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TENNESSEE MANUFACTURERS ASSOCIATION

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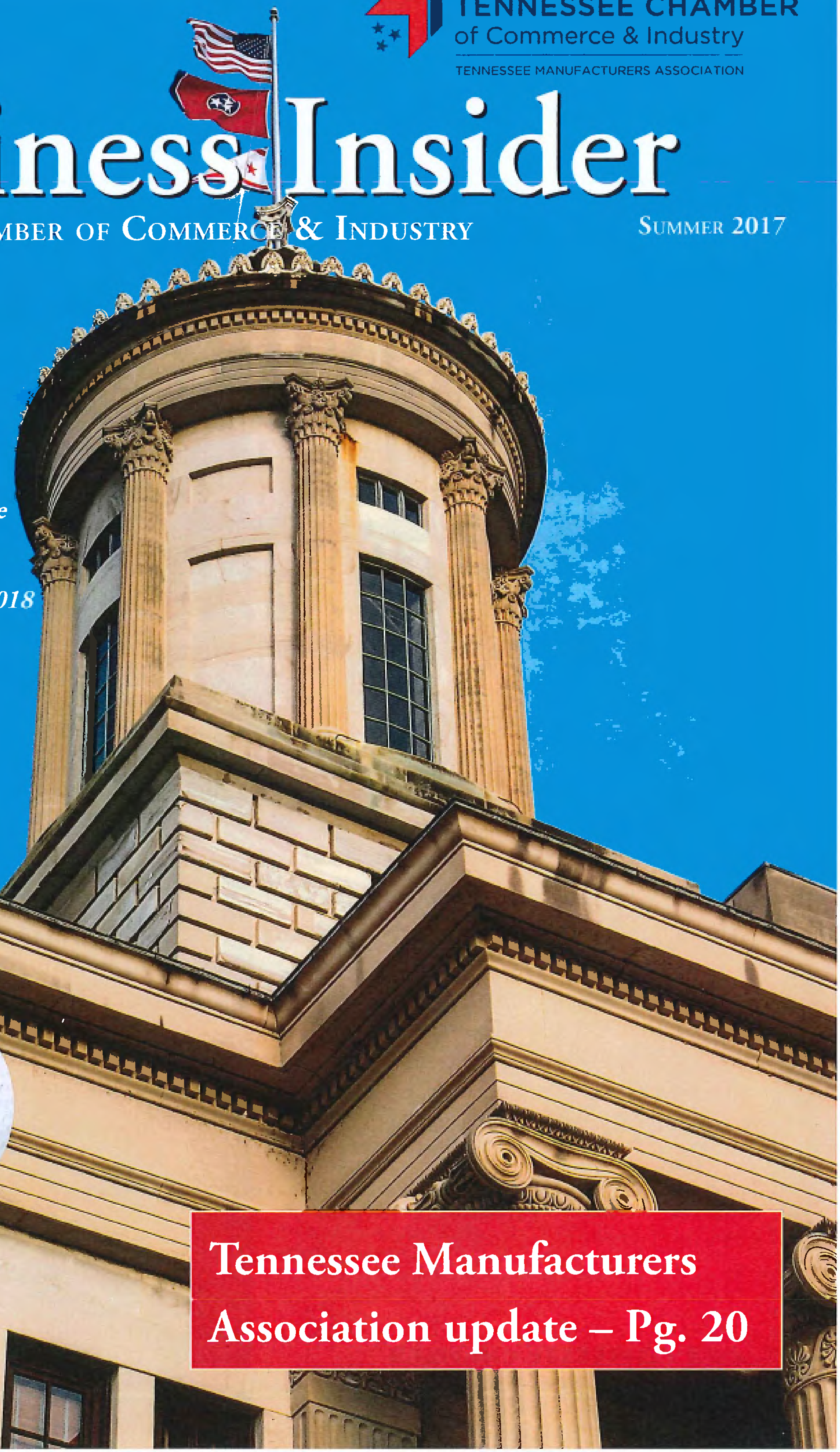

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2017 LEGISLATIVE SESSION STRENGTHENS TENNESSEE'S BUSINESS COMPETITIVENESS

By: **Bradley Jackson, Charles Schneider** and **Ted Boyatt**

Despite the politically unpredictable climate that has seemingly evolved since the 2016 elections, Tennessee's 2017 legislative session produced some of the most significant policy successes for the Tennessee Chamber and our state's business community in recent memory. Although much of the session was marked by political volatility and turbulence, the final legislative days following passage of a highly-contentious tax and infrastructure bill, along with a historic $37 billion state budget, saw battle-fatigued legislators temperately and relatively peacefully embrace a delayed May adjournment to return home to their districts.

