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Opinion No. 12-07

Border Region Retail Tourism Development District Act

QUESTION

Under what circumstances, if any, would Article II, Section 24 or 31, of the Tennessee Constitution prohibit the use of Tennessee sales tax revenue for any of the purposes set forth in the Border Region Retail Tourism Development District Act codified at Tenn. Code Ann. §§ 7-40-101 to -111?

OPINION

The use of these sales tax funds in accordance with the Act constitutes a public purpose. Thus Article II, Sections 24 and 31, of the Tennessee Constitution do not prohibit the distribution of sales tax revenue as provided by the Act.

ANALYSIS

For the purpose of "increas[ing] tourism and the competitiveness of this state with bordering states," the Border Region Retail Tourism Development District Act the "Act" "empower[s] local governments to encourage the development of extraordinary retail or tourism facilities, including shopping, recreational, and other activities." Tenn. Code Ann. § 7-40-102. Pursuant to the Act, if a municipality bordering a neighboring state "finances, constructs, leases, equips, renovates, assists, incents, or acquires an extraordinary retail or tourism facility or a project" in a certified border region retail tourism development district, a portion of the Tennessee sales and use tax revenue distributed to the municipality shall be used "for payment of the cost of the economic development project, including principal and interest on indebtedness, including refunding indebtedness of the municipality or industrial development corporation related to the development of the project." Tenn. Code Ann. § 7-40-106(a) and (c).

The Act defines "economic development project" and "extraordinary retail or tourism facility" as follows:

> (6) "Economic development project" or "project" means the provision of direct or indirect financial assistance, including funds for location assistance, to an extraordinary retail or tourism facility and other retail or tourism facilities developed to accompany the extraordinary retail or tourism facility in a border region retail

> tourism development district by a municipality or an industrial development corporation . . .;
>
> (7) "Extraordinary retail or tourism facility" means a single store, series of stores, or other public tourism facility or facilities located within a border region retail tourism development district, and shall include retail or other public tourism facilities that are reasonably anticipated to draw at least one million (1,000,000) visitors a year upon completion. The extraordinary retail or tourism facility shall reasonably be expected to require a capital investment of at least twenty million dollars ($20,000,000) including land, buildings, site preparation costs, and is reasonably anticipated to remit at least two million dollars ($2,000,000) in state sales and use tax, annually, when completed . . . .

Tenn. Code Ann. § 7-40-103.

To receive the special distribution of state sales and use tax revenue, the municipality and the border region retail tourism development district must satisfy several requirements. First, the municipality must "adopt an ordinance designating the boundaries" of the district, which must have a boundary that "is no more than one-half (½) mile from an existing federally-designated interstate exit, is no more than twelve (12) miles from a state border as measured by straight line, [and] is no larger than a total area of nine hundred fifty (950) acres." Tenn. Code Ann. § 7-40-103(3) and -104(a)(1). The Commissioner of Revenue then determines (1) whether the district's boundaries and size conform with the Act and, (2) with the approval of the Commissioner of the Department of Economic and Community Development, whether the distribution is in the "best interests of the state," as defined by the Act.[1] Tenn. Code Ann. § 7-40-104(a)(3)-(4). After the distribution commences, the municipality must annually submit to the Commissioner of Revenue "a summary of the cost of the economic development project with supporting documentation," which the Commissioner reviews to confirm the amount of the distribution. Tenn. Code Ann. § 7-40-104(c). Also, before the municipality issues "bonds to finance the cost of an economic development project that will be repaid in whole or part" from the distribution, it must "submit a proposed debt amortization schedule for such bonds" to the Commissioner of Revenue for approval. Tenn. Code Ann. § 7-40-109. The distribution ends after thirty years or once the cost

[1] The Act defines "best interests of the state" as

> a determination by the commissioner of revenue, with approval by the commissioner of economic and community development, that:
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> (A) The economic development project or extraordinary retail or tourism facility within the district is a result of the special allocation and distribution of state sales tax provided for in § 7-40-106; and
>
> (B) The district is a result of the project or extraordinary retail or tourism facility . . . .

