Approved [signature: Keith Roe]
Date 1/30/90

MINUTES OF THE House COMMITTEE ON Taxation.

The meeting was called to order by Representative Keith Roe, Chairperson, at 9:00 a.m./p.m. on January 25, 1990 in room 519-S of the Capitol.

All members were present except:

Committee staff present:
Tom Severn, Research Department
Chris Courtwright, Research Department
Don Hayward, Revisor's Office
Lenore Olson, Committee Secretary

Conferees appearing before the committee:
Representative George Teagarden
Representative Joan Wagnon
Representative Elaine Wells
Representative Ginger Barr
Representative Don Rezac
Butch Felker, Mayor of Topeka
Dennis Shockley, City of Kansas City, Kansas
Ernie Mosher, League of Kansas Municipalities
Karen France, Kansas Association of Realtors
Bev Bradley, Kansas Association of Counties
Mike Engler, Topeka
Leroy Jones, Brotherhood of Locomotive Engineers
Paul Fleener, Kansas Farm Bureau
Dee Likes, Kansas Livestock Association
Bob Corkins, Kansas Chamber of Commerce and Industry
Cedric Moege, Topeka, Silver Haired Legislator
Vic Miller, Topeka City Council

A motion was made by Representative Roe, seconded by Representative Lowther, to introduce a bill to authorize a mill levy rollback sales tax and an additional half percent sales tax for cities and counties. (Attachment 1) The motion carried.

Representative George Teagarden presented a proposal for a bill to increase the following taxes - the revenue to be used as a direct reduction for existing levies: Sales Tax, Individual Income Tax, Corporate Income Tax, and State-wide intangibles tax. (Attachment 2)

A motion was made by Representative Wagnon, seconded by Representative Harder to introduce as a bill the proposal by Representative Teagarden. The motion carried.

Chairman Roe turned the Committee's attention to HB 2636.

Representative Joan Wagnon stated that she asked for HB 2636 to be introduced because she thought discussion needed to be opened on the use of local option taxes. Representative Wagnon distributed three items (Attachment 3):

1. A 1981 Memorandum from Staff pointing out that Kansas had established an earnings tax in 1970 which was repealed in April 1972 because no one took advantage of it.
2. A Legislative Finance Paper by Steven Gold, on the use and coverage of both local sales and income taxes.
3. A reprint of a book, "Local Revenue Diversification - Local Income Taxes," published by the Advisory Commission on Intergovernmental Relations.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

Representative Wagnon stated that HB 2635 is far from a perfect proposal, but that local option income taxes have a historical trend of reducing property taxes.

Butch Felker, Mayor of Topeka, testified in support of HB 2636, stating that the Topeka City Council feels it would help them dramatically. The present assessed value for Topeka is approximately $587 million, changing daily due to protests, currently numbering 1000. Mayor Felker also stated that $253 million of additional property is off tax rolls, which is 37 to 40 percent of city property; and the increased demand for services is increasing property taxes. In reply to a Committee question, Mayor Felker replied that Shawnee County has no countywide sales tax and Topeka has a 1 percent citywide sales tax.

Dennis Shockley, City of Kansas City, Kansas, testified in support of HB 2636, stating that ownership of property is no longer the single measure of the ability to pay taxes. Mr. Shockley said that a tax based directly on income or earnings is a much fairer tax because, under such a tax, no payment is due unless the taxpayer actually received income during the taxable period. (Attachment 4)

Ernie Mosher, League of Kansas Municipalities, testified that he appears in general support of HB 2636, on behalf of the League's member cities. They generally favor a procedure whereby the locally determined tax rate may be applied to the individual's state reported taxable income or tax liability, with the local tax collected by the state and returned to the levying unit; provisions should be made for both a city or countywide tax. (Attachment 5)

Karen France, Kansas Association of Realtors, testified in support of the concept of HB 2636. Ms France also requested HB 2636 be amended to include the provisions from the local option income tax for schools bill which provide that the question of imposing an earnings tax must be approved by the voters and in the alternative, if at least 5% of the qualified electors of the city submit a petition requesting it, the city must put such a proposal on the ballot. (Attachment 6)

Bev Bradley, Kansas Association of Counties, requested an amendment to HB 2636, which would allow counties the same authority as cities in imposing income and privilege tax surtaxes. (Attachment 7)

Representative Elaine Wells testified in opposition to HB 2636, stating that it is taxation without representation and is not fair. (Attachment 8)

Representative Ginger Barr testified in opposition to HB 2636, stating that it would hurt the City of Topeka and only help outlying areas of a large community - it would hurt opportunities to attract new business to the city and would be very costly to the State of Kansas. (Attachment 9)

Representative Don Rezac testified in opposition to HB 2636, stating that he does not think it is fair to tax people who live outside a city to pay for services from which they get very little benefit. (Attachment 10)

Mike Engler, Topeka, testified in opposition to HB 2636, stating that it would be a tool for certain taxing units to impose a second property tax on those living outside the taxing unit and paying property tax to another entity. (Attachment 11)

Leroy Jones, Brotherhood of Locomotive Engineers, testified in opposition to HB 2636, stating that they believe that only the State of Kansas should have the power to impose an income tax. One problem they see with this kind of bill for property tax relief is that non-resident wage earners are helping to reduce property taxes in cities they do not reside in. (Attachment 12)

Paul Fleener, Kansas Farm Bureau, testified in opposition to HB 2636, stating that they believe it preempts use of the income tax or the earnings tax by the local unit which provides the greatest service to the largest number of people (taxpayers) in the state. (Attachment 13)

Dee Likes, Kansas Livestock Association, testified in opposition to HB 2636, stating that it appears to them that a city wide earnings tax of this nature would be levied against the incomes of many rural people yet would do nothing to offset property taxes where those people live or where they operate their farming activity. (Attachment 14)

Bob Corkins, Kansas Chamber of Commerce and Industry, testified in opposition to HB 2636, stating that a likely business response would be to curtail any activity in the earnings tax-imposing city - at the very least, intra-state trade would be discouraged and economic growth would suffer. (Attachment 15)

Cedric Moege, Silver Haired Legislator, Topeka, testified that he is in the middle regarding HB 2636. He stated that he would be in favor of an earnings tax for the City of Topeka with two conditions. There must be a tax lid on personal and real estate property and the people must be allowed to vote on tax issues. Mr. Moege also stated that an earnings tax would be allright if it is kept simple - a 1 percent payroll tax and a one percent corporate tax would be acceptable with a property tax lid.

Vic Miller, Topeka City Council, testified that he doesn't object to HB 2636 being county-wide - that it would work better if it were and the revenue be distributed to the varying local units of government the same way the county-wide sales tax is handled. Mr. Miller also stated that of many people attending annexation debates, Lake Sherwood people told him they would not object to an earnings tax - they just did not want to be part of the corporate city limits.

Chairman Roe concluded the hearing on HB 2636.

The minutes of January 24, 1990, were approved.

The meeting adjourned at 11:00 a.m.

HOUSE COMMITTEE ON TAXATION

DATE 1/25/90

NAME	ADDRESS	REPRESENTING
Jim Byers	Topeka	KsBA
E.A. Mosher	Top	League of Ks Municipalities
VIC MILLER	TOPEKA	CITY OF TOPEKA
Elaine Wells	Carbondale	Legislator
Don Rezac	Onaga	Leg.
Dee Likes	Topeka	KLA
Ginger Barr	Auburn	Rep.
Steve Stotts	Topeka	Revenue
MARK A. BURGHART	"	"
Jim Young	Topeka	City of Topeka + AARP-CTTF
Ron Smith	"	Ks Bar Assn
Jim Yonally	Overland Park	NFIB/Kansas
Julie Hein	Topeka	Hein & Ebert
Curtis Perry	Topeka	Ks. Peace Officers Assn.
Edward Moses	Topeka	SHL
Laurie Hartman	Topeka	Ks. Bar Ass'n
Marcie Beasley	Topeka	Rep. Ginger Barr
Leroy Jones	"	Brotherhood of Locomotive Engineers
Charles Nicolay	"	Ks Oil Marketers assn
Janet Stubbs	"	HBAK
PAM Somerville	TOPEKA	KDOT
MIKE ENGLER	"	SELF
Katha Hurt	Manhattan	Legislator
Don Seifert	Olathe	City of Olathe

HOUSE COMMITTEE ON TAXATION

DATE 1-25-90

NAME	ADDRESS	REPRESENTING
Paul Rhode	Manhattan	Manhattan Mercury
Jamie Schwartz	Topeka	KPL Gas Service
Alan E. Sims	Overland Park	City of Overland Park
Bernie Koch	Wichita	Wichita Area Chamber
Mike Germann	Wichita	Boeing Commercial Airplanes - Wichita Division
Kevin Robertson	Topeka	Ks Lodging Assn
Cathy Holdeman	Wichita	City of Wichita
Tom Whitaker	Topeka	Ks Motor Carriers Assn
Tom Tunnell	Topeka	Ks Grain & Feed Assn

KEITH ROE
REPRESENTATIVE, 109TH DISTRICT
JEWELL, SMITH, OSBORNE COUNTIES

STATE OF KANSAS

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
CHAIRMAN: TAXATION
VICE-CHAIRMAN: LEGISLATIVE, JUDICIAL AND CONGRESSIONAL APPORTIONMENT

1. Mill Levy Rollback Sales Tax

-- All cities and counties would be authorized to levy a special 1/4th cent sales tax with the revenue earmarked exclusively for rolling back property tax levies and\or paying principal and interest on general obligation bonds;

-- This authority would be in addition to all other local sales tax authority and could be imposed by governing bodies (subject to protest petition), and elections would not be required;

-- Unlike the normal distribution for existing countywide sales taxes, a county imposing this tax would not be required to share the revenues with cities.

2. Additional Half Cent Authorization

-- All cities and counties also would be authorized to levy an additional half percent sales tax, increasing the normal maximum amount that could be levied by any city or county to 1.5 percent (excluding the mill levy rollback sales tax and additional authority granted under current law to Jackson and Wyandotte counties);

-- No change would be made in the distribution formulas for countywide sales taxes in place under current law (cities would receive a share of countywide sales taxes);

-- As under current law, elections would be required to raise the rate.

1/25/90
attachment 1

225 W. WEBSTER
P.O. BOX 364
MANKATO, KANSAS 66956-0364

STATE CAPITOL
TOPEKA, KANSAS 66612-1591

GEORGE TEAGARDEN
REPRESENTATIVE, TWELFTH DISTRICT
ANDERSON, FRANKLIN, LINN,
MIAMI COUNTIES
ROUTE 2, BOX 89A
LA CYGNE, KANSAS 66040

STATE OF KANSAS

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
RANKING MINORITY MEMBER: APPROPRIATIONS
MEMBER: COMMERCIAL AND FINANCIAL INSTITUTIONS

January 24, 1990

Property Tax Replacement Act-1990

Property tax is an outdated method of funding local government. The burden has become too great. I believe that essential services should be financed by property taxes but a broader tax base is needed for many of the services that local government is asked to provide. Therefore, I am recommending the following taxes be considered by this committee and used as a direct reduction for existing levies.

Sales Tax: 2.25% increase state wide with repeal of local option sales taxes. I believe that we should have a uniform tax rate throughout the state.

Individual Income Tax: a third bracket to raise $100 million.

Corporate Income Tax: Increase rates to raise $25 million.

State wide intangibles tax: to be collected and dispersed at local level.

The sales and income taxes would be collected by state and dispersed as a direct property tax replacement through the LAVTR (50%) and SDEA (50%).

It is my intention that the above tax increases would replace at least 25% of the property tax state wide. If we are serious about property tax relief then we must reduce the reliance on it in funding local government.

I would ask this committee to draft and seriously consider this proposal. This is the year to do something substantial in the area of property tax relief. I believe this proposal is responsible and realistic.

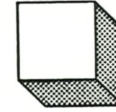
Thank you for your consideration.

George Teagarden

George Teagarden
Representative

GT:js

1/25/90
Attachment 2



Introductory Notes

This study is one of a series done by staff and consultants of the Advisory Commission on Intergovernmental Relations on ways in which local governments can lessen their reliance on property taxes by diversifying their revenue bases.

For many years, the local property tax has been the fiscal mainstay of local governments, and it remains their major revenue source. Its dominant role has been due to its many virtues as a revenue raiser: for local governments it is easily enforced because a tax on land and buildings is virtually impossible to evade or avoid; it is capable of generating large amounts of revenue; rates are easily adjusted; and its ad valorem character makes it the only tax presently employed in the United States that taxes unrealized capital gains. While this last characteristic is popular with tax administrators, it makes the levy unpopular with those who must pay the property tax, and it can create a serious burden for the elderly and low-income homeowners and farmers.

Given the acknowledged strengths of the property tax as a revenue raiser, why should local governments wish to resort to other types of taxes? One of the most important reasons is that the inflation of the late 1970s emphasized a major shortcoming of the property tax. Because it taps unrealized capital gains, it is capriciously related to the flow of cash into taxpayers' pockets. As inflation sharply increased land values, property tax bills increased, and taxpayers became increasingly irate and fearful that steadily rising property taxes would force them to sell their homes. The passage of Proposition 13 in California in 1978 marked the most dramatic effort to shield homeowners by capping property taxes.

Another reason for diversifying revenue sources is to gain added protection over the course of the economic cycle. At times when property tax revenues lag, they can usually be supplemented by revenues from the more elastic local income and sales taxes. When local income and sales

tax receipts reflect drops in economic activity, the much more stable property tax provides a reliable stream of revenues.

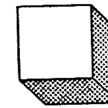
The basic political and economic reasons for diversification of local tax systems lie in the fact that there is no such thing as a perfect tax. · major tax has unique strengths and weaknesses. The more inten-y any tax is used, the more obvious its defects become and the less obvious its virtues. For example, the property tax scores high marks for the reasons cited above: ease of enforcement, fine tuning, and the ability to tax unrealized capital gains. However, when the tax on real property is raised too high, it is widely perceived as a threat to home ownership and a deterrent to certain types of capital intensive business development. In the same way, the local sales tax has the advantage of being convenient, usually paid out in small increments, difficult to avoid, and levied on consumption rather than savings; however, it also is widely perceived as being regressive and as creating an unfavorable business climate. Personal income taxes can be designed to make allowances for individual circumstances of the taxpayer, and they are not regressive, but the automatic re-sponse of the tax to inflation has created wide public resentment. A local income or wage tax also may cause taxpayers to move out of the jurisdiction and thus avoid the jurisdictional reach of local government. User charges have the advantage of providing a direct way to link private benefits to public costs incurred; however, too heavy a reliance on user charges can hurt low- and moderate-income families.

The lesson is clear; an efficient and equitable local revenue system should rely on a well-balanced and diversified set of taxes. In addition to avoiding the problems created by excessive reliance on any single tax, a balanced and diversified revenue system may create a more favorable business climate, lessen taxpayer discontent, and provide for stability of revenue throughout the course of the business cycle.

Professor Holley Ulbrich of Clemson University prepared this report on local income taxes. The author wishes to thank John Fava, John Gambill, Steven D. Gold, Robert Inman and Robert Schwab for their extensive and constructive comments on this study. At ACIR, John Shannon, the former Executive Director, was responsible for the initiation of this series of studies. We are grateful for his continuing active role in developing and reviewing the reports. Susannah E. Calkins took major responsibility for supervising the preparation of the report and incorporating the comments of reviewers. Joan Casey edited the report. Mary Dominguez typed the numerous revisions.

This is a Staff Research Report. It is designed to provide information on local income taxes, but does not present any new ACIR recommendations.

John Kincaid
Executive Director



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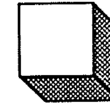


Introduction

Local revenues can be diversified and heavy reliance on the property tax can be avoided by adding nonproperty taxes to the revenue base of a local government. Among the most potentially important of the nonproperty taxes suitable for use by local governments is the local income tax. At present, it is a modest source of local tax revenue, but it is important for a number of large cities.

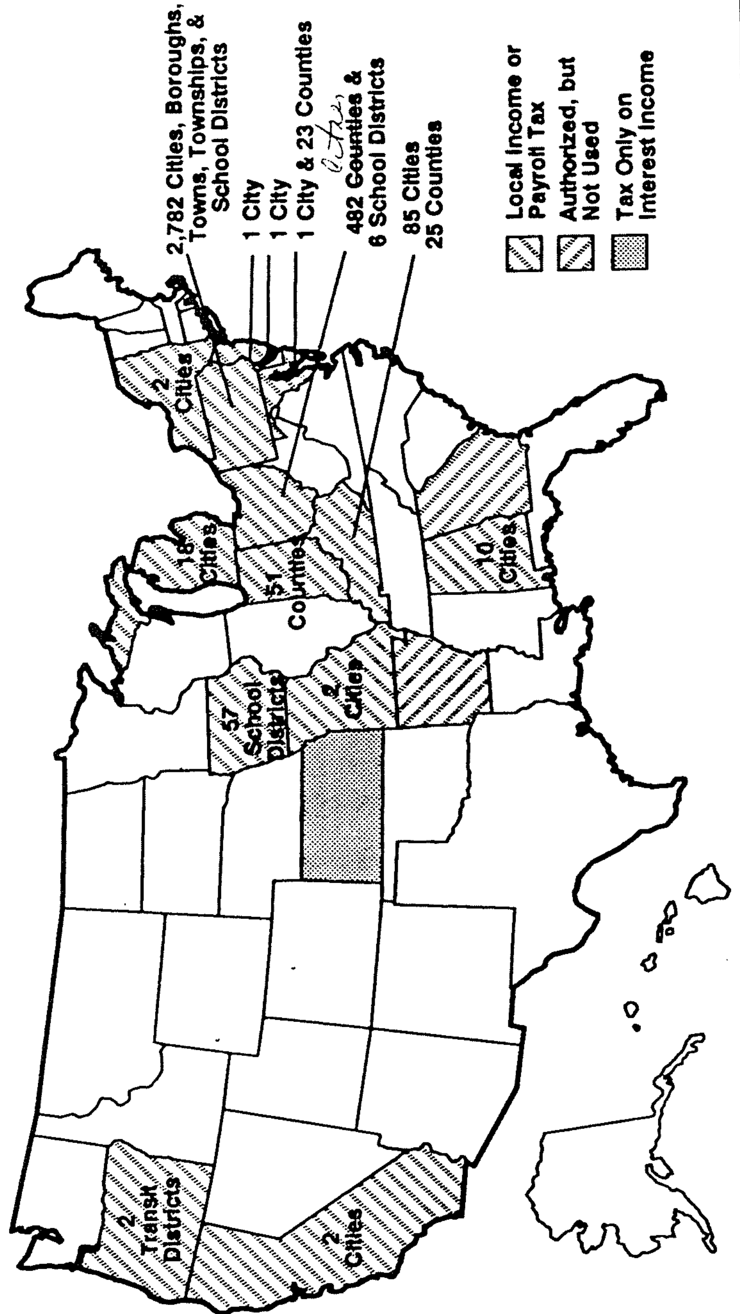
Local nonproperty taxes have five objectives: (1) to obtain additional revenue while avoiding higher property taxes,(2) to broaden the distribution of the local tax burden to include more of those who benefit from local public services, (3) to make the tax structure more flexible with respect to local circumstances, (4) to make the tax structure more responsive to rising costs and service demands, and (5) to reduce relatively high tax rates in overlapping jurisdictions, all of which employ the property tax.[1] Local income taxes can address all of these objectives, but they are most often levied in order to avoid greater dependence on the local property tax, traditionally the mainstay of local government revenues, and to tax those who work in the central city but live in the suburbs.

In 1987, a total of 3,550 local government units—primarily cities, but also boroughs, towns, townships, counties, school districts, and transit districts—levied some form of income, wage, or payroll tax (see Figure 1 for the states where these units are located).[2] Nationwide, personal income taxes rank third in local tax revenue, behind property and sales taxes (general and selective combined).[3] Although nationally the local income tax accounts for only 5.9 percent of all local tax revenues, in the states where they are used, local income taxes yield from 3.8 percent (Alabama) to 28.9 percent (Maryland) of local tax revenues, and from 1.7 percent to 20.7 percent of all local own-source revenues.[4]

In most states local governments are required to have authorization from the state legislature to impose an income or payroll tax. That

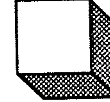
Figure 1

USE OF LOCAL INCOME AND PAYROLL TAXES, BY TYPE OF JURISDICTION, 1988



authorization usually dictates the form of the tax, the permissible range of rates, and the treatment of nonresidents. Local income taxes are most often authorized for use by general purpose local governments, although Iowa, Ohio, and Pennsylvania also allow school districts to use them.

Typically, the income tax is an alternative rather than a complement to a local sales tax. Only five states (Alabama, California, Missouri, New York, and Ohio) use both local income or wage taxes and local sales taxes, and there are actually only seven cities that levy both—Birmingham, Alabama; Los Angeles and San Francisco, California; Kansas City and St. Louis, Missouri; and New York City and Yonkers, New York. Ohio, which authorizes both types of local taxes, limits the income tax to cities and the sales tax to counties. All states that authorize a local income tax also have a broad-based state income tax.[5]



Types of Income and Wage Taxes

There are basically three varieties of local income or wage tax: (1) the wage or payroll tax, (2) the piggyback tax, and (3) the locally designed, broad-based income tax. (See Figure 2, which gives a brief description of local income and wage taxes in the various states where they are used.) The most common is the payroll tax, also known as the wage tax or the earned income tax. This tax is levied at a single flat rate. It is usually collected by payroll withholding, so it is a tax on wages and salaries only rather than on total income. For local governments in three states (California, Oregon, and New Jersey), the payroll tax is legally imposed on employers rather than employees. Economic theory suggests that the legal incidence may have no relationship to the actual distribution of the tax burden between employer and employee and that a part of the burden will fall on each. The distribution of the burden depends on how costly it is for employers and employees to relocate in order to avoid the tax, and how competitive the markets are in which they buy and sell.

Unlike the federal income tax and most state income taxes, the payroll tax typically has no exemptions, deductions, or filing of tax returns by the taxpayer. The administration is thus simple, but not always equitable. Payroll taxes tend to be at least slightly regressive, much more so than most income taxes, because they make no allowance for the different circumstances of different households. Some form of a payroll tax is used by local governments in 9 of the 14 states presently employing local income or payroll taxes: Alabama, California, Delaware, Kentucky, Missouri, New Jersey, Ohio, Oregon, and Pennsylvania. (While California, New Jersey, and Oregon do not identify their taxes as income taxes, their local taxes on income are sufficiently similar to the payroll tax used in other states to justify treating them in the same fashion.)[6] Local income taxes in Michigan are also of this type, except that used by the city of Detroit.

