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Opinion No. 08-101

Financing for a Religious Entity under Tenn. Code Ann. §§ 67-4-3001, *et seq.*

QUESTION

May Rutherford County officials legally authorize the use of tax increment financing under Tenn. Code Ann. §§ 67-4-3001, *et seq.,* for a religious, privately-owned business entity?

OPINION

Tennessee statutes appear to authorize use of taxes levied under the statutes to finance any "project" that meets statutory criteria. Included within the term "project" is a privately-owned amusement park. Nothing in these statutes prohibits financing solely because it would benefit a "religious," privately-owned business entity.

Whether governmental aid violates the Establishment Clause of the United States Constitution depends on all the circumstances, not simply the status of the organization that the aid benefits. In making this determination, courts use the following guidelines. First, when it is claimed that a denominational preference exists, the initial inquiry is whether the law facially differentiates among religions. Second, if no such facial preference exists, courts examine three criteria to determine if governmental aid violates the Establishment Clause: (1) whether the program or authorization for the aid has a secular legislative purpose; (2) whether its primary effect is one that neither advances nor inhibits religion, or whether it constitutes a governmental endorsement of religion; and (3) whether it fosters excessive government entanglement with religion. In this case, the statutes authorizing tax increment financing are available on a neutral basis to any organization that meets the requirements. Moreover, the statutes further their declared public purpose of promoting economic development. Thus, the statutes have a secular purpose. Whether the particular transaction violates the other prongs of the test outlined above would depend on all the facts and circumstances. These would include the nature of the benefit conferred on the organization, the particular use of bond proceeds, and the project that the proceeds finance.

ANALYSIS

This request concerns the use of tax increment financing under Tenn. Code Ann. §§ 67-4-3001, *et seq.* The request asks whether county officials may legally authorize financing under this statutory scheme for a religious, privately-owned business entity. The request expressly states that it does not wish us to address whether a proposed Bible theme park now under consideration in

Rutherford County is "religious" in nature. Of course, as further discussed below, the nature of the project will ultimately be an important issue in whether it may constitutionally be financed with tax increment bonds. Further, this Office is not familiar with how financing for that project will be structured. This opinion will assume that the county industrial development corporation would issue bonds under Tenn. Code Ann. §§ 7-86-101, *et seq.*, and that the bonds will be paid solely from the designated sales tax revenues. This opinion will address general statutory authority for this transaction and, also, outline generally the constitutional issues that providing tax increment financing for the benefit of a religious entity might raise.

A. Statutory Authority

The first issue, of course, is whether state statutes authorize the transaction. The request cites Tenn. Code Ann. §§ 67-4-3001, *et seq.* These statutes appear to authorize use of taxes levied under the statutory scheme to finance a privately-owned amusement park that meets other statutory criteria. Nothing in these statutes prohibits financing solely because it would benefit a "religious," privately- owned business entity.

Tenn. Code Ann. §§ 67-4-3001, *et seq.*, were enacted in 2007 by Public Chapter 500. Tenn. Code Ann. § 67-4-3001 provides:

> (a) This part shall be known and may be cited as the "Local Tourism Development Zone Business Tax Act."
>
> (b) The taxes imposed by this part shall be in addition to all other privilege taxes.
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> (c) It is the legislative intent, within the framework of this part, to recognize that there are limitations upon state taxation imposed by the constitutions of the United States and of this state and not to impose the tax where prohibited by the constitutions; but it is intended to impose that tax to the extent permitted under the constitutions and the words of imposition used in this part.

Under Tenn. Code Ann. § 67-4-3003, a local government may levy a sales tax on business activity in a "qualified public use facility." The city or county ("municipality" under Tenn. Code Ann. § 67-4-3002(4)) must obtain certification of the tourism development zone in which the qualified public use facility is located before it may levy the tax. Tenn. Code Ann. § 67-4-3003(a). Under Tenn. Code Ann. § 67-4-3005, the tax revenues designated by the municipality must be deposited in a qualified public use facility development fund:

> . . .which shall be used as set forth in § 7-88-106 for the purpose of paying the cost of the qualified public use facility and the costs of bonded indebtedness, principal and interest, including expenses of the bond sale or sales, incurred by the municipality or public authority in financing, acquiring, constructing, leasing, equipping and renovating a qualified public use facility. The remaining revenue shall be deposited in the general fund of the municipality.

