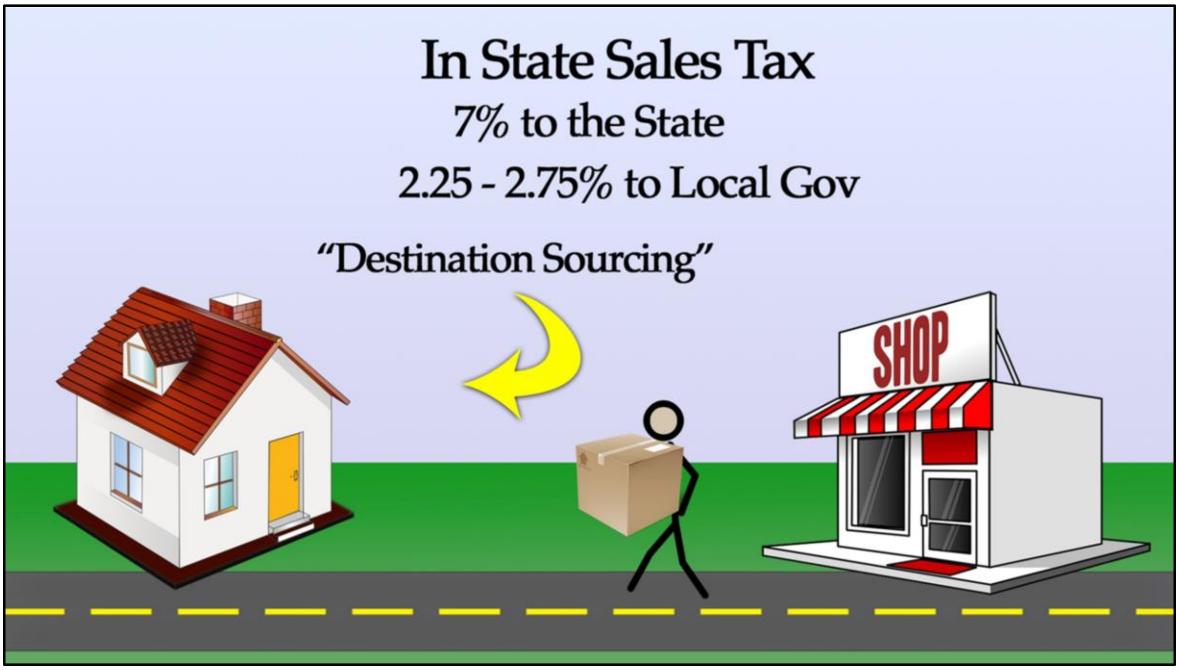
2019 Priorities



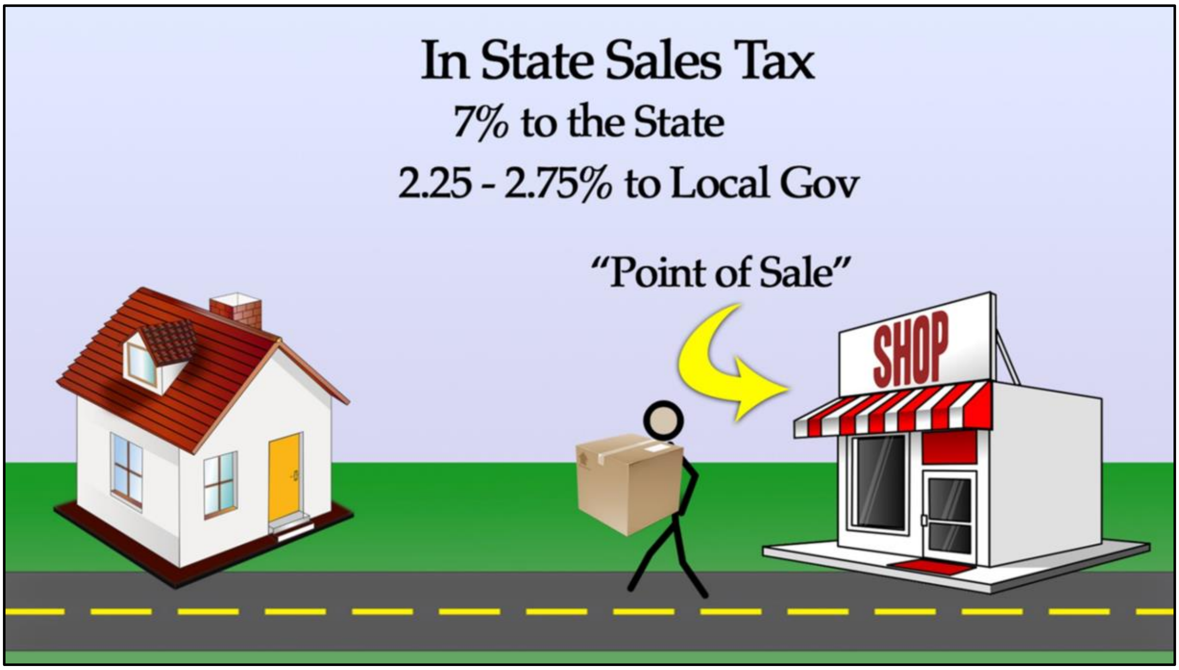
MANDATORY SALES TAX COLLECTION FROM OUT-OF-STATE SELLERS

In their 2018 decision South Dakota v. Wayfair, Inc., the Supreme Court ruled that states may charge tax on purchases made from out-of-state sellers with substantial sales in that state, even if the seller does not have a physical presence in the taxing state.

In 2007, Tennessee adopted the Streamline Sales & Use Tax Agreement which simplified our state's tax code so that out-of-state sellers could more easily navigate and remit sales tax collections to Tennessee and its many taxing jurisdictions. This law, or some new bill adopting similar measures, creates the necessary framework that allows Tennessee to take advantage of the *Wayfair* ruling and require mandatory sales tax collections from out-of-state sellers. However, not all provisions in the 2007 law have taken effect in Tennessee, and some of the provisions that have taken effect need adjustment to make the law workable.

When Tennessee adopted the measures included in the Streamline Sales & Use Tax Agreement (2007) **"destination sourcing"** was a requirement. This is desired for online/out-of-state sales tax collections because those revenues should flow to the situs of the buyer: the revenues follow the good to its "destination."

However, if the delayed provisions in the law adopted in 2007 were allowed to go into effect without modification, in-state purchases would also be subject to destination sourcing. This would mean that if a resident of City A purchased a home furniture set in City B, when that furniture is delivered to the resident in City A the tax money would follow the "destination sourcing" to City A. City B, which made investments to create the conditions for that business to operate in City B would lose the tax revenue that followed the purchase to City A.



It's essential to ensure "point of sale sourcing" for in-state purchases that keep local tax dollars in the community making the investments that support economic development. A dollar spent in City B should stay in City B.

