TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 97-59

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, under the facts presented, a 2nd tier subsidiary of a regulated financial corporation is a financial institution for Tennessee franchise, excise tax purposes and whether such a subsidiary should be included in the combined Tennessee franchise, excise tax return filed by the regulated financial corporation's holding company.

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

Bank X is a regulated financial corporation incorporated in Tennessee and primarily engaged in providing banking services within Tennessee. Because it is a regulated financial corporation, it qualifies as a financial institution under T.C.A. § 67-4-804(a)(7). Bank X is owned by a bank holding company and owns several subsidiary corporations.

One of Bank X's wholly owned subsidiaries is Company A, an investment management company doing business in Tennessee but incorporated and commercially domiciled outside Tennessee. Company A holds and manages certain investment obligations including U.S. Treasury securities, federal agency securities, state and municipal securities, mortgage backed securities held for investment (i.e. collateralized mortgage obligations) and equity securities. Company A also makes, holds and manages loans to related companies in the combined group. Interest income from the intercompany loans generates significantly less than 50% of Company A's total gross income. Company A's activities are limited to those within the scope of business activities authorized for a subsidiary of a regulated financial corporation.

As is required by T.C.A. § 67-4-805(a)(3), Bank X files a combined franchise, excise tax return with all of its unitary entities qualifying as financial institutions. Currently,

Company A is included in the combined Tennessee franchise, excise tax return filed by Bank X.

Bank X is considering the creation of a new subsidiary (Company B). Bank X will transfer certain of its operations and all of its stock in Company A to Company B in exchange for 100% of Company B's stock. Company B will be incorporated outside Tennessee but will have Tennessee business activity and will lease office space in Tennessee. Thus, Company B will be doing business within Tennessee for franchise, excise tax purposes. After the proposed transaction, Company A will be a wholly owned subsidiary of Company B. Although Company A will have a new owner (Company B), its operations will be exactly the same as they were before the transaction. Company B will not be a "holding company" as defined in T.C.A. § 67-4-804(a)(8) or a "regulated financial corporation" as defined in T.C.A. 67-4-804(a)(11)

QUESTIONS PRESENTED

1. After the proposed transaction, will Company A still qualify as a financial institution for Tennessee corporate franchise, excise tax purposes?

2. After the proposed transaction, should Company A be included in the Tennessee combined franchise, excise tax return filed by Bank X's holding company?

RULINGS

1. No.

2. No.

ANALYSIS

1. AFTER THE PROPOSED TRANSACTION, COMPANY A WILL NOT BE A FINANCIAL INSTITUTION

For purposes of the Tennessee corporate franchise, excise tax, T.C.A. §67-4-804(a)(7) defines a financial institution as follows:

> "Financial Institution" means a holding company, any regulated financial corporation, a subsidiary of a holding company or regulated financial corporation,

or any other corporation organized under the laws of the United States or any other taxing jurisdiction that is carrying on the business of a financial institution. However, "financial institution" does not include insurance companies subject to tax under §§56-4-201 - 56-4-214.

T.C.A. § 67-4-804(a)(2)(A) and (B) define the "business of a financial institution as follows:

(2) (A) "Business of a financial institution" means:

(i) The business that a regulated financial corporation may be authorized to do under state or federal law or the business that its subsidiary is authorized to do by the proper regulatory authorities;

(ii) The business that any corporation organized under the authority of the United States or organized under the laws of any other taxing jurisdiction or country does or has authority to do which is substantially similar to the business which a corporation may be created to do under title 45, or any business which a corporation or its subsidiary is authorized to do by title 45;

(iii) Otherwise making, acquiring, selling or servicing loans or extensions of credit including, but not limited to, the following:

(a) Secured or unsecured consumer loans;

(b) Installment loans;

(c) Mortgage or deeds of trust or other secured loans on real or tangible personal property;

(d) Credit card loans;

(e) Secured or unsecured commercial loans of any type;

(f) Letters of credit and acceptance of drafts;

(g) Loans arising in factoring; and

(h) Any other transactions of a comparable economic effect;

(iv) Leasing or acting as an agent, broker or adviser in connection with leasing real and personal property that is the economic equivalent of an extension of credit; or

(v) Operating a credit card business.

