CMAP

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DIVERGENCES IN STATE REVENUE DISBURSEMENTS

To meet their residents' needs, municipalities depend on a combination of local revenues such as property tax and state-generated revenues including income tax. Therefore, state tax structures and formulas for allocating revenues to municipalities affect their ability to fund basic services, meet community goals, and attract and retain residents and businesses. Each of the municipalities in the CMAP region receives a share of several state revenue sources, including the income tax, motor fuel tax (MFT), use tax, sales tax, and the personal property replacement tax (PPRT). The state disburses these revenues based on various factors, including population or other criteria long established in state statute.

This Policy Update analyzes the extent to which municipalities rely on any individual state revenue source, highlights factors that create differences between the revenues that communities receive, and suggests potential tax policy changes that can strengthen individual communities and the region.

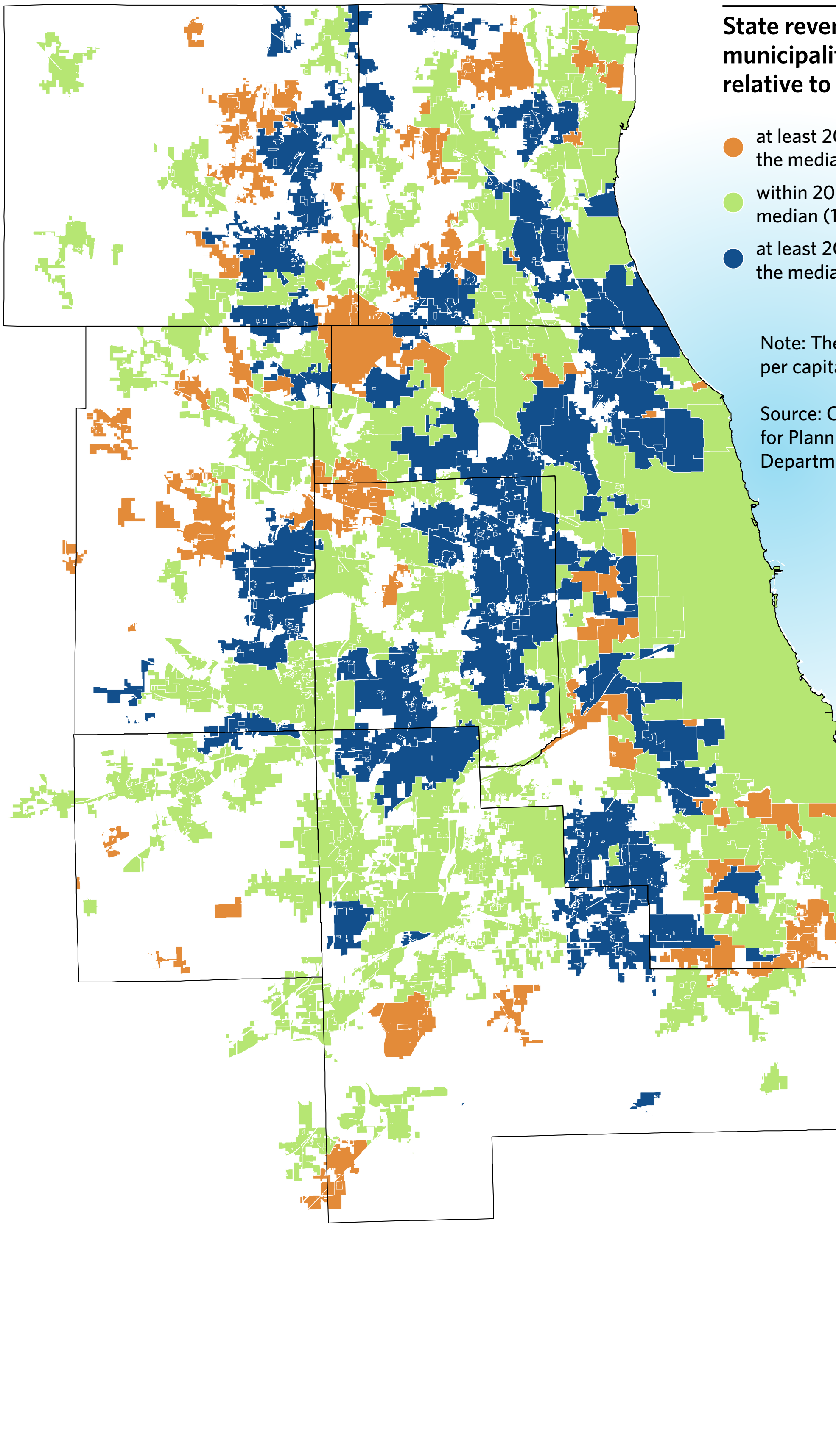
The role of state disbursements to municipalities

