

# Summary and Recommendations: Effects of Sharing of Revenue among School Systems in Counties with More than One School System

Public K-12 education in Tennessee is provided through school systems that in general are operated locally, either by counties, municipalities, or special school districts. State law requires each county to operate a K-12 school system, individually or in partnership with another county, unless all students in the county are served by municipal school systems and special school districts, as is the case only in Gibson County. Currently, 30 of the state's 95 counties have more than one school system. There are 94 county school systems, 33 municipal school systems, and 14 special school districts.

State law requires counties to share local revenue with city school systems and special school districts in the same counties, but there are no sharing requirements for cities and special school districts. Representatives of county officials in Tennessee have expressed concern that education revenue sharing requirements in Tennessee favor city school systems and special school districts at the expense of county school systems. City officials have expressed concerns of their own, mainly that these requirements can be an incentive to counties to find ways to work around them. Responding to these concerns, Senate Joint Resolution 593, sponsored by Senator Haile, directs the Tennessee Advisory Commission on Intergovernmental Relations (TACIR) to study the overall effects on public K-12 education of the laws and regulations related to the sharing of resources between multiple school systems in the same county and the effect of the operation of additional municipal or special school districts within a county.

Building-ownership and transfer of property can also become an issue when new school systems are formed within counties. Since 2013, six new city school systems formed in Shelby County, and other cities have also considered forming municipal school systems. Senate Joint Resolution 593 notes that "the creation of new school districts has in the past created conflict regarding the ownership of existing school buildings and facilities," and state law does not require counties to transfer school property to new school systems. Moreover, in the 110<sup>th</sup> General Assembly, Senate Bill 1755 by Senator Gardenhire, House Bill 1757 by Representative Harry Brooks, as amended, would have required TACIR to recommend "a process for determining the amount that a city must pay to fairly compensate the county for the school property the city seeks to obtain"; but the bill did not pass. Because the disposition of school buildings when a new school system is created relates directly to the division of resources among school systems located in that county,

TACIR staff has included a review of other states' processes for the transfer of real and personal school property when new school systems are formed.

**Local revenue sharing requirements vary for counties, cities, and special school districts under state law.**

Local revenue accounts for \$3.7 billion of the \$10.2 billion<sup>1</sup> of total K-12 education revenue in fiscal year 2017-18 in Tennessee. Almost all of it comes from local property and sales taxes. In counties with multiple school systems, whether local revenue must be shared among all systems in the county varies under state law depending on its source, what the revenue is allocated for, and whether it is earmarked for specific purposes. For instance, state law excludes from sharing requirements all revenue that is used for a "student transportation system" that serves all school systems in the county. Whenever sharing is required, revenue is distributed based on the weighted full-time equivalent average daily attendance for each school system in the county. This provides additional weight for students at different grade levels, career and technical students, and special education students, so the school systems they attend will receive more local revenue to meet the needs of the students they serve.

**Property Taxes**

Property taxes are used by county, city, and special school districts to fund education, though only some of this property tax revenue must be shared. In counties with multiple school systems, countywide property taxes budgeted for education operations and maintenance expenses must be shared with all school systems in the county. In contrast, property taxes levied by cities or by special school districts, which are collected from businesses and residents located therein, do not have to be shared.

**Local Option Sales Taxes**

State law requires that 50% of revenue generated by the countywide local option sales tax rate be shared with all school systems in the county. The other 50% is not earmarked and is distributed either to a city if the situs (location) of the sale is within the city or to a county if the situs of the sale is within the unincorporated part of the county. Cities may use any of their revenue, including the unearmarked half of sales tax revenue collected there, to fund their school systems without sharing with other school systems in the county. But if counties use their unearmarked sales tax revenue for operations and

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<sup>1</sup> Excludes non-revenue receipts, which are receipts from sale of bonds, notes, lease proceeds, insurance recovery, and transfers. Non-revenue receipts were \$790.0 million in fiscal year 2017-18.

maintenance of their county school systems, the revenue must be shared with all school systems in the county. Special school districts cannot impose sales taxes.

### **Mixed Drink Tax**

Half of mixed drink tax revenue is distributed to the state's general fund and is earmarked for education purposes. The other half goes to the city in which the revenue was generated, or for sales in unincorporated parts of counties to the county, and half of the revenue is earmarked for school systems. For counties where the county school system is the only school system in the county, all of the revenue that is earmarked for education (both city and county) is distributed to the county school system, but in counties with more than one school system, the distribution is more complex.

Revenue that is earmarked for education generated within unincorporated parts of counties where a mixed drink tax is levied is distributed to the county school system. Revenue that is earmarked for education and that is generated within cities where a mixed drink tax is levied is distributed based on

- whether the city has a city school system,
- what grade levels the city school system serves,
- whether at least part of the city falls within a special school district,
- which school systems students residing in the city attend, and
- whether the city is in more than one county.

The formula for determining the distribution of revenue in counties with more than one school system was amended in 2014. The statute was amended to clarify the circumstances under which cities with a city school system are required to share their mixed drink tax revenue that is earmarked for education. Previously, five counties filed lawsuits to require cities to distribute some of their mixed drink tax revenue to county school systems. However, the Tennessee Supreme Court ruled in favor of the cities in 2019; and in 2020, the General Assembly removed the expiration date from the formula that was enacted in 2014—as discussed by TACIR members and staff during TACIR meetings, and as recommended in draft versions of this report.

### **Requirements for Capital Expenditures**

Counties often issue bonds for capital expenditures—including new schools, renovations, and buses. As set out in the Tennessee Code Annotated (Sections 49-3-1003 and 49-3-1005) and described by the University of Tennessee's County Technical Assistance Service,

the law requires counties containing city schools or special school districts to distribute the proceeds from a bond issue for school capital purposes on an average daily attendance basis, unless a tax district outside the city or special school district is established. If a tax district is not established, city systems and special school districts are entitled to a proportional share of the proceeds of a school bond issue, or they may waive their rights to such a share. If a tax district is established so that the school bonds are payable only from funds collected outside the city or special district, then the city or special school districts do not share in the proceeds (citations omitted).

Only **six** of 30 multisystem counties have chosen to establish tax districts—also referred to as rural debt service districts—outside their city or special school districts to fund their county school systems’ debt. Because commercial and industrial property is concentrated in cities, a given tax rate applied countywide usually generates more revenue for the county school system—even after sharing with the city school system or special school district—than a property tax for a rural debt service district would.

Bond proceeds are exempt from sharing requirements if they are used for capital expenditures for grade levels not served by the city or special school districts in a multisystem county. Moreover, when capital expenditures are funded from revenue that is not from note or bond proceeds, the Tennessee Court of Appeals has held that “a county may levy a special tax designated for a capital projects fund, such as ‘for the building, repair, and equipment of rural schools,’ or a ‘rural school building and repair fund,’” without having to share the revenue with other school systems in the county.

### ***Disparity in Local Revenue and Increase in County Indebtedness***

In fiscal year 2017-18, cities and special school districts in 28 multisystem counties with county school systems<sup>2</sup> raised \$139.4 million for city school systems and special districts that they did not have to share. This amounts to approximately \$1,237 per student. The 32 city systems in these counties received \$112.2 million in revenue that did not have to be shared—\$84.0 million in city general fund transfers, \$17.9 million in city property tax, and \$10.3 million in cities’ share of local option sales tax revenue. The five special school districts in these counties received \$27.2 million in special school district property tax revenue that they didn’t have to share.

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<sup>2</sup> Excludes Gibson and Carroll counties. Gibson County does not have a county school system, and Carroll County’s county school system is not comparable to other school systems.

As a result, 28 of 32 city school systems and all five special school districts in the multisystem counties received more local revenue per student than their county school systems did in fiscal year 2017-18. City school systems and special school districts in these counties received \$1,193 more per student in local revenue than the county school system. The additional revenue that city school systems and special school districts have access to can be used to pay higher teacher salaries, build and maintain facilities and provide additional programs, tutoring, and advanced classes, thus creating intra-county disparities in student services. It would take an additional \$413.3 million for those county school systems to equal the per-student revenue of the city and special school districts in them. In three of the multisystem counties, the county school systems received more local revenue on a per-student basis than at least one other school system. Crockett County Schools received more local revenue per student (\$1,272) than Alamo and Bells city school systems (\$958 and \$1,139), and Rhea County Schools received more local revenue per student (\$2,161) than Dayton's city school system (\$1,771). None of these city school systems have high schools, which because of their varied and more complex offerings are often more costly. Shelby County Schools received more revenue per student (\$4,462) than Lakeland's city school system (\$4,126) but less than the other five city school systems in Shelby County (\$4,597 to \$5,676).

Because the 30 counties with multiple school systems are required to share bond proceeds with all school systems in the county in most circumstances, these counties appear to be taking on more debt for education capital projects than would otherwise be necessary. Overall school debt per student in Tennessee's 141 school systems was more (\$6,049) for fiscal year 2015-16 than in single-system counties (\$5,653) and city school systems (\$4,406), but less than county school system debt in multisystem counties (\$6,964), which was second only to debt for special school districts (\$8,213).

As noted in the Commission's companion report, *K-12 Public Education Funding and Services*, meeting local needs and the requirements imposed by the federal and state governments often requires more resources than the Basic Education Program (BEP) funding formula alone provides. Because local tax bases vary markedly across the state, and because of complexities in the laws requiring those tax bases to be shared among school systems in the same county, local governments are unable to provide those resources without imposing different tax rates. These challenges, along with differences across localities in the willingness of residents to raise taxes, can lead to both student and taxpayer inequities.

### **Ensuring equity for students and taxpayers.**

According to some county representatives, disparities that result from the state's current education revenue-sharing requirements raise equity concerns. City officials raise similar

concerns about achieving equity for students and taxpayers and face their own challenges because of the complexity of Tennessee's local tax and governance structures and school finance system. State courts, including Tennessee's highest court, have taken the position that equity for students necessitates neither equal funding nor sameness but rather equal opportunity. Equality of opportunity has been a longstanding issue in education. As noted by the US Advisory Commission on Intergovernmental Relations in a 1975 report on education,

equality of educational opportunity is of critical importance in a democratic society dedicated to the proposition that all persons should have an equal chance to develop their potentialities to the fullest. This objective takes on particular urgency as technological advancement causes employment opportunities to become increasingly restricted to persons with professional and technical skills.

That reasoning led to passage of the Education Improvement Act of 1992 and adoption of the BEP formula. The formula is structured specifically to ensure "vertical" equity—treating different students differently—by providing additional funds for early-elementary and high school students, career and technical students, special education students, at-risk students, etc. "Horizontal" equity—treating similar students similarly—is achieved by equalizing funding across school systems, through a process that assumes local governments are imposing comparable tax rates, and then using state funds to make up the difference in the amount of local education revenue those rates produce. The state's education funding formula computes the amount each Tennessee school system needs to fund the defined BEP, determines the amount of education revenue each county can fairly be required to raise, then makes up the difference with state funds. This process is described in the *Blue Book* produced by the State Board of Education and periodically evaluated by Commission staff in reports on student equity.

Taxpayer equity is another longstanding point of discussion in education finance. In a 1999 report, the National Research Council, part of the non-profit National Academy of Sciences, said,

From a school finance perspective, a system would be judged fair to taxpayers if every taxpayer was assured that a given tax rate would translate into the same amount of spending per pupil regardless of where the taxpayer lived.

In order to ensure that similarly situated taxpayers are treated similarly, the state imposes the same taxes on the same things regardless of location. To the extent that taxpayer equity is not achieved across local governments, residents control those decisions through the electoral process. They choose those who set tax rates, and so it can be said



that they have chosen whatever differences exist between localities. Of course, that's not the case with respect to nonresident taxpayers, but they at least have some ability to choose where they procure goods and services and thus have some control over the rates they pay and to whom they pay them.

If public school funds were raised solely from residential property taxes, the problem could be easily solved. Residents who pay those taxes would be funding their own schools wherever counties, cities, and special school districts operate K-12 systems. Where cities or special school districts serve some but not all grade levels, something similar to the current structure for sharing county revenue for schools could be utilized to fund the grades that those cities or districts do not offer.

But that's not how public schools in Tennessee are funded. For instance, taxpayers living in city school systems or special school districts pay county property taxes in addition to city or special school district property taxes. The challenge is devising a way to ensure that taxpayers derive similar benefit from the taxes they pay regardless of whether they live in or receive services from the taxing jurisdiction. Consequently, Tennessee has several examples of taxpayer inequities, some of which favor cities and some of which favor counties.

A county's ability to use countywide revenue in lieu of bonds to fund education capital expenditures without sharing this revenue is one example that improves student equity at the expense of taxpayer equity. This is arguably unfair to taxpayers living in city school systems or special school districts, but it's one of only a few ways counties can address student equity under current law. **Because countywide property taxes and countywide local option sales taxes apply to property and sales within cities and special school districts, the General Assembly could require counties to share this revenue when they use it for education capital expenditures as is required when they use it for education operations and maintenance. But if the state does so, it should consider adopting other alternatives that would improve student equity in counties with multiple school systems while adhering to principles of taxpayer equity. Any such change should be prospective only so as not to create problems with revenues committed to repayment of existing debt or with state or federal maintenance of effort requirements.**

One alternative that could improve both student and taxpayer equity is to remove the requirement that counties share their portion of the unearmarked half of local option sales tax when it is budgeted for education operations and maintenance. Because this revenue is distributed based on the situs (location) of the sale, none of it is generated within cities, and cities are not required to share their portion of the unearmarked half of local option sales tax revenue. If counties were to use all of the \$59.8 million in local option sales tax revenue generated in unincorporated areas to fund county school

systems, it would still be far less than the \$413.3 million needed to eliminate funding intra-county disparities. Again, any such change should be prospective only so as not to create problems with revenues committed by cities to debt repayment or maintenance of effort requirements.

**Transitioning from calculating fiscal capacity at the county level to calculating it at the system level is another alternative that would decrease disparities for students as well as taxpayers.** Both Former Phil Governor Bredesen's Task Force on Teacher Pay (2003) and the BEP Review Committee (2005) have previously recommended that the state adopt a system-level fiscal capacity model. In 2004, the General Assembly asked the BEP Review Committee to give special consideration to "the development and implementation of a system-level fiscal capacity model." Fiscal capacity is the ability of local governments to raise revenue for education from local sources relative to other local governments. The state uses two capacity models to equalize state education funding through the BEP funding formula. Starting in school year 2007-08, a tax capacity model produced by the Center for Business and Economic Research (CBER) at the University of Tennessee has been used in combination with the county-level fiscal capacity model produced by TACIR and used since the inception of the BEP funding formula in 1992-93. Both models are calculated at the county level and don't take into account several factors that drive intra-county disparities, most particularly the counties' relative lack of access to unshared tax bases and the concentration of commercial and industrial tax bases within cities, both of which leave counties with less ability to raise local revenue for county school systems when compared with city school systems and special school districts in the same county. A system-level fiscal capacity model would account for these intra-county differences and essentially eliminate intra-county disparities across school systems. For illustrative purposes only, the prototype system-level fiscal capacity model developed by TACIR and the Tennessee Comptroller of the Treasury staff in 2004, updated to include current data, is provided in appendix G. The original version of this model was reviewed by outside experts at Middle Tennessee State University, Tennessee State University, and Vanderbilt University. Other system-level models could be developed, either by the Commission or by other entities.

### ***Transfer of Property to New City School Systems***

Creating new school systems can lead to conflicts over buildings and facilities. State laws prohibiting the forming of new school systems were enacted for special school districts in 1982 and for city school systems in 1998. New special school districts are still prohibited, but the law for city schools was changed in 2013. Since that time, six Shelby County cities have formed new school systems and other cities have considered doing so.



Although these cities are required by law to provide appropriate school facilities, counties are not required to transfer school property to them.

