

PUBLICATION

Spotlight on Tennessee: 2016 Tax and Related Legislation

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During the 2016 Session, 109th General Assembly, the Legislature considered several tax and related initiatives before adjourning. Although the number of such initiatives this Session was not as large as in the 2015 Session (remember the 2015 Revenue Modernization Act!), several important tax initiatives were nevertheless enacted during 2016. The following is a general summary of some of the more notable initiatives enacted during this most recent Session.

I. Franchise and Excise Taxes

A. Estimated Payments/Penalty Provisions Revised. Tenn. Code Ann. § 67-4-2015 contains F&E tax filing and estimated payment requirements, as well as estimated tax penalty provisions. 2016 Public Chapter No. 881 ("PC 881"), which is effective for tax years beginning on or after January 1, 2016, makes various revisions to that Section such as: (i) clarifying that a taxpayer is required to make four quarterly estimated F&E tax payments for its current year if the taxpayer has a combined F&E tax liability of \$5,000 or more, after application of all available F&E tax credits, for both the immediately preceding tax year and the current tax year; (ii) replacing one of the alternative requirements that quarterly estimated payments be not less than 25 percent of the full combined F&E tax liability for the current year, with a more favorable alternative requirement that such payments be not less than 25 percent of 80 percent of such combined liability for the current year; (iii) replacing the five percent per month penalty for estimated tax underpayments not to exceed a total of 25 percent, with a lower penalty of two percent per month not to exceed a total of 24 percent; and (iv) requiring the Department of Revenue ("Department") to ensure that any new integrated tax system implemented by the Department "will support the annualization of quarterly estimated payments" – which is intended to evidence the Department's commitment to support during the 2017 Session, the annualization of quarterly estimated payments as a defensive method for avoiding the underpayment penalty. Additionally, PC 881 revises the statutory penalty waiver provisions found at Section 67-1-803 to provide that if the taxpayer has filed estimated F&E tax payments by the due date for at least two years, but the estimated payments resulted in an underpayment for which penalties and interest accrued, the Department may consider such estimated payments to be filed in a timely manner for purposes of establishing good and reasonable cause for a waiver in certain circumstances.

B. Adventure Tourism/Jobs Tax Credit. The jobs tax credit, found at Tenn. Code Ann. § 67-4-2109, has been amended by 2016 Public Chapter No. 759 ("PC 759") effective for adventure tourism jobs created in adventure tourism districts on or after July 1, 2017, and with respect to applications submitted to the Department on or after that date. Under PC 759, the definition of "qualified jobs" is amended for those job positions entailing adventure tourism, as defined by State law, where the job position satisfies various conditions including: (i) for a permanent employment position, providing employment in a qualified business enterprise for at least 12 consecutive months to a person for at least 37 and one-half hours per week with or without minimum health care; (ii) for a seasonal employment position as defined by State law, providing employment for at least 26 consecutive weeks with or without minimum health care; and (iii) for a part-time employment position providing employment for at least 20 hours per week for 12 consecutive months with or without minimum health care. A seasonal and part-time position is counted as one-half of one job for this tax credit. Further, PC 759 provides that for such permanent, seasonal or part-time positions involving adventure

tourism, the job position must not have existed in Tennessee as a job position of the taxpayer or of any other business entity for at least 36 months prior to taxpayer's application.

C. Rural Economic Opportunity Act of 2016/Jobs Tax Credit. As enacted by 2016 Public Chapter No. 1019 ("PC 1019"), this Act amends the jobs tax credit found at Section 67-4-2109 so as to allow the Department of Economic and Community Development to designate an enhancement county as either a tier 1, tier 2, tier 3 or tier 4 based upon unemployment, per capita income and other statistical data. Further, PC 1019 reduces the 25 qualified jobs requirement under such Section to 20 qualified jobs if the enterprise is located in a tier 3 enhancement county, and reduces such number to ten qualified jobs if the enterprise is located in a tier 4 enhancement county. Further revisions to the jobs credit are made by PC 1019 so as to encourage qualified job employment in each of the classified tier enhancement counties. PC 1019 is effective July 1, 2016, and many of its provisions are applicable to tax years ending on or after July 1, 2016.

D. Qualified Data Center Modifications/Jobs Tax Credit. As enacted by 2016 Public Chapter No. 1001 ("PC 1001"), the sales tax requirements for being in a "qualified data center" are relaxed (see the sales tax discussion below). One such relaxed requirement reduces the number of net full-time employee jobs from 25 to 15 during an investment period not to exceed three years, provided, however, that any qualified data center applying for the jobs tax credit under Section 67-4-2109 must certify on its business plan that it has not, within the previous 12 months, been found to be in violation of the federal WARN Act, the Fair Labor Standards Act or immigration laws. PC 1001 is effective July 1, 2016, and shall apply to tax years ending on or after July 1, 2016.

