

PUBLICATION

Spotlight on Tennessee: 2013 Tax and Related Legislation

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The 2013 Session, 108th General Assembly, considered numerous tax and related initiatives, many of which passed. The subject matter of these initiatives this year was very broad, ranging from efforts toward amending the Tennessee Constitution, further rollbacks in the sales tax rate on food, significantly revising the business tax, and increasing the exemption for the Hall income tax, among others. The following is a general summary of just some of the more notable successful initiatives in 2013.

No Income Tax -- Amending Tennessee's Constitution

The Tennessee Senate, with the concurrence of the Tennessee House of Representatives, passed Senate Joint Resolution 1 as the next step toward amending the Tennessee Constitution to expressly state that "... the Legislature shall not levy, authorize or otherwise permit any state or local tax upon payroll or earned personal income or any state or local tax measured by payroll or earned personal income... ." There have been several rather old decisions by the Tennessee Supreme Court, beginning in 1932, in which the court has ruled that the Legislature lacks constitutional authority to levy a state income tax other than the current Hall income tax, which is measured by dividends from stocks and interest on bonds. Nevertheless, from time to time proponents of a state income tax have insisted that current judicial thinking would allow such a tax under one or more different theories. Those proponents in many instances point to prior opinions of the Tennessee Attorney General, such as a 1999 opinion in which such a tax was alleged to be constitutionally defensible. The Legislature obviously wishes to shut the door on this debate by amending the Constitution. One of the next steps in this process will be a statewide vote on this amendment in the next general election in which a governor is chosen, which would be in November 2014.

Sales and Use Taxes

Further Reduction of State Rate on Food. Public Chapter 323 continued Tennessee's efforts to reduce the tax impact on purchasing food. Under this legislation, effective July 1, 2013, the Tennessee state tax rate is reduced from 5.25 percent to 5 percent of the retail price of food and food ingredients for human consumption. This rate reduction does not apply to prepared food, dietary supplements, candy, alcoholic beverages and 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.

Streamlined Sales Tax Again Extended. According to the Department of Revenue (Department), the Streamlined Sales and Use Tax Project is a national effort to find solutions to simplify and modernize complex sales tax systems which are imposed by a significant number of states. Tennessee has been an associate member of the Streamlined Sales Tax Governing Board since its inception in 2005. However, also since its inception, there have been concerns within the state that Tennessee should not become a full member of the Project. As a result, and even though legislation was enacted years ago to conform our sales and use tax laws with the Project, the effective date of many of those conforming statutes has been delayed on several occasions. The last such delay was until July 1, 2013, but Public Chapter 480 has again extended that effective date until July 1, 2015. The Department recently issued a notice stating that the primary sales and use tax changes to become effective July 1, 2015 include:

1. requirements that sales delivered or shipped to the customer be sourced to the delivery or shipping destination;
2. modifications to the single article limitation on local option sales taxes;
3. use of a single sales and use tax return covering multiple dealer locations; and
4. implementation of certain privilege taxes in lieu of sales tax.

Franchise and Excise Taxes

"Final Return Status" Introduced. Public Chapter 321 introduces the concept of a "final return status" into both the Tennessee excise and franchise taxes. That term means that the taxpayer has commenced the process of effecting a surrender of charter, withdrawal of qualification, merger, consolidation, liquidation, complete sale, transfer or distribution of assets, among other similar events, that results in or is intended to result in the taxpayer ceasing to exist or no longer being subject to the tax. This status shall apply to the first return that reflects any activity or event giving rise to such status, and the taxpayer shall file a return for each tax period during which the taxpayer is in such status. Where a taxpayer is in final return status, and the return is to include a period of less than 12 months (other than a return based upon a 52 – 53 week year), the return as to franchise tax shall be prorated to cover the proportionate part of the year with various other adjustments.

In addition, if a taxpayer is in final return status and effects a complete liquidation, the franchise tax shall be computed using net worth or the minimum tax base on the date immediately preceding the liquidating event, but otherwise any return for such tax purposes of a taxpayer in final return status shall be computed using the average monthly value of net worth or the minimum measure in Tennessee. These final return status amendments were effective May 13, 2013. Additionally, and for tax years in which a discharge of indebtedness occurs on or after October 1, 2013, Public Chapter 321 also provides that there shall be added to the net loss as determined for excise tax purposes the amount excluded under certain conditions from federal gross income as the result of the discharge of indebtedness provisions under Section 108 of the Internal Revenue Code.

