Understanding the Impact of Adopting Local Option Sales Taxes

David L. Sjoquist

Financing Municipalities in New England: Revisiting the State-Local Relationship

Federal Reserve Bank of Boston

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I. Some Background
States with Local Sales Taxes

NYC was the first – 1934
12 states in 1963
25 states in 1975
30 states in 1980
33 states in 1994
34 states currently
[5 states without state sales tax]
Sales and Gross Receipts Taxes
Percent of Taxes

Source: Tax Foundation and Census Bureau
Sales Tax as % of Property Tax

Source: U.S. Census Bureau, State and Local Government Finances
## Local Sales Tax as a Percent of Local Taxes (2005)

<table>
<thead>
<tr>
<th>State</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arkansas</td>
<td>50.2%</td>
</tr>
<tr>
<td>Louisiana</td>
<td>49.7%</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>39.5%</td>
</tr>
<tr>
<td>Alabama</td>
<td>38.6%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>37.5%</td>
</tr>
<tr>
<td>Colorado</td>
<td>29.7%</td>
</tr>
<tr>
<td>Arizona</td>
<td>24.8%</td>
</tr>
<tr>
<td>Tennessee</td>
<td>24.3%</td>
</tr>
<tr>
<td>Missouri</td>
<td>23.3%</td>
</tr>
<tr>
<td>South Dakota</td>
<td>21.3%</td>
</tr>
<tr>
<td>Georgia</td>
<td>19.9%</td>
</tr>
<tr>
<td>North Carolina</td>
<td>18.9%</td>
</tr>
<tr>
<td>Washington</td>
<td>18.4%</td>
</tr>
<tr>
<td>Utah</td>
<td>18.0%</td>
</tr>
<tr>
<td>Wyoming</td>
<td>17.2%</td>
</tr>
<tr>
<td>New York</td>
<td>16.6%</td>
</tr>
<tr>
<td>California</td>
<td>15.8%</td>
</tr>
<tr>
<td>Alaska</td>
<td>14.5%</td>
</tr>
<tr>
<td>Kansas</td>
<td>14.0%</td>
</tr>
<tr>
<td>Iowa</td>
<td>11.1%</td>
</tr>
</tbody>
</table>

Source: Census Bureau, State and Local Government Finances
Examples

Georgia

All are 1% and countywide. Referendum is required

- MARTA
  - Transit system
- LOST
  - Property tax relief
  - General expenditures
- SPLOST
  - Infrastructure
- ESPLOST
  - Education Infrastructure
- HOST
  - Homestead exemption
- MOST
  - Water/sewer – city of Atlanta
California

1.00% (Bradley-Burns Sales Tax)
- 0.25% - to county of sale; dedicated to transportation
- 0.75% - to city or county depending on location of sale

Local option – up to 1.5%
- rates range from 0.125% to 1.5%
- Majority are earmarked – transportation, libraries, etc.
II. Some Implications
A. Growth

Predicted Growth

Source: Dye and Merriman (2005); Bruce, Fox, and Tuttle (2006)
B. Stability

Annual Percentage Change in Sales Tax Revenue

-0.15 -0.1 -0.05 0 0.05 0.1 0.15

1999 2000 2001 2002 2003 2004 2005 2006

Year

Massachusetts, Georgia
Annual Growth Rates
Sales Tax and Property Tax
(Georgia)
C. “Fiscalization”

Increased inter-jurisdictional competition for retail, especially large shopping centers.

Wassmer (2002) found that in the West

- 10% increase in state reliance on local sales tax led to a 2.4% increase in retail sales in non-central areas

Lewis (2001) surveyed California city managers

- Retail was the most desirable land use
- Retail increased the likelihood of providing incentives
- Sales tax revenue was the most important factor influencing development decisions.
D. Effects on Expenditures and Property Taxes

Two Contrasting Views:

- Elected officials respond to the demands of voters, who are rational and informed.

- Elected officials are able to manipulate voters, who are not informed.
General Evidence

• more diversified/complex tax structure is associated with more expenditures

• adoption of new tax does not lead to increases in expenditures
More Specific Evidence

- Sjoquist, Walker, and Wallace (2005): Cities differ in how much property tax is reduced.
- Jung (2001): in Georgia 28% of local sales tax revenue went to property tax relief.
- Sjoquist, Walker, and Wallace (2005): some cities do not increase expenditures, but others do.
E. Equity By Income

- Retail sales component is regressive
- Sales tax on business purchases is also regressive
- Distribution of burden depends on tax base

Source: Derrick and Scott (1998)
Tax Burden
(Massachusetts, 2002)

Income Category
- Sales Tax
- Property Tax

Source: Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, Institute on Taxation & Economic Policy
F. Equity by Geography
1% Sales Tax Revenue Per Capita (2006)

Revenue per Person

Counties

- Georgia
- Ohio

Revenue per Person ranges:
- 0-60
- 61-85
- 86-110
- 110-135
- 136-160
- 161-185
- 186-210
- 210+
Ohio

County Tax Base Per Capita/
State Tax Base Per Capita
G. Effect on Tax Base

Increasing the total tax rate from 5% to 6% would reduce sales tax base by 11 percent.

Bruce, Deskins, and Fox (2006)
III. Policy Issues
A. Choosing Among Alternatives

Alternatives:
• Local income or payroll tax
• Gross receipts tax
• Hotel/motel tax
Factors to Consider

- Diversifies tax structure
- Relationship to benefits of public services
- Equity
  - By income class
  - Across jurisdictions
- Mobility of tax base
- Stability of revenue
- Economic distortions
- Ability to export burden to nonresidents
- Visibility of tax
B. Policy Choices: Local Sales Tax

- Conformity with state base
- Universal versus local option
- Situs
- Coordination
- State v. local administration
References


