

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 95-06**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether [CORPORATION A], a corporate general partner in [PARTNERSHIP 1], a partnership doing 100% of its business in Tennessee, is subject to Tennessee corporate franchise, excise tax, and whether the partnership itself and Tennessee resident [MR. X], a limited partner and employee, are subject to the Tennessee Income Tax also known as the Hall Income Tax.

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.

Under the provisions of T.C.A. § 67-1-109(a)(2), this letter ruling may be revoked or modified by the commissioner, or her successors, 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 his 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 retroactive revocation of the ruling must inure to his detriment.

FACTS

FACT PATTERN ONE

A partnership, to be named [PARTNERSHIP 1], will be formed under Tennessee law, or under the law of another state. The partnership will operate an [BUSINESS] and will do

one hundred percent (100%) of its business in Tennessee. One of its minority limited partners will be [MR. X], a resident of Tennessee. The majority ownership of 65 to 75 percent of the income and capital interest will be held by nonresident individuals. [CORPORATION A] will be a corporate general partner with a 1% capital and profits interest. [CORPORATION A] will be owned or controlled by a nonresident who holds a majority limited partnership interest. The corporation will have no business or contact with Tennessee other than its general partnership interest in [PARTNERSHIP 1].

The partnership agreement will contain provisions allocating any net operating loss to partners with positive capital accounts. [MR. X], as a minority limited partner will be subject to a mandatory sell back agreement requiring him to sell his limited partnership interest back to the partnership upon termination of his employment with the partnership, however, the partnership agreement does not otherwise permit the transfer of the limited partnership interests. [MR. X] will have no certificate evidencing his minority limited partnership interest, the partnership agreement itself being the only evidence of such interest. There will be no written agreement requiring the partnership to pay [MR. X] interest on any money. [MR. X] is also employed by the partnership as one of its managers.

FACT PATTERN TWO

Same as Fact Pattern One, except that [MR. X]'s limited partnership agreement allows his interest to be assigned to another person, but the assignee would have no right to vote on partnership matters and would have no right to any distribution of partnership funds or other assets.

FACT PATTERN THREE

Same as Fact Pattern One, except that [MR. X] is only an employee of the partnership and is not a partner. He has an employment agreement with the partnership which provides that he will accrue deferred compensation equal to a percentage of the partnership's income and/or asset base. The agreement also provides that [MR. X] is entitled to a pro rata distribution of any accrued compensation if the partnership makes a distribution to its partners.

FACT PATTERN FOUR

Same as Fact Pattern One, except that [MR. X] is issued a certificate evidencing his limited partnership interest and [MR. X] is free to sell, assign or transfer the certificate and his partnership interest to another person.

QUESTIONS

1. In Fact Pattern One, will [CORPORATION A] be subject to Tennessee corporate franchise/excise tax?
2. In Fact Pattern One, will [PARTNERSHIP 1] be subject to the Tennessee Hall Income Tax?
3. In Fact Pattern One, will income [MR. X] has as a result of his partnership interest in [PARTNERSHIP 1] be subject to the Tennessee Hall Income Tax?
4. In Fact Pattern Two, will income [MR. X] has as a result of his partnership interest in [PARTNERSHIP 1] be subject to the Tennessee Hall Income Tax?
5. In Fact Pattern Three, will income [MR. X] has as a result of his employment agreement be subject to the Tennessee Hall Income Tax?
6. In Fact Pattern Four, will income [MR. X] has as a result of his partnership interest in [PARTNERSHIP 1] be subject to the Tennessee Hall Income Tax?

RULINGS

1. Yes. 2. Yes. 3. No. 4. No. 5. No. 6. Yes.

ANALYSIS

1. [CORPORATION A] IS SUBJECT TO FRANCHISE/EXCISE TAXES

T.C.A. § 67-4-806(a) imposes the Tennessee excise tax as follows:

“All corporations . . . doing business in Tennessee shall . . . pay to the commissioner of revenue annually an excise tax . . . equal to six percent of net earnings . . .”

When a partnership or joint venture is doing business in Tennessee, an out-of-state corporation having a general partnership or joint venture interest has sufficient Tennessee

nexus to be subject to corporate franchise, excise taxes here. See: *Federated Stores Realty, Inc. v. Huddleston*, 852 S.W.2d 206 (Tenn. 1992). Profits or losses of [PARTNERSHIP 1] attributed to [CORPORATION A] due to its general partnership interest would be included in federal taxable income and thus in the Tennessee excise tax base under T.C.A. § 67-4-805(a)(1). The corporate partner's franchise tax minimum measure will include its ownership share of specific partnership property in accordance with T.C.A. § 67-4-906(a)(1), (3) and (7)(a). Under T.C.A. § 67-4-811(b)(2), (e)(2) and (g)(2) and 67-4-910(b)(2), (e)(3) and (g)(2), [CORPORATION A]'s ownership share of [PARTNERSHIP 1]'s property, payroll and sales must be included in its apportionment formula for franchise, excise tax apportionment purposes.

