

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 96-15**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether a limited partnership doing business in Tennessee will be subject to Tennessee corporate franchise, excise taxes and whether its foreign limited partner will be subject to such taxes. Also, how the partnership's foreign general corporate partner with nexus in Tennessee should compute its pro-rata share of the partnership business operations for franchise, excise tax purposes and if the foreign limited corporate partner has nexus in Tennessee, how it should compute its pro-rata share of the partnership business operations for franchise, excise tax purposes.

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

Parent Company (PC) is incorporated in Delaware and commercially domiciled in [STATE A - NOT TENNESSEE]. PC owns stock in a number of subsidiaries, including two newly formed subsidiaries, S1 and S2. PC engages in a number of businesses directly and through its subsidiaries. PC is currently engaged in real estate development and management. It anticipates expanding its real estate development and management business operations into Tennessee and is considering conducting these operations through a limited partnership.

As part of PC's expansion into Tennessee, it will form a Tennessee limited partnership (TNLtd.). The partnership will operate exclusively in Tennessee and will invest in, construct, acquire and/or rent Tennessee properties. TNLtd. will either operate such properties directly or sublease the properties to tenants operating in Tennessee. The partnership may also perform certain property management activities with respect to its

properties. S1 and S2 will be the sole partners in TNLtd. S1 will be a 1% general partner and S2 will be a 99% limited partner.

S1 is a foreign corporation subject to Tennessee franchise, excise taxes. It will conduct its management activities of TNLtd. both from its corporate headquarters in [STATE A - NOT TENNESSEE], as well as from its office in Tennessee. S2 will not be incorporated in Tennessee and will not obtain a Certificate of Authority to transact business in Tennessee. S2 will maintain its commercial domicile in [STATE A - NOT TENNESSEE] and will have no connection with Tennessee other than its limited partnership interest in TNLtd. S2 will be solely a passive investor in the partnership, will exercise no power or control over the partnership and will not participate in TNLtd.'s management in any way.

QUESTIONS PRESENTED

1. Will TNLtd. be subject to Tennessee corporate franchise, excise taxes?
2. Will S2's limited partnership interest in TNLtd. create sufficient nexus in Tennessee to subject S2 to Tennessee corporate franchise, excise taxes?
3. How will S1 report its pro-rata share of TNLtd.'s business operations on its franchise, excise tax return?
4. In the event S2 is subject to Tennessee franchise, excise taxes, how will it report its pro-rata share of TNLtd.'s business operations on its franchise, excise tax return?

RULINGS

1. No.
2. No.
3. S1's ownership share of TNLtd.'s net earnings must be included in the corporation's net earnings subject to apportionment for excise tax purposes. In addition, depending on the applicable subitems in T.C.A. § 67-4-906(a)(7), S1 must include its ownership share of TNLtd.'s real or tangible property, or its capital account shown on the partnership's book and records, in its franchise tax minimum measure. S1's ownership share of TNLtd.'s property, payroll and receipts must be included in its apportionment formula for franchise, excise tax purposes in accordance with the provisions of T.C.A. § 67-4-811 and 67-4-910.
4. Question 4 is inapplicable because S2 will not be required to file a Tennessee franchise, excise tax return.

ANALYSIS

1. TNLtd. IS NOT SUBJECT TO FRANCHISE, EXCISE TAXES

T.C.A §§ 67-4-806(a) and 67-4-903(a) impose Tennessee corporate franchise, excise taxes as follows:

(a) All corporations, cooperatives, joint-stock associations and business trusts, including regulated investment companies and real estate investment trusts, organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee and including state chartered savings and loan associations and federally chartered savings and loan associations doing business in Tennessee shall, without exception other than as provided herein, pay to the commissioner of revenue, annually, an excise tax, in addition to all other taxes, equal to six percent (6%) of the net earnings for the next preceding fiscal year for business done in this state.

(a) All corporations, cooperatives, joint-stock associations and business trusts, including regulated investment companies and real estate investment trusts, organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee shall, without exception other than as provided herein, pay to the commissioner of revenue annually a privilege tax in addition to all other taxes, the rate and measure of which are hereinafter set forth. The tax shall be paid for the privilege of engaging in business in corporate form in this state and shall be in addition to all other taxes levied by any other statute.

