IN THE COURT OF APPEALS OF TENNESSEE
MIDDLE SECTION AT NASHVILLE

BRETT R. CARTER,	)	
	)	
Petitioner-Appellant,	)	
	)	
	)	
vs.	)	**No. M2015-00666-COA-R3-CV**
	)	
LARRY B. MARTIN, IN HIS OFFICIAL CAPACITY AS COMMISIONER OF THE DEPARMENT OF FINANCE AND ADMINISTRATION, STATE OF TENNESSEE,	)	
	)	
Respondent-Appellee.	)	

REPLY BRIEF OF APPELLANT

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APPLYING PRINCIPLES OF STATUTORY CONSTRUCTION TO THE STATUTE AT ISSUE IN THIS CASE, IT IS APPARENT THAT THE DOCUMENTS AT ISSUE ARE NOT CONFIDENTIAL TAX ADMINISTRATION INFORMATION.

To make sure that the Court understands the information that is at issue here, the tax study and related documents that are being sought are documents that were used in the development of the Revenue Modernization Act ("RMA") – an act that adopted such substantive tax law changes as (1) market sourcing of receipts under the Tennessee franchise and excise tax, (2) economic nexus for out-of-state taxpayers for franchise and excise tax and business tax purposes, (3) taxation of remotely-accessed software, and (4) click-through nexus for sales tax on out-of-state taxpayers. 2015 Tenn. Pub. Acts. ch. 514, § § 3-7, 9, 14, 17, 21-27 (Appendix). Estimates from the RMA indicated that these provisions would increase state tax revenue by over $150 million over the next five years. *See* Fiscal Note. SB603/HB644 (March 16, 2015) (Appendix). Thus, the tax study and the related documents have everything to do with the development of the substantive tax laws of the state and raising revenues for the state general fund and nothing to do with the Commissioner's duty to administer the state tax laws. Appellee has not cited to one provision of the RMA that addresses the Commissioner's administrative responsibilities. Taxpayers and the citizens of this state are entitled to know how the state tax laws are developed and the considerations made in changing those laws. However, these activities have nothing to do with the determinations made by the Department of Revenue in administering the tax laws with respect to particular taxpayers or policies adopted by the Department on how it will administer these laws. It is these later activities that are protected under the plain reading of the statute, and there is nothing in the statute that expands the confidentiality provisions at issue to the Commissioner's functions in the realm of the legislature and the enactment of substantive tax laws. It is this distinction that is the

fundamental difference between the parties as to why the documents at issue should be produced and are not protected by Tenn. Code Ann. § 67-1-1701.

The result advanced by Appellant is further supported by the presumption that government documents should be open for public inspection, unless otherwise provided by state law. Tenn. Code Ann. § 10-7-503(a)(2)(A). Based on the analysis set forth by Appellant in his original Brief and as set forth below, the taxpayer confidentiality statutes do not extend to protect the documents at issue here. If, however, the Court determines that it is a close call, the presumption of openness of government documents should prevail as it is the government's burden to establish nondisclosure of records. Tenn. Code Ann. § 10-7-505(c). As set forth in detail below, the confidentiality of tax administration information does not extend to documents produced as part of the Department's legislative efforts to enact the RMA. The General Assembly narrowly drafted Tenn. Code Ann. § 67-1-1701(6) to only apply in the context of the Department's "administrative" functions, including "assessments, collection, enforcement, litigation, publication, and statistical gathering functions" under the state tax laws. Thus, the Department's legislative efforts as sought here are not confidential and must be produced in accordance with Tenn. Code Ann. § 10-7-503.

A. "Development and formulation of state tax policy" must be construed in context with the words and phrases used by the General Assembly in defining tax administration.

Appellee's central argument is that all activities related to the development and formulation of state tax policy – both the development of substantive tax laws and administrative tax policy - are confidential under Tenn. Code Ann. §§ 67-1-1701, 1702(6). This argument focuses the Court on the following phrase in the definition of tax administration – "development and formulation of

state tax policy relating to existing or proposed[1] tax laws." Appellant maintains that this phrase indicates that the development of substantive tax policy – who is taxed, what is taxed and how the tax is calculated – is confidential and cannot be disclosed absent the approval of the Commissioner of Revenue.[2] However, it is axiomatic that in construing statutes in Tennessee, words are known by the company that they keep. *See Lee Medical, Inc. v. Beecher*, 312 S.W.3d 515, 526 (Tenn. 2010). Accordingly, Courts must look to the entire statute and construe words in the context in which they appear in the statute and in light of the statute's general purpose. *State v. Flemming*, 19 S.W.3d 195, 197 (Tenn. 2000); *Lyons v. Rasar*, 872 S.W.2d 895, 897 (Tenn. 1994); *State ex rel. Comm'r of Transp. v. Medicine Bird Black Bear White Eagle*, 63 S.W.3d 734, 754–55 (Tenn. Ct. App. 2001). In *Medicine Bird Black Bear White Eagle*, the Court of Appeals summarized this principle as follows:

> The trial court's expansive interpretation of Tenn. Code Ann. § 46–4–102 results from its focus on the literal meaning of the phrase "any right" without considering the phrase in the context of the words surrounding it or in the context of the entire statutory scheme for terminating burial grounds. Of course, the phrase "any right," when considered in a vacuum, is expansive enough to encompass every sort of right—legal, contractual, moral, and constitutional. However, the General Assembly did not use the phrase in a vacuum, and thus we must consider the phrase in context.

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[1] The reference to proposed tax laws is likely used to cover administrative policy development and discussions that occur prior to the enactment of a statute. Oftentimes, tax statutes are effective upon passage. Thus, the Department of Revenue must begin preparation for the administration of a tax law prior to its enactment. Absent this broad wording by the General Assembly, the administrative policy development that occurred prior to the enactment of a tax law could arguably be subject to disclosure, while administrative policy development that occurred after passage would be protected.

[2] The decision to disclose "tax administration information," other than tax returns and "tax information," is within the sole discretion of the Commissioner of the Department of Revenue:

> The commissioner is authorized to disclose tax administration information, other than returns and tax information, if the commissioner determines that such disclosure is in the best interests of the state; provided, that no provision of law shall be construed to require disclosure of criteria or standards used or to be used for the selection of returns or persons for audit or examination, or data used or to be used for determining such criteria or standards, if the commissioner determines that such disclosure will impair assessment, collection, or enforcement under state tax laws.

Tenn. Code Ann. § 67-1-1711.

Medicine Bird Black Bear White Eagle, 63 S.W.3d at 755 (emphasis added).

In this case, the full sentence that is the focus of this appeal provides as follows:

> "Tax administration" also means the development and formulation of state tax policy relating to existing or proposed tax laws, related statutes and reciprocity agreements and includes assessments, collection, enforcement, litigation, publication, and statistical gathering functions under such laws, statutes, rules or reciprocity agreements.

Tenn. Code Ann. § 67-1-1701(6). Thus, the "development and formulation of state tax policy relating to existing or proposed tax laws" must be read in context that there is a modifying phrase that follows and identifies the types of policy development that are covered by the statute, and "includes assessments, collection, enforcement, litigation, publication, and statistical gathering functions under such laws." It is uncontroversial that the functions listed are functions included within the Commissioner's administrative responsibilities. Thus, to read the preceding phrase to include the legislative policy development of substantive sales and use tax, franchise and excise tax, business tax, or property tax laws simply ignores the context and words used in the statute and the basic canons of statutory construction.

Appellee would have this Court construe the applicable phrase "development and formulation of state tax policy" in a literal sense and in a vacuum, but as set forth in *Medicine Bird Black Bear White Eagle*, this Court must consider this phrase in context. Here, the context of the statute, which focuses on the Department's development of policy related its administrative functions, is also consistent with the general purpose of the broader confidentiality statutes, which protect confidential documentation obtained and generated by the Department of Revenue in administering the state tax laws. To attempt to expand this provision to include the Departmental functions related to the development of state tax laws regarding the imposition of state taxes is an overly broad interpretation of the statute in light of the context of the statute and principles of statutory construction addressed above and should be rejected by this Court.