Figure 2

COMPARATIVE ANALYSIS OF FOUR TYPES OF LOCAL INCOME TAXES

		Local Income Tax Tied to Federal or State Tax		
	Local Wage or Payroll Tax	Percentage of State Income Tax Liability	Flat Rate on Federal Adjusted Gross Income	Locally-Designed Progressive Tax
Examples of Usage	**1A** Most common: found in nine of 14 states using local income taxes.	**1B** Maryland Counties	**1C** Indiana Counties	**1D** New York City
General Characteristics	**2A** Flat rate on wages and salaries, no exemptions, no deductions.	**2B** Includes the exemption and deduction pattern of the state income tax; also has the broader definition of taxable income set forth in 2B.	**2C** No exemptions or deductions *but* has a much broader definition of taxable income than set forth in 2A.	**2D** Locally set exemptions and deductions patterned on broad definition of income.
Tax Base	**3A** It does not tax all forms of income. It also fails to shield subsistence income from taxation.	**3B** Taxes all forms of income. It also shields subsistance income from taxation.	**3C** It taxes all forms of income. However, it fails to shield subsistence income from taxation.	**3D** Taxes all forms of income. It also shields subsistence income from taxation.
Taxpayer Compliance Requirements	**4A** *Minimal:* Only self employed have to file returns.	**4B** *Fairly Light:* Just one added calculation on the state income tax return.	**4C** *Fairly Light:* However, all taxpayers must file a simplified return.	**4D** *Heavier:* More calculations required.
Revenue Stability: Revenue Yield During Periods of Economic Growth	**5A** Will grow automatically at same rate as the community's wage and salary base.	**5B** Will grow automatically at a somewhat faster rate than the growth in the community's income.	**5C** Will grow automatically at same rate as the community's income.	**5D** Will grow automatically at a somewhat faster rate than the growth in the community's income.
Revenue Stability: Revenue Yield During Periods of Economic Recession	**6A** Will decline automatically at same rate as the community's wage and salary base.	**6B** Will decline automatically at a somewhat faster rate than the drop in the community's income.	**6C** Will decline automatically at same rate as the drop in the community's growth.	**6D** Will decline automatically at a somewhat faster rate than the drop in community's income.

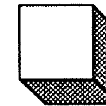
3-7

The second variety, used in Indiana, Iowa, and Maryland, and in the cities of Detroit, Michigan, and Yonkers, New York, is tied to federal or state income taxes. The local taxes are based on either adjusted gross income or on state tax liability. Iowa and Maryland have broad-based, 'erately graduated state income taxes, and the local income taxes in ; states (computed as a percentage of state taxes) share those charac- ...istics. Detroit and Indiana county income taxes are based on federal adjusted gross income rather than state income tax liability. Administration is simplified by tying the tax liability directly to the state income tax or to federal adjusted gross income. Therefore, this tax can be relatively inexpensive in terms of both administrative costs and taxpayer compliance costs. Because this type of tax uses a broader income base than wages or payrolls, it tends to be less regressive. Applying a flat rate to adjusted gross income tends to be roughly proportional, while a local income tax computed as a percentage of state income tax liability is more progressive because it taxes all forms of income and incorporates deductions and exemptions.

Tying a local income tax to either a state income tax or federal adjusted gross income results in a tax that has significantly different characteristics than a payroll tax. Among them are a broader base, the possibility of exemptions and deductions and a graduated rate structure, coverage of a different set of taxpayers, and different administrative and compliance characteristics.

The third type of local income tax is that employed by New York City, which is unique: a broad-based tax similar in structure to the New York State personal income tax, utilizing the same deductions and exemptions, but having its own progressive rate schedules.[7] This tax is very similar in structure, although differing in specifics, to the progressive income taxes of New York State and other states. Prior to 1976, New York City residents had to file separate city returns; now they are able to make the computations on their state forms, but there are still differences in the income base and other features that raise taxpayer compliance costs.

Table 1 identifies the important features of local income taxes and the extent of their use. The table also includes the two states in which such taxes are authorized but not presently used, as well as Kansas, which taxes only interest.



History and Usage

Local income, wage, and payroll taxes have been employed since the first enduring one was adopted by the city of Philadelphia in 1938 under enabling legislation passed in Pennsylvania in 1932. (A local income tax was instituted in Charleston, South Carolina, in the nineteenth century, but was quickly abandoned.)[8] These taxes are still far less important in the local revenue structure than property taxes or than either local sales taxes or fees and charges.

Development of Local Income Taxes

The movement to diversify local revenue sources received its first major impetus during the Great Depression. Land values and income from real property were falling far more rapidly than property tax burdens, and foreclosures to pay property taxes were increasingly common. Hostility toward the property tax, combined with pressing expenditure demand to meet the needs of the unemployed, forced local governments to look for other ways of raising revenue.[9]

Initial adoptions took place in response to fiscal pressures: Philadelphia (1938), St. Louis (1948), Cincinnati (1954), Pittsburgh (1954), and Detroit (1962) all adopted local income taxes. There was a wave of adoptions in the late 1960s and the 1970s, again primarily in cities, for the purpose of providing property tax relief, diversifying the local revenue base, and extracting revenue from suburban residents who worked in the central city. The wave of adoptions has peaked, however, and the potential for further adoptions does not appear to be great in the near future unless additional states pass enabling legislation. Even where the state permits local income taxes, these levies have been widely adopted in only three states.

From the first local income tax in Philadelphia until 1962, all the local income taxes adopted were of the earned income/payroll type. In

1962 the first local income tax tied to the state income tax was adopted in Detroit; state authorization was not required because Detroit is a home rule city. As other Michigan cities began to follow suit, the state, in order to impose some uniformity, enacted a statute in 1964 that authorized cit- o adopt local income taxes. The Detroit tax remains unique among igan's local income taxes, with a higher rate and a base that is essen- y federal adjusted gross income.[10]

The third type of local income tax was adopted in 1966 in New York City. Although the city's definition of taxable income was similar to the federal definition, the city adopted its own progressive rates instead of a fixed percentage of the federal or state tax liability.

In 1967, the Maryland legislature adopted the nation's only mandatory local income tax, requiring Baltimore City and every county to levy a local income tax on residents. The legislation gave the counties authority to set a county rate within the range of 20 percent to 50 percent of the taxpayer's state income tax liability. Nineteen of the 24 jurisdictions have chosen the 50 percent rate. To date, this is the only state where the income tax does not have a local option regarding the actual imposition of income tax, although there is local leeway with respect to rates.

More recent state authorizations of the local income tax in New Jersey (1971), Georgia (1974), and Oregon (1975) have gone back to the local payroll model rather than the piggyback type or locally designed, broad-based income tax. To date, however, only two transit districts (encompassing four counties) in Oregon, and one city in New Jersey have enacted local income taxes under these authorizations. No local jurisdiction in Georgia has elected to impose an income tax.

Current Usage

Today, local income and payroll taxes are used by about 3,550 local governments in 14 states: Alabama, California, Delaware, Indiana, Iowa, Kentucky, Maryland, Michigan, Missouri, New Jersey, New York, Ohio, Oregon, and Pennsylvania. These taxes are also authorized in Georgia and Arkansas (see Table 1). In addition, Kansas taxes only interest.

In terms of sheer numbers, local governments in Pennsylvania are the biggest users of the local income tax—approximately 2,800 of the 3,550 total local governments with such a tax. Pennsylvania authorizes use of e local income tax by cities, boroughs, towns, townships, and school districts. Ohio has the next largest number of users, with 482 cities and 6 school districts. Maryland also has relied heavily on the local income tax; it is used by all 23 counties and the city of Baltimore, and produces a significant share of their revenues. In the remaining states authorizing local income or payroll taxes, an estimated total of 121 cities, 76 counties, 57 school districts, and 2 transit districts employ such taxes (see Figure 1).

In 1970, local income taxes produced 4.2 percent of total local government tax revenues. In 1986, that proportion had risen to 5.9 percent

Table 1

MAJOR FEATURES OF LOCAL INCOME AND PAYROLL TAXES—1988

State	Number of Local Governments With Tax	Range of Rates	Type of Tax	State or Local Administration
Alabama	10 Cities	1%	Gross Receipts (= earned income)	Local
Arkansas	None (only cities may use)	—	Percent of State Income Tax (residents only)	Either
California	2 Cities: San Francisco and Los Angeles	0.75-1.5%	Payroll	Local
Delaware	1 City: Wilmington	1.25%	Payroll/Earned Income	Local
Georgia	None (available to counties; cities if county does not use the tax)	1%	Percent of State Taxable Income	State
Indiana	51 Counties	0.5-1% residents; 0.25 nonresidents	Federal Adjusted Income	Local
Iowa	57 School Districts	4.25-10% on residents	Percent of State Income Tax	State
Kentucky	85 Cities 25 Counties	1.0-2.5%[1] residents; 0.5-2.2% nonresidents	Payroll/Earned Income	Local
Maryland	23 Counties One City: Baltimore	20 to 50% (all but 4 use 50% of state income tax liability)	Percent of State Income Tax	State
Michigan	17 Cities	1.0-2.0% residents; 0.5-1.0% nonresidents	Payroll	Local
	Detroit	3% residents 1.5% nonresidents	Federal Adjusted Gross Income	Local
Missouri	2 Cities: Kansas City and St. Louis	1%	Payroll	Local
New Jersey	1 City: Newark	0.75%	Payroll[2]	Local

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Table 1 (cont.)

MAJOR FEATURES OF LOCAL INCOME AND PAYROLL TAXES—1988

State	Number of Local Governments With Tax	Range of Rates	Type of Tax	State or Local Adminis-tration
New York	2 Cities:			
	New York City	Residents: graduated to 3.5%; Nonresidents: less than 1%	Income Based	State
	Yonkers	Residents: 15% Nonresidents: 0.5%	Percent of State Tax Liability Earned Income	State
Ohio	482 Cities	1.5-2.25% (most often 2%)	Earned Income[3]	Local
	6 School Districts	0.25-1.0%	Earned Income	Local
Oregon	2 Transit Districts (encompassing 4 Counties)	.5-.6%	Payroll	State
Pennsylvania	Cities, Boroughs, Towns, Townships and School Districts—Total: 2,782 estimated	up to 1%; Home Rule Cities: up to 2%; Philadelphia 4.96%;[4] Pittsburgh 4.0%[5]	Earned Income	Local
Estimated Total Users: 3,550				
Exhibit:				
Kansas	Counties	0.125-0.75%	Interest Income Only	Local
	Cities	0.125-2.125%	Interest Income Only	

[1]Residents pay 1.25% to the city and 0.75% for schools; nonresidents pay city tax only.

[2]Payrolls of less than $2,500 per quarter and all public employees are exempt.

[3]Taxpayers may credit taxes paid on their city of employment against taxes due to their city of residence in all Ohio cities.

[4]Nonresident rate is 4.31%.

[5]City tax is 2.125%, and school district tax is 1.857%. Nonresident rate is 1%.

Source: Commerce Clearing House, *State Tax Reporter*, various issues.

Table 2

LOCAL GOVERNMENT REVENUES, 1950-86

(in millions of dollars)

Year	General Revenue From Own Resources	Tax Revenue	Income Tax[1] Amounts	Income Tax[1] As Percent Of Local Revenue
1950	$9,586	$7,984	$64	.8
1955	14,737	11,886	143	1.2
1960[2]	22,912	18,081	254	1.4
1965	32,362	25,116	433	1.7
1970	51,392	38,833	1,630	4.2
1971	57,491	43,434	1,747	4.5
1972	64,449	48,930	2,241	4.6
1973	70,489	53,032	2,406	4.5
1974	76,742	56,515	2,413	4.3
1975	84,357	61,310	2,635	4.3
1976	93,186	67,557	3,127	4.6
1977	102,031	74,794	3,752	5.0
1978	110,730	80,381	4,071	5.1
1979	117,209	80,606	4,309	5.3
1980	130,027	86,387	4,990	5.8
1981	145,736	94,776	5,531	5.8
1982	163,240	103,641	6,105	5.9
1983	179,143	113,145	6,445	5.7
1984	196,504	123,399	7,215	5.8
1985	216,103	134,473	7,974	5.9
1986	233,406	144,997	8,536	5.9

[1]Census data for local income taxes do not include payroll taxes in California, New Jersey, and Oregon. They include local corporate income taxes. Beginning with 1982, separate data on local corporate income taxes are available: 1982—$1,027 million; 1983—$1,105 million; 1984—$1,535 million; 1985—$1,521 million; 1986—$1,588 million.

[2]Alaska and Hawaii included for first time.

Source: U.S. Bureau of the Census, *Governmental Finances*, various years.

of total local government tax revenues (see Table 2). There has been a slight increase during the 1980s in the number of jurisdictions using the local income tax from approximately 3,200 in 1979 to 3,550 in 1987,[11] but most of the total revenue growth has come from rising income and/or rising rates where the tax was already in use. The local income tax's relative share of total local revenue has remained modest and essentially unchanged during the last seven years.

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In 1985, in the three states where they were most intensively used by local governments, these taxes accounted for as much as 13.6 percent of all local general revenues (taxes plus federal and state aid and user charges) (see Table 3). For some cities, it is a significant source of revenue. Philadelphia, for example, derives almost half of its own-source general revenue from this tax. (See Table 4 for some representative revenue figures for large cities.)

Table 3

LOCAL INCOME TAXES AS A PERCENTAGE OF LOCAL REVENUES, SELECTED STATES, FISCAL YEAR 1986

	Local Income Tax As a Percent of		
	All Local Revenues	Own-Source Revenues*	Tax Revenues
Maryland	13.6	20.7	28.9
Ohio	8.9	14.8	22.3
Pennsylvania	9.2	14.6	22.5

*Local general revenue exclusive of federal and state aid.

Source: Computed from *Significant Features of Fiscal Federalism, 1988 Edition*, Volume II (M-155 II), Table 65, p. 70.

Rates

In jurisdictions employing a single flat rate on payroll or wages, the rates range from 0.25 percent in several school districts in Ohio to 4.96 percent in Philadelphia. The most commonly used rate is 1 percent. Higher rates are found in Pittsburgh (4%, of which 2.125% is for the city and 1.875% is for the school district), Detroit (3%), Scranton, Pennsylvania (2.2%), large cities in Ohio (2% and 2.25%), San Francisco (1.5%), and Wilmington, Delaware (1.25%). In most cases, residents and nonresidents pay the same rate. In Michigan, however, nonresidents pay half the residents' rate. In Ohio school districts, nonresidents are exempt, and in some Pennsylvania cities, they pay a lower rate than residents.

States using the state or federal income base vary in their approach to rate setting and to taxation of nonresidents. In Maryland, residents pay 20% to 50% (usually 50%) of their state tax liability; nonresidents are exempt. Given the state rates, for those 19 (out of the total of 24) jurisdictions employing the 50 percent local rate, the effective rate is 2.5% of adjusted gross income in excess of $3,000. In Iowa, residents pay only a school district tax of up to 10% of their state tax liability. In Indiana, the tax is 1% of county adjusted gross income (0.25% for nonresidents).

Table 4

CITY REVENUES FROM LOCAL INCOME TAXES, 1984-85

	Total Revenue (millions)	Percent of Own-Source Revenue
All Cities*	**$6,627.0**	**4.4%**
Cities with Population:		
Greater than 1 million	$4,151.0	20.3
500,000-999,999	924.0	9.7
100,000-499,999	753.0	4.3
Less than 100,000	799.0	2.5
Selected Large Cities:		
Akron, OH	53.2	46.1
Baltimore, MD	92.0	14.3
Birmingham, AL	27.0	15.9
Canton, OH	22.4	56.7
Cincinnati, OH	112.1	44.9
Cleveland, OH	160.3	54.6
Columbus, OH	146.8	53.0
Dayton, OH	66.9	51.8
Detroit, MI	246.1	34.6
Flint, MI	22.2	12.6
Grand Rapids, MI	19.3	24.4
Kansas City, MO	74.0	19.6
Lexington, KY	44.3	40.1
Louisville, KY	51.1	36.1
New York City	3,159.6	23.0
Philadelphia, PA	745.4	49.2
Pittsburgh, PA	54.7	23.6
San Francisco, CA	82.9	4.4*
St. Louis, MO	78.0	21.8
Toledo, OH	87.5	51.6
Wilmington, DL	17.3	25.9
Yonkers, NY	19.2	10.9

*Does not include San Francisco and Los Angeles, CA, or Newark, NJ. Data for San Francisco from Carolyn Sherwood-Call, "The Labor Tax as an Alternative Revenue Source," *Proceedings of the Seventy-Ninth Annual Conference*, National Tax Association, 1986, p. 88.

Source: U.S. Department of Commerce, Bureau of the Census, *City Government Finances in 1984-85*, U.S. Government Printing Office, Washington, DC, 1986.

In New York, local income taxes are used only in New York City and Yonkers. In Yonkers, the tax is 15% of state tax liability (0.5% on earned income for nonresidents). New York City has progressive rates ranging from 1.5% to 3.5% of income for residents, and a single rate of 0.45% nonresidents.

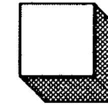
Revenues

In fiscal year 1986, local income taxes generated $8.5 billion in revenues. National figures on the relative importance of local income taxes are deceptively low because of the limited number of jurisdictions using them. In Ohio, Pennsylvania, and Maryland, the three states where the local income tax is most widely used, it is a sizable local revenue source (see Table 3).

For large cities, this tax can be of particular importance. Table 4 summarizes the revenues from the local income or payroll tax for 22 cities that employ the tax fairly heavily. The data indicate that five cities derived more than 50 percent of their own-source revenues from local income taxes in 1985, while seven other cities obtained more than 25 percent. In 1985, this tax provided almost half of its own-source revenues for Philadelphia, more than 50 percent for five Ohio cities, 23 percent for New York City, 22 percent for St. Louis, and 20 percent for Kansas City. In San Francisco, increases in the payroll tax rate from 1.1 percent to 1.5 percent in 1980 helped to blunt the impact of Proposition 13 on the city's revenues.[12] Thus, although not as widely used as the property tax, local sales tax, or fees and charges, the local income or payroll tax clearly plays a significant role in certain states and cities, especially large cities.

Geographic Distribution

The use of the local income tax is concentrated largely in the mid-Atlantic region and the Midwest (see Figure 1), with Pennsylvania, Ohio, and Maryland making the most intense use of this tax. Use of the tax is scattered across the rest of the country with no particular pattern, except that it is not used at all in New England or the Southwest, and very little in the Southeast and the West. In six states—Alabama, Arkansas, California, Missouri, Ohio, and New York—local governments may impose both local income (or payroll) taxes and local sales taxes. However, no cities in Georgia or Arkansas use the local income tax, and it is limited to only six cities combined in California, Missouri, and New York. In Ohio, the income tax is limited to municipalities, the sales tax to counties. Thus, there is very little overlap of a local income tax with a local sales tax.



Design Issues and Safeguards

In its 1974 report *Local Revenue Diversification: Income, Sales Taxes and User Charges*, ACIR cautiously supported the use of local income and sales taxes to achieve greater balance in local revenue sources:

> When equipped with proper safeguards, local income and sales taxes should be viewed as one of several appropriate means for achieving a more balanced use of property, income and sales taxes.
>
> The Commission concludes that our tradition of strong local government argues in favor of a state policy that grants wide latitude to local elected officials in the selection of appropriate revenue instruments to underwrite the expenditure requirements of their diverse constituencies. . . .
>
> The Commission recommends that state governments permit general purpose local governments to diversify their revenue structures by levying either a local sales tax or a local income tax or both provided that the states take the necessary steps to insure the creation of a system of coordinated local income and sales taxes.
>
> To achieve a coordinated system of local nonproperty taxes for general purpose local governments, the Commission recommends that states [take the necessary safeguards]:
>
> *Safeguard: Uniform Tax Base*
>
> > Provide a uniform local tax base which should conform to that of the state if the state imposes the levy.
>
> *Safeguard: State Administration*
>
> > Collect and administer the local income or sales tax and designate or create a state agency to administer the local tax if the state does not impose such a levy.

Safeguard: Universal or Widespread Coverage

Encourage universal or widespread coverage by (1) mandating a minimum local levy and permitting counties and those cities with populations of at least 25,000 to choose a rate above this, subject to a specified maximum, or by (2) giving first option to adopt the tax to the local government of widest jurisdictional reach with sharing provisions for municipal governments. The authority to adopt local sales and income taxes should also be extended to cities with populations of at least 25,000 if the larger unit of general government does not adopt the tax.

Safeguard: Constrained Rate Option

Permit local flexibility by specifying a range of tax rates that general purpose local governments may impose.

Safeguard: State Equalization

Minimize local fiscal disparities in those states characterized by a high degree of local fiscal responsibility and a fragmented local governmental structure by adopting an equalizing formula for the distribution of local nonproperty tax revenues among constituents within the local taxing authority of widest jurisdictional reach and adopting new programs or using existing state programs of general support to offset fiscal disparities among local taxing authorities with the widest jurisdictional reach.

Safeguard: Income Tax Sharing

Specify arrangements for sharing taxes on earned income by nonresidents between tax levying jurisdictions of residence and employment.[13]

The recommended safeguards call attention to several important design issues in a local income tax, of which we shall examine four. The first issue is the base; specifically, whether to tax only payroll or wages or to use the broader base of the state income tax. With a payroll tax, the state must also decide whether the base should include residents only or extend to nonresidents employed in the taxing jurisdiction. The second issue is whether the state or local government should be responsible for administration. The third issue is whether the tax should be employed by all local governments of a particular type (e.g., school district, city, county) or on a local option basis. The fourth issue is whether the state should specify a single rate or a range of local rates.

Earned Income or All Income?

In 9 of the 14 states where local governments presently levy an income tax, the tax base is wages and salaries only. (In addition, all but

... city in Michigan use this type of tax.) Typically, there is a low flat rate; the most widely employed rate is 1 percent. This tax base usually excludes interest, dividend and rental income, self-employment income, retirement income, and any other forms of income not easily taxed by payroll withholding. Payments are usually received from persons who work in the city even if they reside outside the city. (However, in several states, nonresidents pay a lower rate. Taxation of nonresidents is addressed below in the evaluation section.) Clearly this choice of a flat rate with withholding as the collection method represents a vote for administrative simplicity and local control at the expense of greater equity.[14]

The major alternative is to make state taxable income or federal adjusted gross income the base for the local income tax and to link collection to state income tax collections. This "piggyback" option broadens the base to include all income and shifts the burden of collection to the state. From the local perspective, this option is likely to change the composition of the taxpaying group. A payroll or wage tax is usually collected at the workplace. Those who work in the city but reside outside will pay the tax, but any "reverse commuters" who live in the city but work outside it can escape the tax. With the piggyback type of tax, city residents also constitute city income taxpayers. In most states with a piggyback local income tax, some effort is made to capture income tax revenues from those who commute into the taxing city or county. Typically, nonresidents who work in the taxing jurisdiction are liable for the tax, but at a lower rate (see Table 1). The piggyback type of income tax, in comparison to a wage or payroll tax, involves some loss of local control and simplicity, offset by a gain in equity.