The ability of local governments to achieve their goals—such as economic development initiatives, increased public works or safety services, or quality of life improvements—is essential to the advancement of northeastern Illinois. Too often, however, municipalities collect insufficient revenues to deliver services, maintain infrastructure, and fulfill other necessary government functions.

Wide differences between communities in overall revenue levels are driven in part by divergences in state revenue disbursements, which in turn are prompted by differences in local land use mix, the size and composition of the local tax base, and state statutory criteria. Lack of state revenues for smaller or struggling communities can drive up local tax rates, and at times affect differences in service levels. The draft ON TO 2050 plan highlights the role that revenues play in a municipality's capacity to provide services and infrastructure, as well as to support a broad range of development types.

State revenue sources that partially fund municipalities in the Chicago region include the income tax, MFT, use tax (a tax paid on items purchased out of state or delivered from out of state for use in Illinois), sales tax, and PPRT. Municipalities in northeastern Illinois vary in terms of their reliance on any individual revenue source, including state disbursements as well as locally imposed taxes and fees, such as property and utility taxes. At the median level, 30 percent of municipal revenues come from these state disbursements of income, sales, and other taxes, with the middle half of municipalities in the region receiving between 23.3 and 40.5 percent of their revenues from state disbursements. Municipalities with lower levels of state disbursements must rely on property taxes and other local taxes or fees. Reforms to state revenue sharing criteria could help municipalities that have high service needs but currently receive relatively lower shares of state revenue, resulting in high local tax rates.

The map below illustrates the differences in state revenues distributed to municipalities per capita in 2015, in terms of difference from the median level. A relatively wide distribution exists across municipalities in the region, with just 41.8 percent of municipalities receiving disbursements within 20 percent of the median level. On the lower end, 74 municipalities received at least 20 percent less than the median level.



State revenues distributed to municipalities per capita, relative to the median, 2015

- at least 20 percent less than the median (74 municipalities)
- within 20 percent of the median (119 municipalities)
- at least 20 percent more than the median (92 municipalities)

Note: The median level of disbursement per capita is roughly $277.

