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Chapter 18: Financial Institutions

Overview of Financial Institution Taxation

Financial institutions (FI)[1] doing business[2] and having a substantial nexus[3] in Tennessee file a combined[4] franchise and excise tax return with unitary[5] businesses. This return is the FAE174 Financial Institution and Captive Real Estate Investment Trust Tax Return.

The franchise and excise tax is computed on the combined net worth and net earnings of the unitary group.[6] Electing taxpayers may calculate their franchise tax net worth base on a consolidated basis[7] with affiliated group[8] members instead of a combined basis with unitary businesses.

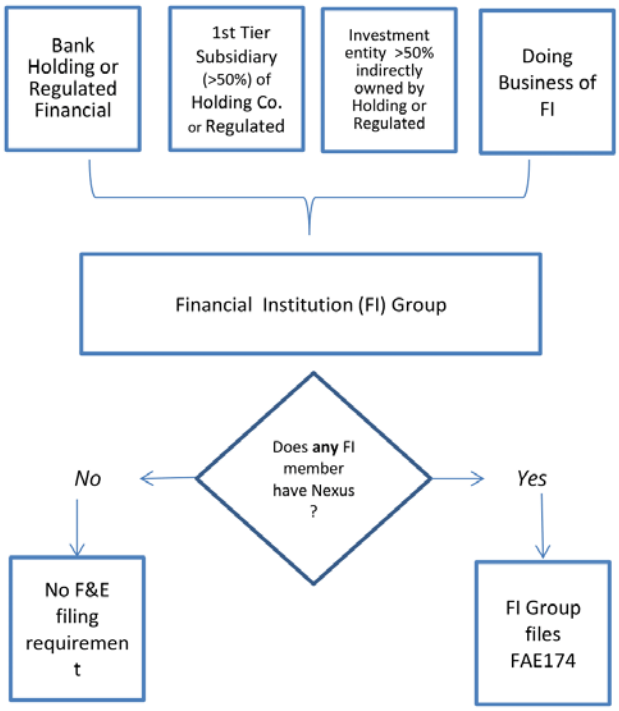
Multistate[9] taxpayers filing Form FAE174 generally apportion net worth and net income based on a receipts factor.[10] The property and payroll factors are not considered unless consolidated net worth (CNW) is apportioned using Schedule 174NC.[11]

Preliminary audit steps should be done to determine:

- If the business is a financial institution;
- If the business has nexus with the state; and
- If there are any unitary businesses that should be included in the combined franchise and excise tax return.

See the decision chart on the following page, which identifies entities that should be included in an FI group.

Decision Chart - Entity Inclusion in FAE174 Unitary Return



Financial Institution Defined

A financial institution[12] is a:

- Holding company;[13]
- Regulated financial corporation;[14]
- Subsidiary of a "bank" holding company or a regulated financial corporation;
- Investment entity[15] that is indirectly more than fifty percent (50%) owned by a "bank" holding company or a regulated financial corporation; or
- Any other person that is carrying on the "business of a financial institution."[16]

Insurance companies are <u>not</u> financial institutions.

Note that the five-part definition of a "financial institution" contains numerous statutory terms that are defined under Tenn. Code Ann. § 67-4-2004. Each of these terms are discussed below.

1. Holding Company

The first type of financial institution listed above is a holding company, but only certain types of holding companies are considered financial institutions. The holding company must:

- Meet the definition of a bank holding company under 12 U.S.C. § 1841(a) of the Bank Holding Company Act of 1956 ("BHCA"); or
- be a corporation defined as a "savings and loan holding company," "multiple savings and loan holding company," or "diversified savings and loan holding company," under 12 U.S.C. § 1467a(a)(1).

Generally, a bank holding company is formed or registered under the BHCA, which has control over a bank. A savings and loan holding company is one that directly or indirectly controls a savings association.

The federal code *exempts certain entities* from being a bank holding company.[17] It defines "bank" and lists exceptions to that definition.[18] An entity that might appear to be a bank holding

company may actually be a parent to a regulated financial corporation instead of a bank holding company. For example:

- An entity called XYZ Bank USA is not considered a bank under 12 U.S.C. § 1841(c)(2)(H) because it is an industrial loan company.

- XYZ's parent does not meet the state's definition of a holding company because, technically, it owns a regulated financial corporation and not a bank (even though "bank" is in the subsidiary's name).

Please see 12 U.S.C. § 1841(c)(2) for more examples of entities that should not be considered banks for the purpose of identifying bank holding companies. Discussed under this federal code section are foreign banks, insured institutions, trusts, credit unions, credit card operations, and industrial banks.

All bank holding companies are required to register with the Board of Governors of the Federal Reserve System and file certain reports. The 50 largest bank holding companies are listed at https://www.ffiec.gov/npw/Institution/TopHoldings and their report filings may be viewed at https://www.ffiec.gov/npw/. In addition, if there are more than 2,000 shareholders, the bank holding company must register with the Securities and Exchange Commission.

In summary, all banks are regulated financial corporations under Tennessee code, but not all regulated financial institutions are banks under 12 U.S.C. § 1841. A company that is a parent to an entity with "bank" or "trust" in its name does not automatically make it a holding company per Tenn. Code Ann. § 67-4-2004(21).

2. Regulated Financial Corporation

A second type of financial institution is a "regulated financial corporation," as defined under Tennessee law.[19] A regulated financial corporation is an FI if it is:

- An institution that has *accounts insured* under the Federal Deposit Insurance Act ("FDIC") per 12 U.S.C. § 1811; or

- A *member* of a federal home loan bank;[20] or

- Any other bank or thrift institution[21] organized under the laws of any jurisdiction.[22]

Regulated financial corporations include banks and thrift institutions *organized in a foreign country* that are engaged in the business of receiving deposits, any corporation organized under 12 U.S.C. §§ 611-6311,[23] Edge Act corporations, and any agency of a foreign depository, as defined in 12 U.S.C. § 3101. An Edge Act corporation is a subsidiary of a U.S. or foreign bank that *engages in foreign banking operations*; these subsidiaries are authorized under the 1919 Edge Act.

Note that many corporations are regulated by someone, but the franchise and excise tax definition of a "regulated financial corporation" is very specific. For example:

- Deferred presentment service entities and trust companies performing fiduciary duties are subject to Title 45 - Banks and Financial Institutions (Tenn. Code Ann. §§ 45-2-2001, 45-17-102) - but they are not regulated financial corporations under Tenn. Code Ann. § 67-4-2004(45).

- However, regulated financial corporations are financial institutions because their business is authorized by *Tennessee Code Annotated*, Title 45, and they are doing the "business of a financial institution."[24]

- In other words, an entity that is not a regulated financial institution may still be considered a financial institution if it meets one of the other criteria.

Office of the Comptroller of the Currency

National banks and federal savings associations are "financial institutions" for franchise and excise tax purposes because they are regulated financial corporations per Tenn. Code Ann. § 67-4-2004(45).

They are chartered and controlled by the Office of the Comptroller of the Currency ("OCC"). The OCC's website has links to Lists of Financial Institutions and many helpful topics.[25] The OCC ensures that national banks and federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. The Comptroller of the OCC is also the director of the FDIC and NeighborWorks® America. In regulating national banks and federal thrifts, the OCC has the power to:

- Examine the national banks and federal thrifts;

- Approve or deny applications for new charters, branches, capital, or other changes in corporate or banking structure;

- Take supervisory actions against national banks and federal thrifts that do not comply with laws and regulations or that otherwise engage in unsound practices;

- Remove officers and directors, negotiate agreements to change banking practices, and issue cease and desist orders as well as civil money penalties; and

- Issue rules and regulations, legal interpretations, and corporate decisions governing investments, lending, and other practices.

3. Subsidiary of a Holding Company or Regulated Financial Corporation

Part 3 of the Tennessee FI definition states that a *subsidiary* of a "bank" holding company or regulated financial corporation is also considered a financial institution. The subsidiary must be a first-tier subsidiary. A *second-tier subsidiary* is not a financial institution and should **not** be included in a combined FAE174 return.[26]

The term "subsidiary" is not defined in the franchise and excise tax statutes. However, based on the basic tenets of statutory construction, the common use of the word "subsidiary" indicates that a subsidiary is a company that is owned greater than 50% by another company,[27] which is known as the "parent." The subsidiary can be a company, corporation, or limited liability company. For purposes of the Tennessee FI definition, a subsidiary is not required to be a banking-type business. The only requirement is that it be a first-tier subsidiary of a "bank" holding company or regulated financial corporation.

4. An Investment Entity that is *Indirectly* More Than 50% Owned by A Holding Company or Regulated Financial Corporation

Part 4 of the Tennessee FI definition includes a person that receives more than 50% of its gross income from *investment securities*, from the business of a financial institution, and is indirectly more than 50% owned by a "bank" holding company or a regulated financial corporation.[28]

Investment securities include:

- Any note;

- United States treasury securities;
- Obligations of United States government agencies and corporations;
- Obligations of state and political subdivisions;
- Corporate debt securities;
- Participations in securities backed by mortgages held by the United States or state government agencies;
- Loan-backed securities;
- Bonds, debentures, evidence of indebtedness; and
- Other similar debt investments.

5. An Entity Carrying on the Business of a Financial Institution

The last part of the Tennessee FI definition states that any entity *carrying on the business of a financial institution* is a financial institution. Many taxpayers may be defined as FIs because of the following lengthy definition of the "business of a financial institution."[29]

The business of an FI means:

- The business that a regulated financial corporation may be authorized to do under state or federal law *or the business that its subsidiary is authorized to do by the proper regulatory authorities*;
- The business that *any person*[30] organized under the authority of the United States or organized under the laws of any other taxing jurisdiction or country does or has *authority to do that is substantially similar* to the business that a corporation may be created to do under *Title 45*,[31] or any business that a corporation or its subsidiary is authorized to do by Title 45.

  - Title 45 - "Banks and Financial Institutions" - regulates banking institutions, savings and loan associations, credit unions, industrial loan and thrift companies,

pawnbrokers, money transmitters, business and industrial development corporations (BIDCO), international banking, flex loan providers, mortgage lending, savings banks, title pledge lenders, deferred presentment services, and cash payment instrument services.

- Otherwise making, acquiring, selling or servicing loans or extensions of credit, including, but not limited to, the following:
  - Secured or unsecured consumer *loans*;
  - Installment *loans*;
  - Mortgages or deeds of trust or other secured *loans* on real or tangible personal property;
  - Credit card *loans*;
  - Secured or unsecured commercial *loans* of any type;
  - Letters of credit and acceptance of drafts (*a letter of credit is a written commitment by a bank on behalf of a buyer that guarantees payment*);
  - The holding of participation loans in which more than one lender is a creditor to a common borrower;
  - Loans arising in factoring;[32] and
  - Any other transactions of a comparable economic effect;
  - Leasing or acting as an agent, broker or adviser in connection with leasing real and personal property that is the economic equivalent of an extension of credit;[33] or
  - Operating a credit card business.

