



Digging For Dollars

A Guide to Local Government Revenues



Table of Contents

I. Property Tax	1
II. General Sales Tax and Excise Taxes	4
III. Service Charges and Regulatory Fees	5
IV. Payments in Lieu of Taxes (PILOTs)	7
V. Income Taxes	8
VI. Other Innovative Revenue Sources	8
VII. Additional Resources	9

DIGGING FOR DOLLARS: A Guide to Local Government Revenues

As a result of the Great Recession, state and local government revenues declined at the same time as demand for public services skyrocketed. Spending, particularly on vital services, has been slashed, even though it is well-documented that such cuts create a drag on recovery. State and local employment has plummeted by almost 700,000 jobs: 543,000 in local government and 154,000 in state government.

In this environment, a small number of municipal bankruptcies have generated alarmist headlines about the state of local government. However, from 2010 to the present, there have been only 26 Chapter 9 filings. All but six of these were filed by utilities, hospitals or other smaller special districts. Each of these was caused by unique factors and they represent a tiny fraction of the over 89,000 local governments nationwide.

Rather than relying solely on spending cuts, local governments can increase revenues, continue to provide vital public services and aid recovery. This guide explains sources of local revenue and will equip AFSCME activists and leaders to work with community groups and public officials to raise needed revenues. Local politics will shape what is feasible in any jurisdiction, and state laws and regulations may limit local government control, but many local jurisdictions have revenue options they can exercise, even in these difficult times.

The primary sources of local government revenue are the property tax, sales and excise taxes, charges and fees, Payments in Lieu of Taxes (PILOTs,) and income taxes.

I. Property Tax

Property tax, paid by both residents and businesses, is the major source of revenue for local governments. It is levied on two categories of property: **real property**, which is immobile (e.g. land), and **personal property**, which is mobile and includes **tangible property** (e.g. equipment) and **intangible property** (e.g. stocks). In recent decades, the property tax base has shifted away from personal property to real property, due to the complexity of assessing personal property and the higher growth rate of real property.

The property tax has advantages. It is relatively stable and somewhat progressive -- people who own more property tend to pay more in taxes. Its major disadvantage is that it is one of the most unpopular taxes. Although property taxes can be increased by simply increasing the rate, elected officials are reluctant to do so. However, there are ways to increase revenue without increasing tax rates.

Action	Advantages	Disadvantages
<p>Raise the assessment ratio - the ratio of property value subject to taxation to full market value - to the state's legal limit.</p>	<ul style="list-style-type: none"> • Equalizes taxation among cities and towns in a state. 	<ul style="list-style-type: none"> • Politically unpopular.
<p>Appraise property more often. Property should be appraised at least every three years.</p>	<ul style="list-style-type: none"> • Can capture revenue that should be paid and prevent sudden large shifts in the tax burden. 	<ul style="list-style-type: none"> • May not be cost-effective, especially where property value is stagnant or even declining.
<p>Limit tax abatements - reductions in taxes on a business, intended to attract new investment.</p>	<ul style="list-style-type: none"> • There is little evidence that abatements affect economic development. • Although local governments typically grant abatements, because they are largely supported by property taxes, public schools suffer. These abatements are granted with no input from school boards or parents. • Local property taxes are deductible from federal income taxes. 	<ul style="list-style-type: none"> • The misperception that abatements can create jobs can lead to a "bidding war" if surrounding jurisdictions offer abatements.
<p>Narrow the types of property granted exemptions or limit the extent of exemptions. For example, limit exemption of properties owned by religious institutions to only those used for religious purposes, means test exemptions, enact "circuit breakers."</p>	<ul style="list-style-type: none"> • Allows tax-exempt entities to partially compensate for public services used. 	<ul style="list-style-type: none"> • State regulations can impose limitations, but it may be possible to negotiate tax settlements into a permitting process.

