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Chapter 1: Introduction

History

Since the enactment of the Tennessee Corporate Excise Tax (“excise tax”) in 1923, and the Tennessee Franchise Tax (“franchise tax”) in 1937, businesses operating for-profit have been subject to tax for the privilege of doing business or exercising the corporate franchise in Tennessee. The imposition of the excise tax was first upheld by the Tennessee Supreme Court in 1924 in *Bank of Commerce & Trust Co. v. Senter*.¹ The imposition of the franchise tax was first upheld by the Tennessee Supreme Court in the 1936 case of *Corn v. Fort*.²

Initially, franchise and excise tax was levied solely upon the privilege of engaging in business in the corporate form.³ In 1999, the Tennessee General Assembly passed the Tax Revision and Reform Act that broadened the scope of the franchise and excise tax to all “persons” doing business in Tennessee, including pass-through entities such as limited liability companies (“LLC”) and limited partnerships (“LP”).⁴ In 2015, the Tennessee General Assembly made another significant update to franchise and excise tax law when it passed the Revenue Modernization Act, which made significant changes to the state’s nexus provisions.

Current excise tax laws are found in Tenn. Code Ann. §§ 67-4-2001 *et seq.*, and franchise tax laws are found in Tenn. Code Ann. §§ 67-4-2101 *et seq.* Rules and regulations can be found at TENN. COMP. R. & REGS. 1320-06-01-.01 *et seq.* or online under the Tax Resources page on the Department’s website.⁵

Overview

Franchise and excise tax is imposed on entities that operate in Tennessee and offer their owners limited liability protection. In-state and out-of-state entities can both be subject to franchise and excise tax.⁶ These taxes are accrued taxes imposed on the privilege of doing business in this state or by exercising the corporate franchise.⁷ Both taxes are solely for state purposes and no county, municipality, or local taxing district has the power to levy similar taxes.⁸

Although the franchise and excise tax are two separate taxes and are computed separately, the Department of Revenue (the “Department”) administers both taxes together under a singular tax structure. Taxpayers must file both taxes on one return, Form FAE170.⁹ The return is filed on an annual basis, concurrent with each federal return filing period.

1. Entities Subject to Franchise & Excise Taxes

For franchise and excise tax purposes, each taxpayer is considered a separate and single business entity and must file individual tax returns. Entities other than unitary groups of financial institutions and captive real estate investment trust (“REIT”) affiliated groups are not permitted to file a consolidated or combined franchise and excise return.¹⁰ Unitary groups of financial institutions and captive REIT affiliated groups are required to file Form FAE174.

General partnerships and sole proprietors are not subject to franchise and excise tax because they do not offer their owners limited liability protection.¹¹ Not-for-profit entities are not generally subject to franchise and excise tax.¹²

Businesses disregarded for federal income tax purposes are not disregarded for franchise and excise tax purposes except for LLCs whose single member is a corporation (“SMLLC”).¹³ Additionally, a taxable business that is inactive or has had its charter or other registration forfeited, revoked, or suspended, but has not been dissolved or otherwise properly terminated with the Tennessee Secretary of State, is not relieved from filing a return and paying the minimum franchise tax.¹⁴

2. Rates and Impositions

Franchise Tax

Franchise tax is based on the greater of the taxpayer’s net worth or the book value of real or tangible personal property owned or used in Tennessee, based upon values determined at the end of the taxable period.¹⁵

- The franchise tax rate is 25 cents per \$100, or .25% of a taxpayer’s net worth at the close of the tax year covered by the required return.
- The minimum franchise tax payable each year is \$100.¹⁶

Excise Tax

Excise tax is based on the taxpayer’s net earnings or net loss for the taxable year.¹⁷ “Net earnings” or “net loss” is defined as a taxpayer’s federal taxable income or loss before the operating loss deduction and special deductions,¹⁸ with certain adjustments that are required under Tennessee excise tax law.¹⁹

- Tennessee imposes a 6.5% corporate excise tax on the fiscal year net earnings of all persons engaged in business in Tennessee except nonprofit entities, entities otherwise specifically exempt, and businesses not subject to excise tax, such as sole proprietors.²⁰ This rate was set in 2002 by the Tennessee General Assembly.^{21 22}

3. Credits

Credits offset tax liability. Depending on the type of credit and the year, a credit may offset both franchise and excise tax or it may offset just one of the taxes. Unused tax credit may or may not be allowed to offset future tax. While the tax code does not specify the order in which to apply credits, the Department applies credits that do not have a carryover provision first. Franchise and excise tax credits that are currently in effect are found in Tenn. Code. Ann. §§ 67-4-2009, 67-4-2109. (Please see Chapter 15 for more information on Credits.)

4. Exemptions

There are seventeen types of exemptions available to entities which will be explained in detail in this publication.²³ Filing requirements differ based on the exemption type. Two of the most common exemptions are Family-Owned Non-Corporate Entities (“FONCE”) and Obligated Member Entities (“OME”). (Please see Chapter 2 for more information on Exempt Entities.)

¹ *Bank of Commerce & Trust Co. v. Senter*, 149 Tenn. 569, 260 S.W. 144 (1924).

² *Corn v. Fort*, 170 Tenn. 377, 95 S.W.2d 620 (1936).

³ *Mid-Valley Pipeline Co. v. King*, 221 Tenn. 724, 431 S.W.2d 277, 1968.

⁴ 1999 Tennessee Laws Pub. Ch. 406, Tenn. Code Ann. §§ 67-4-2007, 67-4-2105.

⁵ Tn.gov/Revenue

⁶ Tenn. Code Ann. §§ 67-4-2007(b), 67-4-2105(a).

⁷ Tenn. Code Ann. §§ 67-4-2005, 67-4-2104.

⁸ Tenn. Code Ann. §§ 67-4-2002, 67-4-2102.

⁹ Form FAE174 if a financial institution or captive real estate investment trust

¹⁰ Tenn. Code Ann. §§ 67-4-2007(e)(1), 67-4-2106(c).

¹¹ Tenn. Code Ann. § 67-4-2004(19).

¹² Tenn. Code Ann. § 67-4-2004(34); activities outside scope of exempt status may be taxed.

¹³ Tenn. Code Ann. §§ 67-4-2007(d), 67-4-2106(c).

¹⁴ Tenn. Code Ann. §§ 67-4-2007(b), 67-4-2105(c).

¹⁵ Tenn. Code Ann. §§ 67-4-2104, 67-4-2105(a).

¹⁶ Tenn. Code Ann. § 67-4-2119.

¹⁷ Tenn. Code Ann. § 67-4-2007.

¹⁸ Tenn. Code Ann. § 67-4-2006(a).

¹⁹ Tenn. Code Ann. § 67-4-2006(b).

²⁰ Tenn. Code Ann. § 67-4-2007.

²¹ 2002 Tennessee Laws Pub. Ch. 856.

²² See Chapter 14 for the tax rate when an election has been made under Tenn. Code Ann. § 67-4-2023 involving certified distribution sales.

²³ Tenn. Code Ann. § 67-4-2008.