

State Sales Tax Revenue Sharing – Existing Conditions, Implications, and Policy Options

Counties, municipalities, and other local units of government receive shares of state tax revenue according to various formulas. In the chapter on reforming state and local tax policy, GO TO 2040, northeastern Illinois’ comprehensive regional plan, includes an analysis of these existing revenue sharing arrangements and provides the following implementation action area, to be fully fleshed out by the Regional Tax Policy Task Force:

<p>Evaluate state and local revenue sharing criteria with particular emphasis on the sales tax</p> <p>Lead Implementers: Task Force, CMAP Board, State, counties, municipalities</p>	<p>More than \$4 billion in state tax revenue, much of which is made up of sales tax, is disbursed annually to local governments in northeastern Illinois. Evaluate state/local revenue sharing criteria including the sales tax, income tax, personal property replacement tax, and MFT. The task force should analyze the fiscal, economic, and equity impacts of altering disbursement criteria and make appropriate recommendations to the state and/or propose regional or subregional actions. The sales tax disbursement, which is based on local retail sales, should receive particular emphasis. Prepare detailed recommendation.</p>
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Information on current revenue sharing arrangements in Illinois can be found in the [overview of state and local revenues and expenditures](#) report provided at the April 8, 2011 meeting of the Regional Tax Policy Task Force. The purpose of this interim report is to illustrate some of the existing conditions, implications, and policy options regarding the state sales tax and its allocation to local governments based on point of sale.

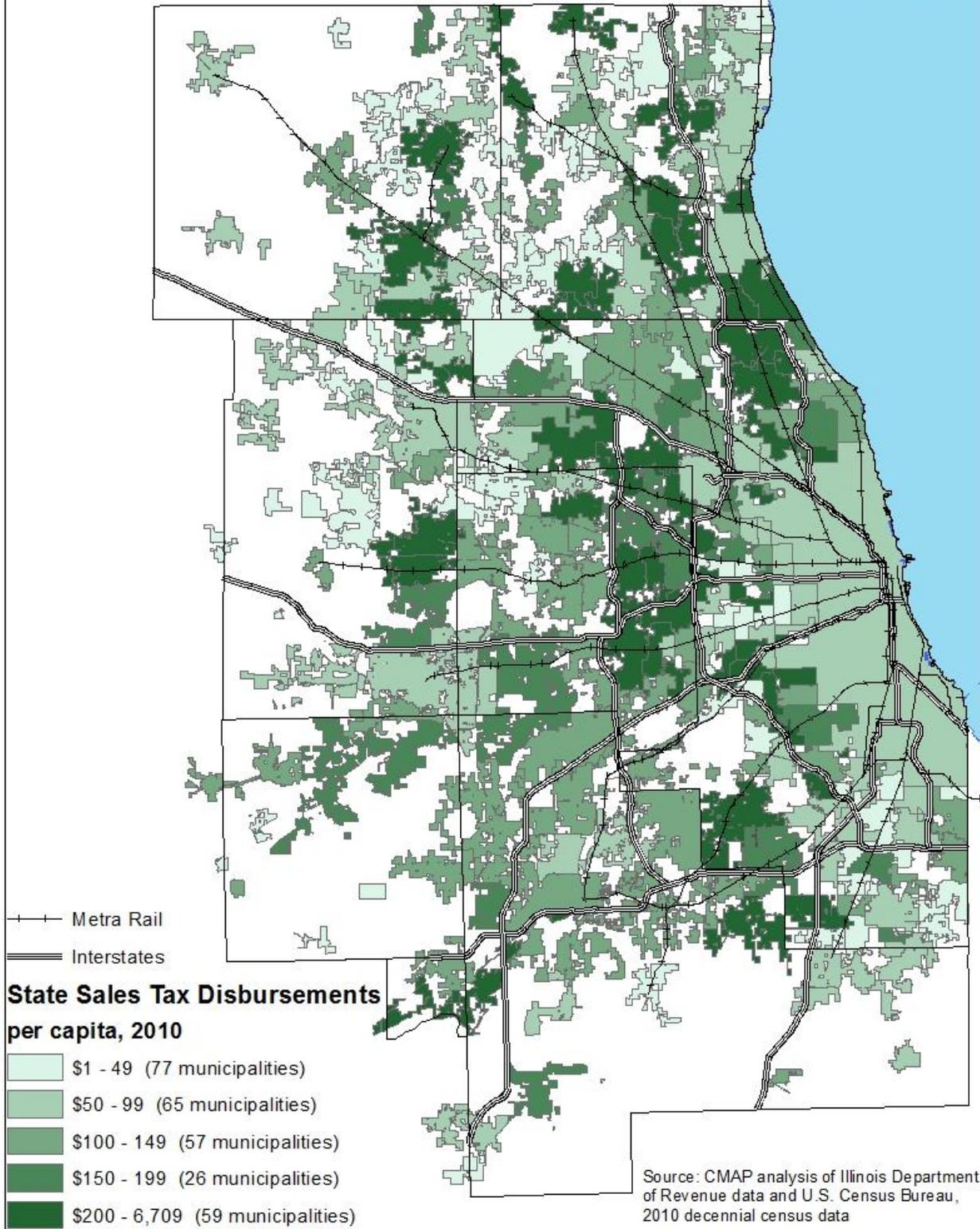
Existing Conditions of State Sales Tax Sharing

