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Hot Topic: Changes in the Rate and Distribution of the Business Tax Effective September 1, 2002

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#84

**CHANGES IN THE RATE AND DISTRIBUTION
OF THE BUSINESS TAX
EFFECTIVE SEPTEMBER 1, 2002**

By Dick Phebus

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2002 *Tenn. Pub. Acts* 856 (the Tax Reform Act of 2002) amends the business tax law, requiring businesses to pay fifty percent more in taxes when renewing business licenses. The effective date of the increase is September 1, 2002. Municipalities that currently levy and collect these taxes need to be aware of the changes that have been made in both the rates and the distribution of the tax. Municipalities that do not levy a business tax by the authority found in *Tennessee Code Annotated* 67-4-704 are not affected by these changes until and unless they levy such a tax.

No Legislative Body Action Required

Acts 2002, Chapter 856 levies the increase in the current business tax rates. No legislative action by the governing body of your jurisdiction is required. The maximum rates will automatically increase on September 1, 2002, to the new rates found in the business tax law.

Effective Date

While language in the Tax Reform Act of 2002 implies that the changes are effective for tax periods ending on or after September 1, 2002, Tennessee Department of Revenue officials have determined that the legislative intent of the act was to have the new rates apply to businesses with transactions occurring on or after September 1, 2002. Therefore, all classifications will be required to file two business tax returns if their tax period ends on or after September 1, 2002.

Rate Changes

The minimum business tax remains \$15 for all business classifications except Class 5. The minimum for Class 5 increases from \$300 to \$450, with the maximum capped at \$1,500. All tax rates are increased by 50 percent for Class 1 through Class 5. The new maximum rates are as follows:

Classification 1:

- 1/10 of one percent of all retail sales of businesses classified under *T.C.A. 67-4-708(1)(A)*;
- 1/40 of one percent of all wholesale sales of businesses classified under *T.C.A. 67-4-708(1)(B)*;
- 3/80 of one percent of all wholesale sales of businesses classified under *T.C.A. 67-4-708(1)(B) & (C)*;
- 1/20 of one percent of all retail sales of businesses classified under *T.C.A. 67-4-708(1)(D)*.

Classification 2:

- 3/20 of one percent of all retail sales;
- 3/80 of one percent of all wholesale sales.

Classification 3:

- 3/16 of one percent of all retail sales;
- 3/80 of one percent of all wholesale sales.

Classification 4:

- 1/10 of one percent of compensation under contract for services including extermination, installation of personal property and all construction activities, payable as follows:
 - If less than \$50,000, payable to municipality in which person is domiciled;
 - If \$50,000 or more received, payable to municipality or county in which such contract was performed;
 - No deduction is permitted for costs incurred under contract;
- 1/10 of one percent of the gross proceeds received by people engaged in the business of selling livestock, poultry or other farm products, if such people are not specifically exempted from such tax under *T.C.A. 67-4-712*.

Classification 5:

- 3/10 of one percent of the gross income of the business, subject to the following:
 - Minimum tax of \$450 per annum;
 - Maximum tax of \$1500 per annum.

Distribution of New Taxes

Taxing municipalities will continue to distribute to the state 15 percent of the local tax collected and retain 85 percent. The change in distribution applies to tax funds collected as a result of the increased rates adopted by the Tax Reform Act of 2002, which must be paid in full to the commissioner of revenue. The new business tax form will have two columns for calculations: one for local tax and one for the new state tax.

Personal Property Tax Credit

Credit for personal property taxes will continue to be applied against any local business tax due. However, the credit may not be applied against the new state business tax due. Many businesses use this credit against the business tax, thereby reducing any amount of tax due. Such credit may still be applied with regard to the local portion of the business tax, but it may not reduce the amount of taxes due to the state as a result of the 50 percent increase. Businesses will not be able to completely eliminate their business tax liability with this credit.

