Transparency of Business Incentives in Tennessee

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Executive Summary

Tennessee uses a diverse array of incentives to entice businesses and industries to relocate to Tennessee, begin or expand operations, or remain within the state. Tennessee's toolbox of business incentives includes:

- **Payment in Lieu of Tax (PILOT) agreements** – In a PILOT agreement, a local government authority takes ownership of a business property, thereby exempting the business property from property taxes, and leases the property to a business. The business makes payments to the local government in lieu of the property taxes that would have otherwise been paid absent the PILOT agreement. Businesses benefit from PILOT agreements because they pay a percentage of the full amount in property taxes that would have been owed without the agreement.
- **Tax credits** – Tax credits directly reduce the amount, dollar for dollar, of the taxes owed by a business. Tax credits used by businesses are based on job creation, money invested by a business, the type of business, the types of equipment purchased by a business, and location (i.e., an additional tax credit can be claimed by businesses that create jobs in economically distressed counties).
- **Tax exemptions** – Many goods and services bought, leased, or imported into Tennessee are subject to sales and use taxes. Over the years, several state programs have been created to encourage businesses to relocate to Tennessee or expand existing operations by allowing them to purchase some items or equipment tax-free. For example, businesses may not have to pay sales tax on computers, software, or hardware if the equipment is used for a data center that meets certain criteria.
- **Grants** – Business incentive-related grants may be awarded directly to businesses that commit to create jobs, invest in a Tennessee-based facility, or increase spending in the state. Grants may also be awarded to local governments for projects that benefit businesses.
- **Other types of business incentives include tax increment financing (TIFs), Tourism Development Zones (TDZs), and others.**

Tennessee policymakers have increasingly focused on making business incentives more transparent. *Transparency of Business Incentives in Tennessee* provides a catalog of Tennessee's business incentives, an assessment of the current level of transparency for each incentive, overall conclusions, and policy options for some incentives.

Conclusions

The degree of transparency differs across the business incentives used in Tennessee. Each type of business incentive is subject to different regulations and is administered by different government entities at the state and local level. Transparency for some business incentives involves public hearings before an incentive is provided to a business, annual reports that provide details on the status of the incentive program, or the posting of data and information online in an easy-to-understand form. For other incentives, state law does not require periodic reports on the status of programs, and data and information are not posted online. Details about some incentives are kept confidential because a business's tax returns or proprietary information are involved. Information may also be kept confidential if the release of such information would harm the state's business recruitment efforts, placing the state at a competitive disadvantage relative to other states in enticing a business to move to Tennessee.

Evaluations are not required for most business incentive programs. The Comptroller's Office of Research and Education Accountability (OREA) found one type of business incentive with a required evaluation on a periodic basis: business tax credits. A 2015 state law requires the Department of Revenue and the Department of Economic and Community Development to jointly review business tax credits every four years and recommend whether each credit should be modified, discontinued, or left alone. Following the law's passage, the departments contracted with a private firm for the first evaluation of business tax credits, which was published in 2016. The evaluation recommended the state consider ways to restructure certain tax credits to make them more efficient and effective, and to replace one of the state's sales tax credits. The evaluation also recommended that the two departments produce an annual report on tax credits to improve transparency, bring about more consistency in monitoring, and encourage more collaboration among state departments involved with business incentives.

Policy Options

Policy options are provided for certain incentives in *Transparency of Business Incentives in Tennessee*, but the General Assembly may also wish to consider the following more general policy options:

- Should there be a central repository for existing business incentive information including Economic and Community Development grant reports, the regular evaluations of business tax credits, TNInvestco annual reports, PILOT annual reports, the state's Comprehensive Annual Financial Report (CAFR), and any reports the General Assembly may require in the future?
- Should there be public reporting requirements created for TIFs, TDZs, Labor and Workforce Development grants, and local grants? (See sections on each incentive for further details.)
- Should there be an evaluation of each type of business incentive, as is currently required for business tax credits?

Tax Increment Financing (TIF)

Tax increment financing (TIF) can be used as a business incentive when local governmental agencies use it to fund economic development projects (e.g., clearing blight, improving infrastructure, or building new facilities). Once a TIF project is planned, a local governmental entity, generally an Industrial Development Board (IDB), acts as a tax increment agency and borrows money to fund the economic development project. The borrowed money is repaid using the increases in property tax revenues that result from the development. TIF projects can be funded through several processes. A loan can be taken out from a private bank or bonds can be issued by the tax increment agency. Funding can also be provided by the company benefitting from the TIF project and the tax increment agency commits to refund the company.

State and local agencies involved in TIF projects

Comptroller of the Treasury (COT)	Department of Economic and Community Development (ECD)
COT is one of the state agencies that must approve plans, called TIF economic impact plans, in order for the TIF project to proceed. As part of the approval process COT must determine whether the TIF project is in the "best interest of the state," meaning that the project would not have occurred but for the financing of the project through a TIF plan. The State Board of Equalization (SBOE) in the Comptroller's Office is responsible for collecting finalized plans and statements submitted by tax increment agencies annually.	ECD is one of the state agencies that must approve a TIF economic impact plan for the TIF project to proceed. As part of the approval process, ECD must determine whether the TIF project is in the "best interest of the state," meaning that the project would not have occurred but for the financing of the project through a TIF plan.
Tax increment agency	**Local legislative bodies**
Any housing authority, industrial development board (IDB), or community redevelopment agency can serve as a tax increment agency, which creates a TIF economic impact plan, submits the plan to local and state entities for approval, and takes out a loan to finance the project.	Local legislative bodies (e.g., county commissions, city councils) must approve a TIF economic impact plan for the TIF project to proceed.