Overall, this year's session will most likely be remembered for addressing the key issue of taxes, with lawmakers voting to modernize Tennessee's outdated tax laws relative to both transportation infrastructure and business taxes on manufacturers. Prior to 2017, Tennessee's fuel taxes, the revenues from which are dedicated to funding road and transportation projects, had remained stagnant for nearly 30 years. These static fuel tax revenues, combined with rising construction costs, booming infrastructure demands, and improved vehicle fuel efficiency standards, had created a multibillion-dollar backlog of road projects across the state.

Concurrently, for our state's economic development relative to manufacturers, persistent questions surrounding the fairness of the state's business taxes had lingered since 1996. In that year, Tennessee adopted a double-weighted sales formula for manufacturers' franchise and excise tax assessments, later moving to a triple-weighted formula in 2014. Although the Tennessee Chamber played a major role to get both of these revised tax assessment formulas enacted, it was apparent from the feedback of our business and manufacturing members that our state needed further action on both manufacturing taxes and transportation infrastructure in order to remain economically competitive.

To remedy these obsolete transportation and business tax structures and generate adequate funding for much-needed road projects, Governor Bill Haslam introduced the IMPROVE Act, or what would later become known as the Tax Cut Act of 2017. Upon its first public introduction in late January, legislators initially gave the proposal a cold reception. However, as it progressed through the committee system, legislative leaders and administration officials masterfully renegotiated and strategically modified the bill to offset the moderate fuel tax increases with simultaneous cuts to other taxes on manufacturers, personal investment income, and even grocery purchases. When combined with input and mounting grassroots support from the Chamber and other allied partner organizations, the legislation slowly evolved into a more comprehensive policy solution for both taxes and infrastructure that could garner broad public and legislative approval. In the end, the final result called for reasonable hikes of 6 and 10 cents on gas and diesel taxes, respectively, while also cutting a combined total of over $400 million annually in business and personal taxes, including a critical single sales

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<u>Business Tax Update</u>: IMPROVE Act Signed by Governor

By: **Carl E. Hartley, Esq.**, *Chair, TN Chamber Tax Committee*

On April 26, Governor Haslam signed the IMPROVE Act (that is, the Improving Manufacturing, Public Roads and Opportunities for a Vibrant Economy Act), also known as the 2017 Tax Cut Act. The Act is now 2017 Public Chapter No. 181.

A. <u>State Transportation Infrastructure Projects and Funding.</u> The Act specifically lists 962 road and bridge projects across the State which, at some point, will be funded in whole or in part by sources within the Act. These projects impact all of Tennessee's 95 counties in varying degrees.

Funding sources include several taxes and fees, with the principal sources being an increase over three years in the gas and diesel taxes. The current 20¢ per gallon gas tax will be increased to 24¢ effective July 1, 2017, then to 25¢ effective July 1, 2018, and finally 26¢ effective July 1, 2019. Similarly,

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IMPROVE ACT Signed by Governor *Continued from page 3*

the current 17¢ per gallon undyed diesel tax will increase to 21¢ effective July 1, 2017, 24¢ effective July 1, 2018 and 27¢ July 1, 2019. An existing 1.4¢ per gallon license tax and fee will continue to be added to both gas and diesel taxes. See Notice #17-18 just published by the Tennessee Department of Revenue as to dyed diesel fuel.

Tax on certain alternative fuels would also increase over three years. Currently at 14¢ a gallon the liquefied gas tax would increase to 17¢ per gallon effective July 1, 2017, 19¢ per gallon effective July 1, 2018, and 22¢ per gallon effective July 1, 2019. Compressed natural gas currently at 13¢ per gallon would increase to 16¢ effective July 1, 2017, 18¢ effective July 1, 2018 and 21¢ effective July 1, 2019. Other fees and taxes are also imposed or increased to assist with this funding, such as a $100 registration and renewal fee with respect to electric vehicles.

The Legislature expressed its intent that these 2017 increases shall be used for the above-referenced transportation and related projects.

