Alternative Revenue Sources and Structures for Baltimore City

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Executive Summary

The goals of this project were to explore revenue-raising options for Baltimore City that: 1) reduce disparities between city and suburban property tax rates, 2) maintain or enhance equity, and 3) increase revenue to Baltimore City government. While the scale of the City's fiscal stress and inter-local disparities will require a mixture of solutions that include intergovernmental aid, the parameters of this paper are limited to own-source revenue possibilities. It is exploratory in nature and limited in scope, seeking to highlight options that warrant deeper analysis. In each case, however, even an overview quickly focuses on the tradeoffs between the city's human development, community development, and economic development goals on the one hand, and the need to generate more revenue on the other.

To select options that are worth exploring in greater detail, the project team was guided by the following general principles:

- Ease of implementation - can be done within existing law if possible
- Productivity – generates the largest revenue increases
- Relief – has the potential to reduce property tax rates
- Burden shifting – avoids or mitigates the effects on those negatively affected by a change in existing revenue structure

As pointed out in a recent fiscal overview prepared by the Maryland Department of Legislative Services,[1] despite the recent redevelopment successes, declining crime rates, and rising school test scores, Baltimore City's high poverty rate has translated into tax base growth that is inadequate to meet demands for public service expenditures. Growth in property and income tax revenues in the last four years is less than half the rate of growth in the state's major metropolitan counties, even though the City has taxed its anemic bases heavily. Local tax burdens[2] in Baltimore are well above the four largest counties, and the City appears to rely on user fees to a greater extent than do other Maryland counties. To fill the gap between its needs and its resources, the City has become more reliant on state and federal funding as primary sources of funding for services targeted to its neediest citizens.

Like other cities experiencing fiscal stress, Baltimore has sought to reduce the size of its workforce and to increase the efficiency of its operations. Also like them, it has found that containing expenditures is not enough, and so continues to be interested in making incremental progress by getting more productivity out of its own current and potential resource bases. Initial exploration of several options revealed three promising avenues for further investigation.

[1] Department of Legislative Services, Office of Policy Analysis (December 2001). "Baltimore City Fiscal Overview," Annapolis, MD (mimeo).

[2] Local tax revenues as a percent of net taxable income.

Taxation of utilities

Public utility taxes have the potential for generating significant revenues with relatively low rates, in large part because they are broad-based taxes. Cities tax utilities in a wide variety of ways. The Census Bureau enables us to compare cities' selective sales taxes on public utilities, gross receipts taxes, gross and net income taxes, and franchise taxes applied directly, and solely, to public utilities. But it does not give us insight into the role of this source of revenue in those cities that include utilities in their general taxation of business property, sales, gross receipts, or income. Using just the Census Bureau data as a pointer, however, it is clear that California cities have used "utilities user taxes" since the late 1960s to reduce reliance on property taxes. While they vary from city to city, theses taxes on natural gas, electric power, telephone (including cellular), and cable television services generate a substantial portion of locally-generated revenues. Chicago has also significantly increased the role of utility tax revenues in the Corporate Fund (its general fund). If Baltimore's public utility taxes generated only the narrowly-defined (by Census) big-city average of 4.9 percent of revenues generated from its own sources, it would have increased its revenues from this source by 69 percent, from $25.3 million in FY2002 to $42.7 million.

Currently, Baltimore City taxes electricity, natural gas, and steam based on units of energy delivered. It does not tax cellular telephone service. The City can change the way it levies these taxes and broaden their base by city ordinance, which is an implementation advantage. A bill introduced last year in the Baltimore City Council[3] would repeal the City's telecommunications and energy taxes and replace them with a five percent gross receipts tax on the producers of these services.

The City should explore all the approaches described here and develop an appropriate combination of franchise agreements for independent entries into the public right of way, and taxes on sales and/or deliveries of utility service to all users in the city by all suppliers. The preferred approach should seek to minimize volatility through unit-based rather than *ad valorem* levies; keep rates as low as possible by broadening the base, including wireless telephony; take into account deregulation impacts; and make appropriate tradeoffs with economic development objectives.

Regional sales tax for culture and leisure

A regional sales tax to fund regional cultural and leisure assets in the Baltimore metropolitan area would bring Baltimore City significant benefits if structured on the Allegheny[4] Regional Assets Districts model. The approach holds the possibility of not only stanching the bleeding of City-supported cultural institutions and recreation venues, but also the possibility of enhancements to them and relief for taxpayers.

In the Pittsburgh area, half the revenues from a one percent sales and use tax and one percent hotel excise tax are allocated to the regional asset district to fund regional cultural and

[3] CC 570, introduced October 4, 2001 by Councilman Abayomi.
[4] Allegheny County, Pennsylvania

recreational assets. The other half of the revenues provide modest tax relief to localities in the region, based on a distribution formula that is weighted by tax capacity and effort.

A similarly structured one percent sales tax in the Baltimore metropolitan area (without the hotel tax) would save Baltimore City over $25 million in funds currently devoted to cultural and recreational assets, and bring it almost $50 million in shared revenues. Even if a substantial portion of the funds were used to restore City support of cultural institutions and recreation that has been eroded over the years as budget woes have intensified, tax relief could also be pursued. The new revenues might also enable the City and other jurisdictions to expand recreation-related after-school activities. Other localities in the region would also experience cost savings and enhanced revenues. State legislation would be required to implement this option.

Statewide earnings tax

A mobile tax base of over $6 billion annually leaves the City as commuters return home each night. Taxing earnings where they are earned and at the residence of the worker recognizes the benefits and costs that commuters carry from home to workplace. Safety of their persons and their property must be protected in both places. Their travel imposes infrastructure maintenance and solid waste costs on the destination jurisdiction. On the other hand, ready availability of an expanded regional labor pool is attractive to businesses in each "receiving" locale. A metropolitan job market provides wider economic opportunity for the region's citizens.

If an earnings tax of one percent combined with local income tax credits for earnings taxes paid were adopted, Baltimore City would be among the seven jurisdictions that would experience a net increase in revenues. It is estimated that earnings tax revenues would be $32 million, an addition of 22 percent to current income tax revenues. Maryland residents would experience no change in tax liability, and non-residents would not be taxed unless their states (including the District of Columbia) imposed taxes on Maryland residents. Maryland residents working out of state would be taxed on their income as they are today. State legislation would be required to implement this option.

Split-rate property tax

The tax shifting implications of a graded or "split" property tax were explored. But since it does not generate new revenue for the city and would dramatically depart from the history and culture of the State of Maryland, it is unlikely that this approach would be worth the significant educational effort that would be required to pass legislation to implement it.

In sum, the most difficult-to-implement sales and wage tax options hold promise for significantly enhancing revenues and offering a chance of tax relief for Baltimore citizens. However, several unilateral options, most notably utility-related fees and taxes (including cellular telephone taxes), may hold the potential for appreciable revenue gains. Alternative approaches to utility taxation, including gross receipts-based levies as well as charges for usage of public right-of-ways, meet the tests that have guided this investigation, and warrant further analysis. Though more difficult to implement, regional sales tax and general or selected local sales taxes, particularly those dedicated to a specific purpose, also hold promise.

Table ExSum-1. Estimates of Revenue Implications

Type of Revenue	Application	Revenue Enhancement for Baltimore City
User Fees/Charges	Increase use of user fees and charges for city services	Projections unavailable
Utility Taxation	Sales price-based tax of 8% on energy Sales price-based tax of 12% on telecommunications	$60 million $30 million
Sales tax: Regional Asset District	Additional 1% sales tax, with ½% allotted for cultural assets and ½% allotted for tax relief	$28.1 million in savings, from cultural assets removed from city budget; $47.6 million in tax relief; $107.6 million available for cultural funding in the region
Selective Sales Tax	1% sales tax on food & beverages sold in restaurants (not hotels)	At least $558,000
Earnings Tax	1% on earnings by workers in Baltimore City Maryland Residents taxed 1% of earnings by the county in which they work, receive credits against income tax in county of residence.	$67 million $32 million
Split-Rate Property Tax	Taxation of land and improvements at different rates. Land taxed at 5x the rate of improvements.	Revenue neutral for the City

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A Johns Hopkins Institute for Policy Studies consulting team was asked by the Baltimore Efficiency and Economy Foundation[5] to explore revenue-raising options for Baltimore City that: 1) reduce disparities between city and suburban property tax rates, 2) maintain or enhance equity, and 3) increase revenue to Baltimore City government.

To select options that are worth exploring in greater detail, the project team was guided by the following general principles:

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I. Introduction

"The city does not expect to be able to balance its FY92 budget without significant disruptions to normal operations." (1991)

"*The city's limited revenue is exhausted and by itself [the city] can no longer preserve the basic public services needed to stabilize our community and support its economic growth.*" (1999)

"…the City has narrow operating margins and a structurally insufficient revenue base (p.27)…The sluggish revenue growth [2.9 percent] that is forecast for the City cannot keep pace with the 15.9 percent increase in appropriations that was requested by City agencies for operations in Fiscal 2002. Available resources will continue to fall short of the demands for funding of services." (2002)

In good economic times and in bad, the structural mismatch between Baltimore's revenue-raising capacity and expenditure need makes balancing the budget very difficult. As these excerpts from its budget messages reflect, Baltimore City government enters the 21st century in the throes of "retrenchment." This word is relatively new to the public lexicon, but has become an increasingly apt description of widespread local government responses to fiscal stress, which has lingered in older cities despite the economic expansion of the 1990s. Now with the economy souring, cities across the country are having increased trouble balancing their

[5] With funding from the City of Baltimore, T.Rowe Price Associates Foundation, and the France-Merrick Foundation.

budgets. The National League of Cities' 2001 survey found that "the percentage of cities that say they are better off financially is the lowest since 1994" (56 percent) and "less than half of the cities (46%) expect to be in a better financial situation in 2002 than in 2001."[6]

Expenditures

The National League of Cities survey describes the actions taken by cities to adjust to straitened fiscal conditions. On the expenditure side, 44.4 percent of the largest (over 300,000 population) U.S. cities had taken steps in 2001 to increase productivity, a trend echoed in Baltimore in the CitiStat-driven efforts to reduce overtime and increase efficiency. More than 23 percent of the largest cities, like Baltimore, contracted out public services. Over 18 percent of the largest cities entered into interlocal agreements to share costs, almost 18 percent reduced city employment, and 14.5 percent reduced the growth rate of the operating budget. Other expenditure tactics employed by less than five percent of the largest cities included reductions in capital spending, and service levels.

Baltimore has reduced employment supported by the General Fund from 12,220 in 1990 to 8,844 in 2002. The population has been decreasing dramatically at the same time, so General Fund positions per 1,000 population have decreased more modestly, from 16.6 to 14.1. It should be noted, however, that households requiring public services have not decreased as dramatically as population (because average household size is shrinking) and even with fewer people, vacant properties still require city services, as do non-residential establishments and commuters.

Revenues

Many cities, Baltimore included, are finding that containing expenditures is not enough. With regard to revenues, the National League of Cities survey found that almost 40 percent of the largest cities increased the level of fees or charges, by far the most popular own-source revenue action taken in FY 2001. Over 11 percent instituted new fees and charges. Almost 18 percent increased the number or level of impact or development fees. While 21.4 percent lowered property tax rates, 10.7 percent raised them.

In order to meet its extraordinary expenditure needs[7] Baltimore City has consistently more heavily taxed its relatively meager revenue bases than other counties in Maryland. (For most purposes, Baltimore City is considered a county in Maryland law.) Periodically, the Maryland Department of Legislative Services[8] performs an analysis of the tax capacity and tax effort of Maryland's jurisdictions. The results, shown in **Table I-1** below, measure the potential of a county to raise revenues from its own sources relative to that of other counties (tax

[6] Pagano, Michael A. (2001). "City Fiscal Conditions in 2001," A Research Report of the National League of Cities, Washington, D.C.

[7] What the city must spend, given its characteristics, to provide services of average quality. See Ladd, Helen F. and John Yinger (1989), America's Ailing Cities (Baltimore MD: The Johns Hopkins University Press) and Rafuse, Robert W., Laurence R. Marks, and Carol E. Cohen (April, 1990), "Local Government Spending in Maryland: Needs and Performance," prepared for the Maryland Commission on State Taxes and Tax Structure.

[8] Formerly the Department of Fiscal Services.

capacity[9]) and the degree to which a county exploits its capacity, again relative to other counties (tax effort[10]). The department's analysis shows Baltimore City's tax capacity to be less than 60 percent of the state average, worsening over time, and continuing to lag its neighbors.

Table I-1. Tax Capacity & Effort

(state average=100)

	Anne Arundel	Baltimore City	Baltimore County	Anne Arundel	Baltimore City	Baltimore County
	Tax Capacity			Tax Effort (all taxes)		
1980-82	99	58	106	89	165	99
1983-85	100	56	102	91	171	97
1986-88	104	56	101	92	169	97
1987-89	104	56	100	91	163	99
1990-92	107	56	101	90	158	97
1993-95	113	52	98	85	162	96
1996-98	113	53	98	86	164	94

Source: Maryland Department of Fiscal Services (1990, 1997, 2000)
Tax Capacity and Effort of Local Governments in Maryland

Clearly, fully addressing this magnitude of disparity in capacity calls for dramatic changes in expenditure responsibility, government structure, and/or intergovernmental aid, which are all strategies that have been pursued in the past and will be in the future. However, the City continues to be interested in making incremental progress by getting more productivity out of its own current and potential resource bases. This study looks at possibilities for achieving this goal, the issues that surround their implementation, and the implications of their adoption. The study is exploratory in nature. Estimates of revenue impacts are necessarily rough given our limited scope – no detailed analysis of the effects of exemptions has been undertaken, for example. The options identified by our sponsors have been investigated with an eye toward highlighting opportunities, but in some cases cited here, corrective actions or initiatives can be undertaken based on the limited data now available. More complete analysis, like that done by the District of Columbia Tax Revision Commission in 1998[11] under the direction of Philip M. Dearborn, would require an intensive multi-year effort.

[9] A single statewide average tax rate is multiplied by each county's actual tax base for each of eight taxes to produce the "hypothetical yield" that each county would collect if it taxed at the statewide average rate. The resulting hypothetical revenue is divided by county population to produce a hypothetical yield per capita, which is then divided by the hypothetical statewide yield per capita (the sum of all the hypothetical yields divided by the state population.) An index with 100 equaling the state average is the result.

[10] Actual county receipts divided by the calculated hypothetical yield. 100 equals the state average.

[11] Taxing Simply, Taxing Fairly

II. Revenue Structure in Other U.S. Cities and Maryland Counties

Like other cities, Baltimore City exists in law as a creature of its state. The State of Maryland makes the rules about how the City can raise money and what responsibilities it has for spending. Maryland permits localities to levy taxes on property (both real and personal) and requires that they tax the income of their residents. State laws govern the definition of bases and application of rates. The State has reserved general sales taxes and most business taxes for itself. The most profound state impact on city revenue-raising capacity resulted from a 1948 constitutional change that limited the City's ability to annex the suburban areas that its growth had spawned. The State also decides which functions it will perform and which will be left to the localities. Maryland is a fairly progressive state in this regard, having assumed responsibility for welfare, public transit, and sharing the cost of many health functions.

