

HOUSE BILL 3483
By McMillan

AN ACT to amend Tennessee Code Annotated, Title 67, Chapter 4 and Chapter 6, relative to taxation.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1: Tennessee Code Annotated, Section 67-4-2006(b)(1), is amended by adding the following as a new subitem (L):

(L) Any otherwise deductible intangible expense paid, accrued or incurred in connection with a transaction with one or more affiliated business entities that are primarily engaged in the acquisition, use, maintenance or management, ownership, sale, exchange or any other disposition of intangible property. The adjustments in this subdivision shall not apply to such portion of the intangible expenses that the taxpayer can establish meets one (1) of the following:

(i) The taxpayer paid, accrued, or incurred such portion to a person during the same fiscal year who is not an affiliated business entity; or

(ii) The transaction giving rise to the intangible expenses has a substantial business purpose and economic substance and contains terms and conditions comparable to a similar arm's length transaction between nonaffiliated business entities.

For purposes of subdivision (i) and (ii) above, the taxpayer shall establish that it meets the requirements in accordance with the procedures set forth in subsection (d).

Nothing in this subdivision shall be construed to limit or negate the provisions of Sections 67-4-2014 or 67-4-2112 where deemed appropriate by the commissioner.

For purposes of this section the following definitions shall apply:

(a) "Affiliated business entity" means a business entity in which the taxpayer, directly or indirectly, has more than fifty percent (50%) ownership interest or a business entity that, directly or indirectly, has more than fifty percent (50%) ownership interest in the taxpayer.

(b) "Intangible expense" means expenses related to, or in connection with, the acquisition, use, maintenance or management, ownership, sale, exchange, or any other disposition of intangible property to the extent such amounts are allowed as deductions or costs in determining federal taxable income for purposes of subsection (a) above.

(c) "Intangible property" means patents, patent applications, trade names, trademarks, service marks, franchise rights, copyrights, licenses, research, formulas, designs, patterns, processes, formats, and similar types of intangible assets.

SECTION 2: Tennessee Code Annotated, Section 67-4-2006(b)(2), is amended by adding the following as a new subitem (N):

(N) Any item of income included in the computation of the taxpayer's federal taxable income for purposes of subsection (a) above, that, due to the provisions Section 67-4-2006(b)(1)(L), has not been allowed as an expense deduction for an affiliated business entity subject to the excise tax levied by this part.

SECTION 3: Tennessee Code Annotated, Section 67-4-2006, is amended by adding the following as a new subsection immediately after the existing subsection (c) and relettering the remaining subsections accordingly:

The following procedures must be used to establish that a taxpayer meets the requirements set forth in Tennessee Code Annotated, Section 67-4-2006(b)(1)(L)(i) and (ii):

(1) The taxpayer must first submit to the Commissioner a written request seeking approval for an exemption from making the required adjustments to the taxpayer's net earnings or net losses. Documentation as required by the

Commissioner must be provided to establish that the intangible expense meets the requirements set forth in (i) or (ii).

For purposes of determining whether a transaction giving rise to the intangible expense meets the requirements set forth in (ii) the criteria used shall include but is not limited to the following:

(a) Whether the affiliated business entity licensing the intangibles has substantial business operations as evidenced by permanent office space and full time employees dedicated to the maintenance and protection of the intangibles;

(b) Whether the affiliated business entity is engaged in business activities separate and apart from the licensing of the intangibles to the taxpayer;

(c) Whether legal title and possession of the intangibles is held by the affiliated business entity and whether consideration was involved in the transfer of the intangible property to such entity;

(d) Whether royalty payments received by the affiliated business entity are retained and invested in the ongoing operations of the affiliated business entity's business or returned to the affiliated group as a dividend or loan;

(e) Whether the royalty rates paid were outside the range of royalty rates paid by parties acting at arm's length;

(f) Whether the affiliated business entity assumes and pays the expenses of maintaining and defending the intangibles; and

(g) Any other documentation the Commissioner deems necessary.

(2) After approval of the request, the Commissioner shall issue a letter to the taxpayer stating that the taxpayer has met the requirements set forth in subdivision (i) or (ii). This letter shall also state the effective date of this approval and shall apply to the first and subsequent tax periods beginning on or after the effective date.

