TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 21-06

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 effect for Tennessee franchise tax purposes of an IRC § 754 election and the subsequent decision by the electing partnership to "push down" the new partners' adjusted basis in partnership property to an indirectly owned single member limited liability company.

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 single member limited liability company ("SMLLC") that is treated as a disregarded entity for federal tax purposes. Through a tiered ownership structure consisting of other SMLLCs in the ownership chain, the Taxpayer is indirectly wholly owned by a multimember limited liability company that is classified as a partnership for federal tax purposes, [PARTNERSHIP] (the "Partnership"). The Partnership and the other SMLLCs have no contacts with Tennessee; the Taxpayer is the only entity with activities in Tennessee.

The Taxpayer manufactures tangible personal property at its manufacturing facility in Tennessee. The Taxpayer's earnings are distributed through the ownership tiers and ultimately to the Partnership. The Partnership then distributes those earnings to its partners. As noted above, the Partnership is classified as a partnership for federal tax purposes, while the Taxpayer and the other SMLLCs are disregarded as separate entities for federal tax purposes and are each treated as a division of the Partnership. However, for Tennessee franchise and excise tax purposes, the Taxpayer and the other SMLLCs are classified as separate entities.

Prior to a restructuring that occurred in [YEAR], the Partnership was owned by [NUMBER] members. Pursuant to the [YEAR] restructuring, the members sold [PERCENT] of their interests in the Partnership to [NUMBER] unrelated limited liability companies (the "Purchasers"). The Partnership then made an election under IRC § 754, such that the Purchasers' adjusted basis in the Partnership's property was stepped up to fair market value under IRC § 743(b).

The Partnership and the Taxpayer keep their books under generally accepted accounting principles ("GAAP"). The Partnership and the Taxpayer file consolidated GAAP financial statements that reflect the step-up in the Purchasers' basis in the Partnership's property. Most of the step-up is related to intangible property, not real or tangible property. The Partnership desires to "push down" the Purchasers' step-up in basis in the Partnership's property to the Taxpayer, as recorded on their books and records and as reported on their consolidated GAAP financial statements.

RULINGS

1. If the Partnership elects, for GAAP financial statement purposes, to "push down" the step-up in the Purchasers' basis in Partnership property to the Taxpayer, is the Taxpayer required to calculate its net worth for Tennessee franchise tax purposes to reflect the step-up in the Purchasers' basis in its property?

   Ruling: Yes. If pushdown accounting is elected and applied to the Taxpayer's financial statements, in accordance with GAAP, the Taxpayer must calculate its net worth for franchise tax purposes by including the step-up in basis of its assets.

2. If the step-up is "pushed-down" to the Taxpayer, does the Taxpayer include the IRC § 743(b) tax basis adjustments and associated amortization and depreciation deductions in the Taxpayer's net earnings for excise tax purposes due to the IRC § 754 election made by the Partnership?

Ruling: No. If the Partnership makes an IRC § 754 election that results in a step-up in basis of the Taxpayer's assets for federal income tax purposes, the Taxpayer will exclude the IRC § 743(b) tax basis adjustments and associated amortization and depreciation deductions in its net earnings for Tennessee excise tax purposes.

ANALYSIS

Inclusion of Step-up in Basis When Calculating Net Worth

The Taxpayer must calculate its net worth for franchise tax purposes by including the step-up in basis of its assets. 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] A "person" subject to the Tennessee franchise tax includes, but is not limited to, entities such as limited liability companies.[2] With certain limited exceptions, each taxpayer is considered a "separate and single business entity" for franchise tax purposes, and must file its Tennessee franchise tax return on a separate entity basis.[3] Under TENN. CODE ANN. § 67-4-2106(b) (2013), for taxpayers filing on a separate entity basis, "net worth" is defined as the difference between a taxpayer's total assets less its total liabilities computed in accordance with GAAP.

According to GAAP, "pushdown accounting" is defined as "use of the acquirer's basis in the preparation of the acquiree's separate financial statements."[4] An acquiree shall have the option to apply pushdown accounting in its separate financial statements when an acquirer—an entity or individual—obtains control of the acquiree.[5] The option to apply pushdown accounting may be elected each time there is a change-in-control event in which an acquirer obtains control of the acquiree.[6] "Any subsidiary of an acquiree also is eligible to make an election to apply pushdown accounting to its separate financial statements . . . irrespective of whether the acquiree elects to apply pushdown accounting."[7]

Here, the Partnership is the acquiree, the Purchasers are the acquirers, and the Taxpayer is a subsidiary of the acquiree. The Purchasers' acquisition of [PERCENT] of the Partnership is the change-in-control event that allows for the Taxpayer to use pushdown accounting in its separate financial statements. Accordingly, pushdown accounting allows for the Purchasers' basis to be used in preparation of the Taxpayer's separate financial statements.