State sales tax disbursements account for the largest portion of state and local revenue sharing. Taxpayers in northeastern Illinois paid a total of \$5.2 billion in state sales taxes in 2010. Of that, \$4.0 billion or 77.1 percent went to the State, \$216.4 million or 4.2 percent went to counties and the Regional Transportation Authority (RTA),¹ and \$969.6 million or 18.7 percent went to municipalities.

State sales tax sharing to local governments is based on where the sale took place or where final acceptance of the order occurred. Municipalities (and counties for sales in unincorporated areas) receive 1 percentage point of the 6.25 percent rate on general merchandise sales within their borders. They also receive the full amount of the revenues from the 1 percent state rate on qualifying food, drugs, and medical appliances. Counties receive a quarter of a percentage point of the state rate on general merchandise sales within their borders. The exception is the Cook County share, which is allocated to the RTA. The following map illustrates per capita state sales tax disbursements to municipalities in the region for 2010.

¹ The RTA receives Cook County’s share of the state sales tax. The RTA also collects a mass transit district sales tax, which is not included in this data.

State Sales Tax Disbursements to Northeastern Illinois Municipalities, per Capita



In addition to receiving state sales tax revenues, counties, municipalities, and other units of government can impose local option sales taxes under certain circumstances. This includes municipal home rule sales taxes as well as municipal non-home rule sales taxes that can be adopted through the passage of a referendum up to a maximum rate of 1 percent. Local sales taxes imposed by the RTA, counties, and municipalities have pushed sales tax rates in most jurisdictions in the region above the state rate. Rates range from 7 percent in most of Kane, Lake, McHenry, and Will counties to 10 percent in a handful of municipalities in Cook County. Chicago's sales tax rate on general merchandise is 9.75 percent.

The focus of the remainder of this analysis is on the implications of and scenarios for state sales tax sharing for municipalities. Potential changes could also impact counties and the RTA, however that was not included in this analysis.

Implications of State Sales Tax Sharing

Highly Varied Distribution

Sharing state sales tax revenue based on location of sale results in highly varied disbursements across the region's municipalities. This creates wide differences in terms of municipal capacity to provide essential services, maintain or expand infrastructure, or attract new residents and businesses. To examine the existing disparities, consider the following 2010 statistics, which are also illustrated in Appendix A:

- Municipalities covering 26 percent of the region's population received 50 percent of the municipal disbursements.² The municipalities of the remaining 74 percent of the population shared the other half.
- Median per capita state sales tax revenue is \$100, meaning that half of the municipalities in the region receive less than \$100 in state sales tax revenue per resident, while the other half receives between \$100 and \$6,709.
- When looking at municipalities in the middle of the pack for state sales tax revenue per resident:
 - The municipality at the 75th percentile receives 79.9 percent more per resident than the municipality at the median.
 - The municipality at the 25th percentile receives 54 percent less than the median municipality.
- When revenues from local sales taxes are taken into account, the revenue differential between municipalities becomes larger:
 - The municipality in the 25th percentile is 57.4 percent less than the median of \$130.
 - The municipality at the 75th percentile jumps to 86.1 percent more than the median.

