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SPECIAL ESTATE PLANNING BULLETIN

TN Franchise & Excise Taxes and Limited Liability Companies

We often design and implement limited liability companies (LLCs) or family limited partnerships (FLPs) for clients as part of a comprehensive estate plan. Generally, if the entity is doing business in Tennessee or owns Tennessee real estate, it is liable for franchise and excise (F & E) taxes. Franchise and excise (F & E) taxes are assessed for the privilege of doing business in Tennessee and apply to most types of business entities, including corporations, LLCs and FLPs. The excise tax is based on earnings or income for the tax year, while franchise taxes are based on the greater of net worth or the book value of property owned. It is important to note that these taxes are assessed annually. However, there are a few exemptions from F & E taxes for which most entities we establish for clients will qualify.

Under previous law, LLCs and FLPs in which at least 95% of the ownership interest is owned by members of the same family are exempt from F & E taxes as long as substantially all of the entity's income is derived from royalties, rents, dividends, interest, annuities and sales or exchanges of securities. The Tennessee General Assembly has recently made this exemption more limited. Effective July 1, 2009, this exemption, referred to as the FONCE (Family Owned Noncorporate Entity) exemption, will not be available to any entity receiving substantially all of its income from the rental of (1) industrial and commercial property, as the term is defined by statute or (2) farm property used for recreational purposes.

Of course, other exemptions are still available so this may be a good time to review your existing entity, its income structure and some options that may be available to remain exempt. In fact, this same legislation expands other exemption for entities. While there are advantages and disadvantages in qualifying for an exemption, it is important to be aware of the options that may be available to avoid what is, in certain circumstances, a significant tax.

In addition, the new law imposes annual exemption filing requirements. The new legislation makes certain exemptions contingent upon the filing of the initial Application for Exemption within 60 days of the entity's formation and a separate form to be filed each year thereafter by April 15th. You should contact your Certified Public Accountant or other income tax advisor to make certain that the exemption forms are timely and properly filed.

If you would like to learn more about this new legislation and the impact it may have on your entity and its tax status, please contact our office.