If the "business of a financial institution," as defined above, generates less than 50% of an entity's gross income, the entity will not be considered a financial institution. For purposes of the 50% test, gross income does not include income from nonrecurring, extraordinary transactions.[34]

Doing Business

The intent of the General Assembly is to subject taxpayers to the franchise and excise tax to the extent permitted by the United States Constitution and the Constitution of Tennessee. A

financial institution, standing on its own, will have a franchise and excise tax filing requirement[35] if it is 1) "doing business within this state"[36] *and* 2) has substantial nexus.[37]

The code section that defines "doing business in Tennessee" specifically addresses financial institutions.[38] A financial institution is presumed to be "doing business in Tennessee" if the sum of its assets and the absolute value of its deposits attributable to sources within this state is $5,000,000 or more. Tangible assets are attributed to the state in which they are located.

Income from intangible assets is attributed to the state in which the assets are located. Deposits are attributed to Tennessee if they are deposits made by this state or any of its agencies, instrumentalities or subdivisions or by any resident of this state, regardless of whether the deposits are accepted or maintained at locations in this state. Additionally, a financial institution is deemed to be doing business in this state if the institution:

- Maintains an office in this state;
- Has an employee, representative or independent contractor conducting business in this state;
- Regularly sells products or services of any kind or nature to customers in this state that receive the product or service in this state;
- Regularly solicits business from potential customers in this state;
- Regularly performs services outside this state that are consumed in this state;
- Regularly engages in transactions with customers in this state that involve intangible property, including loans, and result in receipts flowing to the taxpayer from within this state;
- Owns or leases property located in this state; or
- Regularly solicits and receives deposits from customers in this state.[39]

A financial institution is **not** considered to be conducting the "business of a financial institution" in Tennessee if its only activity in the state is the ownership of an interest in one or more of the following types of property:

- An interest in a real estate mortgage investment conduit, a real estate investment trust, or a regulated investment company, as those terms are defined by the Internal Revenue Code of 1986;

- An interest in a loan-backed security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments in relation to payments or reasonable projections of payments on the notes or certificates;

- An interest in a loan, lease, note or other assets attributed to this state and in which the payment obligations were solicited and entered into by a person that is *independent and not acting on behalf of the owner*;

- An interest in the right to service or collect income from a loan or other asset from which interest on the loan or other asset is attributed to this state and in which the payment obligations were solicited and entered into by a person that is *independent* and not acting on behalf of the owner;

- An interest in demand deposit clearing accounts, federal funds, certificates of deposit and other similar wholesale banking instruments issued by other financial institutions;

- An interest in a security; or

- An interest of a financial institution in any intangible, tangible, real or personal property acquired in satisfaction, whether in whole or in part, of any asset embodying a payment obligation that is in default, whether secured or unsecured, if the ownership of the interest would be exempt otherwise as provided in bullet points 1-5 above.[40]

In addition, activities within Tennessee related to the above interests that are reasonably required to evaluate and complete the acquisition or disposition of the property, the servicing of the property or the income from it, the collection of income from the property, or the acquisition or liquidation of collateral relating to the property, are **not** considered to be conducting the business of a financial institution.[41] However, ownership of tangible property in the state may create nexus.[42]

The term "independent person who is not acting on behalf of the owner," which is mentioned in the third and fourth bullet points above, means:

- At the time of the acquisition of the assets, the owner of the asset does not directly or indirectly own 15% or more of the outstanding stock or, in the case of a partnership or limited liability company, 15% or more of the capital or profits interest, of the entity from which the owner originally acquired the asset. In determining indirect ownership, an owner is deemed to own all of the stock, capital interest or profits interest owned by another person if the owner directly owns 15% or more of the stock, capital interest or profits interest in that other person. Also, the owner is deemed to own all stock, capital interest and profits interest directly owned by any intermediary parties in the transaction, to the extent a 15% or more chain of ownership of stock, capital interest or profits interest exists between the owner and any intermediary party;

- The entity from which the owner acquired the asset regularly sells, assigns or transfers interest in such assets to three or more persons during the full twelve-month period immediately preceding the month of acquisition; and

- The entity from which the owner acquired the asset does not sell, assign or transfer 90% or more of its exempt assets to the owner during the full twelve-month period immediately preceding the month of acquisition.[43]

Unitary Group

Generally, entities must file their own separate entity returns based on their own single business activities. Financial institutions, however, are excepted from the separate entity filing requirements; FIs are required to file a combined return with unitary group members.[44] A "unitary business or group"[45] means:

- Business activities or operations *of financial institutions* that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution.

- The unitary concept applies only to financial institutions.

A unitary group filing Form FAE174 must include FIs with no Tennessee connections apart from being engaged in a unitary business with an FI that is subject to franchise and excise tax. Taxpayers should *first* identify entities that meet the definition of an FI and *then* determine the unitary group.[46]

Unitary group members are generally corporations. The definitions of "holding company" and "regulated financial corporation" both reference corporations. However, any entity doing the

business of a financial institution would also be a member of an FI unitary group and could be a partnership or other type of entity. Thus, the combined FI return may include the activities of all types of entities. A real estate investment trust ("REIT")[47] should be viewed like any other corporation. It may file as a part of a unitary group on Form FAE174 if it is a unitary financial institution. Also, as explained in the following section, captive REITs file on Form FAE174. A REIT that is *not* a captive REIT nor unitary with a financial institution must file on a separate entity basis on Form FAE170.

1. Captive Real Estate Investment Trust Affiliated Group

There is a second exception to the general rule that franchise and excise returns should be filed on a separate entity basis. Members of a "captive REIT affiliated group"[48] ("CRAG") are required to file on a combined basis[49] on Form FAE174.

A *captive REIT*[50] is a non-public REIT that is owned at least 80% by another entity. The ownership may be direct or indirect and is determined by generally accepted accounting principles ("GAAP"). A captive REIT affiliated group files a combined return on Form FAE174 and includes the captive REIT and any entity in which the captive REIT, directly or indirectly, has more than 50% ownership interest. However, there is an additional exception to this filing requirement.

A CRAG does not exist if the captive REIT is owned, directly or indirectly, by a bank, a bank holding company, or a public REIT. The CRAG does not include the entity that has the 80%-or-more ownership in the non-public REIT.

There are several Tennessee code sections that address the taxation of REITs. For a complete discussion on this topic, see Chapter 17 of this manual.

2. Exempt Unitary Entities and Apportionment

Credit unions, insurance companies, and non-business trusts are exempt from franchise and excise tax.[51] All exempt entities[52] should be included in the FI group if they are unitary businesses.[53] However, the exempt entity's net earnings should be excluded from the net earnings of the FI group and the receipts should be excluded from both the numerator and denominator of the group's apportionment formula.

An FI group computing its franchise tax net worth base on Schedule F should list exempt unitary businesses on the standard apportionment Schedule SF. However, the exempt businesses should not include their financial information. Listing the exempt unitary businesses on

Schedule SF allows the taxpayer to provide the Department with a complete picture of the taxpayer's organizational structure, but listing them should not affect the tax calculations of any entities subject to franchise and excise tax.

An FI group making the CNW election should list exempt affiliates on the election form. However, the exempt affiliates' net worth should not be included in the consolidated net worth calculation on Schedule F2. See Ruling 17-06.

Trust Preferred Securities Do Not Meet Exemption Criteria

Entities whose purpose is to hold "trust preferred securities" generally are not exempt from franchise and excise tax under Tenn. Code Ann. § 67-4-2008(10).

This franchise and excise tax exemption applies to the asset-backed securitization of debt obligations, such as first or second mortgages, including home equity loans, trade receivables, whether an open account or evidenced by a note or installment or conditional sales contract, obligations substituted for trade receivables, credit card receivables, personal property leases treated as debt for purposes of the Internal Revenue Code of 1986, home equity loans, automobile loans, or similar debt obligations.

Trust preferred securities are hybrid securities that have debt characteristics that provide preferential treatment as debt for federal income tax purposes. However, they also have equity characteristics that allow bank holding companies to count the securities as capital for regulatory purposes. These types of securities are not "debt obligations" for the purpose of the exemption under Tenn. Code Ann. § 67-4-2008(10). See Ruling 11-55.

3. Disclosure Requirement for Financial Institutions

Financial institutions that receive dividends, directly or indirectly, from a captive REIT must disclose the dividends on the Financial Institution F&E Captive REIT Disclosure Form. If the FI fails to make the disclosure, the dividends received deduction with respect to dividends received (directly or indirectly) from the captive REIT will be disallowed and the FI's net earnings will be adjusted accordingly. In addition, the taxpayer will be subject to a 50% penalty on the amount of any underpayment arising from this adjustment.

The penalty is equal to the greater of $10,000 or 50% of any adjustment to the initially filed return. See Tenn. Code Ann. § 67-4-2006(e).

Combined Basis

FI unitary groups complete Form FAE174 on a combined basis[54] for all members of the unitary group. All dividends, receipts and expenses resulting from transactions between members of the unitary group are excluded when computing combined net earnings or net loss,[55] but intercompany transactions are not excluded in computing the nonconsolidated franchise tax base.[56] The following chart shows that eliminations are made except for the franchise tax base computed on Schedule F. The excise tax law does not explicitly state that intercompany eliminations should be made in computing the excise tax apportionment ratio on Schedule SE; however, it is a well-established Department policy that these eliminations should be made.

