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Tennessee: Tax Incentives for Job Creation: A Legislative Update for 2011

By: JOSEPH W. GIBBS, PATRICIA HEAD MOSKAL, BRETT R. CARTER, AND BRIAN S. SHELTON

Bradley Arant Boult Cummings LLP

Nashville, Tennessee

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Tennessee's 2011 legislative session adjourned on 5/21/11, following the enactment by the General Assembly of several important tax bills, including amendments to Tennessee's tax incentive and credit provisions. Overall, the 2011 amendments with respect to tax incentives were relatively light as compared with prior years, but some important modifications were made. (See 2011 Tenn. Pub. Acts 508 (H.B. 1995, 6/16/11), generally effective on 7/1/11.) The following are highlights of the tax incentive changes enacted during the 2011 legislative session.

Job tax credits. Several provisions in the 2011 legislation affect Tennessee's franchise and excise tax credits for job creation.

Commissioners' discretion to reduce job-creation criteria modified. The legislation revised Tenn. Code Ann. §67-4-2109(b)(3)(I) to allow the Commissioner of Revenue and the Commissioner of Economic and Community Development to reduce the job thresholds by as much as 50% for purposes of the "additional annual job tax credit." (Under §67-4-2109(b)(2), the additional annual job tax credit is available for businesses (1) located in certain more-economically distressed counties, designated as a "tier 2 or tier 3 enhancement county," or (2) that involve higher levels of investment and job creation.)

Accordingly, the creation of as few as 50 new jobs (rather than the stated minimum of 100) may qualify for the additional annual job tax credit. The revised section also requires, however, that if the job threshold is reduced, the amount of the credit also is reduced proportionately. The legislation also eliminates the Commissioners' discretion to lower the wage and investment criteria and eliminates the

requirement that the taxpayer be located in a central business district or economic recovery zone to be eligible for the reduced job thresholds. (See 2011 Tenn. Pub. Acts 508, §21.)

First year in which job tax credits may be claimed. To qualify for the basic jobs tax credit under Tenn. Code Ann. §67-4-2109(b)(1) (\$4,500 per qualified job), §67-4-2109(b)(1)(C) required that at least 25 qualified jobs had to be created within 12 months following the effective date of the applicant's business plan. The legislation amends §67-4-2109(b)(1)(C) to provide that the required minimum 25 qualified jobs must be created within the "investment period," which is defined in §67-4-2109(a)(4) as "the period during which qualified jobs are created as a result of the required capital investment; provided, however, that the period shall not exceed three (3) years from the effective date of the business plan." In addition, under §67-4-2109(b)(1)(C) as amended, the credit first applies in the tax year in which the taxpayer first satisfies the capital investment and job creation requirements, and in subsequent tax years within the investment period in which there are additional net increases in qualified jobs. (See 2011 Tenn. Pub. Acts 508, §16.)

The legislation also provides that the additional annual job tax credit (sometimes referred to as the "job tax super credit") may first be claimed, at the taxpayer's election, in any tax year after the taxpayer has met all of the requirements for both the job tax credit and the additional annual job tax credit, but no later than the first tax year following the end of the investment period. (See Tenn. Code Ann. §67-4-2109(b)(2)(C), as added by 2011 Tenn. Pub. Acts 508, §18.)

Taxpayers prevented from claiming multiple additional credits; length of credit period. The legislation clarifies that, for jobs created during a single investment period, a taxpayer is not entitled to the additional annual job tax credit under both (1) the provisions for businesses in a tier 2 or tier 3 enhancement county (Tenn. Code Ann. §§67-4-2109(b)(2)(A)(i) to (ii)), and (2) the provisions for businesses with higher levels of investment and job creation (§§67-4-2109(b)(2)(B)(i) to (v)). (See Tenn. Code Ann. §67-4-2109(b)(2)(D), as added by 2011 Tenn. Pub. Acts 508, §18.)

The enhancement county additional credits can be claimed for up to three years for tier 2 counties and up to five years for tier 3 counties. The additional credits for businesses with higher levels of investment and job creation are allowed for periods ranging from three years for capital investments exceeding \$10 million and at least 100 new qualified jobs, to 20 years for capital investments exceeding \$1 billion and at least 500 new qualified jobs. These additional credits may be claimed beginning with the first tax year in which the qualified business enterprise applies the credit in accordance with §67-4-2109(b)(2)(C), discussed above. Previously, the additional credits had to be claimed beginning with the first tax year

after the initial job tax credit was created. (See Tenn. Code Ann. §67-4-2109(b)(2), as amended by 2011 Tenn. Pub. Acts 508, §17.)

Headquarters facility relocation expense credit extended to existing Tennessee headquarters. Prior law provided a franchise and excise tax credit for any "qualified headquarters facility relocation expenses" incurred by a taxpayer that established a new headquarters facility in Tennessee. The legislation amends that provision to allow the credit for qualified relocation expenses incurred in connection with headquarters facilities already located in Tennessee. (See Tenn. Code Ann. §67-4-2109(h)(2), as amended by 2011 Tenn. Pub. Acts 508, §13.)

