

# PUBLICATION

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## Spotlight on Tennessee: 2012 Tax Legislation

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Many tax and tax-related initiatives were considered by the Tennessee Legislature during the 2012 Session of the General Assembly. While most of these initiatives were not enacted, those which were covered a wide range of topics, including electronic filing, "Amazon" nexus issues, the deductibility of intangible expenses paid to an affiliate and the demise of wealth transfer taxes, among others. The following is a general summary of some of those more notable initiatives enacted in 2012.

### Administrative Provisions

**A. Electronic Filing.** HB2371 (signed by Governor Bill Haslam on April 4, 2012 -- Public Chapter No. 657) authorizes the Department of Revenue to require that any return, report, claim, statement, application or other document to be filed with the Department, including any payment or remittance that accompanies such document, be submitted electronically in a manner approved by the Commissioner of Revenue beginning no sooner than 90 days after the Commissioner has certified that a system is in place for the electronic transmission of such document or payment.

If electronic filing requirements impose a hardship, then the filing may be by paper form but the Commissioner is authorized to require a manual handling fee not to exceed \$25; the cumulative total of manual handling fees to be charged to any one taxpayer for all tax filings in a 12-month period shall not exceed \$50. This new law does not supersede or otherwise affect any electronic filing or payment requirement already provided by law as of January 1, 2012, including any penalty or waiver provisions connected therewith.

**B. Authorization to Extend Filing Due Dates.** HB2372 (signed by Governor Haslam on April 27, 2012 -- Public Chapter No. 842) includes a provision expanding the authority of the Commissioner of Revenue to alter the filing due date for Tennessee taxes administered and collected by the Department of Revenue. Tennessee Code Annotated, Section 67-1-114, provides that when the due date for filing the Tennessee Hall income tax, the franchise and excise taxes or the wealth transfer taxes (such as the gift tax and inheritance tax) occurs on a legal holiday as defined by federal law, the Commissioner is authorized at the Commissioner's discretion to extend the due date of such return to the next succeeding date that is not a Saturday, Sunday or legal holiday.

This new law expands that authority for returns with due dates on or after April 1, 2012, to provide that whenever the Internal Revenue Service generally extends for all taxpayers the due date of a federal return or extends the due date of such return for a specific group of taxpayers such as, but not limited to, those affected by a federally declared disaster, the Commissioner of Revenue is authorized in the Commissioner's discretion to extend the due date for filing of specified returns for taxes administered or collected by the Department to a date that shall not be later than the last day of the extension period specified by the IRS.

### Sales and Use Taxes

**A. Reduction of State Rate on Food.** HB3761 (signed by Governor Haslam on May 21, 2012 -- Public Chapter No. 1058) reduces the Tennessee state tax rate on "food and food ingredients" from 5.5 percent to 5.25 percent effective July 1, 2012. Beginning in 2002, the state sales tax rate on food was kept at 6 percent while the general state rate was increased to 7 percent. The state rate on food was reduced in 2008 to 5.5

percent, and now in 2012 to 5.25 percent. The term "food and food ingredients" essentially means substances that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value. The Department of Revenue has just recently issued a notice that "food and food ingredients" does not include prepared food, dietary supplements, candy, alcoholic beverages or tobacco, all of which continue to be subject to the general state rate of 7 percent plus the applicable local rate. The applicable local rate also applies to food and food ingredients.

**B. "Amazon" Legislation.** HB2370 (signed by Governor Haslam on March 23, 2012 -- Public Chapter No. 624) is commonly called the "Amazon" legislation. With respect to any "person" qualifying under this new law (essentially any business satisfying the criteria of this new law, but in reality tailored for Amazon), and notwithstanding any other provision of existing law to the contrary, the activities of that person's affiliates in Tennessee (including, but not limited to, the activities of selling tangible personal property for resale to a person for delivery to the person's customers in Tennessee and outside this state, fulfillment services and any other non-retail activities) shall not be considered in determining whether the person has physical presence in Tennessee sufficient to establish nexus for Tennessee sales and use tax purposes.

