

# The Tennessee Journal

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## Haslam's 7-cent solution must travel rocky legislative road

It could have been a warm-up for the State of the State address. An overflow crowd Wednesday watched Gov. Bill Haslam unveil his long-awaited gasoline tax proposal and a string of offsetting cuts in other taxes.

City and county mayors joined him onstage. A coalition of supportive organizations, including the Tennessee Road Builders Association, issued laudatory statements. Lt. Gov. Randy McNally and others who were briefed beforehand offered positive comments.

But the proposal will not be easy to pass. A tax increase never is, and that is especially the case in an overwhelmingly Republican legislature in the midst of a record revenue surplus. Winning House approval will be particularly difficult. And senators, who went first on Insure Tennessee, will want to see movement in the House before they act.

Haslam is well aware that this will be his most challenging initiative since the 2015 Insure Tennessee proposal, which of course did not go well. But while there is something in the broad proposal for nearly everyone to dislike or fret over, everyone will like something.

Proposed hikes of seven cents per gallon on gasoline and 12 cents on diesel fuel would push Tennessee's rates to 28.4 cents for gasoline and 30.4 cents for diesel. Also in the package are franchise and excise tax breaks for manufacturers and cuts in the sales tax on food and the Hall income tax. Haslam plans to offer the comprehensive proposal in a single bill.

**Business break.** Multi-state companies with manufacturing operations in Tennessee would be given the option to use a single sales factor in determining how much of their income is subject to Tennessee's 6.5% excise tax. The state estimates this measure, limited to manufacturers, would cost \$113 million.

Currently, the apportionment formula takes into account sales, property, and payroll, with sales triple-weighted and accounting for 60% of the determination. Because of their large capital investments and workforces, manufacturers tend to prefer a formula that considers only sales. But the proposal would give them the choice of single-sales or the current formula.

Haslam says the state would have had to do something to relieve the tax burden for manufacturers even if there had been no surplus, and even if there were no transportation proposal. In the last six months, the governor says, four or five large manufacturers Tennessee was trying to recruit went elsewhere, with franchise and excise taxes a major consideration.

Tennessee imposes the lowest taxes in the nation on individuals, as a percentage of income, but it ranks third-highest in total corporate taxes as a percentage of the state's economy — measured by personal income — and also as a percentage of the state's total tax revenue, according to a report by University of Tennessee economist Bill Fox, using numbers from 2015. Haslam says this is particularly problematic as neighboring states offer industrial prospects a lower tax burden.

The franchise tax on the value of a company and the excise tax on earnings are separate levies, but the two are paid on the same tax form and generally discussed as one. Fox notes that Tennessee's excise tax rate isn't unusually high, though it is difficult to make comparisons because exemptions and other factors affect the "effective tax rate." In any event, he says, the franchise tax — 25 cents for each \$100 of value — hits companies harder than comparable taxes in almost any other state.

Manufacturing is a priority concern for Haslam, who cites its spin-off benefits. Mainly because the state has three automakers — Nissan, General Motors, and Volkswagen — it is home to 914 auto plant suppliers.

But this is one reason the governor urges caution in the handling of the budget surplus. A big slowdown in car sales, say of 10%, could hit the state's economy hard.

**Sales tax on food.** Haslam also proposes to cut another half-cent from the sales tax on unprepared food, dropping the state's rate to 4½ cents per dollar at a cost of \$55 million. The governor and legislature slashed the rate by a quarter-cent in 2012 and another quarter-cent in 2013. The proposed action would reduce Tennesseans' tax payments on food by 10%.

It is a popular move among both Republicans and Democrats. At the same time, it further reduces the

most stable portion of the sales tax. The general state sales tax carries a rate of 7%, but grocery food currently is taxed at 5%. Local option sales tax rates, which can go as high as 2.75%, also apply to food.

**Hall tax.** Last year, the legislature cut the Hall income tax on stock dividends and bond interest from 6% to 5% and declared the levy repealed as of 2022. Haslam had been expected to propose another one percentage point reduction, but instead he is calling for cuts of 1½ points this year and the same in 2018, his final year in office, which would push the rate down to 2%. The Department of Revenue estimates the total reduction would cost state government \$102 million, or \$51 million for each 1½-point slice.

Overall, Haslam is calling for tax cuts amounting to \$270 million, roughly the same as the \$278 million in new revenue that would come from the gasoline and diesel tax hikes and assorted smaller measures. To get to that figure, of course, he is counting two years of Hall cuts while committing to the second one now.

By the governor's tally, tax cuts in his administration already totaled nearly \$270 million — including elimination of the inheritance and gift taxes and earlier actions on Hall and food, as well as the aviation fuel tax cap established in 2015 and other measures, especially the shift two years ago from a double-weighted to triple-weighted sales factor in excise tax apportionment. The new cuts would bring the figure to \$540 million.

