

# LOCAL TAXING AUTHORITY

by Stanley Chervin, Ph.D.

Limits on local taxing autonomy severely restrict funding opportunities for Tennessee's local governments and may affect services available to citizens.

Under Article II, Section 29 of the Tennessee Constitution, the state legislature is authorized to delegate to counties and cities the power to tax for county and city purposes. No power is conferred upon the counties and cities to impose taxes for any purposes unless directed and prescribed by the General Assembly.<sup>1</sup>

## *Article II, Section 29, Tennessee Constitution:*

*The General Assembly shall have power to authorize the several counties and incorporated towns in this State, to impose taxes for County and Corporation purposes respectively, in such manner as shall be prescribed by law. . .*

## LIMITS ON LOCAL TAXING AUTHORITY

Local governments in Tennessee have few taxing options available to them, and they rely primarily on the property tax and the local option sales tax. The property tax is the only unrestricted revenue source for local governments in Tennessee. The local option sales tax is capped at 2.75%, applies only to the first \$1,600 of the price of an item, is subject to state sales tax exemptions, and is subject to the requirement that any increases must pass a voter referendum. Additional, though less significant, revenue sources for local governments include the wheel tax, the local portion of the state gross receipts tax, the hotel/motel tax, and a local gasoline tax.

Limits to local tax authority are not unique to Tennessee. Local governments possess taxing and other revenue authority to the extent allowed under each state's laws.<sup>2</sup> They are figuratively and literally "legal creatures of their states."<sup>3</sup> Such powers flow from taxing powers granted to local governments in state constitutions, general state laws that apply to local governments, special powers conveyed under home rule authority,<sup>4</sup> and specific authority granted

<sup>1</sup>See McLean v. State, 55 Tenn. 22 (1873) Smith v. Carter, 131 Tenn. 1, 173 S.W. 430 (1914) ; TN AG Op. No. 80-39.

<sup>2</sup>The Federal Constitution does not mention local governments.

<sup>3</sup>Chernick, Howard. 1998. "Fiscal Capacity in New York: The City versus the Region", National Tax Journal, Volume 51, no.3, p. 532.

<sup>4</sup>For a full discussion of the history and legal concepts of local governments, see U.S. Advisory Commission on Intergovernmental Relations. 1993. Local Government Autonomy, Needs for State Constitution, Statutory, and Judicial Clarification. Report A-127, October 1993. Washington D.C.

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## FISCAL FLEXIBILITY

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under private acts. The result is wide variation in local taxing authority across the United States, and even within states, significant differences exist among the various forms of local government. Local governments, in the absence of extensive state aid, must have some local fiscal autonomy to finance local services demanded by their citizens. Without a reasonable degree of fiscal autonomy, local governments cannot be responsive to the specific needs of their own citizens, and local governance is greatly limited. The degree to which local governments should have access to local tax bases continues to be a hotly contested and debated issue.

While almost all general-purpose local governments in other states<sup>5</sup> have been given the power to levy property taxes, state restrictions on tax rates, property tax revenue growth, or assessments are common.<sup>6</sup> Restrictions on local taxing authority have always existed, but new restrictions imposed during the last twenty years, especially those imposed on property taxation, have had a pronounced effect on local governments in many states.<sup>7</sup>

**Nationally, local tax autonomy has declined over the last twenty years.**

The presence and impact of restrictions on local revenue-raising autonomy is difficult to evaluate from general statistics on local government taxation. Many other factors impact local government revenue-raising decisions, including the level and

importance of state intergovernmental aid, which vary extensively from state to state, and the actual service responsibilities of each level of government, which can vary from state to state, as well as between local government entities in the same state. What is clear is that local autonomy has declined over the last twenty years. The state share of state-local revenue has risen as states take over responsibility for providing some traditional local services, and as states have increased intergovernmental aid to local governments.

Current detailed data on state-by-state restrictions on local government autonomy including fiscal autonomy is not available. The results of the most recent survey designed to collect such information were published in 1993 by the U.S. Advisory Commission on Intergovernmental Relations.<sup>8</sup> This data is now somewhat dated and does not provide any information on restrictions or limitation on taxes other than the property tax for which more current information is available. Given the continuing significance of the property tax in local government finance,<sup>9</sup> the focus on property tax restrictions and limitations remains a legitimate concern.

