

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 19-05

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The application of the Tennessee franchise and excise community investment tax credit provisions under TENN. CODE ANN. § 67-4-2109(h) (Supp. 2018).

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 the taxpayer's detriment.

FACTS

[TAXPAYER] (the "Housing Entity") was formed in [DATE] for the purpose of building and operating [REDACTED] units of affordable multifamily rental housing in [CITY], Tennessee. The project consists of two sites whose construction was completed in [DATE], one in [REDACTED] and one in [REDACTED].

Since [DATE], the Housing Entity has been pursuing a refinancing of its current first mortgage. During this process, several prospective lenders have indicated that although they could not provide the full proceeds required for a refinancing [REDACTED], they would be willing to provide part of the required loan proceeds through syndicated lending or loan participation. In this case, any loan participations would be made on pari-passu¹ basis with equal risk sharing for all participating lenders.

RULINGS

1. If the Housing Entity refinances its existing mortgage loan and enters into a new mortgage such that a number of financial institutions are parties to a syndicated loan, may each lender claim the community investment tax credit under TENN. CODE ANN. § 67-4-2109(h) for purposes of Tennessee franchise and excise taxes, and if so, how are credits awarded?

Ruling: If the syndicated loan is a qualified loan or a qualified low-rate loan to an eligible housing entity that engages in an eligible activity, then each financial institution that is an originating lender under the loan syndication agreement may claim the community investment tax credit under TENN. CODE ANN. § 67-4-2109(h) with respect to its share of the loan.

There are alternative statutory mechanisms for computing the amount of each originating lender's credit, which are explained below. All of the taxpayers must utilize the same credit computation methodology.

2. If the Housing Entity refinances its existing mortgage loan and enters into a new mortgage such that a number of financial institutions participate in a participation loan to the Housing Entity whereby the originating lender transfers interests in the loan to the participating lenders, may each lender claim the community investment tax credit under TENN. CODE ANN. § 67-4-2109(h) for purposes of Tennessee franchise and excise taxes, and if so, how are credits awarded?

Ruling: There are alternative statutory mechanisms for computing the amount of a lender's credit. Which lenders may claim the credit depends on the statutory mechanism chosen by the originating lender(s).

Only the financial institution(s) that originated the loan may claim the one-time credit set forth in TENN. CODE ANN. § 67-4-2109(h)(1)(A) for a qualified loan, or the one-time credit set forth in TENN. CODE ANN. § 67-4-2109(h)(2)(A) for a qualified low-rate loan. The participating financial institutions are not entitled to claim any credit when the originating financial institution chooses to utilize the credit under TENN. CODE ANN. § 67-4-2109(h)(1)(A) or -2109(h)(2)(A).

However, if the financial institution(s) that originated the loan claims the annual credit under TENN. CODE ANN. § 67-4-2109(h)(1)(B) for a qualified loan, or the annual credit in TENN. CODE

¹ Pari passu is Latin for "on equal footing." Loans that are pari passu have equal rights in payment or equal seniority.

ANN. § 67-4-2109(h)(2)(B) for a qualified low-rate loan, then both the originating lender and all participating lenders are entitled to claim the annual credit under TENN. CODE ANN. § 67-4-2109(h)(1)(B) or -2109(h)(2)(B). The statutory mechanisms for computing the amount of each lender's credit are explained below.

ANALYSIS

LEGAL BACKGROUND

Tennessee imposes an excise tax at the rate of 6.5% on the net earnings of all persons doing business within Tennessee.² Tennessee also imposes a franchise tax at the rate of \$0.25 per \$100, or major fraction thereof, on the net worth of a person doing business in Tennessee.³ Persons subject to Tennessee franchise and excise taxes include, but are not limited to, business trusts, corporations, and financial institutions (including state-chartered or national banks, and state-chartered or federally chartered savings and loan associations).⁴

Tennessee allows credits against a taxpayer's liability for franchise and/or excise taxes in certain circumstances. For example, TENN. CODE ANN. § 67-4-2109(h) sets forth the community investment tax credit and provides that a financial institution⁵ may take a credit against its total liability for franchise and excise taxes when it makes qualified loans,⁶ qualified long-term investments,⁷ grants, or contributions to eligible housing entities⁸ for any eligible activity.⁹

The community investment tax credits provided for in TENN. CODE ANN. § 67-4-2109(h)(1)(A) and (h)(2)(A) are applied one time, and any unused credit under those subsections can be carried

² TENN. CODE ANN. § 67-4-2007(a) (Supp. 2018).