	Eliminations are made to arrive at Tax Base	**Eliminations are made to arrive at the Apportionment Ratio**	**Tenn. Code Ann. § 67-4-_____**
Franchise Tax, Schedule F Nonconsolidated Net Worth	No	Yes (Schedule SE)	2106(b), 2114(c)(1), 2118
Franchise Tax, Schedule F1 Captive REIT Net Worth	Yes	Yes (Schedule N)	2106(b), 2111(g)(2)
Franchise Tax, Schedule F2 Consolidated Net Worth	Yes	Yes (Schedules 174SC, 174NC)	2106(b), 2118(d)(3)(A)
Excise Tax, Schedule J	Yes	Yes (Schedule SE)	2006(a)(3), 2013(b)
Excise Tax, Schedule J, Captive REIT	Yes	Yes (Schedule N)	2006(9), 2013(d)

1. Joint Liability

The members of the FI unitary group designate one member that is subject to franchise and excise tax in this state to file the combined return. Each member subject to tax in this state is jointly and severally liable for the franchise and excise tax liability of the unitary business. However, this liability will not apply to any member that is a limited liability company, limited liability partnership, or limited partnership and meets certain criteria.[57] For example:

- The member was formed and operated for the primary purpose of acquiring, from one or more of its direct or indirect owners, notes, accounts receivable, installment sale contracts, or similar evidences of indebtedness; and

- The member has pledged substantially all (66.67%)[58] of its assets as security, directly or indirectly, for third party borrowings or securitized indebtedness acquired by third parties.[59]

2. FI Unitary Group versus GAAP Consolidated Group

Chapter 9 of this manual contains a section titled "Verifying Affiliated Group Members," which discusses the GAAP rules concerning consolidation. Generally, entities under common control are included in consolidated financial statements. A review of that section may be helpful in understanding why certain entities are included or excluded from consolidated financial statements. Obtaining a basic understanding of the principles of consolidation may be helpful in identifying FI unitary group members.

3. Unitary Group - Federal Form 851

The federal Form 851 - Affiliations Schedule - provides helpful information in determining unitary members to be included on the FAE174 return. Form 851 identifies a corporate parent and its affiliated group. An affiliated group, for the purpose of this federal form, is one or more chains of includible corporations connected through stock ownership with a common parent corporation. The common parent must be an includible corporation and the following two requirements must be met.

- The common parent must own directly stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of at least one of the other includible corporations.

- Stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of each of the other corporations (except for the common parent) must be owned directly by *one or more of the other includible corporations*. For this purpose, the term "stock" generally doesn't include any stock that is nonvoting, nonconvertible, limited and preferred as to dividends, doesn't participate significantly in corporate growth, and has redemption and liquidation rights that don't exceed the issue price of the stock except for a reasonable redemption or liquidation premium.

Form 851 aids in determining FI group members because it shows the relationships between, and the principal business activity codes for, each corporation listed. The principal business activity codes are based on the North American Industry Classification System ("NAICS"). The activity resulting in the largest percentage of a company's total receipts is used in determining

the code. The 520000 series codes are for finance and insurance receipts. Most FI unitary group members will generally be found in this series, but not all entities in this series will meet the state's definition of an FI. For example, a securities brokerage company has a NAICS code of 523120, but is not an FI.

The NAICS website provides a detailed description for specific codes and the names of top businesses found within specific codes.[60] Entities regulated under Title 45 of the *Tennessee Code Annotated* are considered to be doing the business of a financial institution. For example:

- 522110 – Commercial Banking
- 522120 – Savings Institutions
- 522130 – Credit Unions
- 522190 – Other Depository Credit Intermediation
- 522210 – Credit Card Issuing
- 522220 – Sales Financing
- 522291 – Consumer Lending
- 522292 – Real Estate Credit (including mortgage bankers and originators)
- 522293 – International Trade Financing
- 522294 – Secondary Market Financing
- 522298 – All Other Nondepository Credit Intermediation
- 522300 – Activities Related to Credit Intermediation (including loan brokers, check clearing, and money transmitting)
- 523110 – Investment Banking & Securities Dealing

Form 851 has its limitations. It might include corporations that should not be included in the FI group, and it excludes non-corporate entities and corporations filing on a variant of Form 1120 (e.g., Form 1120-REIT) that should be included in the FI group. For example:

- A financial institution unitary group may include partnerships and REITs[61] that would not be listed on federal Form 851.

- Not all corporations listed on federal Form 851 will meet the state's definition of a unitary financial institution, like security brokerage companies.

Franchise Tax Net Worth Tax Base

The franchise tax computation for a Form FAE174 filer is .0025 of the *greater* of the *combined net worth tax base* or the *combined real and tangible property tax base*. The net worth base calculation

is completed on Schedule F unless the taxpayer is a captive REIT or has made a consolidated net worth election.

1. Schedule F – Non-Consolidated Net Worth

A standalone financial institution[62] and a *unitary group* filing on a combined basis[63] computes its net worth franchise tax base on Form FAE174, Schedule F. Combined net worth is the sum of each individual unitary group member's total assets less its total liabilities, as determined under GAAP.[64] The net worth base is computed individually for each unitary group member and then the net worth bases are combined. Each unitary member's net worth, indebtedness add-back,[65] and apportionment ratio is entered individually on Schedule F. The sum of the apportioned net worth amounts for all unitary group members is the net worth franchise tax base that is subject to the .0025 franchise tax rate.

No Eliminations to the Non-Consolidated Net Worth Base

The amount entered on Schedule F under the column Everywhere Total should **not** take into account intercompany eliminations. Intercompany transactions are eliminated when preparing consolidated financial statements under GAAP. However, the separate entity presentation on Schedule F is different from what is normally seen in a GAAP consolidated financial statement. Under GAAP, all the affiliates' assets, liabilities, and net worth values are summed and then eliminations are made to arrive at a single consolidated financial statement. Schedule F is different in that it retains separate entity net worth details. There is no support in the code for intercompany eliminations in this instance and they should not be made in arriving at the Schedule F net worth amount.

Revenue Shifting

Shifting revenue to a unitary group member with a lower apportionment ratio may create tax planning opportunities for taxpayers. This is possible because intercompany eliminations are *not* made in arriving at the non-consolidated net worth amount. If an auditor finds that unitary group members are artificially shifting revenues amongst one another in a manner that does not fairly represent the taxpayers' business activity in this state or their net worth, the auditor may request a variance if the auditor and their supervisor think it is appropriate.[66]

Equity Method Investments – Schedule F

An FI unitary group member that has an ownership interest in another FI member will likely use the equity method of accounting under GAAP to account for its investment if the ownership interest is between 20% - 50%. The investment account on the balance sheet will reflect the initial cost of the investment and the subsequent changes in its value. For example:

- FI unitary group member #10 owns 40% of the common stock of FI unitary group member #21.
- The balance sheet of unitary member #10 has an account on its balance sheet titled "Investment in Unitary Member #21." This account reflects the cost of unitary member #10's 40% stake in unitary member #21 and it is adjusted annually to reflect unitary member #10's 40% share of income and dividends from unitary member #21.
- Both the book value of unitary member #10's investment account (in unitary member #21), which is included in unitary member #10's net worth computation, and the actual net worth of unitary member #21 (per its GAAP books) are included on Schedule F.
- This effectively results in 140% of unitary member #21's net worth being reported on Schedule F—100% of its reported net worth plus unitary member #10's 40% share of its net worth, as reflected in the investment account.
- Taxpayers may avoid this outcome by making a consolidated net worth election and filing Schedule F2.

For more information regarding the GAAP equity method of accounting and the franchise tax consolidated net worth election, see Chapter 9 of this manual.

Apportionment – Schedule SF

A franchise tax apportionment ratio is computed separately for each unitary member on Schedule SF. Each member's net worth plus any applicable indebtedness is multiplied by a quotient of the member's *total receipts* attributable to business in TN, divided by the member's *total receipts* everywhere. This computation applies to all group members, even those that would not be subject to franchise and excise tax if not for being part of the unitary group. For example:

- A unitary member that is not doing business in Tennessee and does not have nexus with Tennessee would still report an apportionment denominator value on Schedule SF and a net worth value on Schedule F.

Certain Eliminations Required for Schedule SF Apportionment Ratio

Dividends, receipts, and expenses resulting from transactions between members of a unitary group are excluded from the return *for purposes of apportionment* under Tenn. Code Ann. § 67-4-2118."[67] In other words, transactions between members are eliminated in arriving at the apportionment ratio that is reported on Schedule SF. Common intercompany transactions that are eliminated from the receipts factor include:

- Management fees
- Interest
- Dividends

    - Dividends are excluded from the numerator and denominator of a unitary member's apportionment ratio if they were:

        - Received from a unitary member included in the return;
        - Received from an 80%-or-more owned corporation that is not unitary; or
        - Non-business earnings.

Receipts Sourcing

Tennessee law defines "receipts" and determines when receipts are attributable to this state for apportionment purposes. "Receipts" means all receipts valued at their *gross* amounts and derived from transactions and activities in the regular course of business.[68] Exceptions to this general rule are as follows:

- Dividends, receipts, and expenses resulting from *transactions between members of a unitary group* are *excluded* from the return for purposes of the apportionment of net worth (single entity, combined, and consolidated) under Tenn. Code Ann. § 67-4-2118.[69]

- Receipts from the disposition of assets such as securities[70] and money market transactions are included to the extent of the *net taxable gain,*[71] rather than the gross proceeds.

    - The *net gain* (rather than gross proceeds) from the asset sale or disposition should be used if the use of gross proceeds would cause distortion in the apportionment ratio.[72]

In summary, the net worth apportionment denominators on Schedule SF will include all receipts for all members of the unitary group. The receipts will generally be valued at their gross amounts,[73] but *there are exceptions as noted above*.

The franchise and excise tax law identifies twelve receipt types, along with sourcing methods for each, that are to be considered in determining financial institution apportionment.[74] Although Schedule SF does not break out the twelve receipt types per entity, each individual entity included on Schedule SF must consider the twelve receipt types for apportionment purposes. For reference, Form FAE174, Schedules 174SC and SE, Lines 1-12, list these receipt types.

Receipt types 1-11 are often referred to as the "enumerated receipts." Receipt type twelve is a "catch all" for receipts that do not fit into any of the other categories. Non-excluded receipts that do not fit into the first eleven enumerated receipts categories are sourced to Tennessee *in the same proportion that the aggregate of the eleven identified receipts are attributed to Tennessee*.[75] For example, *investment* interest and dividends fit into this last "catch all" category. Below is an example of how these non-enumerated receipts are factored into the apportionment calculation.

Financial Institution Apportionment
Proportionate Attribution of Other Receipts,
per Tenn. Code Ann. §§ 67-4-2013(b)(3)(L) and 67-4-2118(c)(12)

Receipt Type	TN	Everywhere	%
1 Interest	300,000	2,100,000	0.142857
2 Service Charges	15,000	74,900	0.200267
3 Trust Department	250,000	2,150,000	0.116279
4 Other Services	112,000	1,199,000	0.093411
5 Rental Income	2,099,000	13,180,000	0.159256
6 Investment Interest and Dividends		6,130,000	0
Total	2,776,000	24,833,900	0.111783
Remove receipts not specifically enumerated in statute		(6,130,000)	

Determine ratio	2,776,000	18,703,900	0.148418

Apply ratio to receipts not specifically enumerated in statute	6,130,000
Non-enumerated receipts sourced to Tennessee	909,804
(909,804 / 6,130,000 = 0.148418)	

The methodology used by taxpayers in reporting apportionment denominator values on Schedule SF often requires audit adjustments. Taxpayers often report the pro forma federal Form 1120, Line 11, amount as the denominator value, but audit adjustments will be needed if any of the following are present:

- There are receipts that are not enumerated in Tenn. Code Ann. § 67-4-2118(c)(1)-(11). These "other receipts" should not impact the apportionment ratio. The "other receipts" are correctly reported in the denominator, but the numerator value should be plugged (as illustrated above) so as to attribute to Tennessee the "other receipts" in the same proportion as the ratio determined by receipts 1-11 in the aggregate. In other words, the ratio for "other receipts" should be the same as the overall ratio reported on Schedule SF for a given member. Common "other receipts" include investment dividends and income.