Impacts on the Provision of Municipal Services and Infrastructure

While high variances exist in terms of sales tax revenues, the expenditure side must also be considered. Shares of sales tax revenue allow municipalities and counties to recoup the cost of providing local government services arising from the revenue generating developments. However, an analysis of a hypothetical sales tax-generating development in the CMAP region illustrates that average associated municipal expenses amount to much less than the revenues generated. Even without a portion from local option sales taxes, municipalities receive over and above the amount of revenue required to provide these services.

² Municipalities were sorted by 2010 state sales tax disbursement per capita

The following table analyses the fiscal impact of a hypothetical retail power center or auto dealership, using data specific to a 30-acre greenfield site in metropolitan Chicago. The analysis compares revenues that would accrue to a municipality as a result of the development, including local taxes and state sales tax disbursements, to municipal expenses that would be required to support the development. See Appendix B for more detail on the methodology used.

Estimated Fiscal Impacts on a Municipality in the CMAP Region for a 30-acre development

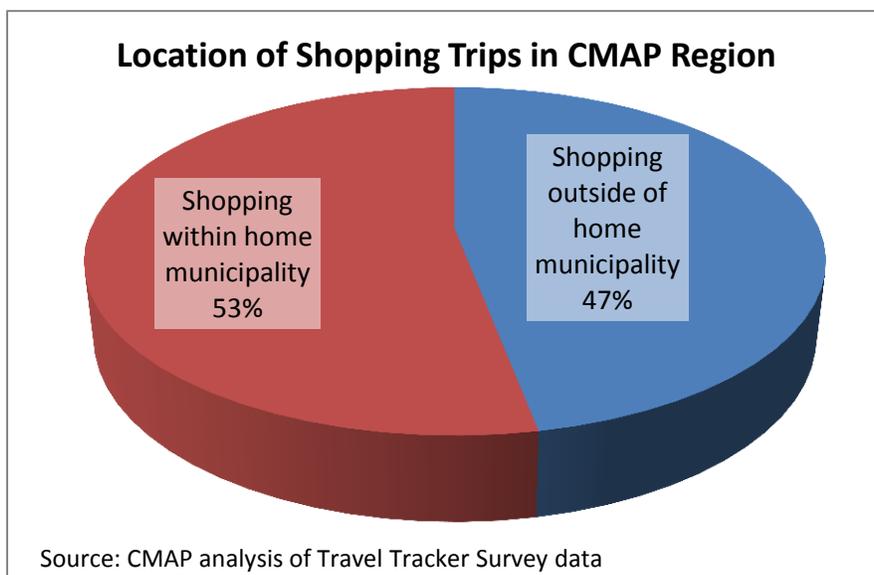
	Retail Power Center	Auto Dealership
Revenues		
Sales taxes	\$1,719,700	\$2,696,300
Property taxes	\$369,000	\$192,500
Telecom taxes	\$2,500	\$1,000
Electricity taxes	\$16,500	\$6,500
Natural gas taxes	\$4,500	\$1,500
Total revenues	\$2,112,200	\$2,897,800
Expenses		
General administration	\$86,000	\$34,000
Fire	\$70,000	\$27,000
Police	\$141,000	\$55,000
Total Expenses	\$297,000	\$116,000
Net fiscal impact	\$1,815,200	\$2,781,800
Notes: Assumes sales tax revenues include share of state sales tax, a 0.87% local option sales tax, property taxes of 1.66%, 4.99% telecom tax, 4.34% electricity tax, and 4.35% natural gas tax. Assumes expenses per resident and worker of: General - \$140; Fire - \$113; and Police - \$228. Source: Analysis of data from Illinois Department of Revenue, Cook County Assessor, DuPage County Assessor, Illinois Department of Commerce and Economic Opportunity, Illinois Comptroller, and S. B. Friedman & Company		