³ TENN. CODE ANN. §§ 67-4-2105(a) and -2106(a) (2013 & Supp. 2018).

⁴ TENN. CODE ANN. § 67-4-2004(38) (Supp. 2018).

⁵ A "financial institution" is defined for franchise and excise tax purposes as "a holding company, any regulated financial corporation, a subsidiary of a holding company or a regulated financial corporation, an investment entity that is indirectly more than fifty percent (50%) owned by a holding company or a regulated financial corporation, or any other person that is carrying on the business of a financial institution." TENN. CODE ANN. § 67-4-2004(17).

⁶ The statute setting forth the credits distinguishes between qualified loans and qualified low-rate loans. TENN. CODE ANN. § 67-4-2109(h)(3)(E) (Supp. 2018) defines a qualified loan as a loan that is at least two percent (2%) below the prime rate at the time of loan approval. TENN. CODE ANN. § 67-4-2109(h)(3)(G) defines a qualified low-rate loan as a loan that is at least four percent (4%) below the prime rate at the time of loan approval.

⁷ TENN. CODE ANN. § 67-4-2109(h)(3)(F) defines a qualified long-term investment as an equity investment made for a period of more than five (5) years to an eligible housing entity.

⁸ Pursuant to TENN. CODE ANN. § 67-4-2109(h)(3)(B), an eligible housing entity is any Tennessee nonprofit corporation with I.R.C. § 501(c)(3) status, the Tennessee Housing Development Agency ("THDA"), a public housing authority, or a development district.

⁹ According to TENN. CODE ANN. § 67-4-2109(h)(3)(A), an eligible activity is "an activity that creates or preserves affordable housing for low-income Tennessean, an activity to help low-income Tennesseans obtain sale and affordable housing, an activity that builds the capacity of an eligible nonprofit to provide housing opportunity to low-income Tennesseans, and any other activities approved by the executive director of the Tennessee housing development agency and the commissioner of revenue."

forward for fifteen (15) years after the tax year in which the credit originated.¹⁰ According to TENN. CODE ANN. § 67-4-2019(h)(1)(A), the amount of the credit is equal to five percent (5%) of a qualified loan or qualified long-term investment to an eligible housing entity for an eligible activity. According to TENN. CODE ANN. § 67-4-2019(h)(2)(A), the amount of the credit is equal to ten percent (10%) of a qualified low-rate loan, grant, or contribution to an eligible housing entity for an eligible activity.

The community investment tax credits provided for in TENN. CODE ANN. § 67-4-2109(h)(1)(B) and (h)(2)(B) are generated annually and are computed based on the unpaid principal balance of the loan as of December 31 of each year for the earlier of the life of the loan or fifteen (15) years. A taxpayer cannot carry forward those credits beyond the tax year in which the credits originated.¹¹ According to TENN. CODE ANN. § 67-4-2019(h)(1)(B), the amount of the credit is equal to three percent (3%) annually of the unpaid principal balance of a qualified loan made to an eligible housing entity for any eligible activity as of December 31 of each year for the life of the loan or fifteen (15) years, whichever is earlier. According to TENN. CODE ANN. § 67-4-2109(h)(2)(B), the amount of the credit is equal to five percent (5%) annually of the unpaid principal balance of a qualified low-rate loan made to an eligible housing entity for any eligible activity as of December 31 of each year for the life of the loan or fifteen (15) years, whichever is earlier.

APPLICATION

If an eligible housing entity¹² refinances an existing debt obligation, the financial institution that makes the new loan is permitted to claim the community investment tax credit set forth in TENN. CODE ANN. § 67-4-2109(h) against its total liability for franchise and excise taxes if the loan is a qualified loan¹³ or a qualified low-rate loan¹⁴ for an eligible activity.¹⁵ A financial institution may claim the community investment tax credit either in the form of one time credits set forth in TENN. CODE ANN. § 67-4-2109(h)(1)(A) and (h)(2)(A) or annual credits set forth in TENN. CODE ANN. § 67-4-2109(h)(1)(B) and (h)(2)(B) regardless of the type of community investment tax credit a financial institution may have claimed on a prior loan to the eligible housing entity on the same eligible activity.

Because the Housing Entity in this case only can refinance the mortgage through financial institutions that will provide the loan proceeds through syndicated lending or loan participation, further analysis is necessary as to whether each financial institution involved is eligible for the community investment tax credit set forth in TENN. CODE ANN. § 67-4-2109(h).

