

PUBLICATION

Legislation Filed Addressing Potential Constitutional Issue with Franchise Tax

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On January 22, 2024, Tennessee Governor Bill Lee's administration filed House Bill 1893 in the 2024 Session of the 113th General Assembly. The apparent purpose of House Bill 1893 is to address the potential constitutional issue with the Tennessee franchise tax. The Attorney General's Office has apparently concluded that the alternative tax base of the franchise tax violates the internal consistency doctrine under the dormant Commerce Clause. We can expect a Senate version of House Bill 1893 to be filed in the coming days. The Bill can be found [here](#).

Please note that this is only the initial filing of this legislative initiative, and there may very well be amendments proposed to House Bill 1893 as the legislative process proceeds. With that caveat, the following are a few highlights from this initial filing of House Bill 1893:

- The alternative measure of the franchise tax using real and tangible personal property in Tennessee is repealed by this Bill effective upon enactment.
- The effective date of the Bill is upon the Governor signing this legislation into law.
- The Tennessee Department of Revenue (Department) is directed by this Bill to issue a refund equal to the amount of tax actually paid minus the amount of tax otherwise due without the alternative minimum measure of the franchise tax.
- A refund claim must be filed on a form prescribed by the Department exclusively for the purposes of seeking a refund pursuant to this legislation and must not include a claim for refund on any other basis. (Comment: We do not yet know when this refund claim form will be available.)
- The refund must be claimed within three years from December 31 of the year in which the "payment" was made or within any period covered by an extension agreement with the Department. (Comment: This provision should allow a taxpayer to file a refund claim as far back as payments made in 2021 since the statute of limitations should remain open for those 2021 payments through December 31, 2024.)
- This Bill also authorizes the Department to refund, in accordance with this legislation, a claim properly filed prior to January 1, 2024, that alleges the franchise tax is unconstitutional by failing the internal consistency test.
- The Department is not authorized by this Bill to make a refund unless a claim is filed.
- The interest rate that will apply to the refund is the rate established by federal law for large corporate overpayments in the amount of the federal short-term rate plus 0.5 of a percentage point, with interest beginning 90 days from the date that the Department receives the refund claim and proper proof to verify that the refund or credit is due and payable. (Comment: That interest rate is less than the rate generally applied under Tennessee law to refunds.)
- No attorneys' fees are to be added to the amount of the refund due.
- All refunds paid pursuant to this Bill must be paid from an appropriately designated fund established by the Department of Finance and Administration.
- Should a refund claim pursuant to this Bill be denied by the Department, certain litigation remedies under Tennessee law are applicable.

- Exempt finished goods inventory will be subtracted in calculating the property factor for apportionment purposes (Comment: The present law only permits the subtraction of such inventory if it is located in Tennessee. The Bill appears to eliminate that location requirement.)
- Taxpayers who have paid the franchise tax based upon net worth are not affected by this Bill.

The enactment of this Bill would be a major shift in the administration and enforcement of the franchise tax, especially for real property owners. As a group, real property owners tend to be the most hard hit by the alternative minimum tax base measure which is now constitutionally suspect. The net worth measure can be significantly less than the alternative measure for mortgaged property.

Additionally, leased real property and tangible personal property in Tennessee will, upon enactment of this Bill, no longer be double taxed. Under present law, and unless the net worth measure is applicable, the lessor pays franchise tax on the book value of the property and the lessee pays franchise tax based on a multiple of the annual rent that is attributable to real property and tangible personal property. Upon enactment of this Bill, a lessee will no longer pay any franchise tax on leased property, and the lessor should pay less because any debt on the property will reduce net worth.

As referenced earlier, amendments may be offered for this Bill as the legislation process proceeds, and we will strive to keep you advised as material developments occur.

Our attorneys and our dedicated [State Public Policy Advocacy Group](#) will be monitoring developments and can offer assistance to clients who desire to engage or be heard as part of the legislative process.

Additionally, please do not hesitate to contact [Carl E. Hartley](#), [William H.D. Fones, Jr.](#), [Steven K. Wood](#), [Jacob D. Baggett](#), or your counsel at Baker Donelson, to address matters particular to your facts and circumstances.