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Financing Municipal Government

by Fred M. Oliver
Partner, Salt Lake City Office

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Since the early beginnings of local government in the United States primary dependence has traditionally been placed on the property tax as the major source of revenue for financing the basic services of government. The primary reason for this was based on the fundamental concept that the services originally performed were the protection of life and property and that the cost of such services should be levied on those who received the benefit of such services.

Thus, the "benefits received" principle became the traditional basis for determining which segment of the population to impose the costs of local government upon. This principle has withstood the test of time and even today is still the cornerstone of taxation for local government. Despite all of the historical increases in property tax rates generally, the "raise that breaks its back" has not yet arrived.

Some 1962 statistics, drawn from data in United States Census Bureau publications, bear out the conclusion mentioned above. Of all *tax* revenues received by local governments in the United States in that year, 87% came from property taxes and only 13% from non-property tax sources. In 1952, ten years before, 88% of total tax revenues came from the traditional property tax.

However, when the relationship of property tax revenues to total revenues of all local governments in the United States is considered, a noticeably different trend is observed. In 1961, for example, of the total income received by state and local governments in the United States, only 39% was from the general property tax. This point was reached in 1961 after a long period of gradual departure from the property tax as a base of taxation.

Gradual Shift to Non-property Taxes

It was in the mid-thirties that the trend away from this traditional reliance on the property tax first became noticeably discernible, although a very gradual change in this direction actually began as far back as 1900. A sharp acceleration occurred after World War II. For example, between the years of 1942 and 1949, in all cities having 1940 populations of 25,000 or more, property taxes collected increased 223%. Other types of revenues,

such as aid received from other governmental units and charges for current services, increased 82% and 100% respectively.

While this same trend has since continued across the nation, its pace has slowed somewhat, especially since the mid 1950s. The principal growth has been in the development of new types of revenue, such as income taxes, refuse-collection fees and sewer-service charges. In some areas increases in revenues from these sources has been substantial.

The basic reason underlying this gradual trend away from the traditional property tax is that both the cost of existing services and the demand for many new services have grown faster than has the property tax base. In short, the need of cities generally for more revenue, plus a desire to make the local tax system more diversified than it has been in the past, have furnished the motivation to adopt new forms of revenue, including income and other non-property taxes and other types of charges or fees.

In addition, urbanization has been continuing for some time, which in turn has made it necessary to perform either additional services or to intensify and increase the standard of performance of older services. Numerous studies would also indicate that as a city increases in size, its costs per capita for performing a given service tend to increase geometrically. The impact of this has been felt by almost all cities, particularly those whose population growth was rapid.

None of the above-mentioned factors take into account one of the principal causes for rapid increases in governmental costs and hence the need for more revenues, namely, inflation in the price level. We are all familiar with the impact of this force on wages and salaries as well as on the cost of commodities and other materials and supplies required in rendering municipal services.

With the marked acceleration of the income tax rates by the Federal government during the war and post-war years, the pattern set by this type of tax has gradually been adopted by many units of local government. While very few cities have actually moved into the income tax field, many have utilized the principle of "ability to pay" inherent in the income tax, in a variety of other forms of revenue, such as business license taxes, franchise taxes, admissions taxes, cigarette and tobacco taxes, and similar charges.

A very significant factor influencing the course of new types of revenue has been that of statutory authority or restriction. Before many of these new revenues can be inaugurated, enabling statutes must be enacted in state legislatures and such laws are often difficult to pass or at least may require introduction in more than one session

of a legislature before being adopted. Even where statutory authority is granted, in some instances a local community may not adopt a newly authorized type of revenue because it may not be suited to the city; unsuitability may spring from economic, geographic, or related factors, or its adoption may not be politically feasible.

Recent Trend to State Grants-in-aid and State-collected, Locally Shared Revenues

One of the interesting trends in local government revenues has been the development of state grants-in-aid and state-collected, locally shared taxes. Because of the difficulty of raising additional revenues from existing local tax sources and the fact that local officials may dislike the responsibility for raising local taxes, state aid has been favored by many local governments as a solution to their financial problems.

A distinction is usually made between a state grant-in-aid and a state-collected, locally shared tax. Grants-in-aid are lump-sum payments given by the state to local governments for certain specific functions. These grants are usually made contingent upon acceptance by the local units of certain standards and requirements established by the state.

Shared taxes, on the other hand, are refunds to local governments of taxes imposed and collected by the state on the basis of some equitable formula, leaving the local governments in full control of expenditures. Frequently, payments made by the state may have some of the characteristics of both types of assistance.