Action	Advantages	Disadvantages
<p>Increase tax collection rates by:</p> <ul style="list-style-type: none"> • Adjusting delinquency fees to allow penalty to float with interest rates. • Publicizing egregious delinquencies. • Issuing property tax bills more regularly – for example, monthly or quarterly. • Using small-claims court for minor delinquency cases. • Withholding payments to contractors who owe delinquent taxes or service charges. • Conducting a tax audit to identify misallocated or unreported taxes. Private firms offer this service, for a charge, but it is likely more cost-effective to do in-house. • Offering limited amnesty for delinquent taxes. 	<ul style="list-style-type: none"> • Below market interest rates and low penalties incentivize late tax payment. • Issuing property tax bills more regularly can help reduce “sticker shock” which can create resentment of the tax. 	<ul style="list-style-type: none"> • Increased penalties may cause hardship for taxpayers under financial strain. Waivers for special conditions can be offered.
<p>Enact impact fees, which are charges to developers for the cost of related off-site capital improvements, or require developers to dedicate capital improvements, such as new streets, lighting and drainage, as a condition of approval.</p>	<ul style="list-style-type: none"> • Reduces the financial burden on residents who would otherwise share the cost of new facilities through higher taxes and service charges. • Impact fees are generally collected prior to construction. 	<ul style="list-style-type: none"> • Opponents contend that fees are passed to residents through increased housing costs. However, studies suggest that the fees, if designed equitably, are borne by developers in the short term and, in the long term, result in lower prices for undeveloped land.
<p>Enact special assessments - a levy on property owners for the increased property value created by nearby public improvements.</p>	<ul style="list-style-type: none"> • Shifts part of the cost of improvements to property owners who benefit from increased property values. 	<ul style="list-style-type: none"> • Levied after a project is completed. Construction phase largely financed with general funds.

Recommended actions

Local governments should regularly examine property tax administration. Revenues recovered through improvements often more than pay for themselves. Governments should carefully examine their assessment policies, such as frequency of assessments, to make sure money is not being lost through poor practices.

Property tax abatements should be examined to make sure they are worth the cost and that promises made when they were granted were kept. In particular, have promised jobs become a reality?

Property tax exemption procedures should be reviewed regularly and exempt properties should be assessed regularly. The cost of granted exemptions should be easily available. Often limits placed on exemptions can be effective, like a maximum dollar value or maximum number of acres. Government should also consider narrowing the types of properties that are granted exemptions.

II. General Sales Tax and Excise Taxes

The **general sales tax** is second only to the property tax as a revenue source for local governments. It is levied on a broad range of goods and some services.

Excise taxes are levied on specific types of transactions and are often included in the price of products or services. Excise taxes fall into three categories. **Benefits-based taxes** recover at least part of the cost of a public service from those who benefit from it. For example, gasoline taxes are usually dedicated for street and road maintenance. Excise taxes also include **sumptuary taxes**, also known as **sin taxes**, which are levied to discourage consumption of certain goods, like tobacco or alcohol, or to pay for their social cost. **Privilege taxes** are levied on particular types of businesses or transactions, such as cable services, electricity use or admission tickets. Privilege taxes also include **occupation privilege taxes** levied on particular professions or individual employees.

Advantages

- The general sales tax meets less political resistance because it is collected in small increments over a large number of transactions.
- Taxes on goods and services paid by commuters, tourists and non-local businesses reduce the tax burden on local households.
- Excise taxes are often earmarked for purposes that benefit consumers of the good or service being taxed. For example, 60 to 80 percent of hotel and motel occupancy tax revenue is earmarked for tourist-related services, including the promotion of tourism.
- Benefits-based taxes compensate for increased demand for public services.
- Sin taxes have been shown to reduce consumption of goods with high social costs, such as tobacco and alcohol.
- Excise taxes levied on luxury items, such as furs and jewelry, can be progressive.

Disadvantages

- Sales tax revenues fluctuate with the economy. Revenue can drop during downturns.
- Local sales taxes shift more of the local tax burden from businesses onto households.

