



Tax Insights
from State and Local Tax
Services

Tennessee expands family-owned entity exemption ownership rules for franchise and excise tax

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In brief

What happened?

On April 6, [SB1910](#) was enacted, which amended the definition of “family-owned” for purposes of the family-owned noncorporate entity (FONCE) exemption under Tenn. Code Ann. § 67-4-2008(a)(11). The change, which takes effect on July 1, 2026, broadens and clarifies which owners may be counted toward the 95% family-ownership threshold by expressly recognizing ownership held by qualifying relatives, trusts for their benefit, and estates of deceased qualifying relatives. It also updates the definition of “relative” to more clearly include certain spouse, former spouse, and lineal descendant relationships.

Why is it relevant?

The FONCE exemption can eliminate Tennessee franchise and excise tax for qualifying entities, which have gross receipts derived from passive investment income (such as rents from farm or residential property, royalties, dividends, or interest) or a combination of passive income and farming.

For closely held family limited liability companies (LLCs), limited partnerships (LPs), and limited liability partnerships (LLPs), eligibility often depends on technical ownership rules, and this amendment makes those rules more accommodating to common family succession and ownership structures. As a result, some entities may newly qualify, while others may be in a stronger position to maintain and substantiate exemption status. The change is especially important for entities that hold assets or generate income through trusts, estates, or more complex family relationships.

Actions to consider

Entities that currently claim, or may be eligible to claim, the exemption should review their ownership structure in light of the revised definition. That review should focus on whether interests held by trusts, estates, former spouses, or descendants connected through spouse or former-spouse relationships can now be counted toward the 95% family-ownership threshold.

In detail

Tennessee has broadened and modernized the ownership test for the FONCE exemption from franchise and excise tax. Under current law, Tennessee's excise tax generally applies at a rate of 6.5% of net earnings, but certain entities are exempt, including qualifying family-owned noncorporate entities (FONCE exemption). To qualify, an entity must satisfy both an ownership test and a gross-receipts test. For purposes of the ownership test, current law defines "family-owned" to mean that at least 95% of the entity's ownership units are owned by members of the family. Family members are identified through a list tied to an individual owner and include ancestors, spouses or former spouses, lineal descendants, certain descendants of a spouse or parent, spouses or former spouses of lineal descendants, and the estate or trust of a deceased individual who qualified while living.

The new statute replaces that definition. Instead of looking to "ownership units," the new law provides that an entity is family-owned if at least 95% of its voting rights, capital interest, or profits are owned by natural persons who are relatives, by trusts for the benefit of those relatives, or by the estate of a deceased individual who was a relative while living. It also replaces the prior list of qualifying family members with a new definition of "relative." Under that definition, natural persons are relatives if, by blood or adoption, they descend from a common ancestor and are related as first cousins or closer, or if they are a spouse or former spouse of such a person, or a lineal descendant of a spouse or former spouse of such a person.

Importantly, the legislation does not change the rest of the exemption framework.

Observation: In practical terms, the new statute is likely to help family-held LLCs, LPs, and LLPs that are near the qualification line or that have more complex ownership arrangements. Entities with ownership held through trusts, estates, former spouses, or blended-family relationships may find it easier to qualify for, preserve, or substantiate exemption status under the revised language.

The legislation also makes certain changes to Tennessee's wills, estates, and trusts laws, including simplifying proof of out-of-state wills, expanding rights for charitable trust beneficiaries, increasing the small-trust termination threshold to \$250,000, among others.

Let's talk

If you have questions about these changes, please contact:

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