Local income taxes are not a significant source of local government revenue in the United States;<sup>10</sup> however, in the eleven states that authorize some form of income or payroll tax the tax can be important. In these states, the state government

**There are no easy solutions to swelling local government fiscal problems.**

<sup>5</sup>Includes counties (3,034), municipalities (19,429), and towns and townships (16,504). These three types of local governments generally provide a collection of public services (rather than limited or single services such as provided by school districts, airport authorities, irrigation districts, etc.). Data from 2002 Census of Governments.

<sup>6</sup>Brunori, David. 2003. *Local Tax Policy*. The Urban Institute, Washington D.C., p. 61. There were such restrictions in 44 states as of 2002. The best known and most controversial is Proposition 13 passed in California in 1978. For additional detail, see O'Sullivan, Arthur. 2001. "Limits on Local Property Taxation." In *Property Taxation and Local Government Finance*, Edited by Wallace E. Oates, Chapter 7. Lincoln Institute of Land Policy, p. 177-178. For a detailed description of each state's program, see Appendices in Baer, David. 2003. *State Programs and Practices for reducing Residential Property Taxes*. Report #2003-04, AARP Public Policy Institute: Washington D.C., May 2003.

<sup>7</sup>Other restrictions imposed on local governments by state constitutions or state statutes include debt limits, referendum requirements, bond duration guidelines, and interest ceilings.

<sup>8</sup>See data for 1990 by the Advisory Commission on Intergovernmental Relations (1993). The report provides information on various state controls over local issues, by state, including annexation and consolidation, local elections, local administrative operations and procedures, financial management and personnel management. However the data on financial management (revenue and debt issues) includes tax information on property taxes only.

<sup>9</sup>During fiscal 2003, property taxes accounted for almost 49.2% of total local general own source revenue, and 73.5% of total local taxes (U.S. Census 2003 annual estimated data reflects revenue and tax information for counties, municipalities, towns and townships, and school districts). General sales taxes accounted for only 11.1% of total taxes.

<sup>10</sup>Local income taxes represented only 4.7% of total local taxes for 2003 U. S. Census (2003 annual estimates).

strictly controls the tax base and the tax rates that local governments can impose.

## CHALLENGES TO LOCAL FISCAL AUTONOMY

There are no easy solutions to swelling local government fiscal problems. The fiscal pressures experienced by some local governments resulting from rapid population growth represent only one dimension of a broader range of fiscal problems likely to continue and worsen for most local governments. One student of local government finance offers a less than optimistic prognosis:<sup>11</sup>

1. Local government taxing options: Options are likely to decline over time as continued local tax competition and changes in national and global business opportunities reduce local attempts to shift tax burdens onto businesses. Increases in the residential share of overall taxation will limit future tax growth opportunities.
2. Local property tax: The local property tax will continue as the mainstay of local government finance for the somewhat obvious reason that there are no obvious replacements for it. This is especially true in Tennessee where the combined state and local sales tax is already one of the highest in the country and the outlook for some fiscal relief from an income tax appears unlikely.
3. User fees and charges: The evidence in other states already points to an increased dependence on user fees and charges in the local government revenue stream. While not easy to levy and increase, the evidence seems to show that these revenue sources are easier to sell than increased property and sales taxes.

4. State intergovernmental aid: The greatest unknown is the degree to which state governments recognize the fiscal plight of local governments and the degree to which they are willing to belly up to the bar and provide unrestricted state intergovernmental aid. While their willingness to assist local governments in financing local education has grown significantly over the years, state unrestricted aid for other local services (perhaps with the exception of highway and street aid) is not widespread.

**The local property tax will continue as the mainstay of local government finance.**

It must also be noted that the problems faced by local governments are fueled in part by the existing large number of local governments, their boundary-driven local tax bases, and their frequent willingness to compete with one another through various tax breaks and giveaways. While somewhat in its infancy, more cooperation among local governments in the provision of public services, and more sharing of tax-revenue bases would reduce some of the fiscal stress that will continue to accumulate.<sup>12</sup>

<sup>12</sup>See Stenberg, Carl W. 1999. "Structuring Local government Units and Relationships," Presentation at *Symposium on the Future of local Government in Michigan*, June 23-25, 1999. Paper available on October 5, 2005 at website [http://www.mml.org/foundation/structuring\\_relationships.htm](http://www.mml.org/foundation/structuring_relationships.htm).

<sup>11</sup>Peterson, John. 1999. "Financing Local Government Services." Presentation at *Symposium on the Future of Local Government in Michigan*, June 23-25, 1999. Paper available on October 5, 2005 at website <http://www.mml.org/foundation/symposium.htm>.

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- Analyze the functions of local governments and their fiscal powers,
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