unrelated to and outside the scope of the activities that gave it exempt status.¹⁴

Consequently, if any of the aforementioned criteria are applicable to the Pension Trust through the SMLLC's operations, it will be subject to Tennessee excise and franchise taxes to the extent indicated above.

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5/30/17

¹³ TENN. CODE ANN. § 67-4-2105(b).

¹⁴ *Id.*