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[1] TENN. CODE ANN. §§ 67-4-2105(a) (Supp. 2020) and -2106(a) (2013).

[2] TENN. CODE ANN. § 67-4-2004(38) (Supp. 2020).

[3] TENN. CODE ANN. § 67-4-2106(c) (2013).

[4] FASB *Accounting Standards Codification* (hereinafter "ASC") at ASC 805-50-20, available at https://asc.fasb.org/glossarysection&trid=2899271 (last visited April 16, 2021).

[5] ASC 805-50-25-4.

[6] ASC 805-50-25-6.

[7] ASC 805-50-25-8.

For Tennessee franchise tax purposes, the Taxpayer must file its return on a separate entity basis. The Taxpayer maintains its separate entity books and records in accordance with GAAP. "Net worth" is expressly defined as being computed in accordance with GAAP.[8] GAAP permits the use of push-down accounting.[9] Therefore, if the Taxpayer elects to apply pushdown accounting, the step-up in basis of its assets will be reflected in its balance sheet, and the Taxpayer must compute its net worth by including the step-up in basis.

Inclusion of IRC § 743(b) Tax Basis Adjustments and Associated Amortization and Depreciation Deductions in Net Earnings

For Tennessee excise tax purposes, the Taxpayer's net earnings or net loss will be determined without making any addition or subtraction relating to the IRC § 743(b) basis adjustment pursuant to an IRC § 754 election. Tennessee imposes an excise tax at the rate of 6.5% on the net earnings of all persons doing business in Tennessee.[10] A "person" subject to the Tennessee excise tax includes, but is not limited to, entities such as limited liability companies.[11] For purposes of the Tennessee excise tax, business entities are classified consistent with the way the entity is classified for federal income tax purposes.[12] However, entities that are disregarded for federal income tax purposes, with certain limited exceptions, shall not be disregarded for Tennessee excise tax purposes.[13] With certain limited exceptions, each taxpayer is considered a "separate and single business entity for excise tax purposes, and must file its Tennessee excise tax return on a separate entity basis.[14]

Pursuant to TENN. CODE ANN. § 67-4-2006(a)(4) (Supp. 2020), in the case of a taxpayer treated as a partnership for federal tax purposes, or any other person required to file a federal partnership return on a federal form 1065 or any variation of that form, including but not limited to, limited liability companies, "net earnings" or "net loss" is defined as an amount equal to:

> The amount of ordinary income or loss determined under the applicable provisions of the Internal Revenue Code, including, but not limited to, guaranteed payments to partners and capital gains, which additional items are not already included in ordinary income or loss; . . .

Further, TENN. CODE ANN. § 67-4-2006(b)(1)(H) states:

> There shall be added to a taxpayer's net earnings or net losses: . . . any depreciation that the taxpayer deducted in computing its federal taxable income in excess of that which the taxpayer could have deducted in computing such income…"

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[8] *See* TENN. CODE ANN. § 67-4-2106(b) (2013).

[9] *See generally* ASC 805.

[10] TENN. CODE ANN. § 67-4-2007((a) (Supp. 2020).

[11] TENN. CODE ANN. § 67-4-2004(38).

[12] TENN. CODE ANN. § 67-4-2007(d).

[13] *Id*.

[14] TENN. CODE ANN. § 67-4-2007(e)(1).

Turning to the provisions of the Internal Revenue Code, under IRC § 754:

> If a partnership files an election, in accordance with regulations prescribed by the Secretary, the basis of partnership property shall be adjusted, in the case of a distribution of property, in the manner provided in section 734 and, in the case of a transfer of a partnership interest, in the manner provided in section 743.

IRC § 743(b) provides:

> In the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which the election provided in section 754 is in effect or which has a substantial built-in loss immediately after such transfer shall—
>
> 1) increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of his interest in the partnership over his proportionate share of the adjusted basis of the partnership property, or
>
> 2) decrease the adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of his interest in the partnership.
>
> Under regulations prescribed by the Secretary, such increase or decrease shall constitute an adjustment to the basis of partnership property with respect to the transferee partner only.

