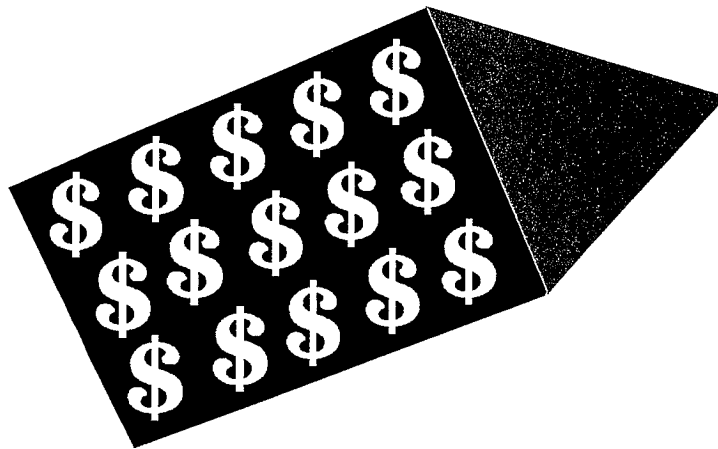


Staff Report

State Shared Taxes in Tennessee



**The Tennessee Advisory Commission on
Intergovernmental Relations**

March 2000

State Shared Taxes on Tennessee

Prepared by:

Principal TACIR Staff Contributors

Harry A. Green, Ph.D.
Executive Director

Stan Chervin, Ph.D.
Consultant

Cliff Lippard
Director of Fiscal Affairs

Other TACIR Staff Contributors

Lynnise Roehrich-Patrick
Director of Special Projects

John Eley, Ph.D.
Senior Research Associate

Frank Costello
Research Associate

Matthew McCrickard
Research Associate

Kim Robertson
Publications Assistant

Other Contributors

Ross Loder, Director of Research
Tennessee Municipal League

Lynne Holliday, Senior Financial Specialist
County Technical Assistance Service

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EXECUTIVE SUMMARY

This report explores the significance of state-shared taxes in Tennessee and the fiscal impact of eliminating such revenue sharing with local governments. This issue was discussed at the December 1999 meeting of the Tennessee Advisory Commission on Intergovernmental Relations (TACIR) at which time the TACIR staff was directed to prepare this report. The Commission discerned that state-shared taxes are a critical issue in the face of a major state fiscal crisis. This crisis has prompted some policy makers to suggest that part of the solution may lie in reducing the level of state-shared taxes provided to local governments.

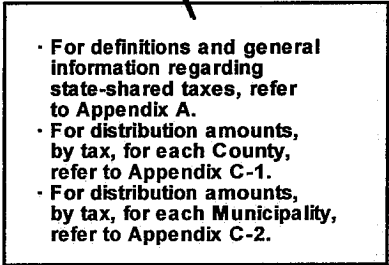
This report focuses on the following state tax sharing topics:

- the importance of state-shared taxes to the state and the local governments;
- volatility and growth trends;
- statutory sharing requirements and restrictions;
- distribution methods; and
- the history of state-shared taxes in Tennessee.

Cities and counties have relied on state-shared taxes to varying degrees for more than one hundred years. Over that time, the amounts and types of taxes shared have grown and now total over \$700 million. Their importance to local governments varies from tax to tax and from place to place. Each tax has its own unique distribution formula—in some cases they favor counties, in some cases cities, and in some cases both are treated alike. Some have restrictions on how they can be used. In addition, the amounts generated by some taxes are more volatile than others, fluctuating widely from year to year. The more volatile taxes make less reliable sources of revenue for recurring obligations. Consequently, the impact on local governments of such volatility varies, depending on the relative importance of the different shared taxes to the local revenue stream. To put the potential impact of a loss in state-shared taxes in perspective, this report presents information on how property tax rates would be affected¹—and how reliable the revenue from property taxes could be—if cities and counties chose that source to replace state-shared taxes.

Taxes Subject to Sharing

As shown in Table *i*, Tennessee shares portions of 13 taxes with its local governments. State gasoline and motor fuel taxes made up more than one-third of all state-shared taxes in fiscal year 1999. Both cities and counties receive these funds each year. Allocations from the state sales and use taxes, which are distributed only to cities, made up another

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- For definitions and general information regarding state-shared taxes, refer to Appendix A.
 - For distribution amounts, by tax, for each County, refer to Appendix C-1.
 - For distribution amounts, by tax, for each Municipality, refer to Appendix C-2.

¹ This information was developed by the University of Tennessee's County Technical Assistance Service (CTAS) and the Tennessee Municipal League (TML), at the request of the TACIR. These two agencies and the TACIR worked together to ensure the accuracy and objectivity of this report.

quarter of the total. Ten other taxes made up the remaining 38 percent.