Tenn. Code Ann. § 67-4-3005(a). Thus, the taxes designated under this statute are set aside, first, to pay for the costs of the facility and bonded indebtedness incurred by the municipality or public authority to build it. The term "public authority" means, "any agency, authority or instrumentality described by § 7-88-103." Tenn. Code Ann. § 67-4-3002. Under that statute:

> "Public authority" means any agency, authority or instrumentality created or authorized by any municipality or by two (2) or more municipalities acting jointly, including, but not limited to, any public building authority organized pursuant to the provisions of title 12, chapter 10 or an industrial development corporation organized pursuant to chapter 53 of this title.

Tenn. Code Ann. § 7-88-103(5). Therefore, the privilege tax levied under this statute is to be used to pay debt service on bonds issued by the municipality or a public authority, including an industrial development corporation.

The question is whether revenues under this statute may be used to finance a public use facility owned and/or operated by a private, religious company. Key to the question presented is the meaning of the term "qualified public use facility." The term includes any privately-operated tourist attraction or amusement park that otherwise meets the requirements of the act. Tenn. Code Ann. § 67-4-3002(7) provides that:

> "Qualified public use facility" means a building, complex, center or facility described by the provisions of § 7-88-103.

Tenn. Code Ann. § 7-88-103(7) provides in relevant part:

> (A) "Qualified public use facility" includes:
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> (i) Any building, complex, center, facility or any two (2) adjacent buildings, complexes, centers or facilities containing at least two hundred fifty thousand square feet (250,000 sq. ft.), in the aggregate, inclusive of exhibit halls, ballrooms, meeting rooms, lobbies, corridors, service areas and other building areas, or areas enclosed thereby, constructed, leased, equipped, renovated, acquired or expanded after January 1, 1998, as a project meeting the requirements of title 9, chapter 21, title 12, chapter 10 or chapter 53 of this title, by a public authority or municipality for purpose of furnishing economic development centers, renovated or new or expanded community facilities for conventions, meetings, exhibitions, trade shows, sports events or other events for educational, entertainment, business, association, cultural, public interest, public service and common interest groups, organization and entities and that requires:
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> * * * *
>
> (b) On or after January 1, 2007, a local investment of public or private funds of not less than two hundred million dollars ($200,000,000);

> (ii) *Any privately owned or operated amusement or theme park* that involves an investment of funds of more than one hundred million dollars ($100,000,000); or
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> (iii) *Any privately owned or operated tourism attraction* involving an aggregate investment of public and private funds in excess of two hundred million dollars ($200,000,000) that is designed to attract tourists to the state, including a cultural or historical site, a museum or visitors center, a recreation or entertainment facility, and all related hotel or hotels, convention center facilities, administrative facilities and offices, mixed use facilities, restaurants and other tourism amenities constructed or acquired as part of the attraction;
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> (B) "Qualified use public facility" also includes qualified associated development. An investment in qualified public use facilities required by a lease from a municipality shall be considered a local investment of public funds for the proposes of this chapter.

(Emphasis added).

Under Tenn. Code Ann. § 7-53-302(a)(4), an industrial development corporation ("IDB") may acquire or build one or more "projects." The term "project" includes:

> Any facilities for any recreation or amusement park, public park or theme park suitable for use by any private corporation or any governmental unit of the state of Tennessee, including the state of Tennessee[.]

Tenn. Code Ann. § 7-53-101(11)(A)(ix). The IDB is authorized to issue its bonds for the purpose of carrying out any of its powers. Tenn. Code Ann. § 7-53-302(a)(9). This statutory scheme is to be liberally construed in light of its public purpose outlined in Tenn. Code Ann. § 7-53-102(a). Tenn. Code Ann. § 7-53-102(b).