Relatedly, Treas. Reg. § 1.743-1(j)(1) states:

> The basis adjustment constitutes an adjustment to the basis of partnership property with respect to the transferee only. No adjustment is made to the common basis of partnership property. Thus, for purposes of calculating income, deduction, gain, and loss, the transferee will have a special basis for those partnership properties the bases of which are adjusted under section 743(b) and this section. The adjustment to the basis of partnership property under section 743(b) has no effect on the partnership's computation of any item under section 703.

Treas. Reg. § 1.743-1(j)(2) goes on to state:

> The partnership then adjusts the transferee's distributive share of the items of partnership income, deduction, gain, or loss, in accordance with paragraphs (j)(3) and (4) of this section, to reflect the effects of the transferee's basis adjustment under section 743(b). These adjustments to the transferee's distributive shares must be reflected on Schedules K and K-1 of the partnership's return (Form 1065).

Regarding an additional deduction, Treas. Reg. § 1.743-1(j)(4)(i)(A) states:

> The amount of any positive basis adjustment that is recovered by the transferee in any year is added to the transferee's distributive share of the partnership's depreciation or amortization deductions for the year. The basis adjustment is adjusted under section 1016(a)(2) to reflect the recovery of the basis adjustment.

The IRS has advised that Section 743(b) adjustments are personal to the transferee and do not affect common basis.[15] The IRS has further stated that IRC § 743(b) was enacted to ameliorate the tax consequences to a transferee partner by giving a partnership the option to eliminate discrepancies between a transferee partner's inside basis[16] and outside basis[17] when the partnership's inside basis in its property is not equal to the fair market value of the property.[18] An IRC § 754 election equalizes the new partner's inside and outside basis pursuant to an IRC § 743(b) basis adjustment.

Here, the Partnership made an election under IRC § 754, such that the basis of the Purchasers' assets[19] was stepped up to fair market value, under IRC § 743(b). According to the Treasury Regulations, this basis adjustment constitutes an adjustment to the basis of partnership property with respect to the transferee only. No adjustment is made to the common basis of partnership property.[20] For purposes of the IRC § 754 election, the Purchasers are the transferees and the Taxpayer constitutes partnership property.

For federal income tax purposes, the step-up in basis is attributable to the Purchasers rather than the partnership property. In other words, nothing changes with respect to the *Partnership's* "inside basis" in the partnership property as a result of the IRC § 754 election, and the IRC § 743(b) basis adjustment is only determinative of the *Purchasers'* distributive share of the Partnership's items of income, deduction, gain, or loss. The Partnership adjusts the Purchasers' distributive share of the items of partnership income, deduction, gain, or loss to reflect the effects of the Purchasers' basis adjustment under § 743(b).[21] These adjustments to the Purchasers' distributive shares must be reflected on Schedules K and K-1 of the Partnership's return (Form 1065).[22]

The adjustment of the stepped-up basis applies only to the Purchasers for federal income tax purposes. The applicable provisions of the Internal Revenue Code and the accompanying regulations

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[15] *See* Office of Chief Counsel, IRS, memorandum, POSTU-101184-15 (June 30, 2017) (noting that Chief Counsel Advice may not be used or cited as precedent).

[16] "Inside basis" is the partnership's tax basis in individual assets.

[17] "Outside basis" is the tax basis of each individual partner's interest in the partnership.

[18] *Supra* note 15, citing Jt. Comm. On Taxation, Summary of the New Provision of the Internal Revenue Code of 1954, 92 (1955).

[19] Because the Taxpayer is disregarded for federal income tax purposes, the assets and liabilities of the Taxpayer are treated as assets and liabilities of the Partnership.

[20] Treas. Reg. § 1.743-1(j)(1).

[21] *See* Treas. Reg. § 1.743-1(j)(2).

[22] *Id.*

expressly state that no adjustment is made to the common basis of partnership property. For Tennessee excise tax purposes, partnerships are taxed directly at the partnership level, rather than the partner level. Accordingly, for Tennessee excise tax purposes, the Taxpayer's net earnings or net loss will be determined without making any addition or subtraction relating to the IRC § 743(b) basis adjustment pursuant to the IRC § 754 election.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 6/10/2021