

State and Local Tax Bulletin

May 19, 2011
Tennessee Edition



Upcoming Seminars Involving Members Of Our SALT Practice Group

May 23, 2011

COST's 2011 Spring Audit Session/Income Tax Conference will be held in Albuquerque, New Mexico. BABC attorneys Chris Grissom and Will Thistle will be speaking on "State Taxation of Owners of Pass-Through Entities." For more information, visit the COST website at www.cost.org.

June 24, 2011

The Tax Executives Institute (TEI) Region VII Annual Conference will be held on Hilton Head Island. Chris Grissom and David Huizenga of Jefferson Wells will be co-presenting "Developing State Tax Audit Management Strategies & Current Trends." For more information, visit the TEI website at www.tei.org.

June 27, 2011

The Institute for Professionals in Taxation's (IPT) Annual Conference will be held in San Antonio, Texas. Chris Grissom and Ben Turner of Aaron's Inc. will be co-presenting "Developing State Tax Audit and Appeals Strategies and Audit Maxims to Live By." For more information, visit the IPT website at www.ipt.org.

Judicial Update: Leasehold Interest Is Subject to Property Tax Despite Payment In Lieu of Tax Agreements

By Joe Gibbs, Pat Moskal, Brett Carter and Brian Shelton

The Tennessee Court of Appeals recently held in *Creative Label, Inc. v. Weakley County Assessor of Property* that payments made in lieu of property tax ("PILOT") reduce the value of taxable leasehold interests but do not exempt taxpayers from *ad valorem* taxes on the leasehold interest. This case serves as an important reminder for businesses negotiating property tax incentives with local taxing authorities that the tax exempt status of real property owned by an industrial development board and leased to the business extends only to the fee simple interest in the real property; the leasehold interest in the property remains taxable notwithstanding PILOT agreements if the leasehold has value.

Creative Label operated a manufacturing and warehousing facility leased from the Industrial Development Board ("IDB") in Martin, Tennessee. The terms of the lease required the IDB to acquire and construct a project in Martin Industrial Park and lease the project to Creative Label for a term of 99 years at a rental amount of \$1.00 per year. As part of this transaction, Creative Label also entered into PILOT agreements with the local taxing authorities, agreeing to pay \$4,000 per year to Weakley County and \$2,000 per year to the City of Martin. The County later issued a property tax assessment against Creative Label on the leasehold interest in the tax-exempt property.

Creative Label challenged the assessment before the State Board of Equalization arguing that the payments made pursuant to the PILOT agreements satisfied the taxpayer's entire *ad valorem* tax obligation, even though the payments were less than the tax otherwise due on the fair market value of the leasehold interest in the property. The State Board of Equalization determined that the leasehold interest was taxable.

The taxpayer appealed to the trial court and then to the Court of Appeals, both of which rejected the taxpayer's challenge, concluding that the leasehold interest remained taxable despite the PILOT agreements. The Court of Appeals also held that the payments made by the taxpayer pursuant to the PILOT agreements reduced the tax liability by the amount of those payments.

Practice Pointer:

Businesses entering into PILOT agreements with local taxing authorities should remember that Tenn. Code Ann. § 67-5-502(d) imposes property tax on "all other interests of whatever character . . . in real property, including the interest that the lessee may have in and to the improvements erected upon land where the fee . . . is exempt to the owner." Accordingly, a lease between an industrial development board and the business should be structured so that the leasehold interest does not have value.

Legislative Update

Since our April 21, 2011 issue of the *[SALT Bulletin: Tennessee Edition](#)*, in which we reported on the enactment of several tax bills as of that date, the Tennessee General Assembly has passed the following additional tax bills that have now been signed into law:

Public Chapter 93 (Senate Bill 0742), Personal Property Schedules

Current law allows a taxpayer to amend a timely-filed personal property tax schedule by September 1 of the following tax year. Public Chapter 93 provides that personal property schedules may be amended only for the following reasons: adding or deleting of property to correctly reflect its status as of assessment date; correcting the reported cost or vintage year of property; correcting the name or address of the taxpayer; deleting property reported more than once resulting in a duplicate assessment; reporting property in the appropriate group; and correcting other reporting clerical errors. The new law clarifies that taxpayers may not amend personal property schedules to submit original claims for nonstandard valuations if the property was not the subject of properly documented claims for nonstandard valuations in timely-filed personal property schedules. Current law also provides that the county assessor is to furnish reporting schedules to taxpayers by February 1, and Public Chapter 93 specifies that the failure of a taxpayer to receive the schedule does not excuse the taxpayer from filing a personal property schedule by March 1.