The TIF process

A tax increment agency (often an IDB) identifies an economic development project and begins developing a TIF economic impact plan.

→ The TIF economic impact plan outlines an area in which property values and property tax revenues are expected to increase as a result of the project.

↓ The tax increment agency approves the TIF economic impact plan and submits it local legislative bodies, whose approval is necessary for a TIF project to proceed.

→ The base tax amount is set based on the property taxes collected in the plan area, if any, the year before the TIF ecominic impact plan is approved.

↓ The TIF economic impact plan is submitted to ECD and the Comptroller's Office. Both agencies must approve the plan for the project to proceed.

→ If approved by both state agencies, the tax increment agency takes out a loan to begin the economic development project.

↓ Any property tax revenue in the plan area above the base tax amount is used to repay the debt.

→ Each year the tax increment agency must send the State Board of Equalization a statement outlining the amount of revenue used to repay the debt.

Transparency of TIFs

TIF economic impact plans must be approved by the tax increment agency (generally an IDB) and the local legislative body (e.g., city council, county commission). The tax increment agency must hold a public hearing about TIF plans and post a notice of the hearing at least two weeks in advance. Local legislative bodies also are required to post a public notice for their meetings, including any meetings where a proposed TIF plan is brought before the body for approval.

Tax increment agencies must file an annual statement with the State Board of Equalization (SBOE) outlining the amount of property tax revenue allocated to the agency to repay debt incurred as part of the TIF economic development project. Finalized TIF economic impact plans and the annual statements submitted by tax increment agencies are not posted online, but are open public records that can be requested pursuant to the Tennessee Public Records Act. Some information related to trade secrets, marketing information, and capital plans may be redacted.

The public can access additional information about TIF projects that are financed through bonds, including information on the amount of debt incurred and repayment plans. Bond-related materials are uploaded to the EMMA website – a searchable database of all bonded debt.[1] EMMA stands for "Electronic Municipal Market Access" and is the official online resource on municipal debt. The site provides public access to official disclosures, credit ratings, total principal amounts, and other information and documents. When a tax increment agency takes out a loan from a private bank or institution, however, the TIF project is not currently subject to the same disclosure measures. As of June 2018, municipalities are not required to disclose private debt on the EMMA site, but may choose to do so. The majority of TIF projects use private loans.

Policy Options

The General Assembly may wish to consider the following policy options regarding TIFs:

- Should the annual statements filed by tax increment agencies with the SBOE be expanded to include additional information, such as the amount of debt principal paid, amount of interest paid to date, remaining debt still to be paid, and projected economic impact?
- When a tax increment agency takes out a loan from a private bank or institution, should it be required to post information about such debt on the EMMA site?

[1] A searchable database of all bonded debt can be found on the EMMA website: https://emma.msrb.org/Search/Search.aspx.

Tourism Development Zones

State law allows municipalities to propose the creation of tourism development zones to promote tourism through development projects in and around qualified tourism facilities (e.g., convention centers, amusement parks, museums, etc.). Municipalities borrow money to finance these projects, and the growth in sales and use tax revenues produced in the zone as a result of the project are set aside to pay off the debt. In this sense, the financing method used in tourism development zones is similar to that used for tax increment financing. (See page 3 for more information on tax increment financing.)

Businesses benefit from tourism development zone projects, which leverage public funding for construction, renovation, and infrastructure projects designed to spur economic activity within the zone. In some cases, tourism development zone revenues are used to fund a project for a specific business. For example, in 2015 the city of Memphis took on $84 million in debt to finance projects in the tourism development zone around Graceland in Memphis. The funding was used to build a hotel as part of a revitalization plan developed by Elvis Presley Enterprises. The resulting increase in sales and use tax revenues above a certain base amount within the tourism development zone is being used to pay off the debt.

There are two types of tourism development zones in Tennessee: *tourism development zones*, which are designed to improve tourism and tourism-related structures and areas, and *border region retail tourism development zones*, which are designed to promote retail economic activity and tourism in areas of Tennessee that border another state. Local authorities must submit a tourism development zone designation or plan to the Department of Finance and Administration (F&A) for approval. To be approved, the proposed tourism development zone and related development projects must be certified by F&A and the debt repayment plan included in the application cannot exceed 30 years. (In accordance with state law, F&A has not accepted new applications for border region retail tourism development zones since 2011 and has not accepted new applications for tourism development zones since 2007.)

Transparency of Tourism Development Zones

Municipalities must approve the creation of a tourism development zone through an ordinance or resolution; thus, the meetings during which tourism development zones are discussed and voted on are open to the public, and posted notice of these meetings is provided by the municipality.

The tourism development zone application submitted by a municipality to F&A includes a master development plan, a resolution adopted by the municipality's legislative body, a letter of intent, and other information required by the department. The application materials are not publicly compiled or published, but they are open public records that could be requested pursuant to the Tennessee Public Records Act. Some information related to trade secrets, marketing information, and capital plans may be redacted.

The public can access additional information about tourism development zone debt through the EMMA website (see page 4) if the debt is financed through bonds. When a tax increment agency takes out a loan from a private bank or institution, however, the project is not currently subject to the same disclosure measures. Municipalities can post information about such debt on the EMMA website, but as of May 2018, this is not required.