We emphasize, again, that our Office is not familiar with how the proposed transaction might be structured. But the statutes outlined above contemplate use of taxes levied under Tenn. Code Ann. §§ 67-4-3001, *et seq.*, to support financing for a privately-owned amusement park, including one owned and operated by a private religious business. No other Tennessee statute would prohibit such use.

B. Constitutional Provision

i. Use of Tax Monies for a Public Purpose

The next issue is whether the use of the tax levied under Tenn. Code Ann. §§ 67-4-3001, *et seq.*, for the benefit of a private religious business violates any constitutional provision. Under Article II, Section 24, of the Tennessee Constitution, "[n]o public money shall be expended except pursuant to appropriations made by law." This limitation has generally been interpreted by

Tennessee courts to mean that the appropriation of public monies to other than "public purposes is beyond the power of the legislature." *Demoville and Company v. Davidson County*, 87 Tenn. 214, 10 S.W.2d 353, 355 (1889). Similarly, under Article II, Section 29, of the Tennessee Constitution, the General Assembly may authorize counties and cities to impose taxes for county and city purposes. The General Assembly has expressly provided that assistance under Tenn. Code Ann. §§ 7-53-101, *et seq.*, "is in the public interest and serves a public purpose of the state." Tenn. Code Ann. § 7-53-102(a). This statute satisfies the requirement for a public purpose under Article II, Section 24, and Article II, Section 29, of the Tennessee Constitution. *See, e.g., Ragsdale v. City of Memphis*, 70 S.W.3d 56 (Tenn. Ct. App. 2001), *p.t.a. denied* (2001) (use of city and county funds for a sports arena was for a public purpose; the fact that a private company would derive some financial benefit did not invalidate the public purpose).

ii. Establishment Clause

The only other constitutional provision that the question implicates is the Establishment Clause of the United States Constitution and a comparable provision in the Tennessee Constitution. The Establishment Clause of the First Amendment to the United States Constitution provides that "Congress shall make no law respecting an establishment of religion[.]" The First Amendment is applicable to the states through operation of the Fourteenth Amendment. At a minimum, the First Amendment guarantees that the government may not coerce anyone to support or participate in a religion or its exercise, or otherwise act in a way that establishes a state religion or religious faith or which tends to do so. *Lee v. Weisman*, 505 U.S. 577, 112 S.Ct. 2649, 2655, 120 L.Ed.2d 467 (1992). Similarly, Article 1, Section 3, of the Tennessee Constitution provides that "no preference shall ever be given, by law, to any religious establishment or mode of worship."

Whether governmental aid violates the Establishment Clause of the United States Constitution depends on all the circumstances, not simply the status of the organization that the aid benefits. In making this determination, courts use the following guidelines. First, when it is claimed that a denominational preference exists, the initial inquiry is whether the law facially differentiates among religions. *Hernandez v. Commissioner of Internal Revenue*, 490 U.S. 680, 109 S.Ct. 2136, 2146, 104 L.Ed.2d 766 (1989). Second, if no such facial preference exists, courts frequently use a three-part test articulated in *Lemon v. Kurtzman*, 403 U.S. 602, 91 S.Ct. 2125, 29 L. Ed.2d 745 (1971). Under this test, the criteria to be examined in determining whether a statute violates the Establishment Clause are: (1) whether the statute has a secular legislative purpose; (2) whether its primary effect is one that neither advances nor inhibits religion; and (3) whether it fosters excessive government entanglement with religion. The *Lemon* test has been criticized in some cases. *See, e.g., Orden v. Perry*, 545 U.S. 677, 685-86, 125 S.Ct. 2854, 162 L.Ed.2d 607 (2005). In that case, the Court found that the *Lemon* test was "not useful" in determining whether a display of the Ten Commandments on the Texas Capitol grounds violated the Establishment Clause. *Id.* At the same time, the Court did not reject use of the test in other contexts. We think the *Lemon* test still applies in determining whether use of tax increment financing for the benefit of a religious business violates the Establishment Clause. Under *Lemon* as later refined in what is known as the "endorsement test," courts look to whether a reasonable observer would believe that a particular action constitutes an endorsement of religion by the government. *Adland v. Russ*, 307 F.3d 471, 479 (6th Cir. 2002), *cert.*

denied, 538 U.S. 999, 123 S.Ct. 1909, 155 L.Ed.2d 826 (2003) ("endorsement test" is a refinement of the second prong of the *Lemon* test).

