

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 14-12**

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

Whether income from stock in a state-chartered public trust company doing business in Tennessee is exempt from the Tennessee individual income tax.

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 ruling herein is binding upon the Department, and is 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

[TRUST COMPANY], also known as [REDACTED] (the "Trust Company"), a Tennessee corporation located in Nashville, Tennessee, is a state chartered public trust company organized under TENN. CODE ANN. §§ 45-2-201 to 45-2-217 and 45-2-1701(b) (2013). The Trust Company

is regulated by the Tennessee Department of Financial Institutions, which considers the Trust Company a non-depository bank.

The Trust Company is in the business of providing clients a variety of estate settlement and trust administration services by acting as the executor, trustee, or agent on their behalf. It administers personal trusts, asset protection trusts, and charitable trusts, among others, and provides a number of specialty services such as the coordination of elder or special needs care and related household services. The Trust Company does not offer asset management services, but rather focuses on trust administration in coordination with its clients' own financial advisors.

RULING

Is income from stock in the Trust Company exempt for purposes of the Tennessee individual income tax under TENN. CODE ANN. § 67-2-104(e)(6) (2013)?

Ruling: Yes. Income from stock in the Trust Company is exempt from the Tennessee individual income tax under TENN. CODE ANN. § 67-2-104(e)(6) (2013).

ANALYSIS

TENN. CODE ANN. § 67-2-102 (2013) imposes the Tennessee individual income tax at the rate of 6% on “incomes derived by way of dividends from stocks¹] or by way of interest on bonds of each person, partnership, association, trust and corporation in the state of Tennessee who received, or to whom accrued, or to whom was credited during any year” such dividend or interest income. Accordingly, the shareholders of a corporation such as the Trust Company will be liable for the income tax on any dividends from the corporation, unless an exemption applies.² One exemption that potentially applies to income derived by way of stock in the Trust Company is found under TENN. CODE ANN. § 67-2-104(e)(6) (2013), which provides an exemption from

¹ TENN. CODE ANN. § 67-2-101(6) (2013) defines the term “stocks” in pertinent part to mean “shares of stock issued by corporations chartered and organized under the laws of the state of Tennessee, or of any other state, or of the United States, or of any foreign government.” The term dividend, though undefined by statute, has been defined by Tennessee courts as “the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock.” *Dobson v. Huddleston*, 863 S.W.2d 392, 396 (Tenn. 1993) (quoting *Gallagher v. Butler*, 378 S.W. 2d 161, 167 (Tenn. 1964)).

² The burden is on the taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that “exemptions are strictly construed against the taxpayer, who has the burden of proving entitlement to the exemption.” *Steele v. Indus. Dev. Bd. of the Metro. Gov't of Nashville & Davidson Cnty.*, 950 S.W.2d 345, 348 (Tenn. 1997); *see also Am. Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn. Ct. App. 2000) (quoting *Rogers Grp., Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn. Ct. App. 1995)) (“Although the rule is well-established that taxing legislation should be liberally construed in favor of the taxpayer and strictly construed against the taxing authority, it is an equally important principle of Tennessee tax law that ‘exemptions from taxation are construed against the taxpayer who must shoulder the heavy and exacting burden of proving the exemption.’”). The Tennessee Supreme Court has also recognized that any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *See Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)).

the income tax for “income from any stock in any *bank, state or federally chartered, doing business in this state.*”³.

For the exemption under TENN. CODE ANN. § 67-2-104(e)(6) to apply to income derived from stock in the Trust Company, the Trust Company must therefore be properly characterized as a state or federally chartered bank. For the reasons set forth below, income from stock in the Trust Company qualifies for this exemption because the Trust Company is considered to be a “state chartered bank” for purposes of the exemption.

The term “bank” is nowhere defined in the individual income tax provisions; it is unclear from the statutory language exactly what types of entities are considered “banks” for purposes of the exemption.

The treatment of the Trust Company as a non-depository bank regulated and chartered under state banking laws strongly suggests that income from stock in the Trust Company comes within the scope of the exemption. The Trust Company is chartered by the State of Tennessee under the Tennessee Banking Act, Title 45, Chapters 1 and 2.⁴ Additionally, the Trust Company is regulated by the Tennessee Department of Financial Institutions, which considers the Trust Company to be a non-depository bank.

The legislative history of TENN. CODE ANN. § 67-2-104(e)(6) further supports the conclusion that the exemption in question applies to income from stock in a trust company that is chartered under the Tennessee Banking Act and regulated by the Tennessee Department of Financial Institutions as a non-depository bank.