Tenn. Code Ann. § 7-40-103(2).

of the economic development project has been fully paid, whichever is sooner. Tenn. Code Ann. § 7-40-106(b).

The municipality may "limit, condition, or provide incentives or financial support in the district as it deems appropriate" to "benefited property owners" within the district, including requiring them to "participate in the repayment of such in an amount equal to twenty-five percent (25%) of the property tax for the real property owned" within the district. Tenn. Code Ann. § 7-40-110. However, the municipality may not provide financial support to retailers already "located within a fifteen-mile radius of the district" and in Tennessee, unless the retailer increases the sales floor space of its existing store by at least 35%. *Id*. Also, a municipality may use the incremental increase in property tax revenue directly resulting from development within the district to pay for costs relating to district formation and district projects. *Id*.

A municipality may delegate to an industrial development corporation "the authority to carry out all or part of the project and to issue revenue bonds to finance a project . . . and to incur cost for the project" and agree to pay the tax revenue distribution to the corporation in an amount "sufficient to service the repayment of such bonds and costs incurred." Tenn. Code Ann. § 7-40-107.

The question presented is whether the Act is constitutionally infirm because it lacks a public purpose. As noted in a recent opinion of this Office, Tennessee courts have interpreted the provision of Article II, Section 24, of the Tennessee Constitution that "[n]o public money shall be expended except pursuant to appropriations made by law" as a prohibition against the appropriation of public monies for other than public purposes. *See* Op. Tenn. Atty. Gen. No. 08-101, at 4 (May 6, 2008) (citing *Demoville and Company v. Davidson County*, 87 Tenn. 214, 10 S.W.2d 353, 355 (1889)). Article II, Section 31, which prohibits "[t]he credit of this State [from being] hereafter loaned or given to or in aid of any person, association, company, corporation or municipality," has a similar public purpose requirement. The Tennessee Supreme Court explained the meaning of the term "public purpose" as follows:

> [t]he obvious purpose of this Section of our Constitution was to prevent the State from using its credit as a gratuity or donation to any person, corporation, or municipality. ***It is further obvious that it was not designed to prevent the State from using its credit to aid persons, corporations, or municipalities if required to accomplish a State or public purpose,*** or to fulfill a State duty or obligation under its police power. Under the authorization, the Legislature and not the courts is the exclusive judge of the manner, means, agencies and methods to meet and fulfill these purposes.

West v. Tennessee Housing Development Agency, 512 S.W.2d 275, 283-84 (Tenn. 1974) (quoting *Bedford County Hospital v. Browning*, 189 Tenn. 227, 232, 225 S.W.2d 41, 43 (1949)) (emphasis added).

The Tennessee Supreme Court has further recognized that the concept of a "public purpose" is flexible, and must necessarily broaden as "the functions of government continue to

expand" to "meet the growing needs of a more complex social order." *West*, 512 S.W.2d at 280. Courts, in addressing a challenge to the constitutionality of an act as not evincing a public purpose, must presume the act is constitutional, provide great deference to the General Assembly's judgment that an act serves a public purpose, and cannot consider the wisdom of the General Assembly's policy decisions. *Id.* at 279; *Ragsdale v. City of Memphis*, 70 S.W.3d 56, 71-72 (Tenn. Ct. App. 2001).

With this background, we will turn to the specific cases where Tennessee courts have addressed constitutional challenges to legislation on grounds that it lacked a public purpose under either Section 24 or 31 of Article II the Tennessee Constitution. In determining whether the Act in question satisfies public purpose requirements under Sections 24 and 31, it is also helpful to review the decisions of Tennessee courts in cases concerning Article II, Section 29, which includes a public purpose requirement for cities and counties.