Effects of Streamline: Destination Sourcing for In-state Purchases

- 2003 UT Study
- 193 cities increase of $19 million ($26.1 million)
- 150 cities decrease of $57 million ($78.3 million)
- Loss 3X Gain

A 2003 study commissioned by TML demonstrated that winners and losers would be created by a change from “point of sale” to “destination” sourcing, with the losers missing out on $78.3 million in 2018 dollars based on the conditions and estimates of 2003. The losses would be three times as great as the gains to communities that benefit from the change.

Cities and counties agree: local dollars should stay local.

Single Article Cap

Up to $1,600		
Taxing Jurisdiction	**Tax Rate**	**Recipient of Revenues**
State	7%	State
City	2% - 2.75%	City

$1,601 - $3,200		
Taxing Jurisdiction	**Tax Rate**	**Recipient of Revenues**
State	7%	State
City	2.75%	State

Another issue related to adopting the provisions of the Streamline Sales Tax Agreement is how it affects our state's Single Article Cap provisions. In the early 2000's, when the state faced a budget shortfall, the state raised the single article cap from $1,600 to $3,200. However, the state applied a universal 2.75% "local" rate to the dollars between $1,601 - $3,200 and kept all those additional revenues for the state.

Effects of Streamline: Single Article Cap

Current Law

Up to $1,600		
Taxing Jurisdiction	Tax Rate	Recipient of Revenues
State	7%	State
City	2% - 2.75%	City
$1,601 - $3,200		
Taxing Jurisdiction	Tax Rate	Recipient of Revenues
State	7%	State
City	2.75%	State

Delayed TN Provision

Up to $1,600		
Taxing Jurisdiction	Tax Rate	Recipient of Revenues
State	7%	State
City	2.50%	City
$1,601 - $3,200		
Taxing Jurisdiction	Tax Rate	Recipient of Revenues
State	7%	State
City	2.50%	City

The Streamlined Sales Tax Agreement adopted by Tennessee in 2007 requires universal rates for out-of-state sellers. A provision in the 2007 Act, the implementation of which has been delayed until July 1, 2019, adopted a universal 2.5% local rate for the Single Article Cap and appears at first glance to direct those revenues to the proper local jurisdiction. But, there's a catch…