While the law in Tennessee does not speak to the transfer of real or personal property when an existing city forms a new school system, current annexation statutes and those for disbanding school systems, as well as laws in other states, may provide guidance for establishing requirements and methods. Options range from imposing specific obligations to requiring a local committee to create a plan for the transfer by agreement. For example, current statutes authorize the creation of a planning commission for consolidating school systems when an existing system is being disbanded or systems are merging and sets out considerations for those commissions that include the transfer of assets and liabilities. Current annexation laws in Tennessee require local agreements for transferring property and arbitration to settle disagreements. Laws in a few states also address transferring titles of school property between school systems and the settlement of outstanding debt for the property, but no examples of the use of those laws in recent decades were found.

Providing a method in statute should ensure greater predictability and fairness for school systems and taxpayers and may reduce the likelihood of litigation. **The General Assembly should establish a method for transferring school property, both real and personal, to new school systems formed by existing cities. A local committee could be created to determine what property should be transferred and what the city should pay for it. Whoever determines the city's liability should consider past and future contributions of the city and the county to procure and maintain the property in question. Relevant unit costs in the BEP could be used to calculate the value of new real and personal property subject to transfer. For instance, textbook unit costs are based on the actual cost of textbooks that will be purchased for the upcoming school year.**

Currently, city residents vote in a referendum on whether to form a new city school system before they know what it will cost the city, and by extension the city's taxpayers, to acquire all of the property it will need. **The General Assembly should require that the purchase price of the property be determined before the city referendum on the creation of a city school system.**

***Other concerns about local revenue and services in Tennessee warrant further study.***

In addition to this report, work continues on TACIR's local revenue and services series, and the second interim report on education funding was published in January 2020. Its more holistic treatment of revenue provides helpful context for evaluating other potential sources of education funding: state-shared taxes, for instance. During its discussion of

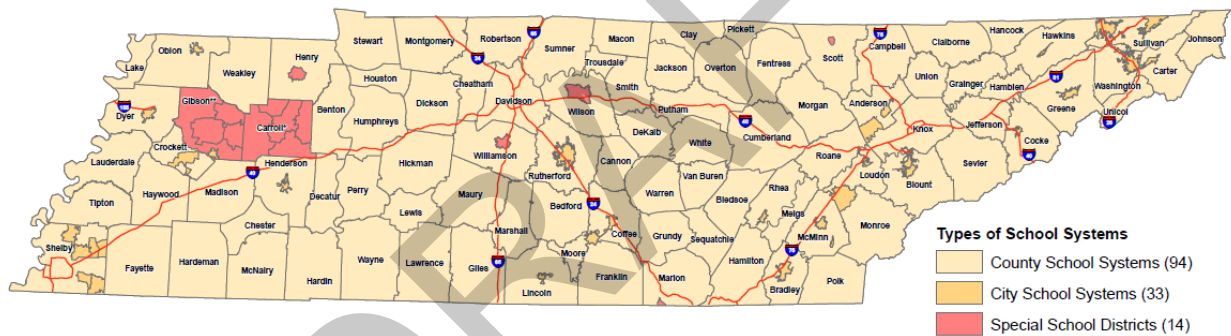
House Bill 971 by Representative Sargent, Senate Bill 1075 by Senator Watson, the House Finance Ways and Means Committee asked TACIR to study the revenue sources of cities and counties in Tennessee and the services cities and counties provide. In February 2019, TACIR published the first interim report in this series on Internet Sales Tax in Tennessee. A comprehensive study of local government revenue and services is planned, which will follow a second interim report on education funding. This set of reports is designed to form a foundation for further work by a task force of stakeholders to develop a set of specific legislative proposals for consideration by the Governor and the General Assembly. Any such task force, to be successful, must include representatives of those affected by the changes as well as those with responsibility for adopting and implementing them.

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# Analysis: Effects of Sharing of Revenue among School Systems in Counties with More than One School System

Public K-12 education in Tennessee is provided through school systems that in general are operated locally—either by counties, municipalities, or special school districts.<sup>3</sup> State law requires each county to operate a K-12 school system, either individually or in partnership with another county, unless all students in the county are served by municipal school systems and special school districts, as is presently the case in Gibson County only.<sup>4</sup> Currently, 30 of the state’s 95 counties have more than one school system. There are 94 county school systems, 33 municipal school systems, and 14 special school districts.<sup>5</sup> See maps 1 and 2 and table 1.

**Map 1. Tennessee Public School Systems.**



Source: Tennessee Advisory Commission on Intergovernmental Relations; Tennessee Department of Education, 2017-18 School Year.

\*Carroll County has five special school districts. Carroll County Schools is a countywide system that provides a technical training center, a special learning center, an alternative school, and transportation services to all public school systems in the county.

\*\*Gibson County has no county school system, one city school system, and four special school districts.

<sup>3</sup> Tennessee Department of Education “2017-18 Annual Statistical Report.”

<sup>4</sup> Tennessee Code Annotated, Section 49-2-101 et seq.

<sup>5</sup> Tennessee Department of Education “2017-18 Annual Statistical Report.”

**Map 2. Tennessee Counties with Multiple School Systems**



Source: Tennessee Advisory Commission on Intergovernmental Relations; Tennessee Department of Education, 2017-18 School Year.

\*Carroll County has five special school districts. Carroll County Schools is a countywide system that provides a technical training center, a special learning center, an alternative school, and transportation services to all public school systems in the county.

\*\*Gibson County has no county school system, one city school system, and four special school districts.

**Table 1. Number of Tennessee Public School Systems by County, Fiscal Year 2017-18**

County	Number of County School Systems	Number of City School Systems	Number of Special School Districts	Total Number of School Systems
Single-system	65	0	0	65
County and City systems	23	32	0	55
County system and Special School Districts	6	0	10	16
City systems and Special School Districts	0	1	4	5
<b>TOTAL</b>	<b>94</b>	<b>33</b>	<b>14</b>	<b>141</b>

Source: Tennessee Department of Education, Annual Statistical Report, Fiscal Year 2017-18.

State law requires counties to share local revenue with city school systems and special school districts in the same counties,<sup>6</sup> but there are no sharing requirements for cities and

<sup>6</sup> Tennessee Code Annotated, Sections 49-3-315(a), 49-3-1003, and 9-21-129. See also *Harriman v. Roane County*, 553 S.W.2d 904 (Tenn. 1977).

special school districts. Representatives of county officials in Tennessee have expressed concern that education revenue sharing requirements in that state favor city school systems and special school districts at the expense of county school systems.<sup>7</sup> Responding to these concerns, Senate Joint Resolution 593 directs the Tennessee Advisory Commission on Intergovernmental Relations (TACIR) to study both the overall effects on public K-12 education of the laws and regulations related to the sharing of resources between multiple school systems in the same county and the effect of the operation of additional municipal or special school districts within a county (see appendix A).

Senate Joint Resolution 593 also notes that “the creation of new school districts has in the past created conflict regarding the ownership of existing school buildings and facilities,” and state law does not require counties to transfer school property to new school systems. In the 110<sup>th</sup> General Assembly, Senate Bill 1755 by Senator Gardenhire, House Bill 1757 by Representative Harry Brooks, as amended, would have required TACIR to recommend “a process for determining the amount that a city must pay to fairly compensate the county for the school property the city seeks to obtain,” but the bill did not pass (see appendixes B and C).

### **Whether local revenues must be shared varies under state law**

In counties with multiple school systems, revenue raised for K-12 education may or may not be shared among all systems in the county—under state law—depending on the revenue’s source, what it is allocated for, and whether it is earmarked for specific purposes. For instance, state law excludes from sharing requirements revenue used for a “student transportation” system that serves all school systems in the county.<sup>8</sup> Revenue from federal sources, including payments in lieu of taxes from the Tennessee Valley Authority, is also excluded from these requirements regardless of how it is spent.<sup>9</sup> In

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<sup>7</sup> Interviews with Dan Eldridge, mayor of Washington County and Richard Venable, mayor of Sullivan County.

<sup>8</sup> Tennessee Code Annotated, Section 49-3-315(a).

<sup>9</sup> State ex rel. Conger v. Madison County, 581 S.W.2d 632 (Tenn. 1979); Oak Ridge City Schools v. Anderson County, 677 S.W.2d 468 (Tenn. Ct. App. 1984); Crider v. Henry County, 295 S.W.3d 269 (Tenn. Ct. App. 2008). TVA PILOT revenue distributed to local governments is not earmarked and may be used for any local government purpose, including education. For fiscal year 2017-18, the state distributed \$103.0 million in TVA PILOTs to county governments in Tennessee, of which counties with more than one school system received \$42.5 million and used \$22.8 million (53.6%) to fund county school systems. See TACIR’s 2019 report *Tennessee Valley Authority’s Payments in Lieu of Taxes Annual Report to the Tennessee General Assembly*.

contrast, revenue from state and local sources that counties allocate for schools' operation and maintenance must be shared with all school systems in the county.<sup>10</sup>

Local county revenue is subject to sharing requirements, but local revenue from cities and special school districts is not. Given that local revenue accounted for \$3.7 billion of the \$10.2 billion<sup>11</sup> in public K-12 education revenue for fiscal year 2017-18 in Tennessee<sup>12</sup>—state funding amounted to \$4.9 billion and federal revenue was \$1.2 billion<sup>13</sup>—these sharing requirements affect a substantial portion of education revenue. Whenever sharing is required, revenue is distributed based on the weighted full-time equivalent average daily attendance (WFTEADA) for each school system in the county (see appendix D).<sup>14</sup> This provides additional weight for students at different grade levels, career and technical students, and special education students so that the school systems they attend will receive more local revenue to meet the needs of the students they serve.<sup>15</sup>

Almost all of the local revenue affected by these sharing requirements comes from local property and local option sales taxes. Sharing requirements also apply to some of the revenue from both the mixed drink tax and the revenue used for capital expenditures, while interest earned on general-purpose school funds is exempt.

### **Property Taxes**

Local property taxes can be levied by counties, cities, and special school districts<sup>16</sup> and are used by each to fund education.<sup>17</sup> Countywide property taxes, in particular, are the largest source of local revenue used for K-12 education in Tennessee, accounting for \$2.1 billion of the \$3.7 billion in local revenue raised for education in fiscal year 2017-18.<sup>18</sup>

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<sup>10</sup> Tennessee Code Annotated, Section 49-3-315(a).

<sup>11</sup> Excludes non-revenue receipts, which are receipts from sale of bonds, notes, lease proceeds, insurance recovery, and transfers. Non-revenue receipts were \$790.0 million in fiscal year 2017-18.

<sup>12</sup> Tennessee Department of Education "2017-18 Annual Statistical Report."

<sup>13</sup> Ibid.

<sup>14</sup> Tennessee Code Annotated, Sections 49-3-315(a), 49-3-1003, and 9-21-129.

<sup>15</sup> Tennessee Department of Education.

<sup>16</sup> Tennessee Code Annotated, Sections 67-5-102 and 67-5-103. Special school districts are authorized to levy property taxes by private act.

<sup>17</sup> Tennessee Department of Education "2017-18 Annual Statistical Report."

<sup>18</sup> Ibid.



In counties with multiple school systems, countywide property taxes budgeted for education operations and maintenance expenses must be shared with all school systems in the county.<sup>19</sup> In contrast, property taxes levied by cities, which are collected from city businesses and residents, do not have to be shared. Likewise, no sharing requirement is placed on property tax revenue collected by special school districts from businesses and residents located therein.

### **Local Option Sales Taxes**

Counties and cities can impose local option sales taxes, though special school districts cannot. Local option sales tax accounted for \$1.3 billion of \$3.7 billion in local revenue for K-12 education in Tennessee in fiscal year 2017-18.<sup>20</sup>

State law requires that 50% of revenue generated by the countywide local option sales tax rate be shared with all school systems in the county.<sup>21</sup> The other 50% is not earmarked and is distributed either to a city, if the situs (location) of the sale is within the city, or to a county if the situs of the sale is within the unincorporated part of the county. Cities may use any of their revenue, including the unearmarked half of sales tax revenue collected there, to fund their city school systems without sharing with other school systems in the county. However, a counties' unearmarked local option sales tax revenue (\$59.8 million in fiscal year 2017-18)<sup>22</sup> that is used for education operations and maintenance must be shared with all school systems in the county.<sup>23</sup>

### **Mixed Drink Tax**

In counties and cities that have approved, by referendum, sales of liquor-by-the-drink, also known as mixed drinks, state law imposes a 15% tax on those sales. Half of mixed drink tax revenue (\$58.9 million in fiscal year 2017-18) is distributed to the state's general fund and is earmarked for education purposes<sup>24</sup>; the other half is distributed to the city (\$56.6 million in fiscal year 2017-18) or county (\$2.3 million in fiscal year 2017-18) in which

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<sup>19</sup> Tennessee Code Annotated, Section 49-3-315(a).

<sup>20</sup> Tennessee Department of Education.

<sup>21</sup> Tennessee Code Annotated, Section 67-6-712.

<sup>22</sup> TACIR staff calculation based on data from the Tennessee Department of Revenue.

<sup>23</sup> Tennessee Code Annotated, Sections 49-3-315(a) and 57-4-103. See also *Harriman v. Roane County*, 553 S.W.2d 904 (Tenn. 1977).

<sup>24</sup> Tennessee Department of Revenue "2017-18 Annual Report."

the revenue was generated,<sup>25</sup> and half of that is earmarked for school systems. For counties where the county school system is the only school system in the county, all of the revenue that is earmarked for education (both city and county) is distributed to the county school system, but in counties with more than one school system, the distribution is more complex.

Revenue that is earmarked for education generated within unincorporated parts of counties where a mixed drink tax is levied is distributed to the county school system. Revenue that is earmarked for education and that is generated within cities where a mixed drink tax is levied is distributed based on whether the city has a city school system, what grade levels the city school system serves, whether at least part of the city falls within a special school district (SSD), which school systems students residing in the city attend, and whether the city is in more than one county:

- If the city where the revenues are collected operates a K-12 school system, the city keeps all revenue for its schools.
- If the city where the revenues are collected does not serve all grade levels, K through 12, the proceeds are to be distributed to the school systems where students that reside in the city attend school, according to weighted full-time equivalent average daily attendance (WFTEADA).<sup>26</sup>
- If an SSD is in the city where the revenues are collected, the revenues are allocated by WFTEADA to the SSD and to the county school system.
- If the city lies in two or more counties, the proceeds are allocated to the county in which they are collected according to the location of the business collecting them.

The current distribution was first enacted in 2014, amending previous language, which some found ambiguous. The statute was amended to clarify the circumstances under which cities with a city school system are required to share their mixed drink tax revenue that is earmarked for education. Previously, five counties filed lawsuits to require cities to distribute some of their mixed drink tax revenue to county school systems. Before it was amended in 2014, state law required half of the revenue distributed to local governments to be distributed “in the same manner as the county property tax for schools is expended and distributed,” that is, to each school system in the county based on weighted full-time equivalent average daily attendance (WFTEADA). However, the

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<sup>25</sup> Tennessee Code Annotated, Section 57-4-306(a).

<sup>26</sup> Public Chapter 901, Acts of 2014 and Public Chapter 194, Acts of 2019.

Supreme Court of Tennessee ruled in favor of the cities in 2019,<sup>27</sup> and in 2020, the General Assembly removed the expiration date from the distribution formula that was enacted in 2014.<sup>28</sup>

The court's rulings relied in part on its understanding of the distribution that the Legislature intended. Attorney General Opinions issued in the early 1980s interpreted the statute to mean that the distribution of the mixed drink tax revenue that is earmarked for education depended on whether a city operates its own school system.<sup>29</sup> Consistent with those opinions, cities had been keeping the earmarked revenue for their city school systems for more than 30 years. In its opinion, the Supreme Court of Tennessee said that "the Legislature's failure to amend the distribution statute after the Attorney General opinions and the universal practical construction of the statute by counties and cities across Tennessee serves as . . . persuasive evidence of the Legislature's intent to adopt that interpretation."<sup>30</sup>

### **Requirements for Capital Expenditures**

Counties often issue bonds for capital expenditures—including new schools, renovations, and buses.<sup>31</sup> More than \$500 million was spent on education capital projects for Tennessee schools in 2017-18,<sup>32</sup> primarily financed with bond proceeds.<sup>33</sup> Whether these bond proceeds must be shared depends on whether they are backed by revenue from areas that include city school systems or special school districts.

