The Tennessee Advisory Commission on Intergovernmental Relations

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MEMORANDUM

TO: TACIR Commission Members

FROM: Harry A. Green
Executive Director

DATE: June 30, 2010

SUBJECT: Mandates from FY 2010 Work Program

On December 9, 2009, the Commission was presented with the recommendations and findings from three mandated TACIR studies from the FY 2010 work program:

- *E-911 Emergency Communications Funding in Tennessee*
- *County Revenue Partnership Fund (CRPF)*
- *Electric Generation and Transmission (G&T) Cooperative Act and Potential for Changes in TVA Payments in Lieu of Taxes*

At this time, the reports are being presented for Commission approval. The CRPF brief and Electric G&T brief are attached for your review and approval. The executive summary of the E-911 draft is attached; the complete report will be provided to you by email prior to the meeting.

E-911 Emergency Communications Funding in Tennessee

At the December Commission meeting, TACIR staff presented the findings and recommendations for the study of HB 0204 (Matheny)/SB 0208 (Stewart). The House State and Local Government Committee referred HB 0204 to TACIR with instructions to report back to the committee its findings and recommendations regarding Emergency Communications Districts (ECD) funding during the 2010 legislative session. Other than minor editing, all recommendations and findings in the final report are the same as were presented in December.

County Revenue Partnership Fund

PC 1057 created a separate account within the state general fund known as the "County Revenue Partnership Fund." Beginning in fiscal year 2009-2010, the act allows the General Assembly to make a specific dollar appropriation to the fund from the portion of the state sales tax earmarked and allocated specifically to the state general fund. Any such appropriation cannot exceed the amount shared with municipalities from the state sales tax in the previous year. Any funds appropriated to the fund are to be distributed on a population basis.

The report notes that any significant future appropriations to the CRPF will only occur as a result of some combination of the following:

- Unexpected rapid growth in existing state sales tax collections
- An increase in state sales tax rate
- Significant broadening of the sales tax base (that would increase both state and local sales tax collections)
- Significant changes in existing statutory tax sharing arrangements some of which date back to the early 20^{th} century

TACIR makes no specific recommendations in this report.

Electric Generation and Transmission Cooperative Act and Potential for Changes in TVA Payments in Lieu of Taxes

<u>The Act</u>

The Electric Generation and Transmission Cooperative Act is a response to a need "for electric utility systems engaged in the distribution of electric power and energy in this state and adjoining states to have additional sources of electrical energy through traditional sources of generation and through renewable, clean and passive sources of electrical energy, as well as through other sources known and those sources yet to be known and discovered."

With that purpose in mind the Act authorizes the creation of nonprofit cooperatives to generate and transmit electricity in Tennessee.

<u>TVA Payments in Lieu of Taxes</u>

The TVA Act of 1933 specifically directs that five percent of the agency's "gross proceeds" be paid to states and local governments, in which the agency owns and operates property, as payments in lieu of taxes.

In fiscal year 2009 the total payments in lieu of taxes were $505 million of which $295 million was paid to the state of Tennessee and its local governments. The estimated payments for FY 2010 are $538 million with $320 million going to Tennessee.

Seven States Power Corporation

The Tennessee Valley Public Power Association, a group consisting of TVA power distributors, organized a nonprofit corporation, the Seven States Power Corporation, to develop cooperatives as authorized by the Act.

Impact of the Act on the TVA PILOT

The critical issue in determining the possible impact of future wholesale power supply arrangements on TVA payments in lieu of taxes is the nature of the contractual arrangements between any new cooperatives and TVA. At the present time a number of legal and accounting issues must be decided before those contractual arrangements can be settled.

Only in the event that revenues generated by any new cooperatives would not pass through TVA accounts would there be any effect on the payments in lieu of taxes. Even then the effect would not be to reduce TVA payments, or even the growth of those payments. Rather, the result would be simply that TVA revenues would not increase by the amount of the power sales by the cooperative. **Any possible negative impact would be on TVA's incremental, or additional, revenues not their base revenue level or growth path.**

Any new co-ops built in Tennessee would be subject to the ad valorem property tax now in place.

Conclusions

To the question of whether a consequence of the Act could change wholesale power supply arrangements between TVA and its distributors so as to affect payments in lieu of taxes in the future, the answer is yes. It is possible that some TVA revenues would not be subject to the PILOT.

Is it likely that the Act will have serious negative consequences for the state and local government revenue streams? TVA revenue forecasts are for between one and two percent growth for the foreseeable future. In fact, there are many factors that will impact TVA revenues in the future and there are no guarantees regarding those revenues and the payments in lieu of taxes.

Recommendations

Two major alternatives were considered. If all sales to distributors continued to go through TVA, then PILOTs would be unaffected by the opening or closing of cooperative-owned generation plants. The co-op owned plants would sell power to TVA, and TVA would, in turn, transmit and sell that power the same as it does now, and all sales would be included in the gross proceeds calculation.

The effect on PILOTs to the state and local governments would be the same regardless of who generated the power. One problem with this alternative is that the cooperatives would not be able to issue tax-exempt bonds to raise money to build their plants. Consequently, the cost of producing power would be higher than if the bonds were tax exempt, which might have an effect on rates.

Another alternative is to make two changes in Tennessee law that could blunt the potential adverse effects of the G&T Act on TVA PILOTs:

- o extend the existing 3% gross receipts tax on certain intrastate power production and distribution sales in Tennessee (T.C.A. § 67-4-405) to intrastate power sales other than to TVA by the cooperatives created under the Act and
- o distribute the revenue from extending the gross receipts tax in the same manner as payments in lieu of taxes from TVA under TCA §§ 67-9-101 and 102.

The TVPPA offered its own recommendation to authorize negotiated payments in lieu of taxes to be determined as the G&T cooperatives bring each new G&T plant on line. The final versions of the bill included input from TACIR staff.

Ultimately the Legislature did amend the original Electric G&T Cooperative Act to address the issues discussed above. A bill was introduced in January 2010 to protect state and local government revenues from a loss of payments-in-lieu of taxes from TVA and after much negotiation a bill was passed in June.

E-911 Emergency Communications Funding in Tennessee

A TACIR Report in Response to the Tennessee General Assembly House State and Local Government Committee

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TACIR Staff Report
June 2010

Purpose

The Tennessee General Assembly directed the Tennessee Advisory Commission on Intergovernmental Relations (TACIR) to conduct a comprehensive study of Tennessee's 911 emergency communications funding system and report back to the House State and Local Government Committee in 2010. The study was requested in response to the changes proposed in SB0208/HB0204:

- An increase in the monthly cell phone service charge from $1 to $1.50
- A reallocation of the distribution of this service charge from the Tennessee Emergency Communications Board (TECB) to local Emergency Communications Districts (ECDs) from 25% to 65%
- The distribution of an additional 5% of the revenue generated to the fifty lowest populated ECDs

This report provides staff findings and recommendations on SB0208/HB0204 and E-911 funding in Tennessee.

Executive Summary

TACIR has prepared this study in response to a referral of SB0208/HB0204 by the House State and Local Government Committee of the 106th General Assembly. That bill, shown in Appendix A, was introduced in 2009 in response to fiscal concerns voiced by some emergency communications districts (ECDs). Although Tennessee is in the vanguard of 911 service provision and was nationally recognized as the top 911 state program in 2005, the continually changing consumer market is challenging Tennessee's current E-911 funding method. This study provides background information on emergency communications in Tennessee to include general findings. It then reviews technology trends impacting funding before making several findings and recommendations for E-911 funding. Finally, it provides related findings and recommendations regarding E-911 structure.

This comprehensive study utilized data from several sources to draw conclusions and make recommendations:

1. Interviews with lawmakers, local government and ECD officials, and other various stakeholders
2. A literature review of scholarly, technical, and regulatory material

E-911 vs. 911

Consistent with TACIR's 2006 report, *Emergency Challenge: A Study of E-911 Technology and Funding Structure in Tennessee*, this report generally uses the term E-911 to refer to all emergency number services in Tennessee, both wireline and wireless.

The three-digit telephone number "911" is designated as the "Universal Emergency Number" for emergency assistance throughout the United States. E-911 is short for enhanced 911, which is a selectively routed 911 call that uses a database to display the caller's location on the call-taker's screen.

E-911 operability–necessary to provide full 911 coverage for cell phone users–was a requirement of the federally mandated Phase-II emergency number implementation.

When discussing funding comparisons with other states, some of which have not fully adopted enhanced 911, the term 911 is used instead. The term 911 is also used when referring generally to call centers, answering points, and individual emergency calls.

3. Collection and analysis of funding, usage, and other pertinent data
4. A review of additional material from TECB meetings and TACIR members
5. The collection of stakeholder comments

General Findings

- The Tennessee Emergency Communications Board (TECB) has worked with the state's ECDs to make Tennessee a national leader in E-911 coverage for both wireline and wireless phones.
- Unlike many Public Safety Answering Points (PSAPs) across the nation, all PSAPs affiliated with Tennessee's one hundred ECDs are wireless E-911 Phase II functioning. This means that each possesses the equipment and technology required to receive a callback number and the approximate latitude and longitude of wireless 911 callers. This assists emergency providers in locating callers. In 2005, Tennessee became the third state in the nation to reach this milestone.
- Tennessee's ECDs are in compliance with all applicable E-911 directives issued by the Federal Communications Commission (FCC).

Technology Trends

With the growing popularity of wireless technology devices that provide users with a variety of communication methods, the wireline customer base has been stagnating or declining in many states for several years. The reasons are clear in most cases: increased substitution of wireless service for wireline service and most recently the availability of alternate voice communications technologies, such as Voice over Internet Protocol (VoIP), that compete directly with traditional wireline service. AT&T reports that landline use has dropped 42% from 2000 to 2008. More than one in five households have discontinued wireline service and rely solely on wireless communications for primary telephone service, and by the end of 2011, approximately 30 million households will be using a VoIP service as either a primary or secondary telephone line.

Findings

- The number of Tennessee wireline subscribers has decreased every year since 2001. In contrast, the number of wireless subscribers has grown each year since 1999.
- From 2005 onward, wireless subscribers have outnumbered wireline subscribers in Tennessee.
- The percent of total wirelines provided to residential customers in Tennessee declined from 67% in 2005 to 61% in 2008.
- With advances in technology, the emergency communication networks built four decades ago are becoming less efficient, less technologically advanced and, as a result, less able to provide the public with 911 services on newer technologies and devices.
- Seen as the future standard for emergency communications, Next Generation 911 (NG-911) is the next phase in 911 service. NG-911 is an Internet Protocol (IP)-based format that provides a standard system by which PSAPs and other emergency service providers will be able to communicate.
- Goals of Tennessee's NG-911 project include improving public safety for citizens and visitors, equalizing E-911 service across the state, preparing PSAPs for future 911 technologies, and transitioning E-911 related network costs from ECDs to the TECB.
- The TECB expects to begin deployment of NG-911 by early 2011.

Recommendations

- TACIR staff makes no recommendation regarding changes to the current implementation plan for NG-911.