B. It is Appellee who is attempting to read portions of the tax administration definition in isolation to reach a flawed construction of the statute at issue.

Appellee argues that Appellant is improperly relying on the isolated phrase of "assessments, collection, enforcement, litigation, publication, and statistical gathering functions under such state laws" and cites the Court to *Cummings v. Sharp*, 122 S.W.2d 423, 425 (Tenn. 1938), which stands for the proposition that "[i]t is not in accord with any rule of statutory construction to lift one sentence out from the statute and construe it alone, without reference to the balance of the statute." Appellee obviously fails to recognize the hypocrisy of this argument as it is he who is relying on an isolated phrase from the statute and advancing an interpretation of the subject definition that is inconsistent with a complete reading of the statute and which ignores the balance of the definition. In particular, the modifying phrase relied upon by Appellant sets forth the areas or topics of tax policy development and formulation that are protected by the statute – those that are related to *administrative* activities of the Department of Revenue – "assessments, collection, enforcement, litigation, publication, and statistical gathering functions" – and not the development of substantive state tax laws.

As the Tennessee Supreme Court has recognized, a statute must be construed in its entirety, and it should be assumed that the legislature used each word purposefully and that those words convey some intent and have meaning and purpose. *Tennessee Growers, Inc. v. King*, 682 S.W.2d 203, 205 (Tenn. 1984). "[I]t is improper to take a word or a few words from its context and then, with them isolated, attempt to determine their meaning." *Eastman Chemical Co. v. Johnson*, 151 S.W.3d 503, 507 (Tenn. 2004) (*citing First Nat'l Bank of Memphis v. McCanless*, 207 S.W.2d 1007, 1009-10 (Tenn. 1948)). That is exactly what Appellee has done here, asking this Court to overlook the remainder of the sentence at issue and the significance of that modifying phrase, but under the rules of statutory construction, Courts must presume that the General Assembly used

every word deliberately and that each word has a specific meaning and purpose. *State v. Hawk*, 170 S.W.3d 547, 551 (Tenn. 2005); *Johnson v. LeBonheur Children's Med. Ctr.*, 74 S.W.3d 338, 343 (Tenn. 2002).

Appellant is merely focusing the Court on the balance of the definition which lists the types of policy development that are protected by the statute, which completely contradicts Appellee's position that all development and formulation of state tax policy is considered "tax administration." Specifically, the statute limits the type of policy development that is considered tax administration to activities that are administrative in nature.

> ... "Tax administration" also means the development and formulation of state tax policy relating to existing or proposed tax laws, related statutes and reciprocity agreements **and includes assessments, collection, enforcement, litigation, publication, and statistical gathering functions under such laws, statutes, rules or reciprocity agreements**.

Tenn. Code Ann. § 67-1-1701(6) (emphasis added). Appellee is asking this court to ignore the last phrase of the definition that sets forth the type of policy development that is *included in the definition of tax administration.* Statutory construction principles are clear that a statute "should be given the construction that will not render its terms useless," and there is a presumption that each word in a statute is used deliberately, and that the use of each word conveys some intent and has a specific meaning and purpose. *Browder v. Morris*, 975 S.W.2d 308, 311 (Tenn. 1998); *Wachovia Bank of North Carolina, N.A. v. Johnson*, 26 S.W.3d 621, 624 (Tenn. Ct. App. 2000) (*citing State v. Netto*, 486 S.W.2d 725 (Tenn. 1972)).

Appellee contends that the last phrase of the definition "simply makes clear that the development of state tax policy relating to state tax laws "**also**" includes "assessments, collection, enforcement, litigation, publication, and statistical gathering functions." Brief of Appellee pg. 13. First, the statute does not use the phrase "and also includes." It, instead, uses the phrase "and includes," which while a subtle difference is significant here because it is not including other

classes. It is listing the classes of activities of the Department that are covered in the first instance. By arguing that the legislature was merely making it clear, Appellee is, in essence, saying that those words were not necessary in the first instance, which is contrary to the principles of statutory construction set forth above. The interpretation advanced by Appellee would render the General Assembly's use of this last phrase as useless and without purpose, but Courts must avoid any "forced or subtle construction that would limit or extend the meaning of the language." *Eastman Chem. Co.*, 151 S.W.3d 507 (*quoting Lipscomb v. Doe*, 32 S.W.3d 840, 844 (Tenn.2000)).

Tennessee Courts have addressed the use of the term "includes" in previous cases and concluded that it is used to identify items *illustrative* of general words in a statute. "[T]he use of the term 'includes' in a statutory definition indicates that the enumerated items that follow are illustrative" of what is included in the general definition but not necessarily exclusive. *Kendrick v. Kendrick*, 902 S.W.2d 918 (Tenn. Ct. App. 1994). Here, the phrase that begins with the word "and includes" is followed by a series of functions performed by the Commissioner that are all administrative in nature in keeping with the Commissioner's role of administering the collection of state taxes. None of the words used indicates that any of the functions performed by the Commissioner outside of those administrative functions (i.e. legislative functions) are covered.. Thus, the statute should be interpreted consistent with these illustrative words and not extend the protections of the confidentiality statute to activities that are beyond the types of activities enumerated by the General Assembly.

Significantly, another rule of statutory construction is that "'the expression of one thing implies the exclusion of all things not mentioned.'" *See Womack v. Corrections Corp. of America*, 448 S.W.3d 362, 374 (Tenn. 2014) (*quoting State v. Lane*, 254 S.W.3d 349, 353 (Tenn. 2008)). In *Womack*, the issue was whether a statute also applied to privately-run prisons, the Court concluded that it did not.

> Despite the broad definition of "inmate" in Tenn. Code Ann. § 41–21–801(4), the language of Tenn. Code Ann. § 41–21–803 continues to be limited to actions filed by inmates housed "in a facility operated by [TDOC]." The General Assembly has not broadened Tenn. Code Ann. § 41–21–803 in the same way that it has broadened Tenn. Code Ann. § 41–21–801(4). Therefore, the omission of privately operated facilities from Tenn. Code Ann. § 41–21–803 supports a conclusion that the General Assembly intended to continue to limit the application of Tenn. Code Ann. § 41–21–803 to facilities operated by TDOC.
>
> In light of these principles of statutory construction, we cannot interpret the language "facility operated by [TDOC]"—as used in Tenn. Code Ann. § 41–21–803 and unchanged since 1996—to include a facility operated by a private corporate entity. We do not believe this language itself supports such a reading.

Womack, 448 S.W.3d at 374 (citations omitted). Because the Tennessee Supreme Court concluded that the General Assembly was clearly thinking of a particular class in drafting the statute, it concluded that the words of more general description were not intended to embrace other items than those items within the class. *Id.* That has particular significance here based on the class of activities that the General Assembly has identified that were within the protections of the confidentiality statute as being administrative in nature. Because legislative functions of the Department of Revenue are not listed in the statute, those activities are not part of the confidential "tax administration information." In other words, "'where it clearly appears that the lawmaker was thinking of a particular class of persons or objects, his words of more general description may not have been intended to embrace any other than those within the class.'" *Sallee v. Barrett*, 171 S.W.3d 822, 829 (Tenn. 2005) (*quoting Automatic Merch Co. v. Atkins*, 327 S.W.2d 328, 333 (Tenn. 1959)).

Appellee's argument fails to comport with basic rules of statutory construction as it (1) renders the last phrase of the sentence as useless, (2) attempts to interpret policy development in a vacuum, (3) reaches a forced or subtle construction of the definition of tax administration, and (4) attempts to expand the class of tax administration that is covered by the statute to include legislative functions. Based on the foregoing, it is apparent that Appellee's construction of the

statute is overly broad and not supported by the words used by the General Assembly. In the definition of "tax administration," the General Assembly stopped short of extending the confidentiality to all the activities that may be performed related to the tax system,[3] leaving the activities related to the Commissioner's function as it relates to legislative decision-making process susceptible to disclosure.

C. The doctrine of *noscitur a sociis* also requires the Court to determine the meaning of doubtful words or phrases by reference to other words or phrases in the statute associated with it.