Previously, local authorities were not required to submit an annual report to the state on the status of tourism development zones, but in April 2018 the General Assembly passed House Bill 1923, which requires local authorities to submit an annual report to the commissioner of F&A and the State Building Commission. This report will include principal debt and interest, revenues generated in each tourism development zone, the cumulative amount of funds expended, and other relevant information. The new law does not require the reports to be published online, but they may be requested pursuant to the Tennessee Public Records Act.

Another source of information regarding tourism development zones is the Department of Revenue's annual report to the General Assembly, which is posted online.[2] The aggregate amount of sales and use tax allocations for tourism development zones is addressed in this report, and according to the department's 2017 annual report, approximately $58 million in sales and use tax revenues were allocated to tourism development zones for fiscal year 2017. (Approximately $52.7 million was allocated for tourism development zones that fiscal year, while approximately $5 million was allocated for border region retail tourism development zones.)

Policy Options

The General Assembly may wish to consider the following policy options regarding tourism development zones:

- Should the Department of Finance and Administration, or other government entity, publish an online list of all tourism development zones and border region tourism development zones, including data such as the debt incurred for each project, and increases in sales and use tax revenue within the zone?
- When a municipality funds a tourism development zone through a private loan, should it be required to post information about such debt on the EMMA site?

The 2018 Event Tourism Act

In 2018, the General Assembly passed the Event Tourism Act, which created an event tourism fund. The purpose of the fund is to incentivize event venues and municipalities to plan and bid for new events, like bowl games or music festivals, by allowing certain event-related expenses to be reimbursed out of tax revenues generated by the event. To certify an event – making it eligible to receive reimbursements – an organizing committee must complete an application that must then be approved by the Tennessee Department of Finance and Administration (F&A) and the Tennessee Department of Tourist Development. Once the event is certified, the State Building Commission defines the boundaries of the event venue and F&A determines the period of time in which the event is expected to have a measurable economic impact. As the event's tax revenues are collected, the Tennessee Department of Revenue sets aside 50 percent of the alcohol privilege taxes that would not otherwise be used for education and 50 percent of the state's share of the sales taxes. After the event, the organizing committee applies to F&A for reimbursement of certain event-specific expenses like labor, equipment, or construction. For example, the cost of hiring additional security could be reimbursed, but the salaries of regular, year-round employees would not qualify for reimbursement. All event tourism applications, documents, and reports are public record, excluding any sections about confidential tax information. The Comptroller's Office can audit any financial records related to certified events. The Event Tourism Act will take effect January 1, 2019.

[2] The Department of Revenue annual report can be found at https://www.tn.gov/content/dam/tn/revenue/documents/pubs/annual_report1617.pdf.

Payment in Lieu of Tax (PILOT) Agreements

The Tennessee Constitution states that all property shall be subject to taxation, but an exception to this constitutional provision is property owned by a government or governmental entity, which is *not* subject to taxation. Local governments have used this provision to create Payment in Lieu of Tax (PILOT) agreements with businesses as an economic development strategy. In a PILOT agreement, a local government authority – typically an industrial development board (IDB) – has ownership or takes ownership of a business property, thereby exempting the business property from property taxes, and leases the property to a business. In return, the business is often required to make lease payments to the local government in lieu of the property taxes that would have otherwise been paid absent the PILOT agreement. Payments in lieu of taxes offset some of the property tax revenues given up by the local government through the PILOT agreement.

State and local agencies involved in PILOT Agreements

Industrial Development Boards (IDBs)
Once given authority by a city or county government, IDBs negotiate and enter into PILOT agreements with businesses. IDBs are the primary type of local government entity that enters into PILOT agreements for business incentive purposes.[3]
Department of Economic and Community Development (TNECD)
TNECD must certify that PILOT agreements lasting longer than 20 years are in the best interest of the state before the agreement can be finalized.[4] TNECD does not have to certify PILOT agreements that last 20 years or less.
Comptroller of the Treasury (COT)
COT must certify that PILOT agreements lasting longer than 20 years are in the best interest of the state before the agreement can be finalized. COT does not have to certify PILOT agreements that last 20 years or less. COT is also responsible for collecting all PILOT agreements and annual reports submitted by businesses that have entered into PILOT agreements. COT compiles these annual reports and posts them online in a searchable database open to the public.

The PILOT agreement process

A local government grants a local government authority, typically an IDB, the ability to negotiate and enter into PILOT agreements.

→ An IDB begins negotiating a lease agreement with a business. This includes determining the PILOT amount and the rent amount.[5]

↓ The business and IDB may agree on expectations for the business, like job creation goals. In some cases, the IDB can end the PILOT agreement if agreed-on expectations are not met.

→ The business must complete and attach a cost benefit form to the PILOT agreement. (See the “What are PILOT cost benefit forms?” box on page 8 for more information.)

↓ If the PILOT agreement is to last more than 20 years, it is submitted for approval to TNECD and COT.

→ Once finalized, the PILOT agreement is sent to COT.

↓ The IDB takes ownership of the property and the terms of the PILOT agreement are put into effect.

→ Businesses with PILOT agreements are required to submit an annual PILOT report to COT and local property assessor every year. (See the “What is in an annual PILOT report?” box on page 8 for more information.)

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[3] Health and Education Boards and Sports Authority Boards can also enter into PILOT agreements.
[4] State law does not define “best interest of the state” in the section relative to PILOTs.
[5] Rent payments are used to pay costs, like mortgage payments, associated with the IDB taking ownership of the property.

