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THE PROPERTY TAX IN TENNESSEE

A SUMMARY OF TACIR REPORTS ON THE PROPERTY TAX AND PROPERTY TAX ISSUES 1999-2010

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This report is the sixth and final in TACIR's recent series of special reports on the property tax in Tennessee, all completed since February 2009. The first five reports in the series covered significant concerns with the property tax in Tennessee, including greenbelt valuation, tax base disparity, local dependence on the property tax, utility taxes, and property tax circuit breakers. While this report provides summaries of the five reports addressing these concerns, it also provides a broader perspective, reviewing TACIR property tax reports dating back to 1999.

As noted in *Intergovernmental Challenges and Achievements: Twenty-five Years in Review* (April 2006), TACIR actually began in-depth studies of the property tax as early as 1981, when the Commission undertook a study on the issue of property tax modernization in Tennessee. The Commission conducted public hearings and studies that resulted in a published Commission Report, *Property Tax Modernization* (March 1984). That report included numerous recommendations for changes in the way the state's property tax was being levied and administered.

While TACIR continued to study property taxes following that first report, a more deliberate agenda focused primarily on local taxes began in earnest in 1999 following the publication of *Financing Tennessee Government in the 21st Century* (January

TACIR'S COMPREHENSIVE PROPERTY TAX SERIES

- *The Cost of a Property Tax Circuit Breaker Program in Tennessee* (March 2010)
- *Taxing Utilities in Tennessee* (October 2009)
- *The Importance of the Property Tax Among Tennessee Counties* (May 2009)
- *Property Tax Disparity Among Tennessee Counties: An Analysis of Changes in Real Per Capita Property Tax Bases* (March 2009)
- *Greenbelt Revisited* (February 2009)

1999). While this publication focused primarily on fiscal challenges facing state government in the 21st Century, it noted that local governments faced similar challenges, all the more daunting given that their fiscal flexibility depended primarily on only two taxes—the property tax and the local option sales tax. The latest reports, in conjunction with other reports dating back to 2002, support several key findings and recommendations related to the property tax:

- The property tax is the most important source of tax revenue in 94 of the 95 counties in the state. This dependence will increase as the second major source of tax revenue, the local option sales tax, becomes more and more restricted as a result of the statutory cap of a 2.75% rate.

- The residential share of the total property tax burden in the state will continue to rise as residential property assessments continue to grow faster than utility, commercial, and industrial assessments.

- Exemptions, preferential assessment rules, and various tax incentive programs that impact property tax liabilities cost local governments millions of dollars in uncollected taxes. They also impose unfair tax burdens on households and businesses that enjoy no property tax breaks or subsidies and, as a result, bear more than their fair share of the local tax burden.

- Property tax base and sales tax base disparities remain significant among Tennessee counties and municipalities. While the fiscal impact of such disparities has been somewhat muted by programs such as the Basic Education Program (BEP), which provides state aid for local education services, little has been done to offset the impact of such disparities as they affect the provision of other local services.

- The importance of the property tax to local governments in Tennessee will continue to rise, given the limited fiscal alternatives currently available to local governments. Rising property taxes will, in turn, increase calls for a broader form of property tax relief than currently exists. This will, in turn, require the state to assume more responsibility for property tax relief and establish a state revenue stream with which to fund the relief.

TACIR'S COMPREHENSIVE PROPERTY TAX SERIES

The first report in the latest TACIR series is *Greenbelt Revisited* (February 2009). This report noted that most states, including Tennessee, authorize special property valuation rules for certain agricultural and forestry landholdings (known generally as greenbelt property). Such property is generally valued for assessment and taxation purposes at a fraction of its market value. The end result is a subsidy for those owning such land and generally, an increased property tax liability for those (in the same taxing jurisdiction) that do not qualify for the subsidy. This report looks at the history of greenbelt legislation, the complex rules and evaluation methods required in its administration, the relative impact of greenbelt valuations among Tennessee counties, and an example of its dramatic impact on property assessments in a small area in Williamson County. The report then provides some options for tightening eligibility requirements for participation in the greenbelt program, and changes to the penalties that apply when previously eligible greenbelt properties become ineligible for the program.

Property Tax Disparity Among Tennessee Counties: An Analysis of Changes in Real Per Capita Property Tax Bases (March 2009). Much has been written on the wide variation in property tax bases among counties. This report analyzes the disparities that exist in inflation-adjusted per capita property tax bases among counties, and changes in this measure at different points in time (1986 versus 1996, 1996 versus 2006, and 1986 versus 2006). Counties with relatively high inflation-adjusted per capita assessments and healthy increases in per capita inflation-adjusted assessments are expected to be fiscally healthier than those at the opposite end of the spectrum. In fiscal year 2006, inflation-adjusted per capita assessments varied from a low of $7,720 in Grundy County to a high of $30,527 in Sevier County.

The Importance of the Property Tax Among Tennessee Counties (May 2009). This TACIR brief updates a previous analysis of the importance of property taxes versus local option sales taxes. The data evaluated consisted of estimated combined county and city property tax collections (counties and cities are not currently required to submit such information to a single state agency) and local option sales taxes (as reported by the Department of Revenue for each county). Data for fiscal years 1987, 1997, and 2007 were included in the analysis. The data show only minor changes in the relative importance of property versus sales tax between fiscal years 1987 and 1997, but a significant shift by 2007. Property taxes, that represented 65.5% of combined property and sales tax collections in fiscal year 1997, increased in importance to 70.5% of combined collections in fiscal year 2007. Reasons for this increase in the relative importance of property taxes include:

(1) rising number of local governments have maxed out their local option tax rate at 2.75%;

(2) the sales tax base itself is inelastic over the long run;

(3) leakages in the sales tax base from untaxed remote sales continue to rise;

(4) the initial (1992) increase in state education aid to local governments (BEP) helped to hold down property tax increases, but this initial spurt in aid has run its course; and

(5) local governments have no other significant taxing authority.

