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Issues Affecting the Budgeting Process

Dear Reader:

The following document was created from the CTAS website (ctas.tennessee.edu). This website is maintained by CTAS staff and seeks to represent the most current information regarding issues relative to Tennessee county government.

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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Issues Affecting the Budgeting Process

Reference Number: CTAS-737

With pressure groups, the general public, and state and federal governments demanding greater services from local governments, planning ahead is an absolute must to prevent a financial crisis.

Communications

Reference Number: CTAS-738

Generally, people will react to problems and the solving of problems in a similar manner when they have the same information or knowledge of the problem and alternative solutions. The point is that some government officials feel that it is unnecessary to communicate all they know about a problem or how it can be solved. They expect the legislative body to raise taxes based on their recommendations without having sufficient information. To motivate the legislative body or other officials to change or solve a problem, sufficient data should be presented to them so that a reasonable decision can be achieved.

Basic Education Program (BEP)

Reference Number: CTAS-739

The Basic Education Program (BEP) was passed into law by then Governor Ned McWhorter and the General Assembly in 1994. The funds generated by the BEP are what the state has defined as sufficient to provide a basic level of education for Tennessee students. This basic level of funding includes both a state share of the BEP and a local share of the BEP.

The BEP has three major categories: instruction, classroom, and non-classroom. Each category is made up of separate components related to the basic needs of students, teachers, and administrators within a school system. [BEP funding allocation example](#)

There are 45 BEP components, most of which are based on student enrollment, also known as average daily membership (ADM). An example of these components are students per teacher, assistant principals per school, or dollars per student for textbooks. They are explained in the [State of Tennessee BEP 2.0 brochure](#).

Funds generated in the instructional component must be spent on instructional salaries and benefits. In total the state funds up to 70% or higher depending on your fiscal capacity of the instructional component, and the local funds 30%.

Funds generated in the classroom components must be spent in either classroom components or in instructional components. State funding is 75% and 25% local.

Funds generated in the non-classroom component must be spent on non-classroom, classroom component or instructional. The state funds 50% of the non-classroom with local funds at 50% also.

Fiscal Capacity

Fiscal capacity is the ability of local governments to fund education from their own taxable sources. The state and local share for each school system is based on an equalization formula that is applied to the BEP. This equalization formula is the primary factor in determining how much of the BEP is supported by the state versus the local district.

There are 2 components in the formula for calculating fiscal capacity. One is TACIR (Tennessee Advisory Commission on Intergovernmental Relations); this is half (50%) of the equation. It uses local revenue, property tax, sales tax, per capita income, ratio of residential & farm to total assessment, and ratio of average daily membership to population.

The Fox model is based on the sum of property tax and sales tax. This new formula determines a county's capacity to raise local revenues for education from its property and sales tax base. This came out of the change of the BEP formula when the BEP 2.0 was implemented. When applied locally, the state and local equalization shares for County System A would be the exact same state and local shares for the cities.

3% Fund Balance Test

Reference Number: CTAS-740

Public Chapter 223 materially changed the state statute regarding uses of unassigned fund balance; however, the 3% fund balance test will have to be met before a Local Education Association's budget will

be approved.

There are provisions applicable after the operating budget is adopted that allow for the use of fund balance. It shall be available to offset shortfalls of budgeted revenues and shall be available to meet unforeseen increases in operating expenses, i.e., major increases in fuel prices or utility cost.

The accumulated fund balance in excess of three percent (3%) of the budgeted annual operating expenses for the current fiscal year may be budgeted and expended for any education purposes but must be recommended by the board of education prior to appropriation by the local legislative body.

Property Tax Freeze

Reference Number: CTAS-741

In November 2006, the voters of Tennessee approved an amendment to Article II, Section 6 of the Tennessee Constitution that gave the Tennessee General Assembly the authority to authorize cities and counties the option to implement a property tax freeze program for individuals 65 and older. As a result of the amendment to the Tennessee Constitution, the Tennessee General Assembly passed the "Property Tax Freeze Act" in June 2007, which was codified in T.C.A. § 67-5-705. Review the [Tennessee Tax Freeze Jurisdictions](#). The program requirements, rules and regulations can be found on the [Tennessee Comptroller of the Treasury – Division of Property Assessments' web site](#).

The enactment of this program will allow counties by resolution to freeze the amount of property taxes paid by those individuals 65 years of age or older who qualify to be frozen at their current level. If a county enacts this program, it will require the Assessor of Property, the Trustee and the Budget/Finance Director to work more closely than before because of the program requirements. The program's requirements will require the county to calculate their penny using both their normal assessment total and their property tax freeze assessment totals. For example, County A who will start their budgetary process in February, will receive their initial assessment total from the Assessor. While the county is working on its initial budget, the tax freeze program is continuing for the Trustee and the Assessor. The deadline for the eligible participants to qualify is 35 days after the delinquency date. Once that deadline has passed, the Trustee has 15 days to compile that list and then turn the list over to the Assessor, who then has 60 days to certify the tax assessment base and turn the information over to the county.

Here is an example of how a county might be affected by the program. County A is calculating its penny from its initial assessment total provided by the Assessor of Property:

<u>Initial Assessment</u>	<u>Variance Rate</u>	<u>Penny Calculation</u>	<u>Net Penny</u>
\$814,530,604	6%	\$81,453- (4,487)	\$76,966

If County A does not intend on raising their property tax rate, the county is in position to proceed with their budget process. Now as a result of County A having passed the resolution to participate in the Property tax Freeze Program, the following information is needed from both the Trustee and the Assessor of Property:

<u># of Participants</u>	<u>Assessment Total</u>	<u>New Assessment Total</u>
1,093	\$21,558,457	\$792,972,147

Now for County A who wants to raise its property tax rate, the following calculation is used:

<u>New Assessment</u>	<u>Variance Rate</u>	<u>Penny Calculation</u>	<u>Net Penny</u>
\$792,972,147	6%	\$72,297-(4,338)	\$67,959

So the negative effect of the Property Tax Freeze Program will be a reduction in the assessment total, which will lead to a reduction in the county's penny calculation. Instead of County A being able to use \$76,966 per penny for any incremental property, the county now has to use \$67,959 –a net loss of \$9,007 per penny for each incremental property tax increase. This reduction in turn can potentially limit County A's ability to raise the amount of property needed to fund its operations. Upon the adoption of a property tax freeze, calculations must be made for additional penny values.

[Example of property tax freeze calculations for tax aggregate freeze totals.](#)

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