Table i. Distributions of State-Shared Taxes and Percent of State Total, Fiscal Year 1998-99

State-Shared Revenues By Source	Total Amount Distributed	Percent
Alcoholic Beverage Tax	\$4,748,931	0.7%
Beer Excise Tax	2,993,946	0.4%
Corporate Excise Tax ¹	24,374,866	3.4%
Gasoline Tax & Motor Fuel Tax ²	255,444,850	35.8%
Gross Receipts Tax-TVA Replace. Rev.	65,965,764	9.2%
Special Petroleum Tax	11,897,000	1.7%
Hall Income Tax	57,508,845	8.1%
Mixed Drink Tax	14,573,477	2.0%
Sales and Use Tax	182,745,185	25.6%
Crude Oil & Natural Gas Severance Tax & Coal Severance Tax	600,992	0.1%
Subtotal	\$620,853,856	86.9%
Beer Wholesale Tax ³	\$90,739,293	12.7%
Subtotal	\$711,593,149	99.7%
Distributions to County Technical Assistance Service, Municipal Technical Advisory Service, UT Center for Government Training, and the TACIR ⁴	\$2,467,021	0.3%
Total	\$714,060,170	100.0%

Sources: TN Department of Revenue and Tennessee Malt Beverage Association

¹ Local governments commonly refer to their distributions from this tax as Bank Excise Tax distributions.

² The Tennessee Department of Revenue reports the Gasoline Tax and Motor Fuel Tax distributions as one category.

³ Data on the distribution of the 17% wholesale beer tax has traditionally not been included in the data released by the Department of Revenue. While the tax is a state levy, it has been treated in statistical releases as a local tax since local governments retain most of the revenue (96.5%).

⁴ These distributions to non-local government entities are reported by the TN Department of Revenue under the category of municipal distributions.

Significance to the State

The significance to the state of state-shared taxes is readily apparent when one examines the amounts of recent distributions and projected future distributions, as well as state-shared allocations as a percent of total fund allocations.

During fiscal year 1999, the State of Tennessee shared over \$711 million dollars with its local governments. An additional \$2.5 million in state-shared revenue was distributed to various state agencies, including the Municipal Technical Advisory Service, the University of Tennessee Center for Government Training, the County Technical Assistance Service, and the TACIR. The Budget of the State of Tennessee estimates that state-shared tax distributions will total \$671.3 million in fiscal year 2001. This amount includes distributions to the various agencies in addition to local governments, but it does not include beer wholesale tax

distributions, a state-shared tax often excluded in reports because 96.5 percent of its collections are returned to local governments. Although this tax is collected and remitted by the beer wholesalers, it is still a state tax, with the Department of Revenue responsible for its administration. Wholesalers retain three percent of the gross tax to defray their costs associated with collecting and remitting the tax; the Department retains one half of one percent to cover administration expenses. TACIR staff, using a simple growth estimate, estimated that beer wholesale tax distributions in 2001 will equal \$94.3 million. Adding this estimate to the State Budget estimate produces an estimate of \$765.6 million for total state-shared distributions for fiscal year 2001.

1998 is the latest year for which fund allocation data is currently available. According to the Department of Revenue's forthcoming *Biennial Report* for fiscal years 1997 and 1998, Tennessee allocated \$596 million dollars to its local governments during fiscal year 1998. This amount represented almost nine percent of all state revenue collected by the Department of Revenue and almost twenty percent of otherwise unrestricted revenues allocated to the general fund (\$3,034,680,000—derived by subtracting from the total the amount shown as earmarked in Table ii).

The proportion of state-shared taxes to all state revenue is even larger when one includes distributions from the beer wholesale tax. Adding the \$89 million in beer wholesale tax distributions to local governments for 1998 to the \$596 million in allocations increases state-shared amount to \$685 million. This increases the proportion of state-shared taxes to total revenue to over 10 percent, and the percent of otherwise unrestricted revenues to nearly 23 percent.

Table ii: Allocation of Tennessee Tax Collections by Fund, 1998

ALLOCATED TO GENERAL FUND	\$ 2,438,597,000
Share of Total Funds Allocated	36.12%
ALLOCATED TO OTHER EARMARKED FUNDS	3,716,863,000
Share of Total Funds Allocated	55.05%
ALLOCATED TO COUNTIES FUND	250,632,000
Share of Total Funds Allocated	3.71%
ALLOCATED TO MUNICIPALITIES FUND	345,451,000
Share of Total Funds Allocated	5.13%
Sum of shares of county & municipal funds	8.84%
TOTAL ALLOCATED	\$ 6,751,543,000

Source: TN Department of Revenue *FY 1997 & FY 1998 Biennial Report*, forthcoming.