For a retail center, the state and local sales tax revenue generated would be 6 times more than municipal expenses associated with the development, and would be 3 times higher than the state sales tax portion alone. For an auto dealership, the discrepancy is even greater – state and local sales tax revenues are between 23 times municipal service expenses, and 12 times the municipal service expenses for state sales tax disbursements generated. Additionally, the municipality receives property and utility tax revenue that can be utilized to recoup the cost of supporting a development. Municipalities utilize surplus revenue generated from commercial properties to support services to residential areas, which do not typically generate enough tax revenue to support needed government services.³

³ University of Illinois Extension, “Costs of Community Services,” Local Government Information and Education Network Fact Sheet 2000-001, <http://urbanext.illinois.edu/lcr/pdf/LGIEN2000-0011.pdf>, (retrieved on April 29, 2011; John L. Crompton, “Programs that Work: Parks and Open Space: the Highest and Best Use of Public Land?,” *Journal of Park and Recreation Administration* 19, no. 3 (2001): 133-154.

While the municipality with the point of sale receives the tax revenue, other nearby municipalities may have to provide services as a result of these developments. Residents shopping outside of their home municipality travel through other municipalities that must provide services or infrastructure associated with that trip. While service and infrastructure costs are likely to be more intense for a municipality with a sales tax generating development, adjacent municipalities also incur these expenses. One of the more visible expenses is the resurfacing or reconstruction of arterial roads, which is done at an average per mile cost of nearly \$400,000 (resurfacing), and \$5,000,000 (reconstruction).⁴

Analysis of available data clearly demonstrates that residents are not bound by their home municipality when making shopping trips. Using CMAP’s trip generation model and information from CMAP’s recent Travel Tracker survey, about 1,466,000 (47 percent) daily shopping trips are made to destinations outside of home municipalities and 1,654,000 (53 percent) are made to destinations within home municipalities.⁵ This data represents the number of shopping trips made, rather than sales made during shopping trips.



Impacts on Land Use and Development

As GO TO 2040 states, the region’s development over the last several decades has resulted in a pattern of land use that is not sustainable. These changes have been driven by diverse factors, including infrastructure investment decisions and household preferences. Tax policies, including but not limited to the sales tax, have also played a key role in driving the development patterns for some communities. The sales tax structure often creates an incentive to attract large footprint retail land uses like big box stores and auto dealerships, and may lead many local governments to make land use decisions at odds

⁴ Based on CMAP analysis for GO TO 2040’s Financial Plan for Transportation. Figures are derived from reported bids for advertised projects and data acquired directly from municipal and county project implementers. In this context, “per mile” refers to “per centerline mile”. As costs obviously vary depending on time and place, these numbers should be treated as illustrative and for planning purposes only.

⁵ See <http://www.cmap.illinois.gov/travel-tracker-survey> for more information on the Travel Tracker Survey. The analysis assumes that the percent of shopping trips made outside the home municipality shown in the [Travel Tracker Survey results](#) is representative of the region’s shopping trips in general, and that the region makes approximately 3,120,000 daily shopping trips for any purpose, as estimated in CMAP’s trip generation model.

with their own comprehensive planning goals. The planning term for this incentive is the “fiscalization of land use”—the orientation of land use decisions to maximize municipal revenue streams. From a regional scale, this can encourage a distended rather than compact pattern of development. Other related regional impacts include a disparity between where people work and live, a lack of access to transit, increased energy use and household costs related to transportation, and increasing levels of traffic congestion.⁶

All that considered, it must be emphasized that local governments are simply playing by the rules established by the state. Municipalities have every incentive to maximize certain revenue streams and minimize the tax burdens faced by their own residents. Furthermore, while the “fiscalization of land use” incentive exists, municipalities across northeastern Illinois remain extremely diverse, with their own unique community characters. Many communities do not prioritize the attraction of large footprint retail, and many others have struck a balance between residential and other development priorities. GO TO 2040’s emphasis on “livability”—the creation of more walkable communities with access to transportation options – is not a “one size fits all” proposition.

