

Economic Nexus Standard for Tennessee Business Tax; Returns Due April 18

Overview

Effective for tax years beginning on or after January 1, 2016, as part of the Revenue Modernization Act enacted in 2015, Tennessee has added a "bright-line" economic nexus standard for purposes of Tennessee's gross receipts-based tax, which is more commonly known as the Tennessee Business Tax (Business Tax).¹ Accordingly, taxpayers having substantial economic nexus with Tennessee may now be subject to the Business Tax, which has an approaching due date of April 18, 2017, for 2016 calendar year taxpayers.²

In this Tax Alert we summarize the Business Tax and offer some taxpayer considerations regarding the impact of the economic nexus standard on out-of-state taxpayers.

Economic Nexus for Business Tax

Effective for tax years beginning on or after January 1, 2016, Tennessee essentially broadened its definition of "substantial nexus in this state" and implemented a "bright-line presence" threshold for Business Tax purposes. Under Tennessee law, a taxpayer is generally deemed to have substantial nexus with Tennessee if:

1. The taxpayer is organized or commercially domiciled in Tennessee;
2. The taxpayer owns or uses its capital in Tennessee;
3. The taxpayer has systematic and continuous business activity in Tennessee that has produced gross receipts attributable to customers in Tennessee; or
4. The taxpayer has bright-line presence in Tennessee.³

A taxpayer is deemed to have bright-line presence in Tennessee for a tax period if any of the following applies:

- a. The taxpayer's total receipts in Tennessee during the tax period exceed the lesser of \$500,000, or 25% of the taxpayer's total receipts everywhere during the tax period;
- b. The average value of the taxpayer's real and tangible personal property owned or rented and used in Tennessee during the tax period exceeds the lesser of \$50,000, or 25% of the average value of all the taxpayer's total real and tangible personal property; or
- c. The total amount paid in Tennessee during the tax period by the taxpayer for compensation exceeds the lesser of \$50,000, or 25% of the total compensation paid by the taxpayer.⁴

However, companies treated as foreign corporations for federal tax purposes that have no effectively connected income in the United States shall not be considered as having substantial nexus for Business Tax purposes.⁵

Business Tax Classifications and Rates

The Business Tax generally is imposed on taxpayers that sell tangible personal property or services in Tennessee, with few exceptions.⁶ The Business Tax is divided into five classifications; and the tax rate imposed is based upon the classification of the dominant business activity of the taxpayer as follows:

- Classification 1: Businesses engaged in making sales of food and beer, building and construction materials, farming tools and supplies, gasoline and fuel oils sold at retail, and gasoline and fuel oils sold at wholesale;

¹ Such "bright-line presence" economic nexus also applies to the Tennessee Franchise and Excise tax for tax years beginning on or after January 1, 2016 under the same legislation; see Multistate Tax Alert released on May 28, 2015 [here](#) for more details on this legislation.

² Tenn. Code Ann. § 67-4-718(g); Tenn. Comp. R. and Reg. 1320-04-05-.30(2).

³ Tenn. Code Ann. § 67-4-702(22)(A).

⁴ *Id.*

⁵ Tenn. Code Ann. § 67-4-702(22)(B).

⁶ Manufacturers subject to the ad valorem tax and non-profit entities are exempt from the Business Tax. See Tenn. Code Ann. § 67-4-712 for a full list of exempt entities.

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- Classification 2: Businesses engaged in the sale of tangible personal property, including but not limited to motor vehicles, clothing, home furnishings, prescription drugs, and plants;⁷
- Classification 3: Businesses engaged in the sale of candy, antiques, books, sporting goods, toys, among other goods, and also business engaged in providing services;⁸
- Classification 4: Contractors and businesses engaged in the sale of certain farm products; and
- Classification 5: Industrial loan and thrift companies and natural gas marketers.⁹

The Business Tax rates per business classification are listed in the chart below.¹⁰ A minimum tax of \$22 is assessed on each taxpayer in classifications 1 through 4.¹¹ Taxpayers falling within classification 5 are assessed a minimum tax of \$450.¹²