State or Local Collection?

For those local governments that use a surcharge on the state income tax, there are clearly significant savings in both administrative costs to the local government and compliance costs to the taxpayer if the program is administered by the state with a single tax form. However, one issue that may arise is how quickly the funds collected by the state are remitted to the local government for investment or expenditure. Having the state serve as the collection agent does not significantly compromise local control over whether to impose the tax and at what rate, although it may reduce taxpayer awareness of how much local as opposed to state tax is being paid. Nevertheless, except for Maryland (where state collection is mandated by law), New York, Iowa, and Oregon transit districts, most local income taxes are administered locally.[15]

The local payroll or wage tax lends itself more easily to local administration than the surcharge on the state income tax. The Pennsylvania payroll tax is entirely locally administered. Some jurisdictions share a collection agency; in Ohio, agencies in three large cities serve the local income tax collection needs of surrounding local governments.[16]

Universal or Local Option?

A tax that is used by all local jurisdictions of a specified type in a state—city, county, or school districts—at a uniform rate is really a tax shared by state and local governments rather than a genuinely local tax. ough the local sales tax is designed as a state-shared tax in several ;s, no states have opted to design the local income tax on the same model as that of the state-shared sales tax. In fact, only Maryland requires that the income tax be levied by all local governments of a particular type (counties). Thus, where local income and payroll taxes are used, even though the state imposes some elements of uniformity, it is still a truly local option tax—both in the decision to use it and often in the rate to be levied as well.

An important aspect of local option is whether voter approval is required. Four states (Arkansas, Georgia, Iowa, and Missouri) require local voter approval to levy the tax; Ohio requires voter approval for school districts but not municipalities, unless they wish to use a rate greater than 1 percent. The requirement of voter approval, except in Missouri, is a ature of the local income tax statutes enacted more recently by state gislatures. The tax is much less likely to be used in states that require prior approval from voters. In Georgia, its use has been inhibited not only by the prior approval requirement, but also because the authorizing legislation requires local governments to give up the established local sales tax if they opt to adopt an income tax.

The advantage of a universal local tax at a uniform rate within the state is that there will be less distortion of local decisions based on different tax situations. The drawback of a universal local tax is that the tax is not adaptable to local needs and preferences and is not under the control of local officials. Such a tax would be closer to state revenue sharing than to a truly local tax.

Rate Uniformity or Rate Diversity?

Another way in which local autonomy can be preserved is by leaving the decision on tax rates to local authorities. In the ACIR recommended safeguards, the Commission sought to balance the desire to preserve local autonomy with a need to limit tax differentials among jurisdictions within state. Their solution was to suggest that local authorities be given a .oice of tax rates within a specified range. ACIR observed that local autonomy could be preserved, even enhanced, as long as rate variations were not extreme. As Table 1 indicates, local rates are typically quite low. Most states specify either a single rate or a narrow range of rates.

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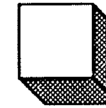

Rationales

The rationales for raising revenue by taxing income rather than, or in addition to, sales or property, or imposing fees and charges is well documented in economics literature. There are two theoretical rationales—benefit and ability to pay—and two pragmatic justifications—revenue diversification and property tax relief.

The Benefit Principle

One principle of taxation is the benefit principle, first enunciated by Adam Smith: the taxes that one pays should be proportional to the benefits enjoyed by the taxpayer. Traditionally, the gasoline tax, earmarked for maintaining existing highways and building new ones, is the clearest example of a benefit principle tax in the United States. Property taxes are often justified on the benefit principle because many local services—fire, police, sanitation, street maintenance—can be regarded as services to property. The value of these services to the taxpayer is roughly proportional to the value of property owned.[17] However, given that a large share of local property tax revenues has been directed to public education in recent times, the argument for property taxes on the basis of the benefit principle is weakened.

The income tax is rarely considered a benefit principle tax, except in the very tenuous sense that the benefit provided may be the general umbrella of state protection of income earning opportunities. Given that a city provides income opportunities to both residents and nonresidents, a local income tax fits under the umbrella of Smith's justification for taxation. To the extent that public services make income earning possible or enhance the earning capacity of local citizens or complement the private uses of income, there is an element of benefit principle even in the income tax.

In fact, a case can be (and has been) made that the benefit principle justifies levying income and payroll taxes on nonresidents who work in a

local jurisdiction. It is argued that these persons use the services of local government. They park in the parking lots, walk the streets, generate trash, consume the city's cultural services, such as museums, and benefit from fire and police protection. If the only source of local revenue is the property tax, many nonresidents will pay no direct taxes to the local government where they work. Only those nonresidents who own or rent business property will pay direct taxes to that local government. (This same argument is used for justifying local sales taxes in a slightly different form.)

Thus, one way to charge for the services that these people enjoy is to levy an income or payroll tax on nonresidents, which then serves as a benefit principle tax. Recognizing that these people do pay property taxes where they reside, and that more local services—especially education—accrue to residents than nonresidents, some cities and counties tax nonresidents at a lower rate (see Table 1).

ACIR's earlier study weighed the advantages and disadvantages of taxing nonresidents:

> Part of the attraction of the local income tax can be found in the fact that it can reach those individuals working in the city but residing elsewhere. Local politicians quite understandably would favor a tax on nonconstituents and this may ease their task of "selling" a local income tax. Nonresidents voice the "taxation without representation" theme and further support their claims that their purchase of goods and services (if taxes are shifted forward) and their provision of factors of production (if taxes are shifted backward) indirectly compensate for the additional public services necessitated by their employment.
>
> * * * * * * *
>
> Judging by actual experience, those local governments that are permitted to tax nonresidents do. The commuter aspect of the local income tax thus raises a basic point of intergovernmental tension—the apportionment of tax liability between the commuter's area of residence and his area of employment since he is, at least potentially, taxable in both.[18]

Frederick D. Stocker, looking for ways to relieve pressures on central city finances in the 1970s, pointed out that taxation of nonresidents was an even more explicit advantage of the municipal income tax:

> One of the most significant features of a municipal income tax is its ability to suck revenues out of the suburbs and into the central city, especially where the income tax applies to the income of residents and nonresidents alike.[19]

Do residents of the suburbs exploit the cultural amenities and other services provided by the central city? David Bradford and Wallace Oates argue that there is little evidence to support this contention. They found that local taxes go overwhelmingly to support services to residents and particularly to schools, where the benefit is tied to the place of residence rather than to employment.[20] David King, however, in a survey of federal systems in several countries, concludes that capturing externalties generated by the city is an important issue in tailoring local public services to taxpayer requirements.[21] We will consider this issue later in this report in a broader context of evaluating the local income tax.

Ability to Pay

A second rationale for a particular tax is that it should be based on ability to pay. The income tax is usually given high marks on this criterion because income is the ultimate source of all tax revenues and, therefore, the best measure of ability to pay.

The relationship between local income taxes and ability to pay varies with the three basic types—earned income/payroll, piggyback (percentage of federal or state tax or taxable income), and the unique New York City progressive tax. ACIR's 1974 study was critical of the third type and, by implication, some taxes of the second type:

> No strong case can be made for use of progressive rate structures in local income taxes. Basically, graduated rates and the use of exemptions are designed to introduce a redistributive element into the local tax structure. This is a function that localities are ill-equipped to perform because their limited jurisdictional reach encourages taxpayer avoidance. Redistribution of income is undeniably a function better performed by the Federal government.[22]

Whether a local income tax is an appropriate mechanism for raising revenue from an ability to pay perspective is, of course, a matter to be decided by local voters and elected officials. If such a tax is to be enacted, however, a strong case can be made on equity grounds for adopting a form of tax that at least shields subsistence income. A flat-rate local income tax, which has no exemptions or deductions, tends to offset the progressive and redistributive elements that may exist in federal and state income taxes, and to contravene the ability-to-pay principle.

The ability of most local tax systems to play a significant role in income redistribution is limited. Most local taxes, namely, property taxes and sales taxes and many user fees and charges, tend to be regressive, although there is an ongoing debate as to whether property taxes are actually regressive. A local income tax that is proportional or mildly progressive might offset to some extent whatever regressivity may exist in the rest of the local tax system.

In addition, taxpayer avoidance presents a problem for local income and payroll taxes. Even the flat-rate payroll tax generates some taxpayer avoidance. There are avoidance problems for a local income tax even when the tax is not progressive; and presumably they become worse with

a progressive income tax. Limited evidence from San Francisco and Philadelphia suggests that avoidance of local income and payroll taxes does occur, taking the specific form of the taxpayer locating outside the taxing jurisdiction to avoid the tax or at least reduce the tax burden.[23]

Some public finance theorists are critical of the use of any local taxes t are based on ability to pay, as opposed to user fees and benefit taxes, cause of undesirable migration effects. A study by Timothy J. Goodspeed, however, finds that migration effects of ability-to-pay taxes imposed by local governments are likely to be very small.[24]

Diversification of the Tax Structure

A third rationale for adopting the income tax is based on its use as a complement to, rather than a substitute for, other local revenue sources, such as property taxes, sales taxes, and fees and charges. The diversification argument has received considerable attention as a way to make the tax structure more equitable and more efficient. A diversified tax structure captures revenues from those who can avoid some taxes but not others, and from those for whom a particular tax poses only a small burden. The property tax is a wealth tax, but not all wealth generates income with which to pay the tax, and not all forms of wealth are subject to the property tax. An income tax can thus generate revenue from those whose income substantially exceeds their local property wealth, while reducing the burden for those with tangible property wealth but low income.

A diversified tax structure can also help to keep all rates lower, and thus reduce the amount of distortion from high rates on a particular tax, such as the property tax. High property tax rates can discourage property improvements, encourage flight to the suburbs, and shift wealth into nontaxable forms. All other things being equal, high income taxes can discourage the substitution of labor for capital, encourage individuals and firms to locate in untaxed or low-taxed areas, and discourage work effort. High sales taxes can discourage consumption and encourage the flight of commercial facilities to other jurisdictions. To the extent that local taxes affect consumption and production decisions and locational choices, lower rates cause fewer such distortions of economic decisions.

Finally, it has been suggested that a diversified tax base offers a state or local government the same advantages that a diversified portfolio of financial assets offers individual investors. Any particular tax has certain strengths and weaknesses in terms of stability, growth, sensitivity to inflation, and the like. A diversified revenue base can offer a better mix of such attributes than dependence on a single tax.[25]

The diversification argument must be applied with caution to localities, however. The ability of a local government to implement a particular type of tax, such as an income or payroll tax, depends critically on its relationship to its surroundings. If the tax is used in adjacent jurisdictions, then there is less likelihood that the local tax will seriously affect locational and other economic decisions. If the tax is unique to the particular

jurisdiction (e.g., the payroll tax in Los Angeles and San Francisco), then the local government must weigh the revenue gains against the possible long-term losses in residents, business firms, and economic activity to the suburbs or other cities that do not levy an income tax.

This potential long-run risk in a local income tax is magnified with higher rates. A case in point is the Philadelphia income tax, one of the highest in the nation at 4.96 percent. This tax has been the main source of increased real tax revenues in Philadelphia during the last 20 years, largely as a result of rate increases. An econometric analysis by Robert Inman and colleagues indicates that the number of jobs lost as a result of the Philadelphia local income tax may be as high as 100,000 over the past 20 years.[26] A proposal was submitted in the 1988 Pennsylvania legislative session to reduce the rate from 4.96 percent to 4.3 percent (3.6 percent for commuters).

As the discussion above clearly shows, part of the case for adoption of a local income tax in any particular local jurisdiction depends on the specific characteristics of the jurisdiction and its revenue system, and also on the type of local income tax being considered. Whether the locality is the only jurisdiction in a region to employ the tax, or whether many other localities in the region also levy an income tax are significant factors in determining its impact on the local economy.

Property Tax Relief

A fourth rationale for using local income and payroll taxes is that they can relieve the burden on the property tax, either by lowering it or not increasing it. This rationale is closely related to the tax diversification argument. However, rather than being a general argument in support of tax diversification, it is directed to the role that local income and payroll taxes can play in helping communities alleviate what many observers see as a heavy reliance on property taxation that leads to high property tax rates, and frequently to taxpayer rebellions like Proposition 13 in California. Proponents argue that adoption of a local income tax can help stabilize the pressure on local property tax levels. Moreover, the authorization of local income taxes provides state legislators with a creditable argument for turning down city and county requests for other forms of "property tax relief," particularly local demands for a state revenue sharing program. However, some critics of the local income tax are concerned that it may be too productive as a revenue source, encouraging the growth of the public sector.

Elizabeth Deran, in a 1968 study of city tax structures, found that cities with income taxes generally exhibited lower property tax rates than cities of comparable size without income taxes.[27] In Indiana, authorization for the local income tax was an intentional part of a general property tax relief program. Starting in 1973,

> counties which chose to levy a local income tax had to freeze their property tax levy; counties which did not levy an income tax

had to freeze their property tax rate . . . . In addition, the state increased aid to local governments . . . . As a result of this program, farm property taxes actually decreased between 1971 and 1977, while residential property taxes increased slowly.[28]

Unfortunately, there are no recent statistical studies that conclusively pport or dispute the role of local nonproperty taxes, such as sales and income taxes, as a form of property tax relief; however, the view that such relief is a major function of other local taxes is widely held among both public finance theorists and practitioners. James Rodgers listed both obtaining more revenue without higher property taxes and reducing property tax burdens among overlapping jurisdictions as being among the five major goals of local nonproperty taxes.[29] Arnold Raphaelson notes that

> . . . there has been a growing hostility to local property taxation in recent years . . . . [A]s local governments turned to other revenue sources, the percentage of total revenues collected as property taxes decreased.[30]

Aronson and Hilley, likewise, see local sales and income taxes as a form of property tax relief:

> The great surge in the use of local sales and income taxes occurred in the 1970s, with their relative importance increasing into the 1980s . . . . The availability of these nonproperty taxes has allowed local governments to diversify their revenue sources. Property tax revenues, which accounted for about 87 percent of local tax collections in 1960, accounted for only 75 percent in 1984.[31]

In a recent study of tax and expenditure limitations, Merriman observes the link between the property tax limitation movement and the use of other local revenue sources:

> . . . the idea that local governments can be induced to use new or different revenue sources through the imposition of a TEL [tax or expenditure limitation] has long been an element in the debate about the wisdom of such measures . . . . [S]ome of the earliest TELs were justified by the argument that they would encourage 'reform' of the property tax . . . later TELs, such as the 1970 state of Kansas measure . . . were sometimes explicitly designed to encourage the use of nonproperty tax revenues.[32]

Merriman also cites a statistical study by Inman, who observed that large cities, given the opportunity, will choose to diversify their tax portfolios, and that offering cities other choices (he mentions local selective and general sales taxes) generated measurable reductions in the share of the property tax in total revenues.[33]

Finally, a group of practitioners/legislators in South Carolina summarized a 1979 review of alternative local revenue sources (including local income and sales taxes) with the following comments:

> . . . overwhelming dependence on the property tax presents many serious problems . . . the property tax does not provide governments with the kind of broad-based, *balanced* revenue system that they must have if they are to function as autonomous governmental entities . . . . Any new tax instruments provided to local governments should be provided as means to make reductions in some existing taxes, most prominently the property tax.[34]

The report went on to recommend the local accommodations tax, the local income tax, and the local sales tax as additional revenue sources. While only one of the proposed alternative local revenue sources (the accommodations tax) was implemented in the short term in South Carolina, a bill introduced in 1987 offered six new local (tax) revenue options and was called the Local Government Finance Act. It met considerable opposition. In 1988, in an attempt to package the idea in a form more palatable to the public, the bill was reintroduced, the number of local tax options was reduced, the use of such taxes was tied to property tax rollbacks, and the bill was retitled the Property Tax Relief Act. Clearly, many see a close need to link the use of local nonproperty taxes with property tax relief.

Although proponents of enacting a local income tax frequently link it to property relief, such "relief" rarely means a reduction in individual property tax bills. The use of a local income tax for property tax relief may prevent further increases in property tax bills, or moderate the rate of future increases. While imposition of a local income tax may reduce the proportion of total local revenues raised from property taxes, it may or may not reduce the total local tax burden.

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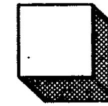

Evaluation

In its original (1961) study of local nonproperty tax revenues, ACIR expressed reservations about the use of local income taxes, primarily because they tap a revenue base already employed by the federal government and many states:

> The mushrooming of miscellaneous kinds of local taxes across the country poses problems of public policy . . . . Local sales, income and tax practices add still another layer to existing tax overlapping.[35]

Among the concerns expressed in that report were distortions of economic choices, high administrative and compliance costs, and limitations on the freedom of the state to expand reliance on income (and sales) taxes. By 1974, however, experience with local income taxes had led to a more positive review in the second ACIR study, which concluded that:

> Local income taxes, like local sales taxes, are one device by which local governments can diversify their revenue structures. As a broad-base tax, the local income tax can produce relatively large amounts of tax revenue at moderate rates, thus relieving pressures on the property taxes. Because local governments operate in an open economy, however, states should accompany authorization of local income taxes with necessary "safeguard" conditions.[36]

Many economists favor use of the income tax by the states and the national government. A progressive income tax usually receives high marks for equity, for minimum distortion of economic decisions, for low administrative costs, and for sensitivity to economic growth. However, economists are more inclined to question its use as a local revenue source because of concerns about tax competition, locational effects, and administrative problems. Like ACIR in the 1961 study, some observers

were initially concerned about overlap and coordination as this tax began to spread.[37] In a federal system, the heavy reliance of one type of government on a particular tax generally limits its use by other governments. Both the individual income tax and the Social Security payroll tax are ajor revenue sources for the federal government, together accounting r about two-thirds of federal revenues in 1986. Because of federal reliance on this revenue source, states generally deferred adopting income taxes in favor of sales taxes, where they had a clear field. Local governments likewise were slow to move into a field already used by the state and national governments.

Nevertheless, the income or payroll tax does offer some attractive features for local governments. In what follows we will evaluate the local income tax on the traditional criteria used to rate revenue sources, paying particular attention to the local aspects of these criteria and placing the evaluation in the context of the types of local income taxes currently in use.

Yield

The yield of any tax depends on the breadth and depth of its base, the opportunities for evasion and avoidance, and the rates levied. Both the payroll tax and the income tax have broad bases. Wages are a large component of income for most people, and the payroll tax allows no deductions or exemptions in most cases. The base for other local income taxes is determined by the base of the state or federal income tax, except for New York City.

The payroll tax is extremely difficult to evade or avoid. Escaping the local income tax depends partly on locational choice and partly on local efforts to ensure compliance. To the extent that individuals can reduce their federal or state income tax liability through deductions, exclusions, or other methods, they can also reduce their local income tax liability (not payroll tax liability) when the local income tax is linked to the state or federal income tax.

Most local income tax rates are low, in the 1 percent to 3 percent range. In comparison, the average effective property tax rate in the U.S. is about 1.2 percent. Given that the property tax is a tax on wealth, the appropriate comparison is between the income tax rate as a percentage of the income base and the property tax as a percentage of the income that the taxed property yields. Assuming that the income yield on assets subject to property taxes is about 10 percent, the property tax rate computed as a percentage of income stream rather than the value of the asset would be 12 percent or a considerably higher rate than the typical local income tax rate.

Elasticity and Stability

Elasticity measures the responsiveness of tax revenue yield to changes in the size of its underlying base. For example, an elasticity of 1.0 indicates that the tax yield will increase by the same percentage as the percentage increase in the income or payroll base. A tax elasticity of more than 1.0 produces an increase in yield greater than the increase in the base: for example, an elasticity of 1.4 means that each 10 percent increase in the tax base produces a 14 percent increase in revenue. An elasticity of less than 1.0 means that yields are increased proportionately less than the increase in the base as the base grows.

Economists have devoted considerable time and effort to estimating the elasticities of various taxes. A recent summary of these studies by the U.S. Department of the Treasury indicates that although there is considerable variation in the estimates of the elasticities of the different taxes, there is general agreement on the relative rankings of the elasticity of different taxes. Table 5 shows the range of elasticity estimates. Note that these are national estimates, not estimates for individual states.

Estimates of state personal income tax elasticities on a national basis range from 1.13 to 2.08. (One estimate of the state income tax elasticity for Arkansas cited in the Treasury study is 2.40). An average income tax elasticity estimate is 1.6. The Department of the Treasury uses a conservative state income tax elasticity figure of 1.4 in its economic analyses.[38] An elasticity of 1.4 -1.6 means that every 10% increase in income would generate a 14 to 16 percent increase in income tax revenue.[39]

For piggyback local income taxes, such as that used in Maryland, the elasticity will depend on the elasticity of the underlying state tax. The elasticity of a local wage or payroll tax is lower than that of the more comprehensive income taxes, but it is also a more stable revenue source because there are greater fluctuations in earnings from the interest, dividends, rent, and capital gains included in an income tax. One study of

Table 5

ESTIMATES OF THE INCOME ELASTICITIES OF THE MAJOR STATE-LOCAL TAXES, ALL STATES, VARIOUS YEARS, 1965-86

Tax	Range of Estimates of Elasticity Economists	Treasury
Personal Income Tax	2.08–1.13	1.4
General Sales Tax	1.37–.59	1.1
Corporate Income Tax	1.34–.73	N.A.
General Property Tax	1.30–.80	N.A.
Taxes, Other Than Income and Sales (including property)	N.A.	.9

Source: A summary of figures for the United States (not individual states) from Robert A. Aten, "Technical Notes on the State-Local Model," in U.S. Treasury, *Federal-State-Local Fiscal Relations*, Technical Papers, Volume II, 1986, Table 1, pp. 576-7.

the revenue fluctuations in four major cities (three of which used payroll-type local income taxes) found that the revenues from this source were highly stable despite ups and downs in the local economy.[40]

Many elected policymakers view as highly desirable a tax whose yield automatically grows at a faster clip than that of the economy. Revenues increase with population and economic activity, financing the additional public services that may be required. However, from the standpoint of the taxpayer, high income elasticity for a tax may mean siphoning off additional revenues to local government automatically rather than subjecting this process to legislative or public approval processes. Those who wish to contain the growth of government would prefer to use a less elastic tax base, or, at least, a flat tax rate.

Elasticity has a downside, too; revenues may drop off sharply in a recession, forcing curtailment of public services. The federal government is able to borrow during recessions, and some state governments have rainy day funds or other resources that will tide them over for a short period, but local governments have less flexibility in coping with a sudden and unexpected decline in revenues.

