Planning fundamentals for public officials and engaged citizens

QUICKNOTES

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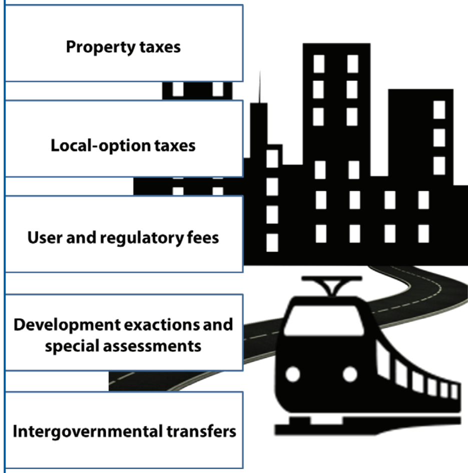
Planning and Local Revenue Sources

Local governments depend on revenue to deliver a range of services, including public education, police and fire, and transit services. Local governments also pay for critical infrastructure, such as roads and water systems, that make local and regional economic development possible. From a planning perspective, it is important to understand how the local revenue structure influences land-use mix, the spatial distribution of development, and economic development decisions in a given community. Because local government revenue structures are highly dependent on state law, and are also influenced by factors such as regional context and types of services provided, the following sections are intended as a general overview of potential local revenue sources and not a prescription for a specific revenue structure.



Local governments use a variety of revenue streams to fund infrastructure and services.

Background

Local governments both generate (own-source) revenue and receive revenue through intergovernmental transfers from state and federal agencies. While the basic species of local revenue sources have not changed over the last several decades, since the late 1970s, state tax reforms and periodic shifts in federal funding priorities have led many local governments to explore revenue alternatives. Meanwhile, cyclical economic downturns (most notably the Great Recession) have also put pressure on local governments to diversify their revenue portfolios. An increasing number of local governments have grown more dependent on non-property tax revenue sources. According to the U.S. Census Bureau, in 2012, local government general revenues totaled nearly $1.5 trillion. Of this, 37 percent came from intergovernmental transfers and the rest from own-source revenue. Property taxes remain the largest locally generated source of revenue, at nearly 30 percent, but own-source revenue sources also include local-option taxes, user fees, regulatory fees, and development exactions and special assessments.

Intergovernmental Transfers

Some intergovernmental transfers fund general local governmental operations, while others are reserved for special purposes. Most intergovernmental transfers for general operations come from various state taxes that are shared with local governments. While direct federal transfers do not account for a large proportion of general operations funding, federal grants, such as Community Development Block Grants, are important supplemental sources of revenue for many local governments.

Property Taxes

Historically, property taxes are the primary mechanism by which local governments generate own-source revenue. Property taxes are also the only form of local tax levied in all 50 states. There are two primary forms of property taxes: real property tax and personal property tax. Real property includes residential and commercial land, as well as improvements to that land. Personal property includes property that is mobile, such as cars, boats, or farm equipment. Both are based on the assessed value of the property, of which owners pay a percentage.

Beginning with California's Proposition 13 in 1978, there have been measures across all 50 states to place limits on property tax increases. While still the largest source by which local governments generate revenue, the property tax has been declining in terms of the overall share of local government revenue since the late 1970s.

Local-Option Taxes

In addition to property taxes, local governments also levy other taxes, including local-option sales taxes

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and individual and corporate income taxes. While revenue from local-option taxes is often earmarked for specific purposes, in many states local governments have wide discretion over how they spend this money. After property taxes, sales taxes are the second largest source of tax revenue for local governments. This category includes both general sales taxes, which apply broadly based on a percentage of the price of goods or services sold, and selective sales taxes, which apply only to specific services or commodities. Examples include hospitality taxes (e.g., room and restaurant taxes) and "sin" taxes (e.g., taxes on gambling, alcohol, and tobacco products). Local collection of sales tax is authorized in 38 states, and the taxes make up highly varying percentages of local tax revenue, from a relatively small part of the revenue structure to over 50 percent. Local-option income taxes are relatively rare. They are most common in central cities that have lost population to suburban migration.

User Fees

Local governments also generate revenue from a range of user fees. Unlike taxes, user fees, which relate to the proprietary powers of local governments, are based on benefit, impact, and use. When cities provide services, they can charge user fees for those services. Common user fees include utility charges, parking fees, and fees for the usage of municipal facilities (e.g., golf courses or recreation centers). In most states local governments can charge user fees that exceed the costs of providing services.

Regulatory Fees

Local governments also generate revenues related to their regulatory powers. When a local government incurs a cost associated with administering regulations, it can charge a fee to cover those costs. Common regulatory fees include business licenses, inspection and code enforcement fees, and charges for development review. In most states, regulatory fees cannot exceed the actual costs of administrative and professional services associated with administering the regulations.

Development Exactions and Special Assessments

Development exactions (i.e., impact fees, fees in lieu of land dedications, proffers, etc.) are designed to mitigate the impacts of new development on public facilities and services. Special assessments are taxes to provide additional facilities and services within a defined subarea of a jurisdiction. Development exactions and special assessments must be tied to the actual costs incurred by the new development or by the additional facilities and services, and the money must be spent on facilities and services that directly benefit the development that incurred the charges.

Effects of Revenue Structure on Land Development

Local revenue structures influence decisions on how and where development happens. For example, local governments that are more dependent on sales-tax revenues often encourage retail stores near their boundaries, allowing them to generate tax revenue and minimize expenditures on infrastructure and services for nonresident shoppers. Jurisdictions that collect local income taxes may encourage employment-intensive uses, such as office park development. Local governments that do not levy sales or income taxes are especially burdened by vacant land and may be motivated to prioritize policies that maximize property values.

Conclusion

Local governments have a variety of sources of revenue, and local revenue structures have a great deal of influence over how communities grow and change over time. Understanding the basic sources of local government revenue and the revenue structure of your community can be important to formulating local policies related to growth and economic development.

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FURTHER READING

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2. Other Resources

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