Disbursement Options

Given some of the issues associated with state sales tax disbursements, GO TO 2040 recommends that the Regional Tax Policy Task Force evaluate the current disbursement criteria. This section will propose a series of different options for disbursing state sales tax revenues. Any of these options could include a multi-year phase-in period or a provision that would prevent a municipality’s disbursement from dropping for a set period (hold-harmless). For the purpose of simplicity, analyses of all the following proposals assume that the new disbursement criteria would have begun in 2010.

Modified Formula

Proposal 1: Population

Instead of location of sale, revenues could be shared on a per capita basis. In other words, sales tax revenues could be shared in the same way as income and motor fuel taxes, which are disbursed to municipalities based on population. Sharing sales tax revenue based on a municipality’s population would provide additional funding support to communities with little commercial development. It would also reorient municipal incentives toward maximizing residential population. On a per capita basis, this would result in no variance in state sales tax revenues among municipalities in the region. In 2010, every municipality would receive \$122 in state sales tax revenue per capita. In other words, 25 percent of the region’s population would live in municipalities collecting 25 percent of the sales tax revenues, and so on. In comparison to disbursing based on location of sale, 172 municipalities would have received higher disbursements in 2010, and 112 municipalities would have received lower disbursements than they otherwise would under location of sale criteria.

Proposal 2: Tax Base

Sales tax revenues could be dispersed on a municipality’s capacity to raise revenue through its property tax base. This method would likely bring about greater equity in municipal funding sources, as economically depressed areas would be provided with more funding than under a system based on the location of sale.

⁶ See GO TO 2040’s chapter on “Achieve Greater Livability through Land Use and Housing”, p.66.

To estimate the effect of disbursing sales tax revenues using tax base criteria, each municipality's population was multiplied by a ratio of the aggregate equalized assessed value per capita in incorporated areas of the region to the municipality's equalized assessed value per capita.⁷ In general, municipalities currently receiving relatively low sales tax revenue per capita would mostly benefit under this new system, while municipalities currently receiving higher disbursements of sales tax revenue per capita would receive less revenue under the new system. Therefore, this change would have the effect of reducing disparity among municipalities. See Appendix A for an illustration of how disbursing revenues using this method changes the variance among municipalities. Outcomes of disbursing sales tax revenues using property tax base in 2010 include:

- In comparison to disbursing based on location of sale:
 - 151 municipalities would receive higher disbursements.
 - 133 municipalities would receive lower disbursements.
- Half of the municipalities in the region would receive less than \$105 in state sales tax revenue per resident, while the other half would receive between \$105 and \$917.
- When looking at municipalities in the middle of the pack for state sales tax revenue per resident:
 - The municipality at the 75th percentile would receive 43.5 percent more per resident than the municipality at the median.
 - The municipality at the 25th percentile would receive 30.8 percent less than the median municipality.

Proposal 3: Combination Formulas

Criteria for disbursement could include several attributes, including the volume of sales in a municipality's borders, a municipality's population, and the property tax base of a municipality. The following two percentage breakdowns are offered to illustrate hypothetical examples of how a combination formula could be operationalized.