Partnerships are not among the business entities upon which Tennessee franchise, excise taxes are imposed. Therefore, TNLtd. is not subject to Tennessee franchise, excise taxes.

2. S2's LIMITED PARTNERSHIP INTEREST IN TNLtd. CREATES NO NEXUS FOR TENNESSEE CORPORATE FRANCHISE, EXCISE TAXES

For many years, the Tennessee Department of Revenue has taken the position that a foreign corporate limited partner is not doing business in Tennessee so as to be subject to Tennessee corporate franchise, excise taxes if its activities are limited as follows:

(1) The corporate limited partner's only business activity in Tennessee is the holding of a limited partnership interest in a partnership(s) with nexus in Tennessee; and

(2) The corporate limited partner exercises no power, management or control over the partnership(s) except such powers or capacities outlined in T.C.A. § 61-2-302 which limited partners may exercise without participating in the management or control of a partnership.

A foreign corporate limited partner's involvement in a partnership doing business in Tennessee appears to be similar to the interest of a foreign corporation whose only Tennessee activity is that of a stockholder in a corporation doing business in Tennessee. Neither the limited partner nor the stockholder have the right to participate in the management or control of the partnership, or corporation, as the case may be, and thus neither are said to be "doing business" in Tennessee so as to be subject to corporate franchise, excise taxes imposed by T.C.A. §§ 67-4-901 et seq. and 67-4-801 et seq. The Department's position with regard to this matter considers a foreign corporate limited partner in a partnership having nexus in Tennessee as having only a passive investment in Tennessee just as does a foreign corporate stockholder in a corporation having nexus in Tennessee. Such a passive investment would not create sufficient tax nexus for Tennessee to impose corporate franchise, excise taxes.

It would be possible for a foreign corporate limited partner in a partnership having nexus in Tennessee to engage in other transactions in Tennessee, either with the limited partnership itself, or with other parties, which would result in sufficient Tennessee minimum contacts to subject it to corporate franchise, excise taxes. For example, such a foreign corporate limited partner which also has a general partnership interest in a partnership with Tennessee nexus, or which also has Tennessee activities which are not protected by Title 15 U.S.C.A. §§ 381-384, would be subject to Tennessee franchise, excise taxes.

Under the facts presented, S2's only activity in Tennessee is a limited partnership interest in a Tennessee partnership. Accordingly, S2 is not subject to Tennessee corporate franchise, excise taxes and is not required to file franchise, excise tax returns with this Department.

3. S1's REPORTING OF ITS OWNERSHIP SHARE OF TN Ltd.'s BUSINESS OPERATIONS

T.C.A. § 67-4-805(a)(1) makes the following provisions concerning the computation of a corporation's net earnings for Tennessee excise tax purposes:

(a) (1) Except as provided in subdivision (a)(2) or (3), "net earnings" is defined as federal taxable income before the operating loss deduction and special deductions provided for in 26 U.S.C. §§ 241-247 and 249-250, and subject to the adjustments in subsection (b).

Under T.C.A. § 67-4-805(a)(1), the starting point for computing S1's net earnings for Tennessee excise tax purposes is federal taxable income before the net operating loss deduction and special deductions. Income from S1's general partnership interest in TNLtd. would be included in the corporation's federal taxable income. Since adjustments in subsection (b) of T.C.A. § 67-4-805 do not operate to remove S1's partnership income from federal net earnings, such income is included in net earnings subject to apportionment for Tennessee excise tax purposes.

T.C.A. § 67-4-906(a)(1), (3) and (7)(A), (B), (C) and (D) make the following provisions concerning the treatment of partnership property for purposes of a corporation's franchise tax minimum measure:

(a)(1) The measure of the tax hereby imposed shall in no case be less than the actual value of the property owned, or property used, in Tennessee, excluding exempt inventory.