(3) The approval shall continue in effect so long as the circumstances justifying the approval remain substantially unchanged, or until changed or discontinued by the department, whichever occurs first. In the event that the department discontinues the approval, reasonable notice shall be given to the taxpayer affected, and any such discontinuation shall apply prospectively to the first and subsequent tax periods beginning on or after the date of such notice.

(4) If the request for exemption is denied, the taxpayer may apply to the Commissioner for a hearing.

(5) As authorized, the hearing is to be held and conducted in accordance with the procedure as outlined under the provisions of Tennessee Code Annotated, Section 67-1-105.

SECTION 4: Tennessee Code Annotated, Section 67-4-2006, is amended by deleting subsection (d) in its entirety and substituting instead the following language:

The amount computed under subsections (a), (b), (c), and (d) shall be the taxpayer's net earnings for purposes of the Tennessee excise tax base to which the tax rate is applied as provided in Tennessee Code Annotated, Section 67-4-2007.

SECTION 5. Tennessee Code Annotated, Section 67-4-2108(a)(6), is amended by deleting subdivision (C) in its entirety and substituting instead the following:

(C) "Finished goods inventory" means tangible personal property that is:

- (i) Owned by the taxpayer;
- (ii) Stored in a facility used primarily for manufacturing, warehousing, or distribution of such inventory;
- (iii) Held for wholesale or retail sale by the taxpayer, but not sold over-the-counter to consumers at the location where stored;
- (iv) Shown as inventory on the taxpayer's books and records kept in accordance with generally accepted accounting principles; and
- (v) In need of no further fabrication or processing by or for the taxpayer; except, in the case of configuring, testing or packaging of computer products;

SECTION 6. Tennessee Code Annotated, Section 67-4-2008(a), is amended by inserting the following as a new subdivision after subdivision (7) and renumbering the following subdivisions accordingly:

(8) Any limited partnership or limited liability company organized exclusively for the purpose of providing affordable housing that meets the following criteria:

(a) The entity must have received an allocation of low-income housing tax credits pursuant to Section 42 of the Internal Revenue Code of 1986, as amended; and

(b) An "extended low-income housing commitment" as defined in Section 42(h)(6)(B) of the Internal Revenue Code of 1986, as amended, must be in effect with respect to each residential building owned by the entity for the period covered by the return.

SECTION 7. Tennessee Code Annotated, Title 67, Chapter 6, Part 3, is amended by adding the following as a new section:

Any taxpayer that moves otherwise taxable aircraft into Tennessee in conjunction with establishing a new "headquarters facility" as defined by § 67-6-224 shall be exempt from any sales and use tax liability that arises solely as a result of moving such aircraft into the state.

SECTION 8. Sections 1 through 5 of this act shall take effect upon becoming a law and apply to tax periods ending on or after July 1, 2004, the public welfare requiring it. Section 6 of this act shall take effect upon becoming a law and apply to tax periods ending on or after June 30, 2003, the public welfare requiring it. Section 7 of this act shall take effect upon becoming a law and expire on July 1, 2008, the public welfare requiring it. All other sections of this act shall take effect upon becoming a law, the public welfare requiring it.

Information on this page is generally current to within an hour.

HB3483 by *McMillan, *Rinks, *Bowers. (*SB3428 by *Crutchfield, *McLeary.)

Taxes - Includes in net earnings for excise taxes deductible tangible expenses connected with affiliated business entities; revises other various franchise and excise tax provisions. -

Fiscal Summary for SB3428

Increase State Revenues: \$3,500,000 FY04-05 / In conjunction with Sections 1,2,3,and 4 of the bill \$6,000,000 / Recurring after FY04-05 in conjunction with Sections 1, 2, 3, and 4 of the bill \$2,000,000 FY04-05 / In conjunction with Section 5 of the bill \$4,000,000 / Recurring in conjunction with Section 5 of the bill Increase State Expenditures - \$71,975 One-Time \$114,539 Recurring Decrease State Revenues: \$100,000 / In conjunction with Section 6 of the bill Exceeds \$100,000 Through FY07-08/ In conjunction with Section 7 of the bill