Because all Maryland localities are subject to Maryland law, which at least provides a common framework, the first analysis compares Baltimore to selected counties in the state. It should be noted, however, that individual counties[12] have been authorized to levy selected sales or excise taxes on hotel occupancy, other transient rentals, utilities, etc. Also, Maryland counties vary in their expenditure responsibilities, most notably in the area of public safety. The comparative per capita tax yields shown in **Table II-1** reveal the pressure put on the property tax base and other sources of revenue by the very weak base of the income tax in Baltimore City.

Table II-1. Property and Income Tax Bases

County	Total assessed valuation ($B)		Per capita property tax base ($)		Net taxable income ($B)		Per capita income tax base* ($)	
	FY1989	*FY1999*	*FY1989*	*FY1999*	*CY1989*	*CY1997*	*CY1989*	*CY1997*
Anne Arundel	7.6	14.1	18,080	29,351	5.1	7.6	11,937	16,177
Balt. City	7.1	8.3	9,430	13,137	4.8	5.3	6,522	8,060
Balt. Co.	11.5	17.9	16,841	24,772	8.9	12.1	12,859	16,805
Carroll	1.8	3.6	14,899	23,575	1.3	2.1	10,537	14,294
Harford	2.3	5.0	14,213	23,075	1.9	3.1	10,432	14,596
Howard	4.1	7.8	25,191	32,262	2.8	4.8	14,947	20,967
Montgomery	19.4	31.7	27,682	37,157	12.6	18.8	16,516	22,688
Prince George's	11.1	17.5	16,091	22,418	7.3	8.9	10,101	11,561
All MD counties**	80.0	133.9	16,724	26,291	53.7	76.8	11,233	15,080

*Using 1990 census and 1997 estimates of population

**And non-resident income tax filers

Sources: Maryland Department of Legislative Services, Local Government Finances in Maryland; Comptroller of the Treasury, Income Tax Summary Report; U.S. Bureau of the Census

[12] Includes Baltimore City.

Property taxes in Maryland

Trends over the past 25 years were examined to look at what other Maryland jurisdictions have done to diversify their revenue sources, particularly those that adopted property tax assessment or revenue caps in the late 1970s and thereafter. Nationally, waves of efforts to roll back property taxes peaked in the late 1970s[13] and again in the late 1980s and early 1990s. Prince George's County's Tax Reform Initiative by Marylanders (TRIM) resulted from a petition drive to amend the county charter in 1978, and placed a ceiling of $2.40 on the county real property tax rate ($.962 in full value assessment). As recently as 1996, Prince George's County voters rejected efforts to repeal the tax cap. Anne Arundel County adopted a charter amendment in 1972 limiting total annual increases in property tax revenues to the lesser of 4.5 percent or the increase in the Consumer Price Index. A similar petition effort in Baltimore County failed in 1990.

Effective 1992, Maryland law (the Homestead Property Tax Credit) required that residential owner-occupied property assessment increases be limited to 10 percent annually. Local governments (counties and municipalities) were permitted to adopt a lower cap annually, which could be as low as 0 percent. **Table II-2** shows county assessment caps for localities in the Baltimore region and other metropolitan counties, as well as the average annual increases in 1999, 2000, and 2001 before the cap was applied. The caps are applied on a property-by-property basis.

Table II-2. Average Annual Reassessments and County Assessment Caps

County	Assessment Cap	Average Annual Increase Before Cap		
		1999	2000	2001
Anne Arundel	4%	1.9%	2.9	4.9
Baltimore City	4%	.9	2.4	3.4
Baltimore County	4%	1.7	1.4	2.1
Carroll County	10%	2.1	2.0	2.6
Harford County	10%	1.9	1.4	3.2
Howard County	5%	1.7	2.2	3.5
Montgomery County	10%	.9	2.1	4.5
Prince George's County	2%	.2	.6	1.6

Source: Maryland Dept. of Assessments and Taxation

The numbers shown above are average annual increases, which include properties that experienced larger and smaller assessments. The good and bad news of Baltimore City's recent growth in property values means that its increases are once again raising the level of "tax expenditures," or taxes foregone through the assessment caps. Properties are reassessed every three years and Group I in Baltimore City, which was reevaluated in 2001, includes the City's largest and most valuable downtown properties and northern tier neighborhoods. Increases in this group exceeded the state average, but the increases in Group II, reassessed in 2002, were less than half the state average. Because the cap is applied on a property-by-property basis, on properties where assessment increases exceeded the cap, the city gave up an estimated $5.2

[13] Proposition 13 in California and Proposition 2-1/2 in Massachusetts are examples.

million in tax revenues this past year. However, while the city's real property tax base is at last increasing, it has yet to regain its 1994 level.

Good comparative data about the finances of Maryland localities over time is available through FY1999, but is still challenging to interpret. The Maryland Department of Legislative Services (DLS) includes revenues from enterprise operations like water and wastewater in "service charges," which are then aggregated into total revenues. In Baltimore City, revenues from water and wastewater (largely from other suburban jurisdictions to which it supplies these services) account for 80 percent of the revenues included in this category. Prince George's County shares in revenues (and expenditures) from the Washington Suburban Sanitary Commission. These two situations (along with Montgomery County, which is not examined here) are completely incomparable to other Maryland jurisdictions and significantly skew the revenue totals in these localities.

Another factor in comparing total revenues as compiled by DLS that must be considered when looking longitudinally is that proceeds from debt, also included in total revenues, is highly variable from year to year in each jurisdiction.

Therefore, to get an idea of how important a role the property tax plays in the portion of the localities' revenue structure that they generate themselves, we subtracted service charges and debt proceeds as well as intergovernmental revenues. With these adjustments, **Table II-3** shows 25-year trends in property tax reliance, which has been declining in most jurisdictions as this source of revenue has been capped. The largest decline was, as expected, in Prince George's County. Only Baltimore City raised a larger share of its (adjusted) own-source revenues from property taxes at the end of the century than it did in 1974.

Table II-3. Property Tax Revenues as a Percentage of Own Source Revenues*

County	1974	1984	1994	1999
Anne Arundel	47.3	45.6	49.2	46.6
Baltimore City	47.7	47.0	50.4	58.2
Baltimore County	53.3	45.9	49.7	47.9
Montgomery County	50.5	42.9	49.5	42.3
Prince George's County	58.4	48.6	51.7	49.6
All Maryland counties	51.1	46.3	50.6	48.7

*Adjusted: total revenue less intergovernmental, debt proceeds, and current services

Source: Maryland Department of Legislative Services, Local Government Finances in MD

Current charges in Maryland

One hypothesis about how localities have made up the reductions in property taxes is that they have increased the fees for services they have charged users, both their citizens and others. Because of the inclusion of utility revenues in the current services data compiled by the Department of Legislative Services, it is not possible to rigorously compare all Maryland localities. Current services/charges are explored in greater depth in **Chapter III.**

Other large cities

For a number of reasons, it is very difficult to make and interpret fiscal comparisons between Baltimore City and other municipalities across the country:

First, as pointed out in the introduction, there are fifty different frameworks for local finance in the U.S. – each state has a different allocation of revenue-raising and service-delivery responsibilities between the state and local governments. Within each state, there is a dizzying array of variations, from the simple case of Maryland counties' different taxing powers to the situation in Pennsylvania, which has several classes of counties, of cities, and of townships.

Second, Baltimore, like many cities in the Northeast, has a high concentration of low-income residents and a skewed distribution of income. Since fiscal systems develop in a manner reflecting local circumstances, fiscal comparisons between Baltimore and cities with a more balanced composition of population and less skewed income distribution are difficult to make and interpret.

Third, data on actual revenues from annual budgets or financial reports for different jurisdictions cannot be compared easily in the aggregate because each government has its own budget definitions, classifications, and reporting requirements.

Fourth, cities vary dramatically in the culture that informs public policymaking. Social, political, geographic, and historical factors have shaped the systems in place and determine what are acceptable alternatives and what are not.

To make any comparisons between Baltimore and other cities, at a minimum we need data on actual revenues collected that utilize the same definitions and reporting conventions across jurisdictions. The Governments Division of the U.S. Census Bureau constructs and reports such data in its annual report *Government Finances* and in the census of governments conducted every five years. In this paper, we use data from the *1997 Census of Governments* to compare Baltimore with other large cities.

Since we are using data from the Census Bureau, we must use their definitions. The Census Bureau starts by defining general revenue as all revenue of a local government except those from liquor stores, utilities run by the local government, or insurance trust funds. A jurisdiction's *total revenue* equals general revenue plus liquor store, utility, and insurance trust revenues.

A jurisdiction's *general revenues* are divided into four major categories: 1) taxes; 2) intergovernmental revenues; 3) current charges; and 4) miscellaneous general revenues. A jurisdiction's *general own-source revenues* are the sum of taxes, current charges, and miscellaneous general revenues.

We have chosen to compare Baltimore City to other cities that generally fit the following profile: population greater than 300,000; not growing through annexation; and with similar demographic characteristics. We added cities that may not precisely fit the profile but had adopted revenue-raising approaches that we are exploring elsewhere in this paper.

The major differences in cities' budgets arise from education expenditure responsibility – do they have dependent or independent schools? In most localities, school districts are separate units of government with their own revenue-raising, borrowing, and spending powers. Because only a few big cities have responsibility for schools (Baltimore,[14] Boston, and New York on this list), we have added the relevant school district revenues (and their sources) to the data for each of the other cities to facilitate comparison. Memphis is an anomaly because the county of which it is a part has primary responsibility for funding the schools (which it does through property and sales taxes). Other expenditure responsibility differences (hospitals, ports, airports) that we have not corrected for in this overview will be explored in subsequent chapters.

Table II-4 reveals the great variability among cities even when selection and adjustments are made to enhance comparability. The first cut, between intergovernmental and own-source revenues, puts Memphis, Detroit, Baltimore, Boston, Philadelphia, Cleveland, New York, and San Francisco above the average dependence on intergovernmental revenues, Chicago at the average for these 17 cities, and the remainder below. Baltimore is one of three cities that receives more than 50 percent of its revenue from intergovernmental grants.

Table II-4. Revenue Structure 1997

% of total general revenue (city and school district)

	Intergovtal total	Own source total
Baltimore (de facto city/county)*	53.4	46.4
Boston*	46.4	53.6
Chicago^	37.5	62.5
Cleveland	41.5	58.5
Columbus	26.5	73.5
Dallas^	18.2	81.8
Denver City/County^	26.0	74.0
Detroit	63.0	37.0
Houston^	21.9	78.1
Kansas City^	29.5	70.5
Memphis**	66.5	33.5
New York*^ ^^	38.3	61.7
Philadelphia (de facto city/county)^	44.0	55.3
Pittsburgh	36.1	63.9
San Francisco City/County^	38.0	62.0
St. Louis (de facto city/county)^	31.9	68.1
Seattle^	26.5	73.5

[14] While Baltimore's schools are now a joint responsibility of the city and state, the local share of education funding remains a part of the Baltimore City budget.

* city responsible for schools
**city (20% of local revenues) and county (63% of local) responsible for schools
^ general and selective sales taxes (including gross receipts taxes)
^^ individual and corporate income taxes

Source: U.S. Bureau of the Census 1997 Census of Governments

Focusing on own-source revenues, **Table II-5** provides an overview of the tax bases to which each of the cities has access. Half the cities are able to tax income; in the case of New York, corporate as well as individual income is taxed at the city level. While all the cities levy selective sales taxes, half receive significant revenues from general sales taxes. Baltimore and Pittsburgh are the only income-taxing cities that also receive greater than average (35.1) percent of their own-source revenues from property taxes. Only Boston depends more heavily on property taxes, but it does not impose a local income tax. Only Pittsburgh relies less on current charges. It should be noted that the Census includes gross receipts taxes, which is the way that a number of cities tax businesses and utilities, in its sales tax category, (see **Chapter IV, Public Utility Taxation**).

Table II-5. Own-Source Revenues
% share of total own-source general revenue (city and school district)

	Property tax	Local sales & gross receipts tax	Local income tax	Local current charges
Baltimore (de facto city/county)*	52.2	5.1	14.0	12.0
Boston*	70.2	3.0	*NA*	15.4
Chicago^	43.8	21.3	*NA*	17.5
Cleveland	32.6	2.6	34.0	15.7
Columbus	28.9	0.9	35.5	22.9
Dallas^	43.9	14.1	*NA*	29.6
Denver City/County^	23.4	20.4	*NA*	42.1
Detroit	28.4	4.0	26.7	21.3
Houston^	46.8	18.5	*NA*	23.0
Kansas City^	21.8	24.3	17.0	18.7
Memphis**	46.6	9.0	*NA*	30.1
New York*^ ^^	27.4	14.5	27.2	19.7
Philadelphia (de facto city/county)^	27.9	4.8	29.8	15.3
Pittsburgh	45.1	4.9	6.6	6.9
San Francisco City/County^	25.9	12.9	*NA*	33.3
St. Louis (de facto city/county)^	23.4	23.6	19.3	21.2
Seattle^	29.5	20.8	*NA*	27.3

* city responsible for schools
**city (20% of local revenues) and county (63% of local revenues) responsible for schools
^ general as well as selective sales taxes, including gross receipts
^^corporate as well as individual income taxes

Source: U.S. Bureau of the Census, 1997 Census of Governments

The cumulative effect of statutory limitations on various tax revenue sources can be seen in the extraordinary reliance on current charges, particularly in cities unable to tax income or sales. In the wake of Proposition 13 in California in the late 1970s, these fees have proliferated. Between 1976 and 1987, user fee revenues more than tripled nationwide, from $30 billion to $98 billion.[15] In 1989, an earlier version of the National League of Cities survey cited in **Chapter I** found that 69 percent of cities of over 50,000 population had raised fees and 36 percent had imposed new fees[16] and policy analysts were predicting that cities had reached the saturation point. But a dozen years later, cities are still expanding their use of this revenue source.

While it enjoys access to the income tax base that many other cities do not have, we see from this comparative analysis that Baltimore City receives a relatively small stream of revenues from this source because of the poverty of many of its inhabitants. With no recourse to a general sales tax and relatively low reliance on user fees (again tied to the ability of its poor residents to pay), the City has been forced to depend on the property tax as its fiscal workhorse.

[15] Lemov, Penelope, "User Fees, Once the Answer to City Budget Prayers, May Have Reached Their Peak," Governing, March, 1989, p. 24.
[16] Cited by the Wall Street Journal, November 16, 1989, p. A1.

III. Current Charges

The purpose of this chapter is to explore the extent and nature of Baltimore City's reliance on current charges, how that reliance compares with other large cities, and to identify opportunities for refining or expanding its reliance on current charges.

As described in **Chapter II,** it is very difficult to make and interpret fiscal comparisons between Baltimore City and other municipalities. We have used the Census Bureau's *1997 Census of Governments* to compare current charges in Baltimore with other large cities.

For the purposes of this paper, we are considering current charges in relation to own-source general revenues. The Census Bureau defines General Revenue as all revenue of a local government except those from liquor stores, utilities run by the local government,[17] or insurance trust funds. Current Charges is one of four primary categories of General Revenue.