According to the University of Tennessee, County Technical Assistance Service,

the law requires counties containing city schools or special school districts to distribute the proceeds from a bond issue for school capital purposes on an average daily attendance basis, unless a tax district outside the city or special school district is established. If a tax district is not established, city

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<sup>27</sup> *Coffee Cty. Bd. of Educ. v. City of Tullahoma*, 2018 Tenn. App. LEXIS 29 (Tenn. Ct. App., Jan. 23, 2018)

<sup>28</sup> Public Chapter 696, Acts of 2020.

<sup>29</sup> Tenn. Op. Att'y Gen. 83-36, 1983 Tenn. AG LEXIS 381 (Jan. 18, 1983); Tenn. Op. Att'y Gen. 81-270, 10 Op. Att'y Gen. Tenn. 711 (Apr. 27, 1981); Tenn. Op. Att'y Gen. 80-457, 10 Op. Att'y Gen. Tenn. 231 (Sept. 19, 1980).

<sup>30</sup> *Coffee Cty. Bd. of Educ. v. City of Tullahoma*, 2018 Tenn. App. LEXIS 29 (Tenn. Ct. App., Jan. 23, 2018)

<sup>31</sup> Electronic Municipal Market Access, <https://emma.msrb.org/> (Downloaded on May 7, 2019).

<sup>32</sup> Tennessee Department of Education "2017-18 Annual Statistical Report, Table 49."

<sup>33</sup> Electronic Municipal Market Access, <https://emma.msrb.org/> (Downloaded on May 7, 2019).

systems and special school districts are entitled to a proportional share of the proceeds of a school bond issue, or they may waive their rights to such a share. If a tax district is established so that the school bonds are payable only from funds collected outside the city or special district, then the city or special school districts do not share in the proceeds (citations omitted).<sup>34</sup>

Specifically, state law requires that “the trustee of the county shall pay over to the treasurer of the city that amount of the funds that bear the same ratio to the entire amount arising from this part as the [weighted full time equivalent] average daily attendance . . . bears to the entire [weighted full time equivalent] average daily attendance.”<sup>35</sup> An identically worded statute requires counties to share with special school districts.<sup>36</sup> Similarly, “proceeds from the sale of bonds or notes . . . for school capital outlay purposes shall be shared with any municipal or special school district system within the county or metropolitan government.”<sup>37</sup> Only six of the 30 multisystem counties have chosen to establish tax districts—sometimes referred to as rural tax districts—outside their city or special school districts to fund their county school systems’ debt (see table 2).<sup>38</sup>

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<sup>34</sup> University of Tennessee County Technical Assistance Service “School Bonds.”

<sup>35</sup> Tennessee Code Annotated, Section 49-3-1003(b)(1).

<sup>36</sup> Tennessee Code Annotated, Section 49-3-1003(c)(1).

<sup>37</sup> Tennessee Code Annotated, Section 9-21-129(a).

<sup>38</sup> University of Tennessee County Technical Assistance Service, Tennessee County Tax Statistics, Fiscal Year 2018-19.

**Table 2. Property Tax Revenue for Rural Debt Service Funds by County, Fiscal Year 2017-18**

County	Property Tax Revenue for Rural Debt Service Funds
Williamson	\$ 19,968,574
Roane	1,463,275
Marion	1,300,000
Scott	690,000
Coffee	589,845
Anderson	173,000
<b>TOTAL</b>	<b>\$ 24,184,694</b>

Source: TACIR Staff calculations based on rural debt service property tax rates and assessments.

Because commercial and industrial property are concentrated in cities (see appendix E), a given tax rate applied countywide usually generates more revenue for the county school system—even after sharing with the city school system or special school district—than a property tax for a rural debt service district would. This is the case in 21 of the state’s multisystem counties (see table 3). Three of the five multisystem counties with rural tax districts would generate more revenue for their county school systems through a countywide property tax levied at the same rate as the property tax on their rural tax districts, even after accounting for sharing requirements.

**Table 3. Comparison of Rural Tax District Revenue to Actual Property Tax Revenue after Sharing, Fiscal Year 2017-18**

Multisystem County	Rural Property Assessment (Outside City/SSD) <sup>1</sup>	School Property Tax Rate <sup>2</sup>	Rural Tax District Revenue	County Share of Actual Property Tax Revenue for Schools After Sharing <sup>3</sup>	Difference
Anderson	\$ 628,176,798	1.61050	\$ 10,116,787	\$ 15,639,387	\$ (5,522,600)
Blount	\$ 2,127,762,019	1.07000	\$ 22,767,054	\$ 22,492,980	\$ 274,074
Bradley	\$ 1,101,526,753	0.75020	\$ 8,263,654	\$ 12,757,563	\$ (4,493,909)
Carter	\$ 574,761,060	1.12100	\$ 6,443,071	\$ 6,551,104	\$ (108,033)
Cocke	\$ 449,980,753	0.57700	\$ 2,596,389	\$ 3,128,658	\$ (532,269)
Coffee	\$ 752,179,776	1.64960	\$ 12,407,958	\$ 8,943,714	\$ 3,464,244
Crockett	\$ 175,104,933	0.67470	\$ 1,181,433	\$ 1,155,505	\$ 25,928
Dyer	\$ 369,393,381	0.91400	\$ 3,376,256	\$ 3,643,019	\$ (266,763)
Franklin	\$ 991,429,212	1.04110	\$ 10,321,770	\$ 10,491,342	\$ (169,572)
Greene	\$ 932,950,030	0.77530	\$ 7,233,162	\$ 7,316,524	\$ (83,362)
Hawkins	\$ 882,308,101	0.64000	\$ 5,646,772	\$ 7,907,998	\$ (2,261,226)
Henderson	\$ 252,686,529	0.64000	\$ 1,617,194	\$ 2,356,361	\$ (739,167)
Henry	\$ 42,688,087	0.78790	\$ 3,487,939	\$ 5,118,328	\$ (1,630,389)
Lincoln	\$ 435,034,035	0.78830	\$ 3,429,373	\$ 3,510,640	\$ (81,267)
Loudon	\$ 1,543,409,469	0.86200	\$ 13,304,190	\$ 10,885,791	\$ 2,418,399
Marion	\$ 680,774,664	0.78770	\$ 5,362,462	\$ 5,399,161	\$ (36,699)
McMinn	\$ 727,466,584	0.74690	\$ 5,433,448	\$ 6,733,573	\$ (1,300,125)
Monroe	\$ 992,225,302	0.63400	\$ 6,290,708	\$ 5,217,809	\$ 1,072,899
Obion	\$ 428,950,406	1.12000	\$ 4,804,245	\$ 4,531,072	\$ 273,173
Rhea	\$ 475,112,964	0.42220	\$ 2,005,927	\$ 2,388,757	\$ (382,830)
Roane	\$ 1,110,205,527	1.22500	\$ 13,600,018	\$ 14,855,694	\$ (1,255,676)
Rutherford	\$ 4,990,470,143	1.28350	\$ 64,052,684	\$ 79,385,101	\$ (15,332,417)



Scott	\$ 278,304,771	0.85300	\$ 2,373,940	\$ 2,049,428	\$ 324,512
Shelby	\$ 14,574,956,899	1.99000	\$ 290,041,642	\$ 385,464,792	\$ (93,423,150)
Sullivan	\$ 1,407,595,768	1.35300	\$ 19,044,771	\$ 25,068,490	\$ (6,023,719)
Washington	\$ 1,209,139,096	0.82560	\$ 9,982,652	\$ 13,183,011	\$ (3,200,359)
Williamson	\$ 9,948,066,932	1.21000	\$ 120,371,610	\$ 137,041,726	\$ (16,670,116)
Wilson	\$ 3,146,847,723	1.17450	\$ 36,959,727	\$ 39,638,126	\$ (2,678,399)

Sources: TACIR staff calculations based on data from the Comptroller of the Treasury, the University of Tennessee County Technical Assistance Service, and County comprehensive annual financial reports.

<sup>1</sup>2018 Tax Aggregate Report of Tennessee, Division of Property Assessments, Comptroller of the Treasury. Table 1 Summary of 2018 Assessments for Counties and Municipalities in Tennessee.

<sup>2</sup>Tennessee County Tax Statistics FY 2018, University of Tennessee County Technical Assistance Service.

<sup>3</sup>County comprehensive annual financial reports.

Bond proceeds are exempt from sharing requirements if they are used for capital expenditures for grade levels not served by the city or special school districts in a multisystem county. Newport City Schools operates a K-8 school system, and when Cocke County issued a bond for high school improvements, the City of Newport sued for its proportionate share of the bond proceeds, asserting that the new facilities were sometimes used by K-8 students attending Cocke County Schools. But the court ruled that the bond's main purpose was to improve high school facilities, and "a city or special school district which operates no high schools is not entitled to the pro-rata distribution of the proceeds of bonds issued by a county for high school purposes."<sup>39</sup> This situation is only possible in counties where one or more of the city school systems or special school districts are not K-12 systems. All 94 county school systems in Tennessee are K-12. Of the 33 city school systems, 20 are K-12, 9 are K-8, 3 are K-6, and one is K-5. Of the 14 special school districts, 11 are K-12 and 3 are K-8 (see table 4).

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<sup>39</sup> Newport v. Cocke County, 703 S.W.2d 626 (Tenn. Ct. App. 1985). See also Moody v. Williamson County, 212 Tenn. 666, 371 S.W.2d 454 (1963).

**Table 4. Grades Served by School System, Fiscal Year  
2017-18**

School System	System Type	Grades Served
Anderson County	County	K-12
Clinton	City	K-6
Oak Ridge	City	K-12
Bedford County	County	K-12
Benton County	County	K-12
Bledsoe County	County	K-12
Blount County	County	K-12
Alcoa	City	K-12
Maryville	City	K-12
Bradley County	County	K-12
Cleveland	City	K-12
Campbell County	County	K-12
Cannon County	County	K-12
Carroll County	County*	K-12
Hollow Rock-Bruceton SSD	SSD	K-12
Huntingdon SSD	SSD	K-12
McKenzie SSD	SSD	K-12
South Carroll SSD	SSD	K-12
West Carroll SSD	SSD	K-12
Carter County	County	K-12
Elizabethton	City	K-12
Cheatham County	County	K-12
Chester County	County	K-12
Claiborne County	County	K-12
Clay County	County	K-12
Cocke County	County	K-12
Newport	City	K-8
Coffee County	County	K-12
Manchester	City	K-8
Tulahoma	City	K-12
Crockett County	County	K-12
Alamo	City	K-6
Bells	City	K-5
Cumberland County	County	K-12
Davidson County	County	K-12
Decatur County	County	K-12

DeKalb County	County	K-12
Dickson County	County	K-12
Dyer County	County	K-12
Dyersburg	City	K-12
Fayette County	County	K-12
Fentress County	County	K-12
Franklin County	County	K-12
Gibson County		
Humboldt	City	K-12
Milan SSD	SSD	K-12
Trenton SSD	SSD	K-12
Bradford SSD	SSD	K-12
Gibson County SSD	SSD	K-12
Giles County	County	K-12
Grainger County	County	K-12
Greene County	County	K-12
Greeneville	City	K-12
Grundy County	County	K-12
Hamblen County	County	K-12
Hamilton County	County	K-12
Hancock County	County	K-12
Hardeman County	County	K-12
Hardin County	County	K-12
Hawkins County	County	K-12
Rogersville	City	K-8
Haywood County	County	K-12
Henderson County	County	K-12
Lexington	City	K-8
Henry County	County	K-12
Paris SSD	SSD	K-8
Hickman County	County	K-12
Houston County	County	K-12
Humphreys County	County	K-12
Jackson County	County	K-12
Jefferson County	County	K-12
Johnson County	County	K-12
Knox County	County	K-12
Lake County	County	K-12
Lauderdale County	County	K-12
Lawrence County	County	K-12

Lewis County	County	K-12
Lincoln County	County	K-12
Fayetteville	City	K-12
Loudon County	County	K-12
Lenoir City	City	K-12
McMinn County	County	K-12
Athens	City	K-8
Etowah	City	K-8
McNairy County	County	K-12
Macon County	County	K-12
Madison County	County	K-12
Marion County	County	K-12
Richard City SSD	SSD	K-12
Marshall County	County	K-12
Maury County	County	K-12
Meigs County	County	K-12
Monroe County	County	K-12
Sweetwater	City	K-8
Montgomery County	County	K-12
Moore County	County	K-12
Morgan County	County	K-12
Obion County	County	K-12
Union City	City	K-12
Overton County	County	K-12
Perry County	County	K-12
Pickett County	County	K-12
Polk County	County	K-12
Putnam County	County	K-12
Rhea County	County	K-12
Dayton	City	K-8
Roane County	County	K-12
Robertson County	County	K-12
Rutherford County	County	K-12
Murfreesboro	City	K-6
Scott County	County	K-12
Oneida SSD	SSD	K-12
Sequatchie County	County	K-12
Sevier County	County	K-12
Shelby County	County	K-12
Arlington	City	K-12

Bartlett	City	K-12
Collierville	City	K-12
Germantown	City	K-12
Lakeland	City	K-8
Millington	City	K-12
Smith County	County	K-12
Stewart County	County	K-12
Sullivan County	County	K-12
Bristol	City	K-12
Kingsport	City	K-12
Sumner County	County	K-12
Tipton County	County	K-12
Trousdale County	County	K-12
Unicoi County	County	K-12
Union County	County	K-12
Van Buren County	County	K-12
Warren County	County	K-12
Washington County	County	K-12
Johnson City	City	K-12
Wayne County	County	K-12
Weakley County	County	K-12
White County	County	K-12
Williamson County	County	K-12
Franklin SSD	SSD	K-8
Wilson County	County	K-12
Lebanon SSD	SSD	K-8

Source: Department of Education, Annual Statistical Report, Fiscal Year 2017-18.

\*Carroll County Schools is a countywide system that provides a technical training center, a special learning center, an alternative school, and transportation services to all public school systems in the county and is not comparable to other school systems in the state.

When capital expenditures are funded from revenue that is not from note or bond proceeds, the Tennessee Court of Appeals has held that “a county may levy a special tax designated for a capital projects fund such as ‘for the building, repair, and equipment of rural schools,’ or a ‘Rural School Building and Repair Fund’” without having to share the

revenue with other school systems in the county.<sup>40</sup> McMinn County began apportioning funds from countywide property tax collections to an “educational capital projects fund” in 1996, and in 2014 the City of Athens Board of Education sued for its proportionate share of the revenue.<sup>41</sup> But the Court sided with the county, citing a state law that says “all school funds for current operation and maintenance purposes collected by any county . . . shall be apportioned by the county trustee among the [local education agencies] on the basis of [weighted full-time equivalent average daily attendance].”<sup>42</sup> The Court agreed with the county that funds collected for future capital costs are not for “current operation and maintenance” and are therefore not required to be apportioned to the city school systems in McMinn County.<sup>43</sup> All seven of the counties in Tennessee that have education projects in their general capital projects funds are counties with more than one school system: Coffee, Lincoln, McMinn, Rutherford, Sullivan, Washington, and Williamson.<sup>44</sup> Revenue used for school facility lease payments, another alternative to note or bond proceeds, may not be subject to sharing requirements. In October 2019, Washington County approved a lease-purchase agreement with the city of Jonesborough, which plans to issue bonds to build a K-8 school. Washington County is negotiating a fund-sharing agreement with Johnson City Schools to avoid being sued by them over whether sharing is required by state law in this instance.<sup>45</sup> A bill filed in 2019 would expand the application of the sharing requirement to funds raised for capital projects, but the bill has not passed.<sup>46</sup>

Although city school systems and special school districts are able to use their share of bond proceeds, it can be difficult to plan for because their capital needs may not correspond to bonds issued for the county school system in timing or in cost. City school systems in Shelby County reported difficulty knowing “when—or if—capital improvements funding will come their way if the projects being done by [Shelby County Schools] get behind schedule.”<sup>47</sup>

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<sup>40</sup> City of Athens Board of Education v. McMinn County, 467 S.W.3d 458 (Tenn. Ct. App. 2014). See also Tennessee Code Annotated, Section 49-3-1005(b).