- Local sales taxes may decrease retail sales locally unless regional differences in rates are small or there is widespread adoption of the tax.
- A general sales tax is regressive. Lower-income households pay a higher proportion of their income to the tax.
- Excise taxes on necessities, such as utilities and gasoline, may be regressive.
- Hotel and motel operators often oppose occupancy taxes, claiming they discourage tourism. But studies indicate that tourism is insensitive to modest price increases, especially in resort communities and in large cities that draw convention business.
- Sin and other non-benefits-based excise taxes are generally unattractive revenue sources for smaller local governments because of their high administrative costs and low revenue yield. The revenues from sin taxes also tend to decrease over time.

Recommended actions

Local governments considering sales taxes should carefully study sales tax sourcing and applicable state law to avoid complications. Piggybacking on the state's sales tax collection and enforcement system, and having the state remit the local government portion after collection, is also more cost-effective than local administration.

Exemptions from the sales tax can reduce its regressivity, but also the amount of revenue generated. Twenty-nine states exempt food purchased for home consumption; some states have a two-tiered tax structure and tax food at a lower rate. Many jurisdictions exempt medicines and other necessities. While well-intentioned, such exemptions provide a significant tax break to high-income households as well as low-income. An alternative is providing an income tax credit for lower-income households to offset the tax paid on such purchases.

III. Service Charges and Regulatory Fees

Service charges help finance the cost of providing government services. Charges are generally related to actual use of the service or facility. Local governments charge fees for several types of services:

- recreation and leisure activities, such as swimming pools;
- utility services, including water and electricity;
- public works jobs, like weed-cutting;
- police protection, such as special-occasion escorts;
- planning and economic development activities, like zoning variances;
- sanitation and animal control, including animal trapping and refuse collection; and
- public transportation.

State laws also typically grant local governments limited powers to issue **licenses** and **permits**. A license authorizes an individual or business to engage in an activity and a permit authorizes a

business or individual to take on a particular task. Common sources of license and fee revenues include:

- dog licenses;
- hunting licenses;
- building permits;
- food handlers' licenses;
- motor vehicle repair licenses;
- hospital licenses; and
- barricade permits.

Advantages

- In recent years, local governments have become more dependent on service charges and regulatory fees for revenue, in large part due to resistance to higher taxes.
- Service charges are seen as equitable, as residents pay for the services they use.
- Service charges can be designed to reduce wasteful consumption of some public services.
- Service charges can make some services financially self-supporting.
- Service charges can be paid by nonresidents who might otherwise use services or facilities for free.

Disadvantages

- Service charges may adversely impact low-income users, and access to certain services, such as recreational programs for low-income youth, may be reduced.
- Some charges, such as those related to building and new construction, are highly unstable, which complicates budget planning.

Recommended actions

As the costs of providing services or enforcing regulations changes, local governments should regularly review the fees they charge and compare them to other jurisdictions.

Services that provide private benefits, such as utilities, should be self-supporting. To support the cost of operations, capital outlay and debt service, these services should be priced at full-cost or higher, if permitted, to subsidize other public services. Variable rate structures, with peak-period pricing and different rates for different classifications of users, are more efficient and fair than flat-rate pricing.

Partial-cost pricing is sometimes appropriate for services that benefit the community or that local governments want to encourage. Services which are commonly tax-supported, including recreation and leisure, public works, police and public safety, planning and economic development, public health and sanitation and public transit, are all candidates for partial-cost recovery. To alleviate the burden on low-income users, some local governments base charges

on income, offer vouchers to qualifying households or offer free days at recreational or cultural facilities like the zoo or city pool.

IV. Payments in Lieu of Taxes (PILOTs)

Charitable non-profit organizations, which include private universities, hospitals, museums and churches, are exempt from property taxation in all fifty states. **Payments in lieu of taxes (PILOTs)** are made voluntarily by tax-exempt entities to compensate a local government for some or all of the revenue lost through exemption.

Advantages

- For municipalities with a large share of tax-exempt property, PILOTs can provide substantial revenue.
- PILOTs allow non-profits to share the cost of public services they consume.
- PILOTs export the tax burden to non-residents, particularly in the case of universities.