Combination Formula 1

Of total state sales tax disbursements:

70% based on location of sale: 70% × 1% of sales within municipality's borders

20% based on population: 20% of total disbursements × $\frac{\text{Municipality's population}}{\text{Total population}}$

10% based on property tax base:

10% total disbursements × $\frac{\text{Aggregate equalized assessed value per capita}}{\text{Municipality's equalized assessed value per capita}} \times \text{Municipality's population}$

Disbursing a smaller proportion of revenues based on location of sale results in most municipalities that had been below the median in 2010 doing better. On the other hand, most municipalities above the median of \$100 per capita in 2010 would receive lower revenues under this system than they otherwise would have received under a system of allocated all state sales tax revenues based on location of sale. See Appendix A for an illustration of how disbursing revenues using this method changes the variance among municipalities. Outcomes of disbursing sales tax revenues using Combination Formula 1 in 2010 include:

⁷ A similar formula is utilized in the Minneapolis-St. Paul region for sharing property tax revenues.

- In comparison to disbursing based on location of sale:
 - 162 municipalities would receive higher disbursements
 - 122 municipalities would receive lower disbursements
- Municipalities covering 34 percent of the region’s population received 50 percent of the municipal disbursements. The municipalities of the remaining 66 percent of the population shared the other half.
- Half of the municipalities in the region would receive less than \$108 in state sales tax revenue per resident, while the other half would receive between \$108 and \$4,721
- When looking at municipalities in the middle of the pack for state sales tax revenue per resident:
 - The municipality at the 75th percentile would receive 48 percent more per resident than the municipality at the median
 - The municipality at the 25th percentile would receive 31.4 percent less than the median municipality

The next example is based on the following formula:

Combination Formula 2

Of total state sales tax disbursements:

20% based on location of sale: 20% × 1% of sales within municipality’s borders

10% based on population: 10% of total disbursements × $\frac{\text{Municipality's population}}{\text{Total population}}$

70% based on property tax base:

70% total disbursements × $\frac{\text{Aggregate equalized assessed value per capita}}{\text{Municipality's equalized assessed value per capita}}$ × Municipality’s population

This formula gives more weight to property tax base than the first formula and less weight to location of sale and population. In comparison to disbursements under the current system, most municipalities that had received less than \$100 in state sales tax disbursement per capita receive more disbursement under Combination Formula 2 than they would under a system based entirely on location of sale. At the same time, most municipalities above the median in 2010 would receive less than they otherwise would have. See Appendix A for an illustration of how disbursing revenues using this method changes the variance among municipalities. Outcomes of disbursing sales tax revenues using Combination Formula 2 include:

- In comparison to disbursing based on location of sale:
 - 154 municipalities would receive higher disbursement
 - 130 municipalities would receive lower disbursement
- Municipalities covering 40 percent of the region’s population would receive 50 percent of the municipal disbursements. The municipalities of the remaining 60 percent of the population would share the other half.
- Half of the municipalities in the region would receive less than \$119 in state sales tax revenue per resident, while the other half would receive between \$119 and \$1,357
- When looking at municipalities in the middle of the pack for state sales tax revenue per resident:
 - The municipality at the 75th percentile would receive 24.7 percent more per resident than the municipality at the median

- The municipality at the 25th percentile would received 19.1 percent less than the median municipality