Transparency of PILOT agreements

When an IDB and a business are negotiating the terms of a PILOT agreement, the details of the emerging agreement often remain confidential. Once the proposed PILOT agreement is brought before the IDB for approval, the public can learn the details of the agreement because all IDB meetings are open to the public. It was previously unclear if IDBs were required to post public notice of these meetings, but in 2018 the General Assembly passed House Bill 2664 regarding public hearings for PILOT agreements. This legislation requires IDBs to hold a public hearing before a PILOT agreement is brought to the IDB for approval, and to post a public notice at least five days prior to the hearing. These new requirements take effect on October 1, 2018.

A local legislative body can require that all PILOT agreements be brought before it for approval. Since meetings of local legislative bodies are open and notice of the meetings must be posted, such a requirement would provide the public with an additional opportunity to learn about proposed PILOT agreements. The majority of IDBs are given blanket authority by the local legislative body to enter into PILOT agreements, however, and are not required to present the agreements for approval.

A business that has entered into a PILOT agreement has two reporting requirements. The first requirement is to submit a copy of the PILOT agreement to the Comptroller of the Treasury (COT), which serves as the repository for all PILOT agreements in the state. Finalized agreements are not published online, but are open public records that could be requested pursuant to the Tennessee Public Records Act. Some information related to trade secrets, marketing information, and capital plans, may be redacted. Agreements can be requested from the IDB, local legislative body, or COT.

A PILOT agreement must include a cost benefit form. (See the "What are PILOT Cost Benefit Forms?" box on this page for more information.) OREA analysts reviewed a random sample of 15 PILOT agreements of 20 years or less and found that the cost benefit form required by law for each PILOT agreement was missing or incomplete for five of them. It is unknown whether these PILOT agreements were finalized by an IDB without a cost benefit form, or if the completed form was not included in the copy of the agreement sent to COT.

What are PILOT Cost Benefit Forms?

Businesses are required by law to complete a cost benefit form as part of a PILOT agreement. The form includes information on the assessed value of the property being transferred to the local governmental entity (typically an IDB) and the amount of the payments in lieu of property tax and rent to be paid by the business to the local governmental entity.

The cost benefit form also includes the number of new jobs – and average wages for the new jobs – to be created by the business. Businesses must apply a multiplier to the expected number of new jobs. A multiplier is a measure of the additional economic activity that results from the creation of a particular type of job. For example, the relocation of an automotive manufacturing plant to an area may spur automotive suppliers to grow up around the plant. The multiplier is an attempt to account for the auto supplier jobs created as a result of the relocation of the automotive plant.

What is in an annual PILOT report?

- A list of property owned by the IDB
- The estimated value of the property
- The effective date and end date of the lease
- The amount of payments made in lieu of property taxes
- How the payments in lieu of taxes are allocated between local governments for those PILOTS that involve more than one local government jurisdiction
- The date each listed property is scheduled to return to the regular tax rolls

The second reporting requirement for businesses in a PILOT agreement is to submit an annual PILOT report to COT. (See the "What is in an annual PILOT report?" box on page 8 for a list of the information included in these reports.) The annual PILOT reports are compiled by COT and posted online in a searchable database open to the public.[6]

The Governmental Accounting Standards Board (GASB) released GASB 77, a tax abatement reporting guideline, which took effect in December 2015. The guideline outlines what should be disclosed by governmental entities regarding property tax abatement agreements. GASB 77 does not apply to PILOT agreements, however, because a PILOT is considered a lease agreement between a public and private entity rather than a property tax abatement. The level of disclosure required by GASB 77 goes beyond what is currently required of PILOTs by state law. For example, GASB 77 requires disclosure of the types of commitments made by tax abatement recipients (i.e., number of jobs created or retained) and the amount of taxes foregone by the local government.

Policy Options

The General Assembly may wish to consider the following policy options regarding PILOTs:

- Should additional disclosure requirements be included in the annual PILOT reports submitted by businesses to the Comptroller of the Treasury (COT)? For example, should an annual PILOT report list the commitments made by the business, the progress made toward each commitment, and the amount of taxes foregone?
- Should there be more accountability for IDBs and businesses that submit incomplete or missing cost benefit forms?

[6] The reports and database can be found at https://www.comptroller.tn.gov/SBOE/idbsumm.asp.

TNInvestco Tax Credits

The TNInvestco program began in 2009 during the Great Recession, with the goal of aiding the growth of start-up businesses in Tennessee. The program's premise was to provide venture capital firms with funds to invest in start-up businesses to create jobs, increase tax revenue, boost women-owned and minority-owned businesses, and spur additional investments in the start-up industry. The Department of Economic and Community Development (TNECD) is responsible for the implementation, oversight, and reporting for the TNInvestco program. The program is scheduled to end in 2021.

How does the TNInvestco Program work?

In 2009, TNECD chose TNInvestco (venture capital) firms and provided them with $200 million in tax credits to be sold to insurance companies.

→ The TNInvestco firms raised $149 million to invest in start-up businesses through the sale of tax credits to insurance companies. The TNInvestco firms sold the tax credits to insurance companies at $0.75 for every $1 in tax credits.

↓ Profits generated from the program, such as the sale of a TNInvestco-funded start-up business, are split between the TNInvestco firm and the state.

→ The latest figures available (December 2016) show the state has received $6.4 million in profits from the TNInvestco program.

↓ Each TNInvestco must submit an annual report to TNECD that includes the amount of funding invested by the TNInvestco in start-up businesses, and any follow-on capital invested from other sources. The reports also include job creation numbers and descriptive information about start-up businesses.