In addition to the lack of a statutory definition of the term “bank” for individual income tax purposes, Tennessee’s definition of the term “bank” for banking regulatory purposes is comprehensive and extends to any institution engaged in “banking business.”⁵ As used in TENN. CODE ANN. § 67-2-104(e)(6), therefore, the term “bank” is imprecise and potentially ambiguous. In Tennessee, when statutory text is ambiguous, such that it may reasonably have more than one meaning, one must “resort to the rules of statutory construction and other external sources to ascertain the General Assembly’s intent and purpose.”⁶ One critical method of statutory construction often employed by Tennessee courts is an analysis of the statute’s legislative

³ Emphasis added.

⁴ See TENN. CODE ANN. §§ 45-1-124; 45-2-1701(b) (2013).

⁵ See, e.g., TENN. CODE ANN. § 45-1-103(3) (2013), which defines a “bank” for purposes of the laws governing the organization of banks under Title 45 (Banks and Financial Institutions) to mean in pertinent part “*any person, as hereinafter defined, doing a banking business* subject to the laws of this or any other jurisdiction.” (Emphasis added.) The Tennessee Banking Act, Title 45, Chapters 1 and 2, governs the organization and regulation of state trust companies; trust companies are considered to be conducting a banking business, limited to fiduciary purposes and powers. See TENN. CODE ANN. §§ 45-1-103(27); 45-1-124(b) (2013).

⁶ *Lee Med., Inc. v. Beecher*, 312 S.W.3d 515, 527 (Tenn. 2010). When engaging in this inquiry, one must “presume that the General Assembly intended each word in a statute to have a specific meaning and purpose.” *Id.*

history, including consideration of earlier versions and the entire statutory scheme.⁷ This inquiry may further “be aided by considering the words and legislative purpose of . . . related statutes.”⁸

The relevant history of this exemption dates back to the year 1907 and the enactment of what has been referred to by courts as the “bank stock tax.”⁹ This property tax was imposed on the value of stock held by shareholders of banks and other banking associations as an alternative to taxing bank capital stock or corporate property.¹⁰

In 1931, the Tennessee Legislature enacted the individual income tax as a levy on income derived from stocks and bonds.¹¹ The Legislature’s explicit design for this tax was “to provide for the assessment and collection of taxes upon property that paid no ad valorem tax.”¹² This created a de facto exemption from the income tax on stock held by those already paying the bank stock tax on their shares in a bank or banking association. Thus, while the value of a person’s shares in such entities remained taxable as property, the income derived therefrom continued to be untaxed.

Many years later, in 1977, the bank stock tax¹³ was ultimately repealed as to “banks or banking associations” by removing all reference to these entities in the statute.¹⁴ Without further action, a natural consequence to stockholders through repealing the property tax on their stock in banks or banking associations would be subjection to the subsequently-enacted individual income tax. To avoid this result, the Legislature concurrently enacted the individual income tax exemption for dividends from shares in a “bank, state or federally chartered.”¹⁵ This convergence of critical terms, “bank or banking association” and “bank, state or federally chartered”, operating to

⁷ *Beecher*, 312 S.W.3d at 527; see also *Fusner v. Coop Const. Co., L.L.C.*, 211 S.W.3d 686, 691-92 (Tenn. 2007) (“If the language is ambiguous, a court then must look to the statutory scheme as a whole and to legislative history to determine its meaning.”). It is important to always keep in mind, however, that “the text of the statute is of primary importance, and the words must be given their natural and ordinary meaning in the context in which they appear and in light of the statute’s general purpose.” *Mills v. Fulmarque, Inc.*, 360 S.W.3d 362, 368 (Tenn. 2012).

⁸ *Pickard v. Tennessee Water Quality Control Bd.*, 424 S.W.3d 511, 520 (Tenn. 2013), *reh’g denied* (Jan. 6, 2014).

⁹ See *City of Lewisburg v. First Nat. Bank of Lewisburg*, 563 S.W.2d 891, 892 (Tenn. 1978). This tax originated in Section 24, Chapter 602 of the Public Acts of 1907. *Id.*

¹⁰ *Id.*

¹¹ See *First Nat. Bank of Memphis v. McCanless*, 207 S.W.2d 1007, 1009 (1948) (*discussing Evans v. McCabe*, 52 S.W.2d 159, 161 (1932)).

¹² *Id.* Section 1123(5)(c) in Chapter 20 of the Public Acts of 1931, Extra Session, states that “[n]o person shall be assessed with this tax on any stock in any corporation where the value of the shares are assessed ad valorem to the stockholder by this state.” *McCanless*, 207 S.W.2d at 1007-08.

¹³ By this point, the tax had been recodified in TENN. CODE ANN. § 67-715 (1955).

¹⁴ 1977 Tenn. Pub. Acts Ch. 140, § 2. What remained was a property tax on a shareholder’s stock in any loan company, investment company, or cemetery company. *Id.* Note that the property tax on these remaining entities was repealed in 2011. 2011 Tenn. Pub. Acts Ch. 438, § 1.