II. Sales and Use Taxes

A. Qualified Data Center/Exemption Requirements Relaxed and Expanded. A "qualified data center" is granted a one-half percent sales tax rate pursuant to Tenn. Code Ann. § 67-6-206 with respect to electricity when sold to or used by such center. Pursuant to PC 1001, the conditions for a qualified data center have been relaxed such that the capital investment requirement of \$250 million during an investment period not to exceed three years has been reduced to \$100 million during such investment period; and, further, the requirement that such investment create at least 25 net full-time employee jobs has been reduced to 15 net new jobs. Additionally, PC 1001 modifies Section 67-6-206 so as to provide no tax is imposed with respect to "cooling equipment or backup power infrastructure" when sold to or used by a qualified data center. The term "cooling equipment" is defined by PC 1001 to mean cooling systems, cooling towers and other temperature control infrastructure used primarily for and necessary to the operations of a qualified data center; and the term "backup power infrastructure" means backup power generation, battery systems and related infrastructure, also used by such center. As stated earlier, PC 1001 shall apply to tax years ending on or after July 1, 2016.

B. Compressed Natural Gas/Exemption. Pursuant to 2016 Public Chapter No. 1070 ("PC 1070"), a sales and use tax exemption has been added to Tenn. Code Ann. § 67-6-329 for "compressed natural gas" when taxed as an alternative fuel pursuant to Section 67-3-1101, et seq. PC 1070 is effective July 1, 2016.

C. Retail Accountability Program/2016 Compromise. This Program, found at Tenn. Code Ann. § 67-6-410, was initially enacted in the 2012 Legislative Session and required beer and tobacco wholesalers to provide reports to the Department regarding their sales to retailers. The Department has used those reports for comparison purposes in reviewing Sales and Use Tax Returns filed by retailers purchasing from those wholesalers. Based upon statistical analysis, the purpose of such comparisons was to identify retailers that were allegedly underreporting the retail sale of beer and tobacco products. Such comparisons produced numerous assessments against retailers for alleged underreporting, which in turn increased sales and use tax collections from those retailers. Thereafter, the Program was expanded during the 2015 Session to include "other categories or types of personal property" as to which the Department could require records from

wholesalers; and based thereon the Department established numerous categories of food and beverages sold by wholesalers to retailers for which reports were due. Because of adverse feedback from grocers and other retail taxpayers arising from the 2015 legislation, compromise legislation was passed as 2016 Public Chapter No. 907 ("PC 907") which became effective April 27, 2016. Under this compromise legislation, PC 907 allows the Department to obtain wholesaler reports regarding food, candy or non-alcoholic beverages (including bottled soft drinks), with such reports to be filed on a quarterly basis and with the first such report due July 25, 2016. The Department pursuant to PC 907 shall not issue an assessment or notice of proposed assessment to any retailer based solely upon the wholesaler's report unless the Department first issues to the retailer an inquiry letter setting forth the information that led the Department to its conclusion that additional taxes may be owing and providing the retailer with an opportunity to explain the inconsistencies; and providing for certain relaxed transition provisions involving the sales of candy, food and non-alcoholic beverages, with such transition provisions being deleted on July 1, 2019. As stated by the Department in its public reminder dated June 15, 2016, the Department will not issue any assessments based upon reports from wholesalers of food, candy or non-alcoholic beverages until 2017.

III. Hall Income Tax

A. Angel Investor Credit Established. Pursuant to 2016 Public Chapter No. 1055 ("PC 1055"), which adds new Tenn. Code Ann. § 67-2-124 and which is effective for tax years beginning on or after January 1, 2017, a credit is allowable in the amount of 33 percent of the value of a cash investment by a "angel investor" against the liability of such angel investor under the Hall Income Tax in the tax year for which the investment was made. The term "angel investor" under PC 1055 contains several conditions, including (among others) that: (i) the investor is an accredited investor consistent with federal law; and (ii) invests in a company which at the time of investment is a small business with high-growth potential (including but not limited to tech-enabled start-ups, companies in the field of consumer products, medical devices, among others), where the company satisfies various conditions. This credit under PC 1055 is limited to \$50,000 per angel investor in any tax year, with the maximum tax credits for the 2017 year being \$3 million, \$4 million for the 2018 year and \$5 million for the 2019 year and thereafter. A minimum investment of \$15,000, which represents no more than 40 percent of the capitalization of the company, is required together with numerous other conditions.

B. 2016 Rate Reduction/2022 Abolishment. Pursuant to 2016 Public Chapter No. 1064 ("PC 1064"), the current rate for the Hall Tax is: (i) reduced from six to five percent at Tenn. Code Ann. § 67-2-102; and (ii) is intended to be reduced annually by new Section 67-2-124 through enactments of general bills beginning with the first Session of the 110th General Assembly. Further, the Hall Tax is eliminated in that new Section 67-2-124 for tax years that begin on or after January 1, 2022.