→ TNECD develops an annual report on the entire TNInvestco program for the General Assembly using the information provided in the reports from each TNInvestco firm. TNECD's annual report is published online.

Transparency of the TNInvestco program

TNECD must ensure that TNInvestco firms are compliant with all regulations set forth in state law. TNInvestco firms must prepare adequate and accurate documentation related to their participation in the program. In addition, there is a required annual audit of each firm's financial statements by an independent certified public accountant. The audit includes a review of information, such as follow-on capital invested from other sources and jobs data. This information is kept confidential because it includes details about business strategies and tax returns, both of which are protected as confidential under state law.

The reports submitted by TNInvestco firms to TNECD and the annual report on the program prepared by TNECD both provide additional transparency. Each TNInvestco must submit an annual report to TNECD that includes the amount of funding invested by the TNInvestco in start-up businesses, as well as any follow-on capital invested from other sources. The reports to TNECD also include job creation information and descriptive information about the start-up businesses.

TNECD uses the information contained in these reports from the TNInvestco firms to prepare a required annual report. (See the "What is in TNECD's annual TNInvestco report?" box on age 11 for more information.) A copy of each annual TNECD report is posted on the Tennessee TNInvestco website maintained by the department.[7] Some goals of the program, like job creation and additional investment in start-up businesses from non-TNInvestco sources, are reported on annually in the TNECD report as required by state law. The law states that TNInvestco firms should encourage the participation of minority-owned and women-owned businesses, but does not require participation rates to be reported.

What is in TNECD's annual TNInvestco report?

- The number of participating TNInvestco firms
- The amount of capital each TNInvestco firm received to invest
- The amount of capital that each TNInvestco firm has invested since the start of the program
- The cumulative amount of follow-on capital invested by non-TNInvestco sources in the start-up business following investment by a TNInvestco firm
- The total amount of investment tax credits claimed to date by insurance companies
- The compliance of each TNInvestco firm
- The location and classification of the start-up businesses in which TNInvestco firms have invested
- The number of jobs created and the number of jobs retained in the start-up businesses
- The number of TNInvestco firms that have been decertified and why

[7] The TNInvestco yearly report can be found at https://www.tn.gov/transparenttn/jobs-economic-development/openecd/openecd-tninvestco.html.

Business Tax Credits

Tax credits directly reduce the amount, dollar for dollar, of the taxes owed by a business. Business tax credits in Tennessee are based on the number of jobs created by a business, the amount of money invested by a business, the type of business, the type of equipment purchased by a business, and location (i.e., an additional tax credit can be claimed by businesses that create jobs in economically distressed counties). Business tax credits reduce the amount of franchise and excise tax, and/or the amount of sales and use tax, owed by a business.

What are the types of Business Tax Credits?

Job Tax Credits	
Standard Job Tax Credit:[8] A business that spends over $500,000 in capital investments and creates a minimum number of jobs can claim a credit of $4,500 per new job up to 50 percent of its franchise and excise tax each year.[9]	Enhanced Job Tax Credit: A business that qualifies for a standard job tax credit can claim an additional job tax credit against its franchise and excise tax liability of $4,500 per job when the created jobs are in counties with high unemployment or average wages below the Tennessee average wage.
Super Job Tax Credit: Businesses can claim additional credits against franchise and excise tax liability if they make a higher level of investment, create more jobs, and/or create more high-paying[10] jobs than required for standard job tax credits. Depending on the level of investment and job creation, a business can claim the additional franchise and excise tax credits for up to 20 years.	
Other Types of Tax Credits	
Headquarters Tax Credit: A business that establishes a qualified headquarters or hub in Tennessee can offset up to 100 percent of its franchise and excise tax liability. A business that expands or updates a headquarters facility with a cost of at least $10 million and the creation of at least 100 new jobs can offset up to 100 percent of its state sales and use tax on property related to job creation.	Industrial Machinery Tax Credit: A business that has purchased industrial machinery can claim anywhere from 1 to 10 percent of the machinery's costs as a credit up to 50 percent of its franchise and excise tax each year. This credit can be carried forward for up to 15 years.

Transparency of Business Tax Credits

A 2015 state law requires the Department of Revenue and the Department of Economic and Community Development to jointly review business tax credits every four years and recommend whether each credit should be modified, discontinued, or left alone. The two departments contracted with a private firm for the first evaluation of business tax credits, which was published in 2016.[11] The 2016 evaluation included the following recommendations for the state:

- Consider ways to restructure the job tax credits and machinery tax credit to make the credits more efficient and effective. One option outlined in the report was to make the tax credits refundable for businesses that claim tax credits in excess of taxes owed rather than carrying the credits forward over time.

[8] Job credits can be taken in the tax year in which the business first satisfies the capital investment and job creation requirements. If new jobs are created during the three-year period following the effective date of the business plan, credits can continue to be claimed. Job tax credits can be carried forward for up to 15 years.
[9] To qualify for the credit, a business must make the required capital investment and create at least 25 jobs. If, however, jobs are created in enhancement counties, which are counties with high unemployment or low average wages, the minimum number of jobs to be created is lower.
[10] For the purposes of determining tax credit eligibility, "high paying jobs" are those that pay 150 percent of the state's average occupational wage. Labor data from 2016 indicated the average wage in Tennessee was $19.85 hourly and $41,296 yearly.
[11] The review of tax credits can be found at https://www.tn.gov/content/dam/tn/transparenttn/documents/Tax_Credit_Analysis_FINAL_12-30-2016.pdf.

