$1.2 Billion Tax Refund and $400 Million Annual Tax Cut Proposed for Tennessee Businesses

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Tennessee Governor Bill Lee delivered the State of the State address on February 5, 2024, in which he said, "[w]e will also propose tax cuts again by simplifying our franchise tax and making Tennessee an even stronger choice for companies that choose to do business in our great state."[1] Bills have been introduced in the House of Representatives and Senate that propose (1) changing the calculation of the Tennessee franchise tax base and (2) allowing taxpayers to claim a refund of franchise tax paid during the three prior taxable years in excess of the amount that would have been due had the proposed legislative change been in effect at the time.[2] The change in the franchise tax base is estimated to save business taxpayers approximately $400 million per year going forward, and the refunds have an estimated cost to the state of $1.2 billion.

Under current law, Tennessee's franchise tax (rate of 0.25%) is calculated based on the ***greater*** of (1) the total value of a business' tangible and real property used in the state (the "Property Measure") or (2) its Tennessee net worth (total assets less total liabilities).[3] In testimony before the Senate Finance, Ways and Means Committee on January 9, 2024, Tennessee Department of Revenue Commissioner David Gerregano said his department and tax experts in the Tennessee attorney general's office "identified a significant legal risk in the way that the franchise tax is currently structured that could be extremely costly to Tennessee taxpayers. To allay those risks, we've advised the administration to consider changes to the franchise tax."[4] In response to a question from Senator Jeff Yarbro, D-Nashville (District 21), during the hearing, Revenue Commissioner David Gerregano explained that the concern is that a taxpayer could challenge the constitutionality of the Property Measure on the grounds that it violates the dormant commerce clause and more specifically the internal consistency test used by the U.S. Supreme Court.

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The U.S. Supreme Court applies a four-part test when determining whether a state tax is constitutional under the dormant commerce clause. A tax will satisfy the test if it (1) applies to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) is not discriminatory towards interstate or foreign commerce, and (4) is fairly related to the services provided by the state.[5] In *Maryland State Comptroller of the Treasury v. Wynne*, the U.S. Supreme Court applied the internal consistency test to identify tax regimes that discriminate against interstate commerce by examining "the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate."[6]

The proposed legislative fix is to strike the Property Measure from the statute so that the Tennessee franchise tax is based solely on the net worth of the business in the state. Under the proposed bills, the Tennessee Department of Revenue would then create a form by which taxpayers would file a refund claim. The amount of the refund would equal the amount of franchise tax actually paid minus the amount of franchise tax otherwise due without the Property Measure. Governor Lee briefly addressed this issue in his State of the State address by saying, "[b]ecause we have budgeted wisely through years of extraordinary revenue growth, Tennessee is now equipped to resolve this tax issue . . . ."[7]

As noted in Commissioner Gerregano's testimony before the Senate Finance, Ways and Means Committee on January 9, North Carolina enacted in 2022 a similar change to its franchise tax, which also had an alternative measure using the value of property located in North Carolina to calculate the amount of franchise tax a business would need to pay. The North Carolina franchise tax was based on the ***greater*** of (1) the apportioned net worth, (2) 55% of the appraised value of property in North Carolina, or (3) the actual investment in property in North Carolina.[8] In response to concerns regarding a constitutional challenge, North Carolina struck the two alternative tax bases, determining a business's net base according solely to its apportioned net worth. Unlike Tennessee, however, North Carolina did not include a refund provision for franchise tax paid in prior years based on the alternative tax bases.[9]

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For more information about the proposed legislative changes, please contact the authors of this article or any attorney in Frost Brown Todd's Tax practice. You can also visit our Tax Law Defined® Blog for more insight into the latest developments in federal, state and local tax planning and tax administration.

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[1] State of the State Address (February 5, 2024).

[2] House Bill 1893 was filed for introduction on January 22, 2024, and corresponding Senate Bill 2103 was filed for introduction on January 29, 2024. The bills are currently in each chamber's respective Finance, Ways and Means Committees.

[3] Tennessee Code Annotated § 67-4-2105(a).

[4] Senate Finance, Ways and Means Committee (January 9, 2024).

[5] Md. State Comptroller of the Treasury v. Wynne, 575 U.S. 542, 547 (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).

[6] Id. at 562 (quoting Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995).

[7] State of the State Address (February 5, 2024).

[8] N.C. Gen. Stat. § 105-122(d)

[9] The North Carolina bill was effective for taxable years beginning on or after January 1, 2023, and is applicable to the calculation of franchise tax reported on the 2022 and later corporate income tax returns.

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