Table III-1. Baltimore City Revenues 1997
($millions)

Total Revenue	2,557.9
General Revenue	1,953.0
Intergovernmental	1,046.9
Own-Source	906.1
Taxes	698.2
Current Charges	**109.2**
Misc. General	98.8
Utility/Liquor Store	65.9
Insurance trust	539.0

Source: U.S. Bureau of the Census, 1997 Census of Governments

Using these definitions, **Table III-1** indicates that Baltimore City had total revenues of $2.6 billion in 1997. Of that total, $604.9 million was income to insurance trust funds and from Utility/Liquor Store.[18] General Revenues totaled $1.95 billion – 76.4 percent of total revenues. Own source general revenues were $906.1 million – 46.4 percent of total general revenues. Finally, Current Charges collections totaled $109.2 million, or 12.1 percent of total own-source general revenues.

The Census Bureau defines current charges to include "amounts received from the public for performance of specific services which benefit the person charged, and from the sale of commodities or services other than utilities and liquor stores . . . Charges are distinguished from license taxes, which are privileges granted by the government or fees collected to finance regulatory activities."[19]

[17] Except wastewater (sewerage), which is included in Current Charges.
[18] The entire $65.9 million in the Utility/Liquor category was water utility revenues.
[19] U.S. Census Bureau, Government Finance and Employment Classification Manual, Washington D.C.: Government Printing Office, June 1992, Section 7.21.

Current charges are most appropriate when the benefits of the good or service accrue principally to identifiable consumers, and their demand for the good or service is sensitive to price changes. In such situations, the user charge should be set equal to the marginal cost of providing an additional unit of the good or service.

There are many efficiency advantages of funding public goods and services with user charges. For example, it contributes to increased political accountability in the local budget process. Similarly, increased reliance on user charges may reduce other economic distortions caused by high marginal tax rates on income, sales, or property values. Finally, if consumers are willing to pay for what they get, increased reliance on user charges may lead to different levels of service being provided in some neighborhoods. The recent explosion of *special benefits districts* in urban areas is one manifestation of this benefit.

Two caveats are in order, however. First, to achieve the efficiency gains attributed to user fees, there must be a market for the good or service being produced. That means potential consumers must have the income to translate their needs and/or desires into market transactions. If there is a high percentage of the population with very low incomes, they do not have many votes in the marketplace. Care must be taken in designing user fees to be sensitive to the needs of the less fortunate.

Second, it must be acknowledged that often there are both direct and indirect beneficiaries from specific government services; the benefit-received principle of financing government services implies that both sets of beneficiaries should pay the cost of the service being provided. Too often we tend to focus on the direct beneficiary and overlook those who receive indirect benefits from a particular service. For example, a whole neighborhood of children may receive health benefits from increased cleanliness paid for by collection fees imposed on producers of trash.

Increased reliance on user charges has several important equity benefits as well. For example, by providing a direct and visible link between consumption benefits and payments, unintentional subsides provided to specific, identifiable groups of citizens could be reduced. Also, user charges provide a mechanism for charging non-residents and those occupying tax-exempt properties for public services consumed.

The Advisory Commission on Intergovernmental Relations developed guidelines for determining when it is appropriate (or inappropriate) to consider expanding the role of user charges in financing public goods and services.[20] In summary, they argue that the use of pricing mechanisms for funding the provision of public goods and services is *justifiable* when:

- Benefits are primarily direct, so that charges will not cause significant loss of external benefits;

- Demand has some elasticity, so that the use of prices aids resource allocation and eliminates excessive utilization;

[20] Advisory Commission on Intergovernmental Relations, Local Revenue Diversification: User Charges, Staff Report SR-6 (Washington D.C.: Advisory Commission on Intergovernmental Relations, October 1996), pp. 25-26.

- Charges do not result in inequities to lower-income groups, on the basis of accepted standards; and

- Costs of collection of charges are relatively low.

According to the Advisory Commission on Intergovernmental Relations, use of charges as a mechanism for funding the provision of public goods and services is *more questionable* when:

- External benefits are significant and will be lost in part if charges are made;

- Demand is perfectly inelastic, so that resource allocation is insensitive to the pricing system (even so, however, prices may be warranted on equity grounds);

- Equity standards require that the lower-income groups be assured of obtaining the service; or

- Collection costs are relatively high.

Table III-2 lists a number of current charges and their relative importance as own-source general revenues in Baltimore City and for local governments nationally.[21] In the aggregate, current charges accounted for 12.1 percent of own-source general revenues in Baltimore in 1997. This compared with 25.7 percent for all local governments nationally. If Baltimore were compared to all local governments for only those categories in which it received revenues, the difference is far smaller, 12.1 percent to 14.7 percent. Two sub-categories of current charges account for the vast majority of the difference in relative importance of current charges between Baltimore and all local governments nationally – Hospitals and Miscellaneous Other Charges. Baltimore's City Hospitals were taken over by Johns Hopkins in 1984, so it receives no own-source revenues from this activity while local governments nationally received 7.2 percent of their total own-source general revenues from hospitals.

Table III-2. Current Charges as a Percent of Own-Source General Revenues 1997

	All U.S. Local Governments	Baltimore City
Total Current Charges	25.7%	12.1%
Air Transportation	1.8	NA
Misc. Community Activity	NA	0.5
Education		0.6
School Lunches	1.0	0.4
Elem. Ed. Tuition	NA	0.2
Elem. Ed. NEC	NA	NA
Higher Education	1.0	NA

[21] It is not clear why the Census includes sewerage (waste water) charges in its Current Charges category and water in utilities.

Hospitals	7.2	NA
Highways	0.5	0.1
Housing and Comm. Dev.	0.8	NA
Natural Resources	0.2	NA
Parking	0.3	2.1
Parks and Recreation	0.9	0.7
Sewerage	4.8	6.2
Solid Waste Management	2.0	1.1
Water Transportation	0.3	0.1
Miscellaneous Other Charges	4.3	0.7

Source: U.S. Bureau of the Census 1997 Census of Governments

The other major difference between Baltimore and all local governments nationally was the sub-category Miscellaneous Other Charges. This item includes charges not covered in the enumerated list, "such as those derived from court and recording fees, police, fire, correction, defense, public welfare, public nursing homes, public libraries, and health activities, and other" according to the Census. Census officials who were consulted say that the majority of revenues in this category are labeled "other" and cannot be further elaborated.

Nationally, all local governments received 4.3 percent of own-source general revenues from this source, compared with just 0.7 percent for Baltimore. Part of this difference could simply be comparing apples and oranges, in a sense, because all local governments include special districts, counties and other local governments in addition to municipal governments. A better approach compares Baltimore to other large (over 300,000 population) cities.

We looked at 44 large cities that, like Baltimore, did not have responsibility for owning and/or operating a public hospital, e.g., they received no current charges from hospitals.[22] For these 44 cities, the sub-category Miscellaneous Other Charges accounted, on average, for 4.4 percent of own-source general revenues, compared with just 0.7 percent for Baltimore. **Table III-3** lists nine of these 44 cities that had relatively high reliance on Miscellaneous Other Charges – ranging from Pittsburgh, which received 6.3 percent of its own-source general revenues from Miscellaneous Other Charges, to Buffalo, which received 22.2 percent of its own-source general revenues from Miscellaneous Other Charges.

Table III-3. Miscellaneous Other Charges as a Share of Own-Source General Revenues Selected Cities 1997

Baltimore	0.7%
Baton Rouge	8.1
Buffalo	22.2
Las Vegas	12.0
Long Beach	17.6
Milwaukee	8.1
Pittsburgh	6.3
Sacramento	13.6
Santa Ana	9.7

[22] See Appendix A for a list of the 44 cities used for this comparison.

Tulsa	7.7

Source: U.S. Bureau of the Census, 1997 Census of Governments

One-third of the large cities making the greatest use of Miscellaneous Other Charges were in California and local governments in that state received, on average, 7.4 percent of their own-source general revenues from Miscellaneous Other Charges. This could be a direct result of revenue diversification in the wake of Proposition 13's limitations on property taxes. Further in-depth investigation of individual city finances would be required to tease out the sources of these variations.

A closer look at the 44 comparison cities and Baltimore highlights several other interesting differences. **Table III-4** lists specific current charges and shows the relative importance, on average, for the 44 comparison cities and Baltimore. The data indicate that, on average, the 44 comparison cities received 29.5 percent of their own-source general revenues from Current Charges, compared with just 12.1 percent for Baltimore City. The range is from a high of 56.2 percent in Long Beach to a low of 10.2 percent in Pittsburgh. Of the 44 comparison cities, 23 depended on Current Charges for more than 30 percent of their own-source revenues, while only four generated less than 20 percent of their own-source revenues from Current Charges – Pittsburgh (10.2 percent), Virginia Beach (11.9 percent), Santa Ana (18.1 percent), and Philadelphia (19.1 percent).

In part, this difference again reflects differences in responsibilities across cities. For example, 31 of the 44 comparison cities showed Current Charge revenues from air transportation, typically from local airports. The share ranges from 0.2 percent in San Diego to 29 percent in Atlanta and 22 percent in Dallas and St. Louis. Twelve of the 31 cities showing Current Charge revenue from air transportation received 10 percent or more of their total own-source general revenues from this source. Baltimore receives no income from this source because since 1972 the local airport has been owned and operated by the state.

Similarly, on average, the 44 comparison cities received one percent of their own-source general revenues from water transportation, typically a local port, compared with just 0.1 percent for Baltimore (docking and wharfage fees). Unlike air transportation, however, this average is somewhat misleading since only eight of the comparison cities actually received any revenues from this source. The range is from 24.5 percent of own-source general revenues in Long Beach to 0.1 percent in St. Louis. Other cities receiving some current charges from port activity include Memphis (0.3 percent), Minneapolis (0.5 percent), Milwaukee (1.0 percent), Jacksonville (3.0 percent), Los Angeles (5.6 percent), and Oakland (11.7 percent). Again, Baltimore realized very little revenue from its extensive port activities because the port is owned and operated by the state.

Table III-4. Current Charges as a Percent of Own-Source General Revenues 1997

	44 City Average	**Baltimore City**
Total Current Charges	29.5%	12.0%
Air Transportation	6.0	0.0

Misc. Community Activity	0.0	0.5
Education	0.1	0.6
School Lunches	0.1	0.4
Elem. Ed. Tuition	0.0	0.2
Elem. Ed. NEC	0.0	0.0
Higher Education	0.0	0.0
Hospitals	0.0	0.0
Highways	0.3	0.1
Housing and Community Dev.	0.6	0.0
Natural Resources	0.0	0.0
Parking	0.9	2.1
Parks and Recreation	2.0	0.7
Sewerage	10.3	6.2
Solid Waste Management	3.7	1.1
Water Transportation	1.0	0.1
Miscellaneous Other Charges	4.4	0.7

Source: U.S. Bureau of the Census, 1997 Census of Governments

In addition to a greater reliance on miscellaneous other charges discussed above, the other major difference between the 44 comparison cities and Baltimore is simply a higher reliance on current charges from three individual services. Specifically, the 44 comparison cities, on average, receive 2.0, 10.3, and 3.7 percent of own-source general revenues from Parks and Recreation, Sewerage, and Solid Waste Management. The comparable figures for Baltimore are 0.7 percent, 6.2 percent, and 1.1 percent. According to these data, Baltimore is generating relatively less revenue from Parks and Recreation, Sewerage, and Solid Waste Management charges than the average for the comparison cities.

Baltimore experience and other charges

Current services. Budgeted revenues for Baltimore's Current Services for 2001 are shown below in **Table III-5.**

Table III-5. Baltimore City Current Services Revenues

Category	Budget FY 2001 ($000)
General government	12,395*
Public safety and regulation	6,087
Health	167
Social services	840
Recreation and culture	771
Highways	3,403
Sanitation and waste removal	7,815

**includes at least $7.5 million intragovernmental and intergovernmental charges*

Source: Baltimore City Budget Plan Summary FY 2002

In addition to intragovernmental charges to agencies for central city services and intergovernmental audit fees recovered from grants by the comptroller's office, the largest subcategories of *general government* are charges for lien reports and semi-annual tax payments. The majority of *public safety and regulation* current charge revenues comes from district court

service by the sheriff, port fire protection (from the Maryland Port Administration), and stadium security. *Recreation and culture* revenues come primarily from special facilities, including the Myers and "Du" Burns soccer pavilions and the DiPietro ice rink; swimming pool passes and video rental and other charges make up small portions. Virtually all the *highways* revenues are realized from storage of impounded cars. Within *sanitation and waste removal*, landfill disposal tipping fees account for $4 million, solid waste surcharges for $2.8 million, and fees of $1 million are generated by the Southwest Resource Recovery Facility. Sewerage fees are included in the City's Waste Water Utility Fund, an enterprise fund separate from the General Fund.

Conduits. The Conduit Management Fund was established within the General Fund in the FY 2002 budget, and revenues from it appear in the City revenue category Use of Property rather than Charges for Current Services. The Fund is used to account for revenues (estimated to be $2.8 million in FY 2002) received from non-City entities that rent space in the portion of the underground conduit system that is City-owned and operated. These revenues are offset by the costs of operations and reserves for repair and capital requirements, which are estimated to be $2.5 million. With the authorization of Council Ordinance 00-116 enacted in December 2000, the City may now charge fees above the amounts needed to cover direct costs, in recognition of the value of the public right of way. Excess revenue is transferred to the General Fund.

A 1996 study by David M. Griffith & Associates estimated that if linear foot fees for the electric, telephone, and cable television conduit users at the time were increased from the current rates ($.15 to $.22 per linear foot) to what was then the national average ($2.00 for both linear feet and poles), $25 million in additional revenue could be raised.[23] As an alternative or add-on to per-foot charges (a number of cities levy both), Griffith also did a rough calculation of the per capita revenues received by a group of comparison cities from gross receipts taxes on their electric, gas, and telephone utilities. The firm concluded that Baltimore might raise $28-$48 million by applying taxes to utilities in a similar way. These types of taxes are explored in greater depth in **Chapter IV.**

The Baltimore City Board of Estimates approved an increase in December, 2000 to 58 cents per linear foot for private users other than BGE, the largest user. The rate negotiated with BGE is 27 cents per foot. While the proponents using the Griffith study appear to confuse per-foot user fees in Baltimore with gross receipts-based franchise fees on utilities that enter the public right of way in other cities, the study raises important issues and options about the ways that utilities are taxed. The magnitude of these potential revenues is clearly significant.

Development impact fees. Development impact fees are a special kind of user fee, one that anticipates the public burden of additional users. In Maryland they have been used by Anne Arundel, Carroll, and Montgomery County to help pay for the infrastructure needed to support growth. The legal basis for these fees is the same "benefits" principle undergirding all user fees – beneficiaries should be charged for government services and goods based on their consumption. Applying a rational nexus test, the fees can legally be assessed when 1) there is a reasonable connection between the need for additional public facilities and the growth spawned by a new development, 2) the fee represents the development's proportionate share of the cost of

[23] Cited in Greater Baltimore Committee and Presidents' Roundtable, Management and Efficiency Review: Department of Public Works, July 2000.

the public facilities, 3) the fees benefit the development, though not exclusively, and 4) the fees are earmarked for the purposes for which they were imposed.[24] While it may not appear that Baltimore City, with a declining population, is a prime candidate for such fees, it may be worth exploring in areas such as the waterfront, where the market is relatively strong and marinas and intensive residential development put pressure on existing infrastructure and services. Instead of imposing such fees, city officials, long accustomed to stimulating the weak market in other parts of the City, have been providing waterfront developers with a variety of incentives, including PILOTS (payments in lieu of taxes), property tax credits, below-market loans, grants, and infrastructure improvements (bulkheads, conduits, walkways, parking, etc.).