<sup>41</sup> City of Athens Board of Education v. McMinn County, 467 S.W.3d 458 (Tenn. Ct. App. 2014).

<sup>42</sup> Tennessee Code Annotated, Section 49-3-315(a).

<sup>43</sup> City of Athens Board of Education v. McMinn County, 467 S.W.3d 458 (Tenn. Ct. App. 2014).

<sup>44</sup> County comprehensive annual financial reports.

<sup>45</sup> Houk and Roberts 2019, DeFusco 2019a, and DeFusco 2019b.

<sup>46</sup> Senate Bill 1216 by Senator Crowe, House Bill 1352 by Representative Matthew Hill.

<sup>47</sup> Kennedy 2019.



## **Interest Earned on General-Purpose School Funds**

According to a 2013 Attorney General’s Opinion, interest earned on money in general-purpose school funds does not have to be shared, for instance, when used by a county government for non-school related purposes.<sup>48</sup> Specifically, state law says that “any interest earned on funds that have previously been apportioned to the [school systems] within the county is not subject to apportionment.”<sup>49</sup>

### ***Sharing requirements contribute to disparities in local revenue and increases in county indebtedness***

As noted above, representatives of county officials have expressed concern that the existing sharing requirements favor city school systems and special school districts at the expense of county school systems.<sup>50</sup> While the state’s sharing requirements ensure that those living in special school districts and in cities with city school systems receive a share of the county taxes they pay to the county – as well as a share of the unearmarked half of local sales tax revenue, regardless of where it’s collected – to help fund public education in their communities, placing sharing requirements on counties but not on cities and special school districts prevents counties from using countywide revenue to close funding gaps with city school systems and special school districts. To meet those sharing requirements, these counties are also carrying more debt than they otherwise would.

In fiscal year 2017-18, cities and special school districts in 28 multisystem counties with county school systems<sup>51</sup> raised \$139.4 million for city school systems and special districts<sup>52</sup> that they did not have to share. This amounts to approximately \$1,237 per student. The 32 city systems in these counties received \$112.2 million in revenue that did not have to be shared – \$84.0 million in city general fund transfers, \$17.9 million in city property tax, and \$10.3 million in cities’ share of local option sales tax revenue.<sup>53</sup> The five special school

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<sup>48</sup> Tenn. Op. Att’y Gen. 13-107, (Dec. 20, 2013).

<sup>49</sup> Tennessee Code Annotated, Section 49-3-315(c).

<sup>50</sup> Interviews with Dan Eldridge, mayor of Washington County and Richard Venable, mayor of Sullivan County.

<sup>51</sup> Excludes Gibson and Carroll counties. Gibson County does not have a county school system, and Carroll County’s county school system is not comparable to other school systems.

<sup>52</sup> TACIR staff calculation based on data from the Tennessee Department of Education.

<sup>53</sup> Tennessee Department of Education “2017-18 Annual Statistical Report.”

districts in these counties received \$27.2 million in special school district property tax revenue<sup>54</sup> that they didn't have to share.

As a result, 28 of 32 city school systems and all five special school districts in the multisystem counties received more local revenue per student than the county school system in their county for fiscal year 2017-18. City school systems and special school districts in these counties received \$1,193 more per student in local revenue than the county school system. The additional revenue that city school systems and special school districts have access to can be used to pay higher teacher salaries, build and maintain facilities, and provide additional programs, tutoring, and advanced classes, thus creating intra-county disparities in student services. It would take an additional \$413.3 million for those county school systems to equal the per-student revenue of the city and special school districts they contain.<sup>55</sup>

There is little difference between local revenue per student for county school systems in multisystem counties and single-system counties (\$4,222 and \$4,114, respectively).<sup>56</sup> But an analysis of intra-county disparity between all school systems, as shown on table 5, demonstrates that only four city school systems (Alamo, Bells, Dayton, and Lakeland) received less local revenue per student when compared with the county school system in the same county in fiscal year 2017-18. Crockett County's school system received more revenue per student than both Alamo's and Bell's city school systems (\$1,272, \$958, and \$1,139, respectively).<sup>57</sup> Rhea County school system received more revenue per student than Dayton's city school system (\$2,161 and \$1,771, respectively).<sup>58</sup> None of these city school systems have high schools. Shelby County Schools received more revenue per student than Lakeland's city school system (\$4,462 and \$4,126, respectively) but less than the other five city school systems in Shelby County (\$4,597 to \$5,676).<sup>59</sup>

All other county systems in counties with city school systems (20 of 23) received less revenue per student than each of the city school systems in the same county. Similarly, all five county school systems with special school districts received less local revenue than the special school district in the same county (see table 5).

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<sup>54</sup> Tennessee Department of Education "2017-18 Annual Statistical Report."

<sup>55</sup> TACIR staff calculation based on data from the Tennessee Department of Education "2017-18 Annual Statistical Report."

<sup>56</sup> Ibid.

<sup>57</sup> Ibid.

<sup>58</sup> Ibid.

<sup>59</sup> Ibid.

**Table 5. Actual Local Revenue per Student by School Systems in Multi-system Counties, Fiscal Year 2017-18**

County System	Local	City System	Local
Anderson	\$ 4,036	Clinton	\$ 4,433
		Oak Ridge	\$ 7,420
weighted averages			\$ 6,893
Blount	\$ 4,255	Alcoa	\$ 5,831
		Maryville	\$ 6,116
weighted averages			\$ 6,038
Bradley	\$ 2,698	Cleveland	\$ 3,387
Carter	\$ 2,365	Elizabethton	\$ 3,509
Cocke	\$ 2,292	Newport	\$ 3,136
Coffee	\$ 3,391	Manchester	\$ 5,084
		Tullahoma	\$ 5,472
weighted averages			\$ 5,361
Crockett	\$ 1,272	Alamo	\$ 958
		Bells	\$ 1,139
weighted averages			\$ 1,032

Dyer	\$ 2,884	Dyersburg	\$ 3,582
Franklin	\$ 3,322	Tulahoma	\$ 5,472
Greene	\$ 2,482	Greeneville	\$ 5,420
Hawkins	\$ 2,665	Rogersville	\$ 3,230
		Kingsport	\$ 6,117
weighted averages			\$ 3,230
Henderson	\$ 2,058	Lexington	\$ 2,977
Lincoln	\$ 2,372	Fayetteville	\$ 2,580
Loudon	\$ 4,316	Lenoir City	\$ 5,082
McMinn	\$ 2,207	Athens	\$ 3,906
		Etowah	\$ 2,488
weighted averages			\$ 3,638
Monroe	\$ 2,019	Sweetwater	\$ 2,340
Obion	\$ 2,707	Union City	\$ 3,501
Rhea	\$ 2,161	Dayton	\$ 1,771
Roane	\$ 3,782	Oak Ridge	\$ 7,420
Rutherford	\$ 3,598	Murfreesboro	\$ 4,344
Shelby	\$ 4,462	Arlington	\$ 4,710
		Bartlett	\$ 4,674
		Collierville	\$ 4,713
		Germantown	\$ 5,676
		Lakeland	\$ 4,126
		Millington	\$ 4,597
weighted averages			\$ 4,843

Sullivan	\$ 4,326	Bristol	\$ 5,639
		Kingsport	\$ 6,117
weighted averages			\$ 5,950
Washington	\$ 3,691	Johnson City	\$ 5,852
<b>County System</b>	<b>Local</b>	<b>Special School District</b>	<b>Local</b>
Henry	\$ 3,461	Paris	\$ 4,000
Marion	\$ 2,501	Richard City	\$ 2,824
Scott	\$ 1,329	Oneida	\$ 2,173
Williamson	\$ 8,342	Franklin SSD	\$ 11,887
Wilson	\$ 3,618	Lebanon	\$ 4,719

Source: Tennessee Department of Education and TACIR staff calculations.

Because counties with multiple school systems are required to share bond proceeds with all school systems in the county in most circumstances, these counties appear to be taking on more debt for education capital projects than would otherwise be necessary. Overall school debt per student in the 141 school systems in Tennessee was more in fiscal year 2015-16 (\$6,049) than single-system counties and city school systems (\$5,653 and \$4,406, respectively), but less than county school systems in multisystem counties, which was second only to debt for special school districts (\$6,964 and \$8,213, respectively).<sup>60</sup> See appendix F for infrastructure needs and school debt per student in multisystem counties.

One possible explanation for why multisystem counties have more debt per student than single-system counties is that they issue debt to meet sharing requirements that would not have been issued otherwise. For instance, it's possible that a city school system or special school district does not have any capital outlay needs when it receives its share of bond proceeds. Of the 37 city and special school districts in counties with a county school system, three (Manchester, Richard City, and Dayton) reported having no infrastructure

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<sup>60</sup> US Department of Education, National Center for Education Statistics, Common Core of Data (CCD), "Local Education Agency (School District) Universe Survey"; Tennessee Department of Education, Average Daily Membership (ADM).

needs in 2017 (see appendix F).<sup>61</sup> In the absence of any capital outlay need, the stated purpose of the bond when the bond was issued may be broad enough to allow city school systems and special school districts to use their share of bond proceeds for any non-recurring education expense—computers, for instance. State law permits school systems “to purchase property for school purposes, to purchase sites for school buildings, to erect or repair school buildings, to furnish and equip school buildings and to refund,” and [to] “call or make principal and interest payments on bonds or other obligations previously issued for the same purposes.”<sup>62</sup> But it seems unlikely that short-lived personal property, like computers, would be financed using long term bonds if not for the sharing requirement. Bond proceeds that are not spent within five years of issue may need to be applied toward paying down the principal to avoid the bond losing its tax-exempt status.<sup>63</sup>

From 1997-98 to 2015-16 inflation-adjusted<sup>64</sup> outstanding debt per student increased 55.8% in county systems that are in multisystem counties but only 12.8% for county school systems in single-system counties.<sup>65</sup> Inflation-adjusted per-student debt peaked for county school systems in multisystem counties in 2009-10 at \$7,906 per student, and at \$6,717 per student in 2010-11 for county school systems in single-system counties and has since leveled off for both types of school systems.<sup>66</sup> Outstanding debt per student for cities increased when Memphis City Schools was absorbed by Shelby County School in 2013-14 but remains lower for other types of school systems at \$4,406 per student (see figure 1).<sup>67</sup>

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<sup>61</sup> Tennessee Advisory Commission on Intergovernmental Relations Public Infrastructure Needs Inventory.

<sup>62</sup> Tennessee Code Annotated, Section 49-3-1004(a).

<sup>63</sup> IRS Publication 4079.

<sup>64</sup> Federal Reserve Bank of St. Louis, Government Consumption Price Index 2019.

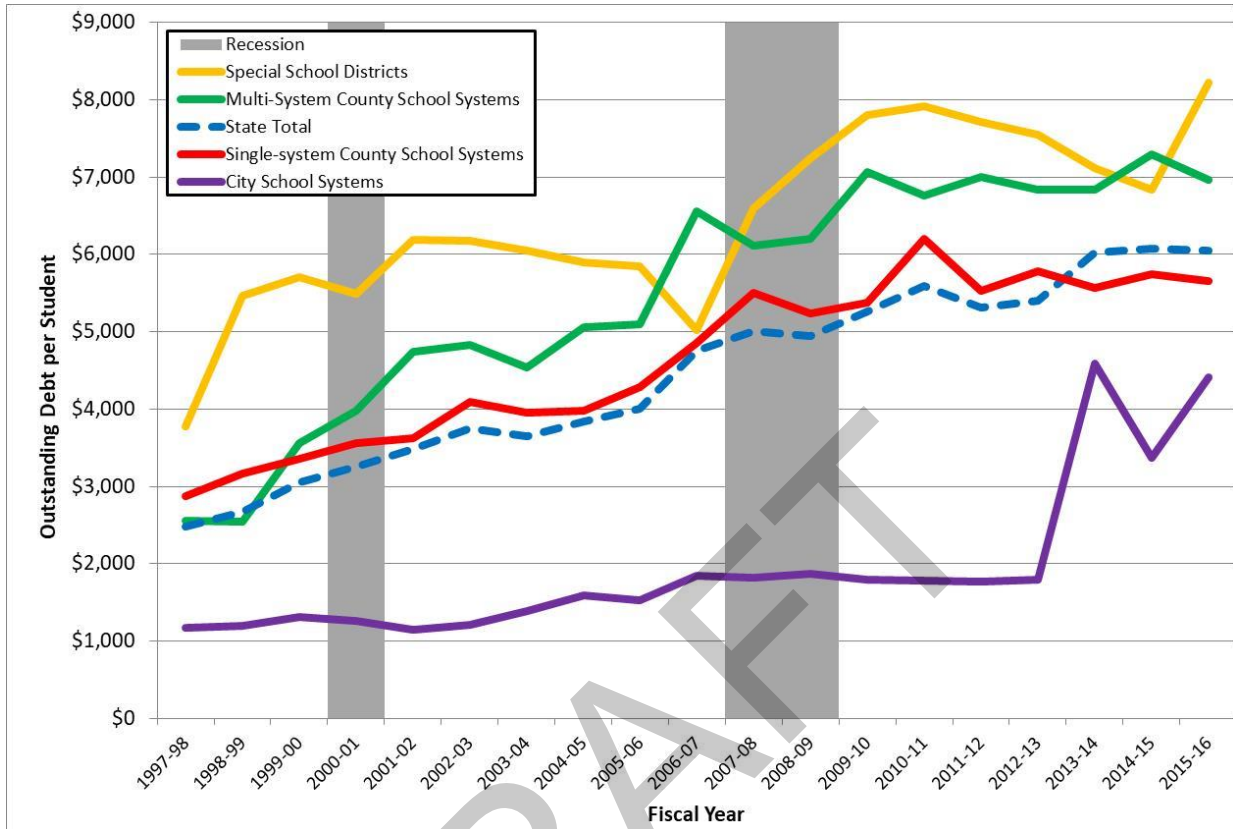
<sup>65</sup> US Department of Education, National Center for Education Statistics 2019.

<sup>66</sup> Ibid.

<sup>67</sup> Zubrzycki 2013 and US Department of Education, National Center for Education Statistics 2019.



**Figure 1. Long-term Debt per Student for Tennessee Public School Systems (2016 Dollars)**



Source: US Department of Education, National Center for Education Statistics, Common Core of Data (CCD), "Local Education Agency (School District) Universe Survey"; Tennessee Department of Education Annual Statistical Report, Average Daily Membership (ADM); Federal Reserve Bank of St. Louis, Government Consumption Price Index.

