

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 20-07

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

Whether a financial institution, whose activities in Tennessee are limited to those identified in TENN. CODE ANN. § 67-4-2004(14)(C), is doing business in this state and is subject to Tennessee franchise and excise taxes.

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 "Fund") is organized as a limited partnership formed and domiciled [OUTSIDE THE UNITED STATES]. The capital investment for the Fund was provided by its limited partner, which is a bank formed in and operating under the laws of a country other than the United States. The general partner of the Fund is domiciled [OUTSIDE THE UNITED STATES] and does not maintain an office, have

any presence directly or through an agent, or provide any services in Tennessee or anywhere else in the United States.

The Fund's only business activity is owning mortgages and receiving payments on those mortgages. The Fund does not conduct any business activity in Tennessee. Its only connections to Tennessee are that, from time to time, some of the real or personal properties securing some of the mortgages the Fund owns are located in Tennessee and some of the borrowers could possibly also be located in Tennessee.

To acquire the mortgages it owns, the Fund relies on the actions of an independent investment manager (the "Investment Manager"). The Investment Manager is a third-party service provider and registered Investment Advisor and is not affiliated with the Fund by ownership or in any other way. The Investment Manager provides similar services for many other clients in addition to the Fund. The Fund receives the mortgages it owns - including those secured by property in Tennessee - through the following process involving the Investment Manager and independent mortgage brokers ("Independent Brokers"):

Step 1: Independent Brokers that are regularly engaged in the business of brokering mortgage loans work with sponsors of mortgages to prepare an offering memorandum that is sent to several prospective lenders or their representatives, including the Investment Manager. Like the Investment Manager, the Independent Brokers are not affiliated by ownership or in any other way with the Fund. The Independent Brokers also have no affiliation with the Investment Manager.

Step 2: The Investment Manager reviews, evaluates, and submits an indication of interest for the mortgage on behalf of its clients. Those clients include the Fund and the Investment Manager's other clients, all of which are prospective lenders. The indication of interest submitted by the Investment Manager does not identify the Fund but is, instead, submitted collectively on behalf of the Investment Manager's numerous clients.

Step 3: After an Independent Broker receives indications of interest from the Investment Manager and from other prospective lenders, the list of potential lenders is narrowed through negotiations and other communications between the Independent Broker and the prospective lenders or their representatives, including the Investment Manager acting on behalf of the multiple clients it represents.

Step 4: If the Investment Manager's indication of interest for a mortgage is ultimately selected by an Independent Broker, the Investment Manager then finalizes a formal application and the essential financial and other terms of the loan documents, which were preliminarily set forth in the indication of interest and commitment documents exchanged in the solicitation process.

Step 5: Simultaneous with the finalization of documentation but after principal material economic terms have been agreed upon, the Investment Manager

decides which of its clients should receive the mortgage. This decision is typically based on a standardized allocation system applicable to all of the lenders the Investment Manager represents.

Step 6: If the Investment Manager chooses the Fund as the client that will receive a particular mortgage, the Investment Manager executes the notes, mortgages, and other loan documents on behalf of the Fund. In some instances, but not always, the Investment Manager will use a single purpose entity as the lender identified in those documents. When a single purpose entity is not used, the Investment Manager identifies the Fund as the lender in the loan documents.

The Investment Manager is never, itself, identified as a lender to a mortgage it acquires on behalf of its clients and never, at any time, owns the mortgages it enters on behalf of those clients. Instead, and assuming the Fund is the client that receives a particular mortgage, the Fund or a single purpose entity is identified as the lender in the notes, mortgages, and other loan documents the Investment Manager acquires on behalf of the Fund.

Step 7: The closing on the loan documents takes place outside Tennessee, and the borrower pays the Independent Broker's fees. The Fund never owns and is never deemed to own any equity interest in a borrower.

After receiving ownership of a mortgage through the activities of the Investment Manager described above, the Fund, through a mortgage servicer or collection agent, collects payments on the mortgage when the payments become due. The Fund's only connections to Tennessee are that some of the mortgages from which it receives those payments are secured, in part, by property located in Tennessee, and some of the borrowers could possibly reside in Tennessee.

RULING

Is the Fund "doing business in Tennessee" as that term is used in TENN. CODE ANN. § 67-4-2004(14) (Supp. 2019) to determine whether an entity has Tennessee franchise and excise tax filing and payment responsibilities?

Ruling: No. The Fund is not "doing business in Tennessee" and is, therefore, not subject to Tennessee's franchise and excise taxes because its activities are limited to those identified in TENN. CODE ANN. § 67-4-2004(14)(C).