Funding

A principal question this study considers is whether Tennessee should adopt an alternative funding method for E-911. Existing E-911 funding mechanisms in Tennessee are similar to those in place in most states. And as in most states, they continue to produce a growing level of total revenue statewide. Despite a shrinking wireline base, the growth in wireless revenue more than offsets the loss of wireline revenue. This method faces challenges, however. The estimated total wireline and wireless revenue for 2008-2009 approached $95 million. TACIR staff is unable to evaluate the impact of alternative funding methods, including those laid out in SB0208/HB0204, on individual ECDs because currently there is no consistent statewide reporting of taxable landline counts by customer type, residential versus business, for each ECD.

Wireline carriers report line counts to the ECDs, but there is no requirement for the ECDs to report the information to the TECB or any other state agency. The TECB does not have the authority to gather this information statewide, and the Tennessee Regulatory Authority (TRA) does not maintain line count information in the format needed to track fees.

Findings

- There is no consistent statewide reporting of taxable landline counts by type, residential versus business, for each ECD.
- Landline surcharges in Tennessee are some of the highest in the United States, while the state's wireless charge is also relatively high.
- There are wide variations in wireline collections among counties with similar demographics.
- The 911 Emergency Communications Fund is protected under a new federal law, the New and Emerging Technology 911 Improvement Act, which prohibits states from diverting funds designated for 911.
- Tennessee's longstanding policy of full cost recovery may be a reason for Tennessee's achievement as the third state in the U.S. to be fully wireless E-911 Phase II compliant. As distributions to wireless carriers decreased, the TECB substantially expanded its current funding for ECD operations through new funding programs, grants, and reimbursements.
- The law requires the TECB to distribute 25% of the revenue generated by the monthly service charge on users and subscribers of non-wireline telecommunications service to the ECDs, but the TECB distributes substantially more funding to the ECDs than the law requires. The total percentage of the TECB's available non-wireline revenue distributed to ECDs was 77% in 2009. The TECB expects this number to increase by approximately 10% in 2010 based on the reduced distribution of cost recovery funds and

projected NG-911 equipment reimbursements. Over 50% of the TECB's budget is dedicated to recurring ECD funding programs.

- The TECB's $14 million operational support fund, put into place partly in response to a recommendation in TACIR's 2006 report on E-911, had a clear effect on ECD solvency as the number of financially distressed districts subsequently declined to two, the lowest since 1998. Also, the number of ECDs that had a negative change in net assets dropped from 22 to zero after the funding program was initiated in 2007.
- The TECB projects non-recurring build-out costs of approximately $44 million over the next five years and recurring operational costs of around $16.5 million annually for the NG-911 project, described in the Technology section. The TECB contends that NG-911 will result in substantial savings for the ECDs, as the TECB will ultimately absorb all trunking and selective routing costs. Currently, the ECDs pay most of those costs. The TECB estimates that the ECDs will collectively save around $5 million annually on trunking and selective routing costs as a result of NG-911 implementation. Once NG-911 is deployed, the TECB asserts that additional funds will be available for the ECDs.
- Tennessee ECDs are permitted, but not required, to use E-911 service fees to pay for dispatching services. It is well accepted by ECD officials throughout the state that E-911 fees should and do cover the full cost of E-911 service, including the purchase of the equipment that allowed Tennessee to become the third state in the nation to be fully Phase II capable. While E-911 revenue is currently sufficient to cover the costs of E-911 service, it will not cover all dispatching costs.
- While the exact number of prepaid wireless users in Tennessee is not known, prepaid wireless revenue represents 7% of Tennessee's total wireless revenue. In 2009, three states passed legislation imposing 911 fees on prepaid wireless customers at the point of sale: Louisiana, Maine, and Texas. In 2010, Tennessee passed similar legislation.

Recommendations

- TACIR staff recommends that providers be required to file a standard line count return with each ECD and that the ECDs be required to file monthly or quarterly statistics with the TECB based on those returns.

- TACIR staff recommends that the TECB analyze the significant differences in the amount of per capita landline revenue raised by ECDs with similar populations to determine the reasons for such wide differences.
- TACIR staff recommends that the General Assembly postpone any changes to the state's E-911 funding system until landline by customer type data is available.
- TACIR staff recommends that a sub-committee of TACIR be appointed to evaluate potential funding structures.
- TACIR staff does not recommend an increase in the state wireless fee.
- TACIR staff also does not recommend any change in the allocation of the E-911 fee until sufficient data is available to conduct a full revenue analysis.
- TACIR staff makes no recommendation regarding changes to dispatching funding or requirements.

Structure

Tennessee's emergency communications system is comprised of Emergency Communication Districts (ECDs), which are generally consolidated on the county level. Tennessee has one hundred ECDs in its ninety-five counties: eighty-five districts cover a one-county area and one district covers a two-county area. Six districts cover a city area and eight districts cover the county outside the city districts (two cities with districts are located in multiple counties).

Findings

- Tennessee has a policy of encouraging consolidation within and among ECDs, evidenced by the statutory guidelines favoring consolidation and the monetary incentives provided by the TECB.
- Despite the lack of TECB incentives for Public Safety Answering Points (PSAP) consolidation, the number of primary PSAPs has declined from 139 to 127 since 2006.
- Nationwide, the current trend in 911 systems is toward consolidation of PSAPs.

- The benefits of consolidation include the opportunity to cut costs through economies of scale as well as the promise of better service.
- The main arguments against consolidation generally involve dispatcher unfamiliarity and the elimination of job positions.
- Other states have used incentives to encourage PSAP consolidation, with varying levels of success. Most of the trends indicate that mandated consolidation is unsuccessful, while funding and mandated feasibility studies have limited effectiveness after a certain point.

Recommendations

- TACIR staff recommends that the TECB continue to encourage ECD consolidation through the reimbursement of associated costs.
- TACIR staff recommends that the TECB require the completion of a thorough cost-benefit analysis demonstrating the potential benefits of a specific consolidation by any ECDs seeking reimbursement of consolidation costs.
- TACIR staff notes that continual advances in E-911 technology will require review and evaluation of potential productivity improvements and cost savings from consolidation of existing PSAPs and the use of virtual PSAPs.

A Publication of the Tennessee Advisory Commission on Intergovernmental Relations

TACIR COMMISSION REPORT

March 2010

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IN THIS REPORT

Public Chapter 1057 of 2008, which created the County Revenue Partnership Fund (CRPF), also directed that TACIR "thoroughly study and evaluate the provisions of this act and related policy matters and shall report its findings and recommendations to the finance, ways and means committees of the senate and the house of representatives on or before June 30, 2010." This report fulfills that requirement. It provides background on the CRPF and other revenue sharing measures and analyzes concerns and issues related to funding and distributing the CRPF. While this report does not offer specific recommendations, it does note what will be required structurally to provide significant appropriations to the CRPF.

COUNTY REVENUE PARTNERSHIP FUND

by Stan Chervin, Ph.D.

EXECUTIVE SUMMARY

Public Chapter No. 1057 of 2008 created the County Revenue Partnership Fund (CRPF) within the state general fund to be distributed to county and metropolitan governments. Funding is to come from specific appropriations from the not earmarked portion of state sales tax revenue. Only 36% of state sales tax revenue is currently not earmarked. Any CRPF appropriations, if made, cannot exceed state sales tax revenue distributed in the previous fiscal year to municipalities. The legislation required that the Tennessee Advisory Commission on Intergovernmental Relations study and evaluate the new law and report its findings and recommendations by June 30, 2010.

The report reviewed existing intergovernmental aid programs, including tax-sharing arrangements between the state and local governments. Total state intergovernmental aid to local governments already exceeds $6 billion, the largest component of which is state aid in support of education (Basic Education Program). State tax sharing itself amounted to $828 million in fiscal year 2008. The single largest tax-sharing program involves the distribution of a portion of state motor fuel taxes to both cities and counties. Such funds are earmarked for use on local roads, highways, and bridges. The single largest tax-sharing program involving funds that are not earmarked is the distribution of a portion of state sales tax collections to municipalities.

The purpose of the CRPF is to facilitate potential future appropriations of unearmarked funds from future state sales tax

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collections to county governments. Such funds would be similar to distributions now made to municipalities. Given the current economic and fiscal environment, it is not likely that any significant amounts will be appropriated.

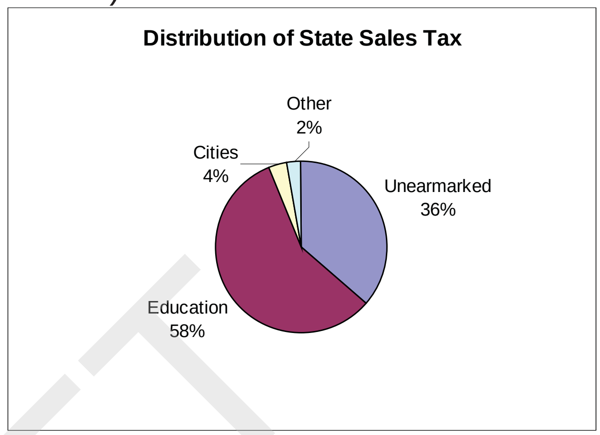
The report notes that any significant future appropriations to the CRPF will only occur as a result of some combination of the following:

- unexpected rapid growth in existing state sales tax collections
- an increase in state sales tax rate
- significant broadening of the sales tax base (that would increase both state and local sales tax collections)
- significant changes in existing statutory tax sharing arrangements some of which date back to the early 20th century

While prior TACIR reports have raised questions regarding the various existing state tax-sharing arrangements, no specific recommendations are made in this report in regard to the County Revenue Partnership Fund.

INTRODUCTION

Public Chapter No. 1057 of 2008 created a separate fund (County Revenue Partnership Fund) within the state general fund to be distributed to county and metropolitan governments (Nashville-Davidson County, Lynchburg-Moore County, and Hartsville-Trousdale County). Funding is to come from specific appropriations from the portion of state sales tax revenue identified in TCA 67-6-103 (a) (1).[1] As a result, any specific dollar appropriation made by the Legislature to the newly created fund would not impact funds specifically earmarked for education (TCA 67-6-103(a)(2)), municipalities (TCA 67-6-103 (a)(3)), the Department of Revenue (TCA 67-6-103(a)(4)), or the state sinking fund (TCA 67-6-103(a)(5)). Only 36% of state sales tax revenue is currently not earmarked (see accompanying pie chart).



The Legislature may make a specific dollar appropriation to the newly authorized fund beginning in any year after fiscal year 2008-2009. The appropriation in any year cannot exceed the amount appropriated in the previous fiscal year to municipalities pursuant to TCA 67-6-103(a)(3)(A). Estimated municipal fund distributions (from state sales tax collections) during fiscal year 2008-2009 are $257 million.[2] Distributions from the County Revenue Partnership Fund are to be made monthly on the basis of population.