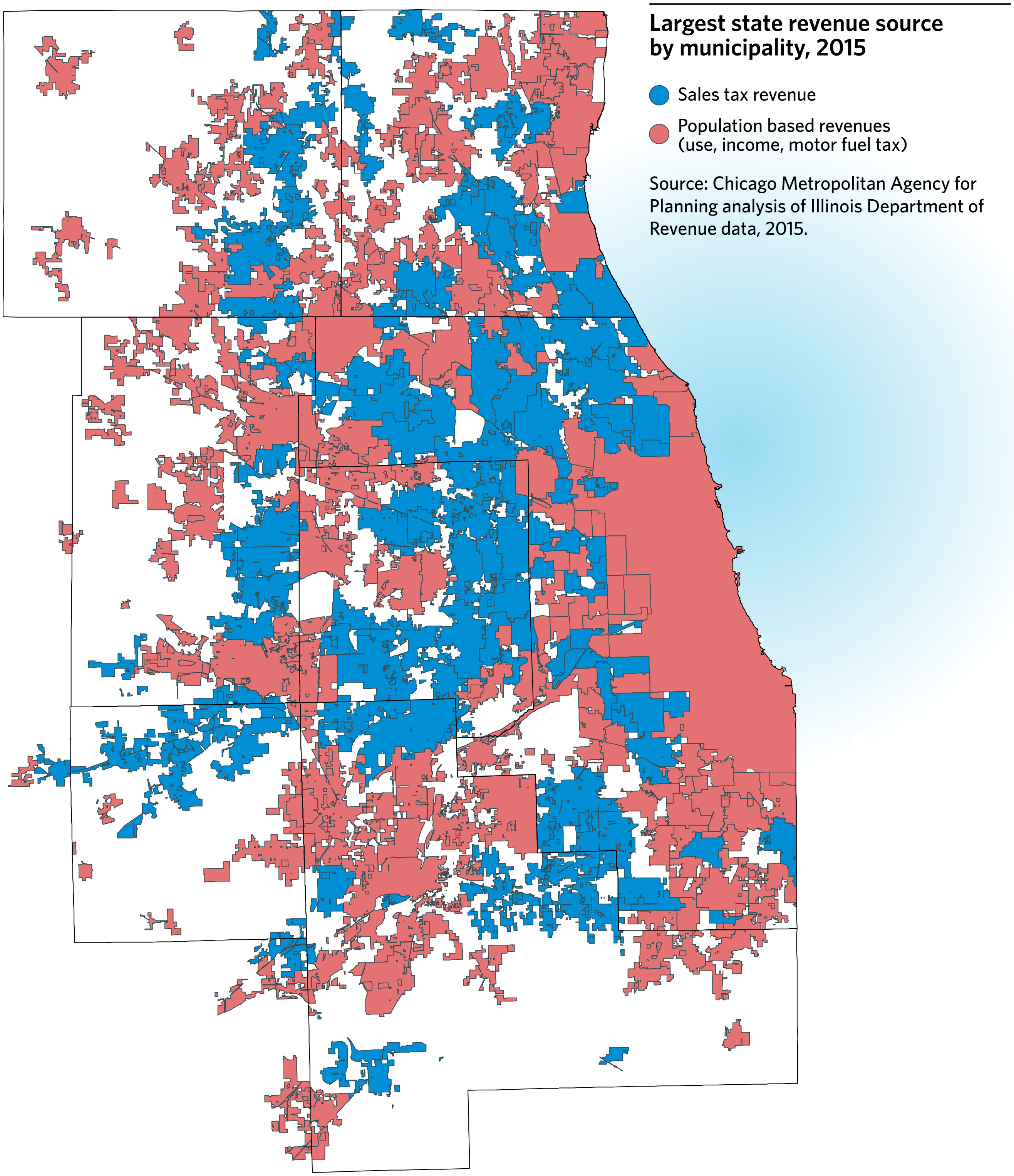
Source: Chicago Metropolitan Agency for Planning analysis of Illinois Department of Revenue data, 2015.

Divergences in state disbursements to municipalities

Municipal revenue levels are affected by how dependent each municipality is on any of the major state revenue sources. Municipalities with stronger revenue levels are better able to maintain their fiscal condition, allowing for greater capacity to meet public service needs and achieve local and regional goals.

In 2015, use, income, and MFT—distributed in proportion to a municipality's share of the state's population—were in the aggregate the largest state sources for 172 of the region's municipalities. Sales tax revenue—distributed based on where sales are generated—was the largest state source for the region's remaining 113 municipalities.