The legislation also revised various definitions applicable to the headquarters facility relocation expense credit, as set forth in Tenn. Code Ann. §67-6-224 (regarding a similar headquarters sales tax credit). These revisions are discussed further below. Other changes to the headquarters relocation expense credit are as follows:

Commissioners granted discretion to reduce job-creation threshold for credit. Similar to a modification regarding the job tax credits discussed above, the legislation amends Tenn. Code Ann. §67-4-2109(h)(9) to allow the Commissioner of Revenue and the Commissioner of Economic and Community Development to lower the job-creation thresholds that apply for purposes of the headquarters facility relocation expense tax credit. As with the job tax credits, here too the job thresholds may be reduced by as much as 50%, and the amount of the credit also would be reduced proportionately. (See Tenn. Code Ann. §67-4-2109(h)(9), as amended by 2011 Tenn. Pub. Acts 508, §15.)

Modification of period for which facility must be used as headquarters. If facility is not used by the taxpayer as a headquarters for at least ten years, a proportionate part of the headquarters facility relocation expense tax credit is subject to recapture. Now, that ten-year period is measured "from the end of the investment period" rather than "from the date of substantial completion of the qualified headquarters facility." (See Tenn. Code Ann. §67-4-2109(h)(5), as amended by 2011 Tenn. Pub. Acts 508, §14.)

Credit and net operating loss carryforward amendments. Prior to the enactment of the new legislation, the 15-year carryforward limitation on the industrial machinery credit, job tax credits, and net operating losses could be waived for taxpayers making a capital investment in excess of \$1 billion (and in some instances, in excess of \$100 million), provided that the Commissioner

of Revenue and the Commissioner of Economic and Community Development determined that the allowance of a longer carryforward was in the best interest of the state. Now, the legislation amends the statutes to curtail the unlimited carryforward; it provides that such carryforward applies only to applications received and approved by the Commissioners on or before 1/1/11. (See Tenn. Code Ann. §§67-4-2109(b)(3)(D) (job tax credit), 67-4-2006(c)(6) and (7) (NOL carryovers), 67-4-2009(4)(C) (industrial machinery credit), as amended by 2011 Tenn. Pub. Acts 508, §§19, 22, 23, 24.)

Headquarters sales tax credit is broadened. Tenn. Code Ann. §67-6-224 provided a sales and use tax credit in connection with qualified tangible personal property used in connection with *establishing* a qualified headquarters facility in Tennessee. The new legislation amends Tenn. Code Ann. §67-6-224 to allow the sales and use tax credit also in connection with the expansion, remodeling, or construction of an existing headquarters facility in the state. The amendments also modify the qualifying job and investment criteria; further define the expenditures that qualify for the credit; revise several other definitions including "qualified headquarters facility" and "full-time employee job"; and limit the Commissioners' discretion to reduce the job-creation thresholds. (See Tenn. Code Ann. §67-6-224, as amended by 2011 Tenn. Pub. Acts 508, §§1 through 12.)

Definition of "qualified headquarters facility" now includes mandatory job creation. The new legislation (in 2011 Tenn. Pub. Acts 508, §7) amends the definition of "qualified headquarters facility" in Tenn. Code Ann. §67-6-224(b)(9) (which also applies for purposes of the franchise and excise tax credit for "qualified headquarters facility relocation expenses" under Tenn. Code Ann. §67-4-2109(h), as discussed above). Under the amended definition, a taxpayer is required to create a minimum number of new jobs at the headquarters facility, in addition to making a minimum capital investment.

A minimum of 100 new full-time jobs must be created, along with a minimum capital investment of \$10 million, in conjunction with the construction, expansion, or remodeling of the headquarters facility (Tenn. Code Ann. §67-6-224(a), as amended by 2011 Tenn. Pub. Acts 508, §1). While the \$10 million/100 jobs test also applied under prior law, a taxpayer that invested a minimum of \$50 million did not need to create any new jobs (see former §67-6-224(b)(7)).

Revised definition of "full-time employee job." The definition of "full-time employee job" in Tenn. Code Ann. §67-6-224(b)(2) (which also applies for purposes of the franchise and excise tax credit for "qualified headquarters facility relocation expenses" under Tenn. Code Ann. §67-4-2109(h), as discussed above) is revised to provide that, to count toward the credit-qualifying threshold, the jobs created must pay at least

150% of Tennessee's average occupational wage for the month of January of the year in which the full-time employee job was created. (See Tenn. Code Ann. §67-6-224(b)(2), as amended by 2011 Tenn. Pub. Acts 508, §3).