The Legislature has made only one appropriation to the CRPF since passage of the law. In the general appropriations act for 2009-2010, a portion of $1,200,000 appropriated to the state as its share of the local costs of implementing SB 2357/HB 2389 is to be distributed to the CRPF. The Commissioner of Finance and Administration will determine the amount that is to assist in funding the local cost of various children's services and mental health.

[1] TCA 67-6-103 establishes the distribution of state sales tax collections. TCA 67-6-103(a) (1) refers to the sales tax apportionment to the general fund (unearmarked portion).

[2] *State of Tennessee, The Budget for Fiscal Year 2009-2010*, page 92.

Public Chapter No. 1057 requires the Tennessee Advisory Commission on Intergovernmental Relations to study and evaluate the new law and report its findings and recommendations by June 30, 2010.[3]

EXISTING STATE INTERGOVERNMENTAL AID TO CITIES AND COUNTIES

In fiscal year 2007, state intergovernmental aid to Tennessee local governments was $6.2 billion.[4] A majority of this amount was in the form of restricted categorical aid or grants, with two-thirds (approximately $4.1 billion) representing state aid for elementary and secondary education (BEP). Only $541.1 million (less than 9%) was distributed to local governments in the form of unrestricted general support aid, primarily from various state tax-sharing arrangements with cities and counties.

Previous reports by TACIR have detailed the many tax-sharing arrangements through which portions of Tennessee state taxes are distributed back to local governments. These distributions are required through specific earmarking provisions in the law, some of which date back to the early 20th century. Thirteen state taxes are shared with local governments.[5] During fiscal year 2008, $828 million of state taxes were shared with local governments.[6] Approximately 60% of this amount went to municipalities and 40% to counties. The single largest distribution ($285.8 million) was from state gasoline and diesel fuel taxes (shared with counties and cities and earmarked for roads, highways, and bridges). The second largest distribution was from the state sales tax ($267 million), almost all of which was distributed to municipalities with no use restrictions.

STATE SHARING OF SALES TAXES[7]

Existing law that requires the sharing of state sales tax revenue with municipalities dates back to the original state sales tax law (1947). When the state sales tax was first passed in 1947, it required that 12.5% (of the revenue generated by the original 2% state sales tax) be distributed to cities on the basis of population. The portion of state sales tax revenue earmarked for municipalities and the per capita basis for its distribution have not changed in over 60 years.[8]

The legislation also provided that 70% (of total collections) be used for education, most of which, at the time, was provided by county governments. It also provided that if revenue collections exceeded $20 million in any fiscal year, the excess was to be distributed 80% among the counties, 12.5% among the cities on a population basis, and 7.5% to the sinking fund. The amounts distributed to counties were earmarked for education, aid to dependent

[3] Public Chapter 1057 of 2008 provides that "The Tennessee advisory commission on intergovernmental relations shall thoroughly study and evaluate the provisions of this act and related policy matters and shall report its findings and recommendations to the finance, ways and means committee of the senate and the house of representatives on or before June 30, 2010."

[4] Public use data for Tennessee state government available at http://www.census.gov/govs/www/state07.html; accessed on July 29, 2009.

[5] See Green et al. January 2004, vi.

[6] Data from the Tennessee Department of Revenue. Excludes distributions of the state 17% wholesale beer tax.

[7] What follows has been excerpted from a prior TACIR publication; see "State Tax Sharing, Fairness, and Local Government Finance in Tennessee," TACIR Staff Report, January 2004, p.14-15.

[8] The 12.5% share at the original 2% tax rate is approximately the same as the current 4.5925% share of a 5.5% state sales tax (1.5% of the current state tax rate of 7% is totally earmarked to education).

children, aid to the blind, and for old age assistance.

Soon after the tax was levied, large "unanticipated" sales tax revenue began to flow into state coffers. The distribution of such "surplus" funds, primarily to counties soon generated some criticisms. Cries of an "unjust and indefensible situation" arose when studies showed that some rural areas were receiving (on an average daily attendance basis and a per capita basis) ten times the amounts received by metropolitan areas.

Over time, as the state sales tax rate was raised, the statutory percent shared with cities was reduced. This was to insure that the additional revenue generated by tax rate increases themselves went to the state general fund (generally for education). The dollar amounts distributed to city governments, however, have grown dramatically over the years. The municipal fund continues to be distributed, with a few exceptions, on the basis of population.[9] Prior TACIR reports on state tax sharing[10] have identified problems with tax sharing arrangements that are based solely on population without regard to local service levels and local fiscal need.

Since 2006 a minor amount of state sales tax revenue has been earmarked to certain county governments. This sharing with some county governments resulted from passage of the "Tennessee River Resort District Act."[11] The states sales tax amounts distributed to county governments as a result of this legislation and certain other exceptions in the law amounted to less than $3 million in fiscal year 2009. These amounts do not impact the portion of the state sales tax earmarked for municipalities.[12]

[9] The exceptions include Gatlinburg, Pigeon Forge, and several other locations that fall within the exceptions described at TCA 67-6-103(a)(3)(B) & (G).

[10] See TACIR reports identified in bibliography.

[11] Public Acts 2005, Chapter No. 212.

PURPOSE OF LEGISLATION AND REVENUE IMPLICATIONS

The largest amount of shared tax revenue to counties currently comes from distributions of gasoline and diesel fuel tax collections. All these funds are restricted (earmarked) for use on roads, highways, and bridges. While restricted, such funds are partly fungible and clearly release some unrestricted local funds that otherwise would be used for roads and highways for use elsewhere.[13]

The primary purpose of the legislation creating the County Revenue Partnership Fund is to facilitate a potential new source of unrestricted general fund revenue to counties similar to the unrestricted sales tax revenue shared with municipalities (4.59% of state sales tax revenue). While the legislation itself does not guarantee any new funds to counties, it does help position them in the future for consideration of an appropriation when state sales tax revenue improves. The existence of a special account that benefits counties will increase the likelihood in the future of appropriations to the account (CPRF) when and if state revenues finally recover from the protracted recession. The largest source of unrestricted shared revenue to counties now

[12] Any distributions made to Tennessee River Resort Districts are paid from the state general fund. Therefore, strictly speaking, the amounts received by counties as a result of the TRRD Act, while computed on the basis of state sales taxes collected in such districts, are not paid from state sales tax revenues.

[13] The 3 cent state gasoline tax increase in 1985 included some "maintenance of effort" requirements that somewhat reduced the fungibility of part of the restricted gasoline and diesel fuel tax distributions. Since six counties had a maintenance of effort requirement of $0 and several others had requirements of less than $100,000, these earmarked state funds were clearly partly to fully fungible.

comes from distributions of Tennessee Valley Authority in lieu of tax payments (gross receipts tax payments).

The legislation capped any fiscal year appropriation to the CRPF to the amount of state sales taxes distributed to municipalities in the previous fiscal year. As worded, any significant apportionments to the CRPF (or to counties or specific counties) could result from some combination of four factors:

1. Substantial and probably unanticipated increases in state sales tax collections
2. An increase in the state sales tax rate without the increase being fully earmarked for education use only
3. Significant broadening of the sales tax base to currently untaxed goods and services
4. A significant change in the existing methods of sharing all state tax revenues with local governments to better reflect local responsibility, local fiscal effort, and local fiscal capacity.

DISCUSSION

SUBSTANTIAL GROWTH IN STATE SALES TAX COLLECTIONS

It is not clear that this option (or turn of events) would provide county governments with significant new unrestricted revenue. Moreover, whatever distributions might be forthcoming from such a source will not represent a stable source of revenue. Such distributions are subject to specific appropriations and not automatic as are those resulting from specific tax-sharing distributions to municipalities. The level of funding in any given year is problematic.

INCREASE IN STATE SALES TAX

In the current economic environment, an increase in the state sales tax rate to benefit primarily county governments is not likely. Eventually, the state will face increased fiscal pressure to replenish its operating revenues as well as its reserves. When that occurs, it is not likely that new programs or increased tax-sharing arrangements with county governments will be a priority. The requirement that appropriations to the CRPF come from the unrestricted sales tax distribution to the state's general fund makes it unlikely that any significant funding to the CRPF will be forthcoming any time soon.

SIGNIFICANT BROADENING OF THE SALES TAX BASE TO CURRENTLY UNTAXED GOODS AND SERVICES

If the sales tax is broadened to include more services not currently in the sales tax base, county governments would benefit in two ways. First, county government local sales tax revenue will increase as a result of the base broadening. This increase will depend heavily on the size of the service sector in the county. Since 50% of the new revenue must be used for education (regardless of where collected within the county), county governments may get some relief from this portion of any resulting sales tax increase. The distribution of the remaining 50% increase in sales tax revenue will depend on where in the county the newly taxed services occur. Second, any increase in state sales tax revenue will increase all sales tax fund distributions, including the distribution to the unrestricted general fund account.[14] This increase may be used to apportion funds to the CRPF.

[14] Unless the new revenue can be identified and is specifically earmarked for other uses.

CHANGE IN DISTRIBUTION FORMULAS

While a distribution method based on population is administratively simple, it does not reflect differences in local government responsibilities, local government fiscal capacity, or local government fiscal effort. The failure of most current state tax sharing arrangements in dealing with and reflecting the reality of very different local responsibilities and fiscal capacities has been identified in prior TACIR publications. These major weaknesses[15] in existing tax sharing arrangements include

- distributions from the state sales tax to all municipalities based on population without regard to the types and level of local services provided;
- distributions to both cities and counties on a per capita basis even though in some cases the population data is distorted by prisoners, military personnel, and college students;
- distributions of any kind without regard to local fiscal capacity (in contrast to BEP grants that consider both required local services and local fiscal capacity);
- distributions from the Hall income tax to local governments based on the residence (city area or county area) of the taxpayer without regard to the number of local services provided, the level of services provided, local tax effort, or local fiscal capacity;
- distribution of gasoline and diesel fuel tax collections made to local governments without any consideration of actual road usage (Green et al. 2005. pp.2-7);
- special distributions to certain resort cities without regard to the level of local taxes generated from non-residents who visit such resort locations (Green et al. October 2004, pp. 44-48);
- none of the existing tax sharing arrangements with cities and counties reflects any consideration of which level of government provides each service and the level of service provided (Chervin 2006);
- existing tax sharing distributions are based on one or some combination of the following: (1) population, (2) land area, (3) situs of collection or taxpayer residence,[16] and (4) simple equal shares (Green et al. 2000, pp. 12-13);
- an almost blind attachment to historically-based criteria, some of which are over seventy years old; and
- a never-ending political response to change by attempting to hold all parties harmless by grandfathering in all parties that might be negatively affected by a distribution change even if the change is related to ongoing changes in the economic environment in which we live.

DISTRIBUTION OPTIONS THAT REFLECT ACTUAL LOCAL SERVICE RESPONSIBILITIES AND LOCAL FISCAL CAPACITY

One might guess from the title of this section that this topic had never before been considered or discussed. In fact, it represents the two major considerations that drive Tennessee's Basic Education Program (since funding began in fiscal year 1992-93):

[15] For a fuller description of the major inequities found in tax-sharing arrangements in Tennessee, see Green et al. January 2004, pp. 80-85.

