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**MINUTES OF THE TENNESSEE ADVISORY COMMISSION ON
 INTERGOVERNMENTAL RELATIONS:**

Local Government Working Group

14 June 2018

Meeting Called to Order

The Local Government Working Group of the Tennessee Advisory Commission on Intergovernmental Relations met in Room 205 of the Rutherford County Courthouse at 9:00 a.m., Executive Director Cliff LIPPARD facilitating.

Present 9	Absent 1
Mayor Ernest Burgess	Mayor Larry Waters
Mayor Keith McDonald	
Mayor Tom Bickers	
Metropolitan Trustee Charles Cardwell	
City Commissioner Betsy Crossley	
Mayor Kenny McBride	
County Executive Jeff Huffman	
Vice Mayor Kay Senter	
Mayor Brent Greer	

1. Call to Order

Before starting the meeting, Executive Director Cliff LIPPARD thanked the local members for attending the meeting and for expressing the interest that prompted the Local Government Working Group meeting. The meeting began at 9:12 a.m.

2. Introductory Remarks and Distribution of Draft Research Material

Dr. LIPPARD began his remarks by recognizing TACIR staff present at the meeting, and then outlined the four broad questions delegated to TACIR for study: (1) What are the sources of state-shared revenue for counties? (2) What are the sources of state-shared revenue for cities? (3) What are the service requirements for counties? (4) What are the service requirements for cities? He then presented and summarized the draft research materials, which included various tables showing state-shared revenue sources and service requirements for cities and counties.

3. Discussion

County Executive Jeff HUFFMAN said all general revenues were important, but asked if the issue of Internet sales tax could be a focus of discussion. LOCAL MEMBERS then agreed that Internet sales tax collections are the driving force behind the interest in meeting and discussed possible implications of the pending Supreme Court decision in *South Dakota v. Wayfair* (2018).

Discussion moved to what should be the next steps from the local members working group assuming the Supreme Court decision in *Wayfair* overturns *Quill* and allows states to impose local sales and use taxes on out-of-state retailers. Mayor MCDONALD said that distributing internet sales tax revenue based on point of delivery would help counties at cities' expense, but Mayor MCBRIDE said we should base the tax on the point of delivery. Multiple LOCAL MEMBERS also raised the issue of whether the Department of Revenue or the vendors themselves would be responsible for collecting and remitting Internet sales taxes.

Mayor MCDONALD said we should focus on additional funding from the state for education from the state's portion of the new internet sales tax and not take away our expected growth in state shared based on delivered package's 9-digit zip code. County Executive HUFFMAN agreed and emphasized that education and public safety are the two biggest funding issues for counties. Mayor Tom BICKERS said that local budget issues would be best alleviated through additional revenues from the state's share of Internet sales tax being put into BEP funding.

Discussion shifted to best ways to put any additional revenues into the BEP formula. Mayor MCDONALD expressed the complexity and political difficulties involved in altering or changing the BEP formula. County Executive HUFFMAN asked what would be the best way to put more money into the BEP formula. In response, Senior Public Policy Consultant Lynnis ROEHRICH-PATRICK suggested that the most effective and easiest way for localities to capture additional revenues through the BEP formula would be to focus on the portion governing teacher pay and benefits or lowering the teacher-student ratio built into the formula, as teacher funding makes up one of the largest portions of the formula.

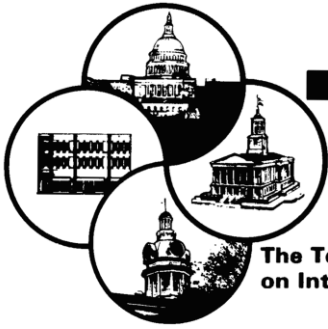
4. Next Steps and Further Research

Mayor BICKERS asked Dr. LIPPARD and TACIR staff to conduct additional research into what percentage of sales taxes the state is actually sharing with localities, including historical trends. Dr. LIPPARD stated that TACIR staff will also continue to update the figures and tables from TACIR's 2004 tax report. County Executive HUFFMAN also requested that TACIR look into recent and historical trends concerning service mandates handed down to localities from the state without additional funds and the costs to cities and counties. Mayor MCDONALD asked that TACIR compile research regarding overall state revenue and local funding now and compare it to historical trends.

Dr. LIPPARD said staff would also work with the group to confirm that the Department of Revenue is using nine-digit ZIP codes and to query the Department about its plans and next steps based on the *Wayfair* decision.