ANALYSIS

LEGAL BACKGROUND

Tennessee imposes an excise tax at the rate of 6.5% on the net earnings of all persons doing business within Tennessee.¹ Tennessee also imposes a franchise tax at the rate of \$0.25 per \$100, or major

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

fraction thereof, on the net worth of a person doing business in Tennessee.² Persons subject to Tennessee franchise and excise taxes include, but are not limited to, limited partnerships.³

“Doing business in Tennessee” is defined as “any activity purposefully engaged in within Tennessee, by a person with the object of gain, benefit, or advantage, consistent with the intent of the general assembly to subject such persons to the Tennessee franchise/excise tax to the extent permitted by the United States Constitution and the Constitution of Tennessee.”⁴

The definition of a “financial institution” includes any entity that generates fifty percent (50%) or more of its gross income from carrying on the “business of a financial institution.”⁵ Furthermore, the “business of a financial institution” includes “making, acquiring, selling or servicing loans or extensions of credit, including . . . [m]ortgages or deeds of trust or other secured loans on real or tangible personal property.”⁶

A financial institution is doing business in Tennessee “if the sum of its assets and the absolute value of its deposits attributable to sources within this state is five million dollars (\$5,000,000) or more.”⁷ In addition, a financial institution is deemed to be doing business in Tennessee if the institution:

- (i) Maintains an office in this state;
- (ii) Has an employee, representative or independent contractor conducting business in this state;
- (iii) Regularly sells products or services of any kind or nature to customers in this state that receive the product or services in this state;
- (iv) Regularly solicits business from potential customers in this state;
- (v) Regularly performs services outside this state that are consumed in this state;
- (vi) Regularly engages in transactions with customers in this state that involve intangible property, including loans, and result in receipts flowing to the taxpayer from within this state;
- (vii) Owns or leases property located in this state; or
- (viii) Regularly solicits and receives deposits from customers in this state.⁸

However, a financial institution is not considered to be conducting the business of a financial institution in Tennessee if its only activity in this state is the ownership of “an interest in a loan, lease, note or other assets attributed to this state and in which the payment obligations were solicited and

² TENN. CODE ANN. §§ 67-4-2105(a) and -2106(a) (2013 & Supp. 2019).

³ TENN. CODE ANN. § 67-4-2004(38) (Supp. 2019).

⁴ TENN. CODE ANN. § 67-4-2004(14)(A).

⁵ TENN. CODE ANN. § 67-4-2004(17), *see also* TENN. CODE ANN. § 67-4-2004(5)(B).

⁶ TENN. CODE ANN. § 67-4-2004(5)(A)(iii)(c).

⁷ TENN. CODE ANN. § 67-4-2004(14)(B).

⁸ *Id.*

entered into by a person that is independent and not acting on behalf of the owner.”⁹ In addition, a financial institution is not considered to be conducting the business of a financial institution in Tennessee when it conducts “activities within this state that are reasonably required to evaluate and complete the acquisition or disposition of the [aforementioned] property, the servicing of the property or the income from it, the collection of income from the property, or the acquisition or liquidation of collateral relating to the property.”¹⁰

Within the context of TENN. CODE ANN. § 67-4-2004(14)(C), an “independent person who is not acting on behalf of the owner” means:

- (i) At the time of the acquisition of the assets, the owner of the asset does not directly or indirectly own fifteen percent (15%) or more of the outstanding stock or, in the case of a partnership or limited liability company, fifteen percent (15%) or more of the capital or profits interest, of the entity from which the owner originally acquired the asset. . . . ;
- (ii) The entity from which the owner acquired the asset regularly sells, assigns or transfers interest in such assets to three (3) or more persons during the full twelve-month period immediately preceding the month of acquisition; and
- (iii) The entity from which the owner acquired the asset does not sell, assign or transfer ninety percent (90%) or more of its exempt assets to the owner during the full twelve-month period immediately preceding the month of acquisition.¹¹

APPLICATION

Tennessee imposes franchise and excise taxes on persons for the privilege of doing business in this state.¹² Persons subject to franchise and excise taxes include limited partnerships.¹³ A limited partnership will be subject to franchise and excise taxes if it is doing business in this state and if it has a substantial nexus in this state.¹⁴ This ruling addresses whether the Fund is doing business in this state so as to be subject to Tennessee franchise and excise taxes.

The statutory definition of “doing business in Tennessee” is broad and encompasses “any activity purposefully engaged in within Tennessee, by a person with the object of gain, benefit, or advantage.”¹⁵ However, within the context of “doing business in Tennessee,” there are certain

⁹ TENN. CODE ANN. § 67-4-2004(14)(C)(iii).