[16] Also known as a "return to origin" basis.

1. Calculate the cost of a reasonable K-12 education program in each school district.[17]
2. Calculate a measure of the fiscal capacity of each district, convert the estimate to a relative index or measure of capacity (vis-à-vis other school districts), then calculate each school districts share of its local program, with the balance financed with state aid. Poor districts generally pay a smaller share of their program costs than wealthier (measured by fiscal capacity) school districts.

Tennessee's education equalization program took years to develop and finance, but the equalization finance program (and its progeny BEP 2.0) is now almost 19 years old, hardly a new concept. What is somewhat new is the concept of sharing state tax dollars with local governments using the same or similar methodology. While certainly an interesting political and administrative challenge, a broad outline of an equalization program for sharing state taxes with local governments (for non-education purposes) was described by Reschovsky[18] for consideration in Wisconsin:

1. "…the starting point is to define a package of basic services and to determine the minimum amount of money that will be required to deliver these services in each municipality."[19]
2. "The second element is to determine the amount of fiscal effort that each municipality must make. The actual dollar contribution that each local government must make toward financing "Badger Basics" will then depend upon the size of its property tax base."[20]
3. "Those municipalities where the cost of providing the package of basic services exceeds the required local contribution would receive a shared revenue payment equal to the difference between the cost of basic services and required local revenues."

There are several implications for such a program in Tennessee:

- Municipalities that do not provide significant services would not likely receive any funds.
- Municipalities that do not impose property taxes or impose low property taxes would not likely receive much in shared taxes.
- Counties that have a large portion of their citizens residing in cities that provide many local services will not receive as much funding as counties that provide all of most of the public services provided within the county.
- The cost of providing government services varies from location to location. Distributions formulas can be adjusted to reflect cost differences in the provision of public services.[21]
- For success, the state government must avoid maintaining prior shared tax levels through various "hold harmless" provisions that only serve to perpetuate poorly designed distributions of the past.

[17] In Tennessee, this includes county, city, and special school districts.

[18] Reschovsky 2002, p. 11.

[19] In Wisconsin, a major portion of local services are delivered by municipalities.

[20] "Badger Basics" refers to the package of basic services that each local government is expected to provide. The property tax reference reflects the fact that property taxes are the primary source of local revenue in Wisconsin.

[21] Bradberry 2007, p. 22 notes the "We find that communities with greater population density, number of commuters, population size, unemployment, and poverty have to spend more per capita to provide a standard bundle of municipal services; that is, they have higher uncontrollable costs."

- A new tax sharing arrangement can include a minimum per capita amount of aid to "help bring everyone to the table" or a reasonable transition period during which time the "new" method supplants the "old" methods.

STATE TAX SHARING ARRANGEMENTS IN OTHER STATES

There is no one-stop-statistical-shopping site for information on how states that share tax revenues with local governments actually distribute such funds.[22] Prior surveys generally reflected distribution methods similar to those currently in use in Tennessee. Those methods include historical-based methods such as (1) situs of tax collections, (2) population, and (3) road miles. A few states have formally recognized the limitations of their existing distribution schemes in addressing the issues of local fiscal imbalances.[23] A few states have actually implemented tax-sharing programs that consider local non-school service needs and local fiscal capacity in their tax-sharing arrangements.[24]

Despite the fact that most states now provide equalization funds to local governments to insure a more equitable distribution of primary and secondary education services, the same logic and reasonableness that drives equalization funds for education has not been embraced by states in guiding distribution of non-school aid to local governments.

CONCLUSION

This report makes no specific recommendations in regard to the County Revenue Partnership Fund. While the intent of the CRPF is to facilitate future appropriations from future unearmarked state sales tax collections to county governments, it is not likely that any significant amounts will become available given current economic conditions.

The conclusion of this report is that any significant future appropriations to the CRPF will only occur as a result of some combination of the four factors:

1. Unexpected rapid growth in state sales tax collections
2. An increase in the state sales tax rate
3. Significant broadening of the sales tax base (that would increase both state and local sales tax collections)
4. Significant changes in the existing statutory tax sharing arrangements some of which date back to the early 20th

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[22] See Zelio 2006.

[23] Fiscal imbalance is intended to refer to the problem of short and long run disconnects between government service responsibilities (actual or promised) and the revenue needed to finance such responsibilities. Tennessee's BEP funding is an example of a state program that recognizes that there was a fundamental disconnect in some counties between the cost of a reasonable level of education services and the county's ability to fund those services.

[24] Minnesota instituted a new LGA (local government aid) program in 2003 that considers "need" and "ability to raise local revenues." In the past, Massachusetts distributed unrestricted local aid based on a similar design (no longer used).

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THE ELECTRIC GENERATION AND TRANSMISSION COOPERATIVE ACT OF 2009 AND ITS POSSIBLE IMPACT ON THE TENNESSEE VALLEY AUTHORITY'S PAYMENTS IN LIEU OF TAXES

by Reuben Kyle, Ph.D.

IN THIS REPORT

In federal fiscal year 2010, the state of Tennessee and its local governments will receive more than $300 million from the Tennessee Valley Authority in payments in lieu of taxes as prescribed by federal law. The critical issue in determining the possible effect of future wholesale power supply arrangements on TVA payments in lieu of taxes is in the nature of the contractual arrangements between any new cooperatives and TVA.

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PURPOSE

Section 4 of Public Chapter 475, Acts of 2009, the Electric G&T (Generation and Transmission) Cooperative Act, required the Tennessee Advisory Commission on Intergovernmental Relations (TACIR) to study "whether the current wholesale power supply arrangements between Tennessee Valley Authority (TVA) and municipal utilities and electric cooperatives are likely to change in the future in a way that could affect payments in lieu of taxes from TVA to the state and to its local governments" and to "include recommendations, if any, on adjustments to the state tax system that would keep the state and local governments whole from such future changes."

THE ISSUE

In federal fiscal year[1] 2010, the state of Tennessee and its local governments will receive more than $300 million from the TVA in payments in lieu of taxes as prescribed by federal law. The purpose of this report is to address the question of whether Tennessee's Electric G&T Cooperative Act (the Act) as originally passed poses a threat to those payments. The answer is that, while the threat is not immediate, the law could result in a reduction of those significant payments. The initial effect might be a slowing of growth in TVA revenue, but over time, payments could decline because of sales by the new cooperatives other than through TVA. The following report

[1]The federal fiscal year is October 1 through September 30; the state fiscal year is July 1 through June 30. Unless otherwise indicated, "fiscal year" in this report refers to the federal fiscal year.

discusses the intent of the Act, the means by which it could produce a reduction in the payments, and a possible remedy.

PAYMENTS IN LIEU OF TAXES BY THE TVA

The TVA Act of 1933 (TVA Act) specifically directs that 5% of the agency's "gross proceeds" be paid in lieu of taxes (PILOTs) to states and local governments where the authority owns and operates property (48 Stat. 58-59, 16 U.S.C. § 831). TVA interprets "gross proceeds" as their operating revenues from the sale of power to municipalities, cooperatives, and industries. The TVA Act specifically excludes sales to federal agencies from the PILOT calculation.

TVA has made in-lieu-of tax payments to the state and local governments in its 7-state region to compensate for lost property taxes since 1933. In addition, TVA makes payments to the state of Illinois for coal reserves owned by TVA.

TVA has made in-lieu-of tax payments to the state and local governments in its 7-state region to compensate for lost property taxes since 1933.

Payments for federal fiscal year 2009 amounted to $505 million, an increase of more than 10% over the previous year. The estimated payments for fiscal year 2010 are $538 million and are paid monthly throughout the year based on that estimate. Payments to each state are based on the share of TVA-owned property and sales in each state. Tennessee's share based on those two factors has been close to 60% of the total each year. (See Table 1 for historical percentages since

Table 1. Allocation to Tennessee from TVA Payments in Lieu of Taxes
Federal Fiscal Years 2000 Through 2010

Fiscal Year	Total TVA PILOTs (5% of Gross Power Proceeds)	Tennessee Percentage	Tennessee Share
1999-2000	$307,551,344	62.17%	$191,203,594
2000-01	$315,074,917	62.53%	$197,014,613
2001-02	$328,326,673	61.30%	$201,263,922
2002-03	$329,367,677	60.77%	$200,171,229
2003-04	$337,704,853	60.21%	$203,345,938
2004-05	$364,896,289	59.80%	$218,209,076
2005-06	$376,145,607	58.76%	$221,017,705
2006-07	$447,079,252	58.74%	$262,604,964
2007-08	$456,774,307	57.98%	$264,836,829
2008-09	$505,152,552	58.44%	$295,197,502
2009-10*	$538,376,884	59.47%	$320,145,815

Source: TVA final fiscal year PILOT calculations as reported to Tennessee Department of Revenue.

*Data for 2009-2010 reflects TVA estimates.

2000.) Total payments to Tennessee for fiscal year 2009 were $295.2 million, and estimated federal fiscal year 2010 payments will total $320 million. Of those total payments, slightly less than 1% is made directly to counties, with the state allocating the balance. In Tennessee, close to half of the payments go to county and city governments.

Under TCA § 67-9-101, payments in lieu of taxes received from TVA are apportioned between the state and local governments as shown in Figure 1.

Figure 1. Tennessee Valley Authority

Tennessee State Revenue Sharing Act

Title 67, Chapter 9, Part 1

From the Allocation of TVA Payments in Lieu of Taxes to Tennessee *(after direct payments to counties[1] and 1977-78 base payment to state,[2] counties and cities)*

	Basis of Apportionment *(§ 67-9-101)*	**Proration to Counties & Municipalities** *(§ 67-9-102)*
Paid to areas with TVA construction[3] *(remainder allocated to CTAS, TACIR and Four Lakes Regional Development Authority)*	3%	
Retained by the State[4]	48.50%	
Paid to Local Governments[5]	48.50%	
Counties—70% of Local Share		
Based on Percent of State Population		*30% (14.55% of total)*
Based on Percent of State Land		*30% (14.55% of total)*
Based on County's Percent of TVA Acreage in Tennessee		*10% (4.85% of total)*
Municipalities—30% of Local Share Based on Percent of State Population		*30% (14.55% of total)*
Total Allocated by State	100%	

[1] $2,167,755 in federal fiscal year 2010.

[2] $55,204,586.

[3] Construction activity on facilities to produce electric power.

[4] Less amount required to guarantee Four Lakes 0.3% of total funds allocated ($780,663 in state fiscal year 2010) per Tennessee Code Annotated § 67-9-102(b).

[5] Less $107,088 to TACIR per TCA § 67-9-102(a)(3) and amount required to guarantee CTAS 0.9% of total funds allocated and TACIR 1.2% of total funds allocated per TCA § 67-9-102(b)(3) ($1,131,962 for the two combined in state fiscal year 2010).

The allocation among local governments is based primarily on population and land area as a percentage of the state totals, with 10% based on the amount of TVA-owned land in each county. Of the total allocation for local governments, 70% goes to county governments and 30% to municipalities. The estimated amounts to be allocated to each Tennessee county and municipality during the state fiscal year 2010 are available in Appendix A.