Commissioners granted discretion to reduce job-creation threshold for sales tax credit. As with the headquarters facility relocation expense tax credit, the legislation allows the Commissioner of Revenue and the Commissioner of Economic and Community Development to lower the job thresholds for purposes of the headquarters sales tax credit. The 50% limit on reducing the job threshold and the proportionate reduction in the credit described above with respect to the headquarters facility relocation expense tax credit apply as well to this sales and use tax credit. (See new Tenn. Code Ann. §67-6-224(e), added by 2011 Tenn. Pub. Acts 508, §12.)

To qualify for sales and use tax credit, new jobs must increase employment. Consistent with allowing the credit for expanding or remodeling existing headquarters facilities, the legislation makes clear that a "new full-time employee job" requires that there be an increase in net employment of the taxpayer above the level of employment existing immediately prior to the beginning of the investment period (which begins one year prior to commencement of the construction, expansion, or remodeling). (See Tenn. Code Ann. §67-6-224(b)(8), as amended by 2011 Tenn. Pub. Acts 508, §6.)

Definition of "qualified tangible personal property" amended. As under the prior law, for purposes of the headquarters sales tax credit, "qualified tangible personal property" generally includes "building materials, machinery, equipment, furniture and fixtures used exclusively in the qualified headquarters facility and purchased or leased during the investment period and computer software used primarily in the qualified headquarters facility and purchased or leased during the investment period." The new legislation adds to that definition, however, the requirement that it includes "only ... such property that is directly related to the creation of the new full-time employee jobs." (See Tenn. Code Ann. §67-6-224(b)(11), as amended by 2011 Tenn. Pub. Acts 508, §9.)

Effective dates. The tax credit and incentive amendments discussed above generally are effective on 7/1/11, and they "apply to any written proposal by the department of economic and community development or the department of revenue on or after such date." (See 2011 Tenn. Pub. Acts 508, §34.)

These effective date provisions appear to mean that the amendments that restrict the Commissioners' allowance of unlimited carryforwards for net operating losses and the job and industrial machinery tax credits to applications received and approved by the Commissioners on or before 1/1/11 (discussed above), would not apply to taxpayers to whom the Department of Economic and Community Development or the Department of Revenue made a written proposal before July 2011. []

Practice Note: Some Useful Definitions Regarding the Headquarters Facility Credits

In addition to definitions discussed in the accompanying article, the following definitions in Tenn. Code Ann. §67-6-224 generally apply for purposes of both the franchise tax credit for qualified headquarters facility relocation expenses under §67-4-2109(h), and the qualified headquarters facility sales and use tax credit under §67-6-224.

"**Facility**' means a building or buildings, either newly constructed, expanded, or remodeled, housing headquarters staff employees and located in a county or metropolitan statistical area in [Tennessee]. A facility may include parking facilities exclusively for the use of headquarters staff employees and visitors; provided, that the parking facilities are built in conjunction with the newly constructed, expanded, or remodeled building or buildings. An expansion of a headquarters facility may be connected to or separate from a headquarters facility or other facilities located in a county or metropolitan statistical area in [Tennessee]. The facility must be utilized as a headquarters facility for a period of at least ten (10) years from the end of the investment period." (Tenn. Code Ann. §67-6-224(b)(1), as amended by 2011 Tenn. Pub. Acts 508, §2.)

"**Headquarters facility**' means a facility in [Tennessee] that houses the international, national, or regional headquarters of a taxpayer, where headquarters staff employees are located and employed, and where the primary headquarters related functions and services are performed." (Tenn. Code Ann. §67-6-224(b)(3).)

"**Headquarters related functions and services**' means those functions involving administrative, planning, research and development, marketing, personnel, legal, computer or telecommunications services performed by headquarters staff employees on an international, national, or regional basis. 'Headquarters related functions and services' does not include functions involving manufacturing,

processing, warehousing, distribution, wholesaling, or operating a call center." (Tenn. Code Ann. §67-6-224(b)(4), as amended by 2011 Tenn. Pub. Acts 508, §4.)

"**Headquarters staff employees**' means executive, administrative, or professional workers performing headquarters-related functions and services. An executive employee is a full-time employee who is primarily engaged in the management of all or part of the enterprise. An administrative employee is a full-time employee who is not primarily involved in manual work and whose work is directly related to management policies or general headquarters operations. A professional employee is an employee whose primary duty is work requiring knowledge of an advanced type in a field of science or learning. This knowledge is characterized by a prolonged course of specialized study." (Tenn. Code Ann. §67-6-224(b)(5).)

"**Qualified headquarters facility relocation expenses**' means those expenses that both the Commissioner of Revenue and the Commissioner of Economic and Community Development determine, in their sole discretion, are necessary to relocate headquarters staff employees to a qualified headquarters facility in [Tennessee]." (Tenn. Code Ann. §67-6-224(b)(10), as amended by 2011 Tenn. Pub. Acts 508, §8.)

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