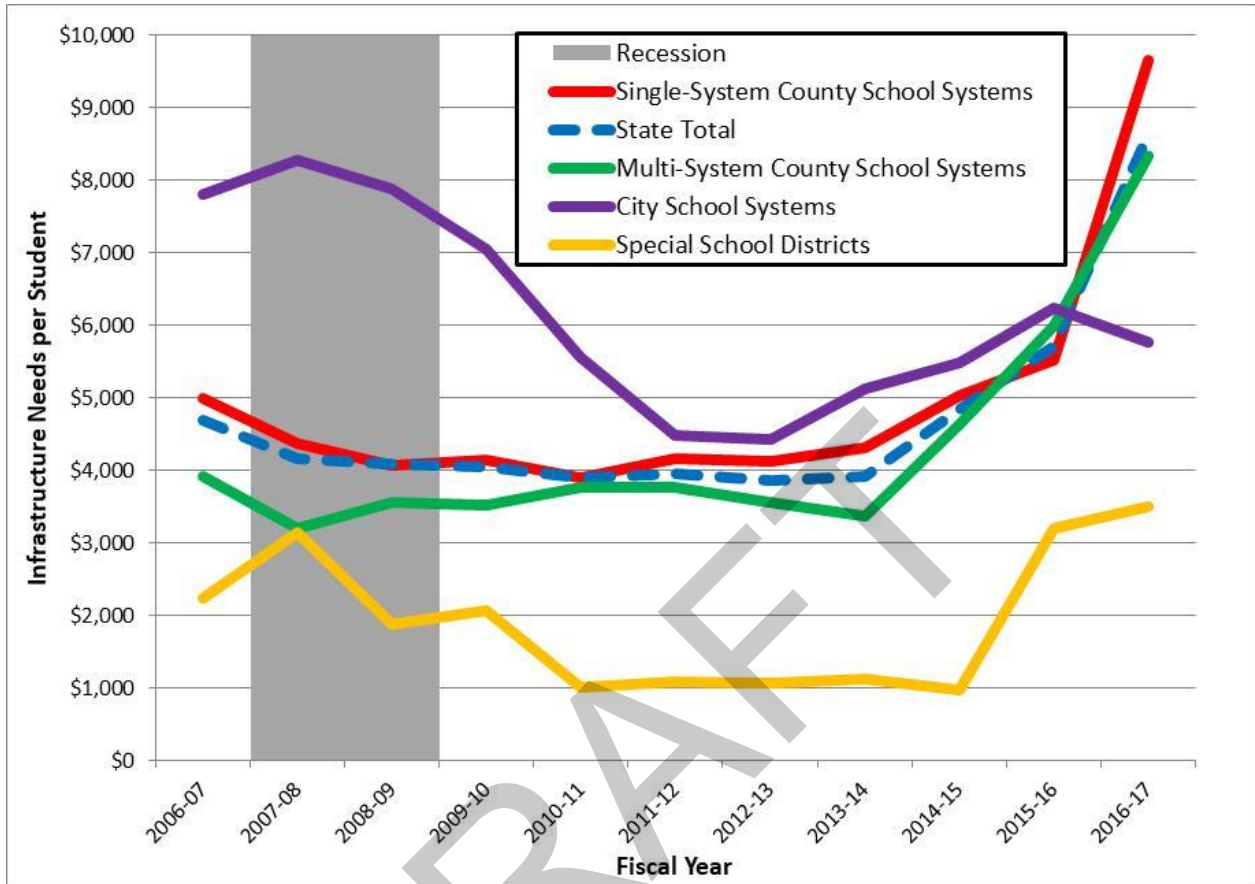
Note: Shelby County Schools absorbed Memphis City School System in fiscal year 2013-14. Carroll County Schools was excluded from the analysis because it is not comparable to other school systems in the state.

As enrollment increases or buildings in a school system age, issuing bonds often becomes necessary to meet infrastructure needs. As of July 1, 2017, counties with multiple school systems have \$8,583 per student in needed improvements while city systems have \$5,933 and special school districts have \$3,596.<sup>68</sup> In fact, 14 of the 28 multisystem counties have more needed infrastructure improvements than the city systems and special school districts within them. At the same time, counties with only a county school system have \$9,946 in per-student infrastructure needs (see figure 2).<sup>69</sup>

<sup>68</sup> Tennessee Advisory Commission on Intergovernmental Relations Public Infrastructure Needs Inventory.

<sup>69</sup> Ibid.

**Figure 2. Estimated Cost of Needed Infrastructure Improvements per Student for Tennessee Public Schools (2016 Dollars)**



Source: Tennessee Advisory Commission on Intergovernmental Relations (TACIR), Public Infrastructure Needs Inventory (PINI); Tennessee Department of Education, Average Daily Membership (ADM); Federal Reserve Bank of St. Louis, Government Consumption Price Index.

Note: Memphis enrollment data was combined with Shelby County so infrastructure data from PINI could be analyzed over multiple years. Carroll County Schools was excluded from the analysis because it is not comparable to other school systems in the state.

As noted in the Commission’s companion report, *K-12 Public Education Funding and Services*, meeting local needs and the requirements imposed by the federal and state governments often requires more resources than Tennessee’s state funding formula provides. Local tax bases vary markedly across the state, and the laws requiring those tax bases to be shared among school systems in the same county are complex. Consequently, local governments are unable to provide those additional resources without imposing different tax rates, rates that local residents may not be willing to accept. These challenges can lead to both student and taxpayer inequities.

## **Ensuring equity for students and taxpayers**

According to some county representatives, disparities that result from the state’s current education revenue-sharing requirements raise equity concerns. City officials raise similar concerns about achieving equity for students and taxpayers and face their own challenges because of the complexity of Tennessee’s local tax and governance structures and school finance system. State courts, including Tennessee’s highest court, have taken the position that equity for students necessitates neither equal funding nor sameness but rather equal opportunity.<sup>70</sup> Equality of opportunity has been a longstanding issue in education. As noted by the US Advisory Commission on Intergovernmental Relations in a 1975 report on education,

equality of educational opportunity is of critical importance in a democratic society dedicated to the proposition that all persons should have an equal chance to develop their potentialities to the fullest. This objective takes on particular urgency as technological advancement causes employment opportunities to become increasingly restricted to persons with professional and technical skills.<sup>71</sup>

That reasoning led to passage of the Education Improvement Act of 1992<sup>72</sup> and adoption of the Basic Education Program (BEP) funding formula. The formula is structured specifically to ensure “vertical” equity—treating different students differently—by providing additional funds for early-elementary and high school students, career and technical students, special education students, at-risk students, etc.<sup>73</sup> “Horizontal” equity—treating similar students similarly—is achieved by equalizing funding across school systems through a process that assumes local governments are imposing comparable tax rates and then using state funds to make up the difference in the amount of local education revenue those rates produce.<sup>74</sup> The state’s education funding formula computes the amount each Tennessee school system needs to fund the defined BEP, determines the amount of education revenue each county can fairly be required to raise, and then makes up the difference with state funds. This process is described in the **BEP**

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<sup>70</sup> Tennessee Small School Systems v. McWherter, 851 S.W.2d 139 (Tenn. 1993).

<sup>71</sup> US Advisory Commission on Intergovernmental Relations 1975.

<sup>72</sup> Public Chapter 535, Acts of 1992.

<sup>73</sup> Roehrich-Patrick et al. 2016. See also Mankiw 2004.

<sup>74</sup> Ibid.

*Handbook for Computation*<sup>75</sup> prepared by the Tennessee Department of Education. The *Blue Book*,<sup>76</sup> which details the major categories and components of the BEP, is produced by the State Board of Education and periodically evaluated by Commission staff in reports on student equity.<sup>77</sup>

Another longstanding point of discussion in education finance is that of taxpayer equity. In a 1999 report, the National Research Council, part of the non-profit National Academy of Sciences, said,

From a school finance perspective, a system would be judged fair to taxpayers if every taxpayer was assured that a given tax rate would translate into the same amount of spending per pupil regardless of where the taxpayer lived.<sup>78</sup>

To ensure that similarly situated taxpayers are treated similarly, the state imposes the same taxes on the same things regardless of location. To the extent that taxpayer equity is not achieved across local governments, residents control those decisions through the electoral process. They choose those who set tax rates and so can be said to have chosen whatever differences exist between localities. Of course, that's not the case with respect to nonresident taxpayers, but they at least have some ability to choose where they procure goods and services and thus have some control over the rates they pay and to whom they pay them.

If public school funds were raised solely from residential property taxes, the problem could be easily solved. Residents who pay those taxes would be funding their own schools wherever counties, cities, and special school districts operate K-12 systems. For cities or special school districts that do not operate K-12, something similar to the current structure for sharing county revenue for schools could be utilized to fund the grades that those cities or districts do not offer.

But that's not how public schools are funded. The challenge is devising a way to ensure that taxpayers derive similar benefit from the taxes they pay regardless of whether they live in or receive services from the taxing jurisdiction. Consequently, Tennessee has several examples of taxpayer inequities. A county's ability to use countywide revenue in

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<sup>75</sup> Tennessee Department of Education 2018.

<sup>76</sup> Tennessee State Board of Education "2018-2019 BEP Blue Book."

<sup>77</sup> See, for instance, Roehrich-Patrick et al. 2016.

<sup>78</sup> Berne and Stiefel 1999.

lieu of bonds to fund education capital expenditures without sharing<sup>79</sup> this revenue is one example of improved **student** equity at the expense of taxpayer equity. **This is arguably** unfair to taxpayers living in city school systems or special school districts, but it's one of only a few ways counties can address **student** equity under current law. Removing a county's sharing requirement for sales within the unincorporated part of the county would improve taxpayer equity by allowing counties to use all \$59.8 million<sup>80</sup> of that revenue (in fiscal year 2017-18) to fund county school systems, though it would still be far less than the \$413.3 million<sup>81</sup> needed to eliminate intra-county funding disparities.

### ***Replacing county-level fiscal capacity with system-level fiscal capacity in the state's Basic Education Program funding formula would reduce intra-county disparities***

The Basic Education Program (BEP) funding formula was adopted by the Tennessee General Assembly as a key part of the Education Improvement Act of 1992 (EIA).<sup>82</sup> The primary purpose of the new funding formula, which was phased in between 1992-93 and 1997-98, was to improve equity within education spending.<sup>83</sup> That purpose was achieved when it comes to inter-county disparities but not intra-county disparities because of the BEP's use of county-level fiscal capacity models instead of a system-level model.<sup>84</sup> Efforts to produce a system-level model to equalize Tennessee's formula for funding public schools began in the early 1990s.<sup>85</sup> Unfortunately, those early efforts were hampered by a lack of data. Improvements in state and federal data collection and reporting systems, however, have made a system-level model possible.<sup>86</sup>

### **County-Level Fiscal Capacity: Intra-County Disparities Remain**

Fiscal capacity is the ability of local governments to raise revenue for education from local sources relative to other local governments. The state uses two capacity models to equalize state education funding through the Basic Education Program (BEP) funding

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<sup>79</sup> City of Athens Board of Education v. McMinn County, 467 S.W.3d 458 (Tenn. Ct. App. 2014). See also Tennessee Code Annotated, Section 49-3-1005(b).

<sup>80</sup> TACIR staff calculation based on data from the Tennessee Department of Revenue.

<sup>81</sup> TACIR staff calculation based on data from the Tennessee Department of Education "2017-18 Annual Statistical Report."

<sup>82</sup> Public Chapter 535, Acts of 1992.

<sup>83</sup> Roehrich-Patrick et al. 2016.

<sup>84</sup> Ibid.

<sup>85</sup> Green and Roehrich-Patrick 2006

<sup>86</sup> Ibid.

formula.<sup>87</sup> Starting in school year 2007-08, a tax capacity model produced by the Center for Business and Economic Research (CBER) at the University of Tennessee has been used in combination with the county-level fiscal capacity model produced by TACIR and used since the inception of the BEP funding formula in 1992-93.<sup>88</sup> Both models are calculated at the county level and don't take into account several factors that drive intra-county disparities, most particularly a counties' relative lack of access to unshared tax bases and the concentration of commercial and industrial tax bases within cities, both of which leave counties with less ability to raise local revenue for county school systems when compared with city school systems and special school districts in the same county.

According to a 2003 comptroller report, the use of a county fiscal capacity model in a system-level funding formula results in "funding inequalities among [school systems] within multi-[school system] counties."<sup>89</sup> Calculating fiscal capacity at the county level instead of at the system level, to equalize state education funding, does not effectively reduce funding gaps within counties because county-level fiscal capacity models treat all school systems within multisystem counties as if they have the same ability to raise revenue for education from local sources. The result is that BEP revenue decreases these funding gaps in 17 counties but actually increases gaps in 11 counties (see table 6), and the amount that counties would need to overcome the disparity in revenue actually increases slightly when BEP revenue is included, going from \$413.3 million to \$414.3 million.<sup>90</sup>

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<sup>87</sup> Tennessee Code Annotated, Section 49-3-307(a)(10).

<sup>88</sup> Public Chapter 535, Acts of 1992 and Public Chapter 369, Acts of 2007.

<sup>89</sup> Tennessee Comptroller of the Treasury 2003.

<sup>90</sup> TACIR staff calculation based on Tennessee Department of Education, Annual Statistical Report, fiscal year 2017-18.

**Table 6. Actual Local Basic Education Program Revenue per Student by School Systems in Multi-system Counties, Fiscal Year 2017-18**

County System	BEP	Local	Local + BEP	City System	BEP	Local	Local + BEP
Anderson	\$ 5,046	\$ 4,036	\$ 9,081	Clinton	\$ 5,056	\$ 4,433	\$ 9,489
				Oak Ridge	\$ 4,871	\$ 7,420	\$ 12,291
weighted averages					\$ 4,904	\$ 6,893	\$ 11,797
Blount	\$ 4,493	\$ 4,255	\$ 8,748	Alcoa	\$ 4,311	\$ 5,831	\$ 10,142
				Maryville	\$ 4,155	\$ 6,116	\$ 10,271
weighted averages					\$ 4,197	\$ 6,038	\$ 10,236
Bradley	\$ 4,835	\$ 2,698	\$ 7,533	Cleveland	\$ 5,036	\$ 3,387	\$ 8,423
Carter	\$ 6,094	\$ 2,365	\$ 8,459	Elizabethton	\$ 5,450	\$ 3,509	\$ 8,959
Cocke	\$ 5,532	\$ 2,292	\$ 7,824	Newport	\$ 5,414	\$ 3,136	\$ 8,550
Coffee	\$ 5,043	\$ 3,391	\$ 8,434	Manchester	\$ 5,399	\$ 5,084	\$ 10,483
				Tullahoma	\$ 4,839	\$ 5,472	\$ 10,311
weighted averages					\$ 4,999	\$ 5,361	\$ 10,360
Crockett	\$ 6,277	\$ 1,272	\$ 7,549	Alamo	\$ 7,211	\$ 958	\$ 8,168
				Bells	\$ 6,572	\$ 1,139	\$ 7,711
weighted averages					\$ 6,948	\$ 1,032	\$ 7,981
Dyer	\$ 5,258	\$ 2,884	\$ 8,142	Dyersburg	\$ 5,376	\$ 3,582	\$ 8,958
Franklin	\$ 5,127	\$ 3,322	\$ 8,449	Tullahoma	\$ 4,839	\$ 5,472	\$ 10,311
Greene	\$ 5,292	\$ 2,482	\$ 7,775	Greeneville	\$ 5,174	\$ 5,420	\$ 10,594
Hawkins	\$ 5,614	\$ 2,665	\$ 8,279	Rogersville	\$ 5,499	\$ 3,230	\$ 8,729
				Kingsport	\$ 4,031	\$ 6,117	\$ 10,148
weighted averages					\$ 5,499	\$ 3,230	\$ 8,729

Henderson	\$ 5,770	\$ 2,058	\$ 7,828	Lexington	\$ 5,944	\$ 2,977	\$ 8,921
Lincoln	\$ 5,536	\$ 2,372	\$ 7,907	Fayetteville	\$ 5,508	\$ 2,580	\$ 8,087
Loudon	\$ 4,471	\$ 4,316	\$ 8,786	Lenoir City	\$ 4,467	\$ 5,082	\$ 9,549
McMinn	\$ 4,851	\$ 2,207	\$ 7,058	Athens	\$ 4,911	\$ 3,906	\$ 8,817
				Etowah	\$ 5,127	\$ 2,488	\$ 7,615
weighted averages					\$ 4,952	\$ 3,638	\$ 8,590
Monroe	\$ 5,440	\$ 2,019	\$ 7,460	Sweetwater	\$ 5,603	\$ 2,340	\$ 7,943
Obion	\$ 5,482	\$ 2,707	\$ 8,189	Union City	\$ 5,139	\$ 3,501	\$ 8,640
Rhea	\$ 5,573	\$ 2,161	\$ 7,733	Dayton	\$ 5,487	\$ 1,771	\$ 7,259
Roane	\$ 4,749	\$ 3,782	\$ 8,532	Oak Ridge	\$ 4,871	\$ 7,420	\$ 12,291
Rutherford	\$ 4,714	\$ 3,598	\$ 8,312	Murfreesboro	\$ 5,088	\$ 4,344	\$ 9,432
Shelby	\$ 5,049	\$ 4,462	\$ 9,512	Arlington	\$ 4,557	\$ 4,710	\$ 9,267
				Bartlett	\$ 4,618	\$ 4,674	\$ 9,292
				Collierville	\$ 4,613	\$ 4,713	\$ 9,326
				Germantown	\$ 4,504	\$ 5,676	\$ 10,179
				Lakeland	\$ 4,660	\$ 4,126	\$ 8,786
				Millington	\$ 5,206	\$ 4,597	\$ 9,803
weighted averages					\$ 4,634	\$ 4,843	\$ 9,477
Sullivan	\$ 4,205	\$ 4,326	\$ 8,531	Bristol	\$ 3,994	\$ 5,639	\$ 9,632
				Kingsport	\$ 4,031	\$ 6,117	\$ 10,148
weighted averages					\$ 4,018	\$ 5,950	\$ 9,968
Washington	\$ 4,066	\$ 3,691	\$ 7,757	Johnson City	\$ 4,016	\$ 5,852	\$ 9,868



County System	BEP	Local	BEP + Local	SSD	BEP	Local	BEP + Local
Henry	\$ 5,333	\$ 3,461	\$ 8,794	Paris	\$ 5,211	\$ 4,000	\$ 9,211
Marion	\$ 5,075	\$ 2,501	\$ 7,576	Richard City	\$ 5,693	\$ 2,824	\$ 8,517
Scott	\$ 6,055	\$ 1,329	\$ 7,384	Oneida	\$ 5,967	\$ 2,173	\$ 8,140
Williamson	\$ 3,408	\$ 8,342	\$ 11,750	Franklin SSD	\$ 4,149	\$ 11,887	\$ 16,036
Wilson	\$ 4,373	\$ 3,618	\$ 7,991	Lebanon	\$ 4,681	\$ 4,719	\$ 9,400

Source: TACIR staff calculations based on Tennessee Department of Education Annual Statistical Reports.