- Consider replacing the headquarters sales tax credit.
- Require the Department of Revenue and the Department of Economic and Community Development to produce a joint annual report. An annual report would serve to increase transparency, improve consistency of monitoring, and encourage collaboration among the Department of Revenue, Department of Labor and Workforce Development, and the Department of Economic and Community Development.

In 2017, the General Assembly required the Department of Revenue to submit an annual report on tax credits to the House and Senate Finance, Ways and Means Committees. The annual report includes:

- the number of businesses claiming credits and the nature and type of each business
- the total amount of credits claimed
- if the credit is based on job creation, the number of jobs created each fiscal year as reported by businesses
- the total amount of credits carried forward from a prior tax year

Information in the annual report is reported in the aggregate and does not disclose credits given to specific businesses. The annual report is not posted online, but is an open public record that could be requested pursuant to the Tennessee Public Records Act. Some information about individual taxpayers, trade secrets, marketing information, and capital plans may be redacted.

Although the annual report is not published online, the state Comprehensive Annual Financial Report (CAFR), which is posted online, includes descriptions and amounts of revenue foregone as a result of each credit.[12]

Tax Exemptions

Many goods and services bought, leased, or imported into Tennessee are subject to sales and use taxes. For example, when a business buys office furniture in Tennessee, it pays sales tax as part of the purchase. If the business orders the same furniture from a state that does not have sales tax, the business instead pays Tennessee use tax, the counterpart of the sales tax. The use tax, levied at the same rate as the sales tax, generates the equivalent amount of sales tax revenue as if the furniture was purchased in Tennessee.

Over the years, several state programs have been created to encourage businesses to relocate to Tennessee or expand existing operations by allowing them to purchase certain items or equipment tax-free. For example, businesses may not have to pay sales tax on computers, software, or hardware if the equipment is used for a data center that meets specific criteria.

Tennessee has five main sales and use tax exemptions for specific types of businesses or products:[13]

- *Industrial Machinery* – the purchase, installation, and repair of industrial machinery and related supplies (e.g., repair parts or lubricants used in machinery) by a qualified manufacturer is exempt

[12] Comprehensive Annual Financial Reports (CAFRs) can be found at https://www.tn.gov/finance/fa/fa-accounting-financial/fa-accfin-cafr.html.
[13] Other types of tax exemptions not listed include: dyed diesel tax exemptions, sales tax reductions for commercial carriers, agricultural exemptions, exemptions for railroad track materials and locomotive radiators, and others.

from sales and use taxes. Utilities, like water, gas and electricity can also be purchased at lower sales tax rates in certain cases.

- *Warehouse/Distribution* – Approved businesses that invest at least $10 million in a building or equipment over a three-year period may purchase material handling and racking systems (e.g., forklifts and industrial shelving to organize and store pallets) tax-free if the equipment is used for a warehouse or distribution center.

- *Call Centers* – Qualified call centers with at least 250 jobs engaged primarily in call center activities do not have to pay sales and use tax on interstate or international telecommunication services.

- *Data Centers* – Qualified data centers that make a capital investment of at least $100 million and create at least 15 new full-time positions with wages of at least 150 percent of the state's average occupational wage[14] may purchase hardware and software tax-free.

- *Research and Development* – Certain equipment used primarily for research and development (e.g., laboratory instruments used to study genetics, human biology, dentistry, bacteriology, veterinary medicine, and more) are exempt from sales and use taxes.

Transparency of Tax Exemptions

To participate in the program, businesses must submit a plan that describes their planned investment, such as money to be spent on restoring a building or buying equipment. Upon approval, the Department of Revenue gives the business a certificate of exemption; when the business buys equipment, sales tax will be waived at the time of purchase. Because tax returns filed with the state do not require sellers to report exempt sales by category of good sold, the Department of Revenue cannot track how much state sales and use tax revenue was foregone as a result of these exemptions (for example, how many computers were sold under the data center program exemption). This information exists only in the individual receipts and records of buyers and sellers.

Due to data limitations, it is not possible to calculate the exact dollar amount of foregone sales and use tax revenue under these exemptions. However, the state's Comprehensive Annual Financial Report (CAFR) includes the aggregate amount of all planned investments that were approved by the Department of Revenue for tax exemptions, as required by governmental accounting standards.

Public reporting of the tax exemptions claimed by individual businesses is limited by state law for confidentiality reasons, but reporting tax exemption information in the aggregate would be possible. The Tennessee Department of Revenue is required to submit an annual report to the General Assembly about the department's operations, but the inclusion of information on tax *exemptions* is not required. In contrast, the department is required to submit an annual report to the General Assembly on tax *credits*. Additionally, state law requires a review of tax *credits* by the department and the Department of Economic and Community Development every four years.

[14] Labor data from 2016 indicated the average wage in Tennessee was $19.85 hourly and $41,296 yearly.

Policy Options

The General Assembly may wish to consider the following policy options regarding tax exemptions:

- Should information on tax exemptions be included in the annual report submitted by the Department of Revenue to the General Assembly or in a separate report?
- Should regular reviews of tax exemptions, which might include an analysis of their impacts and recommendations to modify, discontinue, or take no action for each exemption, be required?

A note about megasites

When a business is deciding where to build a new facility, it often seeks land that is ready for development. To entice those businesses to move to Tennessee, the state or local governments can purchase large areas of land, called megasites, on which infrastructure (roads, utilities, sewer lines, etc.) is built to make the land ready for new businesses. Due to their size and cost, new megasites are not purchased often. For example, as of June 2018, the only megasite purchased by the state was the Memphis Regional Megasite in 2009. Before buying the land, a megasite must be certified through a process approved by the Department of Economic and Community Development that considers factors like zoning, transportation access, utilities access, topography, and community support.

