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MEMORANDUM

To: CMAP Economic Development Committee
CMAP Land Use Committee

From: CMAP staff

Date: December 2, 2015

Re: Comparative assessment of tax policies and land use trends

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Prior CMAP research on the nexus of tax policy and land use focused on the structure of the sales tax and the extent that it affects development in northeastern Illinois. Residential, office, retail, and industrial development each have benefits for the region and its communities. However, current statutory framework in Illinois emphasizes disbursements of state tax revenue to municipalities with greater retail sales. As such, communities may prioritize retail land use or allow development of excess capacity, leading to more retail space than the market requires.

It is important to ensure that all communities have the ability to generate revenue that supports the land uses that those communities have identified as important to support their economic, quality of life, and other goals. In preparation for the region's next comprehensive plan, staff will develop a strategy paper that includes research on how tax structures affect land use and development and outlines case studies from other states on the interaction between tax policies and land use outcomes. Based on this background analysis, policy recommendations or strategies in this area may be developed in FY2017. Topics will focus on state taxes that are disbursed to local governments as well as local taxes, and may include the following types of state and local taxes: sales, individual income, corporate income, payroll, utility, and real and personal property.

Background on local tax reliance

Since the end of World War II, municipalities in the United States have diversified their tax structures, generally decreasing their reliance on property taxes as a municipal revenue source. Between 1970 and 1994, reliance on the property tax as a source of revenue declined in 42 states.[1] During this time period, sales tax, income tax, and user fees and charges increased as

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[1] Brunori, David, "Metropolitan Taxation in the 21st Century," *National Tax Journal* 51 (1998): 541-551.

municipal revenue sources.[2] During this period, local governments were responding to general taxpayer distaste for property taxes.

The amount of tax revenue municipalities collect is dependent on the composition of the tax structure. Taxes have differing elasticities, that is, responses to market conditions. Property taxes, for example, lag the real estate value growth because of property assessment valuations and equalization policies, whereas sales and income tax revenues respond quickly to changes in consumption and employment. During expansionary economic periods, cities that are able to tax sales and earnings have a higher growth rate than cities that are more reliant on property tax revenue as a revenue source.[3] On the other hand, during recessionary periods or other eras when the retail industry is challenged, municipal collections that have a high retail tax component are impacted negatively. In 2010 for example, municipal sales tax receipts decreased by 8.4 percent from the previous year in the United States.[4] As such, an overreliance on highly elastic tax sources like the sales tax can make revenues more unstable. In comparison, property taxes offer more stability than sales or income tax revenue sources.[5]

Current conditions in Illinois

In Illinois, there are a number of mechanisms that the state uses to share revenue with local governments, as well as mechanisms that local governments use to raise revenues, that may have land use and development impacts. In addition, municipalities vary in terms of their reliance on these revenue sources. Previous CMAP research explored municipal tax reliance in more depth; findings of that analysis will be used throughout this section. The following maps provide an overview of municipal reliance on several types of sources in 2012.