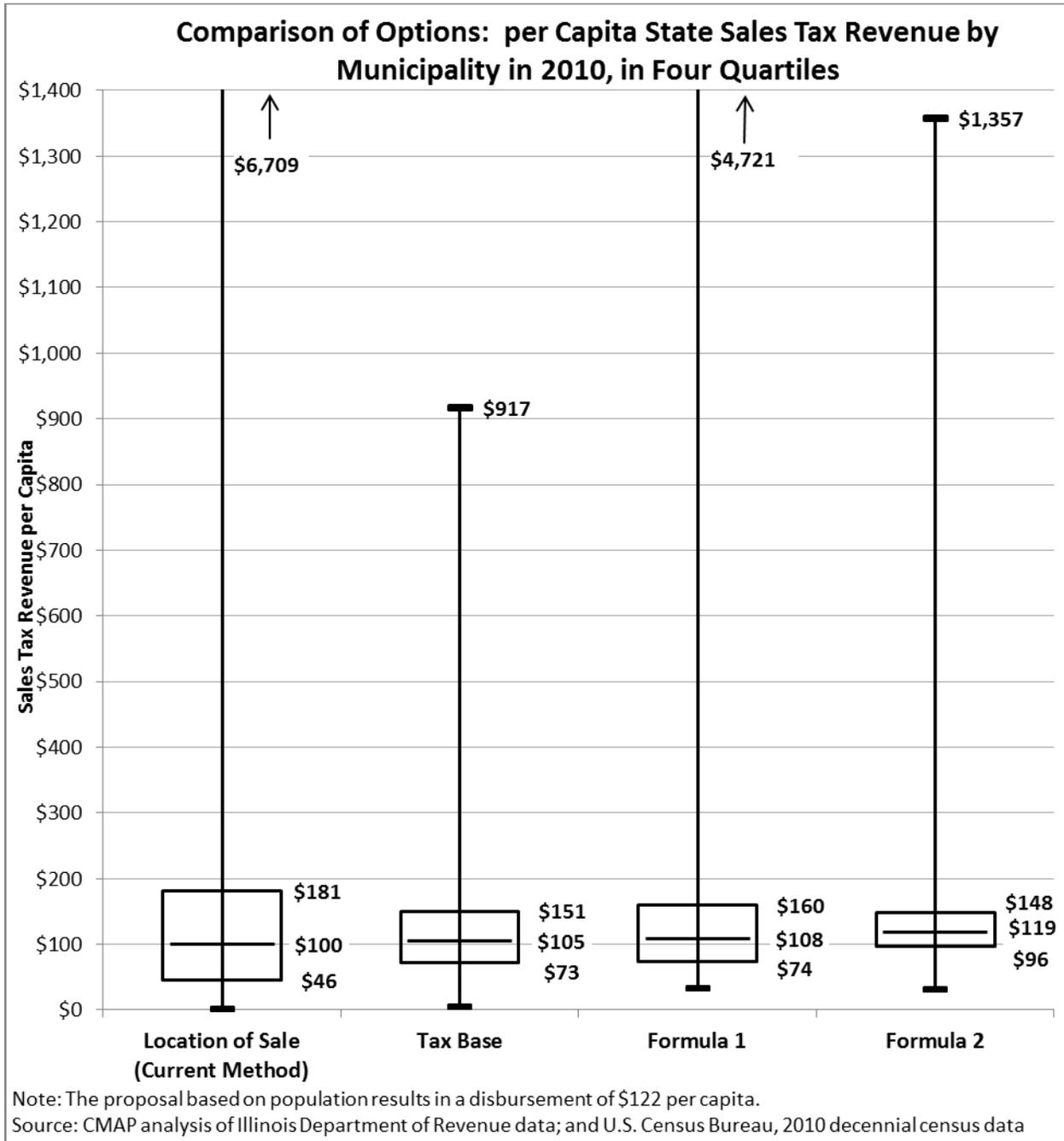
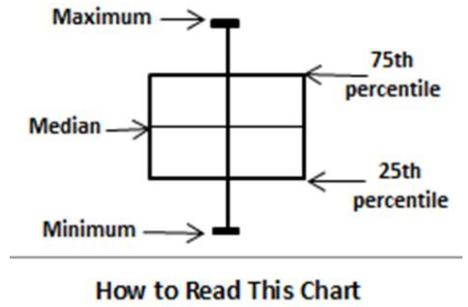
Proposal 4: Set Aside

Instead of disbursing revenues to municipalities and counties, a portion of sales tax revenues could be set aside for other needs, such as those that impact multiple jurisdictions. Transportation, water, or other kinds of infrastructure are examples of the types of capital projects that could be financed through such a strategy, though a universe of other options certainly exists. Like many places across the U.S., northeastern Illinois faces a considerable financial shortfall in its ability to maintain, much less expand, its existing infrastructure. This concern is shared by a variety of different state and local entities, which derive current funding from a mix of federal, state, and local sources. Without raising rates, the existing sales tax base for municipalities would obviously be affected, but benefits would be realized by the expenditure of these funds on projects of a multijurisdictional scale.

