



State and Local Tax Alert

Tennessee Edition



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Tennessee Governor Bill Haslam Calls for Preapproval of Deductions for Intangible Expenses

By Brett R. Carter and Patricia Head Moskal

As part of his 2012 legislative agenda, Tennessee Governor Bill Haslam proposed legislation on January 10 that, if passed, will require companies to file an application with the Department of Revenue seeking preapproval of a deduction for expenses paid to an affiliate for the use of intangible property. [SB2234 / HB2372](#).

This proposal follows a November 2011 DOR notice announcing a compromise opportunity for taxpayers making payments to affiliated intangible companies that arguably may lack economic substance. The Department has compromised a number of Tennessee excise tax assessments against companies that deducted intangible expenses to affiliated intangible holding companies. Those negotiations culminated in a settlement offer in which the Department agreed to drop the assessments if the taxpayers agreed to pay a percentage of the amounts assessed. In the DOR notice, the Department expressed a willingness to extend similar settlement terms to taxpayers that had yet to be audited and/or assessed. Click [December SALT Bulletin](#) to read more about the notice.

In this latest legislative development, the Governor's proposal would require taxpayers paying intangible expenses to affiliated companies to file an application with the Department, seeking advanced approval to deduct the intangible expense. No other State requires a similar advanced approval before a deduction for intangible expenses may be claimed.

The proposal would define intangible expenses to include expenses related to intangible property as well as interest expenses incurred and related to the intangible property transaction. To address exceptions adopted in other states with add-back statutes, the proposed legislation *requires the approval* of applications filed by taxpayers paying intangible expenses to (1) affiliates located in a country that has a comprehensive income tax treaty with the United States and (2) affiliates that pay such expenses to an independent third party (conduit exception). Notably, there is currently no exception for affiliates that are "subject to tax" on income from the intangible property, however, it is anticipated that a "subject to tax" exception will be added at a later date.

It is unclear from the proposed legislation when the application must be filed, but a grace period for interest and penalties is established if the application is filed within sixty days before the due date of the return.

Approved deductions would remain in effect for five years, provided that annual statements are filed certifying that the circumstances surrounding the transaction remain substantially unchanged. The proposal also provides that denials of the application may be challenged in court, and enhanced penalties may be assessed for the failure to comply with the requirements of the proposed bill.

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RELATED ATTORNEYS



Brett R. Carter

615.252.2383

bcarter@babbc.com



Patricia Head Moskal

615.252.2369

pmoskal@babbc.com

SB2234/HB2372 will be referred to both the Senate and House Finance Committees for public hearings at which time the Department of Revenue and the taxpayer community may provide testimony. With the legislative session expected to end in May, the Governor's proposed legislation will likely come to a committee vote in March or April.

Practice Pointer

Tax assessments for this type of intangible expense typically have been made by the Department in situations in which the Department has identified "significant concerns" regarding the economic substance of the underlying intangible holding company transaction. Factors that the Department has considered relevant are: (1) the nature of the intangible property and how it is used; (2) the method by which the intangible asset was transferred to the holding company; (3) whether actual cash was exchanged in the relevant transactions; (4) whether the holding company has separate employees and office space; and (5) whether there are practical economic effects resulting from the transaction aside from tax planning. See Tenn. Ltr. Rul. 06-28; Tenn. Ltr. Rul. 06-35. In those cases where the Department has determined that intangible expenses are not related to bona fide, arms-length transactions, the Department has issued assessments under its variance power disallowing the deduction of the intangible expense.

Bradley Arant Boulton Cummings LLP will be closely monitoring this legislative development. Please contact Brett Carter at 615.252.2383 or Pat Moskal at 615.252.2369 if you have any questions or would like to discuss this issue further.

Bradley Arant Boulton Cummings LLP Office Locations:

ALABAMA

One Federal Place
1819 Fifth Avenue North
Birmingham, AL 35203
205.521.8000

200 Clinton Avenue West, Suite 900
Huntsville, AL 35801
256.517.5100

The Alabama Center for Commerce
401 Adams Avenue, Suite 780
Montgomery, AL 36104
334.956.7700

MISSISSIPPI

188 E. Capitol Street, Suite 400
Jackson, MS 39201
601.948.8000

NORTH CAROLINA

100 North Tryon Street, Suite 2690
Charlotte, NC 28202
704.332.8842

TENNESSEE

1600 Division Street, Suite 700
Nashville, TN 37203
615.244.2582

WASHINGTON, DC

1615 L Street, N.W.
Suite 1350
Washington, DC 20036
202.393.7150

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