The protection offered by this new legislation does not apply in the event that the person's affiliate performs, on behalf of such person, the operation of a retail store or kiosk at which customers may make purchases, returns or exchanges of items, or in the event such affiliate uses personnel (whether directly employed or on a contract basis) to solicit sales of tangible personal property. A person qualifies for the benefits under this new legislation if such person has an affiliate that (i) places one or more distribution facilities in service, directly or through a third party, between January 1, 2011 and January 1, 2014, (ii) makes or causes to be made a capital investment of at least \$350 million between those dates, (iii) creates at least 3,500 qualified jobs between those dates, and (iv) maintains at least that number of qualified jobs until January 1, 2016.

Such a person benefitting from this new legislation and making sales through the person's internet website to Tennessee purchasers is required to notify such purchasers in a confirmation email that the purchaser may owe Tennessee use tax on the total sales price of the transaction and include in the email an Internet link, directly or through the person's website, to the Department's website that allows a purchaser to pay the use tax. The notice required of such person to its Tennessee purchaser must include language that is substantially similar to: "PLEASE BE AWARE THAT THIS ORDER IS SUBJECT TO USE TAX UNLESS AN EXEMPTION EXISTS UNDER STATE LAW. A SALE IS NOT EXEMPT UNDER STATE LAW BECAUSE IT IS MADE THROUGH THE INTERNET."

Such a person benefitting from this legislation is also required to provide each purchaser to whom tangible goods were delivered in Tennessee a statement of the total sales made to the purchaser during the preceding calendar year, with such notice being provided for the 2011 year within 60 days after the effective date (March 23, 2012) of this new law and by February 1 of each subsequent year. This entire legislation is repealed and is no longer applicable on the earlier of (i) January 1, 2014, (ii) upon the date which the person's affiliate or third party fails to meet the qualifying requirements referenced above, or (iii) the effective date of any federal law that authorizes Tennessee to require its sales tax be collected and remitted even if the taxpayer does not have substantial nexus within Tennessee.

**C. Additional Reports from Certain Sellers.** HB2371 (signed by Governor Haslam on April 4, 2012 -- Public Chapter No. 651) authorizes the Commissioner to require persons selling beer and tobacco products to retailers of such beverages or products to file an informational report with the Department; such report to include but not be limited to information such as (i) the seller's name and license number, (ii) the retailer's name, permit and sales and use tax account numbers, (iii) the retailer's location, and (iv) the general type of product sold, the date each type of product was sold, the quantity of each type of product sold, and the monthly sales of each type of product sold.

This informational report shall be filed on a monthly or less frequent basis as determined by the Commissioner; and any seller who fails to provide the information required by this new law is subject to a penalty. Notwithstanding the foregoing, this new law also states that no seller shall be required to change its recordkeeping system for purposes of this new law, and that if the seller's records do not include all of the information requested by the Commissioner, then the requirements of this new law shall be satisfied if the seller includes in the report all of the requested information that the seller does have.

**D. Material Handling Exemption.** HB2372 (signed by Governor Haslam on April 27, 2012 -- Public Chapter No. 842) clarifies the availability of this exemption. In this regard, Tennessee Code Annotated, Section 67-6-206, provides that no sales or use tax is due with respect to industrial machinery. The term "industrial machinery" is defined in Section 67-6-102(46) to include various types of machinery, apparatus and equipment, including material handling equipment and racking systems as addressed in Subsections (H) and (I). Prior to this new law, Tennessee law required that the material handling equipment and racking systems be used by "a corporation subject to Tennessee franchise, excise taxes" where in reality, the Department had been approving this exemption even for those businesses not organized or created in corporate form. This new law replaces the phrase "a corporation subject to Tennessee franchise, excise taxes" with "the taxpayer" so as to confirm the availability of this exemption to more than just corporations.

## **Franchise and Excise Taxes**

**A. Overhaul of Intangible Expense Deductibility.** HB2372 (signed by Governor Haslam on April 27, 2012 -- Public Chapter No. 842) overhauls the method by which the Department of Revenue will consider allowing taxpayers to deduct intangible expenses paid to an affiliate for franchise and excise tax purposes. This new law, effective for tax years ending on or after July 1, 2012, is a significant departure from the previous method for determining deductibility as enacted in 2004. Intangible expense is defined in part to mean an expense related to, or in connection with, the acquisition, use, maintenance, management, ownership, sale, exchange, license, or any other disposition of intangible property (such as royalties, licensing fees, and the like). The term also includes interest expenses to the extent such interest expenses are directly or indirectly for, related to, or in connection with the direct or indirect acquisition, maintenance, management, ownership, sale, exchange or other disposition of intangible property.

