Local Government Sales Taxes: Issues and Options for Revenue Diversification

by

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Retail sales taxes yield lucrative revenue--more than $23 billion in fiscal 1992--for the local governments which levy them. Local governments in 33 states plus the District of Columbia levy them, often conveniently building their tax directly from an overlapping state sales tax. Somewhat over one-half of the cities whose populations exceed 100,000 collect revenue from their own sales tax and almost one-fifth more of them were in overlapping localities levying a tax, sometimes shared with the city. But sales taxes are not the exclusive territory of cities or of governments in urban areas--there are more than 6,000 localities levying them. Taxing local governments include cities, counties, special districts, and even some school districts throughout the United States. The tax represents an important option for revenue diversification, but, as the following sections will discuss, there are important differences in the structure of these taxes, in how the taxes generate revenue for local governments, and in the problems that the taxes create for the people who must pay and administer them.

It is the plan here to explore some key fiscal performance features of local sales taxes and to identify several of their critical characteristics. This report will examine the role of the retail sales tax in government finances, examine several critical features of design of local sales taxes, consider the fundamental administrative choice between administration by the state and administration by the adopting locality, review evidence of the impact of local sales taxes on local business activity, and propose from these reviews several features which experience shows to be important for productive and less complicated use of the option.