A TYPICAL EXPERIENCE WITH STATE-COLLECTED, LOCALLY SHARED REVENUES

This brings me to a major purpose of my paper: to illustrate three types of state assistance to local governments used for a number of years by the municipalities in my own State of Utah. Such dependence has been placed on these revenue sources that as of today they constitute a substantial percentage of total revenue of many units of local government in our State. These three sources are as follows:

Class "B" and "C" road-fund allotment
State liquor-fund allotment
State-collected, locally shared sales taxes

It may be of interest to review some of the background and history of these several sources of State assistance as well as to recount

the extent of the financial contribution they have made to local governmental units in Utah.

Class "B" and "C" Road-fund Allotment

State aid for city streets and county roads was first established on a continuing basis in 1937. At that time the Utah legislature provided an annual appropriation of $800,000 from motor vehicle registration fee revenues for the construction and maintenance of county (Class "B") and city and town (Class "C") streets.

Over the years this allocation has been changed several times, always increased but never reduced. By 1956 the cities, towns and counties were receiving the first $2,000,000 and 50% of all motor vehicle fees collected in excess thereof. In that year, this yielded approximately $2,495,000. By 1963, the formula permitted the local units of government to receive the first $2,000,000 and 75% of the excess over that amount. This yielded $3,765,600, an increase of $291,800 over the $3,473,800 received in 1962. A legislative effort to obtain a full 100% of the motor vehicle registration fees for the cities, towns and counties in Utah seems certain to be made in the 1965 session of the State legislature.

It may be of interest to note how the 1963 total allocation was divided between the counties and the cities and towns. This was as follows:

	Amount	*% of Total*
Counties—Class "B"	$2,248,030	60%
Cities and towns—Class "C"	1,517,510	40%
Total	$3,765,540	100%

The above allotment was based on 20,929 miles of roads, which amounted to an average allocation of $180 a mile.

The apportionment to individual local governments for roads is based on three factors—population, 45%, road mileage, 45%, and land area, 10%. That is, for example, 45% of the total allotment is apportioned among all participating units of government in the ratio of their population, according to the last Federal census, to total population in the State. Apportionment on the basis of the other factors is made in a similar manner.

All funds received under this program are earmarked for road maintenance and construction and may be used for no other purpose. An advance program of the individual roads or streets which are

planned for construction or on which substantial maintenance is to be done must be submitted to the State Road Commission on forms furnished by this agency on or before May 1 of each year. After approval by the Road Commission the community's allotment is released for payment. After the work as planned is completed, a report thereon must be furnished to the State Road Commission. Although the money must be spent specifically for the streets or roads named in the program, reasonable deviation therefrom is permitted by the State agency supervising this program.

In addition to use for road and street construction or maintenance, these funds may be utilized for drainage improvements, if such work is essential to the protection of an adjacent street, and for sidewalk or curb and gutter improvements paid for by the city if adjacent to a State highway. These funds may also be used for road equipment if, in the judgment of the Road Commission's District Engineer, such equipment is needed for the proper maintenance of the community's streets.

One of the interesting requirements established to safeguard Class "B" and "C" road funds is that each year's allotment must be placed in a separate bank account and not commingled in any way with other city funds. The receipt and disbursement of these monies is audited annually by a division of the State Road Commission to ensure that they are spent only for eligible purposes under the statute.

One of the interesting by-products of the separate bank account requirement is that it facilitates the audit of these funds in each city or county.

An allotment granted but not used in a given year may be held for later disbursement. Funds so held may be invested but the interest earned therefrom must be deposited in this special fund.

There has been some criticism in our State of the formula used in the allocation of monies in the Class "B" and "C" road fund. It has been said there is little relation between land area, the miles of road in a city or county, and the amount of traffic or revenue paid by the users. Yet land area and road mileage account for 55% of the formula used for the distribution of these road funds. An alternate plan at one time suggested that 30% be distributed on the basis of vehicle travel, 30% on population, 30% on road mileage and 10% on land area; however, no serious consideration has ever been given to such a plan and the original formula of 45% each on population and road mileage and 10% on area remains in force today.

State Liquor Fund Allotment

Utah's law for many years has provided that all sales of liquor be made through State-controlled liquor stores, the sale of liquor by the drink being unlawful in Utah. The profits from the operation of State liquor stores is retained as a source of revenue for operating State departments and agencies.

In 1947, after several years of agitation and legislative effort, a law was passed providing that all profits in excess of the first $2,250,-000, but not to exceed $1,000,000 a year, be distributed to counties, cities, and incorporated towns. This money was to be distributed on the basis of population in the last Federal census.

The law places no restriction on how this money is to be spent, but the legislative intent was that it be used primarily for police effort to control the liquor problem in each community or county.

The full $1,000,000 has been distributed each year since 1947 to these governmental units, there having been no change in the law or formula on which the distribution is based. In this connection, if a new community was organized between two Federal censuses, it would receive no State liquor fund allotment until the following ten-year census was made. Thus, once a city's allotment is established, it remains the same for the full ten-year period.