- The total income from Form 1120, Line 11, does not consider gross income amounts. For example, there may be a value on Form 1120, Lines 1-10, with a negative amount. Gross income can never be a negative amount. Therefore, an audit adjustment is needed to reflect the gross amount. If Rule 32 applies,[76] then the *net value* may be used, but the net value can never be less than zero. Federal Schedule D and Form 4797, from which many ordinary and capital gains and losses are traced to the first page of the federal return, will show the gross proceeds from asset sales or other dispositions.

Receipts Sourced to Tennessee – Schedule SF

Receipts are attributed to Tennessee as follows:[77]

- Rents received from real or tangible personal property are sourced to Tennessee if the property is located in Tennessee;

- Interest income and other receipts from assets, loans, or installment sale contracts that are primarily secured by or deal with real or tangible personal property, are

sourced to Tennessee if the property/security is located in Tennessee. If any part of the property/security is located both within and outside of Tennessee, *a portion* of the interest or other income is sourced to Tennessee based on the proportion of the "value" of the property in Tennessee as compared the "value" of the whole property;

- "Value" means fair market value at the time the loan is made. If property is pledged as security after the initial loan is made, the ratio (Tennessee/Everywhere) may be adjusted.

- Interest income and other receipts from unsecured consumer loans are sourced to Tennessee if the loan is made to a Tennessee resident, regardless of whether the loan was made at a place of business, by a traveling loan officer, by mail, by telephone or by other electronic means;

- Interest income and other receipts from unsecured commercial loans and installment obligations are sourced to Tennessee if the proceeds of the loan are to be *applied in* Tennessee;

  - If it cannot be determined where the funds are to be applied, the receipts are to be sourced to the state where the business "applied for" the loan.

    - "Applied for" means initial inquiry, customer assistance in preparing the loan application, or submission of a completed loan application, whichever occurs first. "Loan" does not include demand deposit accounts, federal funds, certificates of deposit, and other similar wholesale banking instruments issued by other financial institutions.

- All receipts and fee income from the issuance of letters of credit, acceptance of drafts, and other devices for assuring or guaranteeing a loan or credit are sourced *in the same manner as* interest income/receipts from the loan. *(See bullet points 2, 3, and 4 above.)*;

- Interest income, merchant discount, other receipts, including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders, and fees, are sourced to the state where the card charges and fees are regularly billed;

- Receipts from the sale of an asset, tangible or intangible, are attributed in the same manner that the income from the asset would be attributed under this section;

- Receipts equal to the net gain or income from the sale of a security made by a dealer in the security (26 U.S.C. § 475) are sourced to Tennessee if the dealer's customer is located in Tennessee and the receipt is not sourced under bullet point seven above. A customer is in Tennessee if the customer is an individual, trust, or estate that is a resident of Tennessee and, for all other customers, if the customer's *commercial domicile* is in Tennessee. Unless the dealer has actual knowledge of the residence or commercial domicile of a customer during a taxable year, the customer is deemed to be a Tennessee customer if the billing address of the customer, as shown in the records of the dealer, is in Tennessee;[78]

- Receipts from the performance of fiduciary and other services are sourced to Tennessee if the service is delivered to a Tennessee location under market-based sourcing;[79]

- Receipts from the issuance of traveler's checks, money orders or United States savings bonds are sourced to the state where such items were purchased;

- Receipts from a participating financial institution's portion of participation loans are sourced as otherwise provided above. A participation loan is any loan in which more than one lender is a creditor to a common borrower; and

- Any other receipts of gross income not specifically covered in (1)-(11) above should be sourced to Tennessee in the same proportion that aggregate receipts are attributed to Tennessee under (1)-(11).

    - This is accomplished by computing the apportionment ratio without considering any numerator or denominator values for this twelfth category of receipts. The ratio based on receipt types 1-11 above is then applied to this category of receipts to source the other receipts to Tennessee. See the Receipts Sourcing section in this chapter for an example of this calculation.

2. Schedule F2 – Consolidated Net Worth

A financial institution unitary group filing Form FAE174 on a combined basis may make an election to compute the group's net worth franchise tax base on a consolidated basis. The

election is binding for a minimum of five years[80] and must be agreed to by all affiliated group[81]members. In addition, to be eligible, all members must close their books on the same date.[82] The affiliated group for purposes of the Schedule F2, consolidated net worth ("CNW") calculation might include some affiliates that would not otherwise included in the combined return. An affiliate[83] that is not a financial institution[84] would be included in the CNW calculation, but not the excise tax calculation.[85]

CNW is the difference between the total assets less the total liabilities of the *affiliated group.* The financial data comes from a GAAP basis pro forma consolidated balance sheet that includes all members of the affiliated group. The pro forma consolidated balance sheet is prepared in accordance with GAAP, where transactions and holdings between members of the group and holdings in non-domestic persons have been eliminated.[86, 87]

It is important to note that Schedule F - Non-Consolidated Net Worth - and Schedule F2 - Consolidated Net Worth - each involves different "groups" of entities. Each group has its own unique definition in the franchise and excise tax statutes[88] (e.g., unitary, affiliate) and care should be taken so as to apply the correct definition to a given situation. For example:

- A *unitary group* makes the CNW election to compute net worth on a consolidated basis with its *affiliated group*. The members of the unitary group that are included in the FAE174 return are *financial institutions*, as defined in the franchise and excise tax code.[89]

- The group members of the CNW *affiliated group* are all *domestic persons*[90] in which there is a greater than 50% ownership interest amongst one another.[91]

- So, it is possible that the CNW affiliated group includes entities that would not be included in the excise tax portion of the FAE174 return. One example of this situation might be a construction company that is 51%-owned by a person that is "carrying on the business of a financial institution." Because the construction company is 51%-owned by an FI, it meets the definition of an affiliate and would be included in the FI CNW affiliated group; however, because the construction company is not itself an FI, it would not be included in the excise tax portion of the FI combined return.

Receipts Are Sourced to Tennessee on Schedules 174NC, 174SC, 170NC, 170SC

The CNW apportionment ratio is computed on either Schedule 174SC or 174NC for a *unitary group* filing Form FAE174.[92] However, members of the *affiliated group* that do not meet the definition of "unitary" (like in the construction company example above) would file a separate

franchise and excise tax return on Form FAE170 and would compute their CNW apportionment ratio on either Schedule 170NC or 170SC. All affiliates that are part of a CNW election will be members of either: 1) an affiliated group, or 2) an FI affiliated group. For example:

- All affiliates will file the NC-type schedule, or all affiliates will file the SC-type schedule.
- If the definition of "financial institution affiliated group"[93] is met, then the SC-type of schedule is used.

The term "financial institution affiliated group," in its simplest terms, means that most of the affiliated group's gross receipts come from conducting the business of a financial institution; in this case, the CNW amount is apportioned using a one factor (receipts) formula instead of a three factor formula (property, payroll, and receipts). The term "financial institution affiliated group" should *not* be used outside the context of CNW apportionment.

For more information on how to make the determination of whether a CNW group is an "affiliated group" or an "FI affiliated group," and how to determine which CNW apportionment schedule is correct for a given taxpayer, see Chapter 9 of this manual.

3. Schedule F1 – Captive REIT Net Worth

A captive REIT affiliated group ("CRAG") computes its franchise tax on a combined basis[94] on Form FAE174, Schedule F1 - Captive Real Estate Investment Trust Net Worth. Net worth for a CRAG is the difference between the total assets less the total liabilities of the CRAG, as shown by a GAAP basis pro forma consolidated balance sheet that includes all members of the CRAG. The pro forma balance sheet is prepared in accordance with GAAP, where transactions and holdings between members of the CRAG and holdings in non-domestic persons have been eliminated.[95]

Three Factor Apportionment – Captive REITs

Property Factor:

- The numerator is the average value of the taxpayer's real and tangible personal property, excluding exempt inventory [96] owned or rented and used in this state during the tax period.

- The denominator is the average value of the group's real and tangible personal property owned or rented and used during the tax period, excluding exempt inventory determined on a per member basis.
  - Owned property is valued at its original cost.
  - Property rented by the taxpayer is valued at eight times the net annual rental rate.
  - The property factor is determined based on a pro forma consolidated balance sheet prepared in accordance with GAAP, where transactions and holdings between members of the group and holdings in non-domestic persons have been eliminated.[97]
  - The property factor also includes the ownership share of real or tangible property owned or rented by any general partnership not filing a franchise and excise tax return.[98] Please refer to Chapter 13 of this manual for additional discussions of all the apportionment factors.

Payroll Factor:

- The numerator is the total amount paid in Tennessee by the taxpayer for compensation;
- The denominator is the total compensation of the group paid everywhere during the tax period.

The payroll factor is determined based on a pro forma consolidated income statement prepared in accordance with GAAP, where transactions and holdings between members of the group and holdings in non-domestic persons have been eliminated.[99]

Receipts factor:

- The numerator is the taxpayer's total receipts in Tennessee.
- The denominator is the group's total receipts during the tax period.[100]

The receipts factor is determined based on a pro forma consolidated income statement prepared in accordance with GAAP, where transactions and holdings between members of the group and holdings in non-domestic persons have been eliminated.[101]

Franchise Tax Real and Tangible Property Tax Base

The franchise tax base for real and tangible property is reported on Form FAE174, Schedule G. This schedule is identical to the Form FAE170 schedule, except the values reported on Form FAE174 are the *sum of the unitary group member's* GAAP book values of real and tangible property owned or used within the state. Another difference is that Form FAE170 filers may use tax basis books and records to prepare Schedule G if the taxpayer does not maintain GAAP basis books and records; however, the exception to using GAAP basis books and records is ***not*** available to FAE174 filers.[102]

It is possible that one unitary member owns property that is leased by another unitary member. In this case, *both* the owned property and the rents paid for use of the property are reported on Schedule G of the combined return and no intercompany eliminations are made.[103]

Unitary Members with Short Periods

A *federal* consolidated return must cover the common parent's entire consolidated tax return year and each subsidiary's transactions *for the portion of the year for which it is a member*. If a subsidiary corporation becomes, or ceases to be a member, during a consolidated tax return year, it does so at the *end of the day* on which its status as a member changes.[104] For federal income tax purposes, each subsidiary must adopt the common parent's annual accounting period, but there may be a short period due to acquisitions, reorganizations, dispositions, or similar events. Form FAE174 covers the same reporting period as the federal income tax return of the federal consolidated group parent.[105]

Unitary group members entering or exiting the FI unitary group during the tax year may prorate their portion of the group's franchise tax.[106] If a consolidated net worth election is in effect, any affiliated group member exiting the affiliated group before year end is excluded from the consolidated net worth calculation on Schedule F2 and must complete Schedule F. In this case, both Schedules F and F2 will be completed on Form FAE174 for the tax year.[107] For example:

- New, Inc. is the parent of a federal consolidated group with a June 30 fiscal year end.