Under the doctrine of *noscitur a sociis*, courts determine "the meaning of questionable or doubtful words or phrases in a statute ... by reference to the meaning of other words or phrases associate with it." *See Sallee v. Barrett*, 171 S.W.3d 822 (Tenn. 2005); *see also Hammer v. Franklin Interurban Co.*, 354 S.W.2d 241, 242 (Tenn. 1962) (holding that statutory terms should be construed with reference to their associated words and phrases). In *Sallee*, one of the questions before the Court was whether the government immunity extended to negligent infliction of emotional distress. In construing the applicable statutory provision, the Tennessee Supreme Court analyzed the issue and concluded as follows:

> The statutory language at issue in this case provides that exceptions to a governmental entity's general waiver of immunity for negligent acts include injuries arising out of "false imprisonment pursuant to a mittimus from a court, false arrest, malicious prosecution, intentional trespass, abuse of process, libel, slander, deceit, interference with contract rights, *infliction of mental anguish*, invasion of right of privacy, or civil rights." All of the other torts listed are intentional torts. Applying the doctrines of *noscitur a sociis* and *ejusdem generis*, we interpret the phrase "infliction of mental anguish" with reference to the other words and phrases used with it in this section of the act. Accordingly, the tort of infliction of mental anguish must be read as applying to the same class of torts as the rest of those enumerated. ... Because the rest of the enumerated torts are all intentional torts, we conclude that "infliction of mental anguish" is also meant to include only the intentional tort.

[3] Appellee points to the Department's function of investigating the tax system and recommending legislation that may prevent tax evasion. Brief of Appellant, pg. 13, citing Tenn. Code Ann. § 67-1-102(b)(4) [sic]. However, the classes of activities identified as confidential in the confidentiality statute only relate to the Department's administrative functions and not any of its legislative functions. Thus, consistent with the arguments set forth herein, it would be reading something into the statute that is not there to conclude that those additional legislative functions are also confidential.

Sallee, 171 S.W.3d at 829 (citations omitted). The Court concluded that the terms were limited with reference to other words and phrases used in that section of the act. Because all of the listed terms were intentional torts, the Court concluded that only intentional torts were included in the scope of the governmental immunity.

A similar analysis applies here with respect to the phrase "development and formulation of state tax policy relating to existing or proposed tax laws." Immediately following that phrase, the statute provides that the preceding phrase "includes assessments, collection, enforcement, litigation, publication, and statistical gathering functions." As discussed above, all of these designations relate to administrative functions of the Department of Revenue and none relate to the development of substantive tax laws – i.e., whether a transaction is taxed, what is taxed or how the tax is calculated. Thus, for Appellee to argue that the substantive tax law changes that were the subject of the underlying tax study at issue is somehow covered by the confidentiality provision at issue is simply inconsistent with the provisions of the definition of "tax administration" and the words used therein. As was the case as in *Sallee*, the terms used in the definition of "tax administration" must be read "with reference to the other words or phrases used" in the statute. All of those words relate to administrative functions of the Department and not one even suggests that policy development was intended to include development of substantive tax laws or work related to legislative matters. The only conclusion to be drawn from this is that policy activities of the Department related to substantive tax laws are not included within the scope of the confidentiality protections afforded to "tax administration information." Ultimately, that is not surprising considering the overall scope of the confidentiality statutes, which focus on the protection of taxpayer identity, tax returns and other tax information, all of which are obtained by the Department of Revenue as part of its responsibility to administer tax laws and collect tax revenues. Tenn. Code Ann. § 67-1-1701 et. seq.

D. The doctrine of *ejusdem generis* also supports Appellant's position that the subject statute should be read in context with the specific words that describe the general description of "development and formulation of state tax policy."

As set forth in Appellant's Brief, Courts are guided in their interpretation of statutes by the doctrine of *ejusdem generis*. While the doctrine of *ejusdem generis* generally applies to interpret general words that follow special words, the Tennessee Supreme Court has stated that the rule is the same where special words follow the general words. *See State v. Wheeler*, 152 S.W. 1037, 1038 (Tenn. 1913). That is not surprising considering the overall depth of the statutory construction principles discussed above, which indicate that statutory terms must be read in context and should be construed with reference to their associated words and phrases. Thus, the doctrine of *ejusdem generis* is merely one of the many statutory construction doctrines that when considered together support Appellant's position that the subject statute was interpreted too broadly by the trial court in this case. Here, the trial court concluded that:

> The documents at issue were created at the behest of the Governor, who requested a study of Tennessee's current tax structure and recommendations on how to improve and modernize it. Based on its *in camera inspection* of the documents in question, this Court finds that the withheld documents all contain information about Tennessee's existing laws; evaluations of the current state tax structure; and information about, and evaluations of, potential changes to the state tax structure, as well as related policy issues. Accordingly, this Court finds that the documents reflect the "development and formulation of state tax policy relating to existing or proposed tax laws" and, therefore, constitute tax administration information as defined in Tenn. Code Ann. § 67-1-1701(6) and (7).

(R. Vol. II, pgs. 187-188.) (emphasis added). The trial court failed to properly interpret the subject statutes because it ignores the balance of the definition of tax administration, which provides the categories of "formulation of state tax policy relating to existing or proposed tax laws" that are tax administration. By stopping short of the General Assembly's designation of the categories of activities covered by policy development, the Court reaches an inherently flawed decision that does not comport with foundational principles of statutory construction.

The common-sense conclusion here is that the General Assembly did not pass such a broad confidentiality provision. To the contrary and consistent with the principles of statutory construction set forth above, the General Assembly limited the scope of the tax administration information confidentiality to only to include "assessments, collection, enforcement, litigation, publication, and statistical gathering." Where the general words of "development and formulation of state tax policy relating to existing or proposed tax laws" is followed by the enumeration of particular classes of things, the general words will be construed as applying only to things of the same general class as those enumerated. *Lyons v. Rasar,* 872 S.W.2d 895, 897 (Tenn. 1994) (citing *Nance ex rel. Nance v. Westside Hosp.,* 750 S.W.2d 740, 743 (Tenn. 1988). "Where it clearly appears that the lawmaker was thinking of a particular class of persons or objects, his words of more general description may not have been intended to embrace any other than those within the class." *Automatic Merch. Co. v. Atkins,* 327 S.W.2d 328, 333 (1959) (*quoting State v. Grosvenor,* 258 S.W. 140, 141 (1924)). Here, the General Assembly limited the policy development activities that are protected by the confidentiality statute to policy development relative to the administration of the tax laws and not the formulation and enactment of changes to the tax laws. As the trial court reached an overly broad interpretation of the definition of confidential tax administration information, the court's holding should be reversed.

CONCLUSION

Based on the foregoing, this Court should concluded that the trial court's decision is in error and should be reversed, entering a judgment in Appellant's favor and directing Appellee to produce the documents that were withheld from production in accordance with Tennessee's Open Records Act.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing is being forwarded **via first class mail, postage prepaid,** to:

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on this the 26th day of October, 2015.

Brett Carter
Attorney for Appellant

APPENDIX

OTHER AUTHORITIES

State of Tennessee

PUBLIC CHAPTER NO. 514

HOUSE BILL NO. 644

By Representatives McCormick, Kevin Brooks, Towns

Substituted for: Senate Bill No. 603

By Senator Norris

AN ACT to amend Tennessee Code Annotated, Title 67, Chapter 4, Part 20; Title 67, Chapter 4, Part 21; Title 67, Chapter 4, Part 7 and Title 67, Chapter 6, relative to taxation.

WHEREAS, Tennessee's sales and use taxes, franchise and excise taxes, and business tax are intended to be broad-based taxes levied on all persons engaging in business in this State; and

WHEREAS, advances in technology and business practices now enable out-of-state companies to engage in business in this State in ways previously unaddressed by this General Assembly; and

WHEREAS, a physical presence in this State is now unnecessary to conduct profitable business in this State to the same extent as locally-based businesses; and

WHEREAS, advances in technology now enable out-of-state businesses to comply with this State's tax laws at costs similar to the compliance costs of locally-based businesses; and

WHEREAS, in light of these changes, many states have already reformed their rules for applying taxes to out-of-state businesses; and

WHEREAS, as applied to modern businesses, older provisions of this State's tax laws result increasingly in outcomes unintended by this General Assembly, and discourage businesses from investing in this State's property and people; and

WHEREAS, by changing these laws, this General Assembly intends to keep this State's tax laws in line with modern business practices; now, therefore,

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. This act shall be known and may be cited as the "Revenue Modernization Act."