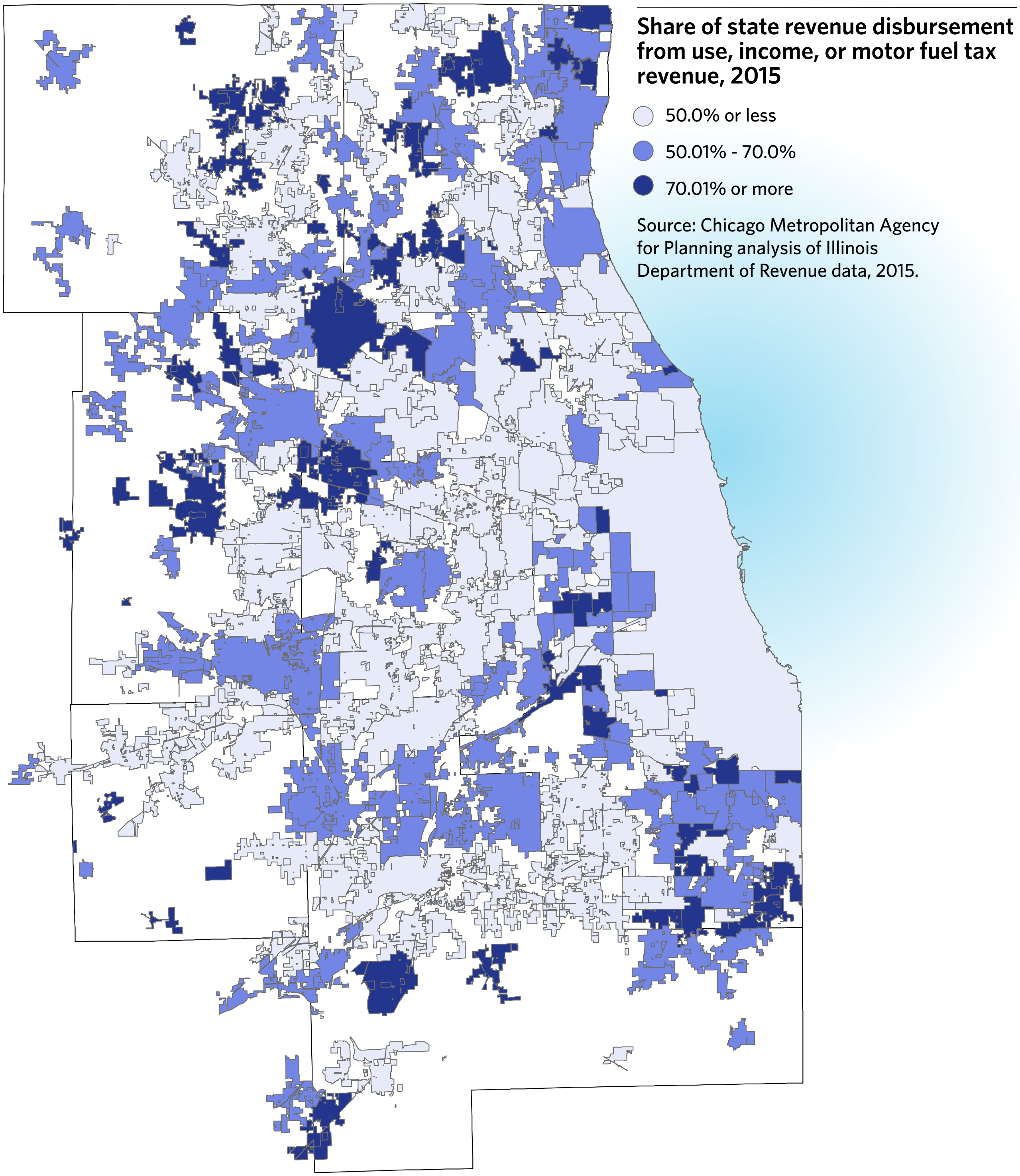
Largest state revenue source by municipality, 2015



Source: Chicago Metropolitan Agency for Planning analysis of Illinois Department of Revenue data, 2015.

On a per capita basis, state revenue from the use, income, and motor fuel taxes goes to each municipality, reflecting its share of the state's population. These revenue sources together represent roughly half of all state revenues provided to municipalities in the region. These revenue sources tend to be a major funding source for communities that are primarily residential and have few businesses, making them very reliant on state revenue disbursements.

Municipalities in the CMAP region receive on average 55 percent of their state disbursements from the use tax, income tax, and MFT combined. Further, municipalities that receive higher shares of their revenue from such population-based revenue sources tend to have lower levels of state revenue overall. For 69 municipalities in the CMAP region, these sources represent more than 70 percent of their state revenue, and each of the municipalities receives total state revenue per capita that is at least 20 percent less than the regional median.


Share of state revenue disbursement from use, income, or motor fuel tax revenue, 2015
50.0% or less
50.01% - 70.0%
70.01% or more
Source: Chicago Metropolitan Agency for Planning analysis of Illinois Department of Revenue data, 2015.