B. <u>Local Option Transit Surcharge.</u> The local surcharge provisions within the Act were the subject of intense deliberations and discussions among interested parties prior to the Act's approval by the Legislature. As enacted, several counties and cities are authorized under the Act to adopt their own local surcharge for purposes of funding a local "transit improvement program" -- provided that the surcharge is approved by a majority of the number of registered voters of the local government voting in an election on the surcharge question.

Those local governments to which these provisions apply include: (i) any county in Tennessee (including any county having a metropolitan or consolidated form of government) with a population in excess of 112,000 according to the 2010 Federal census, and (ii) any city in this State having a population in excess of 165,000 according to such census. The applicable counties would thus include, among several others, Davidson, Hamilton, Knox, Rutherford and Shelby; and the cities would include Chattanooga, Knoxville, Memphis and Nashville.

A local "transit improvement program" consists of specified public transit system projects and services, with the term public transit system including any mass transit system intended for shared passenger transport services to the general public, together with any building, structure, vehicles, etc. needed to operate the transportation facility or provide connectivity for the facility to any interstates, highways,

State Rep. Susan Lynn has used this diagram to inform constituents about the IMPROVE Act.

roads or other non-mass transit system transportation infrastructure.

Further, the term "surcharge" means a tax, or combination of taxes, levied by a local government for said funding purposes; however, any such surcharge is limited to the following local privilege taxes:

(i) Local option sales and use tax (enacted per State law),

(ii) Business tax (enacted per State law),

(iii) Motor vehicle tax (enacted per State law or by applicable private act),

(iv) Local rental car tax (enacted per State law),

(v) Tourist accommodation tax (enacted per State law, or hotel occupancy tax per State law, or by applicable private act), and

(vi) Residential development tax (per the County Powers Relief Act per State law).

In essence, if approved through the election process referenced above, those authorized local governments can impose a surcharge coexistent with any one of the above-referenced six (6) taxes. The Act provides that any surcharge shall be levied, collected, and administered in the same manner as the applicable underlying local tax, and shall be subject to the same conditions, limitations, exemptions, credits, returns and other requirements as are applicable to the underlying local tax.

The rate of a surcharge under the Act depends upon the maximum rate established for a particular surcharge. For instance, a surcharge on the local option sales and use tax may not exceed the maximum rate established for the applicable underlying local option sales and use tax. Additionally, no local government may levy a surcharge on a business tax, a surcharge on a local rental car tax, or surcharge on a residential development tax that separately exceeds the rate of 20% of the current applicable rate of the business tax, local rental car tax, or residential development tax. Still further, no local government may levy any combination of the tourist accommodation taxes, hotel occupancy taxes, local tourism development zone business taxes, state sales and use taxes, local option sales and use taxes, or surcharges on any combination of tourist accommodation taxes, hotel occupancy taxes, and local option sales and use taxes that exceed a combined rate of 20% on hotels, motels or other tourist accommodations which are subject to such taxes and surcharges.

There are several exemptions and/or limitations specifically referenced in the Act which would be applicable to a surcharge on the local option sales and use tax as well as certain of the other surcharges.

The Act provides that a taxpayer shall have the same remedies applicable to the underlying local tax with respect to which the surcharge is imposed. Further, with respect to surcharges that are administered and collected by the Department, the Act states that the law which applies to the recovery of the underlying taxes illegally assessed or collected be conformed to apply to the recovery of surcharges illegally assessed or collected.

For any surcharge that the Department administers and collects, the Act states that the Department shall have the same powers in regard to the underlying local tax and shall remit the proceeds of the surcharge to the local government less an administrative fee.

C. Tax Inequities Addressed by the Act. The tax inequities (that is, rate cuts or other types of tax decreases) addressed by the Act include the following:

(1) Sales Tax on Food Reduced. Continuing the General Assembly's intent to reduce the sales tax on food and food ingredients for human consumption, the Act further reduces the sales tax from its 5% rate to 4% effective July 1, 2017. See the Department's Notice #17-07 addressing this tax rate reduction.

(2) Hall Tax Rate Reduced/Then Eliminated. The General Assembly in 2016 reduced the Hall income tax rate from its historic 6% to 5% effective January 1, 2016. Additionally, the General Assembly last year expressed its intent to continue reducing this tax rate such that the Hall income tax is eliminated for tax years that began on or after January 1, 2022. In furtherance of the foregoing, the Act provides that the rate of the Hall income tax will be 4% for tax years beginning on or after January 1, 2017, 3% for tax years beginning on or after January 1, 2018, 2% for tax years beginning on or after January 1, 2019, 1% for tax years

Charles Schneider, Director of Government Affairs for the Tennessee Chamber, visits Columbia to share information on how the IMPROVE Act will benefit road and bridge improvements statewide.

beginning on or after January 1, 2020, and 0% for tax years beginning on or after January 1, 2021.

