

August 2011

ELECTING UNLIMITED LIABILITY TO BECOME EXEMPT FROM TENNESSEE FRANCHISE AND EXCISE TAXES



James H. Henry II
Attorney at Law

Under current Tennessee law, limited liability companies (“LLC’s”) or limited partnerships (“LP’s”) have several possibilities for legitimately avoiding Tennessee Franchise and Excise taxes (“F&E Taxes”). Some options are available due to the nature of the assets owned (for example a farm or house) and some are available due to the nature of the income (for example, rental income on one to four family residential units), if owned primarily by members of the same family. There are a number of details to those exemptions, which are outside the scope of this article. This article deals with an exemption which is available to LLC’s or LP’s, all of whose members or partners elect unlimited liability, to the same extent as general partners in a general partnership. These entities are referred to as an “Obligated Member Entities (“OME”). There are several major steps which must be followed in order to be entitled to this exemption from F&E Taxes. There are also a number of sub issues and details which are beyond the scope of this article, but the failure to follow these major steps will cause the exemption to fail, even if you might otherwise be entitled to the exemption. It is the purpose of this article to describe those major steps, because we have found some clients are unaware of the number of steps required.

This publication is a service to our clients and friends. It is designed to give only general information on the topic actually covered and is not intended to be a comprehensive summary of recent developments in the law, to treat exhaustively the subjects covered, to provide legal advice, or to render a legal opinion.

1. Articles of Amendment to your Articles of Organization or Certificate of Limited Partnership. You will be required to file an amendment to your Articles of Organization (for an LLC) or your Certificate of Limited Partnership (for LP’s), wherein each member or partner elects unlimited liability to the same extent as a general partner in a general partnership (which is, for most purposes, unlimited personal liability for all entity level debts). This has to be filed with the Tennessee Secretary of State before December 31 of any year to make it effective for the following calendar year. This only has to be filed once, but if any new members or partners are added, they must sign an amendment to this document accepting unlimited liability also and file it with the secretary of state within sixty (60) days of being added to the LLC.



AUGUST 2011

**ELECTING UNLIMITED LIABILITY TO BECOME EXEMPT
TENNESSEE FRANCHISE AND EXCISE TAX**



2. Tennessee Department of Revenue Franchise and Excise Tax Application for Exemption (Department of Revenue Form RV-F1319201). This has to be filed with the Tennessee Department of Revenue within sixty (60) days of the beginning of the first tax year which you claim an exemption. This is filed only once.
3. Franchise and Excise Tax Annual Exemption Renewal (Department of Revenue Form FAE 183). This has to be filed by April 15th of each year, following the end of your fiscal year.

If you fail to file these forms, even though you otherwise are entitled to the exemption, you will not get the benefit of the exemption. The decision to make this election is one that must be carefully considered, based on a “cost/benefit” analysis (i.e. is the election of unlimited liability worth the amount of F&E taxes you will save?). You can investigate the cost of increasing your liability insurance coverage to minimize the risk of unlimited liability, although not every liability is covered by insurance. Also, you can contractually limit coverage in some situations by including language such as this in any contract (this one is for leases):

“[___]. **Liability Limitation.** All obligations and liabilities related hereto shall be and remain solely an obligation of Lessor, and no member of Lessor shall have any liability related hereto.”

You may also need to include certain language in your operating agreement (for LLC’s) or your partnership agreement (for LP’s) to reflect this election and how it may affect each member’s or partner’s relationship with every other member or partner.

If you would like assistance with these documents, or would like to discuss these and other options for LLC’s and LP’s, feel free to contact James H. Henry II or John R. LaBar at (931) 455-9301 to schedule an appointment.

CIRCULAR 230 DISCLOSURE: Henry & McCord informs you that any tax advice contained in this Client Alert was not intended or written to be used, and cannot be used, for the purpose of avoiding federal tax related penalties, or promoting, marketing or recommending to another party any transaction or matter addressed herein.