Disadvantages

- PILOTs are voluntary.
- Non-profit leaders may claim that PILOTs could lead them to raise fees, cut services or reduce employment.
- The cost of government administration of PILOTs, or of potential litigation, may be high.
- Where PILOTs are short-term agreements, they are not a predictable source of income.

Recommended actions

PILOTs make the most sense for municipalities with a large share of tax-exempt property. A systematic PILOT program with multi-year agreements, rather than individually negotiated PILOT agreements, creates a more reliable stream of income. Additionally, a municipality may be able negotiate PILOTs into permitting, zoning and other regulatory processes.

Some jurisdictions have succeeded in obtaining PILOT payments after first proposing mandatory fees, such as a fee per student at local universities.

The amount of PILOT payments is important. Some jurisdictions request PILOT amounts proportional to the non-profit's savings from tax exemption. Some focus on the largest non-profits by setting a property value or annual revenue threshold level that protects non-profits lacking the financial resources to make meaningful contributions.

V. Income Taxes

Some states allow local governments to levy taxes on incomes. An income tax is levied on employee wages and self-employment income. Although employers are liable, **payroll taxes** are considered income taxes as employees often bear the economic burden through lower salaries and wages. Some cities also levy a **corporate income tax**.

Advantages

- A local income tax reaches commuters who work in a city but do not pay for city services.
- A local income tax can be cost-efficient and the compliance rate can be high if the local government piggy-backs on the state income tax.
- It can be progressive, so taxpayers contribute a higher share of their income as it rises. Local piggy-backing onto state income tax is usually automatically progressive.

Disadvantages

- Like the sales tax, an income tax is sensitive to the economy.
- A local income tax can generate public opposition.
- Large differences in income taxes between neighboring jurisdictions could encourage movement of jobs or households.

Recommended Actions

An income tax levy may make the most sense for larger cities with a declining property tax base and a large numbers of commuters. To avoid over-taxing commuters, who would be paying tax in two localities, a limit can be set on their tax rate.

Because of administrative complexity, corporate income taxes are rare outside of the largest cities, including Detroit, New York City and Washington, D.C.

VI. Other Innovative Revenue Sources

Beyond traditional revenue sources, local governments are exploring new ways to generate additional income, recoup costs they incur, collect revenues from otherwise exempt entities and alleviate pressure on the property tax. Here are some more ideas to consider:

- **Marketing of Assets and Services**
 - Charge rent for siting cellular antennas
 - Sell memorabilia
 - Provide services with and to other agencies
 - Charge for private use of public facilities by renting them for particular occasions or leasing unused space

- **Other sources**

- Allow donations to local government activities or facilities to be made in conjunction with utility bill payments
- Offer an optional annual emergency medical response subscription for those who prefer not to be billed on a pay-per-use basis.
- Enact charges for bags to encourage consumers to use their own bags and help pay for cleaning up and landfills
- Enact a charge for bottled water to recognize the cost of recycling or landfill
- Enact a soda fee to address the cost of dealing with bottles and to encourage healthier behavior
- Enact a wheel tax on city-registered vehicles to allocate some of the costs of street maintenance and operations to vehicle owners
- Enact a transportation utility fee, similar to water, sewer or trash collection fees, to allocate the cost of street maintenance to the properties that benefit from it
- Enact a fire service fee, based on the size and type of structure, to help pay for these services
- Enact a snow and ice fee, based on a property's street frontage, to partially offset removal costs

VII. Additional Resources

[Best Practices Report: Local Government User Fees](#), Wisconsin Legislative Audit Bureau: Madison, Wisc., 2004.

<http://legis.wisconsin.gov/LAB/reports/04-0UserFeesFull.pdf>

[Impact Fees and Housing Affordability: A Guidebook for Practitioners](#) by Liza K. Bowles and Arthur C. Nelson. U.S. Department of Housing and Urban Development: Washington, D.C., 2008.

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[Payments in Lieu of Taxes: Balancing Municipal and Nonprofit Interests](#) by Daphne A. Kenyon and Adam H. Langley. Lincoln Institute of Land Policy: Cambridge, Mass., 2010.

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