Business Classification	Retailer Rates	Wholesaler Rates
Class 1A	0.001	0.00025
Class 1B & Class 1C	0.001	0.000375
Class 1D	0.0005	N/A
Class 1E	N/A	0.0003125
Class 2	0.0015	0.000375
Class 3	0.001875	0.000375
Class 4	0.001	N/A
Class 5	0.003	N/A

Business Tax Filing Requirements

The Business Tax generally is assessed on total gross receipts from sales of tangible personal property and services in Tennessee.¹³ Taxpayers with business locations in Tennessee must obtain a business license from each locality (city or county) where they are doing business (provided that locality imposes the Business Tax) and file a Business Tax return with the Tennessee Department of Revenue for each business location.¹⁴ Taxpayers with a business location within the limits of a city that imposes the Business Tax must file two returns with the Tennessee Department of Revenue for that one location – that is, one return for the city and one return for the county where that business is located.¹⁵ Out-of-state taxpayers with no business location in Tennessee generally do not need a business license; instead, these taxpayers would need to file one Business Tax return with the Tennessee Department of Revenue that includes all Tennessee gross receipts.¹⁶ Tennessee Business Tax Forms BUS 415 or 416 must be filed, as applicable, by April 18, 2017 for calendar year taxpayers,¹⁷ and must be filed electronically for the 2016 tax year.¹⁸ An extension of 30 days may be granted for good cause;¹⁹ the extension request must be made in writing and submitted to the Tennessee Department of Revenue before the due date of the Business Tax return. The penalty for failure to file or failure to pay the Business Tax is 5% of the unpaid tax per month, up

⁷ A business selling tangible personal property not listed in another classification generally uses this classification. See Tenn. Code Ann. § 67-4-708(2).

⁸ Certain services are exempt from the Business Tax, including but not limited to legal, accounting, medical, educational, engineering, and charitable services. See Tenn. Code Ann. § 67-4-708(3) for the full list of exempt services.

⁹ Tenn. Code Ann. § 67-4-708.

¹⁰ Tenn. Code Ann. § 67-4-709; Tennessee Form BUS 415 and 416 Instructions.

¹¹ Tenn. Code Ann. § 67-4-714.

¹² *Id.*

¹³ Tenn. Code Ann. § 67-4-704, 705, 717.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Tenn. Code Ann. § 67-4-715(g); Tenn. Comp. R. and Reg. 1320-04-05-.30(2). For fiscal year filers, the tax is due the 15th day of the fourth month following the end of the tax year.

¹⁸ Tenn. Code Ann. § 67-4-715(d); <http://www.tennessee.gov/revenue/article/business-tax-file-and-pay>.

¹⁹ Tenn. Code Ann. § 67-4-718.

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to a maximum penalty of 25% of the unpaid amount; the minimum penalty due for delinquent Business Tax returns will be \$15.²⁰

Considerations

Businesses having substantial nexus with Tennessee or simply generating receipts from Tennessee customers may want to consider reviewing and consulting with their tax advisers regarding the effects of Tennessee's "bright-line presence" economic nexus standard on their Business Tax filing obligations, as businesses with little or no physical presence in Tennessee may now have a Business Tax filing obligation. Per Tennessee's statutes, a taxpayer having substantial nexus with Tennessee that is engaged in business in Tennessee with or without a physical location in Tennessee may be subject to the Business Tax,²¹ and such in-state activity may include but is not limited to the following: the sale of tangible personal property that is shipped or delivered to a location in Tennessee; the sale of a service that is delivered to a location in Tennessee; and the leasing of tangible personal property that is located in Tennessee.²² Businesses should also remember that the Business Tax is a gross receipts-based tax and thus taxpayer protections afforded under Public Law 86-272 may not apply.

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²⁰ Tenn. Code Ann. § 67-1-804(a)(1).

²¹ Tenn. Code Ann. § 67-1-817(a).

²² Tenn. Code Ann. § 67-1-804(a). Note that the Tennessee Department of Revenue's website currently appears to provide outdated guidance on the application of the Business Tax to out-of-state taxpayers; as a result, it is unclear how and, to what extent, the Tennessee Department of Revenue intends to apply and enforce these economic nexus provisions. Strictly construed, the Business Tax may apply to taxpayers that ship goods into Tennessee via common carrier and have no other contact with Tennessee so long as their in-state sales during the applicable tax period exceed \$500,000.