SECTION 2. Tennessee Code Annotated, Section 67-1-803(a), is amended by deleting subdivision (2) and substituting instead the following:

(2) Under no circumstances, however, shall this authority be deemed to extend to any interest payable under the law in connection with any case of tax deficiency or delinquency.

SECTION 3. Tennessee Code Annotated, Section 67-4-702(a), is amended by inserting the following as a new subdivision:

( )

(A) "Substantial nexus in this state" means any direct or indirect connection of the taxpayer to this state such that the taxpayer can be required under the Constitution of the United States to remit the tax imposed under this part. Such connection includes, but is not limited to, any of the following:

(i) The taxpayer is organized or commercially domiciled in this state;

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(ii) The taxpayer owns or uses its capital in this state;

(iii) The taxpayer has systematic and continuous business activity in this state that has produced gross receipts attributable to customers in this state; or

(iv) The taxpayer has bright-line presence in this state. A person has bright-line presence in this state for a tax period if any of the following applies:

(a) The taxpayer's total receipts in this state during the tax period, as determined consistent with § 67-4-2012, exceed the lesser of five hundred thousand dollars ($500,000) or twenty-five percent (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 this state during the tax period, as determined consistent with § 67-4-2012, exceeds the lesser of fifty thousand dollars ($50,000) or twenty-five percent (25%) of the average value of all the taxpayer's total real and tangible personal property; or

(c) The total amount paid in this state during the tax period by the taxpayer for compensation, as determined consistent with § 67-4-2012, exceeds the lesser of fifty thousand dollars ($50,000) or twenty-five percent (25%) of the total compensation paid by the taxpayer;

(B) Notwithstanding subdivision ( )(A), no company that is treated as a foreign corporation under the Internal Revenue Code and that has no income effectively connected with a United States trade or business shall be considered to have a "substantial nexus in this state." For these purposes, whether a company has income effectively connected with a United States trade or business shall be determined in accordance with the provisions of the Internal Revenue Code;

SECTION 4. Tennessee Code Annotated, Section 67-4-711(a)(6), is amended by deleting the subdivision and substituting instead the following:

(6) The sale of any service that is delivered to a location outside this state;

SECTION 5. Tennessee Code Annotated, Section 67-4-717, is amended by deleting subsection (a) and substituting instead the following:

(a)

(1) Except as otherwise provided in this part, all persons with a substantial nexus in this state during the tax period and engaged in this state in any vocation, occupation, business, or business activity set forth as taxable under § 67-4-708(1)–(5), with or without establishing a physical location, outlet, or other place of business in the state, shall be subject to the tax levied by § 67-4-704. For purposes of this section, the phrase "engaged in this state" shall include, but not be limited to, any of the following:

(A) The sale of tangible personal property that is shipped or delivered to a location in this state;

(B) The sale of a service that is delivered to a location in this state;

(C) The leasing of tangible personal property that is located in this state; or

(D) Making sales as a natural gas marketer to customers located within this state through the presence in this state of the seller's property, through the holding of pipeline capacity by the seller on pipelines located in this state, or through the presence in this state of the seller's employees, agents, independent contractors, or other representatives acting on behalf of the seller to solicit orders, provide customer service, or conduct other activities in furtherance of such sales. For purposes of this subdivision (a)(1)(D), the phrase "presence in this state of the seller's property" shall include property owned by the seller in this state during delivery to the customer, whether in a pipeline or otherwise.

(2) All persons that are subject to the tax levied by § 67-4-704 and have a physical location, outlet, or other place of business within a municipality in this state shall be subject to the tax levied by § 67-4-705. Persons that do not have a physical location, outlet, or other place of business within a municipality in this state shall not be subject to the tax levied by § 67-4-705.

SECTION 6. Tennessee Code Annotated, Section 67-4-2004, is amended by inserting the following as a new, appropriately designated subdivision:

( )

(A) "Substantial nexus in this state" means any direct or indirect connection of the taxpayer to this state such that the taxpayer can be required under the Constitution of the United States to remit the tax imposed under this part and part 21 of this chapter. Such connection includes, but is not limited to, the following:

(i) The taxpayer is organized or commercially domiciled in this state;

(ii) The taxpayer owns or uses its capital in this state;

(iii) The taxpayer has systematic and continuous business activity in this state that has produced gross receipts attributable to customers in this state;

(iv) The taxpayer licenses intangible property for use by another party in this state and derives income from that use of intangible property in this state; or

(v) The taxpayer has bright-line presence in this state. A person has bright-line presence in this state for a tax period if any of the following applies:

(a) The taxpayer's total receipts in this state during the tax period, as determined under § 67-4-2012, exceed the lesser of five hundred thousand dollars ($500,000) or twenty-five percent (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 this state during the tax period, as determined under § 67-4-2012, exceeds the lesser of fifty thousand dollars ($50,000) or twenty-five percent (25%) of the average value of all the taxpayer's total real and tangible personal property; or

(c) The total amount paid in this state during the tax period by the taxpayer for compensation, determined under § 67-4-2012, exceeds the lesser of fifty thousand dollars ($50,000) or twenty-five percent (25%) of the total compensation paid by the taxpayer;

(B) Notwithstanding subdivision ( )(A), no company that is treated as a foreign corporation under the Internal Revenue Code and that has no income effectively connected with a United States trade or business shall be considered to have a "substantial nexus in this state";

(C) To the extent a company that is treated as a foreign corporation under the Internal Revenue Code has income effectively connected with a United States trade or business, such company's net earnings and net worth for purposes of the taxes imposed by this part and part 21 of this chapter shall be its net earnings and net worth connected with its United States trade or business, and only property used in, payroll attributable to, and receipts effectively connected with such company's United States trade or business shall be considered for purposes of calculating such company's apportionment fraction;

(D) For purposes of subdivisions ( )(B) and (C), whether a company has income effectively connected with a United States trade or business and the amount of its net earnings and net worth connected with its United States trade or business shall be determined in accordance with the provisions of the Internal Revenue Code;

SECTION 7. Tennessee Code Annotated, Section 67-4-2007(a), is amended by deleting from the first sentence the language "doing business in Tennessee" and substituting instead the language "doing business in this state and having a substantial nexus in this state".

SECTION 8. Tennessee Code Annotated, Section 67-4-2012, is amended by deleting subsection (a) in its entirety and substituting instead the following:

(a)

(1) Except as otherwise provided in this part, for tax years beginning prior to July 1, 2016, all net earnings shall be apportioned to this state by multiplying the earnings by a fraction, the numerator of which shall be the property factor plus the payroll factor plus twice the receipts factor, and the denominator of the fraction shall be four (4).

(2) Except as otherwise provided in this part, for tax years beginning on or after July 1, 2016, all net earnings shall be apportioned to this state by multiplying the earnings by a fraction, the numerator of which shall be the property factor plus the payroll factor plus three (3) times the receipts factor, and the denominator of the fraction shall be five (5).

SECTION 9. Tennessee Code Annotated, Section 67-4-2012, is further amended by deleting subsections (i) and (j) in their entireties and substituting instead the following language as new subsections (i) and (j):

(i)

(1) Sales, other than sales of tangible personal property, are in this state if the taxpayer's market for the sale is in this state. The taxpayer's market for a sale is in this state:

(A) In the case of sale, rental, lease, or license of real property, if and to the extent the property is located in this state;

(B) In the case of rental, lease, or license of tangible personal property, if and to the extent the property is located in this state;

(C) In the case of sale of a service, if and to the extent the service is delivered to a location in this state;

(D) In the case of intangible property:

(i) That is rented, leased, or licensed, if and to the extent the intangible property is used in this state; provided, that

intangible property utilized in marketing a good or service to a consumer is considered used in this state if that good or service is purchased by a consumer who is in this state; and

(ii) That is sold, if and to the extent the property is used in this state; provided, that:

(a) A contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is considered used in this state if the geographic area includes all or part of this state;

(b) Receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease, or licensing of such intangible property under subdivision (i)(1)(D)(i); and

(c) All other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the receipts factor.