Proposal 5: Permissive

Instead of directly disbursing revenues to municipalities and counties, the State could disburse revenues to other local bodies that would have authority to determine disbursement arrangements based on need. These bodies might also be counties, or sub-regional groups of municipalities. This system could increase local cooperation on shared needs, resolve annexation or land incorporation conflicts between municipalities, or to coordinate government services. Under this system, the effect on municipalities would depend on the formula used.

Appendix A: Comparison of Disbursement Options



Appendix B: Fiscal Impact of Development Methodology

The analysis assumes that a typical Chicago-area municipality possesses a 30-acre greenfield site with good access and visibility that it could feasibly choose to develop a retail power center or an auto dealership. A retail power center in the region ranges from 250,000 to 600,000 square feet in size on a site from 20 to 50 acres in size. Power centers typically feature multiple anchor tenants such as home improvement stores, discount department stores, warehouse clubs, and office supply stores. New auto dealership facilities in the region range from 20,000 to 80,000 square feet, with 5 to 25 acres of additional acreage per dealer for storage of automobiles. Small, specialty dealers such as Volkswagen utilize smaller footprints, while a large, used-car dealer such as CarMax requires significantly more space for storage and processing of vehicles.

The analysis assumed a prototypical 30-acre greenfield site for all cases because a consistent site area allows for comparison of each of the land-use development patterns and the resulting fiscal benefits for the land use types being analyzed. Additionally, the 30-acre site area selected for the analysis accommodates the physical development requirements of the land uses evaluated, with some grouping of facilities (such as car dealerships) that may utilize smaller footprints but often collocate in clusters.

Municipal revenues were estimated by calculating the average tax rate for each tax type by county. For the sales tax, the state share was added to the local rate before averaging. Only communities that actually chose to enact any of these taxes were included in the averages.

Sales Taxes: Sales taxes were estimated for the retail power center and auto dealership land uses. Total sales for each tenant type were calculated using typical square footages ranges of other new developments of the same type in the region. The sales per square foot for retail power center tenants was taken from the Urban Land Institute's Dollars & Cents of Shopping Centers 2008. For auto dealers, sales per square foot were estimated utilizing data found in automotive manufacturers' annual reports as well as actual data from Comprehensive Annual Financial Reports of municipalities in the region. The square footage for each development type was then multiplied by the sales per square foot for that development type to calculate total sales.

Property Taxes: To average the high and low ends of municipal property tax revenues, rates from the two counties with the highest and lowest average property tax rates in the region, Cook and DuPage counties, were used. Average Equalized Assessed Value (EAV) per square foot was calculated for each land use type in both counties. This EAV/SF was then multiplied by the total anticipated square footage of the development and the derived tax rate to estimate the range of property taxes for each land use.

Telecommunications Taxes: An analysis of telecom receipts in prototypical communities and consumer spending data was used to estimate the typical amount spent by land use (either on a per square foot or per employee basis) on telecommunications services including phone, cable, and internet. This amount was multiplied by the average tax rate to estimate the range of telecommunications taxes by land use.

Electricity and Natural Gas Taxes: Energy Information Administration (EIA) 2007 Building, Energy Use, and Energy Costs data was used to determine average electricity and natural gas usage by building type and per square foot. The total utility usage for each land use was then multiplied by EIA data on electricity and natural gas costs by state to reach an estimate of electricity and natural gas costs by land use type. The average tax rate was applied to project a range of electricity and natural gas tax revenues.

Municipal operating expenses for serving each land use type were determined by reviewing the expenditures of municipalities that were heavily weighted in the commercial land use categories being considered. Employment data and EAV data by major land use category (e.g., residential, commercial) was used to identify prototypical retail communities. Municipal expenditures were divided by the total population plus the total employment in the municipality to create an expenditures per resident and job figure. The number of jobs for each development type was estimated using Urban Land Institute and Energy Information Administration data. Finally, the total number of employees for each development was multiplied by the appropriate cost per capita + job figure.

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