Conclusion

According to the framework developed by the Advisory Commission on Intergovernmental Relations for determining when to charge for specific services, it could be argued that at least solid waste management and use of the city's rights of way should be prime candidates for enhanced funding by user fees. According to data in a recent study, Baltimore recoups 28.0 percent of the cost of solid waste management from user fees – compared to Indianapolis that recoups 42.1 percent, Jacksonville recoups 44.5 percent, and Seattle recoups 94.7 percent.[25] All Seattle dwelling units are required to pay for trash collection service, but in Indianapolis and Jacksonville, the cities or their contractors collect trash and recycling for no additional fee. As noted above, over $20 million might be realized in increased conduit fee revenue or other restructuring of taxation on public utilities (see **Chapter IV)**. These are changes that the City can make without further state enabling legislation.

However, it should be noted that the Maryland Department of Legislative Services' Tax Capacity and Effort study shows that Baltimore City already relies more heavily than other Maryland counties on fees and charges**,** which raises equity and policy concerns. Additional shifts from government-provided to fee-based services may pose an additional burden on Baltimore's low income residents. A portion of the current budgets for solid waste management or other functions would need to be retained to provide a subsidy for low income residents. Without subsidy, increasing fees for recreational facilities and services, for example, may ration these benefits to the detriment of low-income youth, who are the targets of intensive efforts by the City and foundation communities to expand after-school activities. Fees that fall primarily on new residents, such as impact fees, may likewise discourage potential City residents being sought by Live Baltimore's marketing campaign and other city initiatives. It may be that using the property tax for refuse collection and recreation services is the fairest and administratively simplest way to fund these government services in a city like Baltimore.

[24] David Scott Marks, "Paying for Growth: The Relationship Between School and Transportation Development Impact Fees and Service Needs in Maryland's Anne Arundel, Carroll, and Montgomery Counties, unpublished master's thesis, Johns Hopkins Institute for Policy Studies, 1997.

[25] Michael E. Bell and James O'Keeffe, "Nontax Revenues in the District of Columbia: Current Practice and Future Prospects" in Taxing Simply; Taxing Fairly: District of Columbia Tax Revision Commission – Full Report, (Washington D.C.: Greater Washington Research Center, September 1998), Figure M-10, p. 523.

IV. Public Utility Taxation

Public utility taxation is another form of taxation utilized to varying degrees by local governments across the United States. Public utility taxes have the potential for generating significant revenues with relatively low rates, in large part because they are broad-based taxes. Cities tax utilities in a wide variety of ways. The Census Bureau enables us to compare cities' selective sales taxes on public utilities, gross receipts taxes, gross and net income taxes, and franchise taxes applied directly, and solely, to public utilities. But it does not give us insight into the role of this source of revenue in those cities that include utilities in their general taxation of business property, sales, gross receipts, or income. We have done only limited investigation of the latter approaches here, but their revenue-raising power suggests that they warrant further analysis.

According to data from the 1997 Census of Governments, all local governments in the U.S. received an average of 1.7 percent of their general own-source revenues from public utility taxation. Local governments in 11 states, however, received no, or negligible, revenues from taxing public utilities.[26] Alternatively, local governments in 11 other states received on average more than two percent of their general own-source revenues from this source – Florida (4.6 percent), Missouri (4.2 percent), Virginia (3.8 percent), Kentucky (3.5 percent), California (3.2 percent), Arkansas (3.0 percent), Illinois (2.9 percent), Washington (2.7 percent), Hawaii (2.6 percent), Utah (2.3 percent), and Kansas (2.2 percent).

Tax revenues included in this category include revenues from selective sales taxes on public utilities, gross receipts taxes, and gross and net income taxes applied directly, and solely, to public utilities. These alternative approaches to local taxation of public utilities are briefly discussed below. The options vary in the base against which the tax is applied (gross receipts, income, or sales) and in the taxpayer that is initially assessed (producer or consumer). We found inconsistency across cities in the use of "franchise" to describe taxes that vary in base and payer, and so have not included it in this typology.

Taxes on Producers: *Gross Receipts Tax*

A gross receipts tax is applied to the total receipts of businesses in a city for a variety of utilities – gas, electric, steam, telephone, cable television. In the case of a gross receipts tax on public utilities, a very low rate can potentially generate a significant amount of revenue. However, for local governments considering such a tax, there are some complications associated with its administration – complications that are exacerbated by current trends to deregulate electrical and natural gas industries.

First, there is an issue of economic efficiency. A gross receipts tax is based on the total value of sales of a company, without regard to the net income of the organization or to the ratio of net income to the value of goods sold. Thus, such a tax falls most heavily on industries that have high sales volume and low profit margins. Energy suppliers generally have fallen into this

[26] Connecticut, Indiana, Maine, Massachusetts, Montana, New Hampshire, New Jersey, North Carolina, Ohio, Rhode Island, and Wisconsin.

category, and smaller, marginal producers contributing to the power grid may actually have no profits. In such cases, a net income tax may be more equitable and less discouraging to prospective competitive energy providers.

Second, and potentially more troubling in an environment of deregulation, is the concern about the legality of a gross receipts tax for any individual local government. In order to apply a gross receipts tax to a public utility producer or distributor, that business must have a nexus with the taxing jurisdiction – that is the business must have a physical presence in the taxing jurisdiction. In a 1992 decision, the Supreme Court ruled that the Quill Corporation – an out of state mail-order vendor – was not constitutionally liable for state taxes imposed by the state of North Dakota because it did not have a substantial physical presence in the state. This decision has important implications for a gross receipts tax on out-of-state public utility producers that have no physical presence in the local government administering the tax. In fact, Chicago, which generated substantial revenues from a gross receipts tax on public utilities, recently switched to a unit based tax, in part because of the pressures brought about by deregulation. As a result, while a gross receipts tax might generate significant revenues with a relatively low rate, it may become increasingly difficult for an individual local government to administer such a tax in an environment of deregulation. In fact, the specialized taxation of utilities through a gross receipts tax may be in question. The New York Public Service Commission's 1989 Opinion on Regulatory Policies included a Gross Receipts Tax Note, in which the authors argued that "the historical justification for utility gross receipts tax no longer exists, given the evolution of the telecommunications industry and the resulting replacement of monopolies by a growing array of public and private communications service companies."[27] However, experience in Maryland and other cities around the country has shown that imposing unit-based taxes on utilities has survived the nexus test.

When Maryland deregulated the electric utility industry in 1999, it passed legislation to change the way that the state taxes telephone, electric and gas utilities. It established a franchise tax of two percent on gross receipts derived from business in the state and a tax of .062 cents for each kilowatt hour of electricity and .402 cents for each therm of natural gas delivered for final consumption in the state. Provision was made for credits on the franchise tax for large users and for industrial use in production activities, to be passed on to customers. The legislation also allowed public utilities to claim a credit against their state income taxes of 60 percent of property taxes paid to state and local governments on operating real property. The basis for personal property used in the generation of electricity was ratcheted down in two steps to 50 percent of its value by July 1, 2000 for purposes of computing the property tax. Baltimore City is to receive $453,421 annually from the state in partial reimbursement for the revenues foregone through the personal property exemption. The use of electricity, steam, or natural gas that is provided by other than public utilities (defined as entities with rate schedules on file with the Public Service Commission) is to be taxed through the state's sales and use tax.[28]

Baltimore City followed suit by adopting an ordinance in 1999 that changed its energy tax on electricity, natural gas, and steam from a sales tax based on the price of energy to a unit

[27] Cited in "Telecommunication Services Reseller is Properly Taxed As Vendor of Utility Services; Cable & Wireless , Inc. v. City of New York Department of Finance," New York Law Journal, August 31, 2001.
[28] H.B. 366, 1999.

tax based on the units of energy delivered. Annually, the Director of Finance computes the rates designed to yield in the aggregate the same amount of revenue as the former eight percent tax on the sales price of energy. The rates for 2001 were $.049111 per therm for natural gas, $.005922 per kilowatt hour for electricity, and $.001112 per pound for steam. (See below, Taxes on Consumption, Selective Sales Tax). A bill pending in the Baltimore City Council[29] would repeal the City's telecommunications and energy taxes and replace them with a five percent gross receipts tax on the producers of these services.

In October of 1998, Prince George's County adopted the region's first across-the-board fee on telecommunications companies that are providing new telephone, Internet and other services. Franchise agreements with the county were required of the operators of any telecommunications system on, over, or under any public right of way, and a franchise fee of three percent of gross revenues imposed.[30] In May of 1999, Bell Atlantic-Maryland, Sprint Communications, and AT&T of Maryland succeeded in obtaining a federal court order to the county to stop enforcing its Telecommunications Franchise Law because it was pre-empted under the federal Telecommunications Act of 1996.

The National League of Cities' (NLC) Fiscal Transitions Panel reported its findings and recommendations in July 2000 and its work forms the basis for NLC's ongoing Future of Public Finance initiative. The panel highlighted the increased challenges of measuring economic activity for the purposes of taxation, particularly as deregulation has opened what were once local monopolies for public utilities to national competition.

Taxes on Producers: *Net Income Tax*

An alternative to the gross receipts tax could be a net income tax, such as that applied by most states to corporations. Such a tax might be considered "fairer" than a gross receipts tax because the base of the tax is net income rather than gross sales. However, the revenue generated from such a tax would be more modest since the base of the tax is net income and some public utility producers in an environment of deregulation might have marginal incomes, if not actual losses. Such a tax also must confront the same nexus issue as the gross receipts tax. Net income of a corporation is generally apportioned across taxing jurisdictions according to a formula based on sales, payroll and property. If a local government wanted to impose a net income tax on public utility suppliers, it could be at a disadvantage if there were no substantial physical presence in its jurisdiction. In addition, there could be administrative problems for the local government in obtaining all the information it needs from the company to determine the tax liability under a net income tax. Similarly, there could be major compliance problems for firms required to provide data to a large number of local governments levying such taxes. Corporate income taxes are complex and costly to administer at the state level and these problems would be greatly exacerbated at the municipal level unless it was possible to piggyback local charges on the state's tax.

[29] CC 570, introduced October 4, 2001 by Councilman Abayomi.
[30] Spinner, Jackie, "Prince George's Imposes First-in-Area Phone Fee; AT&T Campaign Backfires as Council Sets Charges for New High-Tech Services," Washington Post, October 29, 1998.

Taxes on Consumption: *Selective Sales Tax*

Another source of local public utility tax revenues is from a selective sales tax. Such a consumption tax can be set as a percentage of the selling price, in which case it would be an *ad valorem* sales tax – revenues for the local government would vary in proportion to changes in the dollar value of electricity or natural gas sold. Such changes could be influenced by the price of the commodity and the amount consumed. As prices increase, consumption declines so the net effect would be uncertain. As a result, such an *ad valorem* tax could make local government revenues from this source more volatile. Baltimore's 12 percent telephone tax is an ad valorem tax on local exchange service; it does not tax wireless telephony. Two other Maryland jurisdictions, Anne Arundel County (eight percent) and Baltimore County (eight percent), levy taxes on wireline telecommunications services.

One of the big questions for local governments is how to handle the growth of wireless telecommunications. Montgomery County has vacillated in its tax treatment. It has levied a flat tax on each telephone line since 1971. In May, 1996, County Executive Duncan vetoed a County Council-passed addition of wireless communication devices to this tax's base. The Council overrode the veto, however, and wireless devices were included, adding $2 million to collections that year. Growth in revenue from this source increased 13 to 27 percent per year (compared to an average of three to four percent growth in land lines), and in FY99 accounted for $2.6 million of the total $9.2 million received from the telephone tax. Telephone taxes overall make up .6 percent of total tax revenues in the county budget. The wireless component of the telephone tax was eliminated on July 1, 1999. In May 2002, the Prince George's County Council enacted an eight percent cellular telephone tax with proceeds dedicated to education, after the Maryland General Assembly made it clear that it was required as part of an overhaul of school governance in the county. The tax is projected to raise $19 million.

Alternatively, such a consumption tax can be set as a fixed amount per unit sold by the public utility, e.g., kilowatts of electrical power or BTUs of natural gas, in which case it would be an *in rem* sales tax. Typically, such a specific tax has the advantage of making revenues from this source less volatile than an *ad valorem* tax.

A per unit consumption tax can be assessed against the individual consumer, as it is in Baltimore on gas, electricity, and steam. The down side to such a form of the tax is that tax-exempt organizations, including the federal government, do not pay such a tax. Alternatively, ***the tax can be assessed against the public utility suppliers***. This is the way it is done in Montgomery County. In that case, the public utility pays the tax on all units distributed, and then it may decide how to pass the tax forward to final consumers. In the end, however, all consumers, including tax-exempt organizations and the federal government, end up paying the tax.

Finally, consumption-based sales taxes, whether *ad valorem* or *in rem***,** could encourage conservation by making the consumption of energy more expensive. However, such a tax could be regressive, falling more heavily on low-income families than high-income families. It would have to be structured in such a way to protect those with the lowest incomes.

Other cities

The experience of individual cities is varied. The following data reflect revenues raised from what the Census Bureau classifies as Public Utility Taxes. That is, these are revenues from taxes only on public utilities. Some local governments may have gross receipts, sales, or income taxes that apply to public utilities and other businesses. In such cases, these tax revenues are not included in the category of public utility taxes; rather they are included under the appropriate category of general taxes. In addition, local governments may also receive property tax revenues from public utilities. These revenues are included with total property tax revenues and are not reflected in the Census-defined public utility tax revenue category.

Using the Census data, we examined 55 comparison cities (over 300,000 population) and on average, these 55 cities generated 4.9 percent of their general own-source revenues from taxes on public utilities in 1997. According to these Census data, Baltimore generated 2.9 percent of its general own-source revenues from this source.

Table IV-1 reveals that the range across the 55 cities, however, is substantial. For example, there are nine cities that do not receive any of their general own-source revenues from taxing public utilities – Boston, Cleveland, Colorado Springs, Columbus, Fort Worth, Mesa, Milwaukee, Philadelphia, and Pittsburgh. Several of these cities in fact do realize substantial revenues from taxation of public utilities, but not in ways that are recognized by the Census Bureau. See the following section.

Only 10 of the cities that tax public utilities generate smaller percentages of their own-source revenues from this source than does Baltimore. The majority of the comparison cities tax public utilities and receive larger percentages of own-source revenue from them than does Baltimore. In eight cities, public utility taxation plays a major role in the revenue structure. More than 10 percent of general own-source revenues are generated by taxing public utilities in Baton Rouge, Chicago, Kansas City, Los Angeles, Miami, Sacramento, Santa Ana, and Wichita. The utility taxes in these cities are described in greater detail following **Table IV-1**.