Megasites are regulated by regional megasite authorities whose members are appointed by the local legislative bodies in counties and cities affected by the site. Multiple business incentives outlined in *Business Incentives and Transparency in Tennessee* can be used as incentives to entice businesses to move to a megasite. For example, while marketing the availability of the site, the megasite authority can begin negotiating a potential PILOT agreement (see page 7) and the Governor could suggest a grant be approved to improve the site through the yearly appropriations bill (see page 19).

Economic and Community Development Grants

The Department of Economic and Community Development (TNECD) offers several grant opportunities to qualifying businesses that commit to training or retraining employees, adding jobs, or making new investments in Tennessee.[15]

TNECD grants are not subject to reporting requirements or open records laws before a business receives a grant. In addition, the Attorney General and TNECD have the authority to keep certain grant-related information confidential if the release of such information would harm the state's business recruitment efforts, such as by placing the state at a competitive disadvantage relative to other states in enticing a business to move to Tennessee.

Transparency of TNECD grants

Tennessee Entertainment Commission Incentive Grants

The Tennessee Entertainment Commission (TEC) is housed within the office of the Governor, and its purpose is to coordinate efforts with various state departments to promote entertainment production in the state. The commission works in conjunction with TNECD to approve and disburse TEC incentive grants, which provide financial incentives for TV and film projects in Tennessee. Qualified projects can receive grants that reimburse up to 25 percent of project expenditures in Tennessee. As of December 2017, the TEC has awarded $51 million in grants to 72 productions.

[15] Additional information about TNECD business development programs can be found at https://www.tn.gov/transparenttn/jobs-economic-development/openecd/tnecd-performance-metrics/openecd-business-development-quick-stats.html.

The executive director of the TEC reports on the grant program's status to the commissioner of Finance and Administration twice a year. (See the "What is in the TEC report?" box on this page for more information.) A copy of each report must be delivered to the Speakers of the House and Senate, the Chairs of the Finance, Ways and Means Committees, the Treasurer, and the Comptroller. The biannual reports are also published online.[16] The information provided in the TEC report addresses one of the program's goals: to increase TV and film industry-related spending in the state. One of the program's other goals, to create jobs, is not addressed in biannual reports.

What is in the TEC report?

Every six months TEC publishes a report that includes:

- An update on the total amount of grants paid to productions and the remaining unobligated grant funding
- The name and type of projects receiving funds
- The budget of each project
- The amount of money spent in Tennessee by production companies for each project
- The grant amount awarded for each project

The Tennessee Job Skills Program

This grant program is designed to create and retain high-skill, high-wage jobs by subsidizing training provided by existing Tennessee businesses.[17] The commissioner of Economic and Community Development reports annually on the status of the program to the Finance, Ways and Means Committees, the House Consumer and Human Resources Committee, the Senate Commerce and Labor Committee, and the Office of Legislative Budget Analysis.

In addition, TNECD is required to collect an application and final report from businesses that receive a training grant. The application includes the number of high-skill, high-wage jobs expected in the future, the skills needed for these jobs, and the training program's expected cost. The final report details the number of trainees who were employed by the business and their starting wages following the conclusion of the training program. Program applications, annual reports, and final reports are not posted online.

The Tennessee Job Skills Program has been winding down and is no longer receiving new state appropriations. TNECD already provides other job training grants through the FastTrack program and will continue to do so once the Tennessee Job Skills Program funds are exhausted.

FastTrack Grants

TNECD administers three FastTrack grant programs, each with specific goals. All three receive state funds; in fiscal year 2016, their total spending was approximately $95 million.

- *Infrastructure Program* – This grant is awarded to local governments or local governmental entities, such as Industrial Development Boards, for specific infrastructure projects (e.g., roads, airports, water and sewer, and access to telecommunication lines) to incentivize new and existing businesses to create new jobs and make capital investments. The infrastructure program includes a local funding match requirement.

[16] Annual reports can be found at the Transparent Tennessee website: https://www.tn.gov/transparenttn/jobs-economic-development/openecd/film-incentives.html.

[17] In relation to the Tennessee Job Skills Program, a "high-wage job" means that the starting wage for a new job created by a business participating in the program will be equal to or greater than the prevailing starting wage for that occupation in the local labor market area.

- *Job Training Assistance Program* – This grant is awarded to businesses to train new employees. For example, TNECD awarded ThyssenKrupp Elevator Manufacturing, Inc. a $94,800 training assistance grant and the company committed to create 158 new jobs and invest $4,082,539 in its facilities in Middleton, Tennessee.

- *Economic Development Fund* – This grant is awarded to local governments or local governmental entities for businesses that are expanding and creating new jobs. These grants are used only when TNECD determines that the economic impact or number of new jobs created would be significant. For example, TNECD awarded an economic development fund grant of $4.8 million benefitting Academy Sports + Outdoors, in conjunction with the corporation's commitment to create 700 new jobs as part of a $100 million expansion project.