Taxing Utilities in Tennessee (October 2009). The report on utility property taxation is divided into two sections. The first describes and discusses the history, importance, and taxation methodology of utility taxation in Tennessee and in other states. The second section focuses on the telecommunications industry and the unique challenges faced in many states, including Tennessee, in applying traditional utility taxation methods to an industry that has undergone dramatic technological and structural changes over the last thirty years.

The Cost of a Property Tax Circuit Breaker Program in Tennessee (March 2010). The last of the reports on selective property tax issues focuses on existing property tax relief programs in Tennessee, the limited assistance provided by these programs, and the potential cost of a broader circuit breaker type of property tax relief program. Simulations that provide property tax relief to households with poverty income level through households with up to 200% of poverty income demonstrate the potential high cost of a circuit breaker type property relief program.

EARLIER REPORTS

The Local Property Tax in Tennessee (February 2002). This was the first of three publications devoted specifically to local government finance in Tennessee.[1] The report chronicled the history of the property tax in Tennessee, addressed the issue of the tax's elasticity and stability (by county), evaluated the equity of the tax (both horizontal and vertical measures of equity), discussed and measured the significant disparities in county per capita assessments, and concluded with the outlook for the property tax in the future. That report noted that despite its shortcomings, in the absence of significant new state intergovernmental aid or increased home rule taxing authority, the property tax is likely to increase in importance in local government finance.

In 2003, TACIR released a major study of property tax assessment in Tennessee, *The Office of the Property Assessor in Tennessee* (March 2003). Its recommendations included creating a more tiered or structured professional education program for assessors, their deputies and staffs; adopting a staffing model for all assessors to use as a guide; establishing requirements for more standardized budgeting techniques by assessor offices across the state; and requiring specific additional training after an assessor has been elected to office.

Property Tax Abatements and Payments in Lieu of Taxes: Impact on Public Education (February 2004). Public Chapter 815 (2002) directed TACIR to study the impact of various property tax abatement programs on the funding of local education. While local governments in Tennessee cannot offer tax abatements to private properties, they can provide comparable tax relief through programs offered by industrial development boards. Such public boards can issue bonds to construct facilities (that are themselves tax-exempt), lease the facilities to private businesses, and require payments in lieu of taxes (PILOTs) from the lessees. Such programs are intended to attract new economic activity and employment to a jurisdiction or retain existing business activities. The question addressed is whether the net impact of such programs has a positive or negative impact on local education financing. The study determined that the existing data provided and collected on PILOT programs was insufficient to evaluate the net impact.

Local Government Property Tax Revisited: Good News and Bad News (July 2006). This report reviewed long run trends in property tax assessments, changes in the relative importance of property versus local option sales taxes between fiscal year 1999 and fiscal year 2005, and identified challenges facing the property tax in the future and possible options to deal with those challenges.

Tax Increment Financing, Opportunities and Concerns (March 2007). This report documents one of the fastest growing economic development tools used to jumpstart economic activity in targeted and generally blighted areas. Tax Increment Financing (TIF) is now offered in almost every state in the country and, over time, has been expanded to cover commercial, industrial, and even residential development activities. TIFs generally use public funds to buy, redevelop, or otherwise

[1] The second publication on local government finances focused on the local option sales tax (June 2002), and the third on miscellaneous local taxes and fees (August 2002).

improve some targeted, undeveloped local area as an incentive for further private investment. All or part of any increased tax collections (most often property taxes) are then used to pay for the cost of the public improvements made that enabled the private development to take place. The report evaluates TIF in Tennessee and makes recommendations for improving the economic efficiency of TIF programs.

Property Tax Reduction and Relief Programs (June 2007). The report describes the various types of property tax relief and reduction programs in use in the United States and their availability in each state. Most states provide some type of tax relief either through some form of exemption, credit, circuit breaker, or tax deferral program. Many states also provide general property tax reduction through laws that limit property tax growth through caps on assessments, tax rates, or property taxes themselves.

Getting it Right: The Effect on the Property Tax Base of Economic Development Agreements and Property Tax Incentives for Businesses (January 2008). This research brief focuses on issues raised by a new state requirement that business payments in lieu of taxes (PILOTs) to local governments be included in the calculation of local fiscal capacity. PILOTs are generally made to local governments partly to compensate them for property taxes not collected on tax exempt real and personal property owned by local governments but leased to for-profit businesses. Available evidence shows that economic development agreements (EDAs) and PILOT information currently collected and made available is incomplete and results in an understatement of the true value of tax exempt property owned by economic development agencies around the state.

CLOSING REMARKS

TACIR has conducted a considerable amount of research on the property tax over the last several years. It is likely that the Commission will return to the topic many times again in the future as the local reliance on the property tax grows and as many of the concerns already studied continue to linger.

TACIR Publication Policy

This brief is the sixth and final in this series of staff-generated special reports on the property tax in Tennessee. This series is part of TACIR's fiscal year 2010 work program that was approved by the TACIR Commission on June 30, 2009.

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