### System-Level Fiscal Capacity: Intra-County Disparities Reduced

Although other changes to state law could decrease some of the disparities for students, transitioning from calculating fiscal capacity at the county level to calculating it at the system level can decrease nearly all of these disparities while adhering to principles of taxpayer equity. A **prototype** system-level fiscal capacity model was developed by TACIR and Tennessee Comptroller of the Treasury staff in 2004 and reviewed by outside experts at Middle Tennessee State University, Tennessee State University, and Vanderbilt University.<sup>91</sup> The **prototype** model was developed following a 2003 recommendation by then-Governor Bredesen’s Task Force on Teacher Pay that the state adopt a system-level fiscal capacity model to provide a fairer method of determining local contribution.<sup>92</sup> In 2004, the General Assembly asked the BEP Review Committee to give special consideration to “the development and implementation of a system-level fiscal capacity model.”<sup>93</sup> The committee endorsed the concept and voted to recommend in its November 2005 report that the county-level model be replaced with a system-level model.<sup>94</sup> Instead, the General Assembly passed Public Chapter 369, Acts of 2007, which, along with other changes to the BEP, included a second county-level fiscal capacity model (the CBER model).<sup>95</sup> A system-level fiscal capacity model would account for intra-county differences, making it possible to see how fiscal capacity per student varies by type of school system (see table 7).

<sup>91</sup> Tennessee Advisory Commission on Intergovernmental Relations 2006.

<sup>92</sup> Green and Roehrich-Patrick 2005.

<sup>93</sup> Public Chapter 670, Acts of 2004.

<sup>94</sup> Basic Education Program Review Committee 2005.

<sup>95</sup> Public Chapter 369, Acts of 2007.

**Table 7. System-level Fiscal Capacity per Student by School System Type, Fiscal Year 2017-18**

School System Type	System-level Fiscal Capacity per Student*
City school systems	\$ 4,275
Counties systems in single-system counties	\$ 3,720
Special school districts	\$ 3,692
County systems in multisystem counties	\$ 3,226
<b>Statewide average</b>	<b>\$ 3,603</b>

Source: TACIR staff calculations using the 2004 prototype system-level model with updated data.

\*Average Daily Membership

Calculating fiscal capacity at the system level instead of the county level, in order to equalize state education funding, effectively reduces funding gaps within counties because system-level fiscal capacity models treat all school systems within multisystem counties as if they have different abilities to raise revenue for education from local sources by assigning them different state-share and local-share percentages. With a system-level fiscal capacity model, the state-share percentages for school systems in the same county would be different—for instance, 73.61% for Anderson County Schools, 53.68% for Clinton City School District, and 58.10% for Oak Ridge Schools. But with county-level fiscal capacity, the actual state-share percentage in the BEP for Anderson County Schools, Clinton City School District, and Oak Ridge Schools is exactly the same for each school system in the county (73.38% for fiscal year 2017-18).

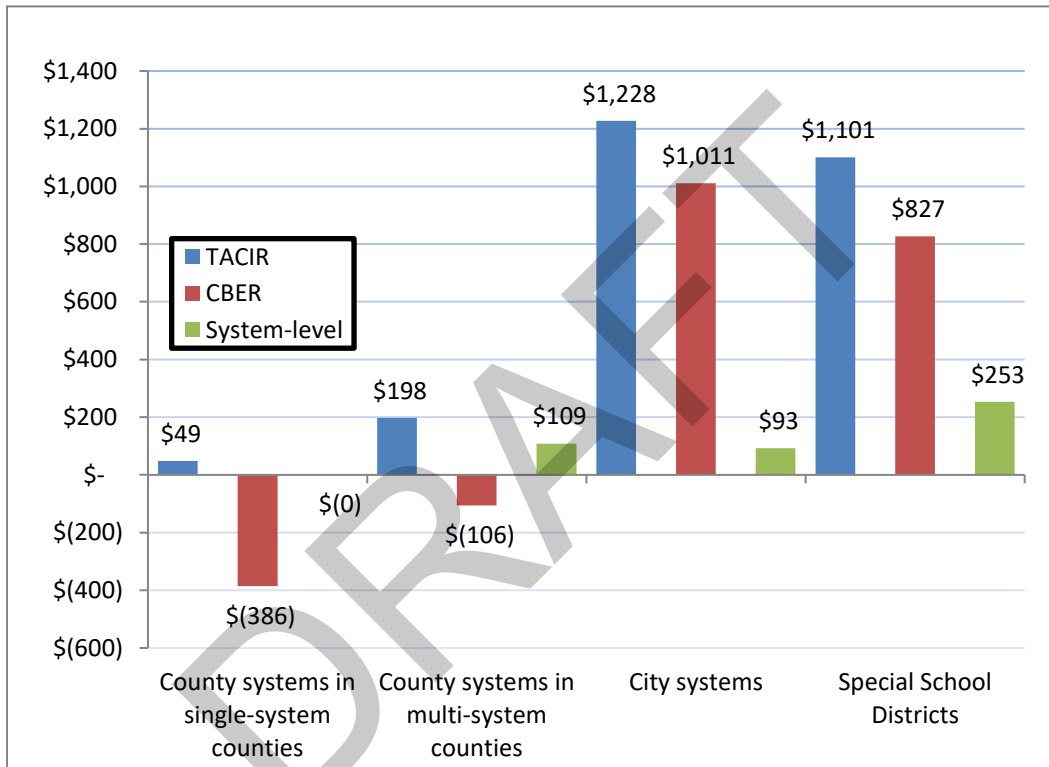
Because county-level fiscal capacity models are not designed to account for additional revenue (that cities and special school districts are able to—and actually do<sup>96</sup>—raise), fiscal capacity per student in both the TACIR and CBER models are, on average, lower than actual revenue per student for city school systems and special school districts. The models are closer to actual revenue per student for county school systems. Statewide, actual revenue per student is higher than fiscal capacity per student, and many

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<sup>96</sup> See table 5 on page 26.

jurisdictions choose to put more revenue into education than required. The prototype system-level fiscal capacity model, developed in 2004 but updated with current data for the purposes of this report, assigns fiscal capacities to city school systems and special school districts that are much closer, on average, to their actual local revenue per student (see figure 3). See appendix G for estimated BEP state share fund for each school system using the prototype model.

**Figure 3. Actual Local Revenue per Student—Less Fiscal Capacity per Student—by System Type, Fiscal Year 2017-18**



Source: Tennessee Advisory Commission on Intergovernmental Relations, Tennessee Department of Education, Tennessee Department of Revenue, University of Tennessee Boyd Center for Business and Economic Research.

As mentioned earlier, adding BEP revenue to local revenue actually increases—from \$413.3 million to \$414.3 million—the amount needed for the 26 of 28 county school systems that received less revenue per student to equalize the revenue. The two counties with greater revenue per student (Crockett and Rhea) would have to reduce their revenue by \$5.9 million to equalize for a net disparity of \$408.3 million. If the two county-level

models currently in use were replaced with the **prototype** system-level model,<sup>97</sup> the net disparity decreases to \$35.4 million, a 91.3% decrease. For estimates of the resulting local and BEP revenue per student for multisystem counties, see table 8.

**Table 8. System-level Fiscal Capacity Local and Basic Education Program Revenue per Student\* by School Systems in Multisystem Counties,\*\* Fiscal Year 2017-18**

County System	BEP	Local	BEP + Local	City System	BEP	Local	BEP + Local
Anderson	\$ 5,288	\$ 4,036	\$ 9,324	Clinton	\$ 3,820	\$ 4,433	\$ 8,254
				Oak Ridge	\$ 4,012	\$ 7,420	\$ 11,433
weighted averages					\$ 3,929	\$ 6,893	\$ 10,822
Blount	\$ 4,555	\$ 4,255	\$ 8,810	Alcoa	\$ 3,265	\$ 5,831	\$ 9,096
				Maryville	\$ 3,285	\$ 6,116	\$ 9,401
weighted averages					\$ 3,222	\$ 6,038	\$ 9,261
Bradley	\$ 5,037	\$ 2,698	\$ 7,736	Cleveland	\$ 4,212	\$ 3,387	\$ 7,599
Carter	\$ 6,113	\$ 2,365	\$ 8,477	Elizabethton	\$ 5,062	\$ 3,509	\$ 8,571
Cocke	\$ 5,794	\$ 2,292	\$ 8,086	Newport	\$ 4,724	\$ 3,136	\$ 7,860
Coffee	\$ 5,218	\$ 3,391	\$ 8,609	Manchester	\$ 4,867	\$ 5,084	\$ 9,951
				Tullahoma	\$ 4,069	\$ 5,472	\$ 9,541
weighted averages					\$ 4,309	\$ 5,361	\$ 9,670

<sup>97</sup> TACIR staff calculations using a one-tier regression-based fiscal capacity model, but other system-level fiscal capacity models are possible. Two-tier models have a county model as tier one while a second tier divides the results of the county model among the systems within multi-system counties. Average tax rates could also be used instead of regression-based weights.

Crockett	\$ 6,492	\$ 1,272	\$ 7,764	Alamo	\$ 6,682	\$ 958	\$ 7,640
				Bells	\$ 6,463	\$ 1,139	\$ 7,602
Dyer	\$ 5,353	\$ 2,884	\$ 8,237	Dyersburg	\$ 4,603	\$ 3,582	\$ 8,185
Franklin	\$ 5,149	\$ 3,322	\$ 8,470	Tullahoma	\$ 4,069	\$ 5,472	\$ 9,541
Greene	\$ 5,428	\$ 2,482	\$ 7,911	Greeneville	\$ 4,704	\$ 5,420	\$ 10,124
Hawkins	\$ 5,757	\$ 2,665	\$ 8,422	Rogersville	\$ 4,938	\$ 3,230	\$ 8,168
				Kingsport	\$ 3,251	\$ 6,117	\$ 9,368
weighted averages					\$ 5,028	\$ 3,230	\$ 8,257
Henderson	\$ 5,779	\$ 2,058	\$ 7,837	Lexington	\$ 4,728	\$ 2,977	\$ 7,704
Lincoln	\$ 5,691	\$ 2,372	\$ 8,062	Fayetteville	\$ 5,132	\$ 2,580	\$ 7,712
Loudon	\$ 4,290	\$ 4,316	\$ 8,605	Lenoir City	\$ 4,237	\$ 5,082	\$ 9,319
McMinn	\$ 4,997	\$ 2,207	\$ 7,205	Athens	\$ 4,116	\$ 3,906	\$ 8,022
				Etowah	\$ 4,766	\$ 2,656	\$ 7,421
weighted averages					\$ 4,123	\$ 3,638	\$ 7,762
Monroe	\$ 5,430	\$ 2,019	\$ 7,450	Sweetwater	\$ 5,224	\$ 2,340	\$ 7,564
Obion	\$ 5,396	\$ 2,707	\$ 8,103	Union City	\$ 4,686	\$ 3,501	\$ 8,187
Rhea	\$ 5,765	\$ 2,161	\$ 7,925	Dayton	\$ 4,824	\$ 2,226	\$ 7,049
Roane	\$ 4,985	\$ 3,782	\$ 8,767	Oak Ridge	\$ 4,012	\$ 7,420	\$ 11,433
Rutherford	\$ 4,437	\$ 3,598	\$ 8,034	Murfreesboro	\$ 3,495	\$ 4,344	\$ 7,839
Shelby	\$ 5,475	\$ 4,462	\$ 9,937	Arlington	\$ 4,001	\$ 4,710	\$ 8,711
				Bartlett	\$ 4,058	\$ 4,674	\$ 8,732
				Collierville	\$ 3,857	\$ 4,713	\$ 8,570
				Germantown	\$ 3,544	\$ 5,676	\$ 9,219
				Lakeland	\$ 4,413	\$ 4,126	\$ 8,540
				Millington	\$ 4,914	\$ 4,597	\$ 9,510

weighted averages					\$ 3,890	\$ 4,843	\$ 8,733
Sullivan	\$ 4,483	\$ 4,326	\$ 8,809	Bristol	\$ 3,453	\$ 5,639	\$ 9,092
				Kingsport	\$ 3,251	\$ 6,117	\$ 9,368
weighted averages					\$ 3,346	\$ 5,950	\$ 9,296
Washington	\$ 4,356	\$ 3,691	\$ 8,047	Johnson City	\$ 3,079	\$ 5,852	\$ 8,931
<b>County System</b>	<b>BEP</b>	<b>Local</b>	<b>BEP + Local</b>	<b>SSD</b>	<b>BEP</b>	<b>Local</b>	<b>BEP + Local</b>
Henry	\$ 5,384	\$ 3,461	\$ 8,845	Paris	\$ 4,893	\$ 4,000	\$ 8,894
Marion	\$ 5,147	\$ 2,501	\$ 7,648	Richard City	\$ 5,150	\$ 2,824	\$ 7,975
Scott	\$ 6,290	\$ 1,329	\$ 7,619	Oneida	\$ 5,897	\$ 2,173	\$ 8,070
Williamson	\$ 2,978	\$ 8,342	\$ 11,320	Franklin SSD	\$ 2,454	\$ 11,887	\$ 14,341
Wilson	\$ 4,161	\$ 3,618	\$ 7,779	Lebanon	\$ 3,525	\$ 4,719	\$ 8,244

Source: Tennessee Department of Education, 2018 Annual Statistical Report.

\*Average Daily Membership.

\*\*Excluding Carroll and Gibson counties. Carroll County has five special school districts. Carroll County Schools is a countywide system that provides a technical training center, a special learning center, an alternative school, and transportation services to all students in the county. Gibson County has no county school system, one city school system, and four special school districts.

***Tennessee's unique local funding structure and a relative lack of independent taxing authority make comparisons with other states difficult***

In other states, school systems are usually fiscally independent, meaning they can levy their own taxes without sharing the revenue. But independent school systems are relatively rare in Tennessee,<sup>98</sup> and unlike many independent school systems in other states, Tennessee's special school districts also receive significant local revenue from counties, making comparisons difficult.<sup>99</sup> In fact, no other state has the variety of school system types in combination with the complex fiscal powers and interrelationships

<sup>98</sup> US Census Bureau 2019a.

<sup>99</sup> Green and Roehrich-Patrick 2005.

among school systems that exist in Tennessee.<sup>100</sup> County and city school systems, which make up 127 of the 141 school systems in Tennessee (90%), have no taxing authority and are dependent on local governments for tax revenue. The 14 other school systems are special school districts, which levy a property tax within their boundaries as authorized by the General Assembly through private acts (see table 9).