Municipalities with smaller populations are more likely to receive larger shares of their state revenue from use, income, or motor fuel tax. These sources often depend less on local land use mix, and therefore on local land use decisions or market factors. The 69 municipalities for which population-based revenues are at least 70 percent of their state disbursements had a median population size of roughly 4,000 in 2015. This stands in stark contrast to the remaining 216 municipalities, which had a median population size of roughly 17,000. In short, smaller municipalities rely more heavily on state revenues.

Median population and median state revenue disbursement per capita, by share of state revenue received from use, income, or motor fuel tax, 2015

Share of state revenue received from use, income, or motor fuel tax	Median population	Median state revenue disbursement per capita, 2015
50.0% or less	18,376	$414
50.1% - 70.0%	13,592	$258
70.1% or more	4,251	$183

Source: Chicago Metropolitan Agency for Planning analysis of Illinois Department of Revenue data, 2015.

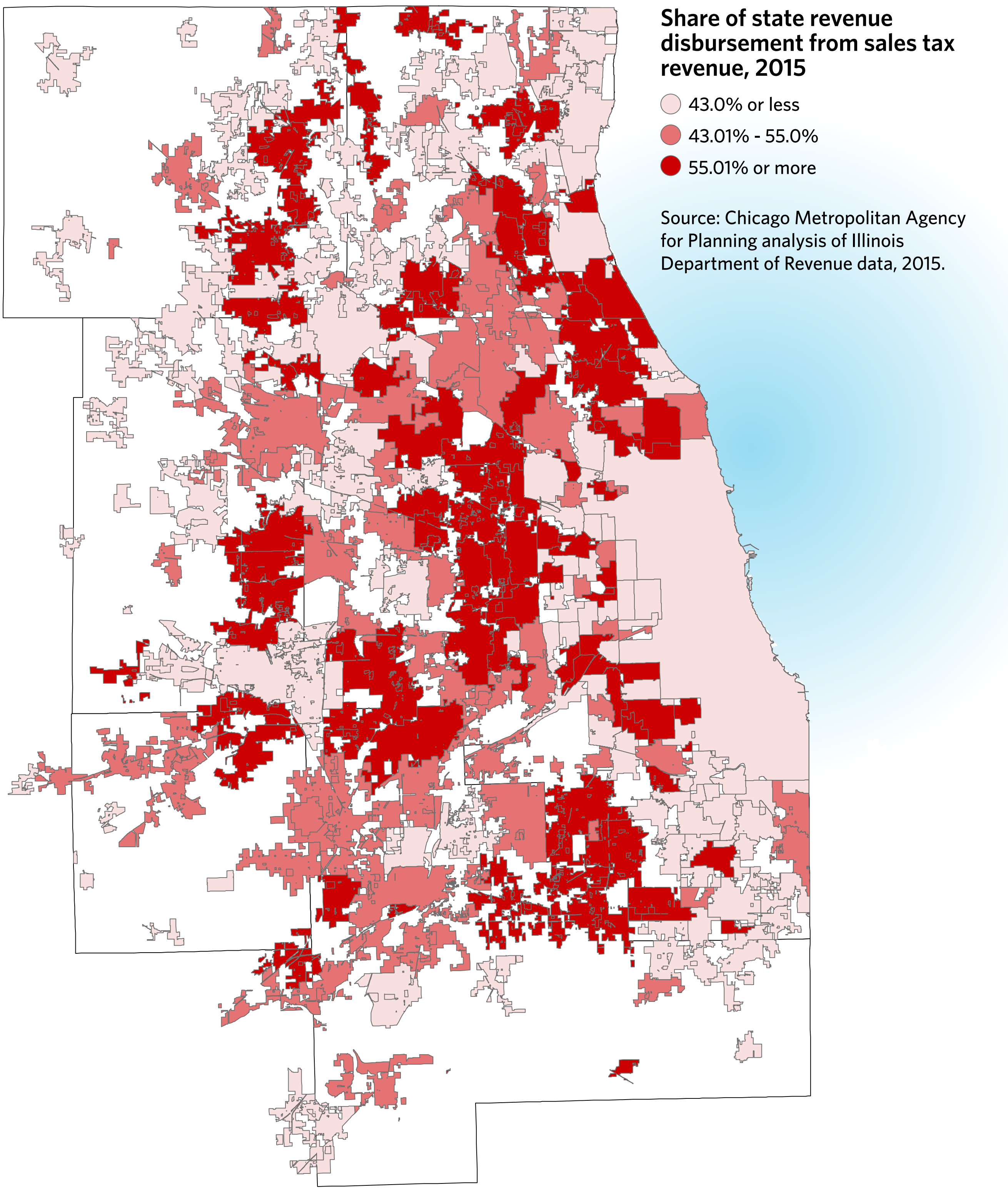
A number of characteristics drive a municipality's reliance on any particular revenue source, such as local land use decisions and resulting development patterns. Relying on any one source can result in disruptive fiscal impacts when economic conditions or patterns change. For example, many municipalities in the region rely heavily on sales tax while keeping a very low property tax rate. During economic downturns or shifts, these municipalities may struggle to provide the same services and activities for their residents. Variation in revenue stability affects the ability of communities to provide consistent services and maintain tax burdens.