(B) Notwithstanding the provisions of this subdivision (a)(2), if the business of a financial institution generates less than fifty percent (50%) of a corporation's gross income, the corporation shall not be considered to be a financial institution under subdivision (7). For purposes of this subdivision (a)(2)(B), the computation of gross income of a corporation does not include income from nonrecurring, extraordinary transactions;

For Tennessee franchise, excise tax purposes, T.C.A. § 67-4-804(a)(7) treats a corporation as a financial institution if it is not an insurance company subject to tax under T.C.A. §§ 56-4-201 - 56-4-214 and meets any one of the following criteria:

(a). It is a holding company as defined by T.C.A. § 67-4- 804(a)(8).

(b). It is a regulated financial corporation as defined by T.C.A. § 67-4-804(a)(11).

(c). It is a subsidiary of a holding company defined by T.C.A. § 67-4-804(a)(8).

(d). It is a subsidiary of a regulated financial corporation as defined by T.C.A. § 67-4-804(a)(11).

(e). It is carrying on the business of a financial institution as defined by T.C.A. § 67-4-804(a)(2).

When the above criteria are applied to the facts presented, the following conclusions are axiomatic for purposes of Tennessee franchise, excise taxes:

(1). None of the corporations involved are insurance companies either before or after the proposed transaction.

(2). None of the corporations involved are holding companies either before or after the proposed transaction.

(3) None of the corporations involved are subsidiaries of holding companies either before or after the proposed transaction.

(3). Bank X is a regulated financial corporation both before and after the proposed transaction.

(4). Prior to the proposed transaction, Company A is a financial institution under criterion (d) above because it is a direct 1st tier subsidiary of Bank X.

As is shown above, both before and after the proposed transaction, Company A does not qualify as a financial institution under (a), (b) or (c) of the criteria above. Before the proposed transaction, Company A qualifies as a financial institution under criterion (d) because it is a direct 1st tier subsidiary of Bank X, a regulated financial corporation.

After the proposed transaction, Company A will no longer be a direct 1st subsidiary of Bank X. Company A will then be a direct 1st tier subsidiary of Company B which is neither a holding company nor a regulated financial corporation, so Company A will no longer qualify as a financial institution under criterion (d).[1]

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[1] The language ". . . subsidiary . . . of a regulated financial corporation . . ." appearing in T.C.A. § 67-4-804(a)(7) means only direct, 1st tier subsidiaries of regulated financial corporations and not to 2nd, 3rd,

Therefore, after the proposed transaction, Company A will not qualify as a financial institution under T.C.A. § 67-4-804(a)(7) unless it is ". . . carrying on the business of a financial institution" under criterion (e).

T.C.A. § 67-4-804(2)(A) defines the "business of a financial institution". Company A is not a regulated financial corporation and, after the proposed transaction, Company A will not be a subsidiary of a regulated financial corporation. Therefore, after the transaction, Company A is not carrying on the "business of a financial institution under T.C.A. § 67-4-804(2)(A)(i).

Under T.C.A. § 67-4-804(2)(A)(ii) a corporation would be carrying on the "business of a financial institution" if it does or has authority to do anything substantially similar to the business that a corporation may be created or authorized to do under Title 45. Title 45 contains the Tennessee statutes under which such companies as banks, savings and loan associations, credit unions, industrial loan and thrift companies, pawnbrokers, issuers of money orders, small business investment companies and industrial development corporations are regulated by the Department of Financial Institutions.

Company A holds and manages investment obligations and intercompany loans. Although companies created under Title 45 may hold and manage investment obligations, a company does not have to be created under, or authorized by, Title 45 to conduct such an activity. So, by holding and managing investment obligations, Company A is not carrying on the "business of a financial institution" as defined by T.C.A. § 67-4-804(2)(A)(ii).

