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Development Taxes and Infrastructure Funding

Dear Reader:

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We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with county government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other CTAS website material.

Sincerely,

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In recent years local governments, especially those in counties experiencing heavy growth, have looked for ways by which those benefitting from the growth could also pay for the increased governmental costs resulting from it. There are three main methods by which a local government may make an assessment against property that the owner wishes to develop: special assessments, impact fees, and privilege taxes.

Special Assessments. These are charges levied against specific parcels of property to recoup part or all of the costs of improvements that directly benefit that property: "The differences between a special assessment and a tax are (1) a special assessment can be levied only on land for special purposes; (2) a special assessment is based wholly on lands benefitted. "*West Tennessee Flood Control & Soil Conservation Dist. v. Wyatt*, 247 S.W.2d 56 (Tenn. 1952). Counties are authorized to levy special assessments by the County Powers Act, T.C.A. § 5-1-118, and T.C.A. § 7-32-101 *et seq*.

The Residential Infrastructure Development Act of 2024 authorizes the establishment of independent special districts as an alternative funding mechanism to finance the infrastructure costs related to residential development. Counties are authorized to borrow money to pay for the infrastructure costs or reimburse the developer for the prior payment of such costs. Special assessments are authorized to be collected to cover the costs paid by the county. T.C.A. § 7-84-701 *et. seq*.

Impact Fees and Adequate Facilities Taxes. Impact fees are a means of regulating new development in a local government. The intent of the fee is to place the financial burden of new growth on areas in which the growth has occurred. The level of the fee must be related to the needs of new development, and revenues generated by the fee should be earmarked for investment in the growth areas. There is no specific statutory authority under general law for counties to impose impact fees. Prior to 2006, impact fees could be imposed by private act. After June 20, 2006, no county is authorized to enact an impact fee on development or a local real estate transfer tax by private or public act. T.C.A. § 67-4-2913.

Adequate facilities taxes are privilege taxes levied on the privilege of construction or development of property. The primary difference between an impact fee and an adequate facilities tax is one of intent: It is a tax if the primary purpose is to raise revenue, but it is a fee if the purpose is regulation of some activity under the government's police power. *Memphis Retail Liquor Dealer's Ass'n Inc. v. City of Memphis*, 547 S.W.2d 244 (Tenn. 1977). The issue of whether a program is a tax or fee becomes significant in determining the level of scrutiny with which courts will look at the program. Since taxes are not regulatory actions, they do not have to meet the same standards as impact fees.

Before 2006, some counties had levied adequate facilities taxes on the privilege of development under authority granted by private act. In 2006, the General Assembly enacted the "County Powers Relief Act," T.C.A. § 67-4-2901 *et seq*., which is now the exclusive authority for counties to levy adequate facilities taxes. This act authorizes counties qualifying as "growth counties" to levy a county school facilities tax on development. A county may meet the criteria to be a growth county by one of two ways: (1) the county experienced a 20 percent or greater increase in population between the last two federal decennial censuses (or the county experiences that level of growth between any subsequent federal censuses); or (2) the county experienced a 9 percent or greater increase in population over the period from 2000 to 2004 (or over any subsequent four year period). To continue to levy this tax, a county must verify qualification with the comptroller every four (4) years, using federal census data estimates, if basing qualification on a nine percent (9%) growth rate, or at the end of the final year of every ten-year census period, if basing qualification on a twenty percent (20%) growth rate. T.C.A. § 67-4-2907.

Before the tax may be levied, the county is required to have adopted a capital improvement program. The tax can then be levied by a resolution adopted by a 2/3 vote of the entire membership of the county legislative body at two consecutive, regularly scheduled meetings. The tax may be levied initially at a rate not to exceed one dollar and fifty cents ($1.50) per square foot on residential property and one dollar and fifty cents ($1.50) per square foot on up to one hundred fifty thousand square feet (150,000 sq. ft.) of commercial property. Once adopted, the rate of the tax cannot be increased for four years. Once the four year period has run, the county legislative body may increase the rate, but by no more than 10 percent. After any increase, the rate is again frozen for a four year period. Public buildings, places of worship, barns and agricultural buildings, replacement buildings for structures damaged by disaster, buildings owned by 501(c)(3) nonprofit corporations, and buildings constructed in an area designated by the federal government as a blighted, distressed, or urban renewal zone are exempt from the tax. All revenue from this tax is turned over to the county trustee for deposit. The revenue is required by law to be used exclusively for funding growth-related capital expenditures for education, including the retirement of bonded indebtedness.

The County Powers Relief Act is the exclusive authority for local governments to adopt any new or additional adequate facilities taxes on development after June 20, 2006. The act prohibits counties from enacting any impact fees or local real estate transfer taxes in the future by either public or private act. The act preserves existing development taxes and impact fees to the extent authorized by any private acts in effect prior to June 20, 2006. The act allows a city or county to revise the dedicated use and purpose of the tax levied by a pre-existing tax from public facilities to public school facilities. Counties that levy a development tax or impact fee by private act under prior law may not levy the school facilities tax authorized by the County Powers Relief Act so long as they are levying and collecting development taxes or impact fees under the authority of the private act. The act includes language that requires the General Assembly to review the provisions of the act to ascertain the effect on and the needs of those counties which did not qualify to levy the tax under the act.

At the date of this publication, Bedford, Cannon, Jefferson, and Loudon counties have adopted the school facilities tax. Counties that adopted adequate facilities taxes before this legislation went into effect are not prevented from imposing the taxes that were granted by private act, nor are they prevented from using the proceeds of these taxes for use on public facilities other than school facilities.

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