Previously existing law required the taxpayer to disclose such intangible expense deduction on the face of the Franchise, Excise Tax Return as a condition to deducting such expense paid to an affiliate. This new law requires the taxpayer to apply to the Commissioner of Revenue for permission to deduct the intangible expenses paid to an affiliate, with such permission being subject to the Commissioner's determination that such expense does not have as one of its principal purposes the avoidance of the excise tax. The Department's review of such application can include considerations developed under federal tax law (such as assignment of income, arms' length and fair market value concepts) in dealings between and among affiliates.

Three exceptions permit the deduction of all or part of the expense, such exceptions being where the affiliate receiving the intangible expense (i) is in a foreign nation that is a signatory to a comprehensive income tax treaty with the U.S., (ii) pays that expense amount to an entity that is not an affiliate, and (iii) is subject to a net income tax in another state. These exceptions may be asserted in the application or by notice provided to the Commissioner at the time of filing the Return.

Under the new legislation, a taxpayer may also seek permission to deduct the intangible expenses by requesting a conference with the Commissioner to review its facts and circumstances and to seek a letter that its intangible expenses are deductible without the necessity of filing the application. If a taxpayer opts for the filing of an application and the application is approved, the approval is effective for so long as the taxpayer submits annually to the Commissioner a certification that the facts and circumstances remain substantially

unchanged. The Commissioner may require a taxpayer to re-apply no sooner than five years following the taxpayer's most recent application. If the application is denied, it appears that a taxpayer must claim the deduction, be assessed by the Department and then commence the pursuit of those remedies applicable for contesting a Tennessee state tax.

Penalties equal to the greater of \$10,000 or 50 percent of the resulting tax adjustment are applicable in certain circumstances. If an application under the new law is submitted at least 60 days prior to the due date of the taxpayer's Franchise, Excise Tax Return, and the application has not been approved or denied by the due date of the Return, then no penalty is assessable in the event that the intangible expense deduction is later disallowed.

**B. Extension Requests.** HB2406 (signed by Governor Haslam on April 4, 2012 -- Public Chapter No. 658) revises certain requirements for requesting an extension of time within which to file the Franchise, Excise Tax Return. Currently, Tennessee Code Annotated, Section 67-4-2015(g), provides that an extension of six months within which to file such a Return shall be granted, provided that on or before the original due date of the Return the taxpayer has paid franchise and excise taxes equal to 90 percent of the liability for the tax year for which the extension is being requested, and the taxpayer complies with other extension request requirements.

This new law, effective for tax periods ending on or after July 1, 2012, provides that an extension of six months within which to file the Return shall be granted if, on or before the original due date of that Return, the extension request is properly filed and the taxpayer has paid the taxes equal to the lesser of: (i) 90 percent of the liability for the tax year for which the extension is being requested, or (ii) 100 percent of the tax shown due on the Return for the preceding tax year, annualized if the preceding tax year is for less than 12 months.

**C. Exclusion of Consolidated Group Members.** HB2372 (signed by Governor Haslam on April 27, 2012 -- Public Chapter No. 842) amends the consolidated group statutory provisions for franchise tax purposes so as to allow a taxpayer to exclude one or more "persons" (essentially meaning business entities) that would otherwise be members of the taxpayer's affiliated group. In this regard, Tennessee Code Annotated, Section 67-4-2103, includes provisions allowing a taxpayer that is a member of an affiliated group or a financial institution affiliated group to elect to compute the net worth under the franchise tax on a consolidated basis, provided that the numerous requirements of that Section are satisfied.

