

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #96-22**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether an I.R.C. § 337 liquidation transaction would result in Tennessee excise tax consequences.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

[COMPANY A], a Delaware corporation, and [COMPANY B], a Tennessee corporation, are members of the same affiliated group. [COMPANY A] is the parent corporation and owns 100% of the stock of [COMPANY B]. [COMPANY A] has no tax nexus in Tennessee for corporate franchise, excise tax purposes.

[COMPANY A] is a holding company for the stock of various subsidiaries in the United States. [COMPANY B] is a manufacturer of [PRODUCTS]. Pursuant to I.R.C. § 332, [COMPANY B] will be liquidated into [COMPANY A] and will cease to exist. For federal tax purposes, no gain will be recognized by [COMPANY B] on the liquidation under I.R.C. § 337.

ISSUE

Will the I.R.C. § 337 liquidation result in any Tennessee excise tax consequences?

RULING

No. Under the present policy of the Department of Revenue, a gain or loss would not be recognized for excise tax purposes.

ANALYSIS

Applicable Statutes

I.R.C. § 337(a) makes the following general statement as to corporations making distributions in complete liquidation to an 80% distributee under I.R.C. § 332.

(a) In General. No gain or loss shall be recognized to the liquidating corporation on the distribution to the 80-percent distributee of any property in a complete liquidation to which section 332 applies.

I.R.C. § 332(a) sets forth the following General Rule concerning corporations in receipt of property of another corporation distributed in complete liquidation.

(a) General Rule. No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation.

When a subsidiary liquidates under I.R.C. § 337 into its parent corporation and no gain or loss is recognized under I.R.C. § 332, the assets of the liquidating corporation are not sold, but are transferred to the parent in cancellation or redemption of the subsidiary's stock, or in satisfaction of a debt owed by the subsidiary. I.R.C. § 334(b) makes the following provision concerning the basis of the assets transferred:

(b) In General. If property is received by a corporate distributee in a distribution in a complete liquidation to which section 332(a) applies (or in a transfer described in section 337(b)(1)), the basis of such property in the hands of such distributee shall be the same as it would be in the hands of the transferor, . . .

T.C.A. § 67-4-805(a)(1) states that "net earnings" for purposes of the Tennessee excise tax base ". . . is defined as federal taxable income before the operating loss deduction and special deductions . . . [and is] . . . subject to the adjustments in subsection (b)". T.C.A. § 67-4-805(b)(1)(D) and (b)(2)(F) provide as follows concerning treatment of I.R.C. § 337 gains and losses for Tennessee excise tax purposes.

(b)(1) There shall be added to the federal taxable income:

(D) Gains not recognized pursuant to 26 U.S.C. § 337;

(2) There shall be subtracted from the federal taxable income:

(F) Losses not deducted pursuant to 26 U.S.C. § 337;

Legislative History

T.C.A. § 67-4-805(a)(1), (b)(1)(D) and (b)(2)(F) were enacted by Section 29 of Chapter 537 of the Public Acts of 1976 and have not changed since that time. Prior to the Federal Tax Reform Act of 1986, I.R.C. § 337 provided that, under certain circumstances, a liquidating corporation could transfer its assets to its shareholders in a tax free transaction prior to their sale. The assets would then be sold by the shareholders, rather than the corporation, and any resulting gains and losses would be recognized for federal purposes at the shareholder level. Without I.R.C. § 337, the liquidating corporation would have had to pay federal capital gains taxes when the assets were sold. Then, when the liquidating corporation distributed the sale proceeds to its shareholders, they would have had to pay a second tax on the dividend. *Tidwell v. Berke*, 532 S.W.2d 254 at 259 (Tenn. 1975).

Unlike the federal government and most states, Tennessee has no individual income tax that would apply to I.R.C. § 337 liquidation gains and losses. T.C.A. § 67-4-805(b)(1)(D) and (b)(2)(F) operated to include I.R.C. § 337 liquidation gains and losses in net earnings for Tennessee excise tax purposes. Accordingly, I.R.C. § 337 liquidation gains were subject to the Tennessee corporate excise tax, assuming they were business earnings or nonbusiness earnings directly allocated to Tennessee.

The Tennessee statutes in question have been upheld by the Tennessee Supreme Court in a number of cases. (See *Tidwell v. Berke*, 532 S.W.2d 254 (Tenn. 1975) and *Cavalier Industries, Inc. v. Olsen*, 786 S.W.2d 950 (Tenn. 1986).

The Federal Tax Reform Act of 1986 changed the entire character and purpose of I.R.C. § 337. Under present law, an I.R.C. § 337 liquidation can occur only when a subsidiary liquidates into a parent corporation owning at least 80% of the subsidiary's stock. In such a case, the assets of the liquidating corporation are not sold, but are transferred to the parent in cancellation or redemption of the subsidiary's stock, or in satisfaction of a debt owed by the subsidiary. No gain or loss is recognized by the liquidating subsidiary on the distribution of its property under I.R.C. § 332. Federal Tax Guide (CCH) *Liquidation of Subsidiaries* § 12,256 (1995).

Since no gain or loss is recognized on the transaction, I.R.C. § 334(b) allows the transferee parent corporation to receive the property distribution from its liquidating

transferor subsidiary at the same basis such property had in the hands of the subsidiary. Federal Tax Guide (CCH) *Liquidations* § 12,263 (1995). If the transferee parent later sells the property, it recognizes a gain or loss to the extent of the difference in the adjusted transferred basis and the selling price.

Policy of the Department

The Department's administrative position, at least since 1990, has been to exclude I.R.C. § 337 liquidation gains or losses from the computation of net earnings (losses) for Tennessee excise tax purposes.

This administrative position has become the policy of the Department. T.C.A. § 67-1-108 addresses changes in tax policy as follows:

If the Commissioner changes the policy of the department as to the taxability of any privilege, such policy change shall be applied to the exercise of such privileges occurring after the date of such policy change only, unless otherwise provided by law.

Absent a change in the current tax policy, a § 337 liquidation of a subsidiary into a parent corporation owning at least 80% of the subsidiary's stock will not result in a gain (or loss) required to be added (subtracted) from the federal taxable income in computing the net earnings for excise tax purposes. Any possible future change in this policy would be applied prospectively under the terms of T.C.A. § 67-1-108.

Charles T. Moore,
Director of Legal Services

APPROVED: Ruth E. Johnson, Commissioner

DATE: 6/24/96