Several of the cities (Miami-Dade and Baton Rouge City-Parish) that receive substantial shares of own-source revenues from utility taxes are city-counties, which should be kept in mind in the search for comparable experiences. None of the eight cities has responsibility for schools, but education funding by their independent school districts has been added to the denominator (total own-source revenues) in all the calculations that produced the results shown in the table below.

Table IV-1. Public Utility Revenues as a Share of Own-Source Revenues 1997
(Baltimore – 2.9%)

No public utility revenues[31]	Public utility revenues <2.9%	Public utility revenues >2.9% <10%	Public utility revenues >10%

[31] Several of these cities in fact do realize substantial revenues from taxation of public utilities, but not in ways that are recognized by the Census Bureau. See the following section.

Boston	Indianapolis (.1)	San Francisco (3.0)	Baton Rouge (10.6)
Cleveland	Cincinnati (.3)	San Diego (3.0)	Kansas City (10.9)
Colorado Springs	Charlotte (.6)	Albuquerque (3.1)	Santa Ana (12.8)
Columbus	Nashville-Davidson (.9)	Tulsa (3.1)	Wichita (13.1)
Ft. Worth	Denver (1.1)	Memphis (3.4)	Los Angeles (13.5)
Mesa	New York (1.1)	Tucson (3.9)	Chicago (13.8)
Milwaukee	Fresno (1.3)	Minneapolis (4.0)	Sacramento (14.0)
Philadelphia	San Antonio (2.1)	El Paso (4.1)	Miami (16.4)
Pittsburgh	Austin (2.4)	Atlanta (4.2)	
	Honolulu (2.4)	Oklahoma City (4.3)	
		New Orleans (4.6)	
		Detroit (4.7)	
		Virginia Beach (5.4)	
		Portland (5.7)	
		Dallas (5.7)	
		Washington DC (5.7)	
		Buffalo (6.0)	
		Phoenix (6.1)	
		Omaha (6.4)	
		Las Vegas (7.0)	
		Oakland (7.1)	
		Houston (7.4)	
		San Jose (8.6)	
		Long Beach (8.7)	
		St. Louis (8.9)	
		Jacksonville (9.2)	
		Seattle (9.5)	

Source: U.S. Bureau of the Census, Census of Governments 1997

Miami-Dade's operating budget combines several taxing jurisdictions, including Miami-Dade (the regional area-wide service provider), the Unincorporated Municipal Service Area (UMSA), the Miami-Dade Library System, and the Miami-Dade Fire Rescue District, as well as numerous proprietary operations[32] and special assessment districts. The UMSA relies heavily on utility tax, communications tax, and electrical utility franchise fee revenue, which constitutes 35 percent of the FY2001-02 revenue budget. ***These fees are charged only to unincorporated area residents.*** The Communications Services Tax Simplification Law passed in 2000 by the state legislature combines seven different state and local taxes and fees and replaces them with a two-tiered state tax and local option tax on communications services. In Miami-Dade, the new tax replaces the telecommunications utility tax, the telecommunications franchise fee, and a cable television franchise fee and will generate comparable revenue levels.

Sacramento, Los Angeles, and Santa Ana and most other cities in California have used "utilities user taxes" since the late 1960s to reduce reliance on property taxes. Sacramento's tax is 7.5 percent of natural gas, electric power, telephone (including cellular), and cable television services. The cities of Sacramento and Los Angeles operate their own electric utilities. In Los

[32] Agencies supported entirely from fees and charges (i.e. Aviation); by a special property tax (Library System and Fire Rescue District); a special assessment (solid waste collection); or by proprietary revenue, including grants, that augment a general fund subsidy (parks and recreation).

Angeles, the tax for residences is 10 percent of telephone charges to users (including cellular) and 10 percent on gas and electricity users; commercial/industrial users pay 10 percent on telephone use, 12.5 percent on electricity, and 10 percent on gas. Revenues from the utility users tax make up 17.2 percent of the city's "general receipts," a close second to property taxes.[33] Non-profit educational institutions pay five percent on telephone and gas. Los Angeles exempts households in which the combined income of all residents is less than the annual minimum set by the U.S. Department of Housing and Urban Development **and** either have at least one resident 62 years old or older or substantially disabled. Taxes are imposed and collected by the utility companies, which remit taxes paid to the City monthly.

In Santa Ana, the utility users tax is six percent on gas, electric, water, and telephone (including cellular and long distance). Cable television franchise rates are comparable to the utility users tax. The city has no plans to change to a per-unit-delivered utility tax.[34] Increases in utility bills following the deregulation of energy in California have prompted the Howard Jarvis Taxpayers Association, which led the Proposition 13 initiative fight for property tax caps in the 1970s, to target utility taxes. Long Beach cut utility taxes in half and faces another initiative to completely exempt natural gas from local taxation. An initiative emerging in Los Angeles would cut the utility tax by 50 percent.

Chicago's Corporate Fund, which is its general fund, has been receiving less and less of the city's property tax revenues over time due both to tax caps and to competing uses to which property tax revenues must legally be committed. After the Board of Education, school finance authority (repaying Board of Education bonds), city colleges, forest preserves, park district, Cook County hospitals, and water reclamation district, less than 10 percent of property taxes collected in the city are left for its Corporate Fund. An analysis in 1997 by the League of Women Voters of Chicago described the revenues that have filled the gap. Utility tax (eight percent on gross receipts of electricity, telecommunications, and natural gas companies) and franchise fee (three to five percent on qualifying revenues of cable television and fiber optics companies that use the city's public ways) revenues increased 40 percent between 1988 and 1997.[35] In January, 2001, as utility costs rose and utility tax revenues along with them, the city dedicated half of its increased revenues to helping poor and elderly Chicago citizens pay their heating bills and repair or replace their furnaces, and for emergency shelters, building inspections, water main repairs and other weather-related services. The other half of the revenue increase was retained to cover the city's own higher-than-anticipated energy costs.[36]

Franchise fees are paid annually to the City of Wichita by Arkla Gas Co., KPL, KG&E, Southwestern Bell, Multimedia Cablevision, Wichita Water & Sewer utilities, Storm Water utility, and Metropolitan Transit Authority for the privilege of doing business in the municipality. The current rate is five percent of gross receipts. In the FY 2001 approved budget,

[33] http://www.lacity.org/cao/budgtsum.htm
[34] http://www.ci/santa-ana.ca.us/departments/finance/budget and telephone interview with revenue specialist Will Holt.
[35] League of Women Voters of Chicago, "A Guide Through Chicago's Tax Maze," http://www.cookcountyassessor.com/lwvc/chgomaze07.html.
[36] Key speeches by Mayor Richard M. Daley, January 10, 2001 http://www.ci.chi.il.us/Mayor

franchise fees made up 20.8 percent of general fund revenue, and have grown 17.6 percent since FY 1998.[37]

A City Auditor's report in October 2000 analyzed Kansas City's tax structure, revenue-raising capacity, and tax effort. It found the tax structure to be balanced, with no single tax accounting for more than one-third of the city's revenue. Utility and franchise taxes have been declining in importance over the past two decades, from 22.8 percent in 1980 to 15.1 percent in 1999. Quarterly license fees on companies that sell electricity, natural gas, steam, and chilled water for heating and cooling, telephone service, and cable television are based on gross receipts. The utility tax is nine percent for electricity, gas, and telephone service to residences and 10 percent for sales to commercial and industrial establishments. The tax rate for cable television is five percent, and for steam and chilled water, four percent. The study notes, however, that utility taxes are regressive. Half the base is generated by commercial customers, who pay the majority of taxes on electricity (which accounts for 60 percent of utility tax revenues).[38] Beginning with the 2001-02 budget year, the city is reducing rates on residential electric and telephone customers by one percent per year to six percent. Rates for residential natural gas customers were permanently reduced to six percent in January 2001. The city's 2001-02 budget includes a 10-year analysis of utility tax collections, which reveals the volatility that results from changes in usage (often weather-related), rate changes, city tax rates, and utilities' gross receipts:

Table IV-2. Kansas City Missouri Utility Taxes

Fiscal year	Factors	% change
1992-3	Mild summer	-0.3%
1993-4	Higher natural gas prices	6.6
1994-5	2.6% electricity rate decrease; cable television franchise rate increased from 3-5%	-2.1
1995-6		6.0
1996-7	38% increase in natural gas prices during the winter; electricity rate decreases	5.6
1997-8	Natural gas revenues down in a mild winter	-3.4
1998-9	Increased electricity usage	4.7
1999-0	Lower rates, mild weather	-1.4
2000-01 budget		3.3
2001-02 budget	Reductions in residential tax rates	-3.7

Source: http://www.kcmo.org/manager/bdgt02/executive overview.pdf

In Baton Rouge, a five percent tax is levied on the gross receipts of utility companies. In the latest available budget, revenues from this source increased six percent from the first half of 1999 to the first half of 2000. Growth in 2001 was expected to be about 1.4 percent. Finance officials here also noted the difficulty of predicting revenues based on gross receipts of utilities, since not only weather but also "the number of commercial and residential customers,

[37] http://www.wichitagov.org/finance

[38] City Auditor's Office, City of Kansas City, Missouri, "Special Report: Comparative Analysis of Tax Effort," October, 2000 http://www.kcmo.org/auditor/00-01audits/taxanalysis.pdf

consumption and the conservation associated with it, and fuel adjustments included in the taxable base" influence the city's take.[39]

Other City Approaches to Taxing Public Utilities Not Included in Census Data

A limited examination of the summary budget documents and websites of several of the cities not shown by the Census Bureau to have any public utility revenues revealed that either the fiscal structure has changed since 1997, or that the revenues were included in other general taxation categories. In Ft. Worth, "other local revenue" in FY00 included $8 million in revenue from a telephone gross receipts tax, primarily a "franchise" fee paid by Southwestern Bell. "Licenses and permits" included "franchise" fees totaling $24 million realized from electric utility and other communications companies. These two sources generated 9.8 percent of general fund revenues. Street rental to cable television service providers yielded another $2.5 million. While precise breakdowns of the 2001-02 budget were not immediately available, the City Manager's budget message noted that utility franchise and street rental fees continued to be well-performing revenues.

In Philadelphia, regulated industries such as financial institutions and public utilities pay the business privilege tax (BPT -- the general fund's third largest revenue source). The BPT is a composite tax and varies depending on industry classification. The current standard rates for non-regulated industries are 0.2525 percent on gross receipts and 6.5 percent on net income. Regulated industries are taxed at the *lesser* of either 0.2525 percent of receipts *or* 6.5 percent of net income.

The gross receipts rate has been steadily lowered since 1996, when it stood at 0.325 percent, and is scheduled to drop to 0.215 percent by 2006. The reductions are aimed at reducing the burdens of smaller businesses that have limited net income and pay most of their tax through the gross receipts portion of the tax. A change in methodology in 1996 requires that any firm with "ongoing activity" in Philadelphia must pay the BPT. Prior to 1996, the factors used to determine the percentage of net income attributable to Philadelphia operations were equally weighted – property, payroll, and gross receipts. After January 1, 1996, gross receipts were double-weighted, which reduced the tax liability of firms located in Philadelphia and increased the tax on firms located outside the city that do business in the city. The City's FY2002-FY2006 Five-Year Financial Plan notes that the BPT is the most volatile and difficult to predict of all city taxes, primarily because of fluctuations in the net income component, which generates 60 percent of BPT revenues.

Cleveland's second largest general fund revenue source is the Local Government Fund and Local Government Revenue Assistance Fund. It was estimated that the City of Cleveland would receive $57.8 million from this source in FY2000, 13 percent of its general fund revenues. These revenues, which have grown 14 percent since 1997, are shown in the city's intergovernmental revenue account.

The State of Ohio shares revenues from state income, sales, corporate franchise, and public utility excise taxes with localities. Under the distribution formula adopted in 1989, 4.2

[39] http://www.ci.baton-rouge.la.us/Dept/finance/

percent of state tax collections are allocated to the Local Government Fund and 0.6 percent of collections are allocated to the Revenue Assistance Fund. Nine-tenths of the funds are distributed to counties by a formula based largely upon municipal tax rolls. Each county in turn divides them among all towns, villages, and municipalities and the county itself, either by a formula based on need or another method agreed upon by the local governments. One-tenth goes to cities that collect an income tax. The Revenue Assistance Fund revenues are distributed on a per capita basis to counties and then on to localities in the same manner. The Ohio public utilities excise tax is levied on utility companies that provide electrical, gas, and telephone service; rates range from 4.75 to 6.75 percent of gross receipts of business in the state. Revenues from this source made up 4.2 percent of the Local Government Fund.

Conclusions, Caveats, and Implications for Baltimore

Public utility taxes have the potential for generating significant revenues with relatively low rates, in large part because they are broad-based. Census data showed that a handful of the cities we looked at for comparison purposes generated significant revenue from public utility taxes, and that the vast majority – nearly 80 percent – did not. However, further investigation revealed that a number of the cities to which Census attributed no public utility revenues in fact receive substantial revenues from applying general business taxes to these regulated businesses. If Baltimore's public utility taxes generated only the narrowly-defined (by Census) big-city average of 4.9 percent of own-source revenues, it would have increased its revenues from this source by 69 percent, from $25.3 million in FY2002 to $42.7 million.

The Baltimore City Department of Finance has made estimates of the net effects of a move to broader-based energy and telecommunications taxation (all energy users, all types of telecommunications including wireless). If taxes were designed as they are today to yield the delivery-based equivalent of a sales price-based tax of eight percent (energy) and 12 percent (telecommunications), an the cost of applying them to city government were subtracted, energy taxes would generate an additional $60 million, and telecommunications taxes, $30 million.

In another estimate, David M. Griffith Associates did a rough calculation of the per capita revenues received by a group of comparison cities from gross receipts taxes on their electric, gas, and telephone utilities as an alternative or add-on to per-foot charges (a number of cities levy both). The firm concluded that Baltimore might raise an additional $28-$48 million by applying taxes to utilities in a similar way.[40] Additional study would be required to estimate the rates on units of gas, electricity, fuel oil, and telephone service delivered that would be required to generate these increases.

However, four important caveats must be kept in mind when considering public utility taxes as a source of revenue for local governments.

First, public utility taxes are typically a state-level tax, in large part for the nexus and administrative reasons discussed above. In an environment of deregulation, a local gross receipts or net income tax on public utilities may be difficult to administer and comply with and could

[40] Cited in Greater Baltimore Committee and Presidents' Roundtable, Management and Efficiency Review: Department of Public Works, July 2000.

create inequities between local and out-of-state providers. Further, many local governments already receive substantial property tax revenues from public utilities when the real property of the public utility is located in their jurisdictions.