- On March 31, 2018, New, Inc. acquired Sub-TN, an entity that is doing business in and has nexus with Tennessee; as a result, the New, Inc. unitary group becomes subject to franchise and excise tax.

- Sub-TN's pre-acquisition activities for January through March 2018, will be included in the calendar year consolidated federal income tax return of Old, Inc. for the 2018 tax year.

- New, Inc. is subject to franchise and excise tax as of April 1, 2018, and it will file a franchise and excise tax return (Form FAE174) covering the tax period that coincides with its federal income tax return period of July 1, 2017 through June 30, 2018. This return will include Sub-TN's activity from April 1, 2018 through June 30, 2018.

- Excise tax is never prorated, but the franchise tax related to Sub-TN may be prorated on both Old, Inc. and New, Inc.'s Form FAE174 filings.

- Old, Inc. should include Sub-TN's pre-liquidation values[108] in the net worth calculation reported on Schedule F of Old, Inc.'s 2018 calendar year FAE174 return, and Sub-TN's franchise tax should be prorated for the short period of January 1, 2018 through March 31, 2018.

- New Inc. has not made a consolidated net worth election, so it will complete Schedule F on its Form FAE174, and Sub-TN's franchise tax should be prorated for the short period of April 1, 2018 through June 30, 2018.

- If New, Inc. had made a CNW election, Sub-TN's tax attributes would have been included in the CNW amount and CNW apportionment ratio, but there would be no proration adjustment for its short period.

Excise Tax

Tenn. Code Ann. § 67-4-2006 defines "net earnings" and "net loss" for corporations, S corporations, partnerships and FIs.[109] Like corporations, the FI calculation begins with federal taxable income or loss before the federal net operating loss deduction and special deductions. All of the Tennessee excise tax statutory add-backs and deductions under Tenn. Code Ann. § 67-4-2006(b)-(c) also apply to FIs.

FIs that form a unitary business compute their excise tax on a combined basis, excluding all dividends, receipts, and expenses resulting from transactions between members of the unitary

group. The excise tax return includes members of the unitary group that would not otherwise be subject to excise tax, if considered apart from the unitary group.[110]

1. Captive REIT Affiliated Group

The excise tax computation for CRAGs begins on Form FAE174, Schedule J4, even though the CRAG may include non-corporate entities.[111] One very important distinction between CRAGs and public REITs is that the dividends paid deduction available to public REITs is **not** permitted for CRAGs.[112] A CRAG will include the dividends paid deduction from federal Form 1120-REIT, Line 21(b) on Form FAE174, Schedule J4, Line 2(b). However, because CRAGs are not allowed to take this deduction for Tennessee excise tax purposes, the deduction is added back on Form FAE174, Schedule J, Line 14.

2. Excise Tax Apportionment – Schedule SE

The excise tax apportionment formula for FIs (standalone FI or FI unitary group) is based solely on a receipts factor.[113] Unitary groups report combined Tennessee and everywhere receipts by enumerated receipt type on the excise tax apportionment Schedule SE. The code enumerates eleven specific receipt types; there is a twelfth "catch all" receipt type for any receipts that do not fit into the other categories. Receipts in this last category are attributed to Tennessee in the same proportion that the other, aggregated enumerated receipts are attributed to the state.[114]

Receipts from all transactions and activities in the regular course of the taxpayer's business are included in the apportionment factor at their *gross value*.[115] However, receipts from the disposition of securities and money market transactions are included to the extent of the *net taxable gain*.[116] The apportionment computation should include receipts from unitary members that would not otherwise have an excise tax filing requirement if they were considered apart from the unitary group.[117]

The excise tax law does not specifically state that taxpayers must exclude transactions between unitary members from the excise tax apportionment ratio, but it is a long-standing position held by the Department that such intercompany eliminations should be made. This treatment is consistent with other provisions in the franchise and excise tax laws. For instance, dividends, receipts, and expenses resulting from transactions between unitary members are excluded[118] in determining the combined net earnings subject to the excise tax. Also, in relation to the franchise tax apportionment ratio,[119] the franchise tax law states that dividends, receipts, and

expenses between unitary members should be excluded. Furthermore, the excise tax apportionment ratio for captive REITs also excludes dividends, receipts, and expenses between CRAG members.[120] A common audit adjustment is the removal of intercompany receipts from the excise tax apportionment formula.

Receipts are attributed to Tennessee as follows:

- Rents received from real or tangible personal property are sourced to Tennessee if the property is located in Tennessee;

- Interest income and other receipts from assets, loans, or installment sale contracts that are primarily secured by or deal with real or tangible personal property, are sourced to Tennessee if the property/security is located in Tennessee. If any part of the property/security is located both within and outside of Tennessee, *a portion* of the interest or other income is sourced to Tennessee based on the proportion of the "value" of the property in Tennessee as compared the "value" of the whole property;

    - "Value" means fair market value at the time the loan is made. If property is pledged as security after the initial loan is made, the ratio (Tennessee/Everywhere) may be adjusted.

- Interest income and other receipts from unsecured consumer loans are sourced to Tennessee if the loan is made to a Tennessee resident, regardless of whether the loan was made at a place of business, by a traveling loan officer, by mail, by telephone or by other electronic means;

- Interest income and other receipts from unsecured commercial loans and installment obligations are sourced to Tennessee if the proceeds of the loan are to be *applied in* Tennessee;

    - If it cannot be determined where the funds are to be applied, the receipts are to be sourced to the state where the business "applied for" the loan.

        - "Applied for" means initial inquiry, customer assistance in preparing the loan application, or submission of a completed loan application, whichever occurs first. "Loan" does not include demand deposit accounts, federal funds, certificates of deposit, and other similar wholesale banking instruments issued by other financial institutions.

- All receipts and fee income from the issuance of letters of credit, acceptance of drafts, and other devices for assuring or guaranteeing a loan or credit are sourced *in the same manner as* interest income/receipts from the loan. *(See bullet points 2, 3, and 4 above.)*;

- Interest income, merchant discount, other receipts, including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders, and fees, are sourced to the state where the card charges and fees are regularly billed;

- Receipts from the sale of an asset, tangible or intangible, are attributed in the same manner that the income from the asset would be attributed under this section;

- Receipts equal to the net gain or income from the sale of a security made by a dealer in the security (26 U.S.C. § 475) are sourced to Tennessee if the dealer's customer is located in Tennessee and the receipt is not sourced under bullet point seven above. A customer is in Tennessee if the customer is an individual, trust, or estate that is a resident of Tennessee and, for all other customers, if the customer's *commercial domicile* is in Tennessee. Unless the dealer has actual knowledge of the residence or commercial domicile of a customer during a taxable year, the customer is deemed to be a Tennessee customer if the billing address of the customer, as shown in the records of the dealer, is in Tennessee;[121]

- Receipts from the performance of fiduciary and other services are sourced to Tennessee if the service is delivered to a Tennessee location under market-based sourcing;[122]

- Receipts from the issuance of traveler's checks, money orders or United States savings bonds are sourced to the state where such items were purchased;

- Receipts from a participating financial institution's portion of participation loans are sourced as otherwise provided above. A participation loan is any loan in which more than one lender is a creditor to a common borrower; and

- Any other receipts of gross income not specifically covered in (1)-(11) above should be sourced to Tennessee in the same proportion that aggregate receipts are attributed to Tennessee under (1)-(11).

- This is accomplished by computing the apportionment ratio without considering any numerator or denominator values for this twelfth category of receipts. The ratio based on receipt types 1-11 above is then applied to this category of receipts to source the other receipts to Tennessee. See the Receipts Sourcing section in this chapter for an example of this calculation.

Captive REIT Affiliated Group Apportionment – Schedule N

CRAGs apportion their excise tax base using the three-factor apportionment formula on Form FAE174, Schedule N.[123] This schedule is identical to the one on Form FAE170, which is derived from Tenn. Code Ann. § 67-4-2012. However, dividends, receipts, and expenses resulting from transactions between members of the CRAG are excluded from the apportionment calculation on Form FAE174.[124]

3. Loss Carryovers

The fifteen-year period in which a taxpayer may utilize loss carryovers applies to FIs filing Form FAE174 just as it applies to Form FAE170 filers. An FI unitary group may take a loss carryforward that was generated by any group member that is *in existence as a member of the group at the end of the group's tax year*; provided, that such loss carryover has not previously been taken by the member itself before it joined the group or by another FI unitary group.[125]

Revenue Ruling 07-14 involves an FI unitary group that includes a parent and lower tier unitary affiliates. The ruling considers the survival of loss carryforwards generated by affiliates that dissolved, merged, converted to an SMLLC, or underwent an F reorganization. This ruling involves a single FI unitary group.

- Dissolution of affiliate. In the event an affiliate (FI member) makes a liquidating distribution of its assets to the FI parent and subsequently dissolves, the unitary group *cannot* use the NOL carryforward generated by the affiliate. Tenn. Code Ann. § 67-4-2006(c)(4) states that the unitary group may take any NOL carryforward "that was generated by any group member *that is in existence as a member of the group at the end of the group's tax year*." Because the affiliate dissolved and is not in existence as a member of the group at the end of the group's tax year, the NOL carryforward generated by the affiliate is not available for use by the unitary group.