All LOCAL MEMBERS agreed that the local government working group should schedule an additional meeting after the Supreme Court's decision in *Wayfair* to further discuss the implications on state sales tax revenue. Mayor MCDONALD expressed the need for the Department of Revenue to be represented at the meeting in case the LOCAL MEMBERS have questions that arise. Metropolitan Trustee Charles CARDWELL said the Commissioner of Revenue needs to be present so that the LOCAL MEMBERS could get concrete answers without a delay for staff to check with the Commissioner. Dr. LIPPARD asked the group if they wanted to meet the day before the next full Commission meeting on September 6th and 7th. Mayor Brent GREER then said that the post-*Quill* meeting should happen earlier than the day before so that the LOCAL MEMBERS would have adequate time to digest and understand implications of the Supreme Court's ruling.

The meeting adjourned at 11:25 a.m., with the next Local Members Working Group meeting to be scheduled after the Supreme Court's decision in *Wayfair*.



TACIR

The Tennessee Advisory Commission
on Intergovernmental Relations



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MINUTES OF THE TENNESSEE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS:

Local Government Working Group

10 August 2018

Meeting Called to Order

The Local Government Working Group of the Tennessee Advisory Commission on Intergovernmental Relations met in Room 205 of the Rutherford County Courthouse at 9:00 a.m., Executive Director Cliff LIPPARD facilitating.

Present 6	Absent 4
Mayor Ernest Burgess	Mayor Tom Bickers
City Commissioner Betsy Crossley	Metropolitan Trustee Charles Cardwell
Mayor Brent Greer	Mayor Kenny McBride
County Executive Jeff Huffman	Vice Mayor Kay Senter
Mayor Keith McDonald	
Mayor Larry Waters	

1. Call to Order

Executive Director Cliff LIPPARD called the second Local Government Working Group meeting to order at 9:00 a.m. and requested approval of the minutes from the June 14 meeting. County Executive Jeff HUFFMAN moved adoption and City Commissioner Betsy CROSSLEY seconded the motion, which passed unanimously.

2. Introductory Remarks

Dr. LIPPARD said that at the June 14 meeting, the Working Group requested to meet following the Supreme Court decision in *South Dakota v. Wayfair, Inc.*,¹ and requested to meet with Commissioner David GERREGANO, Tennessee Department of Revenue (DOR) to discuss that decision and implications for Tennessee. Dr. LIPPARD updated the Working Group on research conducted by TACIR staff and introduced Commissioner GERREGANO.

3. Tennessee's Response to *South Dakota v. Wayfair, Inc.*

Commissioner GERREGANO introduced the DOR staff accompanying him: Barbara SAMPSON, Deputy Commissioner; Christin LOTZ, Director of Research; and Justin MOORHEAD, Legislative Liaison. He provided a brief legal history of out-of-state sales tax collection and explained the physical presence rule from *Bellas Hess*² and *Quill*³, which prohibited states from requiring an out-of-state seller to collect sales tax unless the seller had a physical presence in the state. He said the collection of sales tax by out-of-state sellers for sales made to Tennesseans is about fairness, and while many out-of-state sellers already collect and remit sales tax, there are many sellers without a physical presence in Tennessee that do not. He said states tried to get the US Congress to pass a bill addressing internet sales tax for 15 years without success, but after US Supreme Court Justice Anthony Kennedy invited states to challenge *Quill*,⁴ Tennessee, Alabama, and South Dakota created test cases to do so.

Commissioner GERREGANO said Tennessee's test case is based on a 2016 DOR rule that required out-of-state sellers exceeding \$500,000 in sales in the previous 12 months to collect and remit sales and use tax on taxable personal property.⁵ The rule was challenged in the Davidson County Chancery Court, and the parties to the case agreed

¹ 585 U.S. ___ (2018).

² *National Bellas Hess v. Department of Revenue of Ill.*, 386 U.S. 753 (1967).

³ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁴ See Justice Kennedy's concurring opinion in *Direct Marketing Association v. Brohl*, 575 U.S. ___ (2015).

⁵ Tenn. Comp. R. & Regs. 1320-05-01-.129(2).

to delay enforcement of the rule while waiting to see how the Supreme Court would rule.⁶ However, Commissioner GERREGANO said this lawsuit will not determine when Tennessee may begin requiring out-of-state sellers to collect sales tax because the General Assembly prohibited enforcement of the rule until it reviews the Supreme Court's ruling and approves the rule.⁷

Commissioner GERREGANO explained that the Supreme Court in *Wayfair* overruled *Quill*, which invalidated the physical presence rule, but cautioned states against implementing a requirement that discriminates against or burdens interstate commerce by noting that South Dakota's legal framework provided a safe harbor to sellers who transact only limited business in the state, prohibited retroactivity, and reduced the burden on out-of-state sellers that collect sales tax.