The highest total for tax reductions in any previous administration, Haslam believes, is \$60 million under his predecessor, Gov. Phil Bredesen. The bulk of that came in 2007, when the tax on food was reduced from 6% to 5.5%, just ahead of the Great Recession.

Budget cuts under Haslam add up to more than \$500 million, and he says another \$50 million or so will be included in the 2017-18 budget he presents Jan. 30.

**Reaction.** Numerous legislators expressed agreement that something must be done for roads and gave the governor a figurative pat on the back for his proposal. But some want to change the plan. Several have been quoted by news outlets as suggesting a bigger food tax cut is in order. And some, such as Rep. Ron Lollar (R-Bartlett), question whether the Hall tax cut would be too big a bite at once. Cities and counties receive 37.5% of Hall revenue, based on the residence of taxpayers, and local impact is one reason it is being phased out slowly.

The Hall levy, which treats capital gains distributions in mutual funds as dividends subject to state taxation, is unpopular with most Republican lawmakers. They tend to characterize it as a discriminatory tax on the savings of little old ladies that doesn't apply to workers with six-figure incomes and investments in 401(k) plans. Democrats such as House Minority Leader Craig Fitzhugh (D-Ripley), on the other hand, question the governor's "focus on cutting taxes for millionaires and billionaires."

**Gas tax.** The legislature last raised the gasoline and diesel taxes in 1989, by four cents each, when Ned McWherter was governor. One cent of the diesel increase, designated for local governments, didn't take

effect until 1990. Since then, according to a state comptroller's report last year, the purchasing power of the taxes has declined almost by half. This is partly because fuel taxes are per gallon, unaffected by price, while road construction and maintenance costs have risen substantially. Also, vehicles get better mileage and use fewer gallons of gas than they did 28 years ago for the same trip.

Haslam is calling for the 7-cent gasoline tax hike to address a \$6 billion backlog, as well as projects that Tennessee Department of Transportation officials believe should be added. The increase would cost the average motorist about \$50 a year.

Each penny of tax generates \$31.9 million, \$19.7 million of which would go to TDOT. The department's total funding increase from the tax would be \$138.2 million. Cities and counties would receive \$85 million.

The diesel tax produces \$10.1 million for each penny, so the 12-cent hike the governor proposes would generate \$121.2 million, including \$89.3 million for TDOT.

The fuel tax increases combined would send an additional \$78 million to counties and \$39 million to cities — a big reason so many city and county mayors joined Haslam for the announcement of the proposal Wednesday in the Old Supreme Court Chamber at the Capitol.

With diesel currently taxed at three cents a gallon less than gasoline, Haslam had been widely expected to propose an increase three cents greater for diesel to even the taxes, but he proposed one five cents greater. The trucking industry has been part of the push for more road funding, but Rep. Pat Marsh (R-Shelbyville), who owns a trucking company, told the *Shelbyville Times-Gazette* truckers had expected the rate increases to be closer. Marsh predicted lawmakers will settle on a plan "somewhat" like the governor's.

Haslam held the gasoline tax proposal to seven cents by using other revenue sources.

- He proposes to ban open containers of alcohol in vehicles. Currently, drivers are prohibited from holding open containers, but passengers may. The lack of an open container law has cost the state use of \$18 million in federal funds for road projects. The money instead goes into safety programs. With such a law, the near-equivalent of a cent on the gas tax could be shifted to roads. The plan exempts buses and certain other vehicles. Open container bills have failed in the legislature for years.
- Also proposed is a 3% charge on car rentals, which would bring in nearly \$15 million.
- Increases in vehicle registration fees, with a \$5 hike applying to most cars, would yield about \$33.9 million.
- A new annual fee of \$100 would be put on electric vehicles, which aren't affected by the gas tax. The state estimates it will collect \$250,000 on 2,500 such vehicles.
- Two percent of fuel tax revenues go to the general fund, but the bill will direct that no proceeds from the rate hikes go there, freeing up money for road projects.

In all, the proposal makes another \$296.5 million available for TDOT to spend on projects, counting the \$18 million shift via the open container provision. Actual new money totals \$278.5 million.

# Tennessee News Digest

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● Memphis recorded 228 homicides in 2016, a 42% increase from 161 in 2015 and the city's most ever, eclipsing the 1993 record of 213, *The Commercial Appeal* reported Wednesday. Overall major violent crime also was up.

● In the final days of the Obama administration, the U.S. Department of Agriculture imposed new enforcement rules for the Horse Protection Act that bans devices used in training Tennessee walk-

ing horses. U.S. Sen. Lamar Alexander said he hopes the new agriculture secretary will block the measure, saying he favors wiping out "the contemptible and illegal practice of horse soring," not wiping out walking horse shows.