(2) If the state or states of assignment under subdivision (i)(1) cannot be determined, the state or states of assignment shall be reasonably approximated.

(3) If the state of assignment cannot be determined under subdivision (i)(1) or reasonably approximated under subdivision (i)(2), such sale shall be excluded from the numerator and denominator of the sales factor.

(4) If the application of this subsection (i) to a tax year results in a lower apportionment factor than under the application of the apportionment method in subsection (i) as it was in effect prior to January 1, 2016, then a taxpayer may annually elect to apply the apportionment method in subsection (i) as in effect prior to January 1, 2016; provided, however, the election must result in a higher apportionment factor for the tax year, and the taxpayer must have net earnings, rather than a net loss, for that tax year as computed under § 67-4-2006.

(j)

(1) For any qualified member of a qualified group, total receipts in this state shall equal the receipts from all sales of tangible personal property that are in this state as determined under subsection (h), plus the arithmetical average of the receipts from all sales other than sales of tangible personal property that are in this state as determined under each of the following alternative methods:

(A) All sales that are in this state as determined under subsection (i); and

(B) All sales, other than sales of tangible personal property, where the earnings-producing activity is performed:

(i) In this state; or

(ii) Both in and outside this state and a greater proportion of the earnings-producing activity is performed in this state than in any other state, based on costs of performance.

(2) For purposes of this subsection (j), the following definitions shall apply:

(A) "Qualified expenditures" means expenditures incurred in transactions with persons who are not members of the qualified group for the following:

(i) Purchasing tangible personal property placed in service in this state by a member of the qualified group; and

(ii) Payroll for employees employed by a member of the qualified group at a facility in this state;

(B) "Qualified group" means an affiliated group that meets both of the following criteria:

(i) One or more members of the group is a qualified member; and

(ii) The members of the group, during the tax period, either:

(a) Incur, in the aggregate, qualified expenditures in an amount greater than one hundred fifty million dollars ($150,000,000); or

(b) Make sales that are subject to the tax imposed by chapter 6 of this title in excess of one hundred fifty million dollars ($150,000,000);

(C) "Qualified member" means a person that is principally engaged in the sale of "telecommunications service," "mobile telecommunications service," "Internet access service," "video programming service," "direct-to-home satellite television programming service," or a combination of such services, as each such term is used or defined in chapter 6 of this title.

(3) The method provided by this subsection (j) for determining the total receipts in this state of a qualified member shall be the only method for determining such receipts under this part.

SECTION 10. Tennessee Code Annotated, Section 67-4-2013(b)(3), is amended by adding the following language as a new subdivision (H) and redesignating existing subdivision (H) and remaining subdivisions accordingly:

(H) Receipts equal to the net gain or income from the sale of a security made by a person who is a dealer in such security within the meaning of 26 U.S.C. § 475 shall be attributed to Tennessee if such person's customer is located in Tennessee and such receipt is not otherwise attributed under subdivision (b)(3)(G). For purposes of this subdivision (b)(3)(H), a customer is in this state if the customer is an individual, trust, or estate that is a resident of this state and, for all other customers, if the customer's commercial domicile is in this state. Unless the dealer has actual knowledge of the residence or commercial domicile of a customer during a taxable year, the customer shall be deemed to be a customer in this state if the billing address of the customer, as shown in the records of the dealer, is in this state;

SECTION 11. Tennessee Code Annotated, Section 67-4-2013(b)(3)(I), as redesignated, is amended by deleting the language "§ 67-4-2012(i)" and substituting instead the language "§ 67-4-2012(i)(1)(C)".

SECTION 12. Tennessee Code Annotated, Section 67-4-2013(b)(3)(L), as redesignated, is amended by deleting the language "(b)(3)(A)–(J)" at the end of the subdivision and substituting instead the language "(b)(3)(A)–(K)".

SECTION 13. Tennessee Code Annotated, Section 67-4-2013(d), is amended by deleting the subsection in its entirety and substituting instead the following:

(d)

(1) For tax years beginning prior to July 1, 2016, the net earnings of a captive REIT affiliated group shall be apportioned to this state based on property,

payroll, and double weighted receipts as provided in § 67-4-2012(a)(1), including the factors of those members of the affiliated group that would not be subject to taxation in this state if considered apart from the affiliated group; provided, however, that dividends, receipts, and expenses resulting from transactions between members of the affiliated group shall be excluded for purposes of apportionment under this subdivision (d)(1).

(2) For tax years beginning on or after July 1, 2016, the net earnings of a captive REIT affiliated group shall be apportioned to this state based on property, payroll, and triple weighted receipts as provided in § 67-4-2012(a)(2), including the factors of those members of the affiliated group that would not be subject to taxation in this state if considered apart from the affiliated group; provided, however, that dividends, receipts, and expenses resulting from transactions between members of the affiliated group shall be excluded for purposes of apportionment under this subdivision (d)(2).

SECTION 14. Tennessee Code Annotated, Title 67, Chapter 4, Part 20, is amended by adding the following language as a new section:

(a) Notwithstanding any law to the contrary, a taxpayer that meets the gross sales threshold and the receipts factor threshold during the tax period qualifies for the application of this section and may elect the application of this section by filing an election form with the department and providing such information as may be required by the commissioner on or before the due date of the tax return for the period for which such election is to take effect. Such election shall remain in effect until revoked by the taxpayer or until the taxpayer no longer qualifies for the election.

(b) For purposes of this section, the following shall apply:

(1) A taxpayer meets the gross sales threshold if the taxpayer's sales of tangible personal property made in this state during the tax period to all distributors exceed one billion dollars ($1,000,000,000), as determined under § 67-4-2012 without regard to this section;

(2) A taxpayer meets the receipts factor threshold if the taxpayer's receipts factor, as determined under § 67-4-2012 without regard to this section, exceeds ten percent (10%); and

(3) "Certified distribution sales" means sales of tangible personal property made in this state by the taxpayer to any distributor, whether or not affiliated with the taxpayer, that is resold for ultimate use or consumption outside the state; provided, that the distributor has certified that such property has been resold for ultimate use or consumption outside this state. Such certification shall be made in the manner prescribed by the commissioner.

(c)

(1) A taxpayer that has made the election described in subsection (a) shall, so long as such election is in effect, apportion net earnings and net worth in the manner prescribed elsewhere in this part and part 21 of this chapter; provided, however, that the total amount derived from certified distribution sales shall be excluded from the numerator of the receipts factor, as that term is defined elsewhere in this part and part 21 of this chapter.

(2) A taxpayer that has made the election described in subsection (a) shall, so long as such election is in effect, pay to the commissioner, annually, an excise tax on the total amount of certified distribution sales excluded from the numerator of the taxpayer's receipts factor. The amount of such tax shall be computed in the following manner:

(A) In the case of taxpayers excluding no more than two billion dollars ($2,000,000,000) of certified distribution sales for the tax period, the amount of such tax shall be five-tenths of one percent (0.5%) of the total amount of certified distribution sales;

(B) In the case of taxpayers excluding more than two billion dollars ($2,000,000,000) but no more than three billion dollars ($3,000,000,000) of certified distribution sales for the tax period, the amount of such tax shall be:

(i) Three-eighths of one percent (0.375%) of certified distribution sales in excess of two billion dollars ($2,000,000,000); plus

(ii) Ten million dollars ($10,000,000);

(C) In the case of taxpayers excluding more than three billion dollars ($3,000,000,000) but no more than four billion dollars ($4,000,000,000) of certified distribution sales for the tax period, the amount of such tax shall be:

(i) One-fourth of one percent (0.25%) of certified distribution sales in excess three billion dollars ($3,000,000,000); plus

(ii) Thirteen million, seven hundred fifty thousand dollars ($13,750,000); and

(D) In the case of taxpayers excluding more than four billion dollars ($4,000,000,000) of certified distribution sales for the tax period, the amount of such tax shall be:

(i) One-eighth of one percent (0.125%) of certified distribution sales in excess of four billion dollars ($4,000,000,000); plus

(ii) Sixteen million, two hundred fifty thousand dollars ($16,250,000).