Bill Summary for HB3483 / *SB3428

This bill would revise the present law provisions governing "net earnings" and "net losses" for excise tax purposes. Under present law, specified items are added to or subtracted from a taxpayer's net earnings or net losses. This bill would include as an item to be added to a taxpayer's net earnings or net losses, any otherwise deductible intangible expense paid, accrued, or incurred in connection with a transaction with one or more affiliated business entities that are primarily engaged in the acquisition, use, maintenance or management, ownership, sale, exchange or any other disposition of intangible property. The above adjustment would not apply to such portion of the intangible expenses that the taxpayer can establish meets one of the following: (1) The taxpayer paid, accrued, or incurred such portion to a person during the same fiscal year who is not an affiliated business entity; or (2) The transaction giving rise to the intangible expenses has a substantial business purpose and economic substance and contains terms and conditions comparable to a similar arm's length transaction between nonaffiliated business entities. This bill specifies procedures that must be used to establish that a taxpayer meets the criteria in (1) and (2). Any item of income included in the taxpayer's federal taxable income that, due to above provisions, has not been allowed as an expense deduction for an affiliated business entity subject to the excise tax would be subtracted from the taxpayer's net earnings or net losses. Under present law, the measure of the franchise tax may not be less than the actual value of the real or tangible property owned or used in Tennessee, excluding exempt inventory and exempt required capital investments. "Exempt inventory" means that portion of a taxpayer's finished goods inventory in excess of \$50 million for fiscal years beginning on or after July 15, 1996; \$40 million dollars for fiscal years beginning on or after July 15, 1997; and \$30 million dollars for fiscal years beginning on or after July 15, 1998, that would otherwise be included in the minimum measure of the taxpayer's franchise tax base. "Finished goods inventory" means tangible personal property which is: (1) Owned by the taxpayer; (2) Shown on the taxpayer's books and records kept in accordance with generally accepted accounting principles; (3) Held for wholesale or retail sale; and (4) In need of no further fabrication or processing by or for the owner; except, in the case of configuring, testing or packaging of computer products. This bill would redefine "finished goods

inventory" to specify in regard to (3) that it is the taxpayer who holds the property for wholesale or retail sale and that the property is not sold over the counter to consumers at the location where stored. This bill would include as finished goods inventory tangible personal property which is stored in a facility used primarily for manufacturing, warehousing, or distribution of such inventory. This bill would exempt from excise tax any limited partnership or limited liability company organized exclusively for the purpose of providing affordable housing that meets the following criteria: (1) The entity must have received an allocation of low-income housing tax credits pursuant to the Internal Revenue Code; and (2) An "extended low-income housing commitment" as defined in the Internal Revenue Code must be in effect with respect to each residential building owned by the entity for the period covered by the return. Also, under this bill, any taxpayer that moves otherwise taxable aircraft into Tennessee in conjunction with establishing a new "headquarters facility" would be exempt from any sales and use tax liability that arises solely as a result of moving such aircraft into the state. ON MAY 12, 2004, THE HOUSE ADOPTED AMENDMENT #1 AND PASSED HOUSE BILL 3483, AS AMENDED.

AMENDMENT #1 revises various provisions of this bill and adds several new provisions to this bill, as follows: (1) In regard to this bill's provision regarding the item to be added to a taxpayer's net earnings or losses for franchise and excise tax purposes, this amendment removes the requirement that the affiliated business entities be primarily engaged in the acquisition, use, maintenance, ownership, sale, exchange, or other disposition of intangible property. (2) This amendment removes this bill's provisions describing the portion of a taxpayer's intangible expenses to which the adjustment would not apply and the associated criteria. (3) This amendment redefines "affiliated business" for purposes of the adjustment provided for in this bill to also mean a business entity owned 50 percent or more, directly or indirectly, by a person who, directly or indirectly, has more than 50 percent ownership interest in the taxpayer. This definition would also apply in regard to Chapter 592 of the Public Acts of 2004 (House Bill 3480/Senate Bill 3418) which exempts from the business tax services provided by an affiliated business entity if such services are claimed as cost without any markup whatsoever. Also, this amendment specifies, for purposes of the business tax, that "sales price" for services rendered by a person for an affiliated business entity does not include any amount that is accounted for as a reasonable allocation of cost incurred in providing the service. (4) This amendment revises what would be subtracted from the taxpayer's net earnings or net losses to be any tangible expense paid, accrued or incurred in connection with a transaction with one or more affiliated business entities that has been disclosed. This amendment also provides for the following being subtracted from a taxpayer's net earnings or net losses: any tangible income included in the computation of a taxpayer's net earnings that is accrued or earned in connection with a transaction with one or more affiliated business entities to the extent that the corresponding intangible expense is not disclosed or is otherwise disallowed. (5) This amendment provides that any franchise/excise taxpayer that pays, accrues or incurs intangible expenses as a result of a transaction with one or more affiliated business entities must disclose such intangible expenses on the face of the franchise and excise tax return and complete the appropriate schedule as required by the commissioner. Any taxpayer that deducts intangible expenses arising from a transaction with one or more affiliated business entities in determining Tennessee net earnings that fails to disclose such intangible expenses would be subject to a negligence penalty. If a taxpayer does not meet the disclosure requirements the commissioner would make the adjustments provided for in this bill (in regard to the item to be added to net earnings or losses). (6) Under present law governing business taxes, in addition to a minimum tax, taxpayers pay a tax the rate of which depends on the dominant business/ classification of the business. For example, taxpayers in Classification 2 pay three twentieths of one percent ($3/20$ of 1%) of all the retail sales of the business and three eightieths of one percent ($3/80$ of 1%) of all the wholesale sales of the business. This amendment would specify in regard to the tax rates based upon classification that the amount of taxation would be computed upon the sales price of the item or service subject

