

# PUBLICATION

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## Tennessee Works Tax Act: Senate Bill No. 275/House Bill No. 323

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**Governor Lee's "Tennessee Works Tax Act" passed in the Senate on April 19, 2023, and thereafter was concurred with by the House on April 20, 2023. The Governor is expected to sign this legislation (the Act) into law.**

The Act makes significant changes with respect to Tennessee's business tax, franchise and excise taxes, and sales and use taxes. The following is an overview of the more significant changes as to those taxes based upon the last readily available text from the Legislature. Unless otherwise referenced, these changes are effective upon the Act becoming law.

A. **Business Tax**. Changes to the business tax can be found in Sections 1 through 12 of the Act, with some of the more important changes being as follows:

- **Increase in Level of Nontaxable Sales** – The Act generally increases to \$100,000 the minimum level of taxable sales for business tax purposes, which is an increase from either \$10,000 or \$50,000 depending upon the type of activity involved. That increase will be very helpful to small businesses and can be found in Sections 1 and 4 through 10, effective for tax years ending on or after December 31, 2023.
- **Exemption Expanded for Goods Sold by Manufacturer** – A manufacturer is not subject to the business tax with respect to manufactured goods sold from the manufacturing site. Section 3 of the Act expands that exemption to also include manufactured tangible personal property sold for resale by the manufacturer not only from the manufacturing location but also from a storage or warehouse facility that is situated within a ten-mile radius of the manufacturing location. This expanded exemption should assist manufacturers with limited or restrictive space on the manufacturing floor.
- **Reduced Rate for Certain Taxpayers** – Section 2 of the Act reduces the business tax rate from 3/10 of 1 percent, to 1/10 of 1 percent for those Class 5 taxpayers, namely industrial loan and thrift companies as well as natural gas marketers. The effective date is for tax years on or after December 31, 2023.

B. **Franchise and Excise Taxes**. Changes to the franchise and excise taxes can be found in Sections 13 through 25, Sections 33 and 34, and Sections 36 through 45, with some of the more important changes being as follows:

- **Bonus Depreciation Allowed** – Tennessee has not allowed bonus depreciation in computing net earnings or net loss; however, the Act by virtue of Sections 13, 14, and 16 allows bonus depreciation for assets purchased on or after January 1, 2023. The bonus depreciation is a sliding scale, with the 2023 bonus depreciation rate being 80 percent, and with this bonus depreciation benefit ultimately sunsetting in 2027.

- Family Medical Leave Credit Allowed – The Act also allows against the sum total of franchise and excise taxes, a credit equal to the family medical leave credit in Section 45S of the Internal Revenue Code, as a result of compensation paid in Tennessee during the applicable tax period by the taxpayer, such credit being applicable for tax years ending on or after December 31, 2023, and before December 31, 2025. This credit cannot exceed 50 percent of the combined franchise and excise tax liability shown on the return, and any unused credit can be carried forward for up to 25 years. This credit is so allowed by virtue of Sections 18 and 15.
- Minimum Amount of Net Earnings for Taxability – The Act also introduces, by virtue of Section 17, a deduction of \$50,000 from net earnings such that small businesses may get some relief from the excise tax; however, this deduction cannot create or increase a net loss. The effective date is January 1, 2024, applying to tax years ending on or after December 31, 2024.
- Transition to Mandatory Single Sales Apportionment Factor – Under current excise tax laws, a taxpayer doing business both inside and outside Tennessee is allowed to apportion its net earnings or losses to Tennessee using a formula that uses an apportionment fraction calculated by adding the taxpayer's property factor, plus the payroll factor, and plus three times the receipts or sales factor, divided by five. Manufacturers, on the other hand, have had the option since 2017 to utilize a single sales factor for apportionment purposes. Under Section 19 of the Act, a single sales factor (SSF) apportionment formula would be mandatory for all taxpayers (with some exceptions) for excise tax purposes for tax years ending on or after December 31, 2025. To transition to the mandatory SSF the apportionment formula for a taxpayer's 2024 year would be the property factor, plus the payroll factor, plus five times the receipts or sales factor, divided by seven; and for the 2025 year, the formula would be the property factor, plus the payroll factor, plus 11 times the sales factor, divided by 13. Section 23 of the Act imposes the same transition and mandatory SSF for the franchise tax.
- Exceptions to Mandatory SSF – (a) One exception to the mandatory SSF is found in Section 19(6) for excise taxes and Section 23(6) for franchise taxes. That exception provides in essence, that if the apportionment requirements during a transition year or during a mandatory SSF year result in a lower apportionment ratio than under the application of the apportionment method as applied for years ending before December 31, 2023, then a taxpayer may annually elect to use the apportionment method as it applied to tax years ending before December 31, 2023; provided, however, that such election must result in a higher apportionment factor for the tax year and the taxpayer must have net earnings, rather than a net loss, for that tax year. (b) Another exception is found in Section 19(7) for excise tax purposes and Section 23(7) for franchise tax purposes, which provides in essence, that for tax years ending on or after December 31, 2023, the net earnings for excise tax purposes and net worth for franchise tax purposes must be apportioned to Tennessee by a "qualified member" of a "qualified group", essentially consisting of taxpayers principally engaged in the telecommunications industry, by using the current apportionment formula of the property factor, plus the payroll factor, plus three times the receipts factor, divided by five.
- Unused Credits Carried Forward for 25 Years – The mandatory SSF should result in some taxpayers realizing a decrease in excise and franchise tax obligations, which would certainly be helpful to those taxpayers. However, if those taxpayers also are holding unused excise/franchise tax credits that would otherwise have maximum carry-forward usefulness of only 15 years, some of those taxpayers may not be able to utilize all such credits because of, for example, the reduced tax obligations. In an effort to avoid taxpayers having to write-off unused credits, Sections 40 through 45 extend the usefulness of various credits under the excise and franchise tax laws from 15 years, to 25 years.