**Table 9. Types of School Systems in Tennessee**

School System Type	Number	Ind./Dep.*
County	94	Dependent
City	33	Dependent
Special School District	14	Independent

Source: Tennessee Department of Education, Annual Statistical Report, Fiscal Year 2017-18. US Census Bureau, "Table 9: Public School Systems by Type of Organization and State."

\*Independent school systems have their own taxing authority.

Eliminating overlapping tax bases among school systems and giving them equal authority to raise revenue could reduce intra-county disparities—that is, make each school system independent. The US Census Bureau, in its periodic Census of Governments, classifies public school systems as either dependent school districts, which are agencies of other state or local government entities, or independent school districts, which are fiscally and administratively independent of other government entities. Of the 14,059 school districts in the United States, 12,754 (91%) have independent taxing authority.<sup>101</sup> See table 10 and figure 4.

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<sup>100</sup> Ibid.

<sup>101</sup> US Census Bureau 2019a.

**Table 10. Indicators of School System Fiscal and Administrative Independence**

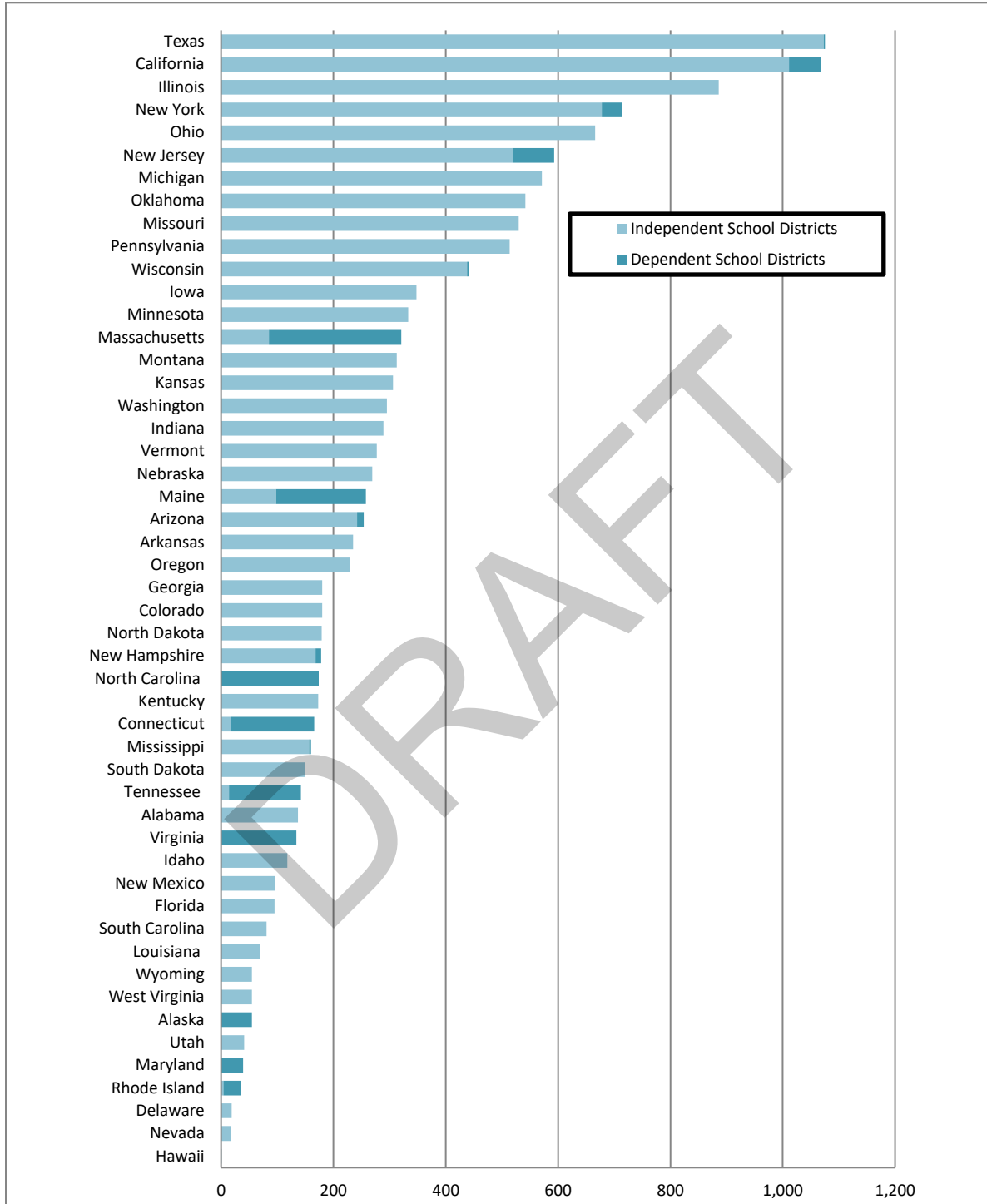
<b>School System Powers Indicative of Fiscal Independence:</b>	<b>School System Characteristics Indicative of Administrative Independence:</b>
<ul style="list-style-type: none"> <li>• Determines its budget without review and detailed modification by other local officials or governments</li> <li>• Determines taxes to be levied for its support</li> <li>• Fixes and collects charges for services, and</li> <li>• Issues debt without review by another local government</li> </ul>	<ul style="list-style-type: none"> <li>• A popularly elected governing body</li> <li>• A governing body representing two or more state or local governments, and</li> <li>• Performs functions that are essentially different from those of its creating government even if its governing body is appointed</li> </ul>

Source: US Census Bureau 2019b.

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**Figure 4. Number of Independent and Dependent School Systems by US State, 2017**



Source: US Census Bureau 2019a.

Note: The Census of Governments indicates that Louisiana, Mississippi, Texas, and Wisconsin have at least one dependent school system. However, closer inspection reveals that almost all K-12 public

education in these states is provided by independent school districts, all with similar taxing authority. And while the federal data indicates that Alabama has only independent school districts, closer review shows that many of those school districts were created by cities or counties and are fiscally dependent on them.

Stakeholders say it can be challenging for school boards of dependent school systems to meet state standards without the ability to control funding.<sup>102</sup> Giving county and city school boards taxing authority—making them fiscally independent—would provide school systems with greater autonomy in the budgeting process, but it would also represent a fundamental change in the operation of most school systems in the state. The last time a special school district was formed in Tennessee was in Gibson County in 1981<sup>103</sup>; forming new special school districts was prohibited in 1982.<sup>104</sup>

### ***Transfer of School Facilities to New City School Systems***

Although Tennessee law establishes rules for the transfer of school facilities and related debt when school systems are disbanded and when cities with school systems annex areas with schools, neither the legislature nor the courts have provided guidance for the transfer of existing county school facilities to newly formed school systems. In fact, state law prohibits creation of new special school districts and, from 1998 to 2013, prohibited the formation of new city school systems.<sup>105</sup> A law partially repealing the prohibition of new city systems was passed in 2011<sup>106</sup> shortly after Memphis residents voted to disband their special school district, effectively merging it with the Shelby County school system. This merger, which became effective in 2013, was the largest school-district consolidation in American history<sup>107</sup> and involved litigation that sought, among other things, to prevent the establishment of any new school systems within the county.<sup>108</sup> The case was filed in

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<sup>102</sup> Telephone Interview with David Huss, April 30, 2019.

<sup>103</sup> Private Acts of 1981, Chapter 62.

<sup>104</sup> Public Chapter 907, Acts of 1982.

<sup>105</sup> Public Chapter 1101, Acts of 1998 and Public Chapter 256, Acts of 2013.

<sup>106</sup> Public Chapter 1, Acts of 2011. Enabling legislation for that law, Public Chapter 905, 2012, was held unconstitutional because it only applied to Shelby County and did not include a provision for local approval.

<sup>107</sup> Center on Reinventing Public Education 2014.

<sup>108</sup> Board of Education of Shelby County v. Memphis City Board of Education, Third-Party Complaint for Declaratory Judgment, 2012 U.S. Dist. (W.D. Tenn. June 26, 2012).

federal district court because it included federal due process and equal protection claims related to the disbanding of Memphis's special school district.<sup>109</sup>

### **Six New City Systems in Shelby County**

Residents of six Shelby County cities voted shortly after the merger of the Memphis and Shelby County school systems to form their own school systems and intervened in the merger lawsuit to establish both their right to form new systems and their right to the school facilities within their borders.<sup>110</sup> Although state law requires city school systems to “[p]rovide school plant facilities which shall meet the minimum requirements and standards of the State Board of Education,”<sup>111</sup> no statute, rule, or case law directly addresses whether newly formed city school systems are entitled to existing school facilities in their districts, or if so, whether or how much the city must pay for those facilities.

For various reasons, the merger lawsuit ended in a number of settlement agreements that included the transfer of existing school facilities from the county school system to the new city systems. Those agreements did not establish a value for the transferred facilities or even that the cities had a right to them, nor did they explicitly involve payment for them. Instead, the cities agreed to make payments for other specified purposes. For example, the Bartlett Board of Education agreed to pay \$608,193 per year for 12 years to the Shelby County Board of Education to reduce the county board's retiree health and life insurance liabilities.<sup>112</sup> The district court approved the agreements and dismissed the lawsuit, noting that the agreements reflected “a consensus among the parties on ‘the best way to resolve [the] complex institutional reform’ at issue.”<sup>113</sup> Because the parties agreed to settle the lawsuit rather than having the issues resolved by a court judgement, the agreements do not establish precedent for future, similar cases and leave unanswered the questions of whether newly formed city school systems are entitled to existing school facilities in their districts, and if so, whether or how much the city should pay for them.<sup>114</sup>

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<sup>109</sup> Board of Education of Shelby County v. Memphis City Board of Education, No. 11-2101, 2011 U.S. Dist. LEXIS 87803 (W.D. Tenn. Aug. 8, 2011).

<sup>110</sup> Board of Education of Shelby County v. Memphis City Board of Education, 911 F. Supp. 2d 631 (W.D. Tenn. Nov. 27, 2012).

<sup>111</sup> Rules and Regulations of the State of Tennessee, Section 0520-1-8-.01.

<sup>112</sup> Agreement of Compromise and Settlement 2014.

<sup>113</sup> Board of Education of Shelby County v. Memphis City Board of Education. Order on Joint Motion for Dismissal with Prejudice. 2014 U.S. Dist. (W.D. Tenn. March 10, 2014).

<sup>114</sup> Lederman 1999.

## Signal Mountain and Brentwood

Only two cities—Signal Mountain in Hamilton County and Brentwood in Williamson County—have taken official action to consider forming a city school system since the six city school systems formed in Shelby County in 2014-15. The lack of a state law providing for the transfer of school property to new school systems remains an issue for cities considering forming new school systems. Brentwood’s city council discussed commissioning a feasibility study focused on forming a city school system, but the city council rejected the feasibility study on a 3-3 vote.<sup>115</sup> Even after conducting the feasibility study, uncertainty would have remained on how the new city school system would acquire school properties from Williamson County Schools. In February 2017, the Signal Mountain Town Council appointed a committee to study the viability of forming a new city-school system. One of the obstacles they identified was the reluctance of Hamilton County Schools to transfer the school buildings in Signal Mountain to the new school system:

The attorney representing [Hamilton County Schools] wrote to the attorney who represents the Town of Signal Mountain in an email stating: “If the County Board [of Education] no longer needed these schools because the students residing within the town limits were going to their own district, then the board could sell these properties or reallocate them as it saw fit,” thereby implying that if a municipal school district should be created, [Hamilton County Schools] would refuse to cede the use of the three school buildings to the new district. Obviously, without those buildings a new school district would not be able to function.<sup>116</sup>

The Hamilton County school board voted 7-1 for a resolution pledging that it would not sell or transfer ownership of its school buildings in Signal Mountain.<sup>117</sup>

## Tennessee Law Governing Transfers of School Facilities Upon Annexation

Although Tennessee law does not directly address the transfer of school facilities to newly formed city systems, in 1898 the Tennessee Supreme Court addressed the transfer of school facilities following municipal annexation. In *Prescott v. Town of Lennox*, the Court held that the newly formed Town of Lennox was entitled to the school in question based on the public trust doctrine: “the title to such property is only held in trust for the

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<sup>115</sup> City of Brentwood 2018.

<sup>116</sup> Signal Mountain School System Viability Committee 2017.

<sup>117</sup> Hughes 2017.

public, and . . . by the change of municipal conditions the [beneficiary] has become that public constituting the new corporation of Lennox.”<sup>118</sup> The court explained its holding by quoting a New Jersey case for the principle that, “Municipal corporations are called into being in the interest of the public, and, in order that they may better serve their purpose, they have the right to create and control all the agencies and appliances essential to the health, safety, and convenience of the communities constituting them.”<sup>119</sup>

Current Tennessee annexation statutes require an annexing municipality and any affected entity, such as a school system, to reach an agreement “for allocation and conveyance to the annexing municipality of any or all public functions, rights, duties, property, assets and liabilities” of the entity.<sup>120</sup> Matters the parties cannot agree upon must be settled by arbitration.<sup>121</sup>

### **Tennessee Law Governing Transfers of School Facilities when Systems are Disbanded**

Tennessee courts and the legislature have also addressed the issue of transferring school facilities following a disbanding and consolidation of school systems. As is the case with Tennessee annexation laws, the laws governing school system consolidations may provide some initial guidance for a future case involving a new city school system, but it is unclear whether a court would apply this body of law or how it would do so. In a case involving a city that owned most of the school facilities of a city school system that disbanded, the Tennessee Court of Appeals held that the county board of education became the owner of the city school board’s property rights.<sup>122</sup> However, the court also held that “legal title held by the city will remain in the city subject to the right of the [county board] to continue to use the property for such school purposes, reserving to the city the right of reversion upon the termination of such use.”<sup>123</sup>

Tennessee statutes authorize the creation of planning commissions to “study and consider the need for and problems in conjunction with the consolidation of all public

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<sup>118</sup> Prescott v. Lennox, 100 Tenn. 591, 47 S.W. 181 (1898).

<sup>119</sup> Inhabitants of Bloomfield v. Mayers, etc., 33 Atl. Rep., 926, (New Jersey, 1896).

<sup>120</sup> Tennessee Code Annotated, Section 6-51-111(a). See also Hamilton County v. Chattanooga, 310 S.W.2d 153 (Tenn. 1958).

<sup>121</sup> Tennessee Code Annotated, Section 6-51-111(b).

<sup>122</sup> City of Shelbyville v. Bedford County Board of Education, 1984 Tenn. App. LEXIS 3014 (Ct. App. July 18, 1984).

<sup>123</sup> Id.

schools within the county into a unified school system and to make and file a written report.”<sup>124</sup> The law further authorizes planning commissions to prepare a consolidation plan, and by so doing requires a commission to consider and provide for the following:

- an administrative organization of the proposed consolidated system;
- a method to ensure no diminution in the level of the educational service in the schools in any of the systems involved;
- an appropriate means for the transfer of assets and liabilities of city and special school district systems;
- plans for disposition of existing bonded indebtedness that shall not impair the rights of any bondholder;
- plans for preserving the existing pension rights of all teachers and nonteaching personnel in the respective systems;
- plans for preserving the existing tenure rights, sick leave rights and salary schedule rights of all teachers and nonteaching personnel in the respective systems;
- appropriate plans for contributions by cities or special school districts to the county for the operation of a unified system of schools during the period of transition following unification, which shall not exceed three (3) years;
- appropriate plans for reapportionment after each federal decennial census of districts for election of members of the school board; and
- any other matters deemed by the planning commission to be pertinent.

Though these considerations may be helpful in developing a method for transferring property to new city school systems, this process is optional and does not dictate how facilities should be transferred. Tennessee law states however that outstanding school debt owed by a city or special school district that disbands remains the obligation of the city or special school district unless the county agrees otherwise.<sup>125</sup>

### **Proposed Legislation to Govern Transfer of School Facilities to Newly Formed Systems**

In response to concerns regarding the lack of a method in state law for the transfer of school buildings to new city school systems, Senate Bill 1755 by Senator Gardenhire and

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<sup>124</sup> Tennessee Code Annotated, Section 49-2-1201.