(3) The tax due under subdivision (c)(2) shall be in addition to all other taxes, including the tax imposed by § 67-4-2007(a).

SECTION 15. Tennessee Code Annotated, Section 67-4-2105(a), is amended by deleting from the first sentence the language "doing business in Tennessee" and substituting instead the language "doing business in this state and having a substantial nexus in this state".

SECTION 16. Tennessee Code Annotated, Section 67-4-2111, is amended by deleting subsection (a) in its entirety and substituting instead the following:

(a)

(1) Except as otherwise provided in this part, for tax years beginning prior to July 1, 2016, the net worth of a taxpayer doing business both in and outside this state shall be apportioned to this state by multiplying such values by a fraction, the numerator of which shall be the property factor plus the payroll factor plus twice the receipts factor, and the denominator of the fraction shall be four (4).

(2) Except as otherwise provided in this part, for tax years beginning on or after July 1, 2016, the net worth of a taxpayer doing business both in and outside this state shall be apportioned to this state by multiplying such values by a fraction, the numerator of which shall be the property factor plus the payroll factor plus three (3) times the receipts factor, and the denominator of the fraction shall be five (5).

SECTION 17. Tennessee Code Annotated, Sections 67-4-2111, is further amended by deleting subsections (i) and (j) in their entireties and substituting instead the following language as new subsections (i) and (j):

(i)

(1) Sales, other than sales of tangible personal property, are in this state if the taxpayer's market for the sales is in this state. The taxpayer's market for a sale is in this state:

(A) In the case of sale, rental, lease, or license of real property, if and to the extent the property is located in this state;

(B) In the case of rental, lease, or license of tangible personal property, if and to the extent the property is located in this state;

(C) In the case of sale of a service, if and to the extent the service is delivered to a location in this state; and

(D) In the case of intangible property:

(i) That is rented, leased, or licensed, if and to the extent the intangible property is used in this state; provided, that intangible property utilized in marketing a good or service to a consumer is considered used in this state if that good or service is purchased by a consumer who is in this state; and

(ii) That is sold, if and to the extent the property is used in this state; provided, that:

(a) A contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is considered used in this state if the geographic area includes all or part of this state;

(b) Receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease, or licensing of such intangible property under subdivision (i)(1)(D)(i); and

(c) All other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the receipts factor.

(2) If the state or states of assignment under subdivision (i)(1) cannot be determined, the state or states of assignment shall be reasonably approximated.

(3) If the state of assignment cannot be determined under subdivision (i)(1) or reasonably approximated under subdivision (i)(2), such sale shall be excluded from the numerator and denominator of the sales factor.

(4) If the application of this subsection (i) to a tax year results in a lower apportionment factor than under the application of the apportionment method in this subsection (i) as it was in effect prior to January 1, 2016, then a taxpayer may annually elect to apply the apportionment method in this subsection (i) as in effect prior to January 1, 2016; provided, however, the election must result in a higher apportionment factor for the tax year, and the taxpayer must have net earnings, rather than a net loss, for that tax year as computed under § 67-4-2006.

(j)

(1) For any qualified member of a qualified group, total receipts in this state shall equal the receipts from all sales of tangible personal property that are in this state as determined under subsection (h), plus the arithmetical average of

the receipts from all sales other than sales of tangible personal property that are in this state as determined under each of the following alternative methods:

(A) All sales that are in this state as determined under subsection (i); and

(B) All sales, other than sales of tangible personal property, where the earnings-producing activity is performed:

(i) In this state; or

(ii) Both in and outside this state and a greater proportion of the earnings-producing activity is performed in this state than in any other state, based on costs of performance.

(2) For purposes of this subsection (j), the following definitions shall apply:

(A) "Qualified expenditures" means expenditures incurred in transactions with persons who are not members of the qualified group for the following:

(i) Purchasing tangible personal property placed in service in this state by a member of the qualified group; and

(ii) Payroll for employees employed by a member of the qualified group at a facility in this state;

(B) "Qualified group" means an affiliated group that meets both of the following criteria:

(i) One or more members of the group is a qualified member; and

(ii) The members of the group, during the tax period, either:

(a) Incur, in the aggregate, qualified expenditures in an amount greater than one hundred fifty million dollars ($150,000,000); or

(b) Make sales that are subject to the tax imposed by chapter 6 of this title in excess of one hundred fifty million dollars ($150,000,000);

(C) "Qualified member" means a person that is principally engaged in the sale of "telecommunications service," "mobile telecommunications service," "Internet access service," "video programming service," "direct-to-home satellite television programming service," or a combination of such services, as each such term is used or defined in chapter 6 of this title.

(3) The method provided by this subsection (j) for determining the total receipts in this state of a qualified member shall be the only method for determining such receipts under this part.

SECTION 18. Tennessee Code Annotated, Section 67-4-2118(c), is amended by adding the following language as a new subdivision (8) and redesignating existing subdivision (8) and remaining subdivisions accordingly:

(8) Receipts equal to the net gain or income from the sale of a security made by a person who is a dealer in such security within the meaning of 26 U.S.C. § 475 shall be attributed to Tennessee if such person's customer is located in Tennessee and the receipt is not otherwise attributed under subdivision (c)(7). For purposes of this subdivision (c)(8), a customer is in this state if the customer is an individual, trust, or

estate that is a resident of this state and, for all other customers, if the customer's commercial domicile is in this state. Unless the dealer has actual knowledge of the residence or commercial domicile of a customer during a taxable year, the customer shall be deemed to be a customer in this state if the billing address of the customer, as shown in the records of the dealer, is in this state;

SECTION 19. Tennessee Code Annotated, Section 67-4-2118(c)(9), as redesignated, is amended by deleting the language "§ 67-4-2111(i)" and substituting instead the language "§ 67-4-2111(i)(1)(C)".

SECTION 20. Tennessee Code Annotated, Section 67-4-2118(c)(12), as redesignated, is amended by deleting the language "(c)(1)–(10)" at the end of the subdivision and substituting instead the language "(c)(1)–(11)".

SECTION 21. Tennessee Code Annotated, Section 67-6-102, is amended by inserting the following as a new subdivision:

( ) "Video game digital product" means the right to access and use computer software that facilitates human interaction with a user interface to generate visual feedback for amusement purposes, when possession of the computer software is maintained by the seller or a third party, regardless of whether the charge for the service is on a per use, per user, per license, subscription, or some other basis;

SECTION 22. Tennessee Code Annotated, Section 67-6-231(a), is amended by designating the current language as subdivision (1) and adding the following language as subdivision (2):

(2) For purposes of subdivision (a)(1), "use of computer software" includes the access and use of software that remains in the possession of the dealer who provides the software or in the possession of a third party on behalf of such dealer. If the customer accesses the software from a location in this state as indicated by the residential street address or the primary business address of the customer, such access shall be deemed equivalent to the sale or licensing of the software and electronic delivery of the software for use in this state. If the sales price or purchase price of the software relates to users located both in this state and outside this state as indicated by a residential street or business address, the dealer or customer may allocate to this state a percentage of the sales price or purchase price that equals the percentage of users in this state. Any dealer that purchases computer software only for the purpose of reselling access and use of such software as described in this subdivision (a)(2) shall be entitled to purchase such software exempt from the tax imposed by this chapter, subject to the same rules that apply generally to any sale of tangible personal property for resale; provided, however, that software purchased by a qualified data center for access and use by an affiliated company, as defined by § 67-6-395(c), shall be deemed to be used and consumed by the qualified data center and not resold to the affiliated company. Nothing in this subdivision (a)(2) shall be construed to impose a tax on any services that are not currently subject to tax under this chapter, such as, but not limited to, information or data processing services, including the capability of the customer to analyze such information or data provided by the dealer; payment or transaction processing services; payroll processing services; billing and collection services; Internet access; the storage of data, digital codes, or computer software; or the service of converting, managing, and distributing digital products.

