TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 98-11

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether a forgiven debt that was treated as a dividend to an estate for federal tax purposes is subject to the Tennessee income tax.

SCOPE

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

FACTS

Prior to his death, Mr. X was a Tennessee resident and a 50% shareholder in Corporation Y. Mr. X's brother was the other 50% shareholder in the corporation. At the time of his death, Mr. X had an outstanding personal loan from Corporation Y in the amount of $[AMOUNT 1]. Mr. X's estate in Tennessee was responsible for numerous debts and did not have the money to repay the $[AMOUNT 1] note to Corporation Y.

Because the estate did not have the money to pay off the note, Corporation Y forgave the debt. Under federal tax law, Corporation Y treated the debt forgiven as a dividend to the estate and the estate treated the note payable as a forgiven debt.

Later, Corporation Y purchased Mr. X's stock from his estate for $1[AMOUNT 2] pursuant to what the taxpayer describes as a "buy/sell agreement" and the estate used the money to pay off other debts for which it was responsible. However, the $[AMOUNT 1] debt to Corporation Y was never repaid because it had been forgiven.

There was never any written agreement whereby Corporation Y was required to pay interest to either Mr. X or his estate in Tennessee.

QUESTION

Is the $[AMOUNT 1] forgiveness of debt that was treated as a dividend to Mr. X's estate under federal law subject to the Tennessee income tax, also known as the Hall income tax?

RULING

No.

ANALYSIS

T.C.A. § 67-2-102 imposes the Hall Income Tax as follows:

> "An income tax in the amount of six percent (6%) per annum shall be levied and collected on incomes derived by way of dividends from stocks or by way of interest on bonds . . ."

T.C.A. § 67-2-110 makes the following provisions applicable to estates that receive taxable dividend or interest income.

> "Trustees, guardians, administrators, executors, and other persons acting in a fiduciary capacity who receive income taxable under this chapter for the benefit of residents of Tennessee shall be required to make returns under this chapter and to pay the tax herein levied. . . ."

Clearly, Mr. X's Tennessee estate is subject to the Tennessee Hall income tax to the extent that it receives dividend or interest income of a taxable nature for the benefit of residents of Tennessee.

First it must be determined whether the $[AMOUNT 1] debt forgiven is "dividends from stocks" or "interest on bonds" under Tennessee income tax laws. If it is neither, it is not subject to the Tennessee income tax and we need not reach the question of whether it was received for the benefit of Tennessee residents.

The Tennessee income tax laws do not look to federal law to determine whether income received constitutes dividends or interest. Thus, the fact that income is classified as dividends or as interest for federal tax purposes does not necessarily mean that such income is “dividends from stocks” or “interest on bonds” for purposes of the Hall income tax.

T.C.A. § 67-2-101(6) defines “stocks” for Hall income tax purposes as follows:

> “ ‘Stocks’ means shares of stock issued by corporations chartered and organized under the laws of the state of Tennessee. or of any other state, or of the United States, or of any foreign government, and all interests in partnerships, associations, or trusts represented by transferable evidence of such interest; . . .”

Thus, in order to qualify as a dividend for Hall income tax purposes, the income received must be based on corporate stock ownership or on an ownership interest in a partnership, association or trust represented by evidence of a transferable interest. Otherwise, the income is not a dividend for Hall income tax purposes regardless of how it is classified under federal tax law.

The loan by Corporation Y to Mr. X and Corporation Y’s subsequent forgiveness of the debt in the hands of Mr. X’s estate were transactions separate and apart from his stock ownership in Corporation Y. The loan was not based on the number of shares of stock Mr. X owned in Corporation Y and the forgiveness of the debt to Mr. X’s estate was not based on the shares of stock held by Mr. X’s estate. Therefore, Corporation Y’s forgiveness of the debt was not a dividend to Mr. X’s estate for Tennessee Hall income tax purposes.

T.C.A. § 67-2-101(1), set forth in pertinent part below, defines “bond” for Hall income tax purposes as follows:

> “ ‘Bond’ means all obligations issued by any . . . corporation . . . evidenced by an instrument whereby the obligor is bound to pay interest to the obligee . . .”

Company Y did not forgive the $[AMOUNT 1] debt of Mr. X’s estate as a result of any instrument whereby it was required to pay interest to Mr. X or to his estate in the form of forgiveness of the debt. No such instrument existed. Therefore, forgiveness of the debt did not result in interest to the estate for Tennessee Hall income tax purposes.

Having concluded that Company Y’s forgiveness of Mr. X’s debt in the hands of his estate did not result in the estate receiving, accruing, or having credited to it, any income that can be classified as dividend or interest income under the Tennessee Hall income tax laws, it follows that the $[AMOUNT 1] in question is not subject to the Hall income tax. Thus, we need not reach the question or whether it was income received by the estate for the benefit of Tennessee residents.

The fact that, pursuant to a “buy/sell agreement” Company Y later purchased from Mr. X’s estate all of the Company Y stock that Mr. X had held before his death is of no consequence. This transaction was nothing more than a stock redemption purchase by

Company Y. It did not result in payment of dividends or interest to anyone and can not be subjected to the Tennessee Hall income tax.

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Arnold B. Clapp, Senior Tax Counsel

APPROVED: ______________________________
Ruth E. Johnson, Commissioner

DATE: 3-4-98