(3) In cases where part or all of the property is rented, the actual value of property will be deemed to be the book value of all property owned as shown by the books and records of such corporation at the close of its last fiscal year preceding the making of the sworn report hereinafter required (excepting books with respect to investment costs kept pursuant to regulations of the interstate commerce commission), plus the value of the rental property used which shall be determined by multiplying the net annual rental by the following multiples:

	Multiples
(A) Real property	8
(B) Machinery and equipment used in manufacturing and processing	3
(C) Furniture, office machinery and equipment	2
(D) Delivery of mobile equipment	1

(7)(A) For purposes of this section, "property" includes a corporate partner's share of any specific partnership property. The value of such partnership property shall be book value (cost less depreciation) as shown on the partnership books.

(B) The provisions of subdivision (a)(7)(A) shall not, however, apply to corporate partners when the specific partnership property is made up of at least eighty percent (80%) real estate (including, but not limited to, apartments, shopping centers, office buildings, hotels, and motels) which is either leased, rented, offered or held for sale, lease or rental to the public in the ordinary course of business.

(C) Notwithstanding the provisions of subdivision (a)(7)(B), the provisions of subdivision (a)(7)(A) shall apply to any partnership property which is occupied by the corporate partner in its trade or business.

(D) The provisions of subdivision (a)(7)(A) shall only apply, however, if the combined annual payroll and book value of the property of the partnership exceeds one million five hundred thousand dollars (\$1,500,000).

If TNLtd. is not a real estate investment partnership under the provisions of T.C.A. § 67-4-906(a)(7)(B) and (C), and if its combined annual payroll and book value of property exceed \$1,500,000, S1 must include its ownership share of the book value of the partnership's Tennessee real and tangible personal property, whether owned or rented from other parties, in its franchise tax minimum measure.

In the event TNLtd. is a real estate investment partnership under the provisions of T.C.A. § 67-4-906(a)(7)(B) and (C), or if its combined annual payroll and book value of property are \$1,500,000 or less, then S1 need not include its ownership share of the book of the partnership's owned or rented Tennessee real and tangible personal property in its franchise tax minimum measure. In such a case, the Tennessee Supreme Court decision in Omnicon, Inc. v. King, 688 S.W.2d 818 (Tenn. 1985) applies and S1 must include in its franchise tax minimum measure its corporate partnership capital account as shown on the partnership's books and records kept in accordance with generally accepted accounting principles.

When a foreign corporate partner, whether general or limited, has nexus both within and without Tennessee, the corporation must compute an apportionment formula for corporate franchise, excise tax purposes under T.C.A. §§ 67-4-910 and 67-4-811. These statutes state that corporate net worth and net earnings shall be apportioned to Tennessee by an average ratio of corporate property, payroll and sales in Tennessee as to property, payroll and sales everywhere. Property to be included in the apportionment formula includes all real and tangible personal property owned or rented from other parties. For this purpose, property owned is valued at original cost. The value of rented property is determined by applying the multiple of 8 to the yearly rent paid for the property.

For purposes of computing such an apportionment formula, T.C.A. §§ 67-4-910(b)(2), (e)(3) and (g)(2) and 67-4-811(b)(2), (e)(2) and (g)(2) provide that, in franchise, excise tax apportionment statutes, the terms "property", "payroll" and "sales" include a corporate partner's share of the partnership's property owned or rented, payroll and sales. T.C.A. § 67-4-804(a)(12) defines the term "sales" as ". . . all gross receipts of the taxpayer not allocated under this chapter." Thus, when S1 computes its apportionment formula on its franchise, excise tax return to apportion net worth and net earnings to Tennessee, it must include in the formula its ownership share of the partnership's property, payroll and receipts.

4. S2 IS NOT REQUIRED TO FILE A TENNESSEE CORPORATE
FRANCHISE, EXCISE TAX RETURN

As has been explained in response to question 2 above, S2 is not subject to Tennessee corporate franchise, excise taxes. Thus the question of how its share of TNLtd.'s business operations will be reported for franchise, excise tax purposes is moot.

Arnold B. Clapp, Tax Counsel

APPROVED: Ruth E. Johnson, Commissioner

DATE: 4/16/96