Administrative/Compliance Costs

The 1974 ACIR study strongly recommended state administration of local income taxes. Although there is very little information on the costs of collecting local income taxes, John W. Lynch estimates the collection cost of a state income tax to be 1.58 percent of revenue collected at a rate of 4 percent, dropping to 1.20 percent at a 5 percent tax rate.[41] State administration of local income taxes can reduce costs, although the savings to the local government in personnel and administrative costs must be weighed against the charges assessed by the state and the costs of delays in receiving the funds collected. Even large cities rely on state administration; New York City's local income tax is administered by the state.

With local administration, taxing earned income only and relying on withholding rather than filed returns by individual taxpayers considerably reduces the complexity and the number of returns, thus lowering administrative and taxpayer compliance costs. Both costs still remain high under the wage or payroll tax for most proprietorships or partnerships because, for these small firms, withholding is often not feasible.[42]

ACIR, in its 1974 study, noted that if progressivity is desired in the local income tax, it is administratively less costly to achieve that goal with exemptions rather than a progressive rate structure:

> While the use of exemptions to achieve progressivity will require the imposition of higher rates on the remaining taxable income to secure an equivalent yield, it at least partially eases administration of the tax by reducing the number of returns that have to be processed. The use of progressive rates, on the other hand, can complicate administration and does not reduce the number of returns.[43]

John Bowman and John Mikesell argue that administrative costs can be reduced while at the same time providing a tax that is more equitable and less likely to distort economic decisions if the tax has state-local base conformity, state administration, and wide area adoptions.[44] However, only Maryland has required state administration, although it is available as an option in other states, such as New York and Iowa.

Equity Aspects

ACIR's 1974 study gave a qualified endorsement to the income tax on equity grounds:

> Concerns for equity effects of a flat rate local income tax—which are generally centered on their application to low-income groups—can be partially resolved by the fact that the actual rates used are low and further mitigated by the inclusion of unearned income in the local tax base. Nor can it be argued that equity is best defended on the basis of progressivity. The introduction of progressivity into the local tax structure via graduated rates requires a defense of a specific graduated structure, with a given degree of progression, rather than a defense of the general concept itself. Seemingly, equity is easiest to defend on the grounds of equivalent rates applied to a broad income tax base. . . .[45]

In states that tie the local income tax to the state tax, the equity of the local tax is keyed to the equity of the state income tax. If the local income tax is levied at a flat rate on the same income base, it will still be mildly progressive as long as there are personal exemptions and standard deductions in the state income tax. If the local income tax is computed as a percentage of the state income tax liability, then it shares all the equity aspects as well as other advantages and defects of the state income tax.

In some cases, the local income tax is viewed as a way to reduce local dependence on state and federal aid to local governments, or state or federal assumption of responsibilities. With the end of General Revenue Sharing in 1986, increased attention has been given to strengthening the local revenue base. The advantages of locally raised revenues are better control and accountability. However, the local income tax does nothing substantial to improve the tax base of low-income jurisdictions and thus alleviate the need for state and federal grants, revenue sharing, or assumption of responsibilities for distributional reasons. According to James Rodgers:

> To redistribute income from high- to low-income jurisdictions, state or federal funding of local expenditures is more effective than any type of local taxation. Distributing state or federally collected revenues back to local government can then be based on a formula that favors poorer jurisdictions. In part, the controversy

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over the extent to which local taxation should be used to fund local expenditures focuses on how much income redistribution among local governments is desirable, how much should be accomplished by giving income transfers to the poor directly, and how much should be provided by transfers of resources to the local governments in which the poor are more heavily concentrated.[46]

Tax Situs: Residents or Workers

The issue of taxing residents or taxing workers is a difficult one that is resolved differently in various states. Extreme lack of coordination of local income taxes between adjacent or overlapping jurisdictions can result in double taxation, but usually that is avoided within a state. In the absence of interstate compacts, however, it is possible for those who commute across state boundaries to experience double taxation.

Usually, basing local income taxation on place of residence favors suburban communities; the choice of workplace favors central cities. Tax credits may be used to balance the claims of two competing jurisdictions. In Pennsylvania, except for Pittsburgh and Philadelphia, residence has preference; in Ohio it is the place of employment. In several states, nonresidents pay a lower tax rate (see Table 1).

Probably no other single issue pertaining to local income taxes has caused as much controversy as the appropriate treatment of nonresidents. This question has important legal as well as economic ramifications, which vary from state to state.[47] Solutions to the problem of whom to tax vary. In Alabama and Kentucky, because the local income tax is set up technically as an occupational license tax, there is no possibility of double taxation. Maryland, Michigan, and Pennsylvania (except for Philadelphia and Pittsburgh) tax residents only. Iowa school districts tax only residents of the school district. Philadelphia, as the largest city in Pennsylvania, is given first claim on taxes from nonresidents, who may then credit their Philadelphia tax against any local tax in their city of residence. Ohio residents are allowed a credit in their city of residence for taxes paid to the city of employment, giving the employment city prior claim.[48]

ACIR's 1974 study recommended that the tax be shared between the places of residence and employment. Pennsylvania has adopted that procedure for overlapping jurisdictions. In most states, jurisdictional overlap is not a problem because, typically, only one type of local government (county, city, or school district) may use the tax.[49]

Locational Effects

The smaller the geographic division that employs the tax and the higher the rate, the more likely it is that the tax will influence taxpayers to locate their work or residence outside the city. Although central cities

have used the tax to capture revenues from commuters, it has probably contributed to some exodus from these cities.

For example, some of the peculiar features of San Francisco's payroll tax generate identifiable locational effects. Firms are excused from the tax if their tax liability would be less than $2,500 (an annual payroll of less than $166,667 at the current rate of 1.5%). In addition, banks, insurance companies, and regulated utilities are exempt by state law. The impact of this exemption is to encourage such firms to locate in downtown San Francisco, contributing to the growth of the banking industry there, but at least some observers note an exodus of labor-intensive firms to the suburbs.[50] Inman's study, cited earlier, also identified some locational impact of Philadelphia's very high local income tax.[51] According to this study, econometric analysis suggests that "perhaps as many as 100,000 jobs were lost over the past two decades."

If the tax is widely used at low rates, locational effects will probably be minimal, especially if the tax reduces the burden on the property tax and/or improves the attractiveness of the locality with better local public services. To date, with the exception of the studies mentioned above, little research has been done to demonstrate the existence or absence of significant locational effects.[52]

One of the purposes of a local income tax in many states is to strengthen the revenue bases of central cities. Capturing the earnings of commuters in the tax base must be weighed against any potential undesired locational effects. At least one study of Ohio cities found that an employment income tax base is stronger than a residence income tax base for central cities, while the reverse is true of many smaller communities.[53]

Relation to State and Federal Income Taxes

As noted earlier, there may be some degree of competition for the same tax base when an income tax is employed by all three levels of government. The fact that this tax is heavily used by the federal and state governments limits its usefulness for local governments, and particularly puts an upper limit on the rates they can set.

Recent changes in the federal income tax code may make local income taxes more attractive as a revenue source. The loss of sales tax deductibility might make the local income tax relatively more acceptable than local sales taxes to taxpayers who itemize; however, even before passage of the *Tax Reform Act of 1986*, less than half of the taxpayers itemized, and the proportion is expected to decline sharply. In addition, lower federal tax rates reduce the value of the deduction. The reduction in federal tax rates may allow some leeway for increased local income tax rates. In states and localities that use federal taxable income as the base for computing the tax, revenue should rise because the federal base has been broadened by the 1986 reforms.[54] The full impact of the 1986 federal income tax reform on state and local finances has yet to be observed,

and states and localities have not had much time to react to changes, but the new tax law appears to be at least slightly more hospitable to expanded use of local income taxes than before, primarily because of the loss of sales tax deductibility and lower federal rates.[55]

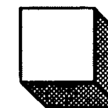
Public Receptivity

The 1987 ACIR annual public opinion survey included a question about the best way to collect additional local revenue.[56] The question was, "If your local government decided to raise a small amount of additional revenue to help meet costs and improve services, which one of these would you prefer?" The responses were as follows:

Charges for Specific Services	33%
Local Sales Taxes	20%
No Tax Increase/No New Taxes (volunteered)	17%
Local Income Taxes	9%
Local Property Taxes	9%
Don't Know/No Answer	12%

Clearly, the local income tax is not a popular alternative source of additional local revenue. Despite the loss of deductibility of sales taxes on federal income taxes, sales taxes remain considerably more acceptable than local income taxes, as do user charges and fees, which also are not deductible. The 1987 public opinion poll also found that increased state income taxes were far down the list of popularity as a source of added state revenue, and even a national sales tax levied by the federal government was preferred to a federal income tax increase.

On the same survey, the federal income tax had finally reversed its steady decline in the rankings on fairness (respondents were asked to select which is "the worst tax, that is, the least fair.") The property tax fared worse in the earliest poll in 1972 (45% versus 19% for the federal income tax), but after 1979 the federal income tax was ranked worst. In 1987, the federal income tax was ranked worst by 30% of respondents, while local property taxes came in second at 24%. (The federal income tax position in 1987 is an improvement from the 35-38% "worst" rankings from 1979 to 1986, perhaps as a result of the 1986 tax reform.) However, the income tax remains unpopular, and the acceptability of local income taxes is probably somewhat influenced by the continued unpopularity of the federal income tax.



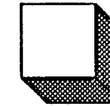
Summary and Conclusions

The local income tax has earned a modest place in the repertoire of local revenue sources. Even though its overall revenue significance is small, it is a major source of revenue in three states and a number of large cities. It has helped some local governments to diversify their revenue systems; made it possible for some jurisdictions to lessen their reliance on the local property tax; and provided some rapidly growing areas with a revenue source that is more capable than the property tax of keeping pace with growing expenditure demands. The local income tax appears to have some distorting effects on locational decisions where it is used only in a few jurisdictions in a region, or where the rate is high. It has enabled central cities to capture tax revenue from commuters, although it is arguable whether those revenues bear any meaningful relationship to the benefits commuters derive from central city services.

Although the pace of adoption of local income taxes has slowed (most local income tax revenue increases have come from economic growth or rate increases), developments on the federal fiscal scene may stimulate more localities to consider a local income tax. These developments include the end of the federal government's General Revenue Sharing program, a steady decline in federal aid (in constant dollars) to states and local governments, and the impact of the *Federal Tax Reform Act of 1986*, which lowered federal personal income tax rates and ended the deductibility of state and local sales taxes. The combined effect of these developments may cause state and local governments that had previously been reluctant to consider authorizing local income taxes to reconsider their adoption. However, as the ACIR poll suggests, a local income tax is not popular as a new source of revenue.

In states and localities considering its adoption, the issues that are consistently most difficult to resolve are the base (earned income or all income), the taxation of nonresidents, the appropriate rate, the types of

jurisdictions to be allowed to use the tax, and whether use of a local income tax should be linked to reductions in property taxes. Those states that have authorized localities to use this tax have resolved these questions in a variety of ways. With declining federal aid and changes in federal tax law, other local governments may be led to explore the local income or payroll tax as one of several potential revenue sources in the last decade of the century.



Notes

[1] Rodgers, James D., "Sales Taxes, Income Taxes, and Other Nonproperty Revenues, " in J. Richard Aronson and Eli Schwartz, eds., *Management Policies in Local Government Finance*, Third Edition (Washington, DC: International City Management Association, 1987), p. 229.

[2] U.S. Advisory Commission on Intergovernmental Relations (ACIR), *Significant Features of Fiscal Federalism, 1988 Edition*, Volume I, M-155 (Washington, DC: ACIR, 1988), Tables 19 (local income taxes) and 20 (local payroll taxes).

[3] ACIR, *Significant Features of Fiscal Federalism, 1988 Edition*, Volumes I and II, M-155/M-155 II, Table 62.3.

[4] Ibid., (M-155 II) p. 54. Property taxes accounted for 74.0% of local tax collections; general and selective sales taxes, for 15.6%; local income taxes for 5.9%; and all other taxes for 4.5%. Local tax revenues refers only to revenues raised through local taxes, not by any other means. If all general revenue (which includes nontax sources) is examined (Ibid., p. 48), for FY 1986 local income taxes at 1.8% are below state aid, property taxes, all user charges, miscellaneous general revenue, federal aid, general sales taxes, and other taxes.

[5] For a description of key features of local income taxes, see ACIR, *Significant Features, 1988 Edition*, Volume I; and Rodgers, "Sales Taxes, Income Taxes, and Other Nonproperty Revenues," pp. 229-59. Current information on local income taxes is available in Commerce Clearing House, *State Tax Reporter* (Chicago: Commerce Clearing House, various years).

[6] For a description of the payroll taxes used in California and Oregon, see Carolyn Sherwood-Call, "The Labor Tax as an Alternative Revenue Source," *Proceedings of the Seventy-Ninth Annual Conference* (Columbus, OH: National Tax Association, 1986), pp. 86-93.

[7] Washington, DC, uses a similar tax, but for purposes of this study it is considered a state rather than a city.

[8] Rodgers, p. 258.

[9] Merriman, David, *The Control of Municipal Budgets: Toward the Effective Design of Tax and Expenditure Limitations*. (New York: Quorum Books, 1987), pp. 20-23.

[10] Rodgers, p. 244.

[11] *ACIR, Significant Features, 1988 Edition*, Volume I, Table 19, p. 46.

LOCAL SALES AND INCOME TAXES: HOW MUCH ARE THEY USED? SHOULD THEY BE MORE WIDESPREAD?

Steven D. Gold, Director
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National Conference of State Legislatures

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SUMMARY

1. The property tax accounts for more than three quarters of local tax revenue, but that proportion has been decreasing. Nonproperty taxes rose from 13.4 percent of local tax revenue in 1967 to 24.1 percent in 1980. For municipalities, nonproperty taxes account for 46 percent of tax revenue, but other types of local government rely on these taxes to a smaller degree.

2. Reliance on nonproperty taxes varies widely from state to state. Within states, large cities and counties are much more likely to employ them than smaller cities.

3. In states where local sales and income taxes are not used, it is usually because states do not authorize them.

4. A requirement for voter approval of the imposition of sales and income taxes reduces the extent to which they are used.

5. Where the maximum tax rate allowed is low, most local governments with the tax levy the maximum rate. When the maximum is above two percent, the proportion of governments levying the maximum rate declines.

6. The number of jurisdictions levying sales taxes increased more than those levying income taxes between 1976 and 1981.

7. The U.S. Advisory Commission on Intergovernmental Relations advocates increased use of local sales and income taxes provided that they are designed in a certain manner. The Commission suggests that taxes should be supplements to state income or sales taxes, state administered and collected, used universally or widely within a state, and with some local flexibility to establish rates within state-imposed limits. Some method should be established to reduce fiscal disparities.

8. Arguments in favor of use of these taxes include the unpopularity of the property tax, their ability to tax commuters in central cities either as shoppers or workers, their relatively high elasticity, and perhaps their fairness in comparison with the property tax.

9. Disadvantages of these taxes include the unevenness of the distribution of taxable sales and income among local jurisdictions and their possible effect in influencing business and individual location decisions. Adoption of ACIR's safeguards tends to mitigate these disadvantages.

10. Substitution of a sales or income tax for a property tax tends to shift the tax burden from homeowners to renters and away from businesses.

Local governments generally have the power to tax only to the extent that state governments grant them that power. Traditionally local governments have relied on the property tax as their major revenue source, but during the past 35 years a considerable amount of revenue diversification has taken place. With many local governments experiencing fiscal stress, they frequently call upon their states to grant them greater flexibility in raising revenue. This is the second of two reports examining the state role in expanding revenue sources available to local governments.

This report is divided into four parts: (1) the characteristics of local sales and income taxes; (2) the extent to which local nonproperty taxes are currently used in each state and how much their use has already expanded; (3) the major considerations in designing local sales and income taxes; and (4) the advantages and disadvantages of the most important local nonproperty taxes, the income tax and the sales tax.

A companion report, How State Governments Can Assist Local Governments to Raise More Revenue, deals with other local taxes--such as on hotel and motel bills, utilities, and cigarettes--and the treatment of tax exempt property.

States are not responsible for all local fiscal problems. Local governments can increase revenue by raising tax rates, increasing user charges and fees, by creative financing, and by other means. Local political and administrative conditions may constrain localities in these areas more than state restrictions. These reports are concerned only with state barriers to local use of alternative revenue sources.

This report does not advocate adoption of any particular revenue source. It is intended as a guide for legislators in considering this subject. Although the focus is primarily on cities and counties, much of the analysis also can be applied to school districts.

1. Description of local sales and income taxes

Local income taxes take varied forms. The oldest are really payroll taxes since they do not cover non-labor income such as interest, dividends, and capital gains. Some of the newer taxes are broader in their coverage, since they tax income as it is defined for state and federal income tax purposes. Usually these taxes are levied in the place of work, so a city or county can tax commuters who work but do not live in their jurisdictions; frequently the place of residence shares in the revenue with the place of work, and in some cases it receives all of the revenue.

Most income taxes, including all of the older ones, are collected by the local government itself. Some of the more recent taxes are "piggybacked" on the state income tax, so that the state handles collections and returns the revenue to the locality levying the tax.

Most local income taxes are levied at a uniform rate with no exemptions or deductions, but there are exceptions. The most common tax rate is 1 percent, but it may be as low as 1/4 percent or as high as 4.3 percent.

Local sales taxes are easier to describe. They are usually levied on substantially the same goods and services as a state's general sales tax. They are usually collected with the state sales tax and returned to the city or county where the sale took place; in some states, however, they are locally administered or the revenue goes to the location where the product is delivered. The most common sales tax rate is 1 percent; localities may or may not have discretion to set the tax rate.

2. The anatomy of local revenue

Table 1 describes the sources of local revenue in 1980 and three earlier periods. The property tax is the largest single source of revenue other than

Table 1

SOURCES OF LOCAL REVENUE, VARIOUS YEARS

(billions of dollars)

Types of Revenue	1979-80	1976-77	1970-71	1957
General Revenue	$232.453	$178.979	$91.964	$25.531
Federal and state aid	102.425	76.948	34.472	7.664
Federal aid	21.136	16.637	3.391	0.343
State aid	81.289	60.311	31.081	7.321
Revenue from Own Sources	130.027	102.031	57.491	17.886
Taxes	86.387	74.794	43.434	14.286
Property	65.607	60.275	36.726	12.385
Income	4.990	3.752	1.747	0.191
General Sales	8.160	5.417	2.339	1.031
Selective Sales	3.912	2.815	1.323	
Other	3.330	2.534	1.298	0.679
Current Charges	27.828	18.977	9.819	
Miscellaneous Revenue	15.812	8.259	4.239	3.580
Utility and Liquor Store Revenues	21.490	15.559	7.545	3.062

Source: U.S. Census Bureau, Governmental Finances in 1979-80, 1976-77, 1970-71; U.S. Census Bureau, 1972 Census of Governments, vol. 6, no. 4: Historical Statistics on Government Finances and Employment.

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state aid. It accounts for more than three-fourths of local tax revenue, half of all locally-raised general revenue, and about one fourth of total general revenue from all sources. The general sales tax is the largest of the nonproperty taxes, followed by the income tax. Current charges (for example, for refuse collection, licenses and permits, and hospital services) are a significantly greater revenue source than either of these taxes.

The property tax is much less dominant in the local revenue picture than it was previously, as Table 2 demonstrates. In 1980 nonproperty taxes represented 24.1 percent of local tax revenue vs. only 19.4 percent three years earlier and 13.4 percent in 1967. This table also shows that municipalities are more dependent on nonproperty taxes than are other types of local governments and that school districts employ these taxes less than other localities.

Reliance on these taxes varies widely from state to state, as the next two tables indicate. Table 3 reveals tremendous differences in the composition of local tax revenue. The states with the heaviest reliance on local income taxes are Kentucky, Maryland, Pennsylvania, and Ohio. Local sales taxes account for the highest proportion of tax revenue in Louisiana, Oklahoma, Alabama, Colorado, Tennessee, California, Alaska, and New York. Local sales taxes are used in 26 states, local income taxes in 14 states, and neither is used in 15 states. This tabulation includes five states (New York, Missouri, Ohio, Alabama, and California) in which both are used. These figures include the recent limited use of income taxation in four states which the Census Bureau does not reflect in its reports. Single governments in California (San Francisco), and New Jersey (Newark), and three governments in Oregon (two transit districts and Portland) levy taxes on business payrolls which are equivalent to many other local payroll taxes. (San Francisco and Newark

Table 2

IMPORTANCE OF LOCAL NONPROPERTY TAXES, VARIOUS YEARS

(percent of total)

Type of Government	Local Nonproperty Tax Revenue Relative to:	Year 1979-80	1976-77	1971-72	1966-67	1962	1957
All local governments	Local tax revenue	24.1	19.4	16.5	13.4	12.3	13.3
	Local general revenue from own sources	16.0	14.2	12.5	10.2	9.7	10.6
	All local general revenue	8.9	8.1	7.8	6.7	6.7	7.5
Counties	Local tax revenue	24.0	18.8	14.4	7.9	6.5	6.3
	Local general revenue from own sources	15.1	13.1	10.6	6.0	5.2	5.1
	All local general revenue	8.3	7.2	6.1	3.6	3.2	3.2
Municipalities	Local tax revenue	46.1	39.9	35.7	30.0	26.8	27.3
	Local general revenue from own sources	30.1	28.3	25.9	22.2	20.3	21.4
	All local general revenue	18.9	17.1	17.3	16.4	16.2	17.4
Townships	Local tax revenue	10.0	8.3	6.6	7.2	6.7	6.4
	Local general revenue from own sources	8.4	7.3	5.8	6.4	6.1	5.8
	All local general revenue	5.9	5.2	4.5	4.8	4.7	4.4
School districts	Local tax revenue	3.9	2.5	1.9	1.6	1.4	1.4
	Local general revenue from own sources	3.2	2.2	1.7	1.4	1.2	1.2
	All local general revenue	1.4	1.2	0.9	0.8	0.7	0.7

Source: 1976-77 and 1979-80: U.S. Census Bureau, Governmental Finances in 1979-80, and 1976-77; previous years: Robert D. Reischauer, "In Defense of the Property Tax: The Case against An Increased Reliance on Local Non-property Taxes," Proceedings of the Conference on Taxation: 1974 (Columbus, Ohio: National Tax Association, 1975), p. 290.