¹⁰ TENN. CODE ANN. § 67-4-2004(14)(C).

¹¹ TENN. CODE ANN. § 67-4-2004(14)(D).

¹² TENN. CODE ANN. §§ 67-4-2005 and -2104.

¹³ TENN. CODE ANN. § 67-4-2004(38).

¹⁴ TENN. CODE ANN. §§ 67-4-2007 and -2105.

¹⁵ TENN. CODE ANN. § 67-4-2004(14)(A).

statutory provisions that apply specifically to financial institutions. Therefore, it must be ascertained whether the Fund is a financial institution for Tennessee franchise and excise tax purposes.

The Fund's only business activity is owning mortgages and receiving payments on those mortgages. The Fund acquires the mortgages it owns through the actions of the independent Investment Manager. Accordingly, the Fund's business activity consists of "acquiring . . . [m]ortgages or deeds of trust or other secured loans on real or tangible personal property," which constitutes the "business of a financial institution."¹⁶ Because the Fund generates 100% of its gross income from carrying on the "business of a financial institution," the Fund is a "financial institution" for Tennessee franchise and excise tax purposes.¹⁷

Notwithstanding the statutory directive, at TENN. CODE ANN. § 67-4-2004(14)(B), which provides specific criteria as to when a "financial institution" is presumed to be "doing business in Tennessee," TENN. CODE ANN. § 67-4-2004(14)(C) provides a statutory safe harbor whereby a "financial institution" is not considered to be "doing business in Tennessee." This statute provides,

[A] financial institution is not considered to be conducting the business of a financial institution in this state, if the only activity of the financial institution in this state is the ownership of . . . [a]n interest in a loan, lease, note or other assets attributed to this state and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.¹⁸

As previously established, the Fund's only business activity is owning mortgages and receiving payments on those mortgages, some of which are secured by property located in Tennessee (the "Tennessee mortgages"); in addition, some of the borrowers could possibly reside in Tennessee. Consequently, the Fund's business activity in Tennessee is limited to owning "an interest in a loan, lease, note or other assets attributed to this state" and collecting income from such property, which is an activity that is also protected under the statutory safe harbor.¹⁹ However, in order for the Fund's ownership interest in the Tennessee mortgages to satisfy the requirements of the statutory safe harbor, such payment obligations must have been "solicited and entered into by a person that is independent and not acting on behalf of the owner."²⁰

The Tennessee mortgages were "solicited and entered into" by the Investment Manager. The Investment Manager does everything necessary to solicit, negotiate, and enter into the mortgages the Fund owns. The Investment Manager negotiates with potential brokers on behalf of all of its clients, including the Fund. It is only after the negotiation and initial documentation process has been completed that the Investment Manager might assign a particular mortgage to the Fund. Even then, the Investment Manager executes the notes, mortgages, and other loan documents for the Fund. The Fund's only involvement in this process is the closing, which takes place outside Tennessee.

¹⁶ TENN. CODE ANN. § 67-4-2004(5)(A)(iii)(c).

¹⁷ TENN. CODE ANN. § 67-4-2004(17), *see also* TENN. CODE ANN. § 67-4-2004(5)(B).

¹⁸ TENN. CODE ANN. § 67-4-2004(14)(C)(iii).

¹⁹ *See* TENN. CODE ANN. § 67-4-2004(14)(C).

²⁰ *Id.*

The Fund is not affiliated by ownership or in any other way with the Investment Manager, the entity from which the Fund originally acquired the Tennessee mortgages. In addition to the Fund, the Investment Manager has numerous other clients, all of which are prospective lenders, to whom the Investment Manager regularly assigns an interest in mortgages; typically, the Investment Manager decides which of its clients should receive the mortgage based on a standardized allocation system applicable to all of the lenders the Investment Manager represents. During any given twelve-month period, the Investment Manager regularly assigns an interest in mortgages to three or more persons and no single person, including the Fund, is assigned 90% or more of such mortgages. Thus, pursuant to TENN. CODE ANN. § 67-4-2004(14)(D), the Investment Manager is an “independent person who is not acting on behalf of” the Fund, and the statutory safe harbor requirements, under TENN. CODE ANN. § 67-4-2004(14)(C), are met by the Fund.

Because the Fund’s business activities in Tennessee are limited to those identified in TENN. CODE ANN. § 67-4-2004(14)(C), the Fund is not “doing business in Tennessee” and is, therefore, not subject to Tennessee franchise and excise taxes.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 10/8/2020