Courts have found that government aid has the primary effect of advancing religion where it flows directly to an institution in which religion is so pervasive that a substantial portion of its functions are subsumed in the religious mission or when it funds a specifically religious activity in an otherwise substantially secular setting. *Roemer v. Board of Public Works of Maryland,* 426 U.S. 736, 96 S.Ct. 2337, 2347, 49 L.Ed.2d 179 (1976) (plurality); *Hunt v. McNair,* 413 U.S. 734, 93 S.Ct. 2868, 2873, 37 L.Ed.2d 923 (1973). Moreover, monitoring a grant to a pervasively sectarian organization to ensure that funds are not used for a religious purpose may cause the government to intrude unduly in the day-to-day operations of religiously affiliated grantees. *Bowen v. Kendrick,* 487 U.S. 589, 108 S.Ct. 2562, 2578, 101 L.Ed. 520 (1988). For this reason, this Office has concluded that a grant of public funds to a "pervasively sectarian" organization such as a church would violate the Establishment Clause of the United States Constitution. Op. Tenn. Att'y Gen. 07-94 (June 12, 2007); *see also* Op. Tenn. Att'y Gen. 08-58 (March 18, 2008) (grants to church-controlled youth groups).

We have found no case law examining whether issuing tax increment bonds to benefit a religious organization would violate the Establishment Clause. Whether the transaction in this case violates the Establishment Clause would require an analysis of all the facts and circumstances surrounding it, especially the project that the bonds will finance. For example, the United States Supreme Court has found that a government may issue tax exempt bonds to fund a project by a religious school or university so long as certain conditions are met. *Hunt v. McNair, supra.* Among other conditions, the buildings financed with the bonds could not be used for sectarian study or religious worship.

More recently, the United States Court of Appeals for the Sixth Circuit has found that issuance of tax-exempt governmental bonds to benefit even a "pervasively sectarian" organization does not violate the Establishment Clause. The bonds, however, financed school buildings. *Steele v. Industrial Development Board of Metropolitan Government, Nashville,* 301 F.3d 401 (6th Cir. 2002), *cert. denied,* 537 U.S. 1188, 123 S.Ct. 1254, 154 L.Ed.2d 1020 (2003); *Johnson v. Economic Development Corporation of the County of Oakland,* 241 F.3d 501 (2001). In *Steele,* the Court upheld issuance of tax-exempt bonds to finance a renovation project for David Lipscomb University. Under the challenged program, a government agency issued tax-exempt bonds and lent the proceeds to various organizations, including the university. Loan repayments from the organization paid principal and interest on the bonds. The loan to the university prohibited the use of financed projects for religious purposes. While the Court found the university to be "pervasively sectarian," it concluded that the program did not violate the Establishment Clause. The Court emphasized that the program under which the bonds were issued conferred an indirect benefit on the institutions whose projects it financed. The Court pointed out that the bonds were available to all applicants, whether religious or not, on a neutral basis, and had been issued for the benefit of other religious and secular organizations. 301 F.3d at 411. The Court also noted that purchasers of the bonds had recourse only against the organizations for loan payments. Thus, the Court found, the program conferred only an indirect benefit of reducing the cost of borrowing funds. The Court found that,

under these circumstances, issuing bonds to benefit the university would not be perceived as a governmental endorsement of religion.

In this case, the statutes authorizing tax increment financing are available on a neutral basis to any organization that meets the requirements. Moreover, the statutes further their declared public purpose of promoting economic development. Thus, the statutes have a secular purpose. Whether the particular transaction violates the other prongs of the *Lemon* test outlined above would depend on all facts and circumstances, especially the nature of the project they finance. Other factors would include the nature of the benefit conferred on the organization and the particular use of bond proceeds.

This Office does not provide opinions on federal tax law, and whether interest on the bonds is exempt from federal income tax must be addressed by competent bond counsel, taking into account all the relevant facts and circumstances.

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