TABLE 3

LOCAL PROPERTY, SALES, AND INCOME TAXES AS A PROPORTION OF LOCAL TAX REVENUE, 1980

State	Percent of total tax revenue		
	Property Tax	Sales Tax	Income Tax
Less than 60% property tax (4 states)			
Alabama	39.0%	31.1%	4.3%
Kentucky	56.6		32.0
Louisiana	41.0	49.7	
Maryland	59.8		29.6
60-80% property tax (17 states)			
Arizona	79.1	15.4	
California	69.2	17.6	
Colorado	69.3	24.6	
Georgia	72.9	14.6	
Hawaii	74.9		
Illinois	77.1	10.1	
Missouri	64.2	14.1	6.8
Nevada	61.1	9.6	
New Mexico	74.0	13.1	
New York	64.9	16.8	12.6
Ohio	72.7	3.8	20.2
Oklahoma	63.2	31.2	
Pennsylvania	63.6		22.6
Tennessee	64.3	24.1	
Utah	77.7	16.0	
Virginia	67.5	11.3	
Washington	62.4	13.7	
80-90% property tax (10 states)			
Alaska	80.3	17.4	
Delaware	87.2		9.2
Florida	81.4		
New Jersey	87.5		
North Carolina	81.1	16.6	
Oregon	89.7		
South Dakota	88.5	6.9	
Texas	83.5	10.2	
West Virginia	80.1		
Wyoming	87.3	10.5	

State	Property Tax	Sales Tax	Income Tax
At least 90% property tax (19 states)			
Arkansas	90.1	0.3	
Connecticut	98.9		
Idaho	96.4		
Indiana	95.0		3.9
Iowa	97.9		
Kansas	92.0	2.8	
Maine	99.4		
Massachusetts	99.3		
Michigan	92.3		5.3
Minnesota	95.3	0.3	
Mississippi	94.1		
Montana	96.9		
Nebraska	90.1	5.8	
New Hampshire	98.3		
North Dakota	95.7		
Rhode Island	99.0		
South Carolina	92.6		
Vermont	99.3		
Wisconsin	98.4		

Note: Taxes other than on property, sales, and income are not shown. For information on those taxes, see Steven Gold, "How State Governments Can Assist Local Governments to Raise More Revenue."

Source: Unpublished tabulation by the U.S. Census Bureau.

relied on home rule powers, and did not have specific authorization from their state governments to levy these taxes.) Approximately 30 small Iowa school districts levy supplements to the state income tax.

There are pronounced regional differences in use of local sales and income taxes. The sales tax is heavily used in the South and West. Nineteen of the 24 states west of the Mississippi use a sales tax, but only four use an income tax (and to a very limited extent). The income tax is most heavily used in the Middle Atlantic and North Central states. New England is unique in that not a single state permits either a local sales or income tax.

Local income taxes are usually levied by cities, but reliance on sales taxes varies more. In half of the sales tax states, both cities and counties use them, and in eight states transit districts also levy them.

Among the 45 largest cities in the country, 24 levied a sales tax and 12 an income tax in 1980. New York City, St. Louis, and Kansas City are the only cities to levy both taxes. This tabulation is perhaps somewhat misleading because twelve of the largest cities are in California and Texas, where local sales taxes are universal. Cities which levy an income tax tend to rely more heavily on it than do cities which levy a sales tax, as Table 4 and Appendix Tables A and B show. Tulsa and Oklahoma City are the only cities to obtain more than 60 percent of their tax revenue from the sales tax, while six cities (Cincinnati, Cleveland, Columbus, Louisville, Philadelphia, and Toledo) derive more than 60 percent of their tax revenue from the income tax.

Local sales and income taxes tend to be used much more frequently by large cities and counties than by smaller units of government. As indicated above, nearly three quarters of the 45 largest cities in the country levy one of these taxes, a much higher proportion than for smaller cities. In 1980, these large cities accounted for approximately 80 percent of sales and income tax

Table 4

PROPORTION OF TOTAL TAX REVENUE FROM LOCAL SALES OR INCOME TAX, FORTY-FIVE LARGEST CITIES, 1979-80

Proportion of Tax Revenue (Percent)	Number of Cities	
	Sales Tax	Income Tax
None	21	33
Under 20	6	0
20-39.9	11	6
40-59.9	5	0
Over 60	2	6
Total	45	45

Source: Appendix

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revenue for all cities in the country, although they collected only 43 percent of all city property tax revenue.

To summarize, local sales taxes are used in more states than income taxes, but income taxes tend to account for a larger proportion of revenue for cities which use them. Both are used more heavily by large units of local government than by smaller ones.

3. Use of local sales and income taxes in relation to state enabling legislation

The preceding section raises an interesting question: to what extent do local governments have unutilized capacity within existing law to raise additional revenue from income and sales taxes? In other words, are state governments holding back local revenue or is it taxpayer resistance or some other factor which keeps localities from fully using local sales and income taxes?

Clearly in many states it is a state restriction which denies local governments these revenue sources. In most states where these taxes are not used it is because the state does not authorize them. But there are some states where these taxes are authorized and unused, while elsewhere they are used by only a fraction of eligible localities or at tax rates below the legal maximums. This section will examine the extent to which this is the case and a subsequent report will evaluate the reasons for the "underutilization" of local sales and income taxes.

Table 5 shows the number of local governments using the sales tax in 1976, 1979, and 1981 and the proportion of eligible units of governments levying this tax in 1981. Table 6 does the same for local income taxes.

The number of jurisdictions levying a sales tax increased to some degree

Table 5

LOCAL GOVERNMENT UNITS WITH SALES TAXES, 1976, 1979, AND 1981, AND PROPORTION WITH SUCH TAXES IN 1981

State, Type of Government (voter approval needed)	1981	1979	1976	Percent of all units, 1981
Alabama				
Municipalities (No)	281	270		67%
Counties (Yes)	40	31		60
Total	321	301	265	
Alaska				
Municipalities (No)	85	86		60
Boroughs (Yes)	7	7		87
Total	92	93	86	
Arizona				
Municipalities (No)	59	39	38	84
Arkansas				
Municipalities (Yes)	2	1	1	*
California				
Municipalities (No)	381	381		92
Counties (No)	58	58		100
Transit district (No)	3	3		
Total	442	442	455	
Colorado				
Municipalities (No)	159	144		61
Counties (Yes)	23	20		37
Transit district (Yes)	1	1		
Total	183	165	121	
Georgia				
Municipalities (Yes)	3	3		*
Counties (Yes)	103	80		65
Transit district (No)	1	1		
Total	107	84	16	
Illinois				
Municipalities (No)	1256	1256		99
Counties (No)	102	102		100
Transit district (No)	1	1		
Total	1359	1359	1342	
Kansas				
Municipalities (Yes)	35	15		6
Counties (Yes)	5	5		5
Total	40	20	7	

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State, Type of Government (voter approval needed)	1981	1979	1976	Percent of all units, 1981
Louisiana				
Municipalities (Yes)	152	136		51
Parishes (Yes)	63	21		100
School districts (Yes)	n.a.	60		91[a]
Total	n.a.	217	183	
Minnesota				
Municipalities (Yes)	1	1	1	*
Missouri				
Municipalities (Yes)	332	214		36
Counties (No)	1	1		*
Transit district (Yes)	3	3		
Total	336	218	152	
Nebraska				
Municipalities (Yes)	7	4		1
Nevada				
Municipalities (No)	c	1		6[a]
Counties (No)	c	12		75[a]
Total	c	13	12	
New Mexico				
Municipalities (No)	76	93		82
Counties (Yes)	8	6		25
Total	84	99	32	
New York				
Municipalities (No)	29	25		5
Counties (No)	45	45		79
Total	74	70	68	
North Carolina				
Counties (No[b])	99	99	96	99
Ohio				
Counties (No[b])	52	50		59
Transit district (Yes)	3	1		
Total	55	51	33	
Oklahoma				
Municipalities (Yes)	398	398	356	70
South Dakota				
Municipalities (Yes)	61	46	18	20
Tennessee				
Municipalities (Yes)	11	12		2
Counties (Yes)	94	92		100
Total	105	104	115	

State, Type of Government (voter approval needed)	1981	1979	1976	Percent of all units, 1981
Texas				
Municipalities (Yes)	921	921		86
Transit district (Yes)	28	25		
Total	949	946	854	
Utah				
Municipalities (No)	n.a.	201		93[a]
Counties (No)	29	29		100
Total	n.a.	230	204	
Virginia				
Municipalities (No)	41	41		100
Counties (No)	95	95		100
Total	136	136	133	
Washington				
Municipalities (No)	264	264		99
Counties (No)	38	38		97
Total	302	302	300	
Wyoming				
Counties (Yes)	15	13	5	65
U.S. Total		5,464	4,896	

Notes: * Less than 1 percent.
a. Percentage based on 1979.
Yes: voter approval needed to impose tax
No: voter approval not needed to impose tax
No[b]: voter approval not needed to impose tax unless a specified percentage of citizens petition.
c. In 1981, Nevada replaced system of local sales taxes with a higher state sales tax, but it also created the possibility of levying new local sales taxes.
Number of government units is as of 1977.
In a small number of states, the source did not provide the exact number of units using the tax in 1981. For example, in Oklahoma it said "nearly 400" municipalities levied a sales tax. Since the actual number in 1979 was 398, in constructing the table it was assumed that no change had occurred. The same procedure was used in other cases where the approximation was very close to the actual number in 1979.

Source: U.S. Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, 1980-81 Edition, Section II. ACIR, Significant Features of Fiscal Federalism, 1979-80 Edition, Tables 78 and 80. Number of governmental units is from U.S. Census Bureau, 1977 Census of Governments, vol 1, Governmental Organization, Table 3.

Table 6

LOCAL GOVERNMENT UNITS WITH INCOME TAXES, 1976, 1979, AND 1981, AND PROPORTION WITH SUCH TAXES IN 1981

State	1981	1979	1976	Percent of all units, 1981
Alabama				
Cities	5	5	6	1
Delaware				
Cities	1	1	1	2
Indiana				
Gross income tax--				
Counties	38	37	38	42
Payroll tax--				
Counties	5			5
Cities	1			*
Iowa				
School districts	26	21	3	6
Kentucky				
Cities		59		15[a]
Counties		8		7
Total	67	67	59	
Maryland				
City	1	1	1	
Counties	23	24	23	100
Michigan				
Cities	16	16	16	19
Missouri				
Cities	2	2	2	*
New York				
City	1	1	1	*
Ohio				
Cities	n.a.	417	385	45[a]
School districts	n.a.	0	0	
Pennsylvania				
Cities, boroughs, towns townships, and school districts	n.a.	3,685	3,515	n.a.

Notes: * Less than 1 percent.
a Percentage based on 1979.
Number of governmental units is as of 1977.

Source: U.S. ACIR, Significant Features of Fiscal Federalism, 1980-81 Edition, Section II. ACIR, Significant Features of Fiscal Federalism, 1979-80 Edition, Tables 80 and 88. Number of governmental units is from U.S. Census Bureau, 1977 Census of Governments, vol. 1, Governmental Organization, Table 3.

in most states between 1976 and 1981, and by a significant number in several (Arizona, Colorado, Georgia, Kansas, Louisiana, Missouri, and South Dakota). By contrast, the number levying an income tax increased little if at all in the majority of states. Apparently barriers to adoption of the sales tax tend to weaken over time, perhaps because of increasing fiscal stress or because it takes a certain amount of time to overcome inertia. Inhibitions about imposing an income tax are more difficult to overcome.

Sales taxes tend to be adopted more broadly across a state than are income taxes. In 20 of the 26 sales tax states at least 50 percent of either cities or counties have adopted the sales tax; the only exceptions are Arkansas, Kansas, Minnesota, Missouri, Nebraska, and South Dakota. By contrast, Maryland and Pennsylvania are the only states where a very high proportion of eligible governments use the income tax. Ohio and Indiana are the only other states where more than a fifth of the jurisdictions levy this tax.

In several states not a single local government levies a sales or income tax although they are permitted to do so. Sales taxes can be imposed by counties in Florida and Wisconsin, by transit districts in Kentucky and Florida, and by certain governments in Oregon. The reason for their absence in Wisconsin is not difficult to understand: revenue from the tax must be distributed to cities and townships, with none being retained by the county which imposes the tax. Local income taxes are permitted for large cities in Arkansas, for cities and counties in Georgia, and for school districts in Ohio, but none are in force. In Georgia, cities and counties must choose between the sales and income tax: only one may be levied, and the unanimous choice until now has been the sales tax.

The requirement that voters approve the tax before it can be imposed reduces the probability that it will be widely adopted. To analyze this

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issue, cities and counties in each state authorizing the sales tax were divided into groups according to whether or not voter approval is required. In 19 of the 22 cases where voter approval was not needed, at least half of the cities or counties levied the tax. The only exceptions were New York and Nevada cities and Wisconsin counties. When voter approval is required, the results are more diverse. At least half of the localities levied the tax in only 10 of 23 cases, but in six cases one percent or less imposed the tax.[1] In three other cases, between 2 and 10 percent of localities imposed the tax, and in four cases between 10 and 50 percent levied it. Thus, requiring voter approval does not doom a local option tax but it reduces its use.

States can also restrict local governments by limiting the maximum tax rate which can be imposed. As Table 7 indicates, twenty-two of the 29 states authorizing local sales taxes limit the tax rate to two percent or less. The highest rates allowed are in Alaska (five percent), Colorado and New York (4 percent), and Alabama, Louisiana, and Oklahoma (3 percent). The table also shows whether many localities actually employ the highest rates permitted. The results are mixed. In general, the higher the maximum sales tax rate, the fewer the number of cities and counties which levy it. When one percent is the maximum, a large proportion of cities and counties set the tax rate at that level. If the tax rate is above 2 percent, only a small percentage of cities or counties set their tax rate at that level. The situation is similar for income taxes. At one percent, a large proportion of governments use the maximum rate; at higher levels, the proportion diminishes.

The description of sales and income taxes in this section is somewhat misleading in several states because all cities and counties are not necessarily treated uniformly. For example, in Minnesota, Duluth is the only city authorized to levy a sales tax, and in Missouri most cities are not

Table 7

TAX RATE LIMITS FOR LOCAL SALES TAXES
October 1, 1979

<u>5 percent (1 state)</u>
Alaska: of 86 municipalities with this tax, only 3 set rate at 5% and 1 at 4%.

<u>4 percent (2 states)</u>
Colorado: of 144 municipalities with this tax, only 4 set rate at 4% and 17 at 3%.
New York: this rate is permitted only in New York City and Yonkers. Elsewhere, 35 of 45 counties levy the maximum 3% rate.

<u>3 percent (3 states)</u>
Alabama: of 270 municipalities with this tax, only 2 set rate at 3%.
Louisiana: of 136 municipalities with this tax, the combined tax rate, including those imposed by parishes and school districts, is the maximum 3% in several.
Oklahoma: of 398 municipalities with this tax, only 16 set the rate at 3%.

<u>2 1/2 percent (1 state)</u>
Tennessee: of 92 counties with this tax, only 14 set rate at 2 1/2%.

<u>2 percent (3 states)</u>
Arizona: of 39 municipalities with this tax, only 4 set rate at 2%.
Arkansas: the only municipality with this tax set rate at 2%.
South Dakota: of 46 municipalities with this tax, only 2 set the rate at 2%.

<u>1 1/2 percent to 1 3/4 percent (3 states)</u>
California, Nevada, and Ohio.

<u>1 percent (11 states)</u>
Florida (none in effect), Georgia, Illinois[a], Kansas, Minnesota, Missouri, Nebraska[b], North Carolina, Texas, Virginia, Wyoming.

<u>Below 1 percent (5 states)</u>
Kentucky (none in effect), New Mexico, Utah, Washington, Wisconsin (none in effect).

[a]Chicago has a higher rate.

[b]Omaha has a higher rate, 1 1/2%.

Source: Same as Table 5.

permitted to impose an income tax. The small proportion of cities with the tax in these states is not a result of local decisions. Likewise, the maximum tax rate is not always uniform across a state. Although some Alaska cities and boroughs may have a combined sales tax rate of 5 percent, most may not exceed 3 percent. In New York, only Yonkers and New York City are allowed to have sales tax rates above 3 percent. In these cases state restrictions on the use of these taxes and permissable rates are more constraining than they appear from Tables 5, 6, and 7. But in most states all cities and counties are treated uniformly.

4. Issues in designing local sales and income taxes

In 1974 the U.S. Advisory Commission on Intergovernmental Relations advocated increased use of local sales and income taxes, reversing a long-standing position which was "fairly negative" toward them. The reasons for this shift are discussed in the next section of this paper, but the ACIR's recommendations rested heavily on its assumptions about how these taxes should be designed. The ACIR argued that states should:[2]

(1) Provide a uniform local tax base which conforms to that of the state if the state imposes the tax.

(2) Collect and administer the tax.

(3) Encourage widespread or universal coverage of the tax.

(4) Allow local flexibility in setting rates subject to state limits.

(5) Take steps to reduce local fiscal disparities both by means of state aid and by redistributing local revenues.

This section discusses each of these recommendations and then considers other issues in designing these taxes.

Uniform tax base and state administration. These two recommendations are designed to minimize administration and compliance costs. When a local tax is

"piggybacked" on the state tax, it is easier for taxpayers to pay the tax and the need for duplicate government administrative machinery is eliminated. Most existing local income taxes do not meet these conditions, although the taxes in Maryland, Indiana, and Iowa--among the newest local income taxes--are supplements to state taxes. The majority of local sales taxes also have bases very similar to those of the state and are administered by it.[3]

ACIR recommends that if a state does not levy the tax itself, it should designate or create a state agency to administer it on behalf of local governments. Since there are only five states without a sales tax and ten without a broad-based income tax, the "piggyback" option is feasible in the great majority of states.

Widespread coverage. ACIR proposed two ways of assuring widespread coverage:

(1) Mandating a minimum local levy and permitting counties and those cities with populations of at least 25,000 to choose a rate above this subject to a specified maximum.

(2) Giving first option to adopt the tax to the local government of widest jurisdictional reach with sharing provisions for municipal governments. The authority to adopt the tax would also be extended to cities with populations of at least 25,000 if the larger unit of general government did not adopt the tax.

The rationale for these objectives is to ameliorate two potential problems--fiscal disparities and incentives to relocate to avoid the tax. Fiscal disparities exist when local governments have widely uneven per capita tax bases. Some evidence indicates that inequalities of sales and income tax bases are even greater than inequalities of property tax bases.[4] When jurisdictions have different sales and income tax rates, shoppers and workers may have an incentive to purchase products or to be employed in the locations where the tax rates are lower.

Both of these problems are alleviated to some extent when the jurisdiction imposing the tax is large. The bigger the government unit, the smaller the

fiscal disparities because potential low-tax enclaves are swallowed up. For the same reason, incentives to relocate are less if a county imposes a tax rather than if a central city and numerous suburbs each have their own differing tax rates because the average distance to avoid the higher tax rate increases as the jurisdiction imposing the tax becomes larger.[5]

Rate flexibility within state limits. This recommendation is a compromise. If the local tax rate is completely uniform, then the tax is essentially a state tax with revenue returned to its place of origin. A strong argument can be made that the revenue from a state tax should be redistributed in some fashion in order to help communities with small tax bases. Besides, many believe that cities or counties with a strong demand for services should be allowed to tax themselves so that they can finance those services. On the other hand, it is widely assumed that if tax rates vary too much, then locational decisions are likely to be seriously distorted.

Use aid to reduce fiscal disparities. In its 1974 report, the ACIR noted that five states had adopted provisions to reduce sales tax revenue within counties (Kansas, Nevada, New York, North Carolina, and Tennessee) but that no state had equalization programs for sales or income taxes among counties. It pointed out that equalization programs which simply brought all jurisdictions up to the statewide average for per capita sales or income tax revenue "need not be particularly expensive" for the state. In Virginia, the 1972 cost of such a program for the sales tax would have been only $18.4 million, and in Maryland it would have been $28.3 million for the income tax.

Other income tax design issues. If a state follows the ACIR's advice and makes its local income tax a supplement to the state income tax, most of its design problems are settled. If, however, the tax is not piggybacked on state tax, a host of decisions must be made about the structure of the income tax.

If it is only on labor income, the tax is regressive, that is, it represents a larger proportion of income for the poor than the rich. This is because other forms of income such as interest, dividends, and capital gains are a much larger proportion of income for high income households than for others.

A second issue is whether to allow personal exemptions, deductions, and/or credits such as are found in most state income taxes and the federal income tax. Such provisions "fine tune" the tax in the eyes of their advocates, but they introduce inequities according to others. They also complicate administration and compliance of the tax and reduce the revenue from it for a given tax rate. The great majority of locally-administered income taxes do not permit exemptions and deductions; the taxes in 16 Michigan cities and New York City are exceptions.

Whether tax rates should be higher for high income households than for others is another issue. New York City is the only locally-administered tax that has graduated rates, but states with "piggyback" income taxes may have progressive rates if the state income tax is progressive. In other words, a local tax which is a uniform percentage of a progressive state tax is itself progressive.

The final issue in designing an income tax is how nonresidents should be treated. An attraction of this tax for central cities is that it offers a means of obtaining revenue from commuters. The treatment of nonresidents varies widely. Usually workers must pay tax where they are employed if their home government does not levy the tax. If both have an income tax, the revenue is usually divided between the two governments. In New York, Michigan cities, and Indiana counties nonresidents are taxed at a lower rate than resident workers. In Maryland and Iowa the tax goes entirely to the place of residence.

Other sales tax design issues. As noted above, the sales tax entails fewer decisions about how it should be designed than does the income tax. The three most important issues are whether the tax should be state-administered, whether the nexus for tax liability should be the location of the seller or the place of delivery, and how taxable sales should be defined.

All but four states in which local sales taxes are imposed provide for either mandatory or voluntary state administration and collection. Most localities opt for the state when given a choice.

Most authorities, including the ACIR, recommend that the sales tax be paid according to where the purchase takes place in order to facilitate recordkeeping, but this procedure exacerbates fiscal disparities because it favors jurisdictions with many retailers. Most states do base the tax on the location of the seller.

The definition of taxable sales is usually the same for the local tax as for the state sales tax. One disadvantage of this procedure is that if the state decided to exempt food or other products, localities may lose substantial revenue along with the state. In rare cases, local governments may continue to tax food even though the state does not.

5. Advantages and disadvantages

Much has been written about the advantages and disadvantages of local income and sales taxes. An assessment of them is complicated for several reasons:

- there are significant differences among the various kinds of local income taxes;
- sales and income taxes have to be compared to each other, to the property tax, to user charges, and to increased state aid as means of financing local services;

- one of the major alternatives to these taxes, the property tax, differs greatly from place to place in terms of how it operates;
- a state's own tax system, the tax systems of neighboring states, and a state's local governmental structure all affect how well local sales and income taxes will operate.

