

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 20-06**

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 survival of a Tennessee net operating loss carryforward in merger transactions involving corporations.

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

The [TAXPAYER] companies (collectively, the "Taxpayer companies") are headquartered in [CITY, STATE], and provide [SERVICES] related to the sale of [REDACTED]. The Taxpayer companies are affiliates with common ownership.

The Taxpayer companies are structured as corporations that have elected Subchapter S status for federal income tax purposes under I.R.C. §§ 1361-1363. There are over [NUMBER] Taxpayer corporations that file Tennessee franchise and excise tax returns, and some of the corporations have substantial Tennessee net operating loss ("NOL") carryforwards.

The Taxpayer companies are contemplating a restructuring arrangement to eliminate redundancies and administrative costs of maintaining such a large number of separate corporations. In the proposed transaction, a new corporation would be created for each line of services provided (*i.e.*, [REDACTED] services in one company, [REDACTED] services in another company, and so on). The existing corporations would enter into federally tax-exempt mergers with the new corporations. The end result would be the current corporations merging out of existence and into the newly created corporations.

As an example ("Merger Transaction #1"), Corporation 1 has a Tennessee NOL carryforward. Corporation 2 does not have a Tennessee NOL carryforward. Corporation 3 has a Tennessee NOL carryforward. All three corporations are owned by a single shareholder. Corporations 1, 2, and 3 merge out of existence and into newly created Corporation 4, which is wholly owned by the same shareholder. Immediately before Merger Transaction #1, Corporation 4 is a shell company with no income, assets, expenses, liabilities, equity, or net worth. Immediately following Merger Transaction #1, Corporation 4 holds the assets, liabilities, and equity of Corporations 1, 2 and 3.

Alternatively ("Merger Transaction #2"), Corporation 1 has a Tennessee NOL carryforward. Corporation 2 does not have a Tennessee NOL carryforward. Corporation 3 has a Tennessee NOL carryforward. Corporation 2 and Corporation 3 merge out of existence and into Corporation 1. Immediately following Merger Transaction #2, Corporation 1 holds the assets, liabilities, and equity of Corporations 2 and 3.

RULINGS

1. Does the exception under TENN. CODE ANN. § 67-4-2006(c)(3) (Supp. 2019) apply to Merger Transaction #1?

Ruling: The exception under TENN. CODE ANN. § 67-4-2006(c)(3) (Supp. 2019) does not apply to Merger Transaction #1 since the exception only applies to a single taxpayer that merges out of existence and into a successor taxpayer.

2. If the response to Question #1 is negative, would the Tennessee NOL carryforwards of Corporation 1 and Corporation 3 be lost following Merger Transaction #1?

Ruling: The exception under TENN. CODE ANN. § 67-4-2006(c)(3) (Supp. 2019) will apply to the first corporation to merge into Corporation 4. For the corporations that subsequently merge into Corporation 4, any Tennessee NOL carryforwards will be lost.

3. Does the exception under TENN. CODE ANN. § 67-4-2006(c)(3) (Supp. 2019) apply to Merger Transaction #2?

Ruling: No. The exception under TENN. CODE ANN. § 67-4-2006(c)(3) (Supp. 2019) will not apply to Merger Transaction #2 because Corporation 1 is not a shell company with no income, assets, expenses, liabilities, equity, or net worth.

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) (Supp. 2019), 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) (Supp. 2019) and -2106(a) (2013). Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, entities such as corporations.

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 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, except for unitary groups of financial institutions, each taxpayer is considered a separate entity. In the case of mergers, consolidations, and like transactions, no loss carryforward “incurred by the predecessor taxpayer shall be allowed as a deduction from net earnings on the excise tax return filed by the successor taxpayer.”² TENN. CODE ANN. § 67-4-2006(c)(2) further provides that “a loss carryforward may be taken only by the taxpayer that generated it, 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 carryforward and deduction from the net earnings of the surviving successor.

Questions 1 & 2

TENN. CODE ANN. § 67-4-2006(c)(3) applies only when a single taxpayer merges out of existence into a successor taxpayer. Therefore, the exception under TENN. CODE ANN. § 67-4-2006(c)(3) does not apply to Merger Transaction #1, which involves the merger of four companies. Instead, the exception under TENN. CODE ANN. § 67-4-2006(c)(3) will apply only to the first corporation to merge into Corporation 4. For the corporations that subsequently merge into Corporation 4, any Tennessee NOL carryforwards will be lost.

Corporation 4 will have income, assets, expenses, liabilities, equity, or net worth following the first merger. This will prevent any subsequent merger from coming under the exception. For tax periods

¹ TENN. CODE ANN. § 67-4-2007(a) (Supp. 2019).

² See *AT&T Corporation v. Johnson*, 148 S.W.3d 74 (Tenn. Ct. App. 2004) (holding that taxpayer was not entitled to use of net operating loss incurred by predecessor); *Little Six Corporation v. Johnson*, 1999 WL 336308 (Tenn. Ct. App. No. 01-A-01-9806-CH00285, May 28, 1999) (holding that taxpayer was not entitled under TENN. COMP. R. & REGS. 1320-6-1-.21(2)(d) to use of net operating loss incurred by predecessor).

following Merger Transaction #1, Corporation 4 may utilize only the Tennessee NOL carryforward generated by the first corporation to merge into it.

Note that the corporations' federal Subchapter S election does not affect the outcome; for purposes of computing Tennessee franchise and excise tax liabilities, the election is irrelevant.³

Question 3

The exception under TENN. CODE ANN. § 67-4-2006(c)(3) will not apply to Merger Transaction #2. The facts indicate that Corporation 1 has a Tennessee NOL carryforward. To generate a net operating loss, the taxpayer cannot be a shell; rather, it must have expenses. In that case, Corporation 1 is not a shell company with no income, assets, expenses, liabilities, equity, or net worth. As a result, the exception will not apply.

APPROVED:

David Gerregano
Commissioner of Revenue

DATE:

9/17/2020

³ Note that the outcomes discussed in this letter ruling could differ under other factual scenarios, including scenarios involving different entity types with different federal tax classifications.