According to TNECD's website, eligibility and funding levels for FastTrack grants are determined by:

- the amount invested by the business
- the number of and wages for new, full-time jobs
- types of skills and knowledge needed by employees
- location of the expansion project

Every quarter, the commissioner of TNECD reports on the FastTrack fund to the commissioner of Finance and Administration. The quarterly report lists the amount of each FastTrack grant commitment, the name of companies receiving a FastTrack grant (if the names have been publicly announced), the total outstanding commitments of the FastTrack grant program, and the total unobligated appropriation in the FastTrack fund. A copy of each quarterly report is given to the Speakers of the House and Senate, the Comptroller, the Treasurer, the Secretary of State, and the Office of Legislative Budget Analysis. TNECD must also provide the State Funding Board with a justification letter outlining the purpose of each FastTrack Economic Development Fund grant. An online searchable database of all FastTrack grants with information on total new job commitments and total capital investments made by recipient businesses is available on the TNECD website.[18]

Launch Tennessee Grants

Launch Tennessee is a public-private organization that is administratively attached to TNECD and provides support, including grant funding, for entrepreneurship in Tennessee. Launch Tennessee has a fund used to invest in Tennessee-based startups, scholarships for minority and women entrepreneurs, and micro-grants to help newer businesses apply for federal or other grants. Launch Tennessee received $1 million in recurring state funding and $1.5 million in non-recurring state funding for the 2018 fiscal year. The organization also receives funding from the federal government and other sources.

The organization must submit an annual report to the Governor and the General Assembly that addresses the organization's financial status. State law requires the organization to hold a public hearing about the annual report and post a public notice about the hearing at least 30 days in advance. Launch Tennessee officials work directly with start-ups and have access to their business plans and proprietary information. State law allows Launch Tennessee to keep sensitive information obtained from start-up businesses confidential if it would put the start-up at a competitive disadvantage.

[18] The searchable database can be found at https://www.tn.gov/transparenttn/jobs-economic-development/openecd/fasttrack-project-database.html.

Labor and Workforce Development Grants

The Department of Labor and Workforce Development (TNLWD) administers three training grants for businesses. These grants are funded through a federal act called the Workforce Innovation and Opportunity Act, and Tennessee is responsible for developing comprehensive and complementary programs that help job seekers acquire skills that meet employers' needs. The training grants provided to businesses are a part of LNLWD's implementation strategy.

- *On-the-Job Training Grants* – This grant program is for qualifying Tennessee employers that hire new employees who need on-the-job training. The program can pay up to 50 percent of the new employee's wages during the training period. Interested businesses must submit a grant application to TNLWD that includes information about the business, an explanation of the training, and goals for the training.

- *Incumbent Worker Training Program* – This grant provides funds for Tennessee businesses for training to upgrade the skills of existing, full-time employees. Participating businesses must apply to TNLWD and, if approved, enter into a contract with a Local Workforce Development Area that includes outcome measures and completion timeframes for the training program. The department may withhold grant funding from participating businesses that do not comply with the contract terms, and may also withhold grant funding if the participating business does not submit required monthly status reports, which are described below.

- *Apprenticeship Training Grant* – Tennessee businesses may also qualify for a grant to fund a new or existing Registered Apprenticeship Program, a government program that incentivizes businesses to hire unemployed individuals who are making a career change. Apprenticeship Training programs also provide current employees with classroom training to advance their career.

Businesses that receive a TNLWD grant must file a final report with the department. For all three of the training programs, participating businesses must submit a monthly status report to TNLWD that addresses:

- the number of employees the business committed to train
- the number of employees trained to date
- the number of employees the business plans to train by the end of the program
- the total amount spent by the business on the training
- the total amount the business has been reimbursed through the grant program
- the expected end date for the training program

Transparency of TNLWD grants

Participating businesses must submit monthly status reports to TNLWD, but there is no required reporting to the legislative branch. Program applications, annual reports, and final reports are not posted online, but they are open public records that may be requested pursuant to the Tennessee Public Records Act. Some information about individual taxpayers, trade secrets, marketing information, and capital plans may be redacted.

Although program specific documentation is not posted online, each year TNLWD publishes an annual report that includes highlights from the previous fiscal year. In the most recent report the training grants were highlighted and TNLWD reported that $2,172,706 was set aside in FY 2016-17 for training at 146 businesses.[19]

Local Grants

Local governments may appropriate funds to promote growth of the business sector. For example, a local legislative body may offer a grant to entice a business to locate a headquarters within that local government jurisdiction. Local governments are not required to report information about these grants to the state, though reporting may be required on the local level. A recent study by the Tennessee Advisory Commission on Intergovernmental Relations (TACIR) found that a total amount for all such local grants was not available.

Grants Authorized by the Annual Appropriations Act

Grants may also be provided to businesses through a specific state appropriation. Appropriations requested specifically for a business may be proposed by the Governor for inclusion in the *upcoming* year's state budget or to the *current* year's state budget through a supplemental appropriation request. State legislators may also propose a state appropriation as a business incentive through an amendment to the annual appropriations bill.

For example, in 2018, a $20 million capital grant was included as a supplemental appropriation to help fund an expansion project at a DENSO Corporation facility in Tennessee.

The Attorney General and the Department of Economic and Community Development have the authority to keep certain grant-related information confidential if the release of such information is deemed harmful to the state's business recruitment efforts, such as by placing the state at a competitive disadvantage relative to other states in enticing a business to move to Tennessee.

A description of grants awarded through direct appropriations may be found in the appropriation bills published on the General Assembly's website.[20]

[19] The TNLWD annual reports can be found at https://www.tn.gov/workforce/general-resources/major-publications0/major-publications-redirect/public-reports-redirect/annual-report.html.
[20] Annual appropriations acts can be found at http://www.capitol.tn.gov/joint/staff/budget-analysis/.

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