No simple, universal judgment about these taxes is possible.

Advantages

One of the ACIR's main reasons in 1974 for advocating these taxes is still valid: the unpopularity of the property tax. Polls have consistently shown that citizens prefer that their local government obtain additional revenue from the sales tax rather than from the property tax. The latest survey, conducted for ACIR in 1981, found that 21 percent of the public favored using a local sales tax compared to only 5 percent who preferred a property tax. The local income tax was favored by only 7 percent, not significantly more than the support for the property tax. (Incidentally, charges for specific services was the most popular alternative, drawing support from 55 percent of those surveyed.)[6]

Doubters may question whether respondents in these polls are completely rational. They speculate that much of the popularity of the sales tax stems from its pay-as-you-go nature, with taxpayers never adding up the total burden of the sales tax. The property tax, on the other hand, is announced to the household in the form of a total annual bill, which often must be paid in two big installments. In other words, the taxpayer's awareness of the property tax is much higher than of local sales or income taxes.

However, taxpayer attitudes in favor of the sales tax and against the property tax seem deeply entrenched. Local governments have to live with these attitudes, so it can be regarded as self-defeating for them to continue to rely on the property tax as their major revenue source. If taxpayers

prefer local sales or income taxes, as surveys consistently show, this is a strong argument in their favor.

A subsidiary question is whether nonproperty taxes substitute for or supplement property taxes--do they provide property tax relief or simply lead to higher government expenditures? It seems clear that, on the average, these taxes are associated with lower property tax levels, but they also often finance higher spending. In other words, the revenue from these taxes is divided between property tax relief and maintenance of local spending.[7]

A second important argument in favor of these taxes is that they enable central cities to obtain revenue from nonresidents who shop and work within their borders. Since these commuters undoubtedly add to a city's financial burdens, it is reasonable that they should contribute to the city's revenue. In extreme cases, such as Cleveland, the majority of a city's income tax revenue comes from commuters.

A third consideration which sometimes favors the income and sales taxes is their elasticity, that is, the responsiveness of their revenue to inflation and economic growth. In some cases, the property tax is very inelastic, either because of the way it is administered or because of the slow growth of property values. The elasticity of the property tax varies considerably among cities; it is especially low in declining cities and places where assessments are seldom adjusted and state-imposed tax limits constrain tax rate increases. In such places, the sales or income tax is useful because its revenue tends to increase annually, if only due to inflation.[8]

A final argument supporting these taxes is more controversial; some politicians and economists consider them to be fairer than the property tax. Whether this is true is debatable. The sales tax is regressive, but much less so if food is exempt or if taxpayers receive an income tax credit for it; the

payroll tax is regressive as well, but a local income tax which is piggybacked on a progressive state income tax is itself progressive; and the incidence of the property tax is unsettled and varies from city to city depending on how it is structured. Most studies suggest that the incidence of the property tax is U-shaped, that is, regressive at low income levels and progressive at high income levels. The question is whether the progressive or regressive portions dominate.[9]

Another aspect of fairness is whether the taxes treat equally well-off households in a uniform fashion. It is not fair for family A to pay more tax than family B when they have the same income, wealth, and number of children. All taxes violate this principle of horizontal equity, but the property tax as actually administered may do more violence to horizontal equity than the sales or income tax. One thing is certain: reducing reliance on the property tax tends to shift the tax burden from homeowers to renters.

The fairness issue is further complicated by the fact that these taxes affect the division of taxes between households and businesses. In urban areas approximately half of the property is frequently paid initially by business, but the proportion of the sales tax paid by business is considerably less, and none of the income tax may fall on business. Even if a business income tax does accompany the personal income tax, the business share of the total is generally considerably less than the business share of the property tax.[10] Depending on the nature of the city's economy, a large share of the business property tax may be exported to nonresidents of the local community, so substituting a sales or income tax for the property tax is likely to increase the locally-borne tax burden. Beyond this, a portion of the business property tax is likely to be shifted to local consumers through price increases and another portion is likely to be borne by property owners. The

fairness issue is not a simple one.

Disadvantages

Two of the major disadvantages of these taxes have already been mentioned in the previous section--the fiscal disparities produced by them and their effect on location decisions. If a state follows the ACIR's recommendations, these disadvantages can be mitigated. Encouraging widepread use of these taxes with tax rates allowed to vary within only a limited range and providing a mechanism for reducing fiscal disparities makes the sales and income tax much less objectionable. In fact, the ACIR's advocacy of them is predicated on such actions.

Tax rate differences will cause significant locational distortions only if there is a sizable gap in tax rates between neighboring governmental units. A 1 percent rate is unlikely to cause a serious flight of business from one jurisdiction to another; even a 2 percent differential may cause serious problems, but with larger tax rate differences, difficulties may arise, especially if the governmental units are relatively small. Still, a city may choose to accept the loss of some businesses as the price it must pay to obtain sufficient revenue to maintain the desired level of services.

Other disadvantages of these taxes appear to be less important than their possible locational effects and the fiscal disparities associated with them. At one time an argument in their favor was that property taxes were high and rising, but thanks to expanded state aid and other property tax relief programs, effective property tax rates are much lower now than they were a decade ago. Another weak argument is that administrative and compliance costs are greater for these taxes than for simply raising the property tax. This is true, but the costs of administering these taxes are low compared to the revenue they raise, especially if the state administers them. A third claim

is that revenue from these taxes is less stable than that of the property tax. In a recession revenue may fall below the projections on which budgets were based. This is true, but the problem is not as serious as in the days before inflation reached high levels. In these inflationary times, revenue from the sales and income tax tends to go up year after year, even during moderate recessions.[11] Finally, local sales and income taxes have been viewed as threats to local government autonomy because of the strings which the state may place on them. This complaint is seldom heard any more, since local autonomy is not perceived to have been reduced in many places which have adopted local sales and income taxes.

Summary of advantages and disadvantages

Strong arguments can be made both for and against these taxes, but the strength of the negative considerations can be reduced through adoption of safeguards such as the ACIR proposed. As one advocate of local sales and income taxes wrote, "It is difficult to find any reason for its (the property tax's) fiscal preeminence."[12]

Rather than permit local sales and income taxes, some state officials favor raising state taxes and using the revenue to increase local aid. Such a policy could target funds to where they are most needed rather than to the places which happen to have the largest fiscal capacity, which local taxes help the most. On the other hand, many state governments are finding it difficult to maintain existing state services, so they are reluctant to raise taxes to aid local governments. In addition, many theoreticians and politicians believe it is best if the government which spends the money has to raise the funds itself. According to this conservative viewpoint, accountability is less when the relation between the pain of raising revenue

is separated from the pleasure of spending it.

6. Conclusion

Local sales and income taxes are already widely used, but their importance could be much greater. This report has reviewed the extent of their use, choices to be faced in designing them, and their advantages and disadvantages. With both state and local governments scrapping desperately for additional revenue, it would not be surprising if local sales and income taxes continued to increase in importance on the fiscal landscape of the 1980s.

Appendix Table A

RELATIVE IMPORTANCE OF LOCAL SALES TAX IN INDIVIDUAL CITY TAX STRUCTURES: 1972, 1977, and 1980

City	Percentage of Tax Revenue City 1980	1977	1972
Austin	27.9	24.3	23.7
Buffalo	0	0	7.2
Chicago	15.1	14.1	14.1
Dallas	25.2	20.5	19.6
Denver	46.4	25.8	22.3
El Paso	27.0	25.2	23.7
Fort Worth	28.2	25.8	25.0
Houston	27.6	17.5	5.6
Kansas City	18.1	19.8	22.5
Long Beach	28.2	19.5	19.5
Los Angeles	25.4	23.1	22.4
Nashville-Davidson	25.3	44.8	41.3
New Orleans	41.5	14.4	13.6
New York	17.0	14.4	13.6
Oakland	26.0	19.7	22.1
Oklahoma City	61.3	53.7	37.8
Omaha	42.2	29.8	26.6
Phoenix	45.1	43.5	39.1
St. Louis	19.0	17.5	11.8
San Antonio	33.8	29.6	26.6
San Diego	41.4	31.1	29.2
San Francisco	14.5	9.8	13.3
San Jose	29.7	24.1	23.5
Seattle	18.5	16.2	14.4
Tulsa	72.7	65.7	55.5

Note: Cities included are those with population of at least 300,000 in 1976.

Source: U.S. Census Bureau, City Government Finances in 1980, and previous years.

Appendix Table B

RELATIVE IMPORTANCE OF LOCAL INCOME TAX IN INDIVIDUAL CITY TAX STRUCTURES: 1972, 1977, and 1980

City	Percentage of Tax Revenue		
	1980	1977	1972
Baltimore	21.7	25.3	14.2
Cincinnati	71.9	65.8	57.7
Cleveland	65.2	55.8	47.8
Columbus	84.1	82.7	78.2
Detroit	38.4	37.7	35.1
Kansas City	32.4	31.6	37.0
Louisville	63.1	61.8	55.0
New York	25.4	22.2	21.0
Philadelphia	65.9	64.3	62.6
Pittsburgh	20.4	15.8	16.9
St. Louis	29.3	27.9	29.4
Toledo	78.8	80.0	74.9

Source: U.S. Census Bureau, *City Government Finances in 1980*, and previous years.

Footnotes

This report is an extension of an analysis of these taxes in Steven D. Gold, Property Tax Relief (Lexington, Mass.: D.C. Heath, 1979), ch. 10. More detailed references can be found in that work.

[1]The ten cases where the tax was adopted widely are Alabama counties, Alaska boroughs, Georgia counties, Louisiana cities, parishes, and school districts, Oklahoma cities, Tennessee counties, Texas cities, and Wyoming counties. On the other hand, the six cases where the tax is hardly used at all are the Arkansas cities, Florida counties, Georgia cities, Minnesota cities, Missouri counties, and Nebraska cities.

[2]U.S. Advisory Commission on Intergovernmental Relations (ACIR), Local Revenue Diversification: Income, Sales Taxes and User Charges (1974), pp. 2-4.

[3]For a very good discussion of state vs. local administration of the local sales tax, see John L. Mikesell, "Local Revenue Diversification through Sales Taxation--A Comparison of State and Local Administration," Proceedings of the Seventy-fourth Conference on Taxation (National Tax Association-Tax Institute of America, 1982).

[4]See, e.g., John H. Bowman and John L. Mikesell, "Fiscal Disparities and Major Local-nonproperty Taxes: Evidence from Revenue Diversification in Indiana, Maryland, Ohio, and Virginia," Proceedings of the Seventieth Conference on Taxation of the National Tax Association, 1977, pp. 412-14; John H. Bowman and John L. Mikesell, "Revenue Diversification within Metropolitan Areas: Effect on Disparities and Central City-Suburban Fiscal Relations," American Journal of Economics and Sociology (1980); Robert D. Reischauer, "In Defense of the Property Tax: The Case Against Increased Reliance on Local Non-property Taxes", Proceedings of the Conference on Taxation: 1974, pp. 300-305.

[5]One of the best analyses of this issue concluded that a one percent increase in the ratio of the city sales tax relative to the sales tax in the surrounding area will cause per capita retail sales to be between 1.69 and 10.97 percent lower than they otherwise would be. John L. Mikesell, "Central Cities and Sales Tax Rate Differentials: The Border City Problem", National Tax Journal xxxiii (June, 1970), p. 213.

[6]ACIR, Changing Public Attitudes on Governments and Taxes: 1981 (Washington, D.C., 1981), p. 7.

[7]Gold, Property Tax Relief, pp. 205-07.

[8]George. E. Peterson, et. al, Urban Fiscal Monitoring (Washington, D.C.: The Urban Institute, 1979), chapters 2-3.

[9]Gold, Property Tax Relief, pp. 23-25, 208-11.

[10] The income taxes in Pennsylvania, Ohio, and Kentucky apply to the net earnings of professionals and the net profits of unincorporated businesses as well as the gross earnings of individuals. Elsewhere, local corporation income taxes occasionally accompany local individual income taxes. See Gold, Property Tax Relief, p. 210; Thomas Muller, Growing and Declining Urban Areas: A Fiscal Comparison (Washington, D.C.: The Urban Institute, 1976), pp. 65-66. 115; and R. Stafford Smith, Local Income Taxes: Economic Effects and Equity (Berkeley: Institute of Governmental Studies, 1972, ch. 2, 3.

[11] Gold, Property Tax Relief, pp. 214, 222; and William B. Neenan, The Political Economy of Urban Areas (Chicago: Markham, 1972), pp. 322-33. In extraordinary situations, such as the recent very depressed conditions in certain Michigan cities, revenue may fall, but in general inflation tends to raise revenue from these taxes.

[12] L. R. Gabler, "A Reconsideration of Local Sales and Income Taxes," Proceedings of the Sixty-seventh Annual Conference of the National Tax Association (1974), p. 281.

Kansas Legislative Research Department June 16, 1981

MEMORANDUM

LOCAL INCOME OR EARNINGS TAXES

Cities

City Home Rule. Article 12, Section 5 of the constitution, approved in the 1960 general election, became effective July 1, 1961. It includes authority, with some limitation, to levy taxes and other charges. The amendment authorizes the Legislature to limit or prohibit taxes, excises, fees, charges and other exactions by enactment applicable uniformly to all cities or to all cities in one of not more than three classes.

Procedure for levying taxes is set forth in K.S.A. 1979 Supp. 12-137 et seq. (first enacted in 1961): ordinance by two-thirds vote; publication; referendum on petition by 10 percent of number of electors who last voted.

Limit: K.S.A. 12-140 (also enacted in 1961) prohibits cities from levying and collecting taxes on income from whatever source derived.

Example: In Hampton v. City of Wichita, 192 Kan. 534 (1964), the Kansas Supreme Court upheld a city's ability to impose an occupation tax under its home rule powers.

Counties

County Home Rule. Statutory home rule power for counties is contained in K.S.A. 19-101 et seq. K.S.A. 19-101a "(a) Counties are hereby empowered to transact all county business and perform such powers of local legislation and administration as they deem appropriate, subject only to the following limitations . . . ."

Limits: K.S.A. 19-101a was amended by the 1980 Legislature to provide that "counties shall have no power to levy and collect taxes on incomes from whatever source derived." (subsection (a) thirteenth).

Other limits on a county's home rule taxing powers are contained in the following subsections of K.S.A. 19-101(a):

> Eighth: Counties are subject to the limitations set by the legislature regarding the imposition of retailers' sales taxes.
>
> Tenth: No county may levy property taxes on a redevelopment area without specifying that a portion of that tax money be used to help pay for bonds issued under the tax increment finance law.
>
> Eleventh: Counties are subject to laws pertaining to tax increment bonds.

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Summary. While the statutes do not contain a specific grant of taxing authority, a tax levy may be assumed valid unless prohibited (see A.G.O. No. 74-303 on county's power to levy taxes to commemorate the Bicentennial).

Procedure: K.S.A. 19-117 (enacted in 1977) provides the procedure "where the board of county commissioners of any county by resolution proposes to levy for revenue purposes any tax, excise, fee, charge another exaction . . . ." The procedure requires a two-thirds vote by the board, subject to referendum upon petition by 5 percent of the voters. Subsection (c) also requires the board to submit to a referendum the question of levying any tax or other revenue measure . . . upon the receipt of a petition signed by not less than 5 percent of the qualified voters of the county or upon receiving resolutions requesting such an election passed by the governing body of each of one or more cities whtin each county which contains a population of not more than 25 percent of the entire population of the county.

Local Earnings Tax

The 1970 Legislature authorized the imposition of a local earnings tax (at 2 percent rate) by cities or counties, subject to voter approval.

No taxes were enacted under this authority and the act was repealed effective April 11, 1972.

Dennis Shockley

City of Kansas City, Kansas

1990 Kansas Legislature

ISSUE #3:

Legislation to allow a local income or earnings tax subject to a vote of the people in the jurisdiction levying the tax

SUMMARY:

The City of Kansas City, Kansas, and the League of Kansas Municipalities have supported the local option earnings tax concept for several years as an alternative to an over-reliance on the property tax. The City of Kansas City, Kansas, has contended for some time that due to fundamental changes in the American economy as well as other factors, ownership of property is no longer the single measure of the ability to pay taxes. A tax based directly on income or earnings is a much fairer tax because, under such a tax, no payment is due unless the taxpayer actually received income during the taxable period.

The local option earnings tax is not a new idea. Several states allow it and, in fact, Kansas allowed cities to enact the tax between 1970 and 1972 because the local option earnings tax was provided in the original Kansas tax lid law. During those robust economic years, however, no city opted for it (1970 Session Laws of Kansas, Ch. 402, Sec. 18; KSA 79-4427, repealed 1972 Session Laws, Ch. 380, Sec. 15, April 11).

Kansas City, Kansas, and other Kansas cities in our metropolitan area have a unique tax situation. Currently 23% of our city's workers pay a 1% earnings tax to Kansas City, Missouri where they earn their income. Kansas City, Missouri has had an earnings tax since 1964 and a 1% earnings tax since 1972. Of persons employed in Kansas City, Kansas, 53% live outside Kansas City, Kansas. Furthermore, Kansas City, Kansas, provides a metropolitan employment base for other cites and counties in two states, thus creating an overburden in demand for municipal services. We feel a fairer tax situation would be created if Kansas City, Kansas, had a voter approved earnings tax. That is why we support legislation to allow our citizens the opportunity to vote on how they are taxed. Also, in 1988 the Topeka City Council expressed an interest in such a tax.

The City of Kansas City, Kansas, believes that an earnings tax, if approved by voters and levied, would provide a more equitable tax mix for local units of government in Kansas.

The current problems with reappraisal and classification, and the tax shifts which apparently have occurred, only strengthen the City's belief that a more diversified revenue base and reducing our reliance

1/25/90
Attachment 4

ISSUE #3 (continued):

on the property tax are goals that need to be actively pursued. The City supports legislation which would permit a local option earnings tax. Further, the City proposes that the revenue generated from this tax be used on a dollar-for-dollar basis to reduce the property taxes of the city's property owners.

efficient and effective administration and enforcement thereof. Upon receipt of a certified copy of an ordinance or resolution authorizing the levy of a local retailers' sales tax, the director of revenue shall cause such taxes to be collected within the boundaries of such taxing subdivision at the same time and in the same manner provided for the collection of the state retailers' sales tax. All moneys collected by the director of revenue under the provisions of this section shall be credited to a "county and city retailers' sales tax fund" which fund is hereby established in the state treasury. Any refund due on any county or city retailers' sales tax collected pursuant to this act shall be paid out of the sales tax refund fund and reimbursed by the director of revenue from collections of local retailers' sales tax revenue. All local retailers' sales tax revenue collected from any county or city pursuant to this act shall be remitted at least quarterly by the state treasurer, on instruction from the director of revenue, to the treasurer of such county or city.

Sec. 17. All retail transactions consummated within a county or city having a retail sales tax, which transactions are subject to the Kansas retailers' sales tax, shall also be subject to such county or city retail sales tax. All retail sales, for the purpose of this act, shall be considered to have been consummated at the place of business of the retailer. In the event the place of business of a retailer is doubtful the place or places at which the retail sales are consummated for the purposes of this act shall be determined under rules and regulations adopted by the department of revenue which rules and regulations shall be considered with state and federal law insofar as applicable. Retail sales involving the use, consumption or furnishing of gas, water, electricity and heat, for the purposes of this act, shall be considered to have been consummated at the situs of the user or recipient thereof, and retail sales involving the use or furnishing of telephone service, shall be considered to have been consummated at the situs of the subscriber billed therefor. The department of revenue is hereby authorized to request and receive from any retailer or from any city or county levying the tax such information as may be reasonably necessary to determine the liability of retailers for any county or city sales tax. In all cases the collection of any county or city sales tax shall commence on the first day of the month, except in no event shall collection of a city or county sales tax begin prior to November 1, 1970, nor prior to the first day of the month next following the sixtieth day after the date of the election authorizing the levy of such tax.

Whenever any sales tax, imposed by any city or county under the provisions of this act, shall become effective, at any time prior to the time that revenue derived therefrom may be budgeted for expenditure in such year, such revenue shall be credited to the funds of the taxing subdivision or subdivisions and shall be carried forward to the credit of such funds for the ensuing budget year in the manner provided for carrying forward balances remaining in such funds at the end of a budget year.

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Sec. 18. (*a*) No city shall levy and collect taxes upon income or earnings, from whatever source derived, without first having submitted such proposition to and having received the approval of a majority of the electors voting thereon at any election authorized by section 9 of this act, except the election to be held in July, 1970, and the only such tax which may be enacted by a city is an earnings tax which conforms to the requirements of this act.

(*b*) The board of county commissioners of each county may submit the question of imposing a countywide earnings tax to the electors at any election authorized by section 9 of this act, and any such board shall submit said question upon submission of the petition provided for in said section 9.

(*c*) Any city or county proposing to adopt an earnings tax shall give notice of its intention to submit such proposition for approval by the electors in the manner required by K. S. A. 10-120 for giving notice of elections for the issuance of bonds. Said notice shall state the time of the election and the rate and effective date of the proposed tax. If a majority of the electors voting thereon at such election fail to approve the proposition, such proposition may be resubmitted under the conditions and in the manner provided in this act for submission of the proposition. If a majority of the electors voting thereon at such election shall approve the levying of such tax, the governing body of any such city or county shall provide by ordinance or resolution, as the case may be, for the levy of the tax. Any repeal of such tax, within the limits prescribed by section 14 of this act, shall be accomplished in the manner provided herein for the adoption and approval of such tax.

Sec. 19. (*a*) As used in this section, unless the context clearly requires otherwise, "earnings" means:

(1) Kansas taxable income of a resident individual, as defined by K. S. A. 79-32,116, for the same year as any city or county tax imposed;

(2) Kansas nonresident taxable income, as defined by K. S. A. 79-32,122, for the same year as any city or county tax imposed; and

(3) Kansas taxable income of a corporation, as defined by K. S. A. 79-32,138, for the same year as any city or county tax imposed.