This new law allows the taxpayer to exclude one or more persons from that affiliated group if the taxpayer submits a written request to the Commissioner, provided that the Commissioner determines either that (i) such persons are included in the taxpayer's affiliated group solely by virtue of a direct or indirect interest and are so operationally remote from the taxpayer that the taxpayer would be unable to obtain the information necessary to calculate the net worth if such persons were included as members, or (ii) such a person has a direct or indirect interest in both the taxpayer and one or more persons described in proviso (i) and is so operationally remote from the taxpayer that the taxpayer would be unable to obtain the information necessary to calculate the net worth of the group if such person was included as a member -- and, in addition to provisos (i) and (ii), the Commissioner determines that the exclusion of such persons from the affiliated group would result in a fair representation of the group's consolidated net worth.

In order to seek approval for such exclusion, the taxpayer must submit a written request including such information as the Commissioner may reasonably require, and such request must be submitted on or before the due date of the Franchise, Excise Tax Return for the period for which such exclusion is to take place.

## **Wealth Transfer Taxes**

**A. Inheritance Tax Phase-Out.** HB3760 (signed by Governor Haslam on May 21, 2012 -- Public Chapter No. 1057) amends the Tennessee inheritance tax by increasing the exemption available to decedents' estates from \$1 million through the end of 2012 to \$1.25 million for estates of decedents dying in 2013; to \$2 million for estates of decedents dying in 2014; and to \$5 million for estates of decedents dying in 2015; until, finally, no inheritance tax is to apply to estates of decedents dying on or after January 1, 2016.

**B. Gift Tax Repeal.** SB2777/HB2840 (signed by the Governor Haslam on May 21, 2012 -- Public Chapter No. 1085) repeals the Tennessee gift tax retroactive to January 1, 2012. Tennessee residents were previously subject to gift tax on gifts over \$13,000 to Class A donees (generally members of the donor's family) and on gifts over \$3,000 to Class B donees (generally non-family members). For decades, the gift tax has applied on a graduated rate schedule ranging from 5.5 percent to 16 percent, depending upon the size of the gift and the identity of the donee.

## **Other Taxes**

**A. Business Tax: Tax Period Change.** HB2371 (signed by Governor Haslam on April 4, 2012 -- Public Chapter No. 657) authorizes the Commissioner to change the tax period established by the business tax to correspond to a particular taxpayer's fiscal year, and also to change the due date of the associated tax return to a date that is not less than two calendar months following the end of such tax period.

**B. Property Tax: Forced Assessments of Personal Property.** SB2260 (signed by Governor Haslam on March 13, 2012 -- Public Chapter No. 571) amends the forced assessment provisions pertaining to tangible personal property found in Tennessee Code Annotated, Section 67-5-903(d). Prior to this new legislation, a taxpayer against whom a forced assessment is made could request the assessor to mitigate the forced assessment to the extent such assessment is shown to exceed the standard depreciated value of the taxpayer's assessable property by 25 percent or more so long as the failure to file the schedule or failure to timely appeal to the county equalization board was not the result of gross negligence or a willful disregard of the law.

This new legislation amends that remedy so as to delete the requirement that the forced assessment be shown to exceed the standard depreciation value of the taxpayer's assessable property by 25 percent or more and substitutes instead the requirement that the taxpayer may request the assessor to mitigate the forced assessment by reducing the forced assessment to the standard depreciated value of the taxpayer's assessable property plus 25 percent.

**C. Recordation Taxes: Tax Base Amendment.** HB3255 (signed by Governor Haslam on April 23, 2012 -- Public Chapter No. 792) deletes the phrase "or major fraction thereof" from the tax base in computing the realty transfer tax under Tennessee Code Annotated, Section 67-4-409(a) and the mortgage tax under Section 67-4-409(b). Prior to such enactment, the realty transfer tax was imposed the tax at the rate of 37¢ per \$100 "or major fraction thereof"; and the mortgage tax was imposed at the rate of 11.5¢ on each \$100 "or major fraction thereof."

## **Conclusion**

As is evident from the above summaries, many of these new laws are complex. As a result, careful consideration is required in determining how such initiatives apply to any particular fact situation. Should you wish to discuss any of these initiatives in more detail, or should you wish to address other Tennessee state or local tax issues, please contact one of the attorneys in the Firm's Tax Department.