IV. Other Tax Related Legislation

A. Property Taxes. Several property tax bills were again enacted during 2016, including (but not limited to): (i) 2016 Public Chapter No. 853 authorizing a county holding land due to delinquent taxes to sell such land during the redemption period under certain conditions; (ii) 2016 Public Chapter No. 938 changing the formula for calculating hearing costs in property tax appeals before the State Board of Equalization; and (iii) 2016 Public Chapter No. 1085 allowing a county which has obtained property at a delinquent property tax sale to evaluate the financial and environmental risks of the property, and when necessary to petition the Chancery Court to void the sale and refer the property to a special master for a deferred sale.

B. Fantasy Sports Tax Act. As part of larger legislation found at 2016 Public Chapter No. 978 ("PC 978"), a new tax: (i) is found at Tenn. Code Ann. § 67-4-3201, et seq.; (ii) is imposed at the rate of six percent on all adjusted revenues of a fantasy sports contest offered by a fantasy sports operator (as defined in and pursuant to the larger legislation) to Tennessee consumers and is in addition to other taxes; (iii) shall be collected and

administered by the Department; (iv) shall be due and payable quarterly as required by PC 978; and (v) shall take effect July 1, 2016.

V. Department's Rulemaking Initiatives

In addition to the legislative initiatives during 2016, the Department has proposed various regulations which have been filed thus far in 2016 with the Tennessee Secretary of State.

A. Proposed Regulations Filed February 25, 2016. The Department filed proposed regulations with the Secretary of State on this date which are intended to clarify and enhance tax laws that were enacted during the 2015 Legislative Session, update other regulations and make numerous housekeeping changes to coordinate with existing statutory laws. Further, these proposed regulations are also intended to repeal previously existing regulations that were merely a repeat of current statutory law or were otherwise obsolete because of such law.

Although these proposed regulations cover a wide variety of topics, there are five general categories addressed by these proposed regulations: (i) taxpayer remedies for disputed taxes; (ii) business (or gross receipts) taxes; (iii) sales and use taxes; (iv) franchise and excise taxes (other than market-based sourcing for the receipts factor of the apportionment formula); and (v) franchise and excise taxes involving market-based sourcing for the receipts factor in regard to sales other than sales of tangible personal property.

Many of these proposed regulations are associated with substantive changes to Tennessee's tax laws. Examples of such substantive changes include (but are not limited to): (i) proposed sales and use tax regulations dealing with the new research and development exemption, effective July 1, 2015; and (ii) proposed franchise and excise tax regulations for the new market-based sourcing within the receipts factor of the apportionment formula for sales other than sales of tangible personal property, effective July 1, 2016, which was part of the 2015 Revenue Modernization Act.

A hearing on these proposed regulations was held on April 26, 2016, and the final version of such regulations has been filed by the Department with the Secretary of State to be effective September 26, 2016.

B. Proposed Regulations Filed June 16, 2016. Following the lead of a few other states, the Department is seeking through these proposed regulations to impose sales and use tax collection responsibilities upon remote vendors engaged in the regular or systematic solicitation of consumers in Tennessee, such as through online purchases. The Department has stated that not only is the State losing significant sales/use tax revenue as a result of on-line purchases where the remote vendor does not collect and remit the tax, but also that such on-line purchases create competitive disadvantages for brick-and-mortar type vendors located in Tennessee who are required to collect and remit the tax.

In particular, the proposed regulations provide that "out-of-state dealers who engage in the regular or systematic solicitation of consumers in this state through any means and make sales that exceed \$500,000 to consumers in this state during any calendar year also have a substantial nexus with ..." Tennessee and must register with the Department by January 1, 2017, if such dealers are not already so registered. Further, the proposed regulations provide that these out-of-state dealers must begin collecting and remitting to the Department the sales and use taxes by July 1, 2017, unless a later date is established by the Department.

A hearing on these proposed regulations is scheduled for August 8, 2016, at 1:30 p.m. (central) at the William R. Snodgrass Tennessee Tower, Nashville, Tennessee. Oral or written comments have been invited by the Department to be made at the hearing, and written comments may be submitted prior to the hearing to Lauren Fields, Associate General Counsel and Assistant Director – Legal, 500 Deaderick Street, 11th Floor, Nashville,

Tennessee 37242.

A copy of all the foregoing filed regulations can be found through the Tennessee Secretary of State's Office.

VI. Conclusion

Many of these new tax and related initiatives are very complex. As a result, before acting upon or in regard to these new initiatives, careful consideration of the foregoing is required in the context of your particular situation.

Please contact the author of this alert, Carl Hartley, or any other attorney within the Firm's Tax Group, should you have any questions or otherwise wish to discuss any of these new Tennessee tax and related initiatives.