

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 19-02**

Revenue rulings are not binding on the Department. 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 excise tax to Internal Revenue Code Subpart F income.

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

The Taxpayer is a global company with various corporate subsidiaries doing business in countries throughout the world. The Taxpayer is organized as a United States corporation under the laws of a state other than Tennessee. The Taxpayer is doing business in Tennessee and is subject to Tennessee's excise tax as a corporation.

The Taxpayer states that pursuant to Subpart F of the Internal Revenue Code (the "IRC"), it is required in each of the Scenarios below to include in its federal taxable income earnings attributable to foreign subsidiaries.

Scenario 1

The Taxpayer directly owns 100% of the stock in a controlled foreign corporation ("CFC 1"), which, in turn, directly owns 100% of the stock in another controlled foreign corporation ("CFC 2"). CFC 1 and CFC 2 are classified as corporations for federal income tax purposes, and each meets the definition of a "controlled foreign corporation" within the meaning of IRC § 957. Pursuant to IRC § 958(a)(2), for purposes of Subpart F of the Internal Revenue Code, the Taxpayer is deemed to directly own the

stock in CFC 2 that is owned by CFC 1. The Taxpayer includes in its federal gross income its 100% share of Subpart F income attributable to CFC 1 and CFC 2 pursuant to IRC § 951. See [Appendix A](#) for an illustration of this scenario.

Scenario 2

The facts are the same as Scenario 1, except that the Taxpayer's ownership of CFC 2 is through a wholly-owned limited liability company (the "SMLLC") organized under the laws of a state other than Tennessee. The SMLLC is disregarded for federal income tax purposes. The SMLLC is not a controlled foreign corporation for purposes of Subpart F. Because the SMLLC is disregarded for federal income tax purposes, the Taxpayer is considered to directly own 100% of CFC 2's stock for federal income tax purposes. The Taxpayer therefore includes in its federal gross income its 100% share of Subpart F income attributable to CFC 2 pursuant to IRC § 951.

See [Appendix B](#) for an illustration of this scenario.

Scenario 3

The facts are the same as Scenario 2, except that the Taxpayer owns 100% of the stock of CFC 2 through an entity (the "Foreign Entity") organized under the laws of a foreign country. The Foreign Entity has elected to be classified as a disregarded entity for federal income tax purposes. The Foreign Entity, however, is not a limited liability company in Tennessee.¹ Because the Foreign Entity is a disregarded entity for federal income tax purposes, the Taxpayer is treated as directly owning all of the stock of CFC 2 for federal income tax purposes. The Taxpayer includes in its federal gross income its 100% share of Subpart F income attributable to CFC 2 pursuant to IRC § 951.

See [Appendix C](#) for an illustration of this scenario.

Scenario 4

The facts are the same as Scenario 1, except that the Taxpayer directly owns 100% of the stock of a corporation (the "Domestic Subsidiary") organized under the laws of the United States, and directly owns 50% of the stock of CFC 2. The remaining 50% of the stock of CFC 2 is owned by Domestic Subsidiary. Pursuant to IRC § 958(b) and, by reference, IRC § 318(a), for purposes of Subpart F, the Taxpayer is deemed to constructively own the stock in CFC 2 that is owned by the Domestic Subsidiary.

The Taxpayer includes in its federal gross income its 100% share of Subpart F income attributable to CFC 2 pursuant to IRC § 951.

See [Appendix D](#) for an illustration of this scenario.

¹ This ruling request does not address whether the Foreign Disregarded Entity qualifies as a limited liability company under Tennessee law.

RULINGS

1. Is the Taxpayer's Subpart F income considered a dividend for purposes of the Tennessee excise tax?

Ruling: Yes, the Taxpayer's Subpart F income is considered a dividend for purposes of the Tennessee excise tax.

2. In each Scenario, for purposes of the Tennessee excise tax, can the Taxpayer deduct from net earnings its Subpart F income pursuant to TENN. CODE ANN. § 67-4-2006(b)(2)(A) (2013)?

Ruling:

In Scenario 1, the Taxpayer is entitled to deduct under TENN. CODE ANN. § 67-4-2006(b)(2)(A) the Subpart F income that it receives from CFC 1 because the Taxpayer owns 100% of the outstanding capital stock of CFC 1. However, the Taxpayer is not entitled to deduct Subpart F income from CFC 2 because it does not own 80% or more of the outstanding capital stock of CFC 2.