(*b*) The rate of any earnings tax shall be two percent (2%) of an individual taxpayer's earnings and two percent (2%) of the earnings of a corporation. If a county or city adopts an earnings tax, there shall be imposed by resolution or ordinance, respectively, on every bank, trust company and savings and loan association located within such county or city a privilege tax in addition to the privilege tax imposed under K. S. A. 79-1107 and 79-1108, and any amendments thereto, at the rate of two percent (2%) according to or measured by the net income, as defined in K. S. A. 79-1109, of such bank, trust company or savings and loan association. No earnings tax shall be imposed by a county or city on any such bank, trust company or savings and loan association. The repeal of a local

earnings tax, as provided in section 18, by a county or city, shall also repeal any privilege tax imposed by such city or county hereunder. Any taxpayer's business income which is or could be subject to more than one earnings or privilege tax by cities or counties in this state shall be allocated and apportioned in the same manner and under the same limitations and conditions as provided in the uniform division of income for tax purposes act, insofar as the same can be made applicable, and under rules and regulations adopted for such purpose by the director of revenue. The total amount of any other individual taxpayer's earnings are subject to an earnings tax hereunder in the city or county of such taxpayer's residence, but only that portion of an individual taxpayer's earnings which are earned in another city or county shall be subject to the earnings tax of such other city or county. Where such individual taxpayer changes his residence, the city or county of his new residence may impose an earnings tax on the taxpayer's earnings for only that portion of the year in which he is a resident of such city or county. Any individual taxpayer, whose earnings are subject to more than one (1) local earnings tax, shall be allowed by each such taxing subdivision a credit of not to exceed fifty percent (50%) of the earnings tax due each of the other taxing subdivisions, or a credit of not to exceed fifty percent (50%) of the earnings tax due that taxing subdivision, whichever is less.

(c) Any city or county levying an earnings and privilege tax is hereby prohibited from administering or collecting any such tax locally, but shall utilize the services of the state department of revenue to administer, enforce and collect such tax. Any ordinance or resolution authorizing the levy of a city or county earnings tax shall incorporate by reference the provisions of article 32 of chapter 79 of the Kansas Statutes Annotated, and acts amendatory thereof, providing the procedure for the collection and administration of income taxes, insofar as the provisions of such law may be made applicable to a city or county earnings tax. The department of revenue is hereby authorized to adopt such rules and regulations as may be necessary to provide for the withholding by employers of any local earnings tax and may require any employer in the state of Kansas to furnish any information necessary for the administration, enforcement and collection of such tax.

(d) Upon the receipt of a certified copy of an ordinance or resolution authorizing the levy of a city or county earnings and privilege tax, the director of revenue shall cause all necessary forms to be prepared and such taxes to be collected at the same time and in the manner provided for the collection of the state income tax and privilege tax. The director of revenue is hereby authorized to administer and collect the earnings tax and privilege tax of any such city or county and to adopt such rules and regulations as may be necessary for the efficient and effective administration and enforcement thereof. The director shall credit all moneys received therefrom to a "city and county earnings and privilege tax fund,"

which fund is hereby established in the state treasury. The director of revenue shall transfer from the "city and county earnings and privilege tax fund" to the "city and county earnings and privilege tax refund fund," which fund is hereby created, an amount deemed sufficient by the director to pay any refunds due from any tax levied under the provisions of this section. All local earnings and privilege tax revenue collected from any county or city pursuant to this act shall be remitted at least quarterly by the state treasurer, on instruction from the director of revenue, to the treasurer of such county or city.

(e) Any city or county earnings and privilege tax adopted under the provisions of this act shall not become effective until January 1 next following the date of its adoption. Whenever any such tax shall become effective at any time prior to the time that revenue derived therefrom may be budgeted for expenditure in such year, such revenue shall be credited to the funds of the taxing subdivision or subdivisions and shall be carried forward to the credit of such funds for the ensuing budget year in the manner provided for carrying forward balances remaining in such funds at the end of a budget year.

Sec. 20. All revenue received by any county treasurer from a countywide earnings and privilege tax or retailers' sales tax shall be apportioned among the county and each city, school district, community junior college district, all or part of which is located in such county, in the proportion that the total tangible property tax levies made in such county in the preceding year for all funds of each such governmental unit, except bond and interest funds, bear to the total of all such levies made in the preceding year. All such moneys retained by the county shall be apportioned and paid into the several funds of the county for which tangible property taxes are levied, except bond and interest funds, in the proportion that the levy for each such fund in the preceding year bears to the total of all such levies made in the preceding year.

All such moneys apportioned to the several cities, school districts and community junior college districts of the county shall be paid to the respective treasurers thereof. Whenever the territory of any city or school district is located in two (2) or more counties and any one (1) or more of such counties do not levy a countywide earnings and privilege tax, the revenue received by such taxing subdivision from the proceeds of the countywide earnings and privilege tax shall be used for the purpose of reducing the tax levies of such subdivision upon the taxable tangible property located within the county levying such countywide earnings and privilege tax, and whenever the same circumstances exist with respect to countywide retailers' sales taxes, or whenever such counties do not levy countywide retailers' sales taxes at a uniform rate, the revenue received by such taxing subdivisions from the proceeds of the countywide retailers' sales tax shall be used for such purpose. In every other case, all revenue received by a school

district or community junior college district from the proceeds of a countywide earnings and privilege tax or retailers' sales tax and all revenue received by a city from the proceeds of a city or countywide earnings and privilege tax or retailers' sales tax shall be deposited in the general fund of such taxing subdivision.

Prior to March 1 of each year, the director of revenue shall advise each county treasurer of the revenue collected in such county from the state retailers' sales tax for the preceding calendar year, and the amount of taxable income reported for individual taxpayers in such county in the preceding calendar year.

Sec. 21. Notwithstanding the provisions of sections 15 and 18 of this act, no city shall authorize and provide for the levy of either an earnings and privilege tax or retailers' sales tax if the county in which such city is located is levying a countywide tax upon such basis. Whenever any county shall approve the levy of a countywide earnings and privilege tax or retailers' sales tax, the levy of any such tax by a city located within such county shall terminate and cease on the date fixed for the application of such countywide levy, but in no event shall such countywide tax be less than the highest rate or rates imposed by a corresponding tax of any city located within such county.

Sec. 22. (*a*) The state board of tax appeals shall not authorize the issuance of no-fund warrants by any taxing subdivision of the state under the provisions of K. S. A. 79-2938, 79-2939, 79-2941 or 79-2951, except upon the basis of a finding of extreme emergency. The term "extreme emergency" shall include but not be limited to additional costs of a school district arising out of the closing of a nonpublic school which offered any of grades 1 to 12, or the closing of a primary or secondary school operated by any institution under the jurisdiction of the state board of regents, which costs cannot be met under the provisions of this act without impairing the educational program of the school district.

(*b*) Whenever any school district or community junior college district shall appeal to the state board of tax appeals pursuant to sections 3, 10(*d*), 12 or 13 for authorization to levy ad valorem taxes or budget for operating expenses in excess of the limitations provided in this act due to the construction of new or additional facilities, the state board of tax appeals may permit any such additional ad valorem tax levies so authorized to be considered as part of the amount of taxes levied in the base year, and may permit any such additional expenditures so authorized to be considered as included within the budget of operating expenses for the fiscal year for which the appeal was made.

Sec. 23. The limitation imposed by this act on the budget for operating expenses by taxing subdivisions shall also apply to other political subdivisions of this state which do not have authority to levy taxes upon tangible property, but tax levies on their behalf are required by law to be made by a taxing subdivision, and any such tax levy which may be made, or is required by law to be made,

for such political subdivision by a taxing subdivision shall be subject to the limitation imposed on property tax levies by section 3 of this act.

Sec. 24. Any public officer or employee, as such terms are defined by K. S. A. 1969 Supp. 21-3110, who violates any of the provisions of this act shall be guilty of a class A misdemeanor and shall be subject to forfeiture of office through ouster proceedings provided by law.

Sec. 25. Any election held under the provisions of this act shall be held in accordance with the provisions of the general election law relating to question submitted elections, unless a contrary requirement is specifically provided herein.

Sec. 26. All other existing aggregate tax levy limitations prescribed by law are hereby suspended, and the limitation upon the aggregate of the tax levies of taxing subdivisions is hereby imposed under the provisions of this act.

Sec. 27. The provisions of this act shall expire on December 31, 1972, and until said date the operation of the following statutes shall be and are hereby suspended: K. S. A. 12-139, 12-140, 12-142, 79-1964, 79-1964a and 79-1964b and K. S. A. 1969 Supp. 72-7016, 72-7019, 72-7020, 72-7021, 72-7022, 72-7022a, 72-7023 and 72-7024.

Sec. 28. K. S. A. 79-2945, 79-2946, 79-2947, 79-2948, 79-2949, 79-2950, 79-2953, 79-2954, 79-2955, 79-2956 and 79-2957 are hereby repealed.

Sec. 29. This act shall take effect and be in force from and after April 1, 1970, and its publication in the official state paper.

Approved March 23, 1970.
Published in the official state paper March 27, 1970.

CHAPTER 403 *

House Bill No. 1253

AN ACT relating to taxation; providing ad valorem tax relief to certain persons over sixty-five years of age by means of income tax credits and refunds; and establishing a homestead property tax relief revolving fund for such purposes.

Be it enacted by the Legislature of the State of Kansas:

Section 1. The purpose of this act shall be to provide ad valorem tax relief to certain persons sixty-five (65) years of age and over who own their homestead, through a system of income tax credits and refunds.

Sec. 2. As used in this act, unless the context clearly indicates otherwise: (*a*) "Income" means the sum of adjusted gross income under the Kansas income tax act, alimony, support money, cash public assistance and relief (not including relief granted under this act), the gross amount of any pension or annuity (including all monetary retirement benefits from whatever source derived,

4.5

League of Kansas Municipalities

Municipal Legislative Testimony

An Instrumentality of Its Member Kansas Cities. 112 West Seventh Street, Topeka, Kansas 66603 Area 913-354-9565

TO: House Committee on Taxation
RE: HB 2636--City Income Tax Option
FROM: E.A. Mosher, Executive Director
DATE: January 25, 1990

I appear in general support of HB 2636, on behalf of the League's member cities. Our convention-adopted Statement on Municipal Policy provides:

"We recommend that a local income or earnings tax be authorized. We generally favor a procedure whereby the locally determined tax rate may be applied to the individual's state reported taxable income or tax liability, with the local tax collected by the state and returned to the levying unit. Provisions should be made for both a city or countywide tax. The formula for the equitable distribution of the revenue from any countywide income tax should balance situs of income, place of residence, revenue need and other factors."

As background to this general statement, I should note that the League, for many years, has supported local non-property tax revenue source options. In addition to income or earnings tax authority, the League supports increasing the present maximum city and countywide local option sales tax authority, as well as authorizing cities and counties to levy a special .25% sales tax, ear-marked for property tax reduction purposes.

It is not news to any of you on this Committee that the economy and financial base needed to support municipal services varies widely throughout Kansas. Even similar size cities, with similar public service demands, have widely varying assessed valuations, both in total amount and in the mix of the tax base. The proportion of real estate that is tax exempt also varies widely. Retail transactions are not uniformly spread throughout all cities. Cities are not all equal, and the revenue base for fairly distributing the cost of government needs to be determined according to local conditions, in our judgment.

Quoted at the end of my remarks is a provision from our Statement of Municipal Policy which sets forth the League's revenue resources policy objections.

We acknowledge that there may be some administrative problems in enforcing the provisions of HB 2636. However, the existence of local income taxes in other states, as shown in the attached report, indicates it can be done. As you know, the bill provides for the use and issuance of rules and regulations by the Department of Revenue to administer the tax.

In summary, we think the non-property tax options of local governments need to be expanded. An income tax is one of the major ways to do this. It is consistent with an apparent, emerging state policy calling for a reduced reliance on the property tax. It may not be extensively used, for a variety of reasons, but it will provide local discretion to design a

President: **Irene B. French**, *Mayor, Merriam* ★ *Vice President:* **Frances J. Garcia**, *Mayor, Hutchinson* ★ *Directors:* **Ed Eilert**, *Mayor, Overland Park* ★ **Harry Felker**, *Mayor, Topeka* ★ **Greg Ferris**, *Councilmember, Wichita* ★ **Idella Frickey**, *Mayor, Oberlin* ★ **William J. Goering**, *City Clerk/Administrator, McPherson* ★ **Judith C. Hollnsworth**, *Mayor, Humbolt* ★ **Jesse Jackson**, *Mayor, Chanute* ★ **Stan Martin**, *City Attorney, Abilene* ★ **Richard U. Nienstedt**, *City Manager, Concordia* ★ **Judy M. Sargent**, *City Manager, Russell* ★ **Joseph E. Steineger**, *Mayor, Kansas City* ★ **Bonnie Talley**, *Mayor, Garden City* ★ *Executive Director:* **E.A. Mosher**

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local tax and revenue system to meet local needs. We support local option income tax legislation.

F-4. General Policy Objectives. The general objectives (the League's) policy recommendations (as to revenue and taxation is) to support a comprehensive revenue resources program which: (a) recognizes the present and future fiscal needs of cities generally, as well as the wide variations which exist among all the cities of Kansas; (b) provides a basic, foundation level of support to enable the average city--especially our smaller cities where come local option taxes may not be feasible--to finance at least a minimum level of public services with reasonable city property tax levels and full use of local fees, charges and other non-tax sources; (c) permits those cities with greater fiscal needs, those cities whose citizens want more than the minimum quantity and quality of local public services, and those cities which want to diversify their revenue sources and reduce their reliance on the property tax, to use local non-property taxes as deemed necessary; and (d) secures fiscal resources, through state assistance and local options, which permits a municipal revenue base that is responsive to economic conditions and municipal needs.

Table 22

Local Government Units with Personal Income Taxes, Selected Years 1976-88[1]

State	1988	1987	1986	1985	1984	1981	1979	1976
Alabama								
Cities	10	10	10	10	8	5	5	6
Delaware								
Cities (Wilmington)	1	1	1	1	1	1	1	1
Indiana								
Counties	68	51	45	44	43	38	37	38
Iowa								
School Districts	60	57	61	57	57	26	21	3
Kentucky								
Cities	81	85	78	67	61	59	59	59
Counties	27	25	14	11	9	8	8	
Maryland								
Counties	24	24	24	24	24	24	24	24
Michigan								
Cities	18	17	17	16	16	16	16	16
Missouri								
Cities (Kansas City and St. Louis)	2	2	2	2	2	2	2	2
New York								
Cities (New York City and Yonkers)	2	2	2	2	2	1	1	1
Ohio								
Cities	481	482	480	467	460	NA	417	385
School Districts	5	6	6	6	6	NA	0	0
Pennsylvania								
Cities, Boroughs, Towns, Townships, and School Districts	2,788	*2,782*[2]	*2,777*	*2,758*	*2,644*	NA	*2,585*	*2,553*
Total (excluding Pennsylvania)	779	763	740	707	688	NA	597	535
Total (including Pennsylvania)	3,567	*3,545*	*3,517*	*3,465*	*3,332*	NA	*3,182*	*3,088*

NA—not available.

[1]Employer payroll taxes are levied in California, New Jersey, and Oregon.

[2]*Italics* are estimates.

Source: ACIR staff compilations based on Commerce Clearing House, *State Tax Guide.*

Table 23

Local Government Income Tax Rates for Selected Cities and Counties, by State, 1988
(in percent)

State	City Name (county)	City Tax Rate		County Tax Rate		Income Tax Based on
		Resident	Non-resident	Resident	Non-resident	
Alabama	Auburn (Lee)	1.0	1.0			Salaries, wages, commissions and other compensation earned in taxing cities.
	Birmingham (Jefferson)	1.0	1.0			
	Gadsden (Etowah)	2.0	2.0			
Delaware	Wilmington (New Castle)	1.25	1.25			Salaries, wages, commissions and other compensation earned in taxing cities.
Indiana	Elkhart (Elkhart)			1.0	0.25	County adjusted gross income.
	Ft. Wayne (Wayne)			1.0	0.25	
	Indianapolis (Marion)			0.5	0.125	
Iowa School Districts	CAL Community	7.50				Local income tax liability equals percentages at left multiplied by state income tax liability. Local tax is actually a school district tax levied on residents of the particular school district.
	Klemme Community	10.50				
	Lincoln-Central	11.25				
	Meservey-Thornton	8.5				
	Stratford Community	6.25				
	Woden-Crystal Lake	10.00				
Kentucky	Covington (Kenton)	2.5	2.5	0.5	0.5	Salaries, wages, commissions and other compensation earned in the taxing cities and counties. City and county taxes do not overl[illegible]
	Frankfort (Franklin)	1.0	1.0	1.0	1.0	
	Lexington (Fayette)			2.0	2.0	
	Louisville (Jefferson)	2.2	1.45	2.2	1.45	
Maryland	Annapolis (Anne Arundel)			50.0	0	Fifty percent of state income tax liability. All state residents [illegible] county tax ranging from 20-[illegible] of state income tax liability. The vast majority of taxpayers pay at the 50% rate. In effect, the local rate translates into 2.5% of adjusted gross income greater than $3,000.
	Baltimore (city as well as Baltimore County)			50.0	0	
	Bowie (Prince George's)			50.0	0	
	Rockville (Montgomery)			50.0	0	
	Hagerstown (Washington)			50.0	0	
Michigan	Detroit (Wayne)	3.0	1.5			All earned income in taxing cities.
	Flint (Genessee)	1.0	0.5			
	Grand Rapids (Kent)	1.0	0.5			
	Lansing (Ingham)	1.0	0.5			
Missouri	Kansas City (Jackson)	1.0	1.0			Salaries, wages, commissions and other compensation earned in taxing cities.
	St. Louis City	1.0	1.0			
New York	New York City	1.5-3.5	0.25			NYC: City income tax for residents ranges from 1.5% of the first $2,500 of state taxable income to 3.5% over $60,000; tax on nonresidents equals 0.25% of earned income. Yonkers: Residents pay 15% of net state tax (after property tax credit); nonresidents pay 0.5% of earned income.
	Yonkers (Westchester)	15.0	0.5			
Ohio	Akron (Summit)	2.0	2.0			Salaries, wages, commissions and other compensation earned in taxing cities.
	Cincinnati (Hamilton)	2.1	2.1			
	Cleveland (Cuyahoga)	2.0	2.0			
	Columbus (Franklin)	2.0	2.0			
	Dayton (Montgomery)	2.25	2.25			
	Toledo (Lucas)	2.25	2.25			
	Youngstown (Mahoning)	2.0	2.0			

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Table 23 (cont.)

Local Government Income Tax Rates for Selected Cities and Counties, by State, 1988
(in percent)

State	City Name (county)	City Tax Rate		County Tax Rate		Income Tax Based on
		Resident	Non-resident	Resident	Non-resident	
Ohio *(cont.)* School Districts	Anna (Shelby)	0.5	0			School district taxes are in addition to other local government income taxes. Only those school districts listed can impose income taxes.
	Arlington (Hancock)	0.75	0			
	Bradford (Miami)	1.0	0			
	McComb (Hancock)	1.0	0			
	West-Liberty Salem (Champaign)	0.5	0			
Pennsylvania	Allentown (Lehigh)	1.045	1.0			Salaries, wages, commissions and other income earned in the taxing cities. Only those school districts listed can impose income taxes.
	Erie (Erie)	1.0	1.0			
	Philadelphia	4.96	4.3125			
	Pittsburgh (Allegheny)	2.125	1.0			
	Reading (Berks)	1.0	1.0			
	Scranton (Lackawanna)	2.2	1.0			
School Districts	Philadelphia	4.96[1]				
	Pittsburgh (Allegheny)	1.875[2]				

Taxes are imposed on the total payroll of employers in the following cities at the rates listed. Many public finance analysts believe that the burden of these taxes is shifted to employees.

State	City Name (county)	Rate
California	Los Angeles	0.75%
	San Francisco	1.50%
New Jersey	Newark	0.75%
Oregon	Clackamas, Multnomah and Washington counties [Portland area]	0.60%
	Lane County Mass Transit District	0.49%

[1] Unearned income, commonly called investment income.

[2] Is included on the same form as city tax. Residents of Pittsburgh pay 4% on earned income.

Source: Commerce Clearing House, *State Tax Reporter* (various volumes), October 1988. See also, U.S. Advisory Commission on Intergovernmental Relations, *Local Revenue Diversification: Local Income Taxes,* SR-10 (Washington, DC: ACIR, 1988).

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KANSAS ASSOCIATION OF REALTORS

Executive Offices:
3644 S. W. Burlingame Road
Topeka, Kansas 66611
Telephone 913/267-3610

TO: THE HOUSE TAXATION COMMITTEE

FROM: KAREN FRANCE, DIRECTOR, GOVERNMENTAL AFFAIRS

DATE: JANUARY 25, 1990

SUBJECT: HB 2636, LOCAL OPTION EARNINGS TAX

Thank you for this opportunity to testify. On behalf of the Kansas Association of REALTORS®, I appear today to support the concept of HB 2636.

As we testified at the hearings for the local option income tax for schools, we believe the property tax burden should be reduced and the local units of government should be given all avenues to finance their budgets to replace the property tax revenue on which they now rely--this means sales tax, income tax, earnings tax, or whatever form of taxation the local units deem is appropriate and which is approved by a vote of the people.

Because of that we do have an amendment we think needs to be made. We ask that when you work this bill that you amend it to include the provisions from the local option income tax for schools bill which provide that the question of imposing an earnings tax must be approved by the voters and in the alternative, if at least 5% of the qualified electors of the city submit a petition requesting it, the city must put such a proposal on the ballot.

We feel the people have had a rude awakening to which governmental unit collects money for which budgets. They are going to be much more watchful of the budgeting process at all levels and they should be given a choice as to whether they feel this kind of tax is appropriate.

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REALTOR®—is a registered mark which identifies a professional in real estate who subscribes to a strict Code of Ethics as a member of the NATIONAL ASSOCIATION OF REALTORS.

The local option earnings tax is just one more avenue which we believe local units could use, in order to reduce the burden on property taxes. However, once again, we believe that, in order for this local option earnings tax to be used to its full potential, it needs to be coupled with a constitutional amendment which will put caps on effective property tax rates. Once again we will leave that part of the solution to another discussion, another day.

We ask that you support this bill, once it has been amended as we discussed. I will be glad to answer any questions you might have.

"Service to County Government"

January 25, 1990

To: Representative Keith Roe, Chairman
Members of the House Taxation Committee

From: Bev Bradley, Legislative Coordinator
Kansas Association of Counties

Re: HB 2636

Thank you Mr. Chairman and members of the committee. I am Bev Bradley, representing the Kansas Association of Counties.

I come before you today respectfully requesting an amendment to HB 2636 which would allow counties the same authority as cities in imposing income and privilege tax surtaxes.

Much has been said already this session about property taxes. It is generally agreed that alternative sources of funding for local governments are desirable. Therefore we believe this is a viable choice for some counties. We would appreciate your positive consideration.