- Merger into parent. In the event an affiliate (FI member) merges out of existence and into the FI parent, the unitary group cannot use the NOL carryforward generated by the

affiliate, because the affiliate group member *was not in existence as a member of the group at the end of the group's tax year.*

- Conversion to SMLLC. In the event the affiliate (FI member) converts from a corporation to an SMLLC, the SMLLC will be disregarded to the parent. Such conversion is tantamount to a merger of the subsidiary out of existence and into the parent. Again, any NOL carryforward generated by the affiliate does not survive because the affiliate group member *was not in existence as a member of the group at the end of the group's tax year.*

- F reorganization. An affiliate that undergoes an F reorganization will not prevent the unitary FI group from continuing to use the NOL it generated. It is important to understand the limited nature of what an F reorganization involves. Under 26 U.S.C. § 368(a)(1)(F), it is "a mere change in identity, form, or place of organization of *one corporation*, however effected." Importantly, an F reorganization cannot involve the merger or consolidation of *two* separate operating companies.

Example

Bank A, Inc., *a standalone bank*, goes through a reorganization that results in it becoming a subsidiary of A-Z Banks, Inc. Historically, Bank A, Inc. filed its own Form FAE174. After the reorganization, it will be included in A-Z Banks, Inc.'s Form FAE174.

Can A-Z Banks, Inc. use Bank A, Inc.'s loss carryover that was generated before the reorganization?

Yes, because Bank A, Inc. existed as a member of the unitary group at the end of the group's tax year and the loss carryover has not previously been utilized.

Credits Available to Financial Institutions

In addition to the credits covered in Chapter 15 of this manual, there are additional franchise and excise tax credits available to financial institutions. These credits involve loans, grants, or contributions in relation to affordable housing, community development financial institutions, or the small business or rural opportunity funds.

1. Affordable Housing

Financial institutions may take as a credit against their franchise and excise tax liability, a credit that is based on qualified loans, qualified long-term investments, grants, contributions, or qualified low-rate loans made to an eligible housing entity for an eligible activity.[126]

Eligible Entities

Eligible housing entities include:[127]

- Tennessee nonprofit organizations and corporations with IRC §501(c)(3) status, including entities created and controlled by such corporation or wholly-owned subsidiaries of such corporation, that engage in eligible activities on behalf of such corporation;
- The Tennessee Housing Development Agency;
- A public housing authority, including an entity created and controlled by such authority, or a wholly-owned subsidiary of such authority, that engages in eligible activities on the behalf of such authority; or
- A development district, including a development district that engages in eligible activities.

Eligible Activities

Eligible activities include activities that:[128]

- Create or preserve affordable housing for low income Tennesseans;
    - "Low-income" means any individual or family at or below eighty percent (80%) of the applicable area median family income, as determined by family size.
- Help low-income Tennesseans obtain safe and affordable housing;
- Build the capacity of an eligible nonprofit to provide housing opportunities to low income Tennesseans, including the construction or expansion of an office or other facility in which low-income housing related planning and educational opportunities will be provided; and
- Any other activities approved by the Executive Director of the Tennessee Housing Development Agency and the Commissioner of Revenue.

Credit Amounts

The credit is equal to:[129]

- **5%** of the qualified loan or qualified long-term investment made; **or**
  - "Qualified loan" means a loan that is at least two percent (2%) below the prime rate, as published by the Wall Street Journal at the time the loan is approved, that does not qualify as a "qualified low-rate loan."
  - "Qualified long-term investment" means an equity investment made for a period of more than five years in an eligible housing entity.
  - Any unused credit allowed under this 5% provision may be carried forward for up to 15 years after the tax year in which the credit originated.
- **3%**, annually, of the unpaid principal balance of the qualified loan made to an eligible housing agency for an eligible activity as of either December 31 of each year for the life of the loan or 15 years, whichever is earlier.
  - Any unused credit under this 3% provision may ***not*** be carried forward.

The credit is also equal to:[130]

- **10%** of a grant, contribution, or qualified low-rate loan made to an eligible housing agency for an eligible activity; **or**
  - "Qualified low-rate loan" means a loan that is at least four percent (4%) below the prime rate, as published by the Wall Street Journal at the time the loan is approved.
  - Any unused credit allowed under this 10% provision may be carried forward for up to 15 years after the tax year in which the credit originated.
- **5%**, annually, of the unpaid principal balance of a qualified low-rate loan made to an eligible housing agency for an eligible activity as of December 31 of each year for the life of the loan or 15 years, whichever is earlier.
  - Any unused credit under this 5% provision may ***not*** be carried forward.

Example

A financial institution makes a $200,000 qualified loan to an eligible housing entity for an eligible activity. Based on this loan, the financial institution can choose to take either a *one-time* credit of $10,000 (5% rate), any unused portion of which can be carried forward for up to 15 years, **or** an *annual* credit that is equal to 3% of the unpaid principal balance of the loan at the end of each year. Any unused annual credits cannot be carried forward. If the loan were payable to the financial institution over a five-year period, the 3% annual credits would be calculated as follows:

Tax Year	Loan Principal Balance	Credit (at 3%)
1	$200,000	$6,000
2	$160,000	$4,800
3	$120,000	$3,600
4	$80,000	$2,400
5	$40,000	$1,200
6	$0	$0

If the financial institution were to make a $200,000 qualified low-rate loan to an eligible housing entity for an eligible activity, this would generate a *one-time* credit of $20,000 (10% rate) **or** *annual* credits at the 5% rate, calculated as follows (assuming same payments terms as above):

Tax Year	Loan Principal Balance	Credit (at 5%)
1	$200,000	$10,000
2	$160,000	$8,000
3	$120,000	$6,000
4	$80,000	$4,000
5	$40,000	$2,000
6	$0	$0

Administration

This program is administered by the Tennessee Housing Development Agency ("TDHA") in cooperation with the Tennessee Department of Revenue (the "Department"). THDA certifies the housing entity and activity as eligible to receive the tax credits, and the Department awards the tax credits to the financial institutions to be claimed on their franchise and excise tax return.

Certificate Form and Reporting the Credit

Before claiming this credit, taxpayers must submit the form Affordable Housing Certificate of Contribution for Tax Credit to the Tennessee Housing Development Agency. Certain parts of this form are to be completed by the contributor (financial institution), eligible organization, THDA, and the Department of Revenue.

The actual credit is claimed on Form FAE174, Schedule D, Line 3 - Community Investment Credit.

Records Retention

Pursuant to claiming this credit, certain records must be maintained by the financial institution and the eligible housing entity.[131]

- The regulated financial institution must maintain a certification from the Tennessee Housing Development Agency establishing entitlement to the credit.
- The eligible housing entity receiving the funds must maintain such records as required by the Tennessee Housing Development Agency, to ensure that affordable housing opportunities are being provided.

The Department of Revenue is authorized to share with the Tennessee Housing Development Agency information necessary to effectuate the administration of this credit. The Tennessee Housing Development Agency is bound by restrictions on the disclosure of such information, which is otherwise applicable to the Department of Revenue.[132]

2. Community Development Financial Institutions

Financial institutions may take as a credit against their franchise and excise tax liability, a credit that is based on qualified loans, qualified long-term investments, grants, contributions, or qualified low-rate loans made to a *community development financial institution* that is certified by the United States Department of the Treasury's Community Development Financial Institutions Fund.[133]

Credit Amounts

The credit is equal to:[134]

- **5%** of a qualified loan or qualified long-term investment made; **or**

- "Qualified loan" means a loan that is at least two percent (2%) below the prime rate, as published by the Wall Street Journal at the time the loan is approved, that does not qualify as a "qualified low-rate loan."

- "Qualified long-term investment" means an equity investment made for a period of more than five years.

- Any unused credit allowed under this 5% provision may be carried forward for up to 15 years after the tax year in which the credit originated.

- **3%**, annually, of the unpaid principal balance of a qualified loan as of December 31 of each year for the life of the loan or 15 years, whichever is earlier.

  - Any unused credit under this 3% provision may **not** be carried forward.[135]

The credit is also equal to:[136]

- **10%** of a grant, contribution, or qualified low-rate loan made; **or**

  - "Qualified low-rate loan" means a loan that is at least four percent (4%) below the prime rate, as published by the Wall Street Journal at the time the loan is approved.

  - Any unused credit allowed under this 10% provision may be carried forward for up to 15 years after the tax year in which the credit originated.

- **5%**, annually, of the unpaid principal balance of a qualified low-rate loan as of December 31 of each year for the life of the loan or 15 years, whichever is earlier.

  - Any unused credit under this 5% provision may **not** be carried forward.[137]

Generally, a community development financial institution may **not** charge a rate of interest that exceeds 24% annually.[138]

Certificate Form and Reporting the Credit

Before claiming this credit, taxpayers should mail the completed form Community Development Financial Institution Certificate of Contribution for Tax Credit to the Tennessee Department of Revenue. To be approved, the form must have three signatures: the contributor (financial institution), the eligible organization, and the Department of Revenue.

The actual credit is claimed on Form FAE174, Schedule D, Line 3 - Community Investment Credit.

3. Rural Opportunity Fund and Small Business Opportunity Fund Credit

This credit is equal to 10% of a financial institution's contribution to the Tennessee Rural Opportunity Fund ("ROF") or the Tennessee Small Business Opportunity Fund ("SBOF"). The credit is allowed annually for 10 years, beginning with the tax year in which the contribution is made. Unused credits are **not** permitted to be carried forward.[139]

For the purpose of this credit, loaning funds to either the ROF or the SBOF constitutes a contribution to these funds. However, if at the close of the tenth year of the period during which the credit is allowed, the taxpayer or its assignee received repayment, or retains any right to payment, of all or any portion of the amount contributed or any interest accrued on the amount contributed, the credit plus interest will be *recaptured* in the first tax year following the ten-year period during which the credit is allowed.[140]

To claim this credit, the taxpayer must complete the Rural Opportunity Fund and Small Business Opportunity Fund Certificate of Contribution for Tax Credit form and mail it to Pathway Lending at the address indicated on the form instructions. Southeast Community Capital Corporation (d/b/a Pathway Lending) is the community development financial institution (CDFI) that manages the ROF and SBOF funds.

4. Job Tax Credit

Generally, qualified business enterprises ("QBE") that qualify for the job tax credit are in the business of manufacturing, warehousing and distribution, processing tangible personal property, a headquarters facility, or back office operations.[141] Financial institutions that are headquarters facilities would be QBEs and may qualify for the credit. Also, financial institutions could qualify for the job tax credit because they are first-tier subsidiaries of a bank holding company or regulated financial corporation and they have made a capital investment that results in the expansion of QBE activities, such as manufacturing, research and development, computer services, call centers, or tourist services.

See Chapter 15 of this manual for a full discussion of the job tax credit.

Credit Carryover

A unitary group of financial institutions may take any qualified credit that was generated by any group member that is in existence as a member of the group at the end of the group's tax year, provided that such credit has not previously been taken by the member itself before it joined

the group or by another unitary group of financial institutions at the time the financial institution generating the credit was a member of that group.[142]

For example:

- A standalone bank merges into a newly-formed subsidiary of a larger bank that has many unitary members. Any unused job tax credit earned by the standalone bank may be used by the larger bank's unitary group after the merger.

