S T A T E O F T E N N E S S E E
OFFICE OF THE
ATTORNEY GENERAL
PO BOX 20207
NASHVILLE, TENNESSEE 37202

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Opinion No. 02-044

In Lieu of Tax Payments in Shelby County

QUESTION

Under Senate Bill 2367/House Bill 2920, an industrial development board may agree with a lessee to accept in lieu of tax payments that are less than the taxes that would be payable if the property were owned by a private owner, but only if certain conditions are met. The provision would be applicable only in Shelby County. Does this proposed legislation violate any provision of the Tennessee Constitution?

OPINION

Absent a rational basis for the different treatment of an industrial development board's power to negotiate in lieu of tax payments in a single county within a narrow population bracket, we think this bill is constitutionally suspect under Article XI, Section 8 of the Tennessee Constitution.

ANALYSIS

This opinion concerns a proposed amendment to Tenn. Code Ann. § 7-53-305. Under subsection (a) of that statute, all property owned by an industrial development corporation created by a city or county is exempt from all state taxation. Under subsection (b), the creating county or city may delegate to the industrial development corporation the power to negotiate and accept payments in lieu of ad valorem taxes from the businesses that lease from the industrial development corporation. Subsection (b) further provides:

> With regard to any project located within an area designated as the center-city area by a municipality in which there has been created a central business improvement district pursuant to chapter 84 of this title, the amount of such payments shall not be fixed below the lesser of:
>
> (1) Ad valorem taxes otherwise due and payable by a tax paying entity upon the current fair market value of the leased properties; or

> (2) Ad valorem taxes that were or would have been due and payable on the leased properties for the period immediately preceding the date of their acquisition by the corporation.

Research indicates that the City of Memphis has created two different central business improvement districts under different provisions of Tenn. Code Ann. §§ 7-84-101, *et seq.* Code of Ordinances, City of Memphis, §§ 7-36 & 7-38. Under current law, therefore, in lieu of tax payments regarding any project located in one of these districts would be subject to the provisions of Tenn. Code Ann. § 7-53-305(b).

Subsection (f) of Tenn. Code Ann. § 7-53-305 imposes a reporting requirement on industrial development corporations that have been delegated the authority to create pilot leaseholds and payments in lieu of ad valorem taxes. This provision only applies to counties with a population of 800,000 or more according to the 1990 federal census or any subsequent federal census and to municipalities within such counties. This provision, therefore, would apply to Shelby County and all cities within Shelby County.

Senate Bill 2367/House Bill 2920 would add the following subsection (g) to the statute:

> (g) An industrial development corporation may not negotiate any payment in lieu of tax agreement for less than the county ad valorem taxes otherwise due unless:
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> (1) The corporation is a joint corporation organized by the county and one or more of the municipalities therein;
>
> (2) The corporation has entered into an interlocal agreement with the county in regard to payments in lieu of ad valorem taxes, or
>
> (3) The corporation has received written approval from the chief executive and the legislative body of the county regarding payments in lieu of ad valorem taxes.
>
> The provisions of this subsection shall only apply to any county having a population of not less than eight hundred ninety-seven thousand, four hundred (897,400) nor more than eight hundred ninety seven, five hundred (897,500) according to the 2000 federal census or any subsequent federal census.

Under the proposed bill, therefore, an industrial development corporation would not be authorized to negotiate any payment in lieu of tax agreement for an amount less than the county property taxes that would be due on the property if it were owned by a private business unless it could satisfy one of the three different conditions listed in the statute.

The proposed bill implicates the equal protection provisions of the United States and Tennessee Constitutions. U.S. Const. Amend. XIV; Tenn. Const. Art. I, § 8 & Art. XI, § 8.[1] The United States Supreme Court has stated that, where taxation is concerned and no specific federal right apart from equal protection is implicated, "the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359, 93 S.Ct. 1001, 1003, 35 L.Ed.2d 351 (1973). In general, a state's classification for tax purposes does not violate the Equal Protection Clause of the Fourteenth Amendment unless it is "invidious" or "palpably arbitrary." *Id.*, 93 S.Ct. at 1004. Similarly, the Tennessee Supreme Court has held that a tax classification which does not interfere with a "fundamental right" (such as the right to vote) or implicate a "suspect class" (such as race) will be subject only to a rational basis test. *Bates v. Alexander*, 749 S.W.2d 742, 743 (Tenn. 1988). The person challenging a tax classification has the burden of showing that it is unreasonable and arbitrary, and "if any state of facts can reasonably be conceived to justify the classification or if the unreasonableness of the class is fairly debatable, the statute must be upheld." *Id.*, citing *Harrison v. Shrader*, 569 S.W.2d 822, 826 (Tenn. 1978).

As we read the general law now in effect, nothing prevents most industrial development corporations from waiving all payments in lieu of ad valorem taxes, so long as the agreement meets specific requirements in Tenn. Code Ann. § 7-53-305(b). The only exception is with regard to projects located in an area designated as the center-city area by a municipality in which there has been created a central business improvement district created under Tenn. Code Ann. §§ 7-84-101, *et seq.* With regard to those projects, the industrial development corporation may not fix in lieu of property taxes below the taxes otherwise due and payable by a tax paying entity upon the current fair market value of the leased properties, or the taxes that were or would have been payable on the leased properties just before the industrial development board acquired them, whichever is less. The proposed bill therefore imposes a restriction that does not exist with regard to most industrial development projects and lifts a restriction that does exist with regard to a particular subset of industrial development projects, namely those in the center-city area in a central business improvement district created under Tenn. Code Ann. §§ 7-84-101, *et seq.* Each of these results — an exception to the general law, and an exception to an exception — is constitutionally suspect absent a rational basis for the different treatment of projects located in a very narrowly defined population bracket.

With regard to projects that are not located in a center-city area within the meaning of subsection (b), the bill would provide that an industrial development corporation may negotiate payments in lieu of taxes for less than the county ad valorem taxes otherwise due only if one of three different conditions is met. This restriction would apply only in counties within a very narrow population bracket, in effect, only to Shelby County. This Office is unaware of any rational basis for treating projects in a county within this

[1] In its present form the bill only applies to one county, and thus, it is also subject to challenge under Article XI, Section 9 of the Tennessee Constitution because it does not provide for local approval. We will not discuss this issue further because, even if the bill did provide for local approval, it would still be constitutionally suspect under Article XI, Section 8 of the Constitution.

population bracket differently from projects in other counties. Similarly, with regard to projects that are located in a city-center area within the meaning of subsection (b), the bill would provide that an industrial development corporation may negotiate payments at a level less than the minimum mandated under that provision, so long as one of three conditions is met. Again, this Office is unaware of any rational basis for treating projects in a center- city area in a single county within a narrow population bracket differently from projects in other counties. For this reason, we think the bill is constitutionally suspect under Article XI, Section 8 of the Tennessee Constitution.

PAUL G. SUMMERS
Attorney General and Reporter

MICHAEL E. MOORE
Solicitor General

ANN LOUISE VIX
Senior Counsel

Requested by:

Honorable Curry Todd
State Representative
204 War Memorial Building
Nashville, TN 37243-0195