Municipalities with smaller population bases are often less able to engage in activities that generate larger amounts of revenue, resulting in greater dependence on population-based revenue disbursements. In particular, retail and other economic activities that generate sales tax revenue account for roughly half of all state revenue disbursements to municipalities in the region. With retail developers seeking large nearby household counts and retail stores often clustered on major transportation corridors, many smaller jurisdictions may have limited retail potential.

Sales tax revenue is disbursed to municipalities based on where sales are generated. Municipalities receive one percentage point of the 6.25 percent state rate on general merchandise sales within their borders and the full amount of the revenues from the one-percent state rate on qualifying food, drug, and medical appliances. Thus, this system also in part favors areas with stronger retail activity and helps fund municipal services associated with those activities. Past CMAP research has indicated that the cost of municipal services to these areas is often substantially lower than the revenues received by the municipality, so that municipalities see net financial gain from increased retail development.

On average, state sales tax revenue represents 43 percent of state disbursements to the CMAP region's municipalities. Municipalities for which state sales tax revenue comprises more than 43 percent of their total state disbursements typically receive higher levels of state revenue overall. The map below shows the percentage of municipalities' state tax revenue that consists of sales tax disbursements.

Share of state revenue disbursement from sales tax revenue, 2015



Source: Chicago Metropolitan Agency for Planning analysis of Illinois Department of Revenue data, 2015.

Municipalities may prioritize land use that generates sales tax—including retail, office, and industrial—because such revenues are determined by the location of sales. Municipalities with retail development often generate more revenue from the sales tax than other municipalities are able to generate from other sources. Further, municipalities with more retail activity and sales tax revenue generally receive higher levels of state revenue overall, contributing to divergences in state disbursements between municipalities.

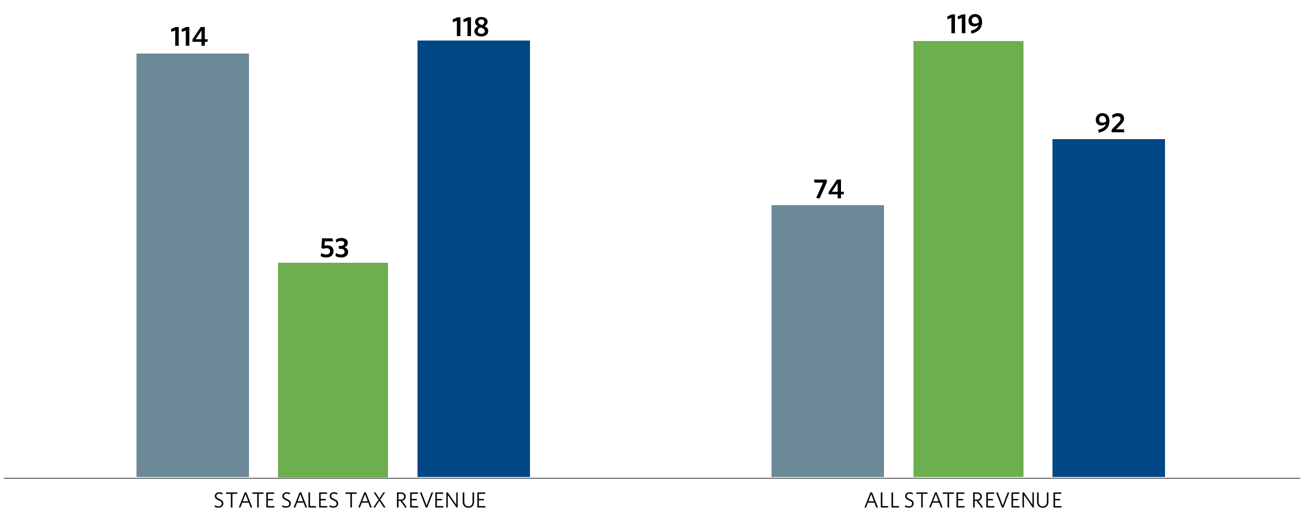
The graph below highlights the more significant disparities that exist in state sales revenue disbursements per capita alone relative to all disbursements of state revenue.