- Optional Apportionment for Certified Distribution Sales Broadened – A taxpayer making "certified distribution sales" and satisfying the conditions of Tenn. Code Ann. Section 67-4-2023 may elect to apportion net earnings for excise tax purposes and net worth for franchise tax purposes according to that Section and shall be responsible for the tax as computed in that Section. Under Sections 33 and 34 together with Sections 36 through 39 of the Act, changes are made to that Section including changes to the definition of "certified distribution sales" would also include sales of alcoholic beverages manufactured in Tennessee, provided the manufacturer and its affiliate satisfy certain conditions. Certain changes made by Section 36 of the Act regarding affiliates of the taxpayer, apply to tax years ending on or after December 31, 2024. Certain other changes in Section 37 of the Act regarding the receipts factor for purposes of Section 67-4-2023, apply to tax years ending on or after December 31, 2025.
- Minimum Value Established for Alternative Franchise Tax Measure – The franchise tax calculation is determined by multiplying the tax rate times the taxpayer's net worth; however, in no case shall that net worth measure be less than the alternative measure which in essence, is the actual value of real or tangible personal property owned or used in Tennessee. This alternative measure of the franchise tax has been described as a hidden property tax that burdens taxpayers with little or no net worth. In an effort to assist those taxpayers, Section 22 of the Act provides that for tax years ending on or after December 31, 2024, this alternative measure applies to the actual value of the taxpayer's aggregate real or tangible personal property in excess of \$500,000.

C. **Sales and Use Taxes**. Changes to the sales and use taxes can be found in Sections 26 through 32 of the Act, with some of the more important changes being as follows:

- 2023 Sales Tax Holiday for Food Purchases – Section 29 of the Act provides that the sale of food and food ingredients is exempt from the tax if sold between 12:01 a.m. ET on August 1, 2023, and 11:59 p.m. ET on October 31, 2023. This exemption does not apply to sales from a micro market, or from a vending machine, or device.
- Certain Exemptions Deleted – Sections 27 and 28 of the Act delete certain exemptions effective July 1, 2024. Section 27 deletes the exemption currently found at Tenn. Code Ann. Section 67-6-329(a)(6) for certain magazines and books where the distributor has limited activities in Tennessee; and Section 28 deletes the exemption currently found at Section 67-6-344 for cooperative direct mail advertising.
- Out-of-State Repairs and Installations Delivered into Tennessee – The Streamlined Sales Tax Project was created in 1999 for the purpose of providing a roadmap for states who want to simplify and modernize sales and use tax administration in their states in order to substantially reduce the burden of tax compliance. Tennessee is an associate member of the Streamlined Project. In order to maintain that associate membership, the Tennessee Department of Revenue has advised that various amendments to Tennessee's sales and use tax laws are required in order to achieve more consistency with the Streamlined Sales Tax Project. Section 26 is one such amendment that addresses the taxability of repairs, installations, and related activities occurring outside Tennessee where the serviced tangible personal property or computer software is delivered to a place inside Tennessee. The Tennessee tax under this amendment would apply to such activities, effective July 1, 2024. This amendment in essence, reverses the Tennessee Supreme Court's decision from 1985 in the case of *LeTourneau Sales & Service, Inc. vs. Olsen, Commissioner, Tennessee Department of Revenue*.

- New Sections 67-6-901 Through 904 – Also as part of achieving more consistency with the Streamlined Sales Tax Project, the Department advised that Section 30 of the Act would add new Tenn. Code Ann. Sections 67-6-901 through 904 to Tennessee's existing sales tax laws. As referenced in new Section 67-6-901, the purpose of these new Sections is to address the determination of whether a transaction is sourced to Tennessee for sales tax purposes. In that regard, new Section 67-6-902 addresses whether the retail sale of a product from out-of-state into Tennessee should be sourced in Tennessee under various circumstances. That new Section also addresses the sourcing of rental payment for transportation equipment; and, in that regard, such sourcing amendments appear to reverse the late-1950s decision by the Tennessee Supreme Court in *Central Transport Co. vs. Atkins, Commissioner, Tennessee Department of Revenue*. New Section 67-6-903 addresses sourcing of products sold or leased from a place of business within Tennessee to various places both inside and outside Tennessee. New Section 67-6-904 addresses sourcing with respect to advertising and promotional direct mail. These sourcing amendments are effective July 1, 2024.
- Amendments Impacting Telecommunication Services – Consistent with the effort to achieve more consistency with the Streamlined Project, Sections 31 and 32 of the Act add new definitions and sourcing provisions to existing Tenn. Code Ann. Section 67-6-905 pertinent to the telecommunications industry, effective July 1, 2024.

This Act covers a wide range of issues with respect to business tax, franchise and excise taxes, and sales and use taxes. There will be taxpayer winners and losers as a result of this Act. Further, the interpretation and administration of these new provisions will take time to develop and may require the Department of Revenue to promulgate regulations and/or issue interpretative notices.

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