S T A T E O F T E N N E S S E E
OFFICE OF THE
ATTORNEY GENERAL
PO BOX 20207
NASHVILLE, TENNESSEE 37202

February 9, 2004

Opinion No. 04-017

Allocation of Portion of Business Tax Revenues to the State

QUESTION

Is it permissible for the Legislature to allocate to the State a portion of the revenues from business taxes imposed by cities and counties, with the result that from businesses located within a city the State receives revenues based on both city and county business tax rates, while from businesses located outside any municipality the State receives revenues based on only the county business tax rate?

OPINION

Yes. There are no constitutional problems presented by such a business tax structure.

ANALYSIS

Tennessee law authorizes each county and incorporated municipality to impose a tax on the gross receipts of businesses within its borders. Tenn. Code Ann. § 67-4-704. The maximum rates that each locality may impose are set out in Tenn. Code Ann. § 67-4-709(b). But it is clear from the wording of § 67-4-704 that localities may choose to impose lesser rates. Op. Tenn. Atty. Gen. No. 02-084 (Aug. 2, 2002).

Traditionally, 15% of all business tax collections have been paid over by the local collectors to the Commissioner of Revenue and allocated to the State's general fund, in accordance with Tenn. Code Ann. § 67-4-724(a)(1). In addition, if the local collector fails to collect the tax and it is delinquent for more than six months, the Commissioner has the duty to step in and collect the tax and allocate it to State purposes. Tenn. Code Ann. § 67-4-719(c)-(e).

The State component of the tax became much more significant, however, with the passage of the 2002 amendments to the tax. Chapter No. 856 of the 2002 Public Acts, section 9, increased the maximum rates by 50% to the levels now specified in Tenn. Code Ann. § 67-4-709(b). Further, that Act provided that the increase in revenues be allocated entirely to the State. Thus, Tenn. Code Ann. § 67-4-724(a)(2) now directs:

> Each local collector of each county and/or incorporated municipality shall pay the Commissioner all increased revenues directly attributable to the 2002 amendments to § 67-4-709(b), provided by Public Chapter 856, §9a.

Thus, the State now receives a significant portion of business tax revenues. The mechanics of this distribution are set out in some detail in Op. Tenn. Atty. Gen. No. 02-084 (Aug. 2, 2002).

The 2002 amendments, however, do not alter the basic operation of the business tax. Previously, the State received 15% of both city and county business tax collections; now it receives that same amount, plus all of the revenue from the increase in rates. A feature of both these regimes, before and after the 2002 amendments, is that the State receives its revenue components from both the county and city collections. Thus, essentially, businesses located in an incorporated municipality pay two business taxes, one to the city and one to the county, while businesses located in the unincorporated areas of a county pay only the county tax. The State accordingly receives two tax payments from businesses located in cities that levy the tax, one funneled through the county collector and one funneled through the city collector. Meanwhile, the State receives only one business tax payment from businesses located in the portion of a county outside any municipality. While the exact amounts may differ because of the various local tax rates, businesses located in cities are generally contributing about twice as much in business taxes to State coffers as businesses located outside city limits.

The instant question is whether this arrangement presents any constitutional problems. This Office believes that it does not. With very few limitations, the structure of the State's tax system is a policy choice for the General Assembly. As "the right to tax is essential to the existence of government, and is particularly a matter for the Legislature," one seeking to challenge a Tennessee revenue statute "bears a heavy burden." *Nolichuckey Sand Co., Inc. v. Huddleston*, 896 S.W.2d 782, 788 (Tenn. Ct. App. 1994), *quoting Vertress v. State Board of Elections*, 141 Tenn. 645, 214 S.W. 737, 740 (1919). Facing such a challenge, a court need only to be able to envision a legitimate justification upon which the Legislature could have acted. *Civil Service Merit Board v. Burson*, 816 S.W.2d 725 (Tenn. 1991). And as the Supreme Court recently summed up in *City of Chattanooga v. Davis*, 54 S.W.3d 248, 276 (Tenn. 2001),

> unless the classification "interferes with the exercise of a 'fundamental right' or operates to the peculiar disadvantage of a 'suspect class,'" Article XI, section 8 requires only that the legislative classification be rationally related to the objective it seeks to achieve.

The disparate impact of the State's component of the business tax is a result of the local nature of the tax and the overlapping of local government jurisdictions in Tennessee. These features of Tennessee government obviously serve many legitimate purposes, prominent among them being affording a measure of self-government to localities across the state. This structure, in and of itself, does not present problems of double taxation or concerns that would otherwise rise to a

constitutional level. Op. Tenn. Atty. Gen. No. 03-103 (Aug. 19, 2003). By its 2002 amendments, the General Assembly essentially increased the business tax by 50% and allocated all of that increase to State purposes. Viewed from this perspective, the Legislature's action had a rational basis. The law simply requires that a significant portion of locally collected business tax revenues now flow to the State. The Legislature often distributes money to cities and counties under different formulas, and it is just as reasonable for it to take money from localities in a way that may impact businesses in cities and counties differently.

It is unusual for a State tax to bear differently in some parts of the state than in others. But, even if this arrangement is characterized as a legislative scheme that results in double taxation of city businesses, there are many conceivable reasons why the Legislature might deem city businesses more proper subjects of taxation than county businesses. In the first place, as discussed in Op. Tenn. Atty. Gen. No. 03-103, double taxation does not violate the Constitution if the Legislature plainly intended that result. Cities generally have more commercial activity and are more lucrative sources of revenue than rural areas. Thus, the Legislature might have thought city businesses better able to bear the burden of business taxes. Cities generally have more powers and more centralized governmental structures than counties, and the Legislature might reasonably have deemed them better able financially to contribute to the State's needs.

These and innumerable other rational bases are more than sufficient to justify the business tax structure in Tennessee, even with its increased State component resulting from the 2002 amendments. Therefore, it is the opinion of this Office that the present business tax structure readily passes constitutional muster.

PAUL G. SUMMERS
Attorney General and Reporter

MICHAEL E. MOORE
Solicitor General

CHARLES L. LEWIS
Deputy Attorney General

Requested by:

The Honorable Paul R. Stanley
State Representative
113 War Memorial Building
Nashville, TN 37243-0196