Second, public utility taxes such as those discussed here should not be confused with what amount to current charges paid by public utilities for access to public rights-of-ways. For example, many local jurisdictions generate revenues, generally modest revenues, from fees charged public utilities, and others, for entering the public right-of-way to build their own conduit system. Such fees are charges for specific services and are not taxes on public utilities. Baltimore is in a unique situation among local governments because it actually owns some of the underground conduit system in the city. In this case, public utilities and others pay rent for space in the City-owned conduit system. But, again, this is a form of current charges paid by utilities for services provided and is quite different from local government taxation of public utilities. See **Chapter III.**

Third, because both cities and their states tax utilities, the combined effect needs to be evaluated when considering local changes. An analysis by the free-market advocate Progress & Freedom Foundation for testimony before a gubernatorial commission in Virginia found that Maryland had the ninth highest combined state and local telecommunications tax rates, primarily because of high state rates. When state and local levies are taken into account, Baltimore had the fifth highest telecommunications taxes among the 20 highest-tax cities. According to the Foundation, taxes accounted for over 25 percent of the phone bill in Baltimore.[41]

Fourth, as seen in Kansas City and Baton Rouge, revenues from gross receipts energy taxes are notoriously volatile.

Baltimore City can change the way it levies these taxes and broaden their base by city ordinance, which is an implementation advantage. It should explore all the approaches described here and develop an appropriate combination of franchise agreements for independent entries into the public right of way, and taxes on sales and/or deliveries of utility service to all users in the city by all suppliers. The preferred approach should seek to minimize volatility through unit-based rather than *ad valorem* levies; keep rates as low as possible by broadening the base, including wireless telephony; take into account deregulation impacts; and make appropriate tradeoffs with economic development objectives.

[41] Eisenach, Jeffrey A., "Reforming Telecommunications Taxes in Virginia: Background Materials," a presentation to the Governor's Commission on Information Technology, October 26, 1999 http://www.pff.org/CITPresentation102699a/background/vabackgr

V: Regional Sales Tax and Other Sales Tax Options

There are two basic approaches to taxation. The basis of some taxes is the ability-to-pay principle and reflects some measure of the taxpayer's ability to pay taxes. An example of such a tax is the income tax. Other taxes are based on the benefits-received principle and reflect the value of benefits received by the taxpayer. An example of such a tax is the selective sales tax on motor fuel consumption, in which revenues generated are dedicated to transportation improvements.

The idea of financing some public services through a regional sales tax is a variation of the benefits-received principle of taxation. Such a tax is based on the recognition that the benefits of some public services accrue to everyone in the metropolitan area. These benefits can be direct benefits for those consuming the public service, or they can be indirect benefits to those living in the metropolitan area.

The Bay Area Rapid Transit System (BART) in the San Francisco Bay area provides an example. Direct beneficiaries ride the trains to go to work, shopping, or for personal travel. They pay a fee to ride on the train because they directly benefit from the service provided. However, in FY2002, only 51 percent of the operating revenues come from the fare box. The remaining operating revenues come from a regional sales tax that is collected by businesses in the region (and ultimately paid by their customers throughout the region) that indirectly benefit from the increased mobility provided by BART. Specifically, the increased mobility in the region resulting from the BART system benefits businesses by enlarging their markets and extending the area from which they can recruit workers. It makes the entire area served by BART a more attractive location for businesses and families.

A similar argument can be made for cultural activities that benefit the entire metropolitan area. Cultural and leisure activities such as art museums, theater performances, major parks and recreational centers, and regional library centers benefit the entire metropolitan area, but are generally funded by the local government where they are located. In Baltimore City's budget for FY2001, expenses for cultural activities totaled $28 million.[42] In order to properly allocate expenses like these, two regions have developed a regional benefits district to pay for cultural and leisure activities that serve regional populations. To fund these activities, the districts levy an additional sales tax on the entire region; the benefit district then funds any cultural activity that, as defined by enabling legislation, benefits the entire region.

Experience in Other Regions

Two metropolitan areas in the United States have cultural benefits districts. The first is the Scientific & Cultural Facilities District in the Denver metropolitan area, which encompasses six counties. Created in 1988 by referendum, the district uses a .1% add-on to the state sales tax levy on all purchases in the region to fund cultural organizations. In the Denver region, the total revenue for the district was approximately $34,000,000 in FY1999.[43]

[42] Baltimore City Budget Plan Summary FY 2002. See Appendix B for list of agencies included.
[43] Scientific & Cultural Facilities District, *Annual Report 1999* (SCFD: Denver, CO, 2000)

The Allegheny Regional Asset District (ARAD) is a special district government established by the Allegheny County Commission on July 1, 1994, after enabling legislation was passed by the Pennsylvania General Assembly in 1993. ARAD is designed to fund regional cultural assets in the Allegheny County area, including the city of Pittsburgh. It was formed in response to a deficiency in resources in the region, as well as the need for a supplemental source of revenue to finance local tax relief. It is the model that seems most applicable to Baltimore, because it raises substantial revenue, because it grew out of a similar situation in which the central city was bearing an undue share of the burden of underwriting the region's cultural and leisure pursuits, and because one of its purposes was local property tax relief.

ARAD does not have any powers of taxation. Instead, Allegheny County is authorized to levy a one percent sales and use tax and a one percent hotel excise tax on the entire county on behalf of ARAD. In 2000, the yield was $73.5 million. The revenues are allocated: 50 percent to ARAD, 25 percent to Allegheny County, and 25 percent directly to qualified municipalities. Municipalities were required to qualify to receive a portion of these funds by meeting requirements that included earned income and property tax rates.

The portion of the sales tax that is not used for the funding of cultural assets through ARAD was designed to offer modest tax relief to county and municipal residents. During the first year of the tax, Allegheny County and the City of Pittsburgh were required to repeal any tax imposed on personal property, and Pittsburgh was required to reduce amusement, athletic, and other taxes to less than five percent. Both the city and the county had to use all other direct disbursements to exempt long-time senior citizen owner-occupants from real property tax increases. All other municipalities in the region were required to use 100 percent of their initial disbursements for tax relief, with 2/3 of their first-year disbursement going to reduce local taxes, and the remaining 1/3 earmarked for senior citizen property tax relief. From the second year on, they were freed from those restrictions, but had instead to contribute 25 percent of any additional revenue received to regional organizations such as the council of governments.

The direct revenue disbursement is based on a formula that is designed to reflect tax capacity and effort. Factors taken into account include property tax base and property tax revenues in relation to the county as a whole. The percentage of total disbursements each community receives is equal to its weighted tax revenue divided by the total weighted tax revenues of all communities. Weighted tax revenue is calculated by dividing the total tax revenue of a community by the community's percentage of the region's property market value:

$$\text{Community A share} = \text{Total funds available} \times \frac{\text{Total Tax Revenue Community A / Community A \% of Regional Property Market Value}}{\text{Sum of Weighted Tax Revenues of all Communities in the Region}}$$

The remaining 50 percent of the sales tax collected (minus state collection fees) are given directly to the Regional Asset District. ARAD places these tax dollars in its "special revenue fund," from which all disbursements are made. ARAD is authorized to use up to one percent of its total funding to pay for administrative costs; these funds are transferred to the District's

"general fund," which is earmarked for only these costs. The remainder is disbursed directly from the special revenue fund to the region's cultural and leisure assets.

Under the Pennsylvania authorizing legislation, ARAD "may assume the financial functions of the city and county with respect to the support of regional civic facilities, regional parks, regional libraries, professional sports facilities, regional cultural facilities and other organizations and properties vital to the quality of life of the region." The majority of the funding (28 percent) went to libraries in 2000, 27 percent to parks, 22 percent to stadiums and convention center, 11.5 percent to arts and culture, and 11 percent to the Pittsburgh Zoo and Aquarium, the Phipps Conservatory and Botanical Gardens, and the National Aviary. It is constrained from providing assistance to any form of training-based health care facility, any park with fewer than 200 acres (unless it crosses city boundaries), any asset that does not have a significant number of regional users, or any library that is not a regional resource center, a district library center, or part of a library system serving multiple municipalities.

ARAD's governing body is a Board of Directors, with four members appointed by the County Chief Executive, two by the Mayor of Pittsburgh, and one elected by the other six appointees. A twenty-seven person Advisory Board provides public input. Grants to cultural assets must be approved by six of the seven members of the Board of Directors.

The grants come in two forms: contractual assets and annual grants. Contractual assets include the larger-scale cultural assets of the region and are given ten-year contracts, under which they are guaranteed funding. For ARAD, these include the Allegheny County Library Association, Allegheny County Regional Parks, the Carnegie Institute, the Carnegie Library of Pittsburgh, the City of McKeesport Renziehausen Park, the City of Pittsburgh Regional Parks, the National Aviary in Pittsburgh, Phipps Conservatory, and the Pittsburgh Zoo. There are also a number of multi-year contractual fundings, including the Mellon arena and a memorial hall. Finally, annual grants are generally smaller grants that are given to individual cultural organizations on a year-to-year basis.

Baltimore Metropolitan Regional Asset District (BMRAD)

To apply the ARAD model to the Baltimore metropolitan region, there are a number of factors that must be addressed. Unlike Baltimore, Pittsburgh is part of a county that includes other municipalities. ARAD's boundaries encompass only Allegheny County, the city of Pittsburgh, and various municipalities therein, rather than a metropolitan region with multiple counties, as BMRAD would. We have used the Baltimore Metropolitan Council's regional definition, which includes Anne Arundel County, Baltimore City, Baltimore County, Carroll County, Harford County, and Howard County.

The other major issue that arises when thinking about applying the ARAD model to Baltimore is that there is no regional body with taxing authority and capacity. It would, however, be possible to create a regional piggyback sales tax collected by the state. The advantages of this approach are several – streamlined tax administration and inclusion of the state exemptions that help to reduce the regressivity of the sales tax, i.e. food, medicine, and medical supplies. The state could transfer the funds collected to a regional body, for example a

special affiliate of the Baltimore Metropolitan Council established for this purpose. In any case, state legislation would be required to authorize the tax, spell out governance, and define eligible uses.

It is important to note here that Maryland's state general sales tax rate (five percent) is relatively low in comparison to other states (although neighboring Delaware has none; it does, however, tax gross receipts). The State of Maryland reserves this revenue source to itself, and only grants selected sales taxing authority to a limited number of jurisdictions. Given that no county in the Baltimore metropolitan area levies a local general sales tax, the combined state and local sales tax rates are low in comparison to other metropolitan areas. The DC Tax Commission reported combined state and local sales tax rates of 6 percent in Atlanta, 8 percent in Birmingham, 8.75 percent in Chicago, 7 percent in Cleveland, 8.25 percent in Dallas, 7.3 percent in Denver, 5.75 percent in DC, 5.9 percent in Kansas City, 8.25 percent in Los Angeles, 6.5 percent in Miami, 7.5 percent in Minneapolis, 9 percent in New Orleans, 8.25 percent in New York, 7 percent in Philadelphia, 6.85 percent in St. Louis, and 8.2 percent in Seattle.[44]

On the negative side, however, sales taxes are very vulnerable to economic cycles; shortfalls in revenues in the current downturn are causing 50 percent of cities to make mid-year adjustments in FY 2001, according to the National League of Cities.[45] The sales tax base is also narrowing because of the transition to a services-based economy, e-commerce, and policy choices to exempt "essentials" from tax. The National League of Cities cites a University of Tennessee study that reported that services, which are largely untaxed by sales taxes, grew from 47 percent of personal consumption in 1979 to 58 percent in 1996.[46] Also, where there is substantial difference among nearby localities, or along state borders, individuals are more likely to travel to make large purchases such as appliances and jewelry in locations with lower sales tax rates. The Maryland Comptroller's "back to school" tax holiday is in part designed to keep these purchases in-state.

To project the likely impact of implementing the ARAD model in the Baltimore region, FY 2000 sales and use tax data, the most recent information available from the Comptroller's office, were used. For congruity, all expenditure and tax figures for the City of Baltimore are based on the same fiscal year. An additional one percent sales tax, covering the metropolitan district, would generate $215,139,000 in revenue. Half of the funds, $107,570,000, would be designated for funding cultural assets and would be placed in the control of a Baltimore Metropolitan Regional Assets District (BMRAD). The remaining funding would be returned to the individual counties and Baltimore City, using a distribution formula like that of ARAD.

The impact on Baltimore's budget would take two forms in this scenario. The first source of relief would come from a reduction in city obligations. The regional asset district would pick up most of the "regional cultural assets" – regional libraries, parks, sports, civic, and cultural facilities – that are presently paid for out of the city budget. BMRAD would pick up funding for the state library resource portion of the Enoch Pratt Free Library, the Baltimore Museum of Art, the Walters Art Gallery, the Baltimore Area Visitors and Convention Bureau,

[44] Taxing Simply, Taxing Fairly, op. cit.
[45] Nation's Cities Weekly, April 16, 2001.
[46] Nation's Cities Weekly, June 25, 2001.

and a portion of the budget for Parks and Recreation, as well as many other smaller grants (see Appendix B for details). A conservative, rudimentary estimate of the savings is $28.1 million, a reduction of 3.1 percent in the city's General Fund budget. The savings are likely to be higher, as the assessment conducted was unable to determine what percentage of the total parks and recreation budget went toward regional facilities and would therefore be assumed by BMRAD.

Baltimore City would also receive back a portion of the additional sales tax earmarked for local tax relief. For every penny of additional sales tax, ½ a cent would be designated for return to localities. We assume that BMRAD would use a formula similar to ARAD, designed to balance tax revenue based on tax capacity and effort. Using this approach, Baltimore City would realize a return of $47.6 million.

Table V-1. Estimated Impact of a Regional Assets District In Metropolitan Baltimore – Revenue Sharing

Jurisdiction	Sales Tax Revenues Shared With Locality ($000)
Anne Arundel Co.	13,955
Baltimore City	47,557
Baltimore Co.	28,667
Carroll Co.	4,097
Harford Co.	6,107
Howard Co.	7,187

Combined with the reduced expenditure requirements, the city would have experienced a net gain of $75.7 million, or 8.4 percent of the City's General Fund budget in FY2000. Even if a substantial portion of the funds were used to restore City support of cultural institutions that has been eroded over the years as budget woes have intensified, tax relief could also be pursued.

No attempt was made to estimate the expenditure savings to other jurisdictions where regional cultural and leisure assets are located. Anne Arundel County's special park facilities such as the Olympic Swim Center, Down's Park, the B&A Trail, and Quiet Waters Park, and its environmental facilities at Jug Bay, Kinder Farm, and Thomas Point; Baltimore County's Oregon Ridge Nature Center; Carroll County's Farm Museum, Hashawa Environmental Center, and Piney Run recreation area; and Harford County's Anita C. Leight Estuary Center, Eden Mill, Swan Harbor Farm and Harford Glen all receive support from their counties' general funds. Addition of these facilities could be accommodated within the half of the BMRAD that is set aside to fund regional assets, and leave funds for smaller arts and culture grants throughout the region, and more ambitious Community and Rural Legacy goals or expanding recreation-related after-school activities.

Sales Taxes in Other Cities

Cities in 33 states currently tax sales, compared to 15 in 1967.[47] Two are worth noting. The sales tax is the second largest revenue source (behind combined utility taxes and franchise

[47] Nation's Cities Weekly, June 25, 2001.

fees paid by utilities) in Chicago's Corporate Fund (its general fund), accounting for 17 percent in 2001. The sales tax in Chicago is 8.75 percent -- 5 percent levied by the State of Illinois, 2 percent by the City of Chicago, 1 percent by the Regional Transportation Authority, and 0.75 percent by Cook County.