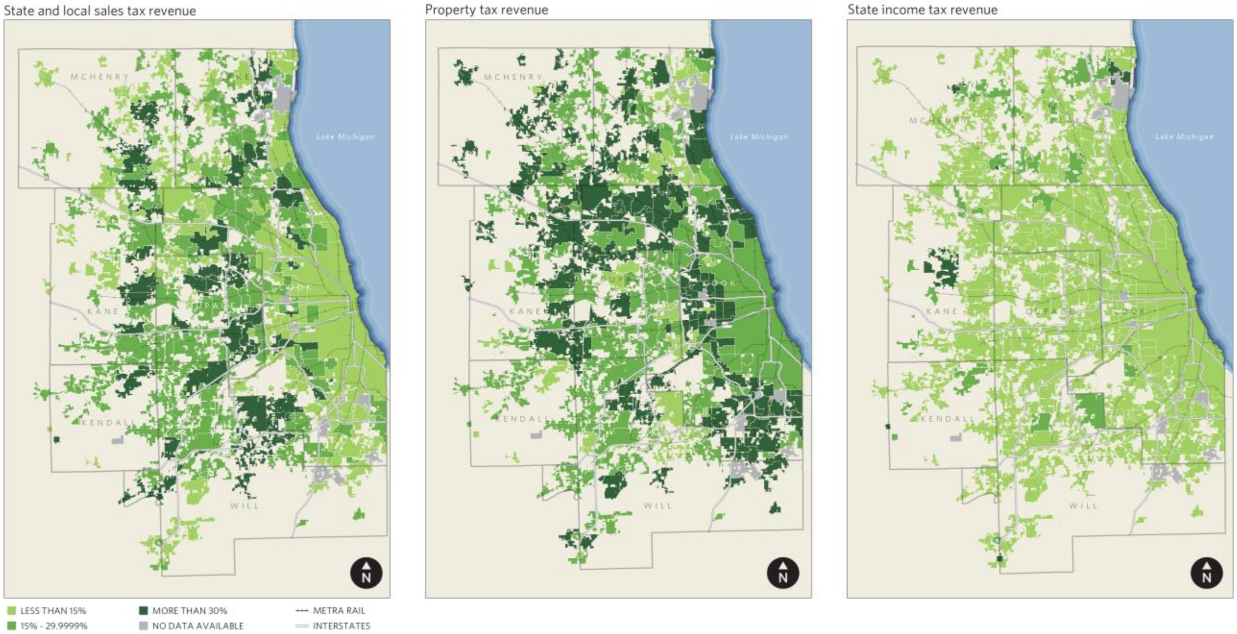
[2] Pagano, Michael A., "City Fiscal Structures and Land Development," Discussion paper for The Brookings Institution Center on Urban and Metropolitan Policy and CEOs for Cities (2003); Wassmer, Robert W., "Comments: Thoughts on Innovative Financing Options for Urban Governments," *Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association* 90 (1997): 387-392.

[3] Pagano, Michael A. "City Fiscal Structures and Land Development." Discussion paper for The Brookings Institution Center on Urban and Metropolitan Policy and CEOs for Cities (2003).

[4] McCarron, John. "On sale." *Planning* 78 (2012): 16-19.

[5] Pagano, Michael A. "City Fiscal Structures and Land Development." Discussion paper for The Brookings Institution Center on Urban and Metropolitan Policy and CEOs for Cities (2003).

Revenue reliance, by municipality, 2012



Source: Chicago Metropolitan Agency for Planning analysis of Illinois Office of the Comptroller data.

State sales tax disbursements

In Illinois, state sales tax is disbursed to municipalities and counties based on where sales are generated. This structure provides revenues to areas with strong retail activity and helps to fund municipal services associated with those activities.

Municipalities receive 1 percentage point of the 6.25 percent rate on general merchandise sales within their borders and 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, except Cook County's share, which is allocated to the Regional Transportation Authority.

Municipalities with higher reliance on sales tax revenues tend to have larger sales tax bases on a per capita basis. This may indicate a preponderance of land uses dedicated to sales tax-generating activities. Potential land uses include retail properties, as well as office or industrial properties where sales are sourced. The preponderance is driven by a combination of local-market demand for businesses, access considerations, proximity to other retailers, and local policy decisions that encourage retail and other sales tax-generating development within their borders. Market factors include a variety of considerations, such as consumer demand, the existence of retail clusters, and the location of distribution networks. Local policy decisions to encourage retail land uses may result from the strong fiscal benefit that retail developments provide to municipalities.

Local sales tax

In addition to receiving state sales tax revenues, counties and municipalities can impose local option sales taxes on general merchandise under certain circumstances. Home rule units may implement local option retail sales taxes of any rate. Non-home rule municipalities require a referendum to implement retail sales taxes, with a maximum rate of 1 percent. Non-home rule counties also require a referendum to implement a sales tax. This source also provides revenues to areas with strong retail activity.

Municipalities that rely more heavily on sales tax revenue were also more likely to have recently increased home rule or non-home rule sales tax rates. Among municipalities that relied on sales tax revenue for more than 30 percent of their overall revenue in 2012, 29.6 percent increased or instituted local option sales tax rates between 2009-14, compared to 16.4 percent of municipalities that have lower sales tax reliance.

State revenues disbursed by population (income tax, use tax, motor fuel tax)

Municipalities and counties receive a share of state individual and corporate income tax revenue based on their share of the state population (for counties this is based on unincorporated population only). The share is equivalent to one-tenth of the revenue generated under the rates in effect before January 1, 2011. In addition, other revenues disbursed to municipalities based on population include state motor fuel tax revenue and use tax revenue. These revenue sources tend to be a major source for communities that are primarily residential and have few businesses.