Revenue disbursements to municipalities per capita, difference from the median, 2015

- at least 20% less than the median
- within 20% of the median
- at least 20% more than the median

Note: The amount of total state revenue municipalities receive varies. Of the 285 municipalities within or overlapping the CMAP region, 119 receive disbursements within 20 percent of the regionwide median. In contrast, only 53 municipalities generate sales tax revenue amounts that fall within 20 percent of the median level of sales tax revenue.

Source: Chicago Metropolitan Agency for Planning analysis of Illinois Department of Revenue data, 2015.



In many states, local jurisdictions receive property tax revenues generated from personal property, such as machinery and equipment, particularly from industrial development. However, Illinois removed personal property from its property tax base in the late 1970s and replaced it with a statewide tax on business income, public utilities, electricity distributors, and telecommunications services. All taxing districts in the state that collected a property tax and had personal property in the base in 1977 (or 1976 for Cook County districts) continue to receive annual PPRT disbursements. Today, these revenues are disbursed based on each district's share of total personal property tax collections in 1976 and 1977.

Due to this structure, only 15 percent of the PPRT revenues disbursed in the region go to municipalities. PPRT revenues account for an average of just three percent of total state disbursements for municipalities in the CMAP region.

However, this statutory framework disadvantages taxing districts that were created after 1977, did not collect property taxes in 1977, or did not have personal property in their tax base. This includes 20 municipalities in the CMAP region that do not receive any PPRT revenue.

Additionally, the allocation strategy has not changed to reflect today's development patterns or tax structures. Municipalities that have added substantial industrial development since 1977 may not benefit from the current PPRT structure. Rather, revenues are prioritized to municipalities that were once heavily industrialized and/or had high property tax levies in the 1970s, potentially failing to address current local needs. Though PPRT revenues account for a small share of total state disbursements, the unequal distribution of PPRT revenues can nevertheless exacerbate disparities in state revenue disbursements to municipalities.

Implications for tax strategies

Divergences in state revenue disbursements have several implications for the region and its communities. Low levels of such disbursements may force some communities to rely more heavily on locally imposed revenues, such as property or utility tax revenue. In some municipalities, those are insufficient, leaving communities vulnerable to inadequate services and infrastructure, and potentially a cycle of decline. The current structure produces more state revenue for communities with higher levels of sales tax revenue. Municipalities with primarily residential development are vulnerable to receiving lower state revenue amounts.

It is important that municipalities can sustain the land use mix that meets their planning goals and improves local quality of life. State revenue disbursements to municipalities with primarily residential or industrial uses may be lower than required to effectively provide public services without putting significant pressure on locally imposed taxes. The need to maintain roads serving retail districts in adjacent communities can exacerbate these disparities.

Moving forward, the ON TO 2050 draft recommends that the State of Illinois should reform state revenue sharing disbursement criteria to reduce wide divergences across municipalities and allow each municipality to support its own desired mix of land uses. The State should engage in fiscally sustainable practices to ensure a stable business climate and guarantee the reliability of state support to the region, including for local governments.

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