Effects of Streamline: Single Article Cap

Up to $1,600

Taxing Jurisdiction	Tax Rate	Recipient of Revenues
State	7%	State
City	2.50%	City

$1,601 - $3,200

Taxing Jurisdiction	Tax Rate	Recipient of Revenues		
State	7%	State		
City	2.50%	City	▶▶▶▶	Remitted to State

The delayed provision also expects local governments to remit those revenues to the state at the end of each tax year. This is an unworkable solution. There's no way for local governments to account for what sales tax revenues are the result of out-of-state, single article cap provisions so as to calculate the remitted amount.

Effects of Streamline: Single Article Cap

- State loses sales tax revenue as a result of uniform rate requirement
- Cities burdened by cumbersome remittance process

Solutions are needed to maximize the sales tax revenue from the uniform rate, and to ensure that cities aren't burdened by a cumbersome and unworkable remittance process.

TML Initiatives

- Adopt mandatory online sales tax collections for out-of-state sales
- Preserve point-of-sale sourcing for in-state sales
- Modify single article provision to ensure workable solution

TML supports adopting mandatory online sales tax collections for out-of-state sellers, preserving point-of-sale for in-state sales, and modifying the single article cap provisions to meet the necessary standards of the Streamline Sales Tax Agreement without burdening local governments with an unworkable remittance process.

INCREASE IN THE PERCENTAGE OF STATE SALES TAX REVENUES SHARED WITH CITIES

In the early 2000s, there was a significant state budget shortfall. The shortfall was so severe that the General Assembly considered imposing a state income tax in order to eliminate the shortfall and produce a balanced budget.

In the end, a state income tax was rejected and the budget shortfall was addressed through a combination of budget actions. While these actions had the intended effect of increasing state revenues and helping to produce a balanced state budget, these actions adversely affected municipalities.

WHY DOES THE STATE SHARE PORTION OF STATE SALES TAX WITH CITIES?

- Tennessee heavily reliant on sales tax to fund state operations
- Cities generate 92% of all the State's sales tax collections
- City residents' taxes finance infrastructure, services, amenities that attract and support businesses that generate revenues
- 1947 – General Assembly returns small portion of state sales tax collections to city taxpayers to offset local tax burden associated with generation of sales tax for the State.

The first adverse action was a reduction in the amount of state sales tax shared with cities.

Tennessee relies upon sales tax to fund its budget.

Ninety-two percent of the state's annual sales tax collections are generated within city limits.

City taxpayers fund local investment in infrastructure, city services, amenities and other activities intended to create an attractive business climate and to support and preserve business operations through their city taxes.
As a result, city taxpayers incur a significant tax burden in order to facilitate the production of billions in sales tax collections for the State each year.

In 1947, the General Assembly realized the heavy tax burden being borne solely by city residents to generate revenues that were used to fund State programs and services across the State. In recognition of this burden, the General Assembly began providing a small portion of state sales tax collections would be returned to cities each year to help offset city taxpayers' burden.

Reduction in Portion of State Sales Tax Collections Shared with Cities

1992 – State Sales Tax Rate Increase from 5.5% to 6%.

- .5% increase earmarked for education
- No portion of the increase shared with cities

2002 – State Sales Tax Rate Increase from 6% to 7%

- 1% increase earmarked for general fund
- No portion of the increase shared with cities

The State continues to share a small portion each year; however, there have been changes over the years that have reduced the benefits of this sharing arrangement.

First, the General Assembly increased the state sales tax rate from 5.5% to 6% in 1992. All of the revenues generated by the .5 % increase are earmarked for education. Consequently, city taxpayers do not receive any benefit as this portion of state sales tax collections are outside the 1947 sharing arrangement.

Second, the State made two additional changes to address the budget shortfall and avoid imposition of a state income tax in 2002: The General Assembly increased the state sales tax rate from 6% to 7%. All of the revenues generated by the 1% rate increase were earmarked for the State's general fund. Consequently, city taxpayers do not receive any benefit as this rate increase is outside the 1947 arrangement.