According to the TVA Act, payments made directly to counties are the 2-year average of ad valorem property taxes on power properties and reservoir land associated with power production. Total direct payments estimated for fiscal year 2010 are $2,167,755. With few exceptions, these amounts are relatively small. The bulk of the revenue for cities and counties from TVA's payments in lieu of taxes estimated at more than $125 million for fiscal year 2010, comes from the state's allocation and is determined by state law. Those estimated amounts range from highs of $6.8 million (to Shelby County) and $7.8 million (to Memphis) to a low of $177 thousand (to Pickett County).

TVA's revenues are the product of two elements:

- power sales and
- rates.

FACTORS AFFECTING TVA REVENUES AND PAYMENTS IN LIEU OF TAXES

TVA's revenues are the product of two elements: power sales and rates. Power sales are subject to a number of factors including economic conditions, weather, and policy initiatives. Currently there is a national, as well as a TVA, push for increased energy efficiency. Improved energy efficiency resulting from so-called smart grids, weatherization, and more efficient construction techniques and appliances will reduce power usage, other things being equal. A November 2009 TVA report indicates that the goal set by TVA and its distributors to reduce summer power demands by 189 megawatts was exceeded by almost 20 megawatts. For 2012, the goal is to reduce power demands by 1400 megawatts.[2] By way of comparison, TVA's Watts Bar Nuclear plant in Rhea County has a capacity of slightly less than 1300 megawatts.[3] Other things being equal, less power demand means lower TVA revenues. At the same time, it should be noted that increased energy efficiency means less pressure for increased investment in new capacity. Less demand for new capacity could in turn benefit TVA customers and ratepayers.

In the current economic environment, TVA power demands have contracted along with the economy. Power sales for 2009 are below

[2] TVA News Release November 19, 2009.
[3] http://www.powerplantjobs.com, see Power Plants in Tennessee, retrieved January 14, 2010.

those of 2008. TVA forecasters expect that, while there is an indication of some recovery of sales, 2010 power sales will still be below 2008 figures. The decline in sales is primarily a consequence of declines in commercial and industrial use. Another uncertainty associated with future power sales is the potential for relocation of current large customers. Current large customers could relocate outside the TVA service region or, conversely, new large customers could move into the Valley region.

The other element in determining revenues is the overall rate. Rates are affected by several factors. Pending federal legislation on energy and environmental policies are likely to affect power generation. To the extent that those new policies require nuclear power or renewable energy sources such as solar and wind power, new generating capacity will be needed. In turn, energy sources could dictate both the size of the facility and its location. Because of the debt limitations imposed by Section 15d(a) of the TVA Act of 1933, as amended (16 U.S.C. § 831n-4), financing any new capital investment in generation and transmission capacity is problematic. Much of the new technology is, for the present, more expensive than the older technologies now in use. By the same token, carbon capturing technology for coal-powered steam plants will be expensive. These developments mean that financing new capacity would tend to raise rates and revenues, other things being equal.

The long-term outlook for energy price inflation leads TVA forecasters to expect the FCA to rise again, producing higher overall rates and, other things remaining equal, higher revenues.

Another key factor affecting overall TVA rates, and TVA revenues, is fuel costs that flow through the fuel cost adjustment (FCA). TVA describes the FCA as a mechanism to help recover largely uncontrollable fuel and purchased power costs. The FCA is calculated every three months as generation fuel costs and the cost of power TVA purchases from other suppliers rise and fall.[4] The FCA calculation works by capturing the difference between the amount that TVA forecasts to pay for fuel during a given quarter and the amount that is collected through rates. Because of the volatility in energy costs—for example, coal and natural gas prices—the FCA increased overall rates in 2008. When those same costs declined, combined with a rainy summer and fall that increased low-cost hydroelectric power generation, fuel costs fell resulting in a lower FCA and overall rates. As a consequence, TVA customers may enjoy a decline in their electric bills.

The long-term outlook for energy price inflation leads TVA forecasters to expect the FCA to rise again, producing higher overall rates and, other things remaining equal, higher revenues. Of course, energy

[4]Beginning in October 2009, the fuel cost adjustment mechanism was modified from quarterly to monthly (TVA Fuel Cost Adjustment Information).

prices are likely to remain volatile and may rise and fall over any given period. So, the expectation is that the FCA will rise or remain stable in the future. Other things remaining the same, an increase in rates means an increase in revenues and an increase in the PILOTs.

PURPOSE OF THE ACT

The Electric G&T Cooperative Act stated as its rationale the need "for electric utility systems engaged in the distribution of electric power and energy in this state and adjoining states to have additional sources of electrical energy through traditional sources of generation and through renewable, clean and passive sources of electrical energy, as well as through other sources known and those sources yet to be known and discovered."[5] With that purpose in mind, the Act authorizes the creation of nonprofit cooperatives to generate and transmit electricity in Tennessee.

The Electric G&T Cooperative Act authorizes the creation of nonprofit cooperatives to generate and transmit electricity in Tennessee.

These cooperatives are to be organized as membership cooperatives in which membership is limited to "distribution cooperatives, governmental electric systems, energy acquisition corporations, another G&T cooperative and joint action agencies created under the laws of any state . . ."[6]

The Act delineates the nature of the cooperatives, their organizational structure, the properties they may own and operate, and the taxable status of the cooperatives, among other things. The cooperatives are not exempt from ad valorem property taxes in Tennessee. They can, however, issue tax-exempt bonds to build the generation facilities, which is an important factor in making them cost-effective.

MOTIVATION FOR THE ESTABLISHMENT OF GENERATION AND TRANSMISSION COOPERATIVES

The initiative for the Act came from the Tennessee Valley Public Power Association (TVPPA), a nonprofit organization of 158 power distributor customers of the TVA. TVPPA's members include approximately 110 municipally owned electric systems and 48 nonprofit rural electric cooperatives that provide electric service to retail customers in the 7-state TVA service area.

Motivation for the Act stems from a long-standing desire among TVA distributors to establish some ownership position in the generating capacity of their power supply. According to TVPPA representatives,

[5] TCA § 48-69-102(a).
[6] TCA § 48-69-112(a).

doing so would serve as a means of balancing the relationship between TVA—the producer and wholesaler of power—and the distributors (or retailers) of TVA power, and thereby provide for greater local involvement in power supply planning and operations.

From TVPPA's standpoint, an ownership position better reflects its members' (and their ratepayers') past and future financial contributions and obligations with respect to the construction and maintenance of power supply assets on the TVA system. This ownership position, in turn, also provides a hedge against any possible future restructuring of TVA, privatization for example.

A second consideration in the creation of generation and transmission cooperatives is TVA's ability to finance new capacity. The U.S. Congress has limited TVA debt to $30 billion, and according to the 2009 TVA Annual report, their current long-term debt is $21.78 billion. As an alternative to increasing their debt to expand capacity, TVA can—and currently does—purchase additional power supply from investor-owned utilities and independent power producers. Financing new capacity through the means provided in the Act, that is non-TVA financed additions to capacity, is attractive both to TVA and to its distributors. According to TVPPA, the Act should provide a mechanism to use low-cost financing to fund future capacity needs within the Tennessee Valley.

A third aim is to avoid the need to rely on raising rates to fund capital investments. Rate-paid capital is an alternative to debt financing that utilities use when it makes sense as a policy to ask existing customers to fund capital improvements. It is less desirable when the goal is to ensure equity between current and future customers by asking them to share in funding new facilities. With debt financing, equity can be balanced by asking new customers to pay connection fees (e.g., tap fees for new water supply lines) to help fund expansion instead of relying entirely on rate increases. Both strategies can involve raising rates. The difference in relation to TVA and the cooperatives is more an issue of timing—with rate-paid capital, rates would be raised in advance to build a reserve for capital outlays; with debt financing, rates would be raised after debt is issued in order to repay it. Because of its debt ceiling, TVA could face the need to raise rates to build a capital investment reserve even though debt financing might be the more equitable alternative. TVPPA and its members consider both increasing rates—especially to fund long-lived generation assets—and excessive reliance on power purchase agreements with independent power producers undesirable alternatives.

At least initially, new capacity created under the Act is expected to be in the form of so-called peaking facilities that are needed only when power demands exceed the TVA's base-load generation capacity. These facilities run in the periods of highest use, which typically occur during the summer and the winter. Market prices for power during these periods can be very volatile, so ownership of, or long-term contracts for, peaking assets is an important component of an overall power supply plan. Nothing, however, restricts future investments created under the Act from being substituted for TVA facilities.

TVA itself owns peaking facilities and contracts for power from many providers throughout the TVA region. Furthermore, under the current negotiations between TVA and TVPPA, any ownership position by TVPPA distributors is not expected to exceed 5% of TVA's total capacity needs in the near term.

The Seven States Power Corporation's purpose is to develop cooperatives as authorized by the Electric Generation and Transmission Cooperative Act.

SEVEN STATES POWER CORPORATION AND THE TENNESSEE VALLEY PUBLIC POWER ASSOCIATION

The TVPPA organized a nonprofit corporation, the Seven States Power Corporation, in July 2007.[7] Seven States Power is an energy acquisition corporation formed under TCA Title 7, Chapter 39. Its purpose is to develop cooperatives as authorized by the Electric G&T Cooperative Act. A majority of the TVA distributor members of TVPPA participated in the formation of Seven States.

The first investment by Seven States was in a generation facility located in Southaven, Mississippi, before the Tennessee Electricity G&T Cooperative Act was introduced.[8] Seven States purchased 70% of the combined-cycle combustion turbine facility from TVA in September 2008, and in April 2009, it purchased an additional 20% giving Seven States 90% and TVA 10% ownership.

The transaction called for Seven States to lease the Southaven facility back to TVA and for TVA to operate it until April 30, 2010, but according to TVPPA representatives, the agreement is likely to be extended for an additional period. The arrangement clears the investment and any associated debt from TVA books, but allows TVA to operate the facility and incorporate the power generated into the TVA system.[9]

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[7]Seven States Power Corporation is a Tennessee non-profit corporation located in Chattanooga, Tennessee.
[8]Seven States Southaven LLC is a Delaware corporation located in Chattanooga and registered with Tennessee's Secretary of State's office in September 2008. Seven States Southaven shares a registered agent with Seven States Power Corporation.
[9]TVPPA http://www.tvppa.com/conferences/annual.htm, retrieved 11/10/2009; TVA Form 10-Q filed July 31, 2009.

Under Tennessee law, electric power cooperatives are subject to ad valorem property taxes. Valuation and assessment is undertaken by the Comptroller of the Treasury's Office of State Assessed Properties. Thus, any new cooperatives created in Tennessee under the Act will be subject to such ad valorem property taxes, which are paid to the county and city where the facility is located. Regardless of what changes might occur in payments in lieu of taxes by TVA, the local government where the facility is built will receive that new property tax revenue from any new cooperative built under the auspices of the Act.

