PUBLICATION

Spotlight on Tennessee: Governor Haslam Seeks to "IMPROVE" the Volunteer State

Authors: Carl E. Hartley
January 24, 2017

Bolstered by a substantial budget surplus in the prior fiscal year and an anticipated surplus this fiscal year, Tennessee Governor Bill Haslam proposed on January 18 a comprehensive and strategic plan not only to assist in funding this State's transportation infrastructure needs, but also to address certain tax inequities and other issues generally. Although the text of the proposed legislation is not yet public, the anticipated Improving Manufacturing, Public Roads and Opportunities for a Vibrant Economy Act (the 'IMPROVE Act') has been promoted by the Governor as reducing various Tennessee taxes by approximately $270 million, while at the same time providing additional revenues through gas/diesel fuel tax increases for infrastructure needs.

The IMPROVE Act, as with any other major bill offered by the Administration, will certainly be subject to the Legislature's analysis and scrutiny in this current Session of the 110th General Assembly. The Legislature reconvenes on January 30, but it is uncertain at this point as to when the applicable legislative committees will begin focusing on the IMPROVE Act.

Overview

The following is a very general overview of the IMPROVE Act as announced by the Governor:

A. **Transportation Infrastructure Needs.** As proposed, the IMPROVE Act would generate additional revenues to assist in funding the large backlog of highway projects throughout the State, (the Administration released a long list of such projects) and provide for future maintenance demands (highway resurfacing, bridge repairs, transit programs, etc.). Such revenues would be generated through a number of sources as follows:

1. Gas Tax – Increasing the gas tax by 7¢ per gallon from its current rate of 21.4¢ per gallon, which has been the rate in effect since 1989;

2. Diesel Tax – Increasing the diesel fuel tax by 12¢ per gallon, from the current rate of 18.4¢ per gallon which has been the rate in effect since 1990;

3. CPI – Indexing (with caps) those fuel taxes to the Consumer Price Index;

4. Other State Sources – Increasing or imposing other fees and taxes such as a $5 increase in the average passenger vehicle registration fee, a three percent charge on rental cars, a $100 annual fee on electric vehicles and increasing charges for vehicles using alternative fuels; and

5. Local Sources – Authorizing locals, through the referendum process, to dedicate local option sales taxes to be used for certain transit projects.

As explained, these initiatives will generate important revenues to assist the State, as well as counties and cities, with respect to addressing transportation infrastructure needs.

B. **Eliminating Certain Tax Inequities.** As listed by the Governor in the promotional materials, the IMPROVE Act would implement changes to this State's taxes by:

6. Groceries – Reducing the Tennessee sales tax on groceries by another 1/2%. The general State sales tax rate is 7% but the State rate applicable to "food and food ingredients for human consumption" has been reduced on several occasions over the last decade or so, with the current State rate on such groceries being 5% effective July 1, 2013. If enacted, the IMPROVE Act would further reduce the State rate on such groceries to 4 1/2%, plus the applicable local tax rate;

7. Hall Tax – Accelerating the ultimate elimination of Tennessee's tax on interest and dividends (called the 'Hall Tax') by a further reduction of 1 1/2% in the Hall Tax rate during 2017 and another similar rate reduction in 2018. The Legislature in 2016: (i) reduced the Hall Tax rate from its historical rate of 6% to 5%, (ii) expressed the intention, but not the commitment, to thereafter annually reduce the Hall Tax beginning with the 2017 Session and (iii) statutorily mandated that the Hall Tax would be eliminated for tax years beginning on or after January 1, 2022. If enacted, the IMPROVE Act would further reduce the current 5% tax rate of the Hall Tax to 2% as a result of these 2017 and 2018 reductions; and

8. Single Receipts Factor – Allowing manufacturers to use a single weighted sales factor for purposes of calculating Tennessee taxable income with respect to the excise tax (6 1/2% tax rate), and as applicable, the franchise tax (25¢ per $100 tax rate, with a minimum measure of the tax base being property owned or used in this State). Since enactment in 1976, apportionment of the applicable tax base for these taxes has been pursuant to a formula which takes into account the average of three factors, those being the property of the taxpayer in Tennessee as the numerator as compared to property of the taxpayer everywhere as the denominator, payroll in Tennessee to payroll everywhere and receipts in Tennessee to receipts everywhere. Tennessee manufacturers have long contended that such apportionment formula does not fairly attribute business income to Tennessee where significant capital and payroll are invested in this State but where the predominant marketplaces for the manufacturer's products are outside Tennessee. Economic development advocates have also expressed concerns that Tennessee's current formula may impede the realization of expansions in this State by existing manufacturers, as well as prevent serious consideration of new site locations in Tennessee by out-of-state manufacturers. In that regard, the promotional materials for the IMPROVE Act recognize that "Tennessee is currently at a competitive disadvantage for manufacturers, losing several candidates recently because of it." This State has made some efforts to compromise this economic inequity by double-weighting the sales factor for tax years beginning on or after December 15, 1998 and thereafter triple-weighting the sales factor for years beginning on or after July 1, 2016. Nevertheless, a multitude of other states have aggressively moved to a single weighted sales factor in regard to their business income taxes. If enacted, the IMPROVE Act would attempt to level the playing field by addressing the foregoing apportionment inequities experienced by manufacturers.

Summary

The IMPROVE Act represents a timely effort to address Tennessee's transportation infrastructure needs and to also deal with certain tax inequities and other issues. As referenced earlier, the text of the IMPROVE Act is not yet public; and, even after being introduced as a bill, it will require passage by both the Senate and the House after analysis and scrutiny through the legislative committee process.

For more information regarding the topics discussed in this alert, please contact the author, Carl Hartley, or William Fones or Steve Wood, in our Tennessee offices of the Firm's Tax Group.