- Bank B, of the ABC unitary group, is acquired by Bank D and joins the DEF unitary group of financial institutions. Any unused job tax credit earned by Bank B while it was a part of the ABC unitary group may be used by the DEF unitary group.

Audit Procedures

Most audit procedures apply to both FI and non-FI audits. The following is a nonexclusive list of audit procedures specific to FI audits.

1. Gather Data

Obtain data and supporting workpapers from the taxpayer and the Department's computer system for each audit period. Such data should include:

- Tax filings
  - Form FAE174 with all supporting schedules, statements, workpapers and elections
  - Federal income tax returns with all supporting schedules, statements and workpapers
- GAAP financial statements; preferably audited and with accompanying footnotes
  - Review 10-K filings for relevant data.[143]
  - GAAP depreciation schedules that tie to the taxpayer's general ledger and show the book values of property owned in Tennessee, including finance leases

- GAAP basis operating lease details, including any amounts charged to expense accounts

- Organization charts; preferably dated and including ownership percentages and NAICS codes
  - These should be reviewed in conjunction with federal Form 851
  - Entities included in the FI combined return should be are identified
- Taxpayer-prepared workpapers that support the franchise and excise tax return
  - Franchise tax net worth - show balance sheet data for each member
    - Schedule F filers should provide each member's indebtedness calculation worksheets to support the inclusion (or exclusion) of indebtedness from the net worth franchise tax base
    - Schedule F1 and F2 filers should show the details of the eliminations of transactions and holdings between members of the affiliated group and holdings in non-domestic persons
  - Franchise tax apportionment – show, by member, the computation of the franchise tax apportionment ratio
    - Schedule F filers should show the details of each member's apportionment ratio calculation reported on Schedule SF
    - Schedule F1 (captive REIT) filers should show the details of each member's apportionment data included in the apportionment calculation on Schedule N
    - Schedule F2 (CNW) filers:
      - Provide all CNW election documents (original election and subsequent amendments)

- Show calculations in determining that affiliated group members are "domestic persons," per Tenn. Code Ann. § 67-4-2004(15)

- Show each member's receipts from both FI and non-FI activities (net of dividends and receipts from transactions between members), to determine whether the affiliated group is an FI affiliated group (Schedule 174SC) or a non-FI affiliated group (Schedule 174NC)

  - Tennessee tangible property owned and rented – show, by member, the book value (cost less accumulated depreciation) of real and tangible personal property and rental expense by classification

  - Excise tax net earnings – show, by member, the tax basis income statement detail

  - Excise tax base modifications – show, by member, any Tennessee modifications (addbacks or deductions) to federal taxable income

  - Excise tax apportionment – show, by member, the computation of the excise tax apportionment ratio

  - Detailed apportionment schedules – show for each member all the enumerated (and type twelve, "catch all") receipts, broken out by state and receipt type

  - Detail of intercompany receipts elimination – show, by entity and general ledger account, the intercompany receipts that were eliminated from the franchise and excise tax apportionment ratio computation

- Support for community investment tax credits (affordable housing and CDFI)

  - Obtain the taxpayer's tentative approval letter with Department control number

  - Verify that the Certificate of Contribution for Tax Credit received from the THDA is complete with all signatures on the second page

  - Note any security agreements signed by the lender and the borrower

- Support for contributions made to the Tennessee Rural Opportunity Fund and/or the Tennessee Small Business Opportunity Fund

  - Unsecured subordinated promissory note showing money was lent by the taxpayer to the fund

  - The promissory note should state that it is intended to qualify as a qualified investment to be used for community development purposes

  - The promissory note usually will have a heading on page one of the note stating the name of the fund to which the contribution is made

2. Determine the Unitary Group and CNW Affiliated Group

- FI unitary group

  - Using the organization chart, financial statement details, federal tax returns, and other relevant documents obtained, identify the universe of entities related to the taxpayer and then determine the entities that should be included in the FAE174 return.

    - An entity's PBA code may help identify its primary business.

    - Auditors should consider using tic marks or highlights to explain why they included or excluded an entity from the unitary group.

  - Identify the parent that is responsible for filing and paying the tax.

  - Test entities included in the return to verify that they meet the definition of a financial institution.

  - Evaluate the entities and conclude whether they are unitary with each other.

- FI CNW affiliated group (if applicable)

  - From the universe of entities related to the taxpayer, as identified from the

organization chart and related documents, identify the related entities that are includable in the taxpayer's CNW affiliated group. See Chapter 9 of this manual for more information regarding CNW affiliated group composition.

- The CNW affiliated group may include entities that would not be included in the FI unitary group. CNW affiliates may include those that do not meet the definition of an FI. Also, they may include those not unitary with the FI group.

- The CNW affiliated group may exclude affiliates found in the FI group. For example, affiliates that are non-domestic[144] persons would be included in the FI unitary group but would be excluded from the CNW affiliated group.

- Determine if the majority of the CNW affiliated group's receipts were derived from conducting the business of an FI[145] for apportionment purposes.

3. Filing Period

- Enter the return's filing period on applicable audit workpapers.

- For each unitary member, include its tax period beginning and end dates on applicable schedules for annualization and proration purposes.

4. Verify Data

Verify the denominator value of the apportionment ratio on Schedule SE

- Reconcile the denominator to the federal return. Make notes of any reconciling items.

- Determine that intercompany transactions have been eliminated from the receipts factor.

- Determine that "other business receipts" reported on Schedule SE, Line 12, do not impact the excise tax apportionment ratio.

    - Recall that "other business receipts" includable on Line 12 are to be attributed to

Tennessee in the same proportion as the aggregate gross receipts included on Schedule SE, Lines 1-11; in other words, the Tennessee numerator of Line 12 must be "plugged" so as to maintain the same apportionment ratio as determined by the ratio of the sum of Tennessee receipts to the sum of everywhere receipts on Lines 1-11.

- Determine that receipts are reported at gross values, unless Rule 32 applies.[146]

Verify the denominator values of the apportionment ratios on Schedule SF

- Follow the same procedures indicated above for Schedule SE, except the values are maintained for each member.

Verify apportionment ratio numerator values

- Document in the audit workpapers the work done to verify the apportionment ratio numerator. Describe documents reviewed and audit findings.

- Pull a sample using a judgmental sampling method so that at least one transaction is understood sufficiently to agree with the taxpayer's sourcing.

Verify credits claimed for community investments (affordable housing and CDFI) and Tennessee opportunity fund contributions (TN ROF and SBOF)

- Obtain Department-issued tax credit control letters and evidence of related loan balances.

Examples of Common Audit Findings

- A brokerage company is erroneously included in the combined return; it is not a subsidiary of a bank holding company or a regulated financial corporation or the direct subsidiary of a bank holding company or regulated financial corporation.

    - A brokerage company does not meet the definition of "business of a financial institution."[147] A brokerage company's main duty is to act as a middleman that connects buyers and sellers to facilitate investment transactions.

- The apportionment ratio does not reflect *gross* receipts and Rule 32 does not apply.[148]

- Dividends, receipts, and expenses resulting from transactions between members of the unitary group are not excluded when computing combined net earnings or net loss.
- Intercompany transactions are excluded in computing the non-consolidated franchise tax base (Schedule F).
- The apportionment ratio does not attribute "other business receipts" (e.g., Schedule SE, Line 12) to Tennessee in the same proportion that the other enumerated receipts are attributed to Tennessee.
- A unitary member that left the unitary group (due to a sale, merger, etc.) is erroneously included on Schedule F2 - Consolidated Net Worth - instead of filing Schedule F and computing its net worth on a separate entity basis.

[1] Tenn. Code Ann. § 67-4-2004(17)
[2] Tenn. Code Ann. § 67-4-2004(14)(B)–(D)
[3] Tenn. Code Ann. § 67-4-2004(49)
[4] Tenn. Code Ann. §§ 67-4-2006(a)(3), 67-4-2007(e)(2)(A), 67-4-2106(b)
[5] Tenn. Code Ann. § 67-4-2004(52)
[6] Tenn. Code Ann. §§ 67-4-2007(e)(2)(A), 67-4-2106(b), 67-4-2114(c)
[7] Tenn. Code Ann. § 67-4-2103(d)
[8] Tenn. Code Ann. § 67-4-2004(2)
[9] Tenn. Code Ann. §§ 67-4-2010, 67-4-2110
[10] Tenn. Code Ann. §§ 67-4-2013(b), 67-4-2118
[11] Tenn. Code Ann. § 67-4-2103(f)
[12] Tenn. Code Ann. § 67-4-2004(17)
[13] Tenn. Code Ann. § 67-4-2004(21)
[14] Tenn. Code Ann. § 67-4-2004(45)
[15] Tenn. Code Ann. § 67-4-2004(30)
[16] Tenn. Code Ann. § 67-4-2004(5)
[17] 12 U.S.C. § 1841(a)(5)
[18] 12 U.S.C. § 1841(c)(1)-(2)
[19] Tenn. Code Ann. § 67-4-2004(45)
[20] Federal Home Loan Banks are a system of regional banks from which local lending institutions everywhere in America borrow funds. About 80 percent of U.S. lending institutions rely on the Federal Home Loan Banks. Federal Home Loan Banks are *cooperatives*. Local lenders likely finance much of their community lending through low-cost funds provided by their regional Federal Home Loan Bank.
[21] A thrift bank is a type of small financial institution that primarily accepts deposits and originates home mortgages and includes savings and loan associations, mutual savings banks, and credit unions.
[22] This also includes banks and thrift institutions organized in a foreign country that is engaged in the business of receiving deposits and any corporation organized under 12 U.S.C. §§ 611-631, Edge Act corporations, and any agency of a foreign depository as defined in 12 U.S.C. § 3101.
[23] *See* the federal law concerning foreign banking at https://www.govregs.com/uscode/title12_chapter6_subchapterII
[24] Tenn. Code Ann. § 67-4-2004(5)
[25] https://www.occ.treas.gov/topics/licensing/national-banks-fed-savings-assoc-lists/index-active-bank-lists.html
[26] Letter Ruling 98-31
[27] The greater-than-50% requirement ensures that the subsidiary is included in only one franchise and excise tax return for a given tax period.
[28] "Investment entity" is defined at Tenn. Code Ann. § 67-4-2004(30); "Investment securities" at Tenn. Code Ann. § 67-4-2004(31).
[29] Tenn. Code Ann. § 67-4-2004(5)