● The Department of Labor and Workforce Development says it hopes to clear a backlog of unemployment claims this month and put new procedures in place to speed up the system. Legislators, who

have received numerous complaints about late checks, were scheduling a meeting with department officials, Rep. Timothy Hill (R-Blountville) told WJHL-Channel 11 in Johnson City.

● Harry Tindell, a Democrat who served in the state House for 22 years, plans to seek a seat on the Knoxville City Council in the Aug. 29 election. Tindell has done some lobbying since leaving the legislature in 2012.

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**Indexing.** The bill will include a provision to index the fuel taxes to the Consumer Price Index, with a cap that has not yet been spelled out. The adjustment would be made every two years. Haslam argues indexing is a good idea, since unlike other tax revenues, fuel tax receipts don't increase with inflation. The idea will be one of the more controversial parts of the legislation. It isn't unprecedented in state law. Legislators' salaries, for example, are indexed to state employee raises and automatically adjusted every two years.

**Bridges.** Officials say if the bill is passed, 94% of all backlogged projects and 56% of interstate projects will be under construction within six years. The plan includes 51 projects tied to economic development. It would replace 162 bridges on state highways and 526 on county roads. Transportation Commissioner John Schroer says bridges are safe at posted weight limits, but limits on many of them have been reduced.

Senate Majority Leader Mark Norris (R-Collierville), who along with House Majority Leader Glen Casada (R-Franklin) will introduce the bill, has expressed strong interest in addressing bridges and unsafe roads. Both leaders have indicated they expect to hear alternative funding ideas from fellow legislators.

**Transit.** At the urging of Nashville Mayor Megan Barry and others, the plan contains a provision enabling local governments to impose, by referendum, a sales tax surcharge for mass transit. A limit on the optional tax hasn't been determined. Barry was out of town Wednesday but issued a statement endorsing Haslam's transportation proposal.

The Nashville mayor and other Middle Tennessee leaders are pushing for a \$6 billion regional transit system that could include both rail and bus features. Moving Forward, an organization composed of Nashville area business leaders, is seeking to identify a local dedicated funding source with the aim of attracting federal and state assistance.

Cities and counties already may impose a local option sales tax up to 2.75%. Most, including Memphis, Nashville, Knoxville, and Chattanooga, which are at 2.25%, are below the limit. Memphis voters rejected a half-cent sales tax increase in 2013. Nashville voters did likewise in 2005. Half of the revenue from the local option tax must be spent on education. This would not apply to the dedicated surcharge, which Barry has said she believes voters would approve.

Senate Minority Leader Jeff Yarbro (D-Nashville) argues the transit option should be broader — including the wheel tax and perhaps other taxes. Administration officials say discussions on the subject are ongoing.

**Opposition.** Although the tax cuts sweeten the deal, many legislators in both houses are opposed to a gas tax hike. Some want to spend a one-time, \$1 billion surplus on highways. Some would like to spend money from the general fund on roads on a recurring basis.

Americans for Prosperity-Tennessee, which opposes a tax increase, is proposing the state designate \$200 million from revenue growth as a recurring annual supplement to the transportation fund.

Haslam argues the state should continue its policy of funding roads from the separate transportation fund, which gets its state money from user taxes. A big advantage to this, he says, is that out-of-state travelers share in the cost, whereas the general fund — though it does include some tourist sales tax dollars — comes mostly from Tennesseans.

While revenue growth this year is in the \$1 billion range, the governor reminds lawmakers that only half or so of the amount is extraordinary. Much of it will cover normal cost increases in TennCare, education, and other areas. Haslam will lay out what he proposes to do with the rest in his budget presentation Jan. 30, but he has signaled already in broad terms his interest in boosting the Basic Education Program and teacher salaries and addressing some long-range fiscal concerns.

From the one-time money, he will propose a transfer of \$120 million to the transportation fund, completing a "repayment" of money diverted from transportation to the general fund during tough budget years in the Sundquist and Bredesen administrations.

**Leaders.** House Speaker Beth Harwell and Lt. Gov. McNally both issued positive statements in response to Haslam's presentation, though neither, especially Harwell, went so far as to endorse the plan.

Perhaps complicating the legislative process to some extent will be prospective gubernatorial campaigns of Norris, Harwell, Fitzhugh, and Sens. Mark Green (R-Clarksville) and Doug Overbey (R-Maryville).

Haslam says he could get through his term without a tax hike, but that he feels obligated to leave the state in better shape than he found it. He has a big selling job ahead of him.

## Tennessee Notes & Quotes

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■ **Bill Fletcher** and **John Rowley**, partners in the Nashville-based Fletcher-Rowley consulting firm, best known for its work nationally on Democratic political campaigns, are splitting up after more than two decades. In a joint announcement Thursday, they said they had “collaboratively and mutually decided to end our successful partnership.” Rowley will launch two new ventures, one involving campaign communications, the other crisis communications. Fletcher will announce a new endeavor shortly. A shifting political environment in recent years has limited the firm’s campaign opportunities in Tennessee. It has handled campaigns throughout the country and increasingly pursued corporate business.