Reductions in Amount State Sales Tax Shared with Cities

State Sales Tax Rate	7.0%
• Earmarked for Education **(1992)** and outside state sharing arrangement	- .5%
• Earmarked for State General Fund **(2002)** and outside state sharing arrangement	- 1.0%
As a result, the State is only sharing portion of sales tax attributable to 5.5% of state's 7% sales tax rate	**5.5%**

The combination of:

1. The '92 increase (.5%) and the '02 increase (1%) in the state's sales tax rate, and

2. The decoupling of both increases from the sharing arrangement enacting in 1947

results in the total amount of state sales tax subject to sharing under the 1947 arrangement to be only those revenues associated with the last 5.5% of the state's 7% sales tax levy. Revenue produced by the first 1.5% of the states' 7% sales tax levy flows wholly to the State.

Reduction in Portion of State Sales Tax Collections Shared with Cities

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- 1% increase earmarked for general fund
- No portion of the increase shared with cities

2002 – Instituted 10% reduction in the amount of state sales tax collections shared with cities under 1947 law.

A third change to the sharing arrangement occurred in 2002 as well.

In addition to decoupling the 1% increase, the General Assembly took the additional step of reducing the total amount of state sales tax collections it shared with cities by 10%.

Single Article

First $1,600 of single article/item

Levy:	Revenues Flow To:
• 7% state sales tax	State
• 2 - 2.75% local sales tax	Local Government

Between $1,601 and $3,200 of single article/item

Levy:	Revenues Flow To:
• 7% state sales tax	State
• 2.75% local sales tax	State

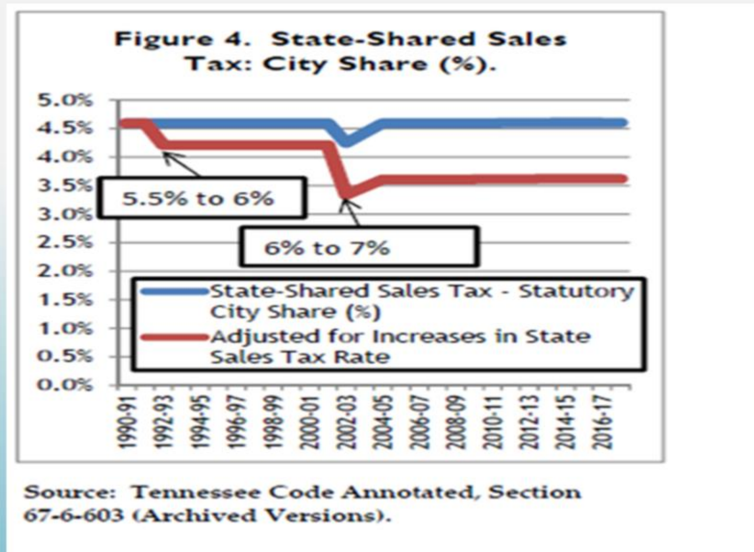
Regrettably, decoupling the 1% increase in the sales tax rate from sharing and reducing the distribution of state sales tax revenues weren't the only changes enacted in 2002 that adversely affected cities.

The General Assembly also chose to increase the single article cap --- that is it increased the portion of the purchase price of a single article or item that is subject to the state sales tax.

Prior to 2002, only the first $1,600 of the sales price of any item was subject to sales tax. The budget shortfall led the General Assembly to raise the amount of each purchase subject to sales tax from $1,600 to $3,200.

Then, the General Assembly took it one step further. In order to generate even more revenue for the State, the General Assembly also decided to keep not only the proceeds from the 7% state sales tax but also the proceeds from the full 2.75% local levy above $1,600.

Denying cities the ability to keep the local sales tax collected on items in excess of $1,600 increases state revenues at the expense of cities.



Two of the three changes implemented in 2002 for the expressed purposes of addressing a budget shortfall remain in effect today-- nearly two decades after the budget crisis was averted.

Eventually, the 10% reduction in state sales tax distributed to cities was eliminated and the rate to be distributed was returned to the level established in 1947.

However, the actions taken to decouple the increased sales tax rate and the 1947 sharing percentage as well as the decision to deny cities the local share on the sales tax levied on an item that cost in excess of $1,600 are still in place.

This fall, TACIR produced a report that determined that the net effect of these two changes has significantly reduced the amount of state sales tax revenues shared with cities. [Red line versus blue line]

Cities continue to generate virtually all of the state sales tax collections utilized to fund most of the State’s operations and programs. Yet, the small amount of state sales tax shared with cities to offset the city taxpayer’s tax burden continues to shrink, whether measured in actual dollars or as a benefit to city taxpayers.