In *Ferrell v. Doak*, 152 Tenn. 88, 89, 275 S.W. 29 (1925), the Supreme Court struck down a private act "empowering the town of Lebanon to issue bonds to be used in the promotion of industrial enterprises within its borders." Under that act, the town was authorized to use the funds to purchase real property, erect a factory on it, and lease it to a private corporation "for a comparatively small consideration." *Id*. at 92. The Court found that the use of such funds would be for a private purpose because "the proposed box factory will be privately owned and controlled [and] the public will have no voice" in its management and operation. *Id*.

Subsequently, however, the Supreme Court upheld the constitutionality of the Industrial Building Bond Act of 1955 in *McConnell v. City of Lebanon*, 203 Tenn. 498, 314 S.W.2d 12 (1958). Pursuant to that act, the City of Lebanon was again authorized to use the proceeds of bonds to purchase real property, build a factory, and lease it to a private corporation. *Id*. at 502. The Court distinguished *McConnell* from *Ferrell*, finding that *Ferrell* "did not purport to express any public policy of the State" because it concerned "a Private Act relating to the city of Lebanon alone." *Id*. at 513. Also, the *Ferrell* private act "did not undertake to set out any standards or checks for guiding the authorities who are to have charge of the making of the contracts for the necessary land, or the contracts for the buildings, or the leasing of the buildings when completed, nor any of the other similar matters contained" in the Industrial Building Bond Act of 1955. *Id*.

More recently, the Supreme Court struck down a city ordinance that called for 75% of tax revenues derived from the ordinance to be "expended in a manner so as to be directly or indirectly beneficial to the business community and tourism in general," without any further instruction to city officials. *Smith v. City of Pigeon Forge*, 600 S.W.2d 231, 232 (Tenn. 1980). The Court held that the ordinance was unconstitutional because it was authorized by city ordinance as opposed to "the clearly expressed public policy of the State" and did not include any "standards or checks to be exercised by public officials upon the use of the funds." *Id*. at 233.

The Tennessee Court of Appeals has found that encouraging the relocation of retail development is a public purpose, *Small World, Inc. v. Industrial Development Board*, 553 S.W.2d 596, 600-01 (Tenn. Ct. App. 1976), and that the construction of a sports arena in Shelby

County served a public purpose, noting that the "fact that a private entity may receive some benefit from the legislation does not invalidate the established public purpose." *Ragsdale*, 70 S.W.3d at 72.

The Border Region Retail Tourism Development District Act is much more similar to the legislation reviewed and upheld in *McConnell*, *Small World*, and *Ragsdale*, than that which was struck down in *Ferrell* and *Pigeon Forge*. The Act is a public act.[2] As noted above, the General Assembly clearly expressed the public purpose of increasing tourism and encouraging the development of retail and tourism facilities, and the Act includes many standards and checks for the distribution and use of the tax revenue to achieve that purpose. Accordingly, it is the opinion of this Office that under the existing precedents, a court would likely find that state sales and use tax revenue distributions made pursuant to the Act would not violate Article II, Section 24 or 31, of the Tennessee Constitution.

It should be noted that *McConnell*, *Small World*, and *Ragsdale* all concerned instances where a public entity—such as a city, an industrial development board, or a sports authority—owned the real property and improvements and leased it to a private corporation. *McConnell*, 203 Tenn. at 502; *Small World*, 553 S.W.2d at 597; *Ragsdale*, 70 S.W.3d at 59-60. Under the Act, a private corporation, instead of a public entity, could own the extraordinary retail or tourism facility and, thus, receive the tax distribution in a more direct manner. Because these more recent precedents do not address situations involving private ownership of the facilities, the argument can be made that such allocations of public funds are for a prohibited private purpose. Nothing in these precedents, however, foreshadows such a distinction, and it can be viewed as a technical one in light of the practicalities of the long-term arrangements under which many lessees of industrial development boards operate. Tennessee courts would have to plow new ground to create a test requiring public ownership of the facilities receiving the distributions to evince a constitutional "public purpose," a course that seems unlikely given past precedent.

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[2] *See* 2011 Tenn. Pub. Acts ch. 420.

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