Questions from LOCAL MEMBERS to Commissioner GERREGANO focused primarily on out-of-state sales tax collection and on the implementation of provisions of the Streamlined Sales and Use Tax Agreement (SSUTA), currently set to take effect July 1, 2019. Commissioner GERREGANO explained that the streamlined provisions would move Tennessee from origin-based (where it's sold) to destination-based (where it's delivered) sourcing for in-state sales, which are currently taxed at the rate applicable to the location of the seller. Using destination-based sourcing, the applicable sales tax is determined based on where the buyer takes possession of goods or receives services. He further noted that Tennessee would likely want to remain an associate member of the SSUTA, but some provisions of the SSUTA required for full member status, including the provision removing the single article cap, would require extensive changes to the state's existing tax structure.

Regarding out-of-state sales tax collection, Commissioner GERREGANO explained that out-of-state sellers currently voluntarily collecting sales tax in Tennessee have the option to either collect sales tax based on the applicable local option sales tax rate based on the customer's address or use a uniform local option rate (2.25%). He said that revenue collected using actual local option sales tax rates, which accounts for approximately 37% of the out-of-state local option sales tax currently collected, is distributed based on situs, and revenue collected using the uniform rate is distributed based on a formula. Commissioner GERREGANO and Deputy Commissioner SAMPSON said the trend is that more out-of-state sellers use applicable local option sales tax rates. Deputy Commissioner SAMPSON explained that the DOR, utilizing geographic information system (GIS) mapping, uses the entire address, not just the ZIP

⁶ *American Catalog Mailers Ass'n v. Tennessee Department of Revenue*.

⁷ Public Chapter 452, Acts of 2017.

code, to determine situs-based distributions. Following the meeting, Commissioner GERREGANO clarified that out-of-state sellers will no longer have the option to use the uniform local rate once the streamlined provisions take effect.

Commissioner GERREGANO and Deputy Commissioner SAMPSON explained that the DOR has the technological capability, within reason, to implement changes necessary because of legislative action but will need some lead-time to begin programming. When asked if states are required to provide software to out-of-state sellers, Commissioner GERREGANO said this issue is not settled, and that states that are full members of the SSUTA bear the cost of paying for software provided by certified software providers, and that, while *Wayfair* pointed to South Dakota's membership in the SSUTA as a possible indication that South Dakota did not create an undue burden on interstate commerce, the ruling does not explicitly require states wishing to collect sales tax from out-of-state sellers to become SSUTA members and provide software. The Supreme Court instead highlighted several features of the SSUTA (of which South Dakota is a member) that reduce the burden on out-of-state sellers.

Discussion shifted to counties' and municipalities' shares of state-shared sales tax. Commissioner GERRAGANO said that the state allocates roughly four percent of the seven percent state sales tax to municipalities based on population regardless of sourcing rules or where the seller transacts business, and other than river resort districts, counties do not receive state-shared sales tax.

4. Distribution of Draft Research Material and Discussion

Dr. LIPPARD summarized the contents of the research materials provided by TACIR staff, which included a document projecting the constitutionality of Tennessee requiring out-of-state sellers to collect sales tax in light of the *Wayfair* decision. The research materials also included updated tables from TACIR staff's 2004 report *State Tax Sharing, Fairness, and Local Government Finance in Tennessee* and additional material in response to questions from the Working Group at the June 14 meeting. Mayor MCDONALD emphasized the need to demonstrate total funding needs for county and municipal governments and that focusing on state-shared taxes provides an incomplete picture of local government revenue sources. Dr. LIPPARD suggested that a TACIR report would start with overall local government revenue sources followed by an analysis of each funding source.

All LOCAL MEMBERS agreed that both counties and municipalities should not attempt to take existing sources of revenue away from each other, and that the state should do more to support local governments financially. They discussed local governments capturing additional funds derived from internet sales tax revenue and the state

providing additional funding for education to allow local governments to implement education-related mandates, emphasizing the difficulty in sustaining funding for education using local government resources.

Mayor BURGESS and Mayor MCDONALD raised concerns regarding the level of funding for services provided by counties and municipalities, respectively. Dr. LIPPARD said TACIR would consider in its research all services local governments provide because, although not all services are mandated, some local governments and their citizens may determine certain services are essential.

5. Next Steps and Further Research

The LOCAL MEMBERS asked Dr. LIPPARD and staff to provide a summary of the Local Government Working Group discussions and perspectives at the next full Commission meeting. They also asked to review the summary prior to the meeting. Dr. LIPPARD said that TACIR hopes to demonstrate in the report the long-term trends in local government revenue sources, service requirements, and service expectations held by citizens. The LOCAL MEMBERS agreed that presenting the overarching trends up front in the report would be beneficial.

The meeting adjourned at 11:21 a.m.