In Scenario 2, the Taxpayer is entitled to deduct under TENN. CODE ANN. § 67-4-2006(b)(2)(A) the Subpart F income that it receives from CFC 2. The SMLLC is disregarded for Tennessee excise tax purposes and is considered a division of the Taxpayer, such that the Taxpayer is treated as directly owning 100% of the stock of CFC 2.

In Scenario 3, the Taxpayer is not entitled to take a deduction under TENN. CODE ANN. § 67-4-2006(b)(2)(A) for the Subpart F income that it receives from CFC 2.

In Scenario 4, the Taxpayer is not entitled to take a deduction under TENN. CODE ANN. § 67-4-2006(b)(2)(A) for the Subpart F income it receives from CFC 2 because it only owns 50% of the outstanding capital stock of CFC 2.

ANALYSIS

Tennessee 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 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

² TENN. CODE ANN. § 67-4-2007(a) (Supp. 2018).

³ TENN. CODE ANN. §§ 67-4-2004(38), -2007(d) (Supp. 2018).

⁴ TENN. CODE ANN. §§ 67-4-2106(c) (2013) and -2007(d).

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) (Supp. 2018), 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 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

Subpart F of the Internal Revenue Code (the “IRC”) provides rules for the taxation of certain U.S. shareholders of controlled foreign corporations. Subpart F is an anti-deferral regime and accelerates taxation of certain undistributed earnings of the foreign corporation.⁹

IRC § 951(a) (West 2018) states that a U.S. shareholder of a controlled foreign corporation (“CFC”) is required to include in federal income its pro rata share of the Subpart F income of a CFC in the year in which the CFC would recognize it as taxable income if subject to tax in the United States. Subpart F income includible in federal gross income by a U.S. shareholder for any taxable year may not exceed the CFC’s earning and profits for the taxable year.¹⁰ IRC § 952(b) (West 2018) provides an exclusion from Subpart F income for U.S.-source income that is effectively connected with a U.S. trade or business.

IRC § 957(a) (West 2018) provides that a “controlled foreign corporation” is any foreign corporation if more than 50% of (1) the total combined voting power of all classes of stock of such corporation entitled to vote, or (2) the total value of the stock of such corporation, is owned by U.S. shareholders at any time during the CFC’s taxable year.

⁵ *Id.*

⁶ *Id.*

⁷ See Treas. Reg. § 301.7701-2(b)(8) (West, Westlaw through September 17, 2018) (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 IRC § 952(a) (West 2018) defines Subpart F income as including certain insurance income, foreign base company income, a portion of international boycott income, the sum of the amounts of any illegal bribes, kickbacks, or other payments paid on behalf of the CFC, and income derived from any foreign country for which IRC § 901(j) denies a foreign tax credit for taxes paid to such country.

¹⁰ I.R.C. § 962(c)(1)(A) (West 2018).

IRC § 951(b) defines a United States shareholder, with respect to any foreign corporation, as a United States person that owns 10% or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation, or more than 10% or more of the total value of shares of all classes of stock of the foreign corporation. Pursuant to IRC § 957(c), a United States person, is generally any domestic corporation, domestic partnership, domestic trust or estate, or United States individual citizen or resident.

IRC § 958 (West 2018) sets forth constructive ownership rules for making CFC and U.S. shareholder ownership determinations. IRC § 958(a) treats stock owned directly or indirectly by a foreign corporation, foreign partnership, foreign trust, or foreign estate as proportionately owned by its shareholders, partners or beneficiaries. IRC § 958(b) incorporates portions of IRC § 318(a), and in part provides that stock owned by a corporation is treated as owned proportionately by a 10% or greater shareholder, and stock owned by a 50% or greater shareholder is imputed to the corporation.

1. Subpart F Income Treated as a Dividend

The Taxpayer's Subpart F income is treated as a dividend for purposes of the Tennessee excise tax.

TENN. CODE ANN. § 67-4-2006(a)(1) (Supp. 2018) provides in pertinent part that for a corporation or "any other taxpayer required to file a federal income tax return on a federal form 1120 or any variation of that form," the term "'net earnings' or 'net loss' is defined as federal taxable income or loss before the operating loss deduction and special deductions provided for in 26 U.S.C. §§ 241, 242 [repealed], 243-247" and as adjusted by TENN. CODE ANN. § 67-4-2006(b) and (c). Thus, any Subpart F income included in federal taxable income or loss before the net operating loss deduction and special deductions will be included in the computation of net earnings or loss.¹¹

Subpart F income is generally treated as a dividend for purposes of the Tennessee excise tax. Tennessee excise tax law does not provide a definition of "dividend" or address the characterization of Subpart F income. However, the treatment of such income as a dividend for excise tax purposes is consistent with the federal treatment of Subpart F income.¹² In particular, the amount of Subpart F income included in federal taxable income is determined based on rules that treat the income as a dividend;¹³ in other words, the income's very inclusion in the net earnings computation derives from its federal treatment as a dividend.