¹⁰ TENN. CODE ANN. § 67-4-2109(h)(8).

¹¹ *Id.*

¹² TENN. CODE ANN. § 67-4-2109(h)(3)(B).

¹³ TENN. CODE ANN. § 67-4-2109(h)(3)(E).

¹⁴ TENN. CODE ANN. § 67-4-2109(h)(3)(G).

¹⁵ TENN. CODE ANN. § 67-4-2109(h)(3)(A).

1. SYNDICATED LOAN

With a syndicated loan, a borrower enters a single credit agreement with two or more originating lenders. All of the lenders participate jointly in the origination and lending process. Each lender has a direct relationship with the borrower and receives its own promissory note from the borrower. In most instances, one or more lenders act as the arranger of the loan and as the agent of the lenders, whereby they collect all payments and fees and distribute them to each syndicated lender. The syndicated lending relationship is pari-passu, and loan repayments are paid pro rata in accordance with the amount of each lender's claim.

The credits set forth in TENN. CODE ANN. § 67-4-2109(h)(1)(A) for a qualified loan and in TENN. CODE ANN. § 67-4-2109(h)(2)(A) for a qualified low-rate loan are one-time credits and are based upon the total amount of the loan. According to TENN. CODE ANN. § 67-4-2109(h)(8), a taxpayer claiming the credits in TENN. CODE ANN. § 67-4-2109(h)(1)(A) or TENN. CODE ANN. § 67-4-2109(h)(2)(A) can carry forward unused credits for fifteen years from the year in which the credit originated. As such, each originating lender financial institution may claim the one-time credits based upon the amount the Housing Entity owes each financial institution under its individual promissory note with that lender. An originating lender financial institution may carry forward any unused portion of the credit for a period of fifteen years beyond the tax year in which the credit originated.

The credits set forth in TENN. CODE ANN. § 67-4-2109(h)(1)(B) for a qualified loan and in TENN. CODE ANN. § 67-4-2109(h)(2)(B) for a qualified low-rate loan are annual credits and are based upon the unpaid principal balance of the loan. According to TENN. CODE ANN. § 67-4-2109(h)(8), a taxpayer claiming the credits in TENN. CODE ANN. § 67-4-2109(h)(1)(B) or TENN. CODE ANN. § 67-4-2109(h)(2)(B) cannot carryforward unused credits beyond the tax year in which the credit originated. As such, each originating lender financial institution may claim the annual credits based upon the balance owed to each originating lender under its individual promissory note as of December 31 of each year. Each originating lender can take the credit for each year of the loan for the life of the loan for a maximum of fifteen years.

All originating lenders must claim the same type of credit. Thus, if the loan is a qualified loan, all originating lenders must claim the credit set forth in in TENN. CODE ANN. § 67-4-2109(h)(1)(A), or they must all claim the credit set forth in in TENN. CODE ANN. § 67-4-2109(h)(1)(B). If the loan is a qualified low-rate loan, all lenders must claim the credit in TENN. CODE ANN. § 67-4-2109(h)(2)(A), or they must all claim the credit set forth in in TENN. CODE ANN. § 67-4-2109(h)(2)(B).

See [Appendix A](#) for an illustration of the community investment tax credit with regard to a syndicated loan.

2. LOAN PARTICIPATION

Loan Participation involves the transfer of ownership of a loan (or portion of a loan) between two or more lenders. An originating lender originates the loan and then transfers ownership interests in the loan to one or more participating lenders while retaining an interest in the loan. The participating lenders do not become parties to the credit agreement and do not have any direct contractual relationship with the borrower. As such, the participating lenders do not maintain a claim against the borrower or collateral securing the loan. The originating lender holds loan

documentation in its own name, holds all original documentation, services the loan, and deals with the borrower on behalf of all participating lenders. Loan participation can be made on a senior/subordinated basis¹⁶ or a pari-passu basis.

The credits set forth in TENN. CODE ANN. § 67-4-2109(h)(1)(A) for a qualified loan and in TENN. CODE ANN. § 67-4-2109(h)(2)(A) for a qualified low-rate loan are one-time credits and are based upon the total amount of the loan.