■ “We have been brothers-in-arms for a long time . . . and had the time of our lives. We have a personal bond we imagined as an intersection of Lennon-McCartney, Butch and Sundance, and Thelma and Louise.” — **Bill Fletcher** and **John Rowley**, on the dissolution of their partnership.

■ Although he did not support **Donald Trump’s** presidential candidacy (nor **Hillary Clinton’s**), Gov. **Bill Haslam** traveled to Washington for President Trump’s inauguration.

■ U.S. Rep. **Steve Cohen** (D-Memphis), on the other hand, announced he would boycott today’s inauguration to show “solidarity” with Rep. **John Lewis** (D-Ga.). Lewis, 76, a civil rights leader in the late 1950s and ’60s, including while a student in Nashville, told NBC News last week he did not view Trump as a “legitimate president.” Trump, in tweets, said Lewis should spend more time helping his “falling-apart,” “crime-infested” district and pointed out the congressman also boycotted President **George W. Bush’s** inauguration. He further tweeted: “All talk, talk, talk — no action or results. Sad!” Cohen said Trump “crossed the Rubicon” and “does not deserve” to be president.

■ *The Tennessean* was interviewing former United Nations ambassador **Andrew Young**, in Nashville Monday for a speaking engagement, when **Donald Trump** called the former Atlanta mayor and one-time aide to **Martin Luther King Jr.** Reporter **Jason Gonzales**, who heard Young’s side of the conversation, quoted him as telling Trump **John Lewis** is “a very good man. He is really a saint. He is kind of disillusioned right now, but he will come back.”

■ Note to journalism students: This does not happen very often.

■ Rep. **Sheila Butt** (R-Columbia), who last week filed a well publicized bill seeking to block the purchase with federal food stamps of ice cream, cake, and other high-calorie, high-fat, sugary foods, said this week she is withdrawing it. Butt said she had learned that the federal government has never granted a waiver such as the one her bill would have sought to let a state impose its own restrictions. Also, she said she is hopeful the new Trump administration will address the issue.

■ “They just don’t like the fact she spent her life trying to help low-income children get an option to a better school.” — *U.S. Senate Health, Education, Labor, and Pensions Committee Chairman Lamar Alexander* (R-Maryville), on Democrats and their “gotcha” questions for education secretary nominee **Betsy DeVos**, a school vouchers advocate. *Alexander drew fire for presiding over what critics charged was a fast hearing. Alexander said it lasted 90 minutes longer than the confirmation hearings for President Obama’s education secretaries.*

■ CPA **Lynn Evans** of Memphis was elected TVA board chairman Thursday. The nine-member board currently has three vacancies, as the Senate chose not to confirm three **Obama** appointments, including the reappointment of **Mike McWherter**, with **President Trump** taking office today. Evans, named to the TVA board in 2013, chaired the Memphis Light, Gas, & Water board in 2008-09.

■ Lt. Gov. **Randy McNally** has named **Rick Nicholson**, his former aide, as chief of staff. He succeeds **Lance Frizzell**, who held the position for six years under Lt. Gov. **Ron Ramsey**. Nicholson, research analyst for the Senate Finance Committee while McNally was chairman, was appointed Senate budget director by Ramsey in 2012.

■ **Jordan Young**, who served as **Ramsey’s** deputy chief of staff for policy, has accepted a position as Senate chief engrossing clerk, a slot that had been vacant.

■ **Adam Kleinheider**, the lieutenant governor’s communications director, this morning changed his Twitter handle from @ramflack to @flacknally. What more needs to be said?

■ “If I had my way, the crane would be the official bird of Shelby County.” — *County Commissioner Heidi Shafer*, on a \$1 billion redevelopment project in the area of St. Jude Children’s Research Hospital that she suggested would help Memphis catch up with the construction cranes she had seen in Nashville.

■ Gov. **Bill Haslam** refers to his tax and transportation plan as the IMPROVE Act. It’s a fine acronym, reminiscent of the FOCUS Act, but the governor might have considered some alternatives:

— Pursuing Opportunities for Transportation, Haslam Offers Logic and Enlightenment (POTHOLE)

— Transportation Advancement with Xenogeneic Growth in Revenue and Available Balances (TAX GRAB)

— Better Utilization and More Pocketing of Your Resources to Offset Anxiety over Dividends (BUMPY ROAD)

— Infrastructure Needs Targeted Heavily and Efficiently, with Dollars for Industry, Traders, Contractors, and Highways (IN THE DITCH)

— Tennessee Asphalt Reapplication and Bridge Appropriation Balancing . . . never mind.