In Miami-Dade, a 1 percent tax on food and beverages in used for homeless and domestic violence programs and facilities. The tax generated $7.3 million in 2000-2001, 85 percent of which went to homeless services. Large restaurants (gross revenue over $400,000) pay the tax, except those in hotels or motels, which pay a 2 percent tax dedicated to tourism and convention promotion. A comparable tax in Baltimore City would have generated at least $558,000 in FY2000.[48]

It should be noted that a number of cities generate substantial revenue by either applying a general sales tax to utility sales, or by levying selected sales taxes on utilities. See **Chapter IV**. It is also clear that what were formerly clear boundaries of tax authority among levels of government in the United States are breaking down, creating a "marble cake" rather than the layer cake of the past. The income tax was once the exclusive purview of the federal government, but now is used by all but nine states and by localities in 15 states. Sales taxes, once reserved to the states, are increasingly playing an important role in diversifying local revenue structure, particularly relieving the burden on the property tax. As mentioned in **Chapter IV**, franchise taxes on utilities have been adopted by cities as well as states, and a wide variety of general and selective sales taxes are being levied for a wide range of dedicated purposes ranging from education and childcare to transportation and convention centers.

[48] Comptroller of Maryland, Consolidated Revenue Report, FY 2000

VI: Earnings Tax

In 1997, localities in 15 states had authority to levy income taxes, some statewide and some in specifically-enumerated cities (including Baltimore, NYC, St. Louis, Kansas City, Philadelphia). In Missouri, localities may tax individual gross earnings at one percent and net business profits at one percent. In FY2000, St. Louis received 40 percent of its General Fund revenues from the income tax. In Baltimore, income tax revenues constitute only 16 percent of the General Fund. Pennsylvania law permits localities to tax wages, earnings, and net profits of all residents and nonresidents employed in municipalities. The state imposes a cap of 4.31 percent on the nonresident rate unless the resident rate exceeds 5.75 percent. Ohio law is described in detail below.

The rationale for taxing commuters

Employment levels affect not only direct and indirect sources of revenue but also the expenditures a local government is required to make. Business property must receive police and fire protection. Employees must be kept safe at work while their homes continue to require public safety vigilance in their absence. Commuters impose additional traffic management, road maintenance, parking, sanitation, and protection costs on their destination locales. In analysis done by the Advisory Commission on Intergovernmental Relations for the Linowes Commission in 1990, levels of employment, commuters, and the miles they traveled were identified as key variables in determining how much Maryland localities had to spend for fire protection, police protection, other public safety, sanitation, other public works, health and hospitals, and transportation.[49]

Baltimore Region Commuters

Estimating the income tax base sharing that is already taking place in the Baltimore Metropolitan area requires precise earnings data by destination for commuters from each county in the region and Baltimore City. The last such data was collected by the Census Bureau for the 1990 census.[50] More recent data will not be available until later in 2002. In 1990, approximately 192,400 non-residents worked in one of 26 regional planning districts in Baltimore City. Using the median wage for each of these districts, it was estimated that commuters to Baltimore City took home approximately $4.2 billion annually in 1990.[51] These approximations understate income because suburban commuters generally hold higher-paying city jobs, but might overstate income in 2001 because of increasing suburbanization of employment since 1990. The U.S. Bureau of Economic Analysis[52] estimates that there was a net[53] outflow of $6.7 billion of earnings from Baltimore City in 1999.

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[49] Rafuse, Robert W., Laurence R. Marks, and Carol E. Cohen, "Local Government Spending in Maryland: Needs and Performance," prepared for the Commission on State Taxes and Tax Structure, State of Maryland, April 16, 1990.

[50] Provided by the Baltimore Metropolitan Council.

[51] For consistency, all tax rates and revenue projections are based on FY1990 data.

[52] Local Area Personal Income

[53] Adjusted for Baltimore City residents working outside the City.

Philadelphia Model Earnings Tax Applied to Baltimore

A number of potential scenarios exist for applying a local earnings tax plan to Baltimore City. The first scenario would simply allow Baltimore City to apply an earnings tax to any non-resident working in the city. A similar system in presently in place in Philadelphia. Pennsylvania law[54] permits municipalities to adopt local option income taxes up to one percent with voter approval. In 1956, a local ordinance was passed amending the City of Philadelphia code, authorizing a 3.19 percent income tax. Pittsburgh has a similar local ordinance, with a maximum of one percent. Other cities in Pennsylvania also levy the tax. Suburban governments (counties, boroughs, and townships) surrounding Philadelphia are not authorized to levy income taxes.

Philadelphia charges all non-residents working inside its city limits an earnings tax that is slightly lower than the rate it charges residents. Current rates on wages and net profits are approximately 4.5 percent for residents and 3.9 percent for non-residents. New Jersey residents employed in Philadelphia are able to take a credit on their state income tax return for wage taxes paid to Philadelphia.

A simple Baltimore earnings tax on all workers in Baltimore City could be collected by the State Comptroller, who currently handles the piggyback income tax. Bureau of Economic Analysis data shows that $18.5 billion was earned in Baltimore City in 1999, $6.7 billion of which was by non-residents. If a one percent tax had been applied to earnings of non-residents, commuters would have generated an estimated $67 million in new revenues. For comparison, receipts from Baltimore's 2.5 percent piggyback income tax in FY99 were $143 million. More precise information from tax returns would most likely result in downward adjustments of revenue to be generated by this option because these estimates are based on gross earnings and don't account for deductions and exemptions (although the tax could be applied on a flat basis on earnings). There would also likely be upward adjustments, because the Bureau of Economic Analysis data is for *net* inflow (outflow) of earnings due to commuting. Earnings of Baltimore City residents who work outside the City have been subtracted from earnings of commuters into the City to produce the $6.7 billion estimate.

The earnings tax in Philadelphia has been blamed by some for the exodus of residents and businesses. The Tax Structure Analysis Report issued in November 2001 by City Controller Jonathan A. Saidel notes that after the wage tax rate was decreased 8.5 percent over the years from 1996 to 2001, job and wage growth produced an 18.8 percent increase in wage tax collections. In addition to business tax reductions, the report calls for acceleration of the pace of wage tax rate reductions, from 4.5385 percent for city residents and 3.9462 percent for non-residents to 3.5 percent and 3.375 percent, respectively, by FY 2007.

Ohio Model

The base of the Ohio local income tax includes:

[54] 53 Pennsylvania Statutes §§ 6902, 6908; 53 Pennsylvania Statutes § 8703.

1) Wages, salaries, and other compensation earned by residents of the municipality;
2) Wages, salaries, and other compensation earned by non-residents working in the municipality; and
3) Net profits of business (both incorporated and unincorporated) attributable to activities in the municipality.

State law requires a flat rate within a jurisdiction so that residents and non-residents face the same rate. A municipality may impose a rate of one percent without voter approval, but anything higher than one percent requires approval by the voters. Rates vary from a low of 0.25 percent to a high of 2.85 percent. Since 1972, the number of Ohio cities and villages levying the tax has grown; in 2001, 525 of 900 communities taxed income, and over half of the taxing municipalities have rates equal to one percent. The Columbus rate is two percent, and generates 64 percent of the city's general funds.

However, each local government then has the option of giving a partial or full credit to their residents who pay municipal income taxes to a different municipality where they are employed. The city of Westerville, an "edge city" outside Columbus, provides an example. Westerville has a local income tax rate of one percent and gives a 75 percent credit to residents who pay other local income taxes in the city in which they work – that is, taxes paid to the city of employment can be used to offset up 75 percent of the tax liability in Westerville. If a resident lives in Westerville and works in Columbus, the resident will pay two percent income tax to Columbus. The resident will be given a credit for the income taxes paid to Columbus equal to 75 percent of the tax liability in Westerville, but will be required to pay 25 percent of their income tax liability to the city of Westerville. Thus, the resident's total local income tax bill will be 2.25 percent of their income – 2 percent going to Columbus, the city of employment, and 0.25 percent going to Westerville, the city of residence.

Applying the Ohio Income Tax Revenue Model to Maryland

In 1995, Senator Barbara Hoffman introduced SB 633, entitled the 1995 Piggyback Tax Reform Act. It would have made the local income tax (piggyback tax) optional, and would have required that instead of or in addition to the income tax, each county would have a one percent earnings tax on the earnings of all Maryland residents employed in their counties. In order to make the impact on taxpayers neutral, the bill followed the Ohio model and specified that a credit for earnings taxes paid to all counties could be claimed against an individual's local income tax liability in the jurisdiction of residence.

Using estimates of commuting patterns and wage rate differentials among the counties, the Department of Fiscal Services prepared a fiscal note on the likely impact of SB 633. When gains from the earnings tax were reduced by credits against income taxes, the net change in revenues for each jurisdiction was calculated.

Table VI-1. Estimated Fiscal Impact of SB 633

Jurisdiction	Net Change
Allegany County	($155,394)

Anne Arundel County	(6,550,744)
Baltimore City	8,660,395
Baltimore County	12,349,308
Calvert County	(2,328,193)
Caroline County	(733,355)
Carroll County	(10,050,696)
Cecil County	(631,402)
Charles County	(3,024,485)
Dorchester County	(129,695)
Frederick County	(6,594,917)
Garrett County	(201,409)
Harford County	(12,811,389)
Howard County	(3,591,742)
Kent County	120,007
Montgomery County	20,280,263
Prince George's County	9,950,367
Queen Anne's County	(1,647,706)
Somerset County	(492,647)
St. Mary's County	(1,502,822)
Talbot County	538,138
Washington County	(1,879,045)
Wicomico County	373,148
Worcester County	54,014

Prepared by the Maryland Department of Fiscal Services, March 1995

The project team has sought to recreate and update the estimates to 2000. While the 1995 analysis did not include individuals who live and worked in the same jurisdiction, the 2000 analysis does. Maryland Department of Labor, Licensing and Regulation data on total wages paid in each jurisdiction were first reduced by the percentage of workers in each county whose residences were out of state[55] (using 1990 census data) to generate taxable wages. A straight one percent tax on earnings was applied to generate estimates of the ***gain*** each jurisdiction would experience.

Next, ***credits*** were calculated by summing the wage taxes paid by residents, for example of county B, either to the jurisdiction in which they live and work, or other Maryland jurisdictions. Wage taxes paid were calculated by multiplying the percentage of the workers of county A that lived in county B (from census) times the total wages paid in county A.

Total credits for wage taxes paid to all jurisdictions by residents of each county were subtracted from its earnings tax gain to yield ***net change.*** Net change represents the redistribution of income tax revenues toward employment centers across the state. The results are presented in **Table VI-2.**

[55] Non-residents of Maryland would not be subject to the earnings tax.

Table VI-2. Estimated Fiscal Effect of Taxpayer-Neutral 1% Wage Tax 1990
(dollars)

Jurisdiction	Earnings	Gain from Earnings Tax	Loss From Credits	Net Change
Allegany County	747,497,888	6,166,599	6,312,451	-145,852
Anne Arundel County	6,867,732,287	66,314,769	75,142,346	-8,827,577
Baltimore City	14,997,034,771	147,252,901	115,017,349	32,235,553
Baltimore County	12,204,675,025	118,123,891	135,620,036	-17,496,145
Calvert County	510,655,270	5,020,743	7,926,626	-2,905,883
Caroline County	206,710,087	1,871,961	2,952,563	-1,080,602
Carroll County	1,257,725,323	11,650,574	22,029,723	-10,379,149
Cecil County	702,535,582	6,066,537	6,823,726	-757,189
Charles County	1,024,225,633	9,708,584	13,473,687	-3,765,103
Dorchester County	298,060,354	2,850,917	3,135,236	-284,318
Frederick County	2,380,673,723	21,994,349	30,082,376	-8,088,027
Garrett County	217,890,232	1,911,643	2,051,365	-139,722
Harford County	1,973,850,181	18,872,353	31,736,146	-12,863,793
Howard County	4,876,055,810	47,597,910	44,329,527	3,268,383
Kent County	185,200,726	1,793,921	1,691,206	102,716
Montgomery County	19,551,947,812	169,400,723	130,930,760	38,469,962
Prince George's County	11,265,520,128	90,694,209	92,071,894	-1,377,685
Queen Anne's County	255,548,834	2,491,029	4,485,009	-1,993,980
Saint Mary's County	1,259,870,362	12,424,038	14,060,269	-1,636,231
Somerset County	184,703,030	1,790,187	2,545,267	-755,081
Talbot County	506,372,789	4,962,453	4,131,836	830,617
Washington County	1,788,266,875	14,209,299	17,120,697	-2,911,398
Wicomico County	1,130,863,610	10,380,962	9,945,568	435,394
Worcester County	489,081,266	4,198,028	4,132,917	65,110
		777,748,579	777,748,579	0

Seven counties would be net beneficiaries of a one percent earnings tax – Baltimore City, Howard County, Kent County, Montgomery County, Talbot County, Wicomico County, and Worcester County. These are counties that generally have a combination of:

- higher-than-average wages (which increase wage gains),
- lower than average percentages of out-of-state workers (which decreases wage gains because they are not taxed), and/or
- lower-than-average percentages of out-bound commuters to other high wage jurisdictions.

Baltimore City and Howard County both had higher than average wages and substantially lower than average percentages of out of state workers. In Montgomery County, a large employment base with the state's highest wages generated enough wage gains to withstand taxes foregone because of a high percentage of out-of-state resident workers and substantial credits paid to outbound commuters. In Talbot and Worcester Counties, wages paid to large numbers of seasonal workers were not substantially diminished by credits to the much smaller number of

residents who commuted out of these counties to work. Wicomico and Kent Counties, because their county seats are the market centers of their largely rural regions, may be experiencing a similar effect. Baltimore County and Prince George's County, which would have experienced net positive change in 1995, both were losers in 2000, mainly because of dramatic increases in credits owed to residents earning high wages outside their counties of residence. The percent of out-of-state resident workers in Prince George's County was also two and one-half times the state average.

City revenue-neutral scenario

A third scenario would be to tax commuters, but hold revenues constant in Baltimore City. This approach would tax the earnings of both commuters and residents at the same rate. To generate FY99 revenues of $143 million, the City would be able to adjust its piggyback income tax rate downward, probably by at least one percent.

The D.C. issue

In Maryland, one of the largest concerns about taxing non-resident workers has always been the fear of reciprocal taxation, whereby governments in Virginia and Washington, DC might impose a wage tax on workers living in the Washington, DC suburbs of Maryland who work in either the District of Columbia or Virginia if Maryland taxed their residents who work in Maryland. The option described above (taxpayer-neutral scenario) may be a way to address this issue. Maryland residents who work out of state would continue to be taxed at their place of residence, and residents of other states working in Maryland would not be taxed here unless their states (including D.C.) adopt an un-reimbursed tax on Maryland residents working in their jurisdictions.

In March, 2002, Delegate Eleanor Holmes Norton (D-DC) introduced federal legislation to impose a two percent income tax on Maryland and Virginia commuters to the District of Columbia. Congress currently prohibits the District from taxing these non-residents, who earn 66 percent of the wages paid in the District. The tax, supported by Mayor Anthony Williams and the DC Council Chair, would be offset by a federal tax credit that would leave commuters financially whole without requiring additional paperwork or tax filings. It was estimated that the tax -- earmarked for school construction and maintenance, transportation, information technology and debt repayment -- would generate $413 million per year, and would represent a major increase in federal aid to the City. Congressional representatives from nearby districts in Maryland and Virginia were reportedly receptive.[56] Del. Norton did not expect the bill to pass, but was seeking to educate lawmakers about a more stable basis for federal aid to the City.