Company A also makes, holds and manages intercompany loans but less than 50% of the corporation's gross income is generated from that activity. T.C.A. § 67-4-804(2)(B) provides that a corporation shall not be considered to be a financial institution if less than 50% of its gross income is generated by conducting the "business of a financial institution". Since Company A's gross income from its intercompany loan activity is less than 50% of its total gross income, that activity does not cause it to be carrying on the "business of a financial institution" under T.C.A. § 67-4-804(2)(A)(ii) even if Company A is created or authorized to conduct such an activity under Title 45.

T.C.A. § 67-4-804(2)(A)(iii) lists a number of activities that are defined as carrying on the "business of a financial institution". Company A's business of making, holding and managing intercompany loans falls within the scope of some of the activities named in the statute. However, since Company A's gross income from its intercompany loan activity is less than 50% of its total gross income, that activity does not cause it to be

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4th, etc. tier subsidiaries. Indiana, one of the states whose financial institution tax statutes were used as a pattern when Tennessee's financial institution tax statutes were drafted, also applies its similarly worded statute in this way.

carrying on the "business of a financial institution" under T.C.A. § 67-4-804(2)(A)(iii). This is true because of the 50% threshold provided by T.C.A. § 67-4-804(2)(B).

As is discussed above, none of the applicable Tennessee statutes classify Company A as a financial institution for purposes of the Tennessee franchise, excise tax.

2 COMPANY A WILL NOT BE INCLUDED IN A COMBINED FRANCHISE, EXCISE TAX RETURN

T.C.A. §§ 67-4-805(a)(3) and 67-4-914(c) require unitary businesses to file Tennessee corporate franchise, excise tax returns on a combined basis in the manner specified by the law. T.C.A. § 67-4-804(a)(16) defines a unitary business as follows:

> "Unitary business" means business activities or operations of financial institutions that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution. "Unitary business" may be applied within a single legal entity or between multiple entities. "Unitary group" includes those entities that are engaged in a unitary business wholly within or within and without this state;
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> (A) Unity is presumed whenever there is unity of ownership, operation and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting or other controlled interaction among entities that are engaged in the business of a financial institution. The absence of these centralized activities does not, however, necessarily evidence a nonunitary business;
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> (B) Unity of ownership does not exist unless the corporation is a member of two (2) or more business entities and more than fifty percent (50%) of the voting stock of each member is directly or indirectly owned by:
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> (i) A common owner or common owners, either corporate or noncorporate; or
>
> (ii) One (1) or more of the members of the group;

Under Tennessee law, a corporation that is a financial institution can not be unitary with a corporation that is not a financial institution because the term "unitary business" is defined by T.C.A. § 67-4-804(a)(16) as the ". . . business activities or operations of financial institutions . . .". Company A is not a financial institution and thus, for purposes of the Tennessee franchise, excise tax, can not be unitary with Bank X's holding company or any other financial institution in the group.

T.C.A. §§ 67-4-805(a)(3) and 67-4-914(c) require financial institutions that form a unitary business as defined in T.C.A. § 67-4-804(a)(16) to file a combined franchise, excise tax return. Since Tennessee law permits only unitary businesses that are financial institutions to be included in a combined franchise, excise tax return and Company A is not a financial institution, Company A will not be permitted or required to be included in the

combined franchise, excise tax return filed by Bank X's holding company. After the transaction, the Tennessee corporate franchise, excise tax return of Company A must be filed on a separate entity basis to include only its own operations.[2]

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Arnold B. Clapp, Senior Tax Counsel

APPROVED: ______________________________
Ruth E. Johnson, Commissioner

DATE: 12-23-97

[2] After the transaction, Company B is a 1st tier subsidiary of Bank X, a regulated financial corporation. Accordingly, after the transaction, Company B is a financial institution under T.C.A. § 67-4-804(a)(7) and must be included in the Tennessee combined franchise, excise tax return filed by Bank X's holding company.