Jobs Tax Credit Amended for Adventure Tourism Zone. Public Chapter 378, effective May 14, 2013, revised the requirements for the jobs tax credit that is available for a qualified business enterprise located within an adventure tourism district. Such a district is a geographic area identified and authorized by a local governing body, and approved by the state, as an area where the promotion of outdoor recreational opportunities is encouraged. Under this new legislation, certain conditions required for the jobs tax credit are made less onerous if the qualified business enterprise is located in either a Tier 2 or 3 enhancement county but not if the enterprise is located in a Tier 1 enhancement county; with the credit being allowed for three years if the enterprise is located in either a Tier 1 or Tier 2 enhancement county, and allowed for five years if the enterprise is located in a Tier 3 enhancement county.

Business Tax

Public Chapter 313, the "Uniformity and Small Business Relief Act of 2013," applies to tax periods that begin on or after January 1, 2014 and makes substantial revisions to the current version of the business tax. That tax was enacted in 1971 as a local option gross receipts privilege tax, to be administered and enforced in large part by local counties and cities adopting the tax. The administration and enforcement of the business tax remained substantially unchanged from 1971 to 2009. Effective generally from and after July 1, 2009, the administration and enforcement of the business tax was statutorily transitioned from local governments to the Department of Revenue. Now, with this new law enacted in 2013, numerous other revisions will be made to the business tax. Some more notable revisions are discussed below:

- New State Tax. This new 2013 legislation will convert the business tax as adopted by counties to a Tennessee state business tax. The Department will collect what was the county portion of the business tax under the new Tennessee state tax and will remit proceeds of such collections to the respective counties in accordance with the allocation provisions in the new legislation. The city portion of the business tax will remain as a city option tax, even though administered and collected by the Department for the cities that have adopted the tax.
- Expanded Nexus. One very visible aspect of this new legislation has the effect of statutorily expanding, in the view of many tax practitioners, the nexus for this tax. Currently, what is known as Rule 28 has required that the business tax is applicable where the taxpayer has a place, location or outlet in Tennessee from which business is carried on. The new law provides that any person "engaged in this state" in a business activity "without establishing a physical location, outlet, or other place of business" in Tennessee shall be subject to the Tennessee state business tax; provided that the term "engaged in this state" shall be limited to the following activities:
 - performing any service in Tennessee to the extent that such service is received by a customer in this state;
 - leasing tangible personal property that is located in Tennessee;
 - delivering tangible personal property to a buyer in Tennessee, when delivered by the seller in the seller's own vehicle; and
 - purchasing and subsequently selling tangible personal property in Tennessee in a wholly in-state transaction where the purchase and subsequent sale are accomplished through the presence in this state of the seller's employees, agents or independent contractors acting on behalf of the seller.

A taxpayer so "engaged in this State" without a physical location is exempt from the city portion of the business tax.

- Licenses. The county clerk, together with the appropriate city official, are still authorized to issue an initial license to the taxpayer; and the issuing officials shall renew a license upon notification from the Department that the taxpayer has filed the appropriate return and paid the appropriate tax. Further, any county or city is authorized to enter into an agreement with the Department pursuant to which the Department will issue or renew, or both, the license. Licenses already in effect on the effective date of this new law continue to be valid until their original renewal date.
- Certain Exemptions. Of interest to many taxpayers is an increase in the exemption from not less than \$3,000 of sales per year to not less than \$10,000 of sales per year. Further, the new law specifically recognizes that the tax shall not be imposed upon receipts from the sales of any services or tangible personal property made by a provider of direct-to-home satellite television programming services.
- Other Provisions. Numerous other revisions to the business tax are included in this legislation, such as revisions to sourcing of sales; authorizing the Department to change tax periods established by the business tax so as to correspond with the taxpayer's fiscal year and to change the due date of the return to not less than two months following the end of such tax period, such change to occur no sooner than 90 days after the Department has certified that a system is in place for the electronic submission of such returns; authorizing the Department to allow the submission of a single, electronic filing that includes all the information to determine the amount of tax properly due and allocated to each jurisdiction; setting new tax rates applicable to gasoline and diesel fuel wholesalers; and providing for the issuance of minimal activity licenses where the taxpayer has sales of more than \$3,000 but less than \$10,000 per year within the jurisdiction.

Hall Income Tax

Exemption for Seniors Increased. Public Chapter 322 continued the initiative from the 2012 Session by increasing the exemption for any person 65 years of age or older with respect to the Hall income tax imposed on dividends and interest. For tax years beginning January 1, 2013, this new law increases the total annual income exemption levels such that seniors who file an individual return and have total income of \$33,000 or less (up from \$26,200), or seniors filing a joint return having \$59,000 or less (up from \$37,000), are exempt from this tax.