(3) Single Sales Factor Apportionment Formula for Manufacturers. Effective for tax years beginning on or after January 1, 2017, a taxpayer whose "principal business in Tennessee is manufacturing" may elect to apportion net earnings for excise tax purposes and may elect to apportion the net worth for franchise tax purposes pursuant to a single sales factor. That single sales factor is in essence a fraction, the numerator of which is the total receipts of the taxpayer in Tennessee during the taxable year and the denominator of which is the total receipts of the taxpayer from any location within or outside this State during the taxable year.

The phrase "principal business in Tennessee is manufacturing" is defined to mean that more than fifty percent (50%) of the revenue derived from the taxpayer's activities in Tennessee (excluding passive income) is from fabricating or processing tangible personal property for resale and consumption off the premises. The phrase "passive income" means dividend income, interest income, income derived from the sale of securities, and income derived from the licensing or sale of patents, trademarks, trade names, copyrights, know-how, or other intellectual property.

In order to elect use of the single sales factor apportionment formula for either tax, the taxpayer must notify the Department of the election, in writing, on its Franchise, Excise Tax Return for the taxable year to which the election applies. Once an election is made, that election shall remain in effect for a minimum of five (5) tax years and thereafter until revoked.

A taxpayer wishing to revoke an election after the minimum five (5) years must notify Department of the revocation, in writing, on its Return for the first taxable year to which the revocation applies.

A taxpayer that revokes the single sales factor election shall not be permitted to newly elect this single sales factor method for a period of five (5) years, beginning with the tax year in which the taxpayer revoked the previous election.

Specifically with respect to the franchise tax, the Act includes an additional provision making the single sales factor operative only if the Tennessee State Funding Board certifies that all payments have been made on bonds issued by the State as of July 1, 2013 which are still outstanding, that the State is not in default in payment of any debt or interest on said bonds, and that the fees and taxes which are to be lowered (one of which being the franchise tax pursuant to this single sales factor apportionment election) will still be sufficient to provide funds adequate to meet all payments required by the State Funding Board as well as provide for other obligations of the State. Hopefully, that certification from the State Funding Board will always be forthcoming.

Also specifically as to the franchise tax, please note that this elective single sales factor apportionment formula does not compromise or otherwise impact a taxpayer's franchise tax liability computed under the minimum measure of the franchise tax base.

(4) Property Tax Relief for Certain Taxpayers. Continuing with the General Assembly's efforts almost each year to assist certain taxpayers with respect to their property taxes, the Act provides that: (i) for taxpayers either 65 years of age or older or totally and permanently disabled, and assuming an annual income from all sources not exceeding $24,000, reimbursement from the State shall be paid on the first $27,000 (up from $23,500) of the full market value of the taxpayer 's property, and beginning in 2018 such amount shall be increased annually to reflect inflation as measured by the U.S. Bureau of Labor Statistics Consumer Price Index; and (ii) for disabled veteran taxpayers, reimbursement from the State shall be paid on the first $175,000 (up from $100,000) of the full market value of the taxpayer's residence. These provisions are effective under the Act on July 1, 2017.

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factor formula for manufacturers' tax assessments long championed by the Tennessee Chamber. Accordingly, the final version of the legislation actually evolved into one of the largest tax cuts in Tennessee history.

Both of these issues presented a keen opportunity for the Tennessee Chamber to engage in the legislature's public policy maneuverings to sharpen Tennessee's business climate and to give our businesses and local chamber partners the opportunity to engage and elevate their voices at a state level. Enacting this type of major tax reform was no easy task, especially at a time of such political uncertainty. However, the fruits of our combined efforts became evident during floor debates in both the House and Senate, as legislators spoke up and recounted interactions from their local chambers and employers back home about the importance of the legislation. Thanks to the determined work of our partner business advocates and local chamber leaders, the IMPROVE Act sailed to overwhelming passage in the Senate and a decisive 60-vote approval in the House.

While tax reform may have emerged as the most prominent headline of the 2017 General Assembly, there were a considerable number of other bills that the Tennessee Chamber also endeavored to defeat, pass, or otherwise amend on behalf of the