According to TENN. CODE ANN. § 67-4-2109(h)(8), a taxpayer claiming the credits in TENN. CODE ANN. § 67-4-2109(h)(1)(A) or TENN. CODE ANN. § 67-4-2109(h)(2)(A) can carry forward unused credits for fifteen years from the year in which the credit originated. As such, only the financial institution that originated the loan may claim the one-time credits based upon the loan amount set forth in the credit agreement. The originating lender financial institution may carry forward any unused portion of the credit for a period of fifteen years beyond the tax year in which the credit originated.¹⁷

TENN. CODE ANN. § 67-4-2109(e)(1) states that “a credit carryforward may only be taken by the taxpayer that generates it.” Accordingly, only the financial institution(s) that originated the loan may claim the one-time credit set forth in TENN. CODE ANN. § 67-4-2109(h)(1)(A) for a qualified loan, or the one-time credit set forth in TENN. CODE ANN. § 67-4-2109(h)(2)(A) for a qualified low-rate loan. The participating lender financial institutions are not entitled to claim any credit when the originating lender financial institution chooses to utilize the one-time credit under TENN. CODE ANN. § 67-4-2109(h)(1)(A) or -2109(h)(2)(A). The participating lender financial institutions are not part of the loan at origination when the total amount of the loan is determined and did not themselves generate the credits. As such, the participating lender financial institutions are not entitled to claim any credit when the originating financial institution chooses to utilize the credit under TENN. CODE ANN. § 67-4-2109(h)(1)(A) or -2109(h)(2)(A).

The credits set forth in TENN. CODE ANN. § 67-4-2109(h)(1)(B) for a qualified loan and in TENN. CODE ANN. § 67-4-2109(h)(2)(B) for a qualified low-rate loan are annual credits and are based upon the unpaid principal balance of the loan. According to TENN. CODE ANN. § 67-4-2109(h)(8), a taxpayer claiming the credits in TENN. CODE ANN. § 67-4-2109(h)(1)(B) or TENN. CODE ANN. § 67-4-2109(h)(2)(B) cannot carryforward unused credits beyond the tax year in which the credit originated. Accordingly, if the originating lender financial institution claims the annual credit under TENN. CODE ANN. § 67-4-2109(h)(1)(B) for a qualified loan or the annual credit in TENN. CODE ANN. § 67-4-2109(h)(2)(B) for a qualified low-rate loan, then both the originating lender and all participating lenders are entitled to claim the credit under TENN. CODE ANN. § 67-4-2109(h)(1)(B) or -2109(h)(2)(B).

If the loan is a qualified loan or a qualified low-rate loan made to an eligible housing entity for an eligible activity,¹⁸ the Department will award credits to each financial institution that is part of the loan participation pursuant to TENN. CODE ANN. § 67-4-2109(h)(1)(B) or TENN. CODE ANN. § 67-4-

¹⁶ The senior lender is paid first, and the subordinate loan participation is paid only if there are sufficient funds left over to make the payments.

¹⁷ See TENN. CODE ANN. § 67-4-2109(h)(8).

¹⁸ This ruling does not address whether any of the lenders are financial institutions under the Tennessee franchise and excise statutes or whether the loan is a qualified loan or a qualified low-rate loan to an eligible housing entity for eligible activity.

2109(h)(2)(B) based upon the unpaid principal balance that the eligible housing entity owes each financial institution as of December 31, according to each financial institution's percentage of ownership in the loan.

Because the credits in TENN. CODE ANN. § 67-4-2109(h)(1)(B) and TENN. CODE ANN. § 67-4-2109(h)(2)(B) are limited to the earlier of fifteen years or the life of the loan, the period for claiming the credit is measured from the date that the loan originated rather than the date that a financial institution became a participating lender. For example, if a loan originates in 2019, and the originating lender takes the credit pursuant to TENN. CODE ANN. § 67-4-2109(h)(1)(B) or TENN. CODE ANN. § 67-4-2109(h)(2)(B) but sells a portion of the loan to a participating lender in 2021, the participating lender is only entitled to take the credit pursuant to TENN. CODE ANN. § 67-4-2109(h)(1)(B) or TENN. CODE ANN. § 67-4-2109(h)(2)(B) through 2033 or the life of the loan, whichever is earlier.

See [Appendix B](#) for an illustration of the community investment tax credit with regard to loan participation.