In the earliest years after the law was enacted, the total fund of $1,000,000 was divided slightly under one-fourth to the counties and three-fourths to the cities. In 1963, based on 1962 liquor profits, the distribution to counties was $267,495 and to the cities, $732,505, or approximately 27% and 73%, respectively. Thus, the counties, with the growth of population slightly in their favor, have gradually qualified for an increased share of the total allotment of $1,000,000.

It may be interesting to note what has happened to the allotments in some of the State's larger cities and counties by reason of population changes during the past decade or two. Salt Lake City, the State's largest municipality, for instance, had an allotment under the 1950 census of $264,379; in the 1960 census this was reduced to $212,719. On the other hand, Salt Lake County's 1950 census allotment of $90,850 was increased to $168,711. These new allotments properly reflect the shifts in population, but they would seem unrealistic in light of changes in operating costs of both units of government. Salt Lake City, for instance, has had much more growth proportionately in the costs of its police operation during this decade than has Salt Lake County, partly from inflation and partly from continued

demand for improved police protection, yet the allotment to control one important phase of the over-all police problem has been reduced very substantially.

Another interesting fact about this liquor-fund allotment is that it amounts to $1.12 per capita, based on a total 1960 population of 890,627 persons in the State.

State-collected, Locally Shared Sales Taxes

Utah enacted a sales tax law originally in 1933, and a use tax law in 1937, levying at that time a tax of 2% on all retail sales of tangible personal property. The use tax was levied on the storage, use, or other consumption of tangible personal property. In 1959 the coverage was broadened to include services and hotel, motel, or tourist accommodations. The State rate was increased to 2-½% in 1961 and to 3% in 1963.

In 1959, under a local-option statute, counties within the State were authorized to adopt sales-tax ordinances permitting the collection of a ½% sales tax on sales or uses of tangible personal property or services within the county; incorporated communities within each county were then permitted to adopt resolutions providing for the collection of the tax on sales or uses within their own communities. However, the incorporated cities and towns could not impose the tax without the enabling authorization by the counties within which they were located. Thus, the local option to apply the tax rested with the respective commissions of the various counties of the State. As of July 1, 1963, all but five of the State's 29 counties will have adopted enabling ordinances to levy the ½% sales tax.

The tax is collected by the State Tax Commission, and is merely added to the previous sales tax of 2-½%; a total of 3% is therefore now collected for State purposes. The State separately accounts for the taxes collected within each city and in the unincorporated areas within each county and distributes its share to each within about sixty days after the close of each calendar-year quarter. It deducts from each governmental unit's gross share the pro-rata cost of collection of the tax, which by agreement is a flat 2-½% of the gross tax collected.

There has been considerable complaint expressed within the State about the imposition of this collection charge, since all of the governmental units deduct from their employees' salaries the State income tax required under its own withholding plan, for which they receive no

collection or service fee. It is entirely possible, therefore, that a concerted effort may be made to remove this collection charge within the next year or so, which will increase the allocation to each governmental unit.

While the legislature technically placed no restriction on the purposes for which the ½% sales tax monies could be spent by the local governmental units, the preamble to the enabling statute did express the legislative intent that they be used primarily for capital improvements and retirement of outstanding bonded debt. While there are no accurate statistics available on the purposes for which such monies have been spent within the cities, towns, and counties, by and large by far the greater amount has been utilized for the purposes described in the legislative act.

Of the three sources of financial assistance received by Utah counties and incorporated communities through State channels, the ½% sales tax has been by far the most substantial in amount. For example, the amounts collected and distributed to these governmental units during the State's last two fiscal years are as follows:

Fiscal years ended:	
June 30, 1961	$4,442,805
June 30, 1962	6,135,593

In 1963 a measure was introduced in the State legislature to distribute the sales taxes as now collected within the respective counties, cities, and towns to all counties and communities on a basis of population. The theory of this proposal was that residents of the small cities did the bulk of their shopping in the larger centers, thus leaving the sales tax on their own purchases in the metropolitan areas. It was claimed that distribution of all sales taxes on a population basis would return to the small cities their fair share of total sales taxes paid. The bill did not pass the 1963 legislature. Incidentally, in an informal opinion the State's Attorney General ruled the distribution of presently collected sales taxes on a population basis to be illegal.

Other Indirect Sources of Assistance

One interesting development in the 1963 session of the Utah legislature was the passage of a bill exempting governmental units from payment of the six-cent State Highway tax on each gallon of gasoline purchased. These units were previously exempt from the Federal excise tax on gasoline but had paid the State tax for many years.

This will serve to reduce operating costs of all the cities, towns, and counties by approximately $200,000 during each year.

In summary, it may be safely concluded that with the expectation of a continued rise in the cost of local government, the search for revenues to finance such increasing costs must likewise continue. Two of the sources to which cities may hopefully look, if they have not already done so, are state grants-in-aid and state-collected, locally shared taxes. Certainly many, if not most states in the union, are already assisting local governments substantially through such sources of revenue.