[30] Tenn. Code Ann. § 67-4-2004(38) defines "person." Any type of "person" may be doing the business of an FI, so non-corporate entities could be included in the unitary return.
[31] *Tennessee Code Annotated*, Title 45
[32] Factoring is a type of debtor financing in which a business sells its accounts receivables to a third party at a discount. Accounts receivable financing is a form of asset-based lending against accounts receivable. These types of transactions have a variety of names and features, but if they effectively are a loan, then the lender may be an FI.
[33] Financing leases under GAAP constitute doing the business of an FI, whereas operating leases do not.
[34] Tenn. Code Ann. § 67-4-2004(5)(B)
[35] *See* Tenn. Code Ann. § 67-4-2007(a)
[36] Tenn. Code Ann. § 67-4-2004(14)
[37] Tenn. Code Ann. § 67-4-2004(49). See Chapter 3 of this manual for information regarding nexus. The definition of "substantial nexus" was enacted in 2015 and is effective for tax years beginning on or after January 1, 2016.
[38] Tenn. Code Ann. § 67-4-2004(14)(B)-(C). *See also* Tenn. Code Ann. § 67-4-2105(d).
[39] Tenn. Code Ann. § 67-4-2004(14)(B)(i)-(viii)
[40] Tenn. Code Ann. § 67-4-2004(14)(C)(i)-(vii)
[41] Tenn. Code Ann. § 67-4-2004(14)(C)
[42] Tenn. Code Ann. § 67-4-2004(49)
[43] Tenn. Code Ann. § 67-4-2004(14)(D)
[44] Tenn. Code Ann. § 67-4-2007(e)(2)(A)
[45] Tenn. Code Ann. § 67-4-2004(52)
[46] *See* Revenue Rulings 06-27, 02-16, and 97-59.
[47] Tenn. Code Ann. § 67-4-2004(44)
[48] Tenn. Code Ann. § 67-4-2004(8)
[49] Tenn. Code Ann. § 67-4-2006(a)(9)
[50] Tenn. Code Ann. § 67-4-2004(7)
[51] Tenn. Code Ann. § 67-4-2008(4), (10), and (14)
[52] Tenn. Code Ann. § 67-4-2008
[53] Tenn. Code Ann. § 67-4-2004(52)
[54] Tenn. Code Ann. § 67-4-2007(e)(2)
[55] Tenn. Code Ann. § 67-4-2006(a)(3)
[56] Tenn. Code Ann. § 67-4-2106(b)
[57] Tenn. Code Ann. § 67-4-2007(e)(2)(B)(i)-(ii)
[58] Tenn. Code Ann. § 67-4-2007(e)(2)(C)(ii)
[59] *See* Tenn. Code Ann. § 67-4-2007(e)(2)(B)-(C) for more information on the criteria that must be met for an LLC, LLP, or LP to *not* be jointly and severally liable.
[60] *See* https://www.naics.com/naics-search-results/
[61] Public REITs are allowed to take the dividends paid deduction. This applies to public REITs filing on either Form FAE170 or FAE174.
[62] Meaning, a financial institution that is not affiliated with another entity, and thus, combined reporting does not apply.

[63] Financial institution unitary groups and hospital companies are required to file combined returns. Tenn. Code Ann. §§ 67-4-2106(b) and 67-4-2112(e).
[64] Tenn. Code Ann. § 67-4-2106(b). Tax basis books are not permitted to calculate combined net worth; the exception for Form FAE170 filers to use tax basis books if GAAP records are not maintained by the taxpayer is *not* permitted for Form FAE174 filers.
[65] Tenn. Code Ann. § 67-4-2107(b)(1)
[66] *See* Tenn. Code Ann. §§ 67-4-2014 and 2112. As is the case with variances requested by taxpayers, variances requested by auditors are subject to approval or denial at the Commissioner's discretion.
[67] Tenn. Code Ann. § 67-4-2114(c)(1)
[68] Tenn. Code Ann. § 67-4-2004(46); TENN. COMP. R. & REGS. 1320-06-01-.32(1)(a)
[69] Tenn. Code Ann. § 67-4-2114(c)(1)
[70] Tenn. Code Ann. § 67-4-2118(c)(8)
[71] Tenn. Code Ann. § 67-4-2118(a)
[72] TENN. COMP. R. & REGS. 1320-06-01-.32(1)(b)
[73] The Form FAE174 instructions indicate that the apportionment schedule uses tax basis values.
[74] *See* Tenn. Code Ann. §§ 67-4-2013(b)(3) and 67-4-2118(c)
[75] Tenn. Code Ann. § 67-4-2118(c)(12)
[76] TENN. COMP. R. & REGS. 1320-06-01-.32(1)(b)
[77] Tenn. Code Ann. § 67-4-2118(c)
[78] Effective for tax years beginning on or after July 1, 2016.
[79] *See* Tenn. Code Ann. § 67-4-2111(i)(1)(C)
[80] Tenn. Code Ann. § 67-4-2103(h)
[81] Tenn. Code Ann. § 67-4-2004(2)
[82] Tenn. Code Ann. § 67-4-2103(c)
[83] Tenn. Code Ann. § 67-4-2004(1)(A)
[84] Tenn. Code Ann. § 67-4-2004(17)
[85] See the CNW discussion in Chapter 9 of this manual for more information.
[86] Tenn. Code Ann. § 67-4-2106(b)
[87] For tax years beginning prior to January 1, 2011, a deduction was available for a specified percentage of a financial institution affiliated group's securities classified as held to maturity or available for sale; this deduction is no longer available. Tenn. Code Ann. § 67-4-2118(d)(2).
[88] Tenn. Code Ann. § 67-4-2004(2) and (52)
[89] Tenn. Code Ann. § 67-4-2004(17)
[90] Tenn. Code Ann. § 67-4-2004(15)
[91] Tenn. Code Ann. § 67-4-2004(2)
[92] Per Tenn. Code Ann. § 67-4-2103(f), if a non-FI affiliated group contains a member that *is* an FI, the FI member must conform to the standard three-factor apportionment formula that is used by the entire affiliated group. The inverse is also true. If an FI affiliated group contains a member that *is not* an FI, the non-FI member must utilize a receipts-only apportionment formula, per Tenn. Code Ann. § 67-4-2118(d)(3).
[93] Tenn. Code Ann. §§ 67-4-2004(18), 67-4-2118(d)(3)-(4)
[94] Tenn. Code Ann. § 67-4-2114(d)

[95] Tenn. Code Ann. § 67-4-2106(b)
[96] Tenn. Code Ann. § 67-4-2108(a)(6)(B)
[97] Tenn. Code Ann. § 67-4-2111(b)(2)(B). If a member of the affiliated group is a common carrier that apportions its income using the special apportionment provisions, *see* Tenn. Code Ann. §§ 67-4-2013(a) and 67-4-2111(b)(3)
[98] Tenn. Code Ann. § 67-4-2111(b)(4)
[99] Tenn. Code Ann. § 67-4-2111(e)(2)
[100] Tenn. Code Ann. § 67-4-2111(g)(2)
[101] *Id.*
[102] Tenn. Code Ann. § 67-4-2108(a)(3)
[103] Previous guidance *that is no longer followed by the Department* stated that "rent paid by one member of the unitary group to another member is excluded if the property has already been included once as property owned."
[104] 26 CFR § 1.1502-76
[105] Tenn. Code Ann. § 67-4-2015(a)
[106] The proration calculation is not shown on the form but should nevertheless be taken into account in reporting the entity's franchise tax on Schedule F.
[107] Tenn. Code Ann. §§ 67-4-2015(a), 67-4-2115(a)
[108] Tenn. Code Ann. § 67-4-2115(b)
[109] Tenn. Code Ann. § 67-4-2006(a)(3)
[110] *Id.*
[111] According to Tenn. Code Ann. § 67-4-2006(a)(9), CRAGs are taxed as corporations for Tennessee excise tax purposes. A Tennessee taxpayer may only file using one of the four Sub-J schedules found in the excise tax portion of the return; in this case, Schedule J4 is the appropriate schedule for CRAGs.
[112] Tenn. Code Ann. § 67-4-2006(b)(1)(O)
[113] Tenn. Code Ann. § 67-4-2013(b)
[114] Tenn. Code Ann. § 67-4-2013(b)(3)(L)
[115] TENN. COMP. R. & REGS. 1320-06-01-.32
[116] Tenn. Code Ann. § 67-4-2013(b)(1)
[117] Tenn. Code Ann. § 67-4-2013(b)(2)
[118] Tenn. Code Ann. § 67-4-2006(a)(3)
[119] Tenn. Code Ann. § 67-4-2114(c)(1)
[120] Tenn. Code Ann. § 67-4-2013(d)(2)
[121] Effective for tax years beginning on or after July 1, 2016.
[122] *See* Tenn. Code Ann. § 67-4-2111(i)(1)(C)
[123] Tenn. Code Ann. § 67-4-2013(d)
[124] *Id.*
[125] Tenn. Code Ann. § 67-4-2006(c)(4)
[126] Tenn. Code Ann. § 67-4-2109(h)
[127] Tenn. Code Ann. § 67-4-2109(h)(3)(B)
[128] Tenn. Code Ann. § 67-4-2109(h)(3)(A)
[129] Tenn. Code Ann. § 67-4-2109(h)(1)

[130] Tenn. Code Ann. § 67-4-2109(h)(2)
[131] Tenn. Code Ann. § 67-4-2109(h)(4)-(5)
[132] Tenn. Code Ann. § 67-4-2109(h)(6)
[133] Tenn. Code Ann. § 67-4-2109(k)
[134] Tenn. Code Ann. § 67-4-2109(k)(1)
[135] Tenn. Code Ann. § 67-4-2109(k)(4)
[136] Tenn. Code Ann. § 67-4-2109(k)(2)
[137] Tenn. Code Ann. § 67-4-2109(k)(4)
[138] Tenn. Code Ann. § 67-4-2109(k)(5)
[139] Tenn. Code Ann. § 67-4-2109(*l*)(1)
[140] Tenn. Code Ann. § 67-4-2109(*l*)(2)
[141] Tenn. Code Ann. § 67-4-2109(a)(5)
[142] Tenn. Code Ann. § 67-4-2109(e)(3)
[143] 10-K filings of publicly traded companies can be accessed on the SEC EDGAR website at https://www.sec.gov/edgar/searchedgar/companysearch.html
[144] Tenn. Code Ann. § 67-4-2004(15)
[145] Tenn. Code Ann. § 67-4-2004(18)
[146] *See* TENN. COMP. R. & REGS. 1320-06-01-.32
[147] Tenn. Code Ann. § 67-4-2004(5)
[148] *See* TENN. COMP. R. & REGS. 1320-06-01-.32