

PUBLICATION

Spotlight on Tennessee: Chancery Court Voids Commissioner's Section 18 Variance and Affirms Cost of Performance Apportionment

August 12, 2008

A recent Tennessee Chancery Court decision should be of interest to service companies and certain other entities apportioning income under state income tax statutes, such as the Tennessee franchise and excise tax statutes, which are patterned after the Uniform Division of Income for Tax Purposes Act, commonly referred to as UDITPA. At issue in this case is the Commissioner of Revenue's allegation that the application of the statutory apportionment formula, the purpose of which is to determine the portion of income taxable in Tennessee, does not operate to fairly represent the extent of the taxpayer's business activities in Tennessee.

This case originated when the Commissioner imposed a variance, pursuant to the authority granted by Tennessee Code Annotated Sections 67-4-2014 and 67-4-2112, to alter the method of calculating BellSouth Advertising & Publishing Corporation's (BAPCO's) franchise and excise taxes for tax years 1997 through 2001. Those Tennessee Sections are patterned after UDITPA Section 18. The resulting assessment was calculated using a market based sales factor instead of the statutorily applicable cost of performance based method used by BAPCO for apportionment purposes. BAPCO filed suit against the Commissioner on July 29, 2004, challenging this assessment. The issue was whether the Commissioner properly invoked the statutorily authorized variance to disallow BAPCO's use of the costs of performance method for calculating the numerator of the sales factor in the standard apportionment formula for calculating franchise and excise taxes.

This decision, issued by a Davidson County, Tennessee, Chancellor, is a case of first impression regarding the Commissioner's use of the statutorily authorized variance for franchise and excise tax purposes. In this decision, *BellSouth Advertising & Publishing Corporation v. Loren L. Chumley, Commissioner of Revenue*, the Chancellor held that the Commissioner's action of imposing a variance was null and void, and set aside the assessment. The Chancellor further held that the use of the cost of performance method was appropriate and consistent with Tennessee statutes and regulations.

If the State appeals, it must file a Notice of Appeal within 30 days of July 31, 2008.