¹¹ For corporations, Subpart F income is included on federal Form 1120, line 28 (taxable income before net operating loss and special deductions). Corporations report Subpart F income on federal Form 1120, Schedule C, Line 14(a), and that amount is included in total dividends reported on Schedule C, line 19 (total dividends), which is in turn reported on Form 1120, Line 4. Federal taxable income as described in TENN. CODE ANN. § 67-4-2006(a)(1) includes Subpart F income as included on federal Form 1120 (U.S. Corporation Income Tax Return), Line 28.

¹² Note that the courts have stated that the federal income tax treatment of a transaction as a taxable dividend distribution is not controlling for state income tax purposes. The Tennessee Supreme Court has held, for example, that the revision of a federal tax law does not precipitate a revised interpretation of a corresponding but unaltered state tax law. *Tidwell v. Berke*, 532 S.W.2d 254, 261 (Tenn. 1975). Similarly, the Tennessee Court of Appeals has stated 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).

¹³ See note 10, supra. Describing the pro-rata share of Subpart F income included in a U.S. shareholder's federal income, IRC § 951 states that it is the amount "which would have been distributed with respect to the stock which such shareholder owns

2. Deduction of Subpart F Income under TENN. CODE ANN. § 67-4-2006(b)(2)(A)

A taxpayer may deduct Subpart F income under TENN. CODE ANN. § 67-4-2006(b)(2)(A) if the taxpayer receives such income from a controlled foreign corporation in which it owns 80% or more of the outstanding capital stock.

TENN. CODE ANN. § 67-4-2006(b)(2)(A) provides a deduction from net earnings or loss for “dividends earned by a taxpayer who owns eighty percent (80%) or more of the outstanding capital stock of a corporation.”

The plain language of the statute indicates that the taxpayer claiming the deduction must directly own stock in the company paying the dividend.¹⁴ Consequently, if a taxpayer does not directly own 80% or more of the outstanding capital stock of the corporation that is deemed to have paid the dividends, it is not entitled to claim the deduction provided by TENN. CODE ANN. § 67-4-2006(b)(2)(A).

Scenario 1

In Scenario 1, the Taxpayer owns 100% of the stock of CFC 1, and, thus, it is entitled to deduct the Subpart F income that it receives from CFC 1.

The Taxpayer is not, however, entitled to take a deduction pursuant to TENN. CODE ANN. § 67-4-2006(b)(2)(A) for Subpart F income generated by CFC 2 because the Taxpayer does not directly own 80% or more of the outstanding capital stock of CFC 2.

Scenario 2

The Taxpayer is entitled to deduct under TENN. CODE ANN. § 67-4-2006(b)(2)(A) the Subpart F income that it receives from CFC 2.

The SMLLC is treated as disregarded for federal income tax purposes. It is wholly-owned by the Taxpayer, which is a corporation for federal income tax purposes and, consequently, Tennessee excise tax purposes. Because the LLC is a limited liability company that is wholly owned by a corporation and disregarded for federal income tax purposes, it is disregarded for Tennessee excise tax purposes.

Because the SMLLC is disregarded for Tennessee excise tax purposes, it is treated as a division of the Taxpayer for purposes of the excise tax. As such, for Tennessee excise tax purposes, the Taxpayer directly owns all of the capital stock of CFC 2 and is entitled to take the deduction under TENN. CODE ANN. § 67-4-2006(b)(2)(A) for Subpart F income that it receives from CFC 2.

... in such corporation.” Moreover, under IRC § 952(c), Subpart F income may not exceed “the earnings and profits” of the CFC in the taxable year. Additionally, the amount of Subpart F income must, under IRC § 951(a)(2)(B), be reduced by actual dividend distributions received by any person, other than the taxpayer, who had owned the taxpayer’s stock during some part of the taxable year.

¹⁴ Note that, although there are the constructive ownership rules under IRC § 958, those principals do not apply for purposes of the deduction under TENN. CODE ANN. § 67-4-2006(b)(2)(A).

Scenario 3

The Taxpayer is not entitled to take a deduction under TENN. CODE ANN. § 67-4-2006(b)(2)(A) for Subpart F income generated by CFC 2.