¹⁵ 1977 Tenn. Pub. Acts Ch. 140, § 8.

maintain the status quo for income tax, indicates a legislative intention that the latter term encompass the former.¹⁶

To determine whether a trust company would have been considered a bank or banking association such that it was subsumed into the term “bank” in the income tax exemption statute, one must track the relevant evolution of the term “bank or banking association.” This analysis begins with the same 1977 Act that, in addition to repealing the bank stock tax and creating the exemption at issue, passed a new property tax on the intangible personal property of banks and banking associations.¹⁷

The intangible property tax imposed on banks and banking associations was subsequently repealed in 1983 and replaced with provisions for special allocations to local governments of excise taxes collected from “banks and banking associations.”¹⁸ Sixteen years later, the Tennessee Legislature enacted the Tax Revision and Reform Act of 1999 with special allocation provisions mirroring those from the 1983 Act.¹⁹ These new provisions were deemed to be the “substitute and successor” of their predecessors.²⁰ The 1999 Act created a shift in terminology from “bank or banking association” to “bank or financial institution.”²¹ Thus, it appears the Legislature intended “financial institutions” to include the same entities that had been considered “banking associations.”²²

Finally, in 2011, the Legislature expanded the excise tax special allocation provisions and explicitly stated that “financial institutions” include “loan or trust companies regulated by the

¹⁶ A “goal” of statutory construction is “to construe a statute in a way that avoids conflict and facilitates the harmonious operation of the law.” *Beecher*, 312 S.W.3d at 527. The words must be given their “natural and ordinary meaning” and should be construed “in the context which they appear in the statute and in the light of the statute’s general purpose.” *Id.*

¹⁷ 1977 Tenn. Pub. Acts Ch. 140, § 1. The Act created a taxable “subclassification of intangible personal property . . . designated as the ‘shares of banks and banking associations.’” *Id.* The net effect of all these provisions was to shift the imposition of the bank stock tax from shareholders to entities, without thereby creating a new liability on shareholders for the individual income tax.

¹⁸ 1983 Tenn. Pub. Acts Ch. 227, §§ 1 & 2.

¹⁹ 1999 Tenn. Pub. Acts. Ch. 406, § 3.

²⁰ *Id.* at § 2 (“The provisions of Sections 3 and 4 of this act shall be deemed to be the substitute and successor provisions to the former provisions of Title 67, Chapter 4, Parts 8 and 9.”) Prior to their repeal, the 1983 special allocation provisions were codified at TENN. CODE ANN. § 67-4-813 (1986).

²¹ *See Id.* at § 3 (amended and codified in part in TENN. CODE ANN. § 67-4-2004 (2013)) (defining “[b]usiness of a financial institution”). While every word in a statute is presumed to have a meaning and purpose, Tennessee courts do not always view a minor shift in terminology, without more, as a fundamental change in the law. *See, e.g., Dockins v. Balboa Ins. Co.*, 764 S.W.2d 529, 532 (Tenn. 1989) (holding that a redrafting to combine multiple provisions had no substantive effect). Additionally, “[t]he background, purpose, and general circumstances under which words are used in a statute must be considered, and it is improper to take a word or a few words from its context and, with them isolated, attempt to determine their meaning.” *Eastman Chem. Co. v. Johnson*, 151 S.W.3d 503, 507 (Tenn. 2004) (citing *McCanless*, 207 S.W.2d at 1009-10).

²² Prior versions of a statute can provide support for more recent enactments lacking clear guidance. *Seals v. H & F, Inc.*, 301 S.W.3d 237, 246 (Tenn. 2010).

department of financial institutions, which do not have deposit facilities.”²³ Altogether, and with consideration of the statutory scheme as a whole, these various pieces of legislative history provide meaningful evidence that the General Assembly intended the term “bank,” as used in TENN. CODE ANN. § 67-2-104(e)(6), to include trust companies that are chartered under the Tennessee Banking Act and regulated by the Tennessee Department of Financial Institutions as non-depository banks.

Accordingly, the Trust Company is properly characterized as a state-chartered “bank” for purposes of TENN. CODE ANN. § 67-2-104(e)(6).

Because the Trust Company is considered a state-chartered bank for purposes of the exemption under TENN. CODE ANN. § 67-2-104(e)(6), any income derived from stock in the Trust Company is exempt from the Tennessee individual income tax.

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APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: November 6, 2014

²³ 2011 Tenn. Pub. Acts Ch. 438, § 3 (codified at TENN. CODE ANN. § 67-4-2020 (2013)). Thus, as a financial institution for purposes of the Tennessee franchise and excise taxes, the Trust Company is subject to special reporting requirements thereunder. *See* TENN. CODE ANN. §§ 67-4-2004(17) (defining financial institutions) and 67-4-2006 (2013) (imposing special filing requirements).