Trustee Not Required to File Return. Public Chapter 480, effective May 20, 2013, amended the Hall income tax to provide that a trustee of a trust which is created under Sections 671 through 678 of the Internal Revenue Code (grantor trusts) as owned by one grantor or one other person which does not obtain a taxpayer identification number under federal law, shall not be required to file a Hall income tax return but shall report the total amount of income received by the trustee to the resident grantor or other person who shall file the return and pay this tax.

Property Taxes

Green Energy Tax Base. Public Chapter 297, effective retroactively for the tax year 2013, revises the tax base for computing property taxes with respect to certain green energy production facilities. About a decade ago, electricity generating facilities using wind as the energy source were statutorily determined to have a tax base for property tax purposes that should not exceed one-third of the total installed facility costs; and, in subsequent years, legislation was enacted providing a "green energy production facility" with a tax base for property tax purposes that would not exceed one-half percent of the facility acquisition value. The term "green energy production facility" in this latter legislation included a facility certified by the Department of Environment and Conservation as producing electricity for use off the premises using geothermal, hydrogen, solar or wind sources. Opponents of the lower tax base authorized for green energy production facilities argued that this lower base violated the Tennessee Constitution. In fact, an opinion issued in late 2012 by the Tennessee Attorney General questioned the constitutional validity of that lower tax base. In order to resolve these constitutional and other issues, Public Chapter 297 -- enacted in 2013 -- provides some analysis and reasoning for authorizing a lower tax base for certain green energy production sources, and determining that:

5. the value of wind source property should not initially exceed one-third of total install costs;
6. the value of solar source property should not initially exceed 12 and one-half percent of total install costs; and
7. the value of other green energy source property (presumably including geothermal and hydrogen) should not initially exceed its "appropriate capacity factor" as determined by the State Board of Equalization in consultation with the Department of Environment and Conservation. A certification from that Department is required in order to be eligible for this lower tax base.

Administrative Revisions. Public Chapter 209, effective April 23, 2013, made numerous technical and administrative revisions to the property tax laws in Tennessee. Just some of those revisions include:

8. the ability of the State Board to communicate certain decisions regarding property tax exemption applications via electronic means to the taxpayer;
9. providing the assessor of property with the express statutory authority to inspect or require the production of books and papers;
10. imposing upon the assessor the duty of confidentiality regarding information obtained from the property owner and providing for sanctions in the event such confidentiality is violated;
11. extending to back assessments, reassessments or corrections of assessment errors the existing statutory mandate that the validity of an assessment shall not be affected by any defect, error,

irregularity or omission unless the foregoing shall result in a denial of minimum constitutional guarantees;

12. declaring that property maps prepared for property tax and assessment purposes shall not be conclusive evidence of property ownership in any court of law;
13. authorizing a county board of equalization to allow appearance before that board by telephone, television, software or other electronic means under certain circumstances; and
14. stating that equalization of commercial and industrial tangible personal property shall be directed using the appraisal ratios adopted by the board in each jurisdiction, but that no equalization factor may exceed a factor of one.

Other Tax Related Legislation

Nursing Home Assessment Fee Modified and Extended. Public Chapter 356, effective July 1, 2013, extends the privilege assessment fee for nursing homes for one year beginning July 1, 2013, and also makes certain modifications with respect to enforcement and challenges.

Economic Development Revisions. Public Chapter 71, effective April 2, 2013, provides that land owned by a political subdivision of the state shall not be considered private land, and any such land that is subject to a purchase option by a private entity shall not be considered to be land that is expected to become privately owned so long as the purchase option covering the land may not be exercised for a period of at least five years following the date of an infrastructure grant. Additionally, effective for all contracts entered into or renewed on or after July 1, 2013, Public Chapter 267 provides that the Department of Economic & Community Development shall execute a separate agreement in connection with certain grants or loans to reserve the right to the Department to recover the amount of money, grants, funds or other incentives disbursed by the Department if the person or entity benefitting from the same fails to fulfill the commitments made by such person or entity to the Department.

Conclusion

Many of these enacted initiatives are obviously very complex. As a result, and before acting upon any of them, careful consideration should be undertaken in regard to how they might impact your particular fact situation. Please contact any of the attorneys in the Firm's Tax Department should you wish to discuss these or other Tennessee tax-related issues.