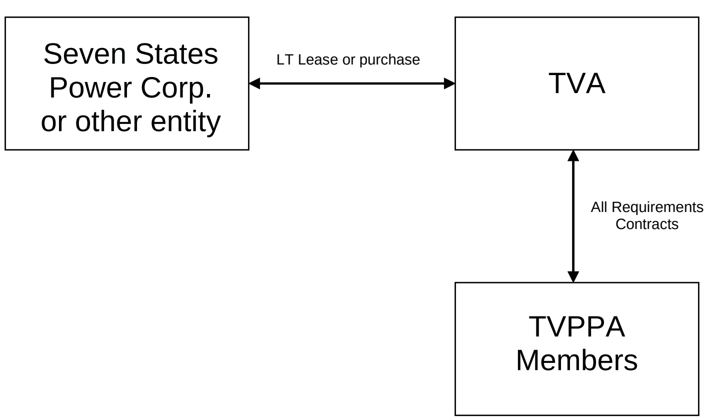
NATURE OF THE NEW COOPERATIVES AND THE CONTRACTUAL ARRANGEMENTS WITH TVA

The critical issue in determining the possible effect of future wholesale power supply arrangements on TVA payments in lieu of taxes is the nature of the contractual arrangements between any new cooperatives and TVA. If future cooperatives created under the Act operate so that their revenues are not recorded as TVA revenues, then TVA revenues could be decreased and with them the PILOT. If they serve to supplement TVA capacity rather than replace it—in the event that TVA is unable to build capacity because of its debt ceiling—then the effect would be to replace the growth in TVA revenue and payments unless the revenue passes through TVA accounts. At this point, legal, financing, and accounting issues that will influence the form of those contractual arrangements remain unresolved.

The critical issue in determining the possible effect of future wholesale power supply arrangements on TVA payments in lieu of taxes is the nature of the contractual arrangements between any new cooperatives and TVA.

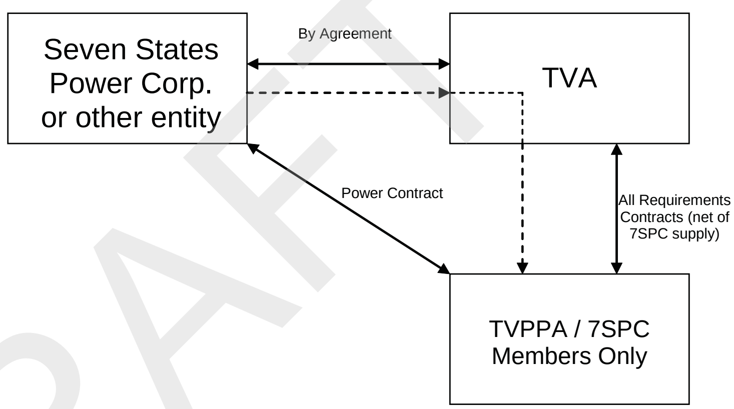
In the case of the facility in Southaven, Mississippi, because of the leaseback arrangement, billing of the power will appear on TVA's books. (See Figure 2.) Thus, TVA revenues will increase with the sale and delivery of power produced by that facility, and to the extent that those incremental revenues are subject to the requirement to make payments to the state and local governments, the PILOT would increase accordingly.

Figure 2. TVA Remains 100% Provider



As long as sales to distributors are made through TVA, the PILOTs will be unaffected by Seven States and the new cooperatives. If revenues generated by any new cooperatives do not pass through TVA accounts, there will be an effect on the payments in lieu of taxes. One possible scenario could be where a Seven States project invested in a unit that replaced an existing TVA unit, for example, if an older coal fired facility were replaced by a new natural gas or clean coal facility and the output is sold directly to Seven States members rather than through TVA. (See Figure 3.) Another scenario would be if the arrangement involving Southaven changed from one where TVA leases the facility and transmits its power supply with all revenues flowing through TVA to one in which Seven States sells the output of Southaven directly to the TVPPA members.

Figure 3. Seven States Power Corp. Supplies Power Directly



Many of TVPPA's members, for example, Nashville Electric Service and Jackson Energy Authority, are part of a Tennessee municipality. Every Tennessee municipality receives funds from the TVA PILOTs under state law and stands to lose if the PILOTs decline. Even so, there are advantages to Seven States Power and its members in financing future investments by selling power directly to distributors rather than through TVA, the main one being the tax-exempt status of the bonds issued to build the facility. No more than 10% of the debt service on state or local tax-exempt bonds can come from payments by any person or entity other than a state or local government.[10] Revenue from sales to TVA would have to be counted toward that 10% limit. If the 10% limit were exceeded, the bonds would not be tax-exempt.

In the scenarios described above in which TVA's gross revenues would decrease, and everything else held constant, TVA's in-lieu-of tax payment would fall. Of course, as noted above for facilities located in Tennessee, the Seven States unit would be subject to ad valorem

[10]Letter from bond counsel to the Division of Bond Finance, Office of the Comptroller, State of Tennessee, dated 26 August 2008.

property taxes in Tennessee that could offset a drop in the direct payments to the local government in which the facility is located. But the TVA's in-lieu-of tax payments to the state would decrease as would the substantial amount of that payment that is allocated by the state to its cities and counties.

The Southaven plant will be one of 20 or more so-called peaking plants that supply power when power demands exceed TVA's base load capacity. One issue not addressed here is whether the power generated by a co-op created under the Act that is not needed by TVA could be sold to a power user outside what is termed the TVA "fence." If that were to happen, those sales would not negatively impact TVA revenues, but would contribute to lower operating costs for the co-op. There would be no negative effect on the PILOTs since TVA itself is not generally permitted to sell power outside the 7-state region.

CONCLUSIONS AND RECOMMENDATIONS

The issue is whether future wholesale supply arrangements between the TVA and its distributors resulting from the passage of the Electricity G&T Cooperative Act of 2009 may affect TVA's payments in lieu of taxes to Tennessee and, in turn, the state's payments to its county and city governments. The Act authorizes the creation of nonprofit cooperatives to generate and transmit electricity in Tennessee.

Such new cooperatives could produce and sell power that would not appear as sales on TVA accounts with the result that TVA revenue would be negatively affected. In turn, TVA's payments in lieu of taxes would be reduced from what they might otherwise have been.

The exact nature of the contracts between TVA and any new cooperatives created under the Act will determine whether that happens. There are no statutory constraints to prevent it. Current TVA revenue forecasts are for a modest growth rate in revenues of between 1%-2% annually for the foreseeable future. In fact, there are many factors that will affect TVA revenues and payments in lieu of taxes in the future, and there are no guarantees as to the future level of such payments.

A consequence of the Act could be both a reduction in payments in lieu of taxes to Tennessee and its local governments and shifts away from direct payments by TVA to counties toward ad valorem property tax payments by any new cooperatives that displace existing TVA facilities.

The issue is whether future wholesale supply arrangements between the TVA and its distributors resulting from the passage of the Electricity G&T Cooperative Act of 2009 may affect TVA's payments in lieu of taxes to Tennessee and, in turn, the state's payments to its county and city governments.

If all sales to distributors continued to go through TVA, then PILOTs would be unaffected by the opening or closing of cooperative-owned generation plants. The cooperative owned plants would sell power to TVA, TVA would, in turn, transmit and sell that power the same as it does now, and all sales would be included in the gross proceeds calculation. The effect on PILOTs to the state and local governments would be the same regardless of who generated the power. One problem with this alternative is that the cooperatives would not be able to issue tax-exempt bonds to raise money to build their plants. Consequently, the cost of producing power would be higher than if the bonds were tax exempt, which might have an effect on rates.

State Tax Adjustment Option

If TVA PILOTs are negatively impacted, changes to existing Tennessee law could blunt potential adverse effects on state and local governments. Suggested changes are to

- extend the existing 3% gross receipts tax on certain intrastate power production and distribution sales in Tennessee (TCA § 67-4-405) to intrastate power sales other than to TVA by the cooperatives created under the Act and
- distribute the revenue from extending the gross receipts tax in the same manner as payments in lieu of taxes from TVA under TCA §§ 67-9-101 and 102.

If state PILOT revenue from TVA is threatened by in-state activities of the new cooperatives, an option exists to help keep state and local government finances whole.

In effect, the 3% gross receipts tax on sales in Tennessee, other than to TVA, by the new cooperatives would raise approximately the same amount of revenue as Tennessee would receive if those sales were made through TVA. Tennessee receives as PILOTs about 60% (Tennessee's share of the total—see Table 1) of the 5% of TVA's gross proceeds that TVA distributes to the states. This equates to PILOTs to Tennessee at approximately 3% of total TVA gross proceeds. One advantage of this alternative is that it would not affect the tax-exempt status of bonds issued to build the G&T cooperatives' facilities. This alternative will not prevent declines in TVA payments to Tennessee that result from displacement by the cooperatives of TVA sales in other states. See Appendix B for additional discussion of the recommendation.

Another option, one proposed in legislation offered by the TVPPA, is to authorize negotiated payments in lieu of taxes to be determined as the G&T cooperatives bring each new G&T plant on line. This option should not be expected to keep the state and local governments whole from future changes in TVA payments in lieu of taxes as contemplated in the study assigned to TACIR by the law that created the G&T cooperatives, and so it was not evaluated further by TACIR staff.

Senate Bill 3333/House Bill 3504 (sponsored by Senator Randy McNally and Representative Craig Fitzhugh) was introduced in the General Assembly this year to address the concerns raised in the TACIR staff's report on G & T cooperatives. The original language in the bill authorized a G&T cooperative to enter into an agreement to make PILOTs to any state or local government. The bill was amended, however, and the TACIR staff provided some assistance in drafting language for the amendment. The amended version of the bill was passed by the General Assembly and became Public Chapter XXX, Acts of 2010. Several versions of amendments were reviewed by the staff, and additionally, the final version was reviewed by and changed again by the Department of Revenue. The Act accomplishes several things, effecting the express intent of the General Assembly to establish an obligation to make in-lieu-of-tax payments to help keep Tennessee and its local governments whole from any diminution in the in lieu of tax payments paid by the Tennessee Valley Authority on account of the provision of wholesale electric current by sources other than the Tennessee Valley Authority to municipal utilities, electric cooperatives and other similar entities for resale within the state. In order to accomplish this intent, the Act imposed a 5% gross receipts tax on wholesale sales of electric power.

The Act also directs TACIR to continue to monitor annually whether the current wholesale power supply arrangements between TVA and municipal utilities and electric cooperatives are likely to change in the future such that payments in lieu of taxes would be affected.

