PERSPECTIVE

Augmenting Property and Sales Taxes

BY KATHERINE BARRETT AND RICHARD GREENE

With billions of dollars flowing from Washington, D.C. to states and localities, it may not feel like this is a time when governments would be on the lookout for new forms of revenue. But the federal dollars are going to run out before long—and fiscally smart places are only using them for one-time expenditures, in any case. So, the hunt is on for new revenues to support services for the long haul.

Right now, most local governments in the United States rely largely on property taxes and sales taxes to pay the bills. But both of these revenue streams are troubled.

"When cities first started to collect sales taxes," said Chris Morrill, GFOA executive director, "goods were two-thirds of what people bought, and the rest was made up by services. Now those numbers have flipped, yet many services aren't taxed."

There's been talk for years about taxing more services, but progress has been slow, and right now, there isn't much action on that front. Janelle Cammenga, policy analyst with the Tax Foundation, said, "The states have lots of revenues, so the base broadening of services isn't on a lot of governors' agendas."

Property taxes, meanwhile, are hugely unpopular among homeowners, and as a result, a number of states have limited communities' ability to raise them. Beyond this, "some jurisdictions allow for several years in between revaluations," said Deborah Carroll, director of the University of Illinois at Chicago's Government Finance Research Center. "That means that real property appreciates in market value faster than its taxable value. In addition, over time, we have seen wealth creation involve fewer tangible things like real property, so property ownership may no longer be the best reflection of taxpayers' ability to pay."

Despite the pressures felt by cities, the job of finding new sources of revenues is a difficult one. As Shayne Kavanagh, GFOA's senior manager for research, observed, "No one wants to be the person who raises taxes. But you can't wave a magic wand and get new revenues. The money is going to have to come from somewhere. At the end of the day, someone is going to have to pay." Those who have to pay the additional taxes may decide to get retribution at the ballot box, though, so elected officials are reticent to move in that direction.

What's more, the very act of finding opportunities and putting them into action is easier said than done, especially for smaller entities. "Maybe less than five percent of cities nationwide have enough capacity to pursue other sources of revenue, said Farhad Omeyr, program director of research and data for the National League of Cities. "Smaller cities, including many in suburban areas, just don't have the capacity to do the research."

These challenges have led the GFOA to launch a new initiative called Rethinking Revenue (gfoa.org/rethinking-revenue), which aims to "develop new ideas for raising local revenues more effectively within existing revenue structures and without requiring new taxes."[1] GFOA has joined forces with other state and local organizations in this enterprise, including the International City/County Management Association, the National League of Cities, the Government Finance Research Center at the University of Illinois, and the National Academy of Public Administration.

In the meantime, while GFOA gets rolling, many communities have been making efforts to raise revenues. Some are simply expanding the usual sources of revenue, according to the Tax Foundation, including cities like Fremont, Oakland, and Oxnard, all in California, which have increased their sales tax rates.[2]

But not all places are focusing on traditional sales and property taxes. Some of these efforts have already paid off, while others are somewhat less certain.

For example, the City of Tulsa, Oklahoma's Authority for Economic Opportunity (TAEO) saw a chance to bring in additional dollars by making sure its publicly owned parking lots were charging market rates. "We did an analysis of other lots and saw that privately owned ones were charging from $20 to $40 in downtown Tulsa," said Kian Kamas, executive director of TAEO, an innovative entity formed by the merger of the Mayor's Office of Economic Development, the Tulsa Industrial Authority, the Tulsa Parking Authority, and Tulsa's Economic Development Commission.

"But we were capped at $10. So, we recommended that we go to $20," she said. This change was approved in late January.

A few years ago, Salt Lake County, Utah, looked to additional revenues that could be found in underutilized properties that belonged to the community.

"We had assets that were costing us money and were being underutilized. In many cases, these were vacant parking lots or buildings that were dark and could be utilized to the public benefit," explained Ben McAdams, former mayor of Salt Lake County and now a senior fellow at Sorenson Impact.

The county first conducted an inventory of its assets, followed by an effort to assign a market value to them. The total was $13.5 billion. Leaders in Salt Lake County resisted the idea of selling these properties for short-term needs, "and we put a priority on bringing these properties up to market value in a way that could generate a return," McAdams recalled. Then COVID hit, stalling the effort, but "I think there's incredible opportunity here," he said.

Another example: For years, many cities have been able to collect franchise fees for the use of their public right of way, like the money paid by utilities for their lines that run above ground on telephone poles or under the street like cable. But "as more consumers drop their cable and satellite television subscriptions, the amount of money that governments can collect from these companies and their customers is shrinking," according to the Pew Charitable Trusts.[3] "States and cities argue that they shouldn't be deprived of taxes on video services just because people have changed how they watch video. But some of their new taxing strategies have landed them in court."

With that in mind, as of October 2021, "Cities and towns in at least 13 states have sued streaming video giants Netflix and Hulu seeking compensation," according to a report from Bloomberg Tax.[5] "Georgia, Indiana, and Missouri cities have won preliminary legal victories, but judges dismissed similar lawsuits in Arkansas, California, Nevada, and Texas."

Right now, most local governments rely largely on property taxes and sales taxes to pay the bills. But both of these revenue streams are troubled.

Litigation continues. In the City of Dallas, Texas, for example, a lawsuit is currently being formulated to allow for the collection of franchise fees from Hulu, Netflix, and Disney+. If successful, "many millions of dollars could be collected by Dallas," said Steven Wolens, principal at McKool Smith, a large national law firm based there. "And of course, that could apply to other cities in Texas."

Many of these innovative approaches toward bringing in additional revenues have inherent risks, but the fact that they exist is a signal that cities and counties know they must do something to deal with the expenses they'll inevitably face in future years.

Katherine Barrett *and* ***Richard Greene*** *are principals of Barrett and Greene, Inc (greenebarrett.com). and are co-authors of the recently released* Making Government Work: The Promises and Pitfalls of Performance-Informed Management.

[1] Deborah A. Carroll, Shayne Kavanagh, and Chris Morrill, "Keeping Up with the Times: Rethinking Local Government Revenues," American Society for Public Administrators' PA Times, January 11, 2022.

[2] Jared Walczak and Jeremiah Nguyen, "Sales Tax Rates in Major Cities, Midyear 2021," Tax Foundation, August 18, 2021 (taxfoundation.org/sales-tax-rates-by-city-2021/#_ftn7).

[3] Elaine S. Povich, "Cities and States Find New Ways to Tax Streaming Services," Stateline, January 18, 2022.

[4] Michael J. Balogna, "Netflix, Hulu in Growing Fight with Cities over Streaming Money," Bloomberg Daily Tax Report, October 12, 2021.