Municipalities Levying a Lower Rate of Business Tax

In cities that have imposed business taxes at a rate below the maximum rate established by the business tax law by imposing a stated fraction of the maximum rate, the new rates in those jurisdictions effective September 1, 2002, will be that same fraction of the new maximum rates. For example, if your city's business tax levy for Class 1 retail sales is currently 1/30 of one percent (one-half the maximum under the old rates), the new rate effective

September 1, 2002, will be 1/20 of one percent. The local share before the 15 percent allocation to the state will remain 1/30 of one percent. The city would remit 15 percent of the local share plus 100 percent of the increased business tax levy.

New Business Tax Form

A copy of the new, revised form that will be used for reporting receipts after August 31, 2002, is provided as an attachment to this publication. This is the recommended format to be used by software vendors and sellers of business tax forms to local governments. For receipts prior to the effective date of the increase, municipalities and businesses should use the current forms.

Phase-in Periods

Because the effective date of the increase does not exactly correspond with the period end dates of any of the classifications, all classifications will be required to file two business tax returns when they next renew their licenses. Taxpayers having transactions prior to September 1, 2002, will file a short-year return using the return form and rates that were in effect prior to September 1, 2002. Taxpayers having transactions occurring on or after September 1, 2002, will file using a revised form reflecting the new tax rates and distributions for local tax and state tax.

The table below is provided to help municipalities understand the use of the short-form filing periods. The first business filers using both the old and new rates will be those in Classification 4. All classifications will file short-year returns until Classification 4 files for the period ending September 30, 2003. Businesses filing the short-year forms with municipalities are required to file both forms no later than the delinquent date for their classification in order to avoid penalty and interest.

Business Classification	Tax Period	Old Rate Short Year	New Rate Short Year	Both Forms Delinquent Date
Classes 1A, 1B, 1C	Jan. 1, 2002 to Dec. 31, 2002	Jan. 1, 2002 to Aug. 31, 2002	Sept. 1, 2002 to Dec. 31, 2002	March 1, 2003
Class 1D – Fuel	Jan. 1, 2002 to Dec. 31, 2002	Jan. 1, 2002 to Aug. 31, 2002	Sept. 1, 2002 to Dec. 31, 2002	March 1, 2003
Class 2	Apr. 1, 2002 to March 31, 2003	Apr. 1, 2002 to Aug. 31, 2002	Sept. 1, 2002 to March 31, 2003	June 1, 2003
Class 3	July 1, 2002 to June 30, 2003	July 1, 2002 to Aug. 31, 2002	Sept. 1, 2002 to June 30, 2003	Sept. 1, 2003
Class 4	Oct. 1, 2001 to Sept. 30, 2002	Oct. 1, 2001 to Aug. 31, 2002	Sept. 1, 2002 to Sept. 30, 2002	Dec. 1, 2002

Allocation of Personal Property Tax Credit and Minimum Tax

As previously mentioned, the personal property tax credit may not be used to reduce any tax due to the state as a result of the increases imposed by *Acts 2002*, Chapter 856. However, businesses may continue to use the credit to offset part or all of the local portion. During the phase-in period described in the table, businesses will be required to file two separate forms for their tax period. The personal property tax credit cannot be prorated; however, Department of Revenue officials have advised MTAS that the credit should be used up on the first “traditional” return (old return), and if the credit cannot be used up, then the remaining credit should be used up, to the extent possible, on the second return (new return). The new return would limit the credit to the local amount and would not offset the state portion. In this way the taxpayer is sure to make full use of the credit for the 12-month period, as would have been possible prior to the law change.

The minimum tax due of \$15 for the new license should be collected only once during this phase-in period. Department of Revenue officials again have advised MTAS that municipalities should collect the minimum tax on the first “traditional” return filed.

Distribution of Business Tax Collections

As stated previously, changes in the business tax law require municipalities to account separately for both local and state business taxes, including penalties and interest associated with each amount. The revised state form that will be used to report and remit the business tax to the Department of Revenue requires separate reporting of gross receipts, interest and penalties for both the local amount and the state amount. A final draft of the form probably will be posted in the near future on the Department of Revenue Web site at www.state.tn.us/revenue.

If You Need Help

Please contact your MTAS Finance or Municipal Management Consultant for further information regarding changes in the business tax law. You also can call the Department of Revenue toll free at (800) 342-1003.

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