ACKNOWLEDGEMENTS

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APPENDIX A

Estimated Distribution of Local Government's Share of TVA Payments to Municipalities During FY 2010

City Name	Payment	City Name	Payment	City Name	Payment
ADAMS	$ 6,226	CALHOUN	$ 5,456	DOVER	$ 15,863
ADAMSVILLE	$ 21,927	CAMDEN	$ 42,110	DOWELLTOWN	$ 3,322
ALAMO	$ 26,319	CARTHAGE	$ 24,762	DOYLE	$ 6,204
ALCOA	$ 85,078	CARYVILLE	$ 24,839	DRESDEN	$ 34,278
ALEXANDRIA	$ 8,954	CEDAR HILL	$ 3,278	DUCKTOWN	$ 4,697
ALGOOD	$ 34,652	CELINA	$ 15,170	DUNLAP	$ 51,791
ALLARDT	$ 7,062	CENTERTOWN	$ 2,827	DYER	$ 26,467
ALTAMONT	$ 12,497	CENTERVILLE	$ 41,883	DYERSBURG	$ 191,981
ARDMORE	$ 13,091	CHAPEL HILL	$ 13,003	EAGLEVILLE	$ 6,182
ARLINGTON	$ 106,782	CHARLESTON	$ 6,930	EAST RIDGE	$ 227,051
ASHLAND CITY	$ 44,552	CHARLOTTE	$ 18,162	EASTVIEW	$ 6,798
ATHENS	$ 146,825	CHATTANOOGA	$ 1,754,192	ELIZABETHTON	$ 155,483
ATOKA	$ 88,983	CHURCH HILL	$ 65,079	ELKTON	$ 6,666
ATWOOD	$ 11,001	CLARKSBURG	$ 3,135	ENGLEWOOD	$ 18,682
AUBURNTOWN	$ 2,772	CLARKSVILLE	$ 1,138,105	ENVILLE	$ 2,530
BAILEYTON	$ 5,544	CLEVELAND	$ 412,391	ERIN	$ 16,391
BANEBERRY	$ 5,159	CLIFTON	$ 33,508	ERWIN	$ 63,805
BARTLETT	$ 516,518	CLINTON	$ 105,634	ESTILL SPRINGS	$ 27,633
BAXTER	$ 14,070	COALMONT	$ 10,428	ETHRIDGE	$ 5,896
BEAN STATION	$ 28,590	COLLEGEDALE	$ 71,657	ETOWAH	$ 40,295
BEERSHEBA SPRING	$ 6,083	COLLIERVILLE	$ 487,367	FAIRVIEW	$ 77,158
BELL BUCKLE	$ 4,455	COLLINWOOD	$ 11,265	FARRAGUT	$ 216,897
BELLE MEADE	$ 32,375	COLUMBIA	$ 369,526	FAYETTEVILLE	$ 77,584
BELLS	$ 25,444	COOKEVILLE	$ 293,230	FINGER	$ 3,850
BENTON	$ 14,807	COOPERTOWN	$ 38,612	FOREST HILLS	$ 51,812
BERRY HILL	$ 7,414	COPPERHILL	$ 5,621	FRANKLIN	$ 618,580
BETHEL SPRINGS	$ 8,393	CORNERSVILLE	$ 11,441	FRIENDSHIP	$ 6,693
BIG SANDY	$ 6,378	COTTAGE GROVE	$ 1,067	FRIENDSVILLE	$ 9,790
BLAINE	$ 18,030	COVINGTON	$ 93,097	GADSDEN	$ 6,083
BLUFF CITY	$ 17,600	COWAN	$ 19,721	GAINESBORO	$ 9,669
BOLIVAR	$ 63,825	CRAB ORCHARD	$ 9,218	GALLATIN	$ 263,099
BRADEN	$ 2,981	CROSS PLAINS	$ 17,128	GALLAWAY	$ 7,326
BRADFORD	$ 12,267	CROSSVILLE	$ 114,768	GARLAND	$ 3,608
BRENTWOOD	$ 387,900	CRUMP	$ 16,732	GATES	$ 9,911
BRIGHTON	$ 28,997	CUMBERLAND CITY	$ 16,643	GATLINBURG	$ 37,204
BRISTOL	$ 284,878	CUMBERLAND GAP	$ 2,596	GERMANTOWN	$ 450,768
BROWNSVILLE	$ 118,398	DANDRIDGE	$ 23,669	GIBSON	$ 4,554
BRUCETON	$ 17,095	DAYTON	$ 72,185	GILT EDGE	$ 5,379
BULLS GAP	$ 7,854	DECATUR	$ 15,687	GLEASON	$ 16,094
BURLISON	$ 4,983	DECATURVILLE	$ 9,525	GOODLETTSVILLE	$ 162,379
BURNS	$ 15,830	DECHERD	$ 24,728	GORDONSVILLE	$ 13,729
BYRDSTOWN	$ 9,933	DICKSON	$ 212,024	GRAND JUNCTION	$ 3,531

Estimated Distribution of Local Government's Share of TVA Payments to Municipalities During FY 2010

City Name	Payment	City Name	Payment	City Name	Payment
GRAYSVILLE	$ 16,952	LAGRANGE	$ 1,496	MILLINGTON	$ 114,768
GREENBACK	$ 10,494	LAKE CITY	$ 21,269	MINOR HILL	$ 4,807
GREENBRIER	$ 59,106	LAKELAND	$ 119,334	MITCHELLVILLE	$ 2,277
GREENEVILLE	$ 170,208	LAKESITE	$ 21,121	MONTEAGLE	$ 13,619
GREENFIELD	$ 24,289	LAKEWOOD	$ 25,752	MONTEREY	$ 29,956
GRUETLI-LAAGER	$ 20,538	LAVERGNE	$ 290,711	MORRISON	$ 7,524
GUYS	$ 5,313	LAWRENCEBURG	$ 118,762	MORRISTOWN	$ 283,813
HALLS	$ 25,422	LEBANON	$ 273,730	MOSCOW	$ 6,281
HARRIMAN	$ 77,186	LENOIR CITY	$ 76,537	MOSHEIM	$ 22,683
HARROGATE	$ 48,677	LEWISBURG	$ 115,221	MOUNT CARMEL	$ 52,747
HARTSVILLE	$ 26,346	LEXINGTON	$ 81,526	MOUNT JULIET	$ 277,587
HENDERSON	$ 68,148	LIBERTY	$ 4,037	MOUNT PLEASANT	$ 49,770
HENDERSONVILLE	$ 474,826	LINDEN	$ 11,172	MOUNTAIN CITY	$ 27,501
HENNING	$ 13,399	LIVINGSTON	$ 43,672	MUNFORD	$ 63,869
HENRY	$ 5,720	LOBELVILLE	$ 11,276	MURFREESBORO	$ 1,107,309
HICKORY VALLEY	$ 1,496	LOOKOUT MOUNTAIN	$ 22,001	NASHVILLE	$ 4,370,642
HICKORY WITHE	$ -	LORETTO	$ 19,471	NEW HOPE	$ 11,474
HOHENWALD	$ 41,550	LOUDON	$ 52,511	NEW JOHNSONVILLE	$ 21,442
HOLLOW ROCK	$ 10,594	LOUISVILLE	$ 23,310	NEW MARKET	$ 13,575
HORNBEAK	$ 4,785	LUTTRELL	$ 12,915	NEW TAZEWELL	$ 31,626
HORNSBY	$ 3,366	LYNCHBURG	$ 5,541	NEWBERN	$ 32,870
HUMBOLDT	$ 104,145	LYNNVILLE	$ 4,511	NEWPORT	$ 79,811
HUNTINGDON	$ 47,841	MADISONVILLE	$ 43,331	NIOTA	$ 10,035
HUNTLAND	$ 10,076	MANCHESTER	$ 103,867	NOLENSVILLE	$ 36,775
HUNTSVILLE	$ 12,409	MARTIN	$ 116,083	NORMANDY	$ 1,551
IRON CITY	$ 4,048	MARYVILLE	$ 254,530	NORRIS	$ 15,907
JACKSBORO	$ 20,758	MASON	$ 15,401	OAK HILL	$ 51,988
JACKSON	$ 657,664	MAURY CITY	$ 8,833	OAK RIDGE	$ 304,554
JAMESTOWN	$ 20,230	MAYNARDVILLE	$ 19,603	OAKDALE	$ 2,684
JASPER	$ 35,356	MCEWEN	$ 18,876	OAKLAND	$ 34,861
JEFFERSON CITY	$ 95,301	MCKENZIE	$ 58,248	OBION	$ 12,475
JELLICO	$ 26,929	MCLEMORESVILLE	$ 3,355	OLIVER SPRINGS	$ 36,335
JOHNSON CITY	$ 629,238	MCMINNVILLE	$ 140,878	ONEIDA	$ 42,154
JONESBOROUGH	$ 47,456	MEDINA	$ 31,736	ORLINDA	$ 9,350
KENTON	$ 14,367	MEDON	$ 2,959	ORME	$ 1,364
KIMBALL	$ 14,433	MEMPHIS	$ 7,778,558	PALMER	$ 7,986
KINGSPORT	$ 498,257	MICHIE	$ 7,117	PARIS	$ 107,398
KINGSTON	$ 60,726	MIDDLETON	$ 7,370	PARKERS CROSSRDS	$ 3,124
KINGSTON SPRINGS	$ 30,504	MIDTOWN	$ -	PARROTTSVILLE	$ 2,926
KNOXVILLE	$ 1,950,396	MILAN	$ 86,739	PARSONS	$ 28,028
LAFAYETTE	$ 42,737	MILLEDGEVILLE	$ 3,157	PEGRAM	$ 23,607
LAFOLLETTE	$ 87,915	MILLERSVILLE	$ 67,422	PETERSBURG	$ 6,761

Estimated Distribution of Local Government's Share of TVA Payments to Municipalities During FY 2010