**2. [PARTNERSHIP 1] IS SUBJECT TO
THE TENNESSEE HALL INCOME TAX**

T.C.A. § 67-2-102 imposes the Tennessee Hall Income Tax as follows:

“An income tax in the amount of six percent (6%) per annum shall be levied and collected on incomes derived by way of dividends from stocks or by way of interest on bonds of each person [or] partnership . . . in the State of Tennessee who received, or to whom accrued, or to whom was credited during any year income from the sources above enumerated . . .”

T.C.A. § 67-2-104(a) provides as follows:

“The tax imposed by this chapter does not apply to the first one thousand two hundred fifty dollars (\$1,250) for each individual return or two thousand five hundred dollars (\$2,500) of combined income for persons who file jointly, of income otherwise taxable under this chapter.”

The partnership, [PARTNERSHIP 1], conducts 100% of its business in Tennessee and is subject to the Hall Income Tax on any dividend or interest income it receives, or which is accrued or credited to it, in excess of the \$1,250 exemption.

**3, 4, and 5 [MR. X] IS NOT SUBJECT TO THE HALL INCOME
UNLESS HE HAS A TRANSFERABLE CERTIFICATE
OF PARTNERSHIP INTEREST OR AN INSTRUMENT
REQUIRING INTEREST PAYMENTS**

T.C.A. §§ 67-2-102 and 67-2-104(a), quoted in part above, impose the Hall Income Tax on all persons in Tennessee who receive, or to whom is accrued or credited, dividend or interest income in excess of \$1,250 for single filers or \$2,500 for persons filing jointly with a spouse. [MR. X] is a Tennessee resident and will be subject to the Hall Income Tax on any dividend or interest income he receives, or has accrued or credited to him in

excess of the applicable exemption. The issue to be resolved here is whether income of [MR.X] from [PARTNERSHIP 1] is “dividends from stocks” or “interest on bonds” subject to the Hall Income Tax.

For purposes of the Hall Income Tax, T.C.A. § 67-2-101(6) defines “stocks” as follows:

“ ‘Stocks’ means shares of stock issued by corporations . . . and all interests in partnerships, . . . represented by transferable evidence of such interest; . . .”

Just as a stock certificate is transferable evidence of the owner’s interest in a corporation, a certificate issued a limited partner by a partnership, if alienable to third parties or to the issuing entity, would be transferable evidence of the limited partner’s interest in the partnership within the meaning of T.C.A. § 67-2-101(6). However, the partnership agreement itself would not constitute transferable evidence of such interest. Certificate of Partnership Interest, 89-75 Op. Att’y Gen. (1989). It has been the long-standing practice of this department to treat a limited partner as having no transferable evidence of his partnership interest if the partnership has not issued him a transferable certificate.

In Fact Patterns One (1) and Two (2), the partnership has not issued [MR. X] a certificate that is transferable evidence of his partnership interest. Without such a certificate, [MR. X] does not have “stocks” as a result of his limited partnership interest and consequently, cannot have income from the partnership which is “dividends from stocks” subject to the Hall Income Tax. In Fact Pattern Three (3), [MR. X] is an employee of the partnership rather than a partner. As an employee, he has no transferable partnership interest and no certificate evidencing such an interest. Thus his income from the partnership cannot be “dividends from stocks” subject to the Hall Income Tax.

In addition to “dividends from stocks,” “interest on bonds” is also subject to the Hall Income Tax. For purposes of the Hall Income Tax, T.C.A. § 67-2-101(1)(A) defines a “bond” as follows:

“ ‘Bond’ means all obligations . . . evidenced by an instrument whereby the obligor is bound to pay interest to the obligee . . .”

In Fact Patterns One (1), Two (2) and Three (3), there is no instrument requiring the partnership to pay interest to [MR. X]. Without such an instrument, none of his income from the partnership can be “interest on bonds” subject to the Hall Income Tax. In Fact Patterns One (1), Two (2) and Three (3), any salaries or wages [MR. X] receives as an employee of the partnership are not subject to the Hall Income Tax because they result from his employment rather than his limited partnership interest.

6. [MR. X] IS SUBJECT TO THE HALL INCOME TAX IF ISSUED A TRANSFERABLE CERTIFICATE OF PARTNERSHIP INTEREST

Under Fact Pattern Four (4), the partnership has issued [MR. X] a certificate evidencing his transferable limited partnership interest. As a result, [MR. X] has "stocks" for purposes of the Hall Income Tax. Any income he receives from the partnership as a result of his partnership interest is dividends on stocks and would be subject to the Hall Income Tax to the extent his taxable dividends and interest exceed the exemption. Likewise, any income the partnership accrues or credits to [MR. X]'s partnership capital account is dividends on stocks subject to the Hall Income Tax.

Salaries and wages [MR. X] receives from the partnership are not subject to the Hall Income Tax because they are paid to him as a result of his employment rather than as a result of his limited partnership interest. As in the first three Fact Patterns, there is no instrument in Fact Pattern Four (4) which requires the partnership to pay [MR. X] interest, so he has no interest income from the partnership for purposes of the Hall Income Tax.

Arnold B. Clapp, Special Counsel

APPROVED: Ruth E. Johnson, Commissioner

DATE: 2/28/95