SECTION 23. Tennessee Code Annotated, Section 67-6-233, is amended by deleting the language "specified digital products" wherever it appears and substituting instead the language "specified digital products or video game digital products" and is further amended by deleting the language "specified digital product" wherever it appears and substituting instead the language "specified digital product or video game digital product".

SECTION 24. Tennessee Code Annotated, Section 67-6-387, is amended by redesignating the existing language as subsection (a) and adding the following as new subsection (b):

(b) There is exempt from the tax imposed by this chapter the access and use of software that remains in the possession of the dealer who provides the software or in the

possession of a third party on behalf of such dealer, as described in § 67-6-231(a)(2), where such access and use of the software is solely by a person or such person's direct employee, as defined in subsection (a), for the exclusive purpose of fabricating other software that is both:

(1) Owned by that person; and

(2) For that person's own use and consumption.

SECTION 25. Tennessee Code Annotated, Section 67-6-395, is amended by deleting subsection (a) in its entirety and substituting instead the following:

(a) There is exempt from the tax imposed by this chapter the use of computer software that is developed and fabricated by an affiliated company, regardless of whether such software is accessed and used as described in § 67-6-231(a)(2) or delivered by other means.

SECTION 26. Tennessee Code Annotated, Title 67, Chapter 6, Part 5, is amended by adding the following as a new section:

It is the legislative intent to impose the taxes levied by this chapter to the fullest extent allowed under the constitutions of the United States and the state of Tennessee.

SECTION 27. Tennessee Code Annotated, Title 67, Chapter 6, Part 5, is amended by adding the following as a new section:

(a) A dealer is presumed to have a representative, agent, salesperson, canvasser, or solicitor operating in this state for the purpose of making sales and is presumed to have a substantial nexus with this state if:

(1) The dealer enters into an agreement or contract with one (1) or more persons located in this state under which the person, for a commission or other consideration, directly or indirectly refers potential customers to the dealer, whether by a link on an Internet web site or any other means; and

(2) The dealer's cumulative gross receipts from retail sales made by the dealer to customers in this state who are referred to the dealer by all residents with this type of an agreement with the dealer exceed ten thousand dollars ($10,000) during the preceding twelve (12) months.

(b) The presumption in subsection (a) may be rebutted only by clear and convincing evidence that the person with whom the dealer has an agreement or contract did not conduct any activities in this state that would substantially contribute to the dealer's ability to establish and maintain a market in this state during the preceding twelve (12) months.

SECTION 28. Tennessee Code Annotated, Section 67-4-2006(b)(2)(N), is amended by deleting the subdivision and by substituting instead the following:

(N) Any intangible expense paid, accrued, or incurred in connection with a transaction with one (1) or more affiliates, if the intangible expense has been disclosed in accordance with subdivision (d)(1) and either of the following conditions are met:

(i) The affiliate to whom the expense has been paid, accrued, or incurred is registered for and paying the tax imposed by this part; or

(ii) The expense was paid, accrued, or incurred to an affiliate in a foreign nation that is a signatory to a comprehensive income tax treaty with the United States or to an affiliate that is otherwise not required to be registered for or to pay the tax imposed by this part;

SECTION 29. Tennessee Code Annotated, Section 67-4-2006(d), is amended by deleting the subsection and by substituting instead the following:

(d)

(1) Any taxpayer that pays, accrues, or incurs intangible expenses as a result of a transaction with one (1) or more affiliates shall disclose the intangible expenses on the form as prescribed by the commissioner.

(2) Any taxpayer that pays, accrues, or incurs intangible expenses as a result of a transaction with one (1) or more affiliates and either fails to disclose the intangible expenses or fails to add the expenses to net earnings or net losses in accordance with subdivision (b)(1)(K) shall be subject to a negligence penalty as set forth in § 67-1-804(b)(2).

SECTION 30. If any provision of this act or the application of any provision of this act to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of the act that can be given effect without the invalid provision or application, and to that end, the provisions of this act are declared to be severable.

SECTION 31. Sections 3, 4, 5, 6, 7, 14, and 15 of this act shall take effect January 1, 2016, the public welfare requiring it, and shall apply to all tax years beginning on or after January 1, 2016. Sections 9, 10, 11, 12, 17, 18, 19, 20, 28, and 29 of this act shall take effect July 1, 2016, the public welfare requiring it, and shall apply to all tax years beginning on or after July 1, 2016. Sections 21, 22, 23, 24, 25, and 27 of this act shall take effect July 1, 2015, the public welfare requiring it. Section 2 of this act shall take effect July 1, 2016, the public welfare requiring it. All other sections of this act shall take effect upon becoming a law, the public welfare requiring it.

HOUSE BILL NO. 644

PASSED: April 22, 2015

BETH HARWELL, SPEAKER
HOUSE OF REPRESENTATIVES

RON RAMSEY
SPEAKER OF THE SENATE

APPROVED this 20th day of May 2015

BILL HASLAM, GOVERNOR

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE

FISCAL NOTE

SB 603 - HB 644

March 16, 2015

SUMMARY OF BILL: *Section 1* names the proposed act as the Revenue Modernization Act. Sections 2, 3 and 4 amend the Business Tax Act. *Section 2* defines a "substantial nexus in this state" to include taxpayers that have a bright-line presence in Tennessee, which is established if, during a tax period: the taxpayer's total receipts in Tennessee exceed the lesser of $500,000 or 25 percent of total receipts everywhere; the average value of the taxpayer's property owned or rented and used in Tennessee exceeds the lesser of $50,000 or 25 percent of the average value of all of the taxpayer's property; or the total compensation paid by the taxpayer in Tennessee exceeds the lesser of $50,000 or 25 percent of the total compensation paid by the taxpayer. *Section 3* authorizes a business tax deduction for the sale of any service that is delivered to a location outside Tennessee, rather than for sales of services that are received by customers located outside Tennessee. *Section 4* expands the scope of business activities subject to the business tax by requiring businesses with substantial nexus in Tennessee to pay the business tax, regardless of whether the business has a location in Tennessee.

Sections 5 through 11 amend the Franchise and Excise (F&E) Tax Law. *Section 5* defines a "substantial nexus in this state" in a similar manner as section 2 above and also includes taxpayers that license intangible property for use by another party in Tennessee and derives income from that use of intangible property in Tennessee. *Section 6* specifies that if a taxpayer disputes the Commissioner of Revenue's denial of an intangible expense deduction from the net earnings and losses when determining the basis for the excise tax, the taxpayer must show by clear and convincing evidence that the determination is incorrect. *Sections 7 and 10* require businesses with substantial nexus in Tennessee, as defined by section 5, to pay the F&E tax. *Sections 8 and 11* implement market-based sourcing, instead of earnings-producing activity sourcing, for sales, other than sales of tangible personal property, for purposes of apportioning the F&E tax. *Section 9* establishes franchise and excise tax incentive for a taxpayer who moves large volumes of product through third-party distributors if the taxpayer chooses to use distribution centers located in Tennessee. Establishes that, to qualify for the incentive, a taxpayer's sales of tangible personal property in Tennessee must exceed $1,000,000,000 and the taxpayer's receipts factor exceeds 10 percent.

Sections 12 through 16 amend the sales and use tax provisions. *Section 12* defines a "video game digital product" as the right to access and use computer software that facilitates human interaction with a user interface to generate visual feedback for amusement purposes, when possession of the computer software is maintained by the seller or a third party, regardless of whether the charge for the service is on a per use, per user, per license, subscription, or some other basis. *Section 13* establishes that, for purposes of the sales and use tax on the use of computer software, such use includes the right to access and use software that remains in the possession of the dealer who provides the software or in the possession of a third-party on

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behalf of such dealer. *Section 14* subjects video game digital products to sales and use tax. *Section 15* declares the legislative intent to impose the sales and use taxes to the fullest extent allowed under the constitutions of the United States and the State of Tennessee. *Section 16* creates a presumption that a dealer has a representative in Tennessee and a substantial nexus if: the dealer enters into an agreement with one or more persons located in Tennessee under which the person, for a commission or other consideration, refers potential customers to the dealer; and the dealer's cumulative gross receipts from retail sales made by the dealer to customers in Tennessee who are referred to by the dealer by all residents with this type of an agreement with the dealer exceeds $10,000 during the preceding 12 months.