<sup>125</sup> Tennessee Code Annotated 49-2-1002(d).

House Bill 1757 by Representative Harry Brooks (110<sup>th</sup> General Assembly) would have required upon the formation of a new city school system that “all real and personal property that is located within the boundaries of the municipality and is owned by the county school system shall be declared surplus property by the county school system and transferred to the municipal school system.”<sup>126</sup> The bill, as amended, would have required TACIR to recommend “a process for determining the amount that a city must pay to fairly compensate the county for the school property the city seeks to obtain,” but the bill did not pass.<sup>127</sup> The process described in the amended version of the bill involved,

- the city identifying all school property within the city that it seeks acquire,
- an agreement on the appraised value by the city and county (or binding arbitration if no agreement can be reached), and
- a calculation of the amount the city is to pay for the school property that considers the contributions of the city and its taxpayers and school support organizations to the acquisition and construction of the properties in question — and to “[pre-K-12] education in general throughout the county” — in the 15 years preceding the city’s proposed acquisition.

Deciding what property to transfer to the new city school system may not be clear-cut in some circumstances—it might not make sense to transfer all of the property that is inside the city. In Shelby County, for instance, Germantown High School was not transferred to the Germantown Municipal School District because a majority of its students were not residents of Germantown (Houston High School was transferred instead).<sup>128</sup> Likewise, transferring facilities may not be equitable if a city forming a new school system does not serve all grade levels and the school within its borders is needed for them.

Appraisals of school buildings can vary significantly.<sup>129</sup> Older buildings may have deferred maintenance costs in excess of the total value of the building, but redevelopment potential might also be considered.<sup>130</sup> Charter schools have acquired fully depreciated buildings for little cost, and the county was willing to sell because it relieved the county of a liability.<sup>131</sup> For new personal property, relevant unit costs in the BEP could be used

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<sup>126</sup> Senate Bill 1755 by Senator Gardenhire, House Bill 1757 by Representative Harry Brooks (2018).

<sup>127</sup> Senate Bill 1755 by Senator Gardenhire, Amendment 1 (2018).

<sup>128</sup> Baker 2013.

<sup>129</sup> Email from Cameron Quick, Chief Operating Officer, Tennessee Charter School Center.

<sup>130</sup> Ibid.

<sup>131</sup> Ibid.



to calculate the value of real and personal property subject to transfer. For instance, textbook unit costs are based on the actual cost of textbooks that will be purchased for the upcoming school year.<sup>132</sup>

Senate Bill 1755, Amendment 1, describes what should be considered “contributions of the city” but does not provide the exact method for calculating those contributions. For instance, in-kind contributions by the city—including student resource officers, maintenance workers, police and fire protection, and the city’s contribution toward roads used by the schools—might all be included in the calculation. Including contributions of school support organizations would be particularly relevant to Signal Mountain because its school support organization, the Mountain Education Fund, contributed \$343,991 to Signal Mountain Schools in fiscal year 2015-16 alone.<sup>133</sup> Moreover, wealthier cities with larger tax bases will have contributed more than a poorer city would have, and nothing in the bill precludes a purchase price of \$0, which may be possible once all of the contributions over 15 years have been considered, especially in the case of older buildings that have depreciated for a number of years.

### **Other States’ Methods for Transferring School Property to New School Systems**

Other states’ laws provide guidance for transferring real and personal property to new school systems, either explicitly or by requiring the formation of a committee to create a plan for the transfer. These laws address transferring the title of school property between school systems and the settlement of outstanding debt for the property. Most states have only one type of school system, making comparisons to Tennessee’s public school systems difficult. Thirty-four states have only independent school systems; school systems in North Carolina and Maryland (with the exception of the City of Baltimore, which operates a school district independent of any county) are dependent on county governments; and Hawaii has a single state school system. Thirteen states, including Tennessee, have more than one type of school system with some combination of county, city, and independent school systems.<sup>134</sup>

Laws in at least seven of these multisystem states provide guidance for transferring school property, and payments for those transfers, when a new school system is formed. Statutes in California, New Hampshire, New Jersey, and New York direct a newly created school system to take possession of school property—the buildings, equipment, and other

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<sup>132</sup> Tennessee Department of Education 2018. According to the BEP *Blue Book* for the 2018-19 School Year, the funding level for textbooks was \$77.50 per student (average daily membership).

<sup>133</sup> Signal Mountain School System Viability Committee 2017.

<sup>134</sup> US Census Bureau 2019b. See also Figure 4 above.



personal property—located in the area transferred from the original school system to the new school system and **authorize or require**

- consideration of the value of the property being transferred,<sup>135</sup>
- contributions made by the original and new school systems for capital costs associated with the property that is being transferred,<sup>136</sup> and
- the new system’s proportionate share of outstanding debt incurred for those capital costs,<sup>137</sup> **which in some states may be based on the assessed value of taxable property** of the transferring territory and the original district.<sup>138</sup>

However, analyzing the effects of these provisions is difficult, both because each state differs in its level of specificity and particular methodology for calculating the amount a new school system must pay and because only one, California, has formed a new school system since 2000.<sup>139</sup> Moreover, there were no school facilities in the new system's boundaries.<sup>140</sup>

Specifying processes for transferring school property **in state law** may provide more guidance to cities seeking to form a new school system, but it may also limit the ability of local governments and school boards to decide on other arrangements unless the law provides flexibility for school systems to do so. For example, California authorizes school systems to agree to a method for dividing bonded indebtedness that considers the “assessed valuation, number of pupils, property values, and other matters” the systems find relevant as an alternative to the method specified in state law.<sup>141</sup> Similar to Tennessee Senator Gardenhire’s Senate Bill 1755, Amendment 1, California provides for the arbitration of disputes arising “between the governing boards of . . . districts concerning the division of funds, property, or obligations.”<sup>142</sup>

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<sup>135</sup> California Education Code, Section 35738; New Jersey Annotated Statutes, Section 18A:13-61 and New York Education Law, Section 2218.

<sup>136</sup> New Hampshire Revised Statutes Annotated, Section 195:28.

<sup>137</sup> California Education Code, Section 35576; New Hampshire Revised Statutes Annotated, Section 195:27; New Jersey Revised Statutes, Section 18A:13-53; New York Education Law, Sections 1504 and 2218.

<sup>138</sup> California Education Code, Section 35576 and New York Education Law, Sections 1504 and 2218.

<sup>139</sup> EdBuild 2019. Loch Arbour left the Ocean Township School District in New Jersey, but students were transferred to neighboring districts and no new school system was formed.

<sup>140</sup> Merl 2004.

<sup>141</sup> California Education Code, Section 35738.

<sup>142</sup> California Education Code, Section 35565.

Three multisystem states—Connecticut,<sup>143</sup> Maine,<sup>144</sup> and Massachusetts<sup>145</sup>—require the creation of a committee to develop a plan for resolving a variety of issues associated with a proposed new school system formation, including how to divide real and personal school property and settle financial obligations between the new and original school systems. While California and New Hampshire direct a new school system to take possession of property located in its territory, committees in these states develop plans that identify the new school system’s liability for the outstanding capital debt of the original school system.<sup>146</sup> These states do not prescribe a particular method that a committee must use in determining how assets should be valued or how outstanding debt should be allocated, but Connecticut<sup>147</sup> requires a committee to consider the ratio of the new school district’s average daily membership to that of the original school district in apportioning the original district’s net assets.

### **Referendum on Forming a New City School System**

Currently, city residents vote in a referendum to determine whether to form a new city school system before they know what it will cost the city—and by extension the city’s taxpayers—to acquire all of the property it will need to operate. The first step in the process is for a city’s governing body to request a referendum on the issue of “rais[ing] local funds to support the proposed city school system.”<sup>148</sup> If **the vote is in favor**, then an initial city board of education is created that plans and manages the school system formation. In at least five other multisystem states—California,<sup>149</sup> Connecticut,<sup>150</sup> Maine,<sup>151</sup> New Hampshire,<sup>152</sup> and New Jersey<sup>153</sup>—an election is held on the issue of forming a new school system after a transition plan is created in order to make voters

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<sup>143</sup> Connecticut Annotated Statutes, Sections 10-63b and 10-63c.

<sup>144</sup> Maine Revised Statutes Annotated, Title 20-A, Section 1466.

<sup>145</sup> Code of Massachusetts Regulations, Title 603, Section 41.02.

<sup>146</sup> California Education Code, Section 35738 and New Hampshire Revised Statutes Annotated, Sections 195:25-195:26.

<sup>147</sup> Connecticut Annotated Statutes, Section 10-63c.

<sup>148</sup> Tennessee Code Annotated, Section 49-2-127.

<sup>149</sup> California Education Code, Sections 35755-35756.

<sup>150</sup> Connecticut Annotated Statutes, Section 10-63c. See also Sections 10-43 and 10-45.

<sup>151</sup> Maine Revised Statutes Annotated, Title 20-A, Section 1466.

<sup>152</sup> New Hampshire Revised Statutes Annotated, Section 195:29.

<sup>153</sup> New Jersey Revised Statutes, Section 18A:13-54 and Section 18A:13-58.

aware of the anticipated costs of forming the new school system before holding a referendum. New York also requires a transition plan to be created before a referendum may be held; however, a referendum is not required if at least two-thirds of the city's local governing body and the existing school system's board of education vote to approve the new school system.<sup>154</sup>

By creating a plan for transferring school property before holding a referendum, local governments may incur costs before knowing whether its voters will approve the creation of a city school system. This issue may be mitigated by first gauging public interest in forming a new school system. For example, Maine initially requires a vote on a petition to create a new school system. If approved, a committee then develops an agreement that includes a plan for dividing school property. If the Maine Commissioner of Education approves the agreement, then another vote is held to approve the new city school system formation and the implementation of the agreement.<sup>155</sup>

### **Other Requirements for Forming a City School System**

Any city wanting to create a new city school system would need to be authorized by its charter to do so. Tennessee cities have one of three different types of charters—home rule, general law, or private act—and the type of charter determines which laws apply to them. Cities with home rule charters may adopt and change their charters by local referendum, and the legislature may not pass private acts that apply to that city.<sup>156</sup> General laws applying to all cities apply to home rule cities as well.<sup>157</sup> All general law charters, along with some private act charters, authorize the creation of city school systems.<sup>158</sup> A city with a private act charter that does not authorize the creation of a city school system would need the General Assembly to pass a private act amending its charter to include the authorization.<sup>159</sup> Before a new city school system may commence instruction, the city must complete a new local education agency operation application and the Tennessee Department of Education must approve the application (See Appendix H).

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<sup>154</sup> New York Education Law, Section 2218.

<sup>155</sup> Maine Revised Statutes Annotated, Title 20-A, Section 1466.

<sup>156</sup> Tennessee Constitution, Article XI, Section 9.

<sup>157</sup> University of Tennessee Municipal Technical Advisory Service 2018a.

<sup>158</sup> Tennessee Code Annotated, Sections 6-2-201(29), 6-19-101(30), 6-19-103, and 6-33-101.

<sup>159</sup> University of Tennessee Municipal Technical Advisory Service 2018b.

Tennessee prohibits a city from operating a school system “unless the school system is large enough to offer adequate educational opportunities” to its students.<sup>160</sup> Tennessee State Board of Education rules require a city seeking to form a city school system to have a “scholastic population within its boundaries that will assure an enrollment of at least 1,500 pupils in its public schools, or . . . at least 2,000 pupils presently enrolled in the proposed school system.”<sup>161</sup> While the optimal school system size has been debated for years, systems “of fewer than 500 students may be too small to provide needed courses and student activities,”<sup>162</sup> and smaller school systems, as well as very large ones, tend to have higher than average administrative costs.<sup>163</sup>

Based on US Census estimates,<sup>164</sup> 37 cities that do not already operate a city school system have populations that meet the requirements for forming a new city-school system (ages 5-18). Of these 37 cities, five have home rule charters, and each of these charters contain authorization for the formation of a school system. Ten of these 37 cities have adopted a general law charter, five of which have a city manager-commission general law charter and seven of which have a mayor-aldermanic general law charter. The remaining 20 cities were created through private acts, and eight of the 20 are already authorized through their private acts to form their own school system. The other 12 cities would have to take the additional step of amending their private acts to include authorization for forming their own school systems (see table 11).

**Table 11: Charter Type of Cities with a Population, Ages 5 to 18, of at Least 1,500**

City	Scholastic Population	Type of Charter
Atoka	2,016	Private Act*
Brentwood	10,081	City Manager-Commission
Brownsville	1,846	Private Act
Chattanooga**	25,309	Home Rule
Clarksville	26,727	Private Act
Columbia	6,669	Private Act*
Cookeville	3,950	Private Act
Crossville	1,992	Private Act
Dickson	2,600	Private Act

<sup>160</sup> Tennessee Code Annotated, Section 49-2-106.

<sup>161</sup> Rules and Regulations of the State of Tennessee, Section 0520-01-08-.01.

<sup>162</sup> Association of Independent and Municipal Schools 2004.

<sup>163</sup> Tennessee Advisory Commission on Intergovernmental Relations 2015.

<sup>164</sup> US Census Bureau, 2013-2017 American Community Survey 5-Year Estimates.

City	Scholastic Population	Type of Charter
East Ridge	3,435	Home Rule
Fairview	1,669	City Manager-Commission
Farragut	4,555	Mayor-Aldermanic
Franklin	13,756	Private Act
Gallatin	5,792	Private Act
Goodlettsville	2,677	City Manager-Commission
Greenbrier	1,617	Private Act
Hendersonville	10,657	Mayor-Aldermanic
Jackson	11,213	Private Act
Knoxville**	24,304	Home Rule
La Vergne	8,345	Mayor-Aldermanic
Lebanon	5,400	Private Act*
Lewisburg	2,164	Private Act*
McMinnville	2,313	Mayor-Aldermanic
Morristown	5,036	Private Act*
Mt. Juliet	6,857	Home Rule
Nolensville	2,180	Mayor-Aldermanic
Paris	1,782	City Manager-Commission
Portland	2,307	Private Act*
Ripley	1,738	Private Act
Sevierville	2,434	Home Rule
Shelbyville	4,052	Private Act
Signal Mountain	1,857	Private Act*
Smyrna	8,495	Private Act
Soddy-Daisy	2,000	City Manager-Commission
Spring Hill	9,671	Mayor-Aldermanic
Springfield	2,942	Private Act*
White House	2,154	Mayor-Aldermanic

Source: US Census Bureau, 2013-2017 American Community Survey 5-Year Estimates and University of Tennessee Municipal Technical Advisory Service.

\*These private act charters authorize the formation of a city school system.

\*\*These cities had city school systems in the past.

State law also requires that voters choose to raise local funds to support a proposed city school system,<sup>165</sup> and State Board of Education rules require the city to spend annually an amount “at least equal to that which a fifteen cents (\$ 0.15) tax levy on each one hundred

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<sup>165</sup> Tennessee Code Annotated, Section 49-2-127.

dollars (\$ 100.00) of taxable property for the current year in said city school district would produce if the same were all collected.”<sup>166</sup>

**Other concerns about local revenue and services in Tennessee warrant further study**

In addition to this report, work continues on TACIR’s local revenue and services series, and the second interim report on education funding was published in January 2020. Its more holistic treatment of revenue will provide a helpful context for evaluating other potential sources of education funding—state-shared taxes, for instance. During its discussion of House Bill 971 by Representative Sargent, Senate Bill 1075 by Senator Watson, the House Finance, Ways and Means Committee asked TACIR to study the revenue sources of cities and counties in Tennessee and the services cities and counties provide. In February 2019, TACIR published *Internet Sales Tax in Tennessee*, its first interim report in this series. A comprehensive study of local government revenue and services is planned following the second interim report on education funding.

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<sup>166</sup> Rules and Regulations of the State of Tennessee, Section 0520-01-08-.01(5).