Public Chapter 103 (House Bill 0302), Amendment to Tax on Unauthorized Substances

Current law levies the "drug tax" on merchants who deal in unauthorized substances, with "merchants" defined as any person who sells or distributes unauthorized substances in a quantity sufficient to create a principal tax liability of at least \$10,000. Public Chapter 103 amends the "drug tax" to make it clear that any person actually engaged in the act of selling, bartering, trading or distributing to another for consideration any unauthorized substances is liable for the tax regardless of the quantity. Following this amendment, the "drug tax" statute continues to include a rebuttable presumption that persons possessing unauthorized substances in quantities sufficient to create principal tax liability of at least \$10,000 are "merchants."

Public Chapter 133 (Senate Bill 0024), Extension of Flood Relief Deadline to File Claims for Limited Sales Tax Refunds

Public Chapter 133 extends the deadline for filing a limited sales tax refund for certain major appliances, residential furniture, or residential building supplies purchased in response to the May 2010 floods for use in the claimant's primary residence. The deadline to make such purchases was extended from September 30, 2010 to April 30, 2011, and the deadline to file claims for sales tax refunds is extended from November 30, 2010 to June 20, 2011.

Public Chapter 160 (Senate Bill 1559), Partial Payment of Delinquent Property Taxes Authorized

Public Chapter 160 authorizes county trustees to accept partial payments of delinquent property taxes, including payment by electronic transfers, bank customer preauthorized payments, wire transfers or ACH credits. Prior to accepting partial payments, county trustees must file plans with the comptroller indicating that the county trustee's office has the accounting system technology to accept partial payments.

For more information, please contact Joe Gibbs, Pat Moskal, Brett Carter, or Brian Shelton at the numbers listed below.

Joseph W. Gibbs
(615) 252-2317
jgibbs@babbc.com

Patricia Head Moskal
(615) 252-2369
pmoskal@babbc.com

Brett R. Carter
(615) 252-2383
bcarter@babbc.com

Brian S. Shelton
(615) 252-2313
bshelton@babbc.com

SALT Practice Group:

Bruce P. Ely, Chair
(205) 521-8366
bely@babbc.com

Brett R. Carter
(615) 252-2383
brcarter@babbc.com

Joseph W. Gibbs
(615) 252-2317
jgibbs@babbc.com

W. Stanley Gregory
(334) 956-7604
sgregory@babbc.com

Christopher R. Grissom
(205) 521-8514
cgrissom@babbc.com

K. Wood Herren
(205) 521-8505
wherren@babbc.com

James E. Long, Jr.
(205) 521-8626
jelong@babbc.com

Patricia Head Moskal
(615) 252-2369
pmoskal@babbc.com

Brian S. Shelton
(615) 252-2313
bshelton@babbc.com

William T. Thistle, II
(205) 521-8985
wthistle@babbc.com

Robert D. Thorington
(334) 956-7609
rthorington@babbc.com

Robert C. Walthall
(205) 521-8308
rwalthall@babbc.com

Stephen M. Wilson
(601) 592-9957
swilson@babbc.com

U.S. NEWS & WORLD REPORT RANKING

Bradley Arant Boulton Cummings LLP has received the fourth highest number of top-tier rankings in the country in the inaugural U.S. News & World Report – Best Lawyers list of top U.S. law firms. As it has done for many years for hospitals and colleges, this year U.S. News, working with the attorney ranking company Best Lawyers in America, ranked U.S. law firms based on a number of criteria, including client satisfaction.



Bradley Arant Boulton Cummings LLP Office Locations:

ALABAMA

One Federal Place
1819 Fifth Avenue North
Birmingham, AL 35203
(205) 521-8000

200 Clinton Avenue West, Suite 900
Huntsville, AL 35801
(256) 517-5100

The Alabama Center for Commerce
401 Adams Avenue, Suite 780
Montgomery, AL 36104
(334) 956-7700

MISSISSIPPI

188 E. Capitol Street, Suite 400
Jackson, MS 39201
(601) 948-8000

NORTH CAROLINA

100 North Tryon Street, Suite 2690
Charlotte, NC 28202
(704) 332-8842

TENNESSEE

1600 Division Street, Suite 700
Nashville, TN 37203
(615) 244-2582

WASHINGTON, DC

1615 L Street, N.W., Suite 1350
Washington, DC 20036
(202) 393-7150

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