In Scenario 3, the Foreign Entity is disregarded for federal income tax purposes and is wholly owned by a corporation. However, the Foreign Entity is not a limited liability company. Thus, the Foreign Entity is considered a single and separate business entity for Tennessee excise tax purposes and is not disregarded for Tennessee excise tax purposes.

The Taxpayer does not directly own the stock of CFC 2 and therefore cannot take the deduction under TENN. CODE ANN. § 67-4-2006(b)(2)(A) for Subpart F income generated by CFC 2.

Scenario 4

In Scenario 4, the Taxpayer is not entitled to take a deduction pursuant to TENN. CODE ANN. § 67-4-2006(b)(2)(A) for Subpart F generated by CFC 2 because the Taxpayer owns only 50% of the outstanding capital stock of CFC 2.

The Taxpayer and the Domestic Subsidiary are separate entities for Tennessee excise tax purposes. Thus, the Taxpayer directly owns only 50% of the stock of CFC 2 for excise tax purposes. Therefore, the Taxpayer cannot take the deduction under TENN. CODE ANN. § 67-4-2006(b)(2)(A) for Subpart F income generated by CFC 2.

APPROVED: David Gerregano
Commissioner of Revenue

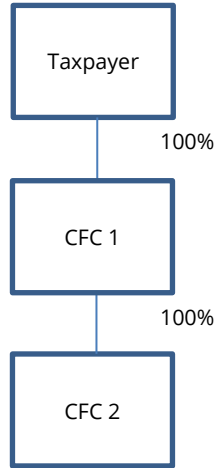
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Appendix A

Scenario 1

Federal

Separate



Separate

Separate

Tennessee

Separate

Separate

Separate

Appendix B

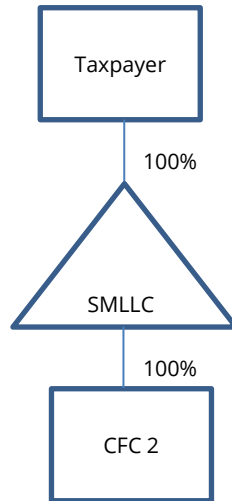
Scenario 2

Federal

Separate

Disregarded

Separate



Tennessee

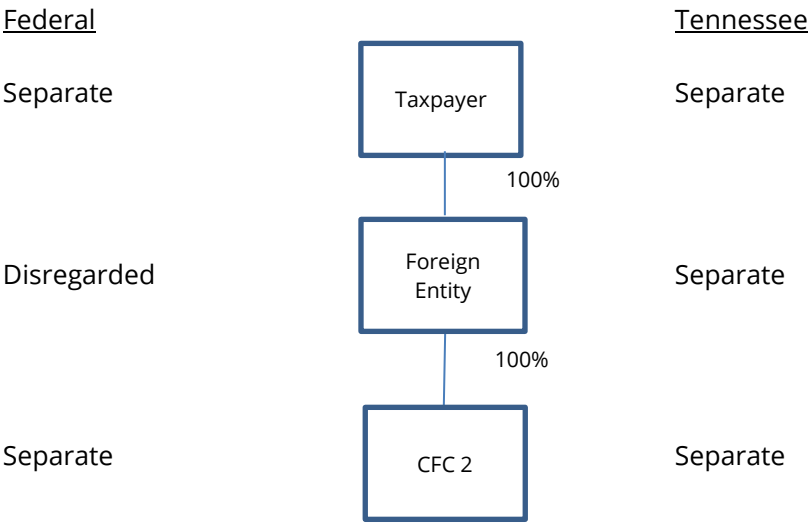
Separate

Disregarded

Separate

Appendix C

Scenario 3



Appendix D

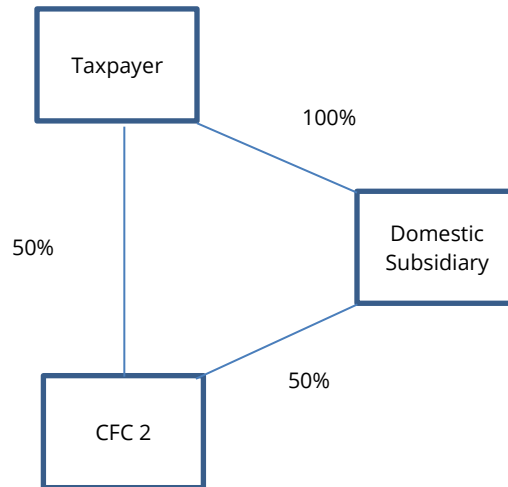
Scenario 4

Federal

Separate

Separate

Separate



Tennessee

Separate

Separate

Separate