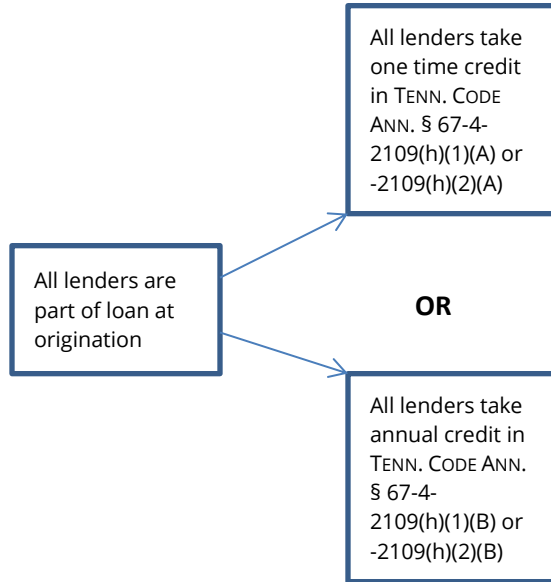
See [Appendix C](#) for an illustration of the application of community investment tax credit to multiple lenders that make a qualified loan to an eligible housing entity for eligible activity.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 8/29/19

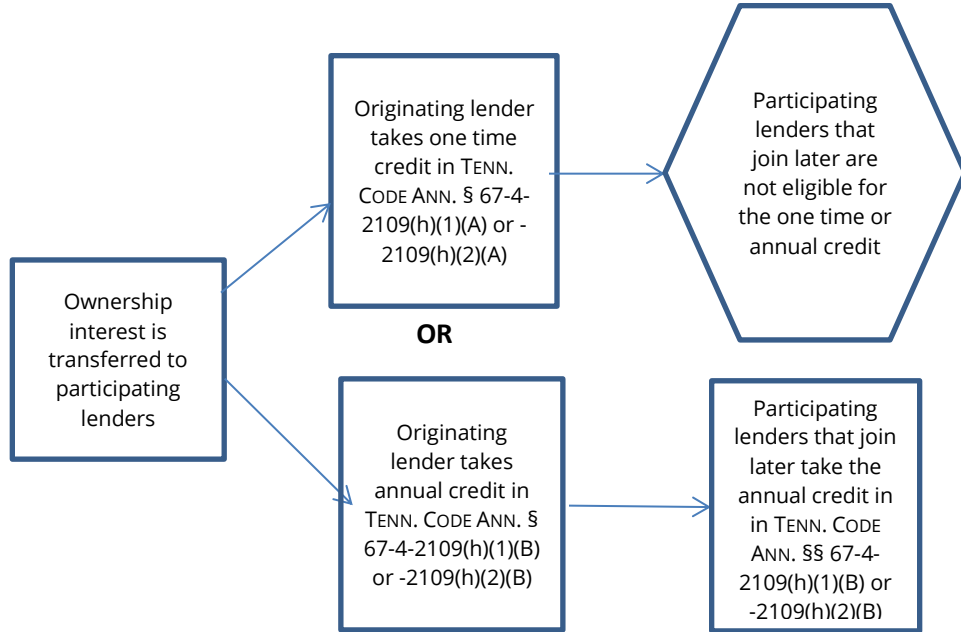
Appendix A

Syndicated Loan



Appendix B

Loan Participation



Appendix C

Application of the community investment tax credit to multiple lenders that make a qualified loan to an eligible housing entity for eligible activity

Statutory Reference for Credit	Amount of Credit	Length of Credit	Syndicated Loan	Loan Participation
67-4-2019(h)(1)(A)	5% of a qualified loan or a qualified long-term investment	One time credit with carryforward of 15 years after tax year in which credit was generated	All lenders can claim this credit	If originating lender takes this credit, participating lenders that join later are not eligible to claim this credit.
67-4-2019(h)(1)(B)	3% annually of unpaid principal balance as of December 31	Annual Credit based on unpaid principal balance as of December 31 of each year for the earlier of the life of the loan or 15 years	All lenders can claim this credit	Originating lender and participating lenders that join later can claim this credit
67-4-2019(h)(2)(A)	10% of a qualified loan or a qualified long-term investment	One time credit with carryforward of 15 years after tax year in which credit was generated	All lenders can claim this credit	If originating lender takes this credit, participating lenders that join later are not eligible to claim this credit
67-4-2019(h)(2)(B)	5% annually of unpaid principal balance as of December 31	Annual Credit based on unpaid principal balance as of December 31 of each year for the earlier of the life of the loan or 15 years	All lenders can claim this credit	Originating lender and participating lenders that join later can take this credit