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STATE OF KANSAS

TOPEKA

HOUSE OF REPRESENTATIVES

ELAINE L. WELLS
REPRESENTATIVE, THIRTEENTH DISTRICT
OSAGE AND NORTH LYON COUNTIES
R.R. 1, BOX 166
CARBONDALE, KANSAS 66414
(913) 665-7740

COMMITTEE ASSIGNMENTS
MEMBER: AGRICULTURE AND SMALL BUSINESS
INSURANCE
PUBLIC HEALTH AND WELFARE
PENSIONS, INVESTMENTS AND BENEFITS

COMMITTEE ON TAXATION

TESTIMONY
on
HOUSE BILL NO. 2636
January 25, 1990

By

REPRESENTATIVE ELAINE L. WELLS

Mr. Chairman and Committee Members:

Thank you for the opportunity to testify on House Bill No. 2636.

In the letters and phone calls I've received about the local earnings tax proposal, the same thematic response is being resounded: "It is taxation without representation!" It makes one think back to the Boston Tea Party and how the colonists were against the taxes that Mother England was imposing upon them. Another quote I've heard has been, "It's just not fair!" Why should a city like Topeka build a raceway, expo center, new malls, and new streets, and then try to pass the cost on to residents who do not live in the taxing district? We can't vote on building these things, yet we will have to pay for them? "It's just not fair!"

Some even said,"They may get ten percent of my earnings but I'll spend eighty percent of it less there because I'll start buying my groceries, gas, clothing, and other goods back home or somewhere else."

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I'm really surprised that employers are not here to indicate the problems they will have, first of all with the administrative costs to keep track of those employees who would have to pay the tax, and secondly, the deterrent it will create in hiring and retention. Persons not living in the local area may tend to seek employment elsewhere which will create a higher turnover and job vacancy rate. Even the fast food places are begging for more employees evidenced by all the "Help Wanted" signs on their signboards.

When I was an Administrator of a health care facility here in Topeka for two years, we employed alot of people who did not live in the city. Many of them were on limited incomes and unlike employees who lived in the city, they had to pay alot more for their gas just to get back and forth to work. An earnings tax will be very regressive for them and will take more out of what they have to have to live on.

The argument may be that a person can choose where he wants to work and it's a 'privilege'. But, we all know that this is not necessarily true. One has to work where there is a job, using the training or skills they've been taught.

Rural Kansas has been encountering an economic decline for quite a few years. Many have been forced to seek employment in the cities due to inflation and the increasing cost of living. They have not done it by choice or because it was a privilege; they simply had to.

Alot of city people drive out to the country for recreation; fishing, hunting, skiing, camping, and many times don't pay anything to enjoy the use of the land for recreation. It's by choice

and a privilege afforded to them. It makes more sense to me to pass a "recreation tax" if we're talking about choices. Rural areas don't derive benefits from people using the areas for recreational purposes like urban areas do from employing rural people. Most rural people who work in the city also buy their goods there and usually don't use many city services, except for the streets.

A survey was performed in our county which showed that forty percent of the people work in Topeka and an even larger amount purchase their goods there. An increase in sales tax would be a lot more fair if the city needs more money, because it does not discriminate against a certain segment of the population.

I hope in your deliberation on this bill that you will take into consideration all the negative impact this legislation would have. It is taxation without representation, it is not fair, and I hope you will oppose it.

Again, thank you.

Roe

GINGER BARR
REPRESENTATIVE, FIFTY-FIRST DISTRICT
SHAWNEE COUNTY
P.O. BOX 58
AUBURN, KANSAS 66402-0058

STATE OF KANSAS

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
CHAIRMAN: FEDERAL AND STATE AFFAIRS
MEMBER: ENERGY AND NATURAL RESOURCES

January 25, 1990

Chairman Roe and Members of the Assessment and Taxation Committee:

I want to take this opportunity before addressing HB 2636 to thank all of you - Republicans and Democrats alike - for all of the work that you have done in studying and proposing various pieces of legislation in regard to the tax crisis in our state. You have all been working very hard on this issue and I hope by this spring we will have some alternatives to relieve some of the tax pressure felt by various segments in our state. I also appreciate the fact that all of us are looking for alternatives within our tax structure to relieve the dependence on property taxes. However, I strongly oppose the earnings tax.

I spoke with Representative Wells yesterday and she shared her opposition to the earnings tax. As I write this testimony, I do not know whether she has spoken on this subject prior to my presentation. Whether she precedes or follows me, I want the Committee to know that all I can say is, "Me, too!" Her concerns represent the same concerns I have as a state representative representing all the very small cities within our county and many of the townships in between.

I do not want to reiterate why Representative Wells might or has already said, but I would like to take the opportunity to state that those who do not reside in a large city also help to pay for the various services they use when they come in to work or shop. For example, the washer and dryer in my home, my stove and refrigerator, my sofa and chairs, my skirts, blouses, coats and scarves were purchased in the City of Topeka and on those items I pay sales tax that did not come back to my home community of Auburn but stayed in the City of Topeka. Representatives Wagnon and Roy live in Shawnee County and traveled to the Capitol this morning. They did not travel the same distance as Representatives Smith, Wells or I traveled. The three of us traveled a greater distance thus using more gas, thus paying more taxes on that gas to get from point A to point B. Some of that state tax money goes back to the City of Topeka, therefore we do help to pay for the roads on which we travel.

The comments I have made so far are ones which you probably feel would be natural to a legislator who represents small outlying communities to a large city. However, I would like to oppose HB as a state representative from the City of Topeka. Although I currently represent only a small portion of Topeka, I have seen that area grow considerably during the eight years of my service. The City of Topeka continues to grow and there have been many changes. It has been estimated that by the year 2000 the center of Topeka will be 29th and Wanamaker. I feel that passage of an earnings tax will hurt

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the City of Topeka and only help outlying areas of a large community. Granted there are some establishments that cannot move from the City of Topeka. The type of business with which I am most familiar is cemeteries. Mount Hope Cemetery and Memorial Park Cemetery cannot pick up and move. There are many businesses that have the luxury of not having to have their businesses in Topeka. For example, my husband who is an attorney, is considering building a new law office. He does not have to be close to a courthouse and although he has looked in various areas of building or leasing in the Topeka area, it is not necessary that he build within the city limits. No matter where he moves, the vast majority of clients will follow him because they want his services and they don't really care if his establishment is in the city limits of Topeka, Auburn, Lawrence, Rossville or Silver Lake. It would be in the best interest ~~of my husband to build his law office in the City~~ of Topeka, ~~therefore~~ the City of Topeka would ~~be~~ broaden~~ing its~~ tax base with property tax.

As a business woman, I try to get the best "bang for my buck". I am concerned about my employees and want to give them the best salaries I possibly can. However, I am more interested in their take home pay than I am in their gross pay. If a community is just going to continue taxing or deducting every increase that I give them, it would be in my best interest to not locate in the City of Topeka if it had an earnings tax. My employees would be coming back to me saying, "Ginger, I need an increase in salary." Therefore, my prices to consumers increase. For those reasons I feel the earnings tax is a deterrent for businesses to locate in Topeka.

As a legislator, I oppose the earnings tax because it is going to cost the state some money. Representative Marvin Smith and I have discussed this issue. Attached you will find information that was given Representative Smith by the Research Department in regard to our state employees' salaries whose workplace is the City of Topeka. It would appear that we have approximately 10,000 state employees who ~~live outside~~ the City of Topeka. As you look at the total of the 1989 estimated state tax gross, you see the total of approximately $225 million. This $225 million would be subject to an earnings tax. If the tax rate were two percent, it would equal $4.5 million. Two hundred twenty-five million times 4% would equal $9 million cost to the state and at 10% the fiscal note would be $22.5 million. It is my understand that there are approximately 40,000 state employees statewide. It is also my understanding that a local school district in the City of Topeka which has an average teacher's salary of $28,000 would cost those teachers $565 at a 2% earnings tax.

Although this idea has been supported by some members of our city council, as a legislator who represents a portion of Topeka, must be opposed to the earnings tax. I feel it will hurt opportunities to attract new business to the city and it will be very costly to the State of Kansas.

Thank you.

STATE OF KANSAS

DEPARTMENT OF ADMINISTRATION
DIVISION OF ACCOUNTS AND REPORTS

MIKE HAYDEN
Governor

JAMES R. COBLER
Director of Accounts and Reports

900 Jackson, Room 251
Landon State Office Building
Topeka, Kansas 66612-1220
(913) 296-2311

January 19, 1990

Mr. Ben Barrett
Legislative Research Department
Room 545-N, State Capitol
Topeka, Kansas 66612

Dear Mr. Barrett:

RE: Estimated Number and Gross Pay of State Employees Whose Work Place is in Topeka

Data accumulated in KIPPS for the quarterly report of employment taxes (unemployment compensation) indicates the following number and gross pay of state employees accounts.

Type	Number	UCI Gross	Est. Cal. 1989 State Tax Gross
Employees Accounts - Shawnee County	10,256	$215,735,038	$235,302,174
Employees Accounts - Other Counties	33,002	686,849,978	749,147,168
Employees - Statewide	43,258	$902,585,016	$984,449,342

We estimate that 405 of the Shawnee County employees are employed at the Forbes facilities which would reduce reported employment data for Shawnee County to arrive at data for the City of Topeka as follows:

Type	Number	UCI Gross	Estimated State Tax Gross
Employees Accounts - Shawnee County	10,256	$215,735,038	$235,302,174
Estimated Shawnee County Employees Outside the City of Topeka	405	8,519,178	9,291,866
Estimated Employees - City of Topeka	9,851	$207,215,860	$226,010,308

If we can provide further information about this matter, please let us know.

Very truly yours,

Jim

James R. Cobler, Director
Division of Accounts and Reports

JRC:HG:cv

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KANSAS LEGISLATIVE RESEARCH DEPARTMENT

Room 545-N -- Statehouse

Phone 296-3181

January 23, 1990

TO: Representative Marvin Smith — Office No. 112-S

RE: State Employees Salaries -- Selected Data

Recently, you asked for information concerning the state payroll for the state as a whole and for employees whose place of work is in the City of Topeka. The enclosed memorandum from Mr. James Cobler, Director of the Division of Accounts and Reports of the Department of Administration, contains this information.

You will note a significant difference in the total for UCI (Unemployment Compensation Insurance) wages and the 1989 calendar year gross figures. This occurs because there are several categories of persons who receive compensation from the state who are not subject to unemployment insurance coverage, such as, for example, student employees at state educational institutions, patients at state hospitals, inmates at correctional institutions, elected officials, members of the judiciary, members of the national guard, and a few others.

We hope this information will be helpful to you. If we may be of further assistance, please let us know.

Ben F. Barrett
Associate Director

BFB/bd

Enclosure

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DON M. REZAC
REPRESENTATIVE, SIXTY-FIRST DISTRICT
WABAUNSEE COUNTY AND PARTS
OF POTTAWATOMIE AND RILEY COUNTIES
(913) 889-4514

STATE OF KANSAS

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS
MEMBER: AGRICULTURE AND SMALL BUSINESS
ENERGY AND NATURAL RESOURCES
PENSIONS, INVESTMENTS AND
BENEFITS

January 24, 1990

TO: House Taxation Committee

FROM: Representative Don Rezac

Mr. Chairman, members of this committee. I am Don Rezac, State Representative from the 61st District. I am here today to voice my opposition to House Bill 2636.

My legislative district consists of all of Wabaunsee County, most of Pottawatomie and Zendale township of Riley. My district is located right between Manhattan and Topeka. Many of my constituents work in these two cities.

If House Bill 2636 would become law and Topeka and Manhattan would pass a earnings tax, it would drain tax dollars from my district to Topeka and Manhattan.

I do not think it is fair to tax people who live outside a city to pay for services from which they get very little benefit. No matter what the surtax percentage would be, it would be too much of a tax increase.

The point was made to me that if the cities don't appreciate the money spent by my constituents now in Topeka, does anyone have an idea of the economic impact if every nonresident who works in the city would refuse to spend one penny in Topeka for a month.

So you can see, this is not a popular idea in my district. I appreciate your time and consideration and will be happy to answer questions.

DON REZAC
State Representative
District #61

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January 23, 1990

Mike Engler
Rt 11, Box 80
Topeka, KS 66618

I work in Topeka and live outside the city limits because I also choose to raise cattle and other livestock which can't be done inside the City.

I am opposed to an earnings tax because:

- It would be taxation without representation, because I would not have a vote or say in the use of my tax money.

- It would not be fairly used to give all tax payers benefits, only those living within the taxing unit would benefit, and further than that as I understand the proposal, only those within the taxing unit who are property owners would benefit. Renters, students and the poor would not benefit.

- It would be especially unfair to a worker who lived a great distance from the taxing unit. For example my place of business employs 20 people who live and work in the State of North Dakota. They help provide profits to a Topeka and Kansas firm yet they never set foot in Topeka. The same thing would be true in thousands of cases, for instance doesn't the U.S. Coast Guard send Topeka originated paychecks to points all over the Nation? Yet how could any exceptions be allowed without creating a totally unadministratable situation?

- This tax would simply be a tool for certain taxing units to impose a second property tax on those living outside the taxing unit and paying property tax to another entity. The argument that those working within the taxing unit but living without should pay for services provided to them is not valid. The real issue is whether the urban population out numbers the rural population and therefore can they force an unfair tax onto the unrepresented minority?

- I do pay sales tax to the City of Topeka on virtually 100% of everything I consume. I do pay property taxes in Shawnee County of which 58% supports a greater Topeka school district, and I do practice my trade in Topeka thereby adding to a more vibrant Topeka economy.

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- I do not ask that Topeka residents pay a special tax to enjoy a Sunday afternoon drive in the country nor to go boating, fishing, hunting, camping or simply enjoy nature in the country. I therefore am annoyed to hear that I should pay a special tax to use a City street to get to work so that I can continue to both make a living and to contribute to the economic well being of the City.

Thank you for the opportunity to speak.

Brotherhood of Locomotive Engineers
Kansas State Legislative Board
P.O. Box 66 • Osawatomie, Kansas 66064

STATEMENT

BY

LEROY JONES

CHAIRMAN

KANSAS LEGISLATIVE BOARD

BROTHERHOOD OF LOCOMOTIVE ENGINEERS

TO

THE HOUSE COMMITTEE ON TAXATION

ON

HOUSE BILL NO. 2636

JANUARY 25, 1990

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Mr. Chairman and members of the Committee. Thank you for the opportunity to appear before you today on House Bill 2636.

I am Leroy Jones, Chairman of the Kansas Legislative Board for the Brotherhood of Locomotive Engineers. I am also appearing on behalf of the Kansas Federation of Labor AFL-CIO. I am here today to speak in opposition to House Bill 2636.

To make this as short as possible, as stated in my testimony last week on House Bill 2611, the School District Income Bill, our official position on income tax bills are that we believe that only the State of Kansas should have the power to impose an income tax. We did however notice that in this bill both the individuals and corporations are to be included, which still does not sway our opinion.

One problem we see with this kind of bill for property tax relief is that non-resident wage earners are helping to reduce property taxes in cities they do not reside in. Thus the wage earner does not receive relief on his property taxes, yet he has to pay taxes to help relieve the property tax burden for others.

In closing, I would like to relay to you once again our strong opposition in allowing anyone but the State of Kansas to impose an income tax.

Thank you once again, for allowing me the opportunity to voice our opinion before your committee.

nsas Farm Bureau

PUBLIC POLICY STATEMENT

HOUSE COMMITTEE ON TAXATION

RE: H.B. 2636 - Local earnings tax for cities

January 25, 1990
Topeka, Kansas

Presented by:
Paul E. Fleener, Director
Public Affairs Division
Kansas Farm Bureau

Mr. Chairman and Members of the Committee:

My name is Paul E. Fleener. I am the Director of Public Affairs for Kansas Farm Bureau. One week ago today you provided us the opportunity to speak to you as **proponents** of H.B. 2611, a measure to authorize a local option income tax for school districts. We offered for your consideration an amendment to that bill to make the first levy on income uniform for all school districts in Kansas, leaving the option to the local board when setting the budget to increase either the income tax or the property tax to arrive at the budget for the school district.

Today you are examining another local option ... an option for cities to impose an earnings tax. We come before you today as **opponents** of H.B. 2636.

We certainly recognize the needs in cities for revenues to provide the services which are so well defined and provided by municipalities. We cannot support the proposal before you. It preempts - in our opinion - use of the income tax, or in the case

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of H.B. 2636 the earnings tax - by the local unit which provides the greatest service to the largest number of people (taxpayers) in the state.

Mr. Chairman, and Members of the Committee we would like to give you some information concerning the property tax ... the general property tax ... which is the tax most often and most vigorously used by local units of government ... cities, counties and schools. Taxes levied on November 1, 1988, for expenditure in 1989, totaled $1.480 **billion.** Of that amount $825.6 million was used for schools - unified school districts, community colleges and vocational education. U.S.D.'s received $672.3 million of general property taxes and another $115.9 million from the motor vehicle tax. Schools, particularly unified school districts, are the major user of property taxes. Counties are in second place. In 1989, counties utilized $333.0 million of the general property tax. Cities came in third at $227.8 million.

H.B. 2636 proposes to allow any city to pass an ordinance imposing a citywide income tax surtax (earnings tax) on any individual or corporation doing business or earning income within the corporate limits of the city. Our policy position, adopted December 5, 1989 at our Kansas Farm Bureau Annual Meeting in Wichita addressed this issue. We related to you last week the support for the local option for schools and our opposition to the use of the local option by other units of government. The two paragraphs said this:

We support legislation to create a school district income tax to be collected by the state from every resident individual and returned by the state to the school district of residence of the individual taxpayer.

We will oppose the application or use of a local income or earnings tax by any other local unit of government.

Mr. Chairman, and Members of the Committee, during this legislative session you have the best opportunity in recent history to reduce the reliance on the property tax and to make available to the citizens of this state the reduction in property tax which could be realized by an income tax surtax allocated for property tax reduction in all unified school districts in the state. We urge you to do that. It would be beneficial to all of the citizens of this state. The bill before you today is very narrowly focused. The beneficiaries are all within the bounds of the few cities that might utilize the option of an earnings tax. In our view the proper way to have the greatest impact on reducing reliance on the property tax is to mandate a portion of income tax for all school districts and to give the option to the school board to increase that income tax as the needs within the district are examined and revenues are developed to meet the needs.

We oppose H.B. 2636 and urge your consideration of our views as you dispose of this measure.

I would be pleased to respond to any questions.

2044 Fillmore • Topeka, Kansas 66604 • Telephone: 913/232-9358
Owns and Publishes The Kansas STOCKMAN magazine and KLA News & Market Report newsletter.

STATEMENT OF THE

KANSAS LIVESTOCK ASSOCIATION

TO THE

HOUSE COMMITTEE ON ASSESSMENT & TAXATION

REPRESENTATIVE KEITH ROE, CHAIRMAN

WITH RESPECT TO HB 2636

PRESENTED BY

DEE LIKES, EXECUTIVE VICE PRESIDENT

JANUARY 25, 1990

Mr. Chairman and members of the committee, in our analysis of House Bill 2636, several questions arose about the impact on rural people which we hope the committee will consider.

It appears that this tax would be levied against the income that any farmer or rancher or their spouse would derive from working a job in a town which imposed the earnings tax. However, what is not clear to us is whether the tax would be levied against a farmer or rancher who resides within the city limits of a city imposing this tax, and conducts his farming and ranching operation outside the city limits in a rural part of the county. Would this person be defined as "earning income within the corporate limits of such city"?

We realize that this proposal is one of many which is being advanced in a genuine attempt to relieve the burden on property tax. We can appreciate that goal because our association has believed for many years that Kansas should rely less on property tax and more on sales and income taxes to fund local units of government. It appears to us, however, that a city wide earnings tax of this nature would be levied against the incomes of many rural people yet would do nothing to offset property taxes where those people live or, in the other instance, where they operate their farming activity. KLA would prefer more reliance on the income tax either through a local school district optional income tax; or a county wide income tax; or possibly even some form of statewide income tax increase with requirements that a corresponding decrease or offset in the property taxes be set in place.

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LEGISLATIVE TESTIMONY

Kansas Chamber of Commerce and Industry

500 Bank IV Tower One Townsite Plaza Topeka, KS 66603-3460 (913) 357-6321

A consolidation of the Kansas State Chamber of Commerce, Associated Industries of Kansas, Kansas Retail Council

HB 2636 January 25, 1990

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

House Taxation Committee

by

Bob Corkins
Director of Taxation

Mr. Chairman and members of the Committee:

My name is Bob Corkins, director of taxation for the Kansas Chamber of Commerce and Industry. Thank you for the chance to speak regarding HB 2636 and its proposal for a local option earnings tax.

> The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.
>
> KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 55% of KCCI's members having less than 25 employees, and 86% having less than 100 employees. KCCI receives no government funding.
>
> The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

KCCI supports the goal of broadening the revenue sources of local governments, but due to great uncertainties within this proposal we must oppose HB 2636. Excessive

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reliance on property taxes has not been a sound policy for a number of reasons, but to substitute property taxes for a tax which causes even greater inequities would be a drastic mistake.

Our primary concern is that new taxes of this kind should not result in a greater net tax burden imposed on the public -- businesses included. Unfortunately, HB 2636 seems to pose exactly such a threat. The even exchange provided in section 4(b) between new earnings tax revenues and reduced property taxes would not even approximate a revenue-neutral enactment.

Both individuals and businesses would suffer from this proposal. Persons who commute to work in a city imposing the tax would not necessarily receive a corresponding reduction in property taxes at their home district. Persons who both reside and work in a city imposing the tax, on the other hand, would very possibly see their property taxes reduce by an amount far exceeding the new earnings tax imposed upon them.

Business would be negatively impacted to an even greater degree. Their greatest difficulty would be in complying with the tax. Apportionment formulas used in allocating Kansas taxable income do not translate into an effective method for apportioning earnings. By imposing the tax on "any individual or corporation doing business or earning income within the corporate limits" of a city, a local earnings tax would apply even to the income from isolated or unsubstantial sales within a taxing city. The property, payroll and sales factors used in the state income apportionment formula would not only give a grossly distorted result when applied to such isolated sales, it would also be a necessary calculation for each such transaction conducted in every taxing city.

The possible impact is therefore staggering. Since the earnings tax is imposed on the basis of Kansas income liability, then the deductible expenses incurred in generating the income from such isolated sales would also need to be apportioned. How does a firm's field sales representative judge which expenses are attributable to these individual sales? How would a firm apportion its total statewide expenses to such sales? If the expenses include media advertising, who would know which sales were achieved as a result of a broadcast which was transmitted miles away from the point of sale? Would such media-

induced sales be "earned" at the site of business headquarters, of the broadcast tower, or of the city where the purchaser resides?

These are just some of the problems which would not be addressed by an apportionment formula, nor by permitting the business to conduct an individual accounting. A likely business response would be to curtail any activity in the earnings tax-imposing city. At the very least, intra-state trade would be discouraged and economic growth would suffer.

Because of these great uncertainties, KCCI urges your rejection of HB 2636.

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