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MULTISTATE INCOME/FRANCHISE

Tennessee enacts several changes to business tax and franchise and excise tax laws

Tax Alert

Overview

On May 11, 2023, Tennessee enacted House Bill 323 (H.B. 323), known as the Tennessee Works Tax Act. The bill includes changes to the business tax, franchise and excise tax, and sales and use tax laws.

This Tax Alert summarizes some of the provisions in H.B. 323 related to the business tax and franchise and excise taxes. H.B. 323 implements several changes to the sales and use tax laws, including rules for the sourcing of sales of tangible personal property, services, and digital products, which will be covered in a separate alert.

Business tax changes

Taxpayers selling tangible personal property or services in Tennessee are generally subject to a gross receipts tax called the business tax. H.B. 323 includes, among others, the following changes to the business tax.

- H.B. 323 increases the filing threshold for taxpayers subject to the business tax from $10,000 in gross receipts to $100,000 in gross receipts. Thus, taxpayers with less than $100,000 in gross receipts in the state will no longer owe business tax; however, taxpayers with more than $3,000 in gross receipts must still obtain a business license.

- Currently, manufacturers selling good from a location in the state subject to an ad valorem tax are exempt from the business tax. H.B. 323 extends this manufacturer exemption for goods sold from a manufacturing location to goods sold from a storage or warehouse facility within a ten-mile radius of the manufacturing location.

- For tax year ending on or after December 31, 2023, H.B. 323 increases the minimum threshold of compensation earned from contracts for various types of work in a county or incorporated municipality that requires a business to file a business tax return in that location, from $50,000 to $100,000.

- The bill also decreases the business tax rate for industrial loan and thrift companies from three-tenths of one percent to one-tenth of one percent.

Franchise and excise tax changes

Tennessee imposes on companies doing business in the state an excise tax based on apportioned net earnings and a franchise tax based on the greater of apportioned net worth or real and tangible property owned or used in the state. H.B. 323 includes, among others, the following changes to the franchise and excise tax laws.

- H.B. 323 adopts single sales factor apportionment for both franchise and excise tax that will be phased in over a three-year period:
    - For tax years ending on or after December 31, 2023, but before December 31, 2024, generally net earnings and net worth must be apportioned by multiplying by a fraction, the numerator of which is the property factor plus the payroll factor plus five times the receipts factor, and the denominator of the fraction is seven;
    - For tax years ending on or after December 31, 2024, but before December 31, 2025, generally net earnings and net worth must be apportioned by multiplying by a fraction, the numerator of which is the property factor plus the payroll factor plus 11 times the receipts factor, and the denominator of the fraction is 13; and
    - For tax years ending on or after December 31, 2025, generally net earnings and net worth must be apportioned by multiplying the earnings by the receipts factor only.
- As of a result of this switch to single sales factor, the current elections available to manufacturers and financial asset management companies to elect single sales factor are repealed for tax years ending on or after December 31, 2025.
- Additionally, H.B. 323 provides that if the phase in of the single sales factor formula results in a lower apportionment ratio than under the current apportionment method for tax years ending before December 31, 2023, taxpayers may elect annually to apply the current apportionment method provided it results in a higher apportionment factor for the tax year and that the taxpayer is not in losses.
- H.B. 323 requires qualified members of a qualified group, generally telecommunications and similar companies, to continue using the current apportionment formula of triple-weighted sales factor plus property factor plus payroll factor, divided by five.
- For tax year ending on or after December 31, 2023, H.B. 323 conforms the excise tax laws regarding the depreciation of certain assets with the federal Tax Cuts and Jobs Act of 2017 for assets purchased on or after January 1, 2023, meaning that Tennessee will no longer decouple from federal bonus depreciation.
- H.B. 323 creates a franchise and excise tax credit for tax years ending on or after December 31, 2023, and on or before December 31, 2025, for compensation paid in this state related to the federal employer tax credit under section 45S of the Internal Revenue Code for employers paying family and medical leave.

- For tax years ending on or after December 31, 2024, H.B. 323 creates a $50,000 deduction from the net earnings calculation for excise tax purposes; however, this deduction may not create or increase a net loss.

- For tax years ending on or after December 31, 2024, H.B. 323 creates a $500,000 exemption for the real and tangible property base of the franchise tax calculation.

- H.B. 323 extends the carry forward period for tax credits earned in tax years ending on or after December 31, 2008, from 15 years to 25 years.

- H.B. 323 makes several changes to the election for "certified distribution sales" for qualifying taxpayers, including extending the definition of certified distribution sales to include sales of alcoholic beverages when such sales are made to an affiliate that continues the manufacturing process prior to the final product being sold for use or consumption outside Tennessee. Effective January 1, 2025, the law also decreases the receipts factor threshold that a taxpayer must meet to qualify for this election, from 10 percent to 7.5 percent, and requires more than 50 percent of the taxpayer's sales in Tennessee to be certified distribution sales for eligibility purposes.

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