Tax Changes Leading to General Fund Reductions
2012 - Present

2012 Food Tax (5.5% to 5.25%)	($589,764)
2013 Food Tax (5.25% to 5%)	($807,600)
2012 Hall Income Exemption (26k/37k)	($514,700)
2013 Hall Income Exemption (33k/59k)	($668,400)
2015 Hall Income Exemption (37k/68k)	($434,900)
2016 Hall Income Rate Cut (6% to 5%)	($12,826,200)
2017 Hall Phase Out/Food Tax Cut (5% to 4%)	($82,248,140)
Total Changes	**($98,089,704)**

In addition to these steps taken by the General Assembly, the General Assembly has enacted legislation directly reducing city revenues by nearly $100 million over the last six years.

TML Initiative

- Increase the percentage of state sales tax collections distributed to cities on a per capita basis from .0463% to .0590%

To help cities recover the revenues lost over the last decade as a result of supposedly temporary initiatives enacted to address a 2002 budget shortfall and to offset the ill effects of the nearly $100 million in city revenues reduced by more recent legislation, Tennessee's cities are asking legislators to support a bill to increase the portion of state sales tax collection distributed to cities from .0046% to .0059%.

Equivalent to CMFO Program Requirements

The following individuals are exempt from the requirements leading to the CMFO designation, but must comply with continuing professional education (CPE) requirements:

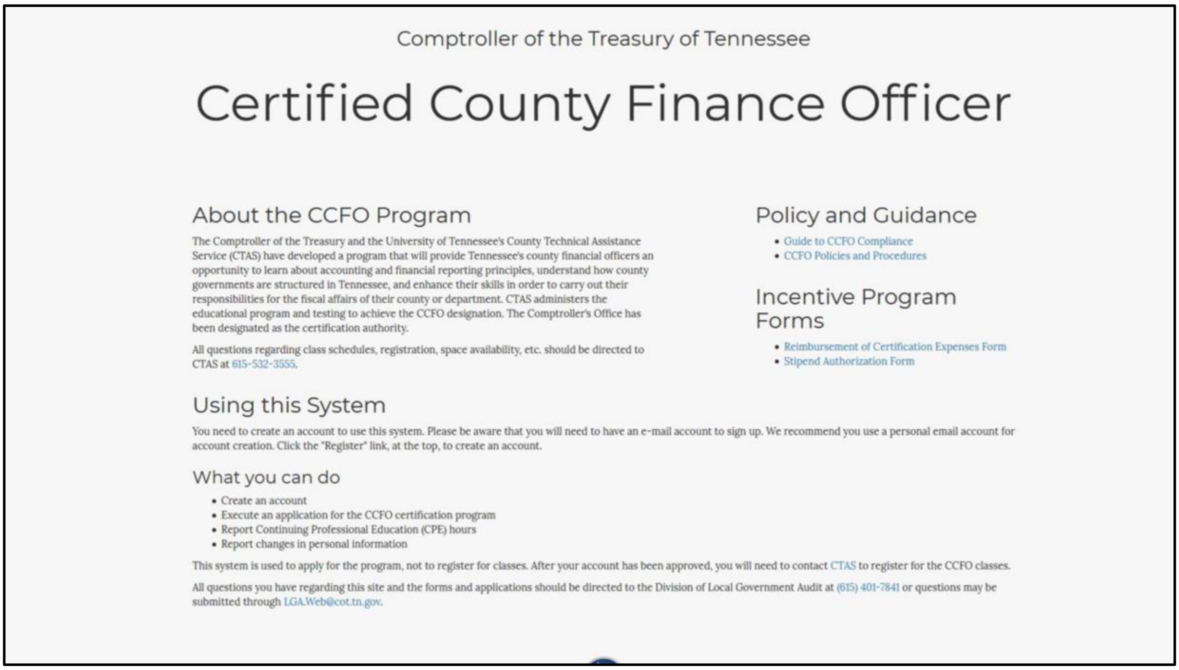
- An individual designated as a certified government finance manager (CGFM) by the Association of Government Accountants.
- An individual designated as a certified public finance officer (CPFO) by the Government Finance Officers Association.
- An individual licensed as a certified public accountant (CPA) by the state board of accountancy and in active status and who has a minimum of five years of primarily governmental experience with at least three of those years in Tennessee.

MUNICIPAL CMFO REIMBURSEMENT FROM THE STATE

In 2007, the General Assembly enacted legislation that required each municipality to employ either a certified municipal finance officer (CMFO) or an individual with equivalent professional qualifications such as a certified public accountant, certified public finance officer or a certified government finance manager.

MTAS, in conjunction with the State Comptroller of the Treasury, develops the curriculum and provides the training and testing leading to the CMFO designation.