to tax. (7) Present law provides for the following credit under the sales and use tax provisions: 100 percent of the sales and use tax paid with respect to pollution control required to bring a purchaser into compliance with pollution control laws or regulations, whether federal, state or local. This amendment would revise this credit to be as follows: 100 percent of the sales and use tax paid with respect to any system, method, improvement, structure, device or appliance appurtenant thereto that is required and primarily used to bring the purchaser into compliance with pollution control laws or regulations, whether federal, state, or local, when such pollution is created in the course of the purchaser's regular business activities. This credit would not be available to persons primarily engaged in processing, treating, or controlling pollution created by others. (8) Under present law, the following is exempt from sales and use tax: the transfer, by any dealer in personal property, of motor vehicles with a Gross Vehicle Weight Rating (GVWR) of a class three or above and trailers, semi-trailers and pole-trailers used in the service of passenger or cargo transportation principally in interstate or foreign commerce by a common carrier or contract carrier under authority granted by the federal government or other state regulatory agency. This amendment would revise this provision to specify that it applies to such motor vehicles when they are used by a carrier holding common or contract carrier operating authority to transport passengers or cargo principally in interstate or foreign commerce. (9) Chapter 592 of the Public Acts of 2004 increased the job tax credit under the franchise/excise tax provisions for business enterprises located in economically distressed counties. Under Chapter 592, the department of economic and community development has the authority to define what qualifies as an economically distressed county. This amendment would require the department to define "economically distressed county" based on unemployment, per capita income and poverty levels of all Tennessee counties using statistical data prepared by any agency of the state or federal government no later than July 1 of each year. The commissioner could determine a county is economically distressed if such county experiences substantial characteristics of economic distress including, but not limited to, major loss of employment, recent high unemployment rates, traditionally low levels of family incomes, high levels of poverty and high concentrations of employment in declining industries. (10) This amendment would exempt the following from sales and use tax: purchases of detailing services and repair services performed on motor vehicles that are held for resale, if such vehicles are held for resale by a licensed motor vehicle dealer or licensed automobile auction. A person selling detailing services must, however, be considered to be the user and consumer of any articles of tangible personal property which that person purchases or uses in performance of such detailing services. (11) Present law contains sales and use tax exemptions for "fabricating or processing tangible personal property for resale". This amendment would include the following as "fabricating or processing tangible personal property for resale": providing fabrication and repair services to aircraft owned by non-affiliated business entities whether commercial, governmental or foreign, provided that the dealer performing such services qualifies for the job tax credit for qualified business enterprises under the franchise/excise tax provisions. ON MAY 19, 2004, THE SENATE SUBSTITUTED HOUSE BILL 3483 FOR SENATE BILL 3428, ADOPTED AMENDMENT #2 AND PASSED HOUSE BILL 3483, AS AMENDED. AMENDMENT #2 allows railroad companies to compute the value of their property, for franchise tax purposes, in accordance with the method used for federal tax purposes so long as such method fairly reflects the property's value.