



# TACIR

The Tennessee Advisory Commission  
on Intergovernmental Relations



# 5

226 Anne Dallas Dudley Blvd., Suite 508  
Nashville, Tennessee 37243-0760

Phone: (615) 741-3012

Fax: (615) 532-2443

[www.tn.gov/tacir](http://www.tn.gov/tacir)

## **MEMORANDUM**

**TO:** Commission Members

**FROM:** Cliff Lippard *Cliff*  
Executive Director

**DATE:** 5 November, 2020

**SUBJECT:** House Bill 971/Senate Bill 1075 (Local Revenue and Services)—Draft Final Report for Review, Comment, and Approval

---

The attached Commission report is submitted for your review, comment, and approval. This is the third and final report of the Commission's comprehensive study of the revenue sources of counties and cities in Tennessee and the services counties and cities provide. The first interim report, published in February 2019, addressed online sales tax collection and distribution, and the second interim report, published in January 2020, focused on K-12 education services and funding. The House Finance, Ways and Means Committee requested this comprehensive study during its discussion of House Bill 971 by Representative Sargent in the 110<sup>th</sup> General Assembly and directed TACIR to address the duties of counties and cities mandated by law and the funds that go from the state to counties and cities to comply with the law. The local government members of the Commission agreed on three principles to guide the Commission's study:

- The report should provide a comprehensive review of trends in local government revenue and services.
- Because of the complexity of the overall revenue system and the potential for unintended consequences, the report should not propose shifting existing sources of revenue among counties and cities.
- The report should explore whether the state should or could do more to financially support local governments.

The two interim reports made specific recommendations concerning state and local revenue. In its first interim report, which focused on online sales tax collection and

distribution, the Commission recommended that the General Assembly enable the Department of Revenue to enforce Rule 129, which would require out-of-state sellers with no physical presence in the state with sales of more than \$500,000 in Tennessee to collect and remit sales tax. The General Assembly subsequently enabled enforcement, effective October 1, 2019. The sales threshold was subsequently lowered from \$500,000 to \$100,000, effective October 1, 2020, and marketplace facilitators like Amazon, eBay, and Etsy were required to collect sales tax on behalf of their sellers. The General Assembly also eliminated the uniform 2.25% rate option for local option sales tax in 2019. Instead, out-of-state sellers are required to collect and report local sales tax based on the local jurisdiction where the sale is shipped or delivered (i.e. destination-based sourcing) as recommended by the Commission. The Commission also recommended against limiting the single-article cap to motor vehicles, aircraft, watercraft, modular homes, manufactured homes, and mobile homes; however, this and other streamlined provisions are set to become effective July 1, 2021, without further action by the General Assembly. The General Assembly has postponed the effective date of the streamlined sales tax provisions every two years since it was originally set to become effective in 2009.

In the second interim report, focused on K-12 education services and funding, the Commission said that given the ever evolving needs of communities in Tennessee and the likelihood that the Basic Education Program (BEP) funding formula could better account for these needs, a comprehensive review of the components should be made by the BEP Review Committee or other designated state and local officials and other stakeholders to ensure that the BEP funding formula supports a commonly accepted basic level of education for Tennessee students. The recommendation seems especially relevant as school systems rethink how they deliver education services during the COVID-19 pandemic (e.g., increased demand for technological resources to facilitate distance learning).

The attached report, which makes no new recommendations, explains that, while providing public services is a primary function of local governments, not all local governments provide the same services, and counties and cities vary in the number of services they provide. Counties and cities are required to provide some of these services under the Tennessee Constitution and state law. These required services contribute significantly to local expenditures. Local governments spent \$34.6 billion statewide to fund local services in 2016-17, of which \$12.0 billion was to provide services required by state or federal law. Many other services, though not required, are provided to meet community needs and expectations. Even for those services that aren't required, local governments may find they are subject to state and federal mandates governing how those services are to be provided. The challenge for local

officials providing these services—regardless of whether the services are required—is how to pay for them.

The total revenue available to local governments to provide services to their communities includes revenue from local taxes and fees and intergovernmental transfers from the state and federal government. Local own-source revenue is the largest source of revenue available for funding local services. In fiscal year 2016-17, of the \$34.8 billion that was available to local governments in Tennessee, according to Census of Governments data, \$26.7 billion was own-source revenue—local taxes and fees. Of the remaining amount, \$7.4 billion was from the state and \$705.5 million was from the federal government.

Local fees—which include charges billed to users of services such as electricity, natural gas, sewerage, water, hospital care, parks and recreation, and transit, among others—accounted for 57% of the own-source revenue local governments received in fiscal year 2016-17. Many of the services for which these fees are charged are funded almost entirely by the revenue generated from them and use of fee revenue is often limited to providing the service that generated it. Another 30% of own-source revenue came from local taxes, and the remaining 12% was employee retirement, interest earnings, special assessments, sale of property, and other revenue. Although adopted locally, the types of taxes and fees that can be levied by local governments and, in some cases the maximum rates that can be charged, are determined by state law.

The share of the revenue provided by the state to local governments has been relatively consistent, particularly over the last two decades, even though the General Assembly has recently enacted state laws increasing funding for certain services. State revenue accounted for 21% of revenue available to local governments in fiscal year 2016-17, the same percentage it accounted for in fiscal year 2000-01. The percentage of overall state revenue that the state has distributed to local governments has also remained relatively flat—hovering around 22% during the last two decades—with the exception of the 2007-2009 recession when the percentage peaked at 31%.

The response to the COVID-19 pandemic may result in a similar peak in the percentage of overall state revenue that the state has distributed to local governments. In response to the pandemic, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act on March 27, 2020. Of the over \$2 trillion in stimulus delivered by the Act, \$150 billion went to the Coronavirus Relief Fund for States, Local and Tribal Governments (CRF) with Tennessee set to receive \$2.65 billion—\$2.36 billion for the state and \$0.29 billion for local governments certified to have a population over 500,000. The Act also included \$30.75 billion for the Education Stabilization Fund (ESF), which included \$13.2 billion for the Elementary and Secondary School Education Relief

(ESSER) Fund and \$3 billion for the Governors Emergency Education Relief (GEER) Fund. Tennessee's share of these funds was \$259.9 million and \$63.6 million, respectively. The \$63.6 million the state of Tennessee received in GEER funding has already helped to support two grant initiatives for K-12 education announced by Governor Bill Lee and the Financial Stimulus Accountability Group on July 7, 2020.

Most of the revenue local governments receive from the state is restricted for use on K-12 education. Of the \$7.4 billion the state distributed to local governments in fiscal year 2016-17, \$5.5 billion was for K-12 education, and most of the remaining \$1.9 billion was generated by state-shared taxes. For each of these taxes, state law requires the state to distribute a portion of the revenue with local governments, which totaled \$1.4 billion for local governments in fiscal year 2016-17. The share of revenue that the state is required to distribute to local governments varies by tax, as does the method for allocating it to individual local governments, which leads to differences in the share of each tax received by counties as compared with cities. In recent years, state-shared tax revenue has increased as a percentage of both total state revenue—including federal intergovernmental transfers—and total state tax revenue.

Although direct federal transfers account for a relatively small portion of revenue available to local governments, changes in this revenue source have been substantial. Adjusting for inflation, direct federal transfers to local governments increased from \$610.9 million to \$989.4 million from fiscal year 2000-01 to its peak in fiscal year 2009-10, subsequently decreasing by \$283.9 million to \$705.5 million in fiscal year 2016-17. Based on data from fiscal year 2011-12 and fiscal year 2016-17, decreases for housing and community development, transit, and electric utilities contributed the most to the decrease.