To maintain certification, a CMFO must earn at least 24 CPE (continuing professional education) hours per year, at least 16 must be classified as financial per CMFO categories.



The Comptroller and CTAS have developed a similar program, the Certified County Finance Officer (CCFO), for county finance professionals.

CTAS administers the educational program and testing required to achieve the Certified County Finance Officer (CCFO) designation. The Comptroller’s Office has been designated as the certification authority. This certification is voluntary and not mandated by state statute.

CMFO / CCFO Comparison

	CMFO	CCFO
Date Established/Implemented	2007 -2013	2015-2018
Objective	ensure competence in the handling of municipal funds and the protection of public moneys	ensure competence in the handling of county funds and the protection of public moneys
Authorization	State Statute (TCA)	Administrative Program (within Comptroller's Office)
Administering Agency (for training and testing)	MTAS	CTAS
Curriculum	11 Courses	11 Courses
Participation in Program	Mandatory	Voluntary
Certification Authority	Comptroller's Office	Comptroller's Office
Maintain Certification Requirements	24 Continuing Professional Education (CPE) hours; 16 hours must be financial training	16 CPE hours of financial training
Stipend	None	One-time $1,000 stipend to qualified county employees for initial training
Reimbursement of Travel Expenses	None	Reimbursement to county for travel expenses incurred for initial training

The problem is an equity issue. While the CMFO and CCFO programs are similar, there are some notable differences.

CMFO / CCFO Comparison

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The CCFO program, which is voluntary, contains a reimbursement component for the initial training courses in the form of a one-time $1,000 stipend paid to the candidate upon completion of the courses and reimbursement to the employer for travel expenses incurred by an employee attending the initial training classes.

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There is no reimbursement or stipend available to municipalities for the CMFO program, which is mandatory.

TML Initiatives

- $1,000 Stipend upon Receipt of Certificate
- Seek Funding for Reimbursement of Travel Expenses Associated with Training

The TML Board has directed staff to develop a reimbursement program for municipal officials who successfully complete the CMFO program to offset the cost of compliance with this mandate. The county CCFO reimbursement program can serve as the model.

DRIVE-THRU WINDOW SALES FOR PACKAGE STORES

The Tennessee Alcoholic Beverage Commission (TABC) is a state agency that regulates the sale of wine and liquor.

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Historically, liquor sales have been restricted to “on-premises” sales, which meant sales were restricted to within the four walls of the liquor store. TABC has long held that drive-thru windows and liquor store parking lots were outside the four walls. Therefore, the sale of alcohol through a drive-thru window or in a parking lot were not permitted under law.

In 2014, the General Assembly enacted the “Wine in Grocery Stores” legislation (Public Chapter 554). This legislation included a provision that allowed liquor stores to deliver alcohol to special events and catered functions outside the four walls of the liquor store.

Public Chapter 554, 2014
(Wine in Grocery Stores Legislation)

Section 12. Tennessee Code Annotated, Section 57-3-406, is amended by adding the following as a new subsection thereto:

(j)(1) Notwithstanding any provision of title 57 to the contrary, retailers licensed under § 57-3-204 are authorized, for a fee or without a fee, to provide, within the state, consulting services related to the products, merchandise and supplies which the retailer is authorized to sell under§ 57-3-404(e) and alcoholic beverages, and supply, deliver and install products authorized to be sold by the retailer to locations outside of the licensed premises in connection with special events, parties, alcoholic beverage tastings, educational classes and the establishment of private collections or wine cellars.

Regrettably, TABC has interpreted this grant of authority broadly to permit package stores to sale alcohol "off- premises." With this new, expansive interpretation, TABC has chosen to extend authority to not only allow for the delivery of alcohol to special events and catered functions, but to also permit the sale and delivery of alcohol through a drive-thru window or parking lot.

Municipalities establish, regulate and enforce the sale of beer in the state. Some municipalities currently prohibit beer sales through drive-thru windows and have relied on the long-held TABC position prohibiting the sale of alcohol through drive-thru windows to ensure consistency and protect local preferences. However, the new TABC interpretation is at odds with existing community standards and desires. As municipalities may not regulate package stores or the sale of alcohol, cities and their residents are powerless to protect their standards and preferences.

TML Initiatives

- Provide discretionary authority to prohibit drive-thru sales at package liquor stores

The law should be modified to ensure the protection of local preference. Legislation should be introduced to provide a city the discretionary authority to enact an ordinance prohibiting the sale of alcohol from a drive-thru window at any package store located within its corporate limits.