Local utility taxes

Municipalities may impose taxes on utilities, such as telecommunications, natural gas, and electricity. It is uncommon for utility taxes to be a major source of revenue, but a few smaller communities do rely on these revenues heavily. Some communities may have few residents and retail establishments, but a handful of businesses that are heavy utility users.

Real property taxes

Individual taxing bodies, including counties, townships, municipalities, special districts, and school districts have their own levy rates that are individually determined by the relationship between their annual financial requests and the assessed value of property within their geographical boundaries. Municipalities in the CMAP region vary in terms of their reliance on property tax revenues, with municipalities that provide services such as fire protection and libraries being more reliant on property tax revenues in comparison to communities where these services are provided by special districts.

Tax policy and land use

The structure of municipal tax revenues – and the potential for tax revenues that can be generated – can influence land use decisions and development projects that municipalities pursue.[6] For example, local decision-makers may pursue retail centers, where the revenue structure is made up primarily of the sales tax, because of the potential for a greater positive

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[6]Pagano, Michael A. "City Fiscal Structures and Land Development," Discussion paper for The Brookings Institution Center on Urban and Metropolitan Policy and CEOs for Cities (2003); Lewis, Paul G. "Retail Politics: Local Sales Taxes and the Fiscalization of Land Use," *Economic Development Quarterly* 15(2001): 21-35; Chapman, Jeffrey. "Proposition 13: Some unintended consequences," Occasional papers, San Francisco: Public Policy Institute of California (1998).

fiscal impact. In some cases, municipalities may pursue retail development that would contribute to sales tax revenue over residential development or other land uses that might produce more high-paying jobs.[7] Likewise, a reliance on income tax based on the location of employment as a revenue source may lead to the pursuit of economic development projects that bring in high paying jobs such as offices, universities, and large institutions.[8] In areas with high reliance on property taxes, communities often pursue high value commercial developments over residential developments in order to expand the size of the tax base. On the other hand, communities that must rely on state revenue disbursed based on number of residents may be more likely to pursue residential developments. Because local tax revenue is based to some extent on land use, development decisions have budgetary implications. Thus, it is important to ensure that the tax structure is balanced in such a way that supports a wide array of land uses.

Potential case study: local income taxes in Ohio

Several states allow municipalities to impose income taxes. One of the states with the most broad authorization is Ohio. Ohio allows municipalities to impose a tax on both individual and corporate income. This includes income of all employees within a municipality, income of residents who work outside the municipality (although typically reciprocity is granted to avoid having to pay two local income taxes), and net profits of businesses within the municipality. Many municipalities in Ohio have a heavy reliance on this tax relative to property tax revenue. In addition, municipalities in Ohio cannot impose other types of taxes, like sales taxes. As a result of this structure, many municipalities in Ohio emphasize job creation, particularly higher wage jobs, for economic development projects. For example, planning is often focused on developing or redeveloping office properties in order to attract businesses. Thus, economic development incentives are also often utilized to encourage high wage job creating businesses. While Ohio communities also employ economic development incentives related to the property tax, like abatements and tax increment financing, income tax rebates and credits are also utilized to encourage development.

CMAP staff plans to review the literature and local plans to evaluate this case study. Other case studies may address the impact of sales tax reliance, revenues generated based on population, and property tax reliance.

Process

CMAP staff is currently reaching out to CMAP committees, conducting research, and interviewing experts and stakeholders to inform the development of the strategy paper. CMAP staff is seeking feedback and ideas regarding this strategy paper, including ideas for potential case studies, resources, and experts and stakeholders to interview. An update will be provided in January/February 2016, and the strategy paper will be complete at the end of February 2016.

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[7] Chapman, Jeffrey. "Proposition 13: Some unintended consequences," Occasional papers, San Francisco: Public Policy Institute of California (1998); Schrag, Peter. *Paradise lost: California's experience, America's future*. New York: The New Press, 1998.

[8] Pagano, Michael A. 2003. "City Fiscal Structures and Land Development." Discussion paper for The Brookings Institution Center on Urban and Metropolitan Policy and CEOs for Cities.

Discussion questions

Staff is interested in feedback on this project. Specific discussion questions include the following:

- What is your overall reaction to the strategy paper and the subject matter?
- What experts and stakeholders should CMAP staff reach out to?
- Are there case studies that would be important to explore in this strategy paper?
- In Illinois, what land uses may be in need of a corresponding local revenue source that helps communities support a land use mix that achieves their economic, quality of life, and other goals?