City Name	Payment	City Name	Payment	City Name	Payment
PHILADELPHIA	$ 5,863	SODDY DAISY	$ 126,836	WAVERLY	$ 44,651
PIGEON FORGE	$ 56,895	SOMERVILLE	$ 29,382	WAYNESBORO	$ 24,509
PIKEVILLE	$ 19,592	SOUTH CARTHAGE	$ 14,323	WESTMORELAND	$ 23,024
PIPERTON	$ 12,299	SOUTH FULTON	$ 27,688	WHITE BLUFF	$ 32,221
PITTMAN CENTER	$ 5,247	SOUTH PITTSBURG	$ 36,566	WHITE HOUSE	$ 108,806
PLAINVIEW	$ 20,527	SPARTA	$ 55,712	WHITE PINE	$ 21,968
PLEASANT HILL	$ 5,984	SPENCER	$ 18,844	WHITEVILLE	$ 51,042
PLEASANT VIEW	$ 45,806	SPRING CITY	$ 23,647	WHITWELL	$ 18,261
PORTLAND	$ 120,357	SPRING HILL	$ 258,094	WILLISTON	$ 3,751
POWELLS CROSSRDS	$ 14,818	SPRINGFIELD	$ 170,838	WINCHESTER	$ 83,657
PULASKI	$ 86,585	ST JOSEPH	$ 9,119	WINFIELD	$ 10,021
PURYEAR	$ 7,337	STANTON	$ 6,765	WOODBURY	$ 26,709
RAMER	$ 3,894	STANTONVILLE	$ 3,432	WOODLAND MILLS	$ 4,235
RED BANK	$ 136,604	SUNBRIGHT	$ 6,347	YORKVILLE	$ 3,223
RED BOILING SPGS	$ 11,254	SURGOINSVILLE	$ 20,472		
RIDGELY	$ 18,338	SWEETWATER	$ 72,718	State Total:	$ 37,848,560
RIDGESIDE	$ 4,279	TAZEWELL	$ 24,487		
RIDGETOP	$ 20,472	TELLICO PLAINS	$ 9,488		
RIPLEY	$ 86,288	TENNESSEE RIDGE	$ 14,675		
RIVES	$ 3,641	THOMPSONS STATION	$ 18,954		
ROCKFORD	$ 9,372	THREE WAY	$ 18,426		
ROCKWOOD	$ 64,705	TIPTONVILLE	$ 52,417		
ROGERSVILLE	$ 47,115	TOONE	$ 3,630		
ROSSVILLE	$ 4,180	TOWNSEND	$ 2,684		
RUTHERFORD	$ 13,993	TRACY CITY	$ 18,470		
RUTLEDGE	$ 13,058	TRENTON	$ 51,515		
SALTILLO	$ 4,488	TREZEVANT	$ 10,076		
SAMBURG	$ 2,860	TRIMBLE	$ 8,008		
SARDIS	$ 4,895	TROY	$ 14,004		
SAULSBURY	$ 1,089	TULLAHOMA	$ 198,617		
SAVANNAH	$ 77,537	TUSCULUM	$ 27,479		
SCOTTS HILL	$ 10,021	UNICOI	$ 38,711		
SELMER	$ 49,959	UNION CITY	$ 119,642		
SEVIERVILLE	$ 136,967	VANLEER	$ 4,994		
SHARON	$ 10,908	VIOLA	$ 1,419		
SHELBYVILLE	$ 182,307	VONORE	$ 12,783		
SIGNAL MOUNTAIN	$ 84,979	WALDEN	$ 21,561		
SILERTON	$ 1,298	WALNUT GROVE	$ -		
SLAYDEN	$ 2,497	WARTBURG	$ 9,790		
SMITHVILLE	$ 43,936	WARTRACE	$ 6,930		
SMYRNA	$ 418,823	WATAUGA	$ 4,433		
SNEEDVILLE	$ 14,862	WATERTOWN	$ 14,972		

Estimated Distribution of Local Government's Share of TVA Payments To Counties during FY 2010

	County Name	Payment		County Name	Payment
1	ANDERSON	$1,094,873	49	LAUDERDALE	$610,913
2	BEDFORD	$712,743	50	LAWRENCE	$828,107
3	BENTON	$1,469,604	51	LEWIS	$334,886
4	BLEDSOE	$457,660	52	LINCOLN	$732,646
5	BLOUNT	$1,286,226	53	LOUDON	$982,871
6	BRADLEY	$960,945	54	MACON	$414,542
7	CAMPBELL	$1,169,473	55	MADISON	$1,123,926
8	CANNON	$341,387	56	MARION	$854,741
9	CARROLL	$740,922	57	MARSHALL	$528,833
10	CARTER	$745,961	58	MAURY	$1,032,125
11	CHEATHAM	$513,074	59	MCMINN	$834,082
12	CHESTER	$365,940	60	MCNAIRY	$674,317
13	CLAIBORNE	$936,118	61	MEIGS	$626,377
14	CLAY	$259,238	62	MONROE	$1,483,670
15	COCKE	$687,170	63	MONTGOMERY	$1,381,430
16	COFFEE	$918,183	64	MOORE	$190,208
17	CROCKETT	$338,213	65	MORGAN	$610,599
18	CUMBERLAND	$930,158	66	OBION	$714,788
19	DAVIDSON	$4,268,764	67	OVERTON	$526,787
20	DECATUR	$665,095	68	PERRY	$704,031
21	DEKALB	$379,875	69	PICKETT	$177,361
22	DICKSON	$795,534	70	POLK	$726,080
23	DYER	$719,928	71	PUTNAM	$775,274
24	FAYETTE	$831,587	72	RHEA	$1,006,074
25	FENTRESS	$563,081	73	ROANE	$1,365,497
26	FRANKLIN	$1,013,308	74	ROBERTSON	$793,292
27	GIBSON	$865,603	75	RUTHERFORD	$1,781,108
28	GILES	$755,611	76	SCOTT	$620,110
29	GRAINGER	$680,311	77	SEQUATCHIE	$326,486
30	GREENE	$1,049,044	78	SEVIER	$1,072,176
31	GRUNDY	$427,238	79	SHELBY	$6,838,956
32	HAMBLEN	$675,487	80	SMITH	$460,698
33	HAMILTON	$3,118,856	81	STEWART	$3,884,293
34	HANCOCK	$247,774	82	SULLIVAN	$1,591,397
35	HARDEMAN	$796,857	83	SUMNER	$1,443,937
36	HARDIN	$988,564	84	TIPTON	$752,240
37	HAWKINS	$1,150,390	85	TROUSDALE	$210,229
38	HAYWOOD	$637,295	86	UNICOI	$285,968
39	HENDERSON	$905,335	87	UNION	$856,127
40	HENRY	$1,590,702	88	VAN BUREN	$292,671
41	HICKMAN	$719,850	89	WARREN	$737,504
42	HOUSTON	$328,036	90	WASHINGTON	$1,038,675
43	HUMPHREYS	$1,434,579	91	WAYNE	$789,117
44	JACKSON	$352,806	92	WEAKLEY	$769,342
45	JEFFERSON	$785,695	93	WHITE	$520,087
46	JOHNSON	$430,290	94	WILLIAMSON	$1,393,894
47	KNOX	$3,159,403	95	WILSON	$1,124,413
48	LAKE	$206,548			
				TOTAL:	**$91,294,220**

APPENDIX B

TCA § 67-4-405 imposes a 3% gross receipts tax on the furnishing or distribution of electric current as well as the furnishing and distribution of gas and water. The tax applies only to intrastate business. The law allows a credit against the gross receipts tax for franchise and excise taxes (paid by for-profit businesses) along with an exemption of the first $5,000 of gross receipts.

The tax does not apply to certain producers, including cities or other political subdivisions of the state owning and operating gas companies, water companies or power plants, nor does it apply to persons meeting the criteria of exempt wholesale generators or Federal Energy Regulatory Commission (FERC) certified wholesale power marketers under the Federal Power Act of 1992, nor does it apply to any governmental agency of the United States.

Amending TCA § 67-4-405 to ensure that the state could tax the gross receipts of any new G&T operation will offer some protection from potential declines in TVA PILOTs resulting from reduced TVA sales in Tennessee because of the 2009 G&T Act. Suggested changes include deleting the current language of TCA § 67-4-405 (b) and replacing it with the following language:

> *(b) This tax does not apply to cities or other political subdivisions of the state owning and operating gas companies or water companies.[11] This tax does not apply to the gross receipts from the sale of power (or the use value of power) if produced by local governments or their subdivisions and if produced from power plant capacity that existed before January 1, 2011.[12] This tax does not apply to the gross receipts of cities, or other political subdivisions, or any other producer or distributor if sold to and distributed by the Tennessee Valley Authority in the Tennessee Valley Region.[13] The tax does not apply to any governmental agency of the United States.*

And add a new subsection (e) as follows:

> *(e) Any gross receipts tax collected from the 3% tax on power production or distribution by generation and transmission cooperatives authorized by TCA Title 48, Chapter 69, shall be added to the amounts received by the state from TVA payments in lieu of taxes and the combined total amount shall then be distributed according to the provisions of TCA § 67-9-101.*

[11]This leaves the current law as it applies to gas and water companies as is.

[12]At least three known local governments or local government subdivisions currently have generating capacity. They produce relatively small amounts of power, generally peaking power, and have agreements with TVA that define and limit the use of this capacity. Examples include city of Bolivar in Haywood County, city of McMinnville in Warren County, and Powell Valley Electric Coop in Hancock County.

[13]Purge all references to "exempt wholesale generators or FERC certified wholesale power marketers under the Federal Power Act of 1992" from the law.

ADDENDUM

Senate Bill 3333/House Bill 3504 (sponsored by Senator Randy McNally and Representative Craig Fitzhugh) was introduced in the General Assembly this year to address concerns raised in the TACIR staff's report on G & T cooperatives. The original language of the bill authorized a G&T cooperative to enter into an agreement to make PILOTs to any state or local government. The bill was amended, however, and the TACIR staff provided some assistance in drafting language for the amendment. Several versions of amendments were reviewed by the staff, and additionally, the final version was reviewed by and changed again by the Department of Revenue. The amended version of the bill was passed by the General Assembly and became Public Chapter XXX, Acts of 2010. The Act accomplishes several things. It

- expresses the intent of the General Assembly to establish an obligation to make in-lieu-of-tax payments to help keep Tennessee and its local governments whole from any diminution in the in-lieu-of-tax payments by the Tennessee Valley Authority on account of the provision of wholesale electric current by sources other than the Tennessee Valley Authority to municipal utilities, electric cooperatives and other similar entities for resale within the state;
- authorizes a G&T cooperative to enter into one or more agreements providing for the making of payments in lieu of taxation to any state or local taxing jurisdiction within or outside of the state to the extent that the G&T cooperative's wholesale sale of capacity and energy to a member or patron of the G&T cooperative results in a diminution in payments in lieu of taxes by the Tennessee Valley authority to such state and local governments;
- defines "payments in lieu of taxes" as payments made by the Tennessee Valley authority to state and local governments on account of its gross proceeds under the federal Tennessee Valley Authority Act of 1933 and deems all such payments to be ordinary operating expenses of the G&T cooperative;
- adds that "governmental electric system" may include, at the election of the G&T cooperative, for purposes of membership in the G&T cooperative, the Tennessee Valley Authority;
- provides that each person, including each governmental and cooperatively organized person, engaged in the business of making covered wholesale sales of electric current to a municipality, electric cooperative or other similar customer shall, for the privilege of doing such business, remit to the state for state purposes a payment in lieu of tax in an amount to be calculated according to the bill;
- provides that the payment in lieu of tax required shall equal 5% of the Tennessee apportioned gross receipts of the person making covered wholesale sales of electric current;
- provides for a credit upon in-lieu-of-tax payments required by this bill for any taxes paid under parts 3, 4, 20 or 21 of Chapter 4 of Title 67 and a further credit for any ad valorem taxes or payments in lieu of ad valorem taxes paid to the state or local governments within the state by or on behalf of any person engaged in a covered wholesale sale of electric current; and

- directs the Tennessee Advisory Commission on Intergovernmental Relations to continue to monitor whether the current wholesale power supply arrangements between TVA and municipal utilities and electric cooperatives are likely to change in the future such that payments in lieu of taxes would be affected–TACIR will report no later than February 1, 2011 and annually thereafter written findings to the Commerce, Labor & Agriculture Committee of the Senate, the Commerce Committee of the House, the Finance, Ways and Means Committee of each chamber and include recommendations, if any, on adjustments to the state tax system that would keep the state and local governments whole from such future changes.