

Income/Franchise:

Tennessee DOR Addresses Pushdown Accounting on SMLLC's Franchise and Excise Tax Computation

Letter Ruling No. 21-06, Tenn. Dept. of Rev. (6/10/21). The Tennessee Department of Revenue (Department) issued a letter ruling addressing the impact of an Internal Revenue Code (IRC) section 754 election on a related single-member limited liability company's (SMLLC) Tennessee franchise and excise tax computation, concluding that, under the provided facts, the SMLLC:

URL: <https://www.tn.gov/content/dam/tn/revenue/documents/rulings/fae/21-06fe.pdf>

1. Must include a step-up in basis for Tennessee franchise (net worth) tax purposes as this portion of the tax is calculated based on amounts reported under generally accepted accounting principles (GAAP); and
2. May not include underlying IRC section 743(b) tax basis adjustments and associated amortization and depreciation deductions in calculating its net earnings for Tennessee excise tax purposes because this portion of the tax is based upon federal income.

Under the facts, a multi-member limited liability company, classified as a partnership for federal tax purposes (*i.e.*, "parent partnership"), indirectly wholly owned the SMLLC through a tiered ownership structure involving other single-member limited liability companies, with the SMLLC at issue being the only entity with in-state activities and thus required to file a separate entity return in Tennessee for state franchise and excise tax purposes. As part of an underlying restructuring plan, the parent partnership made an election under IRC section 754, such that the purchasers' adjusted basis in the parent partnership's property was stepped up to fair market value under IRC section 743(b). For Tennessee franchise tax purposes, the Department explained that because the parent partnership and SMLLC filed consolidated GAAP financial statements reflecting the step-up in basis, the SMLLC must include the step-up in calculating its net worth base. However, for Tennessee excise tax purposes, the Department explained that the adjustment of the stepped-up basis applies only to the purchasers for federal income tax purposes and that because "no adjustment is made to the common basis of partnership property" for federal income tax purposes under Treas. Reg. § 1.743-1(j)(1), no corresponding adjustments are allowed in computing the SMLLC's Tennessee net earnings. Please contact us with any questions.

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