Section 17 establishes the severability clause. *Section 18* establishes effective dates, as follows: sections 2 through 5, and 7 through 11, shall take effect January 1, 2016, and shall apply to all tax years beginning on or after that date; sections 12 through 14, and 16 shall take effect July 1, 2015; all other sections shall take effect upon becoming a law.

ESTIMATED FISCAL IMPACT:

Increase State Revenue – $17,196,600/FY15-16
$36,179,100/FY16-17
$39,869,800/FY17-18
$45,020,000/FY18-19
$45,481,700/FY19-20 and Subsequent Years

Increase State Expenditures – $371,500/FY16-17
$462,000/FY17-18
$452,000/FY18-19 and Subsequent Years

Increase Local Revenue – $7,017,500/FY15-16 and Subsequent Years

The Governor's proposed budget for FY15-16 recognizes a recurring increase in state revenue to the General Fund in the amount of $14,300,000

Assumptions:

Assumptions relative to Sections 2, 3, and 4:

- Based on an analysis of tax returns in the data warehouse, DOR estimates that applying the substantial nexus standard to the state business tax will result in an increase in state business tax revenue of $12,916,054.
- The first year impacted will be FY16-17, as the business tax return is due on April 15, 2017, for taxpayers with a tax year beginning on January 1, 2016.
- Because the taxpayers are based out-of-state, DOR anticipates a lag in full compliance. As a result, the compliance is anticipated to be 50 percent in FY16-17, 75 percent in FY17-18, and 100 percent in FY18-19 and subsequent years.

- Taking into account tax return due dates, the increase in state revenue is estimated to be: $5,534,529 in FY16-17; $9,225,292 in FY17-18; $12,454,305 in FY18-19; and $12,916,054 in FY19-20 and subsequent years.

Assumptions relative to Sections 5, 6, 7, and 10:

- Section 6 will not result in a significant fiscal impact.
- Based on the analysis of estimates of the impact of an economic nexus standard in Connecticut and Washington, DOR estimates that F&E tax collections will increase by approximately 0.26 percent, or $5,156,060, per year.
- Assuming a similar lag in compliance and taking into account the estimated payments requirements, DOR estimates that the state revenue will increase by: $4,511,553 in FY16-17; $4,511,553 in FY17-18; and $5,156,060 in FY18-19 and subsequent years.

Assumptions relative to Sections 8 and 11:

- Based on the analysis of estimates of the impact of market-based sourcing in Pennsylvania and Massachusetts, DOR estimates that F&E tax collections will increase by approximately 0.515 percent, or $10,212,965, per year.
- Assuming a similar lag in compliance and taking into account the estimated payments requirements, DOR estimates that the state revenue will increase by: $8,936,344 in FY16-17; $8,936,344 in FY17-18; and $10,212,965 in FY18-19 and subsequent years.

Assumption relative to Section 9:

- DOR reports that, based on an analysis of F&E tax returns, the distribution center tax incentive will not result in a decrease in the F&E tax liability for the tax year beginning immediately on or after January 1, 2016, of any registered taxpayer with sales of tangible personal property in the state in excess of $1,000,000,000 and a receipts factor that exceeds 10 percent.

Assumptions relative to Sections 12, 13, and 14:

- Based on Gartner's data on worldwide and North American software-as-a-service revenue, and assuming that Tennessee represents two percent of the U.S. market, remote access software market in Tennessee is estimated to be approximately $288,120,000.
- Accounting for the sales to exempt entities and for non-compliance, it is estimated that sales and use taxes will be imposed on 50 percent of such sales, or $144,060,000.
- Based on PricewaterhouseCoopers LLP and Wilkofsky Gruen Associates analysis of the North American market for online and wireless games, and assuming that Tennessee represents two percent of the U.S. market, video game market in Tennessee is estimated to be approximately $97,016,000.
- DOR assumes a compliance rate of 25 percent, resulting in taxable sales of approximately $24,254,000.
- The total taxable sales for remote access software market and video game market are estimated to be $168,314,000 ($144,060,000 + $24,254,000).

- The current state sales tax rate is 7.0 percent; the average local option sales tax rate is estimated to be 2.5 percent; the effective rate of apportionment to local government pursuant to the state-shared allocation is estimated to be 3.617 percent.
- The net recurring increase in state revenue, beginning in FY15-16, is estimated to be $11,355,826 [($168,314,000 x 7.0%) – ($168,314,000 x 7.0% x 3.617%)].
- The total recurring increase in local revenue, beginning in FY15-16, is estimated to be $4,634,004 [($168,314,000 x 2.5%) + ($168,314,000 x 7.0% x 3.617%)].
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Assumptions relative to Sections 15 and 16:

- Section 15 will not result in a significant fiscal impact.
- The fiscal impact of section 16 (click-through nexus) is dependent upon several unknown factors including, but not limited to, the number of entities that will qualify as dealers under the expanded definition and that will be subject to the sales and use tax, the number of dealers that will conduct operations in Tennessee in the future, the extent to which any associate programs currently operating in this state will be canceled as a direct result of this bill, the extent of taxable sales made by newly designated dealers, and the extent to which the tax is currently collected on internet sales in Tennessee.
- Given the extent of unknown factors, determining a precise fiscal impact is difficult. However, based on information provided by DOR, and projections of the University of Tennessee's Center for Business and Economic Research of state and local revenue losses in Tennessee ($606,000,000), and assuming that one percent of such losses is recovered as a result of this section, the recurring increase in state and local government revenue, beginning in FY15-16, is estimated to be $5,840,812 and $2,383,475, respectively.

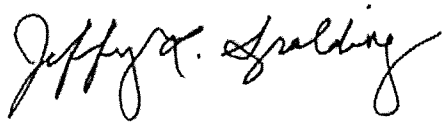
Assumptions relative to Total Revenue Impacts and State Expenditures:

- The proposed legislation is estimated to result in an increase in state revenue of: $17,196,638 ($11,355,826 + $5,840,812) in FY15-16; $36,179,064 ($5,534,529 + $4,511,553 + $8,936,344 + $11,355,826 + $5,840,812) in FY16-17; $39,869,827 ($9,225,292 + $4,511,553 + $8,936,344 + $11,355,826 + $5,840,812) in FY17-18; $45,019,968 ($12,454,305 + $5,156,060 + $10,212,965 + $11,355,826 + $5,840,812) in FY18-19; and $45,481,717 ($12,916,054 + $5,156,060 + $10,212,965 + $11,355,826 + $5,840,812) in FY19-20 and subsequent years.
- The proposed legislation is estimated to result in an increase in local revenue of: $7,017,479 ($4,634,004 + $2,383,475) in FY15-16 and subsequent years.
- Based on information provided by DOR, it is estimated that due to the expected increase in the number of calls regarding the registration and filing requirements, two additional Taxpayer Services Representative 3 positions will be required, beginning in FY16-17, resulting in a one-time increase in state expenditures of $11,400 and a recurring increase in state expenditures of $101,160.
- DOR further informs that two Revenue Enforcement Officer 1 positions will be required, beginning in FY17-18, due to the expected increase in the amount of cases received. The one-time increase in state expenditures is estimated to be $10,000; the recurring increase in state expenditures is estimated to be $101,848.

- Two additional Tax Auditor 2–Special positions will be required, beginning in FY16-17, due to the expected increase in out-of-state businesses that are liable for Tennessee taxes. The one-time increase in state expenditures is estimated to be $10,000; the recurring increase in state expenditures is estimated to be $248,950.
- The resulting increase in state expenditures is estimated to be $371,510 ($11,400 + $101,160 + $10,000 + $248,950) in FY16-17, $461,958 ($101,160 + $10,000 + $101,848 + $248,950) in FY17-18; and $451,958 ($101,160 + $101,848 + $248,950) in FY18-19 and subsequent years.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.



Jeffrey L. Spalding, Executive Director

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