

PUBLICATION

Legislation To Be Filed Addressing Potential Constitutional Issue with Franchise Tax

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On January 4, 2024, Tennessee Governor Bill Lee announced plans to amend the Tennessee franchise tax to simplify the calculation of the franchise tax to "in effect give tax relief to businesses that are invested in our state." Finance & Administration Commissioner Jim Bryson, together with Department of Revenue Commissioner David Gerregano, provided more details during testimony on January 9 before the Senate Finance, Ways and Means Committee.

The franchise tax, together with the excise tax, is the method by which the State of Tennessee imposes taxes upon for-profit entities for the privilege of doing business in Tennessee or for exercising the corporate franchise. The excise tax was enacted in Tennessee in 1923 (1923 Public Chapter 21), and the franchise tax was enacted in 1937 (1937 Public Chapter 100, repealing a 1935 version). For the State's fiscal year ending June 30, 2023, the excise tax reportedly raised (net of estimates) approximately \$2.98 billion and the franchise tax approximately \$1.256 billion. As noted in the Department of Revenue's Franchise and Excise Tax Manual, both taxes are solely for state purposes and no county, municipality, or local taxing district has the power to levy any similar tax.

Since the inception of the franchise tax, and as referenced in the aforementioned Manual, the franchise tax base has been the taxpayer's net worth, or the book value of the property owned, and the rental value of property used in Tennessee, whichever is greater. Once calculated, the franchise tax base is subjected to a tax rate which currently is \$0.25 per \$100 of the tax base.

This alternative tax base model for the franchise tax can produce differing tax consequences for seemingly similar taxpayers, depending upon the facts and circumstances.

In testimony on January 9, Commissioners Bryson and Gerregano made various points regarding the proposed franchise tax amendment. Although no legislative text was produced by the Commissioners at that hearing, their comments regarding the reasoning for the proposed amendment and general information as to such amendment are summarized as follows:

- This matter arose from a claim for refund filed with the Department of Revenue by a taxpayer alleging that the alternative tax base model violates the Commerce Clause of the U.S. Constitution, in particular, the internal consistency doctrine under the dormant Commerce Clause;
- While not expressly agreeing with that allegation, such an allegation nevertheless could result in litigation that in turn would present a financial risk to the State;
- North Carolina at one time had a similar alternative tax base model, but has repealed the property measure of that model;
- After consultation with tax experts at the Tennessee Attorney General's Office as well as within the Department of Revenue, the decision was made to eliminate the alternative property measure from the franchise tax base;
- Refunds would be applicable to impacted taxpayers; and

- Tennessee's fiscal position is such that the State can absorb the expected financial ramifications of this amendment with reoccurring revenues.

Obviously, this is a very fluid situation, and there will be numerous questions and issues to be addressed when the text of the initial draft of the legislative proposal becomes available. For instance, what rights if any will a taxpayer have to contest the impact of this legislation on Franchise & Excise Tax Returns already filed by that taxpayer? How will this legislation impact current controversies within the Department of Revenue's Hearing Office or otherwise in court regarding the franchise tax? Will the Department of Revenue issue guidance and/or FAQs relative to the proposed legislation?

These and numerous other pertinent issues will be addressed in subsequent Baker Donelson alerts as information becomes available.

Our attorneys and our dedicated [State Public Policy Advocacy Group](#) will be monitoring developments and can offer assistance to clients who desire to engage and be heard as part of the legislative process.

In the meantime, please do not hesitate to contact [Carl E. Hartley](#), [William H.D. Fones Jr.](#), [Steven K. Wood](#), or your counsel at Baker Donelson, to address matters particular to your facts and circumstances.