However calculated, it is clear that taxing income at its source would have significant benefits for Baltimore City. Modification of state enabling legislation would be necessary to implement any of the income/earnings tax scenarios described in this chapter.

[56] Hsu, Spencer S., "District Appeals to U.S. For Tax on Commuters," Washington Post, March 11, 2002.

VII: Split Property Tax

In 1997, local governments nationwide generated $209 billion from the local property tax, accounting for 45 percent of general revenues from own sources – the largest single source of own-source revenues for local governments. Baltimore City generated $473 million from the local property tax – 52 percent of general own-source revenues.[57]

In Baltimore, as with virtually every other local government in the U.S., the property tax is an *ad valorem* tax that generates revenue by taxing the value of land and improvements on land at the same rate. For example, in Baltimore, the taxable value of land and improvements on land are taxed at a uniform rate of $2.38 per $100 assessed value.

An alternative to taxing land and improvements on land at the same rate is to tax land and improvements on land at different rates – typically with a higher rate applied to land and a lower rate applied to improvements on land. This is often referred to as a ***graded***, or ***split rate***, property tax. At the extreme, the rate applied to improvements would be zero and the property tax would be a ***land tax*** or ***site value tax***.

The purpose of this chapter is to explore the implications of introducing a graded, or split rate, property tax in Baltimore City.

Advantages of a Graded or Split Rate Property Tax[58]

The rationale for a split rate property tax has evolved over time. Initially, when the idea of taxing only land values was introduced by Henry George in his book Progress and Poverty (1879), the intent was to achieve social justice. George was concerned with the growing disparity in wealth and the persistence of involuntary poverty in a time of rapid economic growth. Cities were growing; undeveloped land was being acquired and developed. Believing that speculators withheld land from productive use in anticipation of future increases in value, George argued that reducing taxes on wages and capital and raising taxes on land would induce owners of unused land to develop it, thereby bringing idle land into productive use and creating more employment. As a result, wages would go up, prices would go down, and the standard of living for workers would increase.

The basic principle underlying the notion of a land tax is the view that land value typically reflects a number of community-specific factors, generally beyond the control of the individual landowner. Such factors might include the nature of surrounding land uses, the availability of publicly-provided infrastructure (roads, sewers, water, etc.), the size and wealth of the community, etc. In such cases, the increase in land value is a return on community-based investments, beyond the control of the landowner, and, in essence, should be returned to the

[57] U.S. Bureau of the Census, *Census of Governments, 1997*.
[58] This section draws on material in Robert M. Schwab and Amy Rehder Harris, "An Analysis of the Graded Property Tax," Taxing Simply; Taxing Fairly, The District of Columbia Tax Revision Commission, September 1998.

community. Alternatively, the value of improvements is created by private capital investment, and as such, belongs to the owner.[59]

In this context, the focus of land tax advocates and many economists interested in a land tax is not so much about poverty alleviation as it is about economic efficiency. Specifically, it is generally acknowledged that taxes not only generate revenues, but they also provide incentives for people to change their behavior to avoid or minimize the taxes they pay. For example, a tax on wages may cause some people to work less, while a tax on capital may cause some people to invest or save less. Similarly, a tax on the value of capital improvements to land may cause some to shift their capital to other uses that are taxed less, thereby reducing investments in improvements. For example, a landowner might build a smaller factory because of the reduced rate of return resulting from the tax on improvements. Alternatively, a landowner may decide not to renovate, or maintain, an existing structure because of the increase in property taxes that might result from such improvements. Economists call the economic costs associated with such changes in behavior the excess burden, or deadweight loss, of a tax. Thus, from the perspective of the property owner, and society, the total burden of a tax on improvements is the amount of taxes paid plus the excess burden, or deadweight loss, of the tax resulting from behavioral changes motivated or induced by the tax.

The situation for land is significantly different because the supply of land is, for all practical purposes, fixed. Therefore, if a tax on the value of land is imposed, or increased, there is nothing the landowner can do to avoid paying that tax – she cannot decrease the amount of land available. Since there is nothing the landowner can do to avoid the tax on land, it does not distort her decisions and there is no deadweight loss from this tax.

In addition to this efficiency argument in favor of taxing land more heavily than improvements, some also argue that taxing land more heavily than improvements may be fairer. Specifically, it is argued that since the ownership of land tends to be concentrated in high-income families and individuals, a tax on land values is more progressive than a tax on land and improvements.[60]

More recently, some environmentalists and planners are advocating a graded, or split rate, property tax, with a significantly higher tax rate on land than on improvements, as a means of addressing urban growth management objectives. According to this view, in urban areas land value is largely site value, that is, the market value generated by the presence of public infrastructure, nearby public and commercial facilities, natural amenities, and accessibility. Thus, a heavier tax on land merely taxes the land rent created over time by the community at large, not the private capital invested in the property improvements. As a result of higher taxes on land, individual property owners would have financial incentives to convert the land to more building-intensive uses or to sell the land to a buyer willing to undertake a substantial capital

[59] Thomas Gihring, "Incentive property taxation: A potential tool for urban growth management," Journal of the American Planning Association, Volume 65, Number 1, Winter 1999, pp. 62-79.

[60] See for example, Roy W. Bahl, "Fiscal Decentralization, Revenue Assignment, and the Case for the Property Tax," in Michael E. Bell and John H. Bowman (editors), Property Rates in South Africa: Challenges in the Post-Apartheid Era, Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2002, Chapter 2.

investment. They argue that such a tax would help achieve urban growth management objectives because:

- Placing higher taxes on land makes it more costly to hold vacant or underutilized land in the urban core. Trends toward infill development and a gradual recentralization of urban development would emerge over time and the demand for sites at the urban fringe would diminish.

- Reducing the tax burden on improvements would facilitate revitalization and the replacement of obsolete buildings in older central cities; property owners, responding to financial incentives to reduce the land-to-improvements value ratio, would build more intensively on vacant and underutilized sites in the urban core.

- The graded, or split rate, property tax would discourage land speculation because the holding of unimproved or underutilized property would diminish the anticipated windfall for the holdout owner.[61]

As a result, these urban planners and environmentalists advocate a graded, or split rate, tax with a significantly higher tax rate on land as a means of helping to:

- Preserve rural open space and resource lands;
- Prevent sprawling, low-density development;
- Direct new growth to existing centers;
- Encourage infill and contiguous development;
- Encourage redevelopment in economically depressed sub-areas; and
- Revitalize declining central business districts,

thereby achieving their objective of reducing automobile dependency and promoting support for transit and pedestrian modes of mobility.[62]

An issue underlying all of these arguments in favor of a graded, or split rate, property tax is the notion that the tax would affect the timing and nature of development of individual sites. Raising the cost of holding land would discourage the speculative holding of land; and reducing the cost of improvements would promote investment in structures. The issue of the timing and nature of development was a fundamental component of George's initial proposal and underlies both the economic efficiency and "green tax" arguments for a differential tax on land.

Obtaining this outcome, however, assumes that the higher tax on land is used to reduce, or eliminate, the tax on improvements that discourages investment in improvements, thereby reducing the intensity with which land is used. Schwab and Harris argue that any tax could stimulate development as long as the negative effects of collecting the tax are less than the positive effects of reducing the tax on structures. The example they use is a head tax that, like

[61] Alan Thein Durning, 1966, This Place on Earth, Seattle: Sasquatch Books, as quoted in Thomas Gihring, "Incentive property taxation: A potential tool for urban growth management," Journal of the American Planning Association, Volume 65, Number 1, Winter 1999, pp. 62-79.
[62] Ibid.

the land tax, has no excess burden. [63] However, the head tax is generally regarded as a very undesirable tax on equity grounds – it is extremely regressive. In fact, Schwab and Harris, looking at an analysis of the Pittsburgh experience,[64] conclude that

> "The role of land-value taxation in Pittsburgh should be understood in a setting of ***differential*** taxation. The relevant issue here is how the effects of the land-value tax ***compared*** with those of the available alternative sources of tax revenues. It appears that a land tax did not cause a building boom in Pittsburgh, but it did allow the city government to avoid policies that might have undercut the boom."[65]

Finally, there are those who argue for a land tax on administrative grounds. Specifically, we heard this argument most often in South Africa where a third of all local governments tax only land values. In many of those cases, local officials argued that a land only tax was desirable because the local government could avoid the costs associated with collecting and maintaining data describing improvements to land. While no systematic evidence was provided to substantiate this claim, it was asserted that a land only tax could reduce the cost of valuing individual parcels by more than 50 percent. These savings in administrative costs, however, would not be realized by a local government with a graded, or split rate, property tax since data on improvements would have to be collected, stored, and maintained.

Disadvantages of Graded Tax or Split Rate Property Tax[66]

There are two major disadvantages to site value taxation. The first is an assessment problem. That is, first, the "bundled" property value must be determined and then partitioned into the land component of value and the improvement component of value. There are several technical approaches used by valuers to address this issue. The preferred method of valuing land for tax purposes is the sales comparison approach. Assessors use actual sales data to determine an average per unit value of land in each category and then make modifications to this average to determine the value for individual properties. The problem with the comparable sales approach, however, is that in developed urban areas there are often insufficient vacant land sales.

In cases where there are insufficient vacant land sales to estimate average land prices by category, assessors must resort to less-preferred approaches to partitioning a property's value into a land and improvement components. One approach is the abstraction approach. In this case improvement values obtained from a replacement cost model are subtracted from the sales price of improved parcels, and the residual is the estimated land value. A second approach is the allocation, or land ratio, method. Here the assessor looks for an area with adequate vacant land sales, calculates a land-to-improvement ratio for properties in that area, then applies that ratio to similar types of improved properties in the area with limited vacant land sales. A third approach is the capitalization of ground rents approach. Under this approach, the net rent paid for land

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[63] Robert M. Schwab and Amy Rehder Harris, "An Analysis of the Graded Property Tax," Taxing Simply; Taxing Fairly, The District of Columbia Tax Revision Commission, September 1998, pp. 222-3.
[64] See below, this chapter, "Experience with Land Taxes."
[65] Schwab and Harris, op.cit., p. 228.
[66] This section draws on material in Roy W. Bahl, op.cit.

leased independent of improvements is capitalized to generate an estimate of land value. Finally, land valuation models can be used to estimate land and improvement values based on actual sales data. In each of these cases, determining land value is a more subjective exercise than total property valuation. In fact, the task of partitioning a property's value into land and improvement components is so complicated that a valuer in Pretoria (which taxes only land values) characterized it as an "Alice in Wonderland-type experience."

The second frequently-discussed disadvantage of a land-only tax is that the value of land is a much smaller tax base than the value of land and improvements. As a result, sufficient revenues can only be generated at higher rates. There can be no question but that it is politically easier to levy a lower property tax rate on a broader base (one that includes the value of improvements) than *vice versa.* This argument is not easily dismissed. Financial officers and elected officials of fiscally strapped local governments too often see downtown office buildings, hotels, and luxury residences as legitimate and fruitful objects of taxation – in part because it is perceived as a way to shift taxes to others. In fact, some countries have made exceptions to their land value tax in order to capture the value of these types of improvements.[67]

A third disadvantage, depending on the point of view of public policymakers, is the shifting of burdens brought by valuing land more heavily. In general, the burden shifts from residential to commercial properties. These shifts are highlighted in the analysis of Baltimore that follows.

Experience with Land Taxes

Pittsburgh was the only major city in the U.S. with a split rate property tax. Pennsylvania is the only state that permits it and Pittsburgh and over a dozen other cities in the state adopted the system in 1913. Under this split rate tax, land was taxed at a rate twice that of structures until 1979 when the differential was increased so that land was taxed five times greater than improvements. Oates and Schwab investigated the impact of this substantial increase in the differential tax on land, compared to improvements, to see if it had a major impact on the economic rejuvenation that took place in Pittsburgh during the 1980s. Their analysis found that the shift toward a split rate tax in 1979 did not ***cause*** the building boom in Pittsburgh in the 1980s – that really resulted from a number of market forces [and changes in federal law that led to a surge in commercial development nationally] beyond the control of local officials. However, they did conclude that relying more heavily on a land tax did allow the city government to generate additional revenues in a manner that did not undercut that boom.[68]

The split rate tax in Pittsburgh was eliminated earlier this year. Allegheny County had hired a consultant, Sabre Systems and Service, to reassess every property in the county, which includes the City of Pittsburgh. In the past, the two-tier tax had generated little controversy; some smaller cities in Pennsylvania believe that it has helped to cushion them from the fiscal

[67] Roy W. Bahl, op.cit
[68] Wallace E. Oates and Robert M. Schwab, "The Impact of Urban Land Taxation: The Pittsburgh Experience," National Tax Journal, Vol. 50, March 1997, pp. 1-21.

effects of the decline of "big steel."[69] However, when Sabre raised "artificially low" land value assessments to what it felt to be "accurate" values this year, and preliminary assessment notices reflecting the reassessments went out, it became clear that some property owners would face extraordinary tax liabilities. The Mayor cited several neighborhoods where land values increased over 200 percent while improvements were assessed 10 to 16 percent lower. One city councilman's analysis found that the reassessments had catapulted land from 10 percent of total property value to 30 percent. On an emergency basis, the City Council, with the reluctant support of the Mayor, approved a new tax plan that would levy a single property tax on the total value of land and buildings, and provide a $10,000 homestead exemption to qualifying property owners. The City, which is left with a $7.2 million deficit, is also challenging the consultants' work and plans to address the tax structure more systematically over the next year.[70]

A number of other cities in Pennsylvania have experimented with the split rate tax, as have a very few cities outside of Pennsylvania.[71] Given the theoretical and administrative arguments made by proponents of a land, or split rate, tax and the findings of Oates and Schwab discussed above, it is somewhat surprising that more cities in the U.S. and in other countries have not tried a land value, or split rate, tax. An international survey of taxes on land and buildings by Youngman and Malme found that of the 14 developed and developing countries studied, only in Australia "is land alone the primary legally prescribed property tax base."[72] Also, Bahl and Linn observed "One could not say that there is a groundswell of enthusiasm for site-value taxation among local governments in developing countries."[73] More recently, Bahl concluded that "if there is a worldwide trend, it is toward taxing the total value of the property."[74]

It is therefore more startling to find that the City Controller of Philadelphia, Jonathan A. Saidel, recently included a split tax in his blueprint to overhaul the city's tax structure in order to halt the exodus of the middle class and businesses. After a year of study, the Tax Structure Analysis Report released in November 2001 calls for instituting a land tax. Under the current system, structures and improvements account for over three-quarters of real estate tax revenues. The change proposed for FY2003, taxing land at 3.44 times the rate imposed on buildings, would generate equal revenue from land and improvements. The Controller's analysis suggests that property taxes would decline modestly for 78 percent of city residents, but increase for 50 percent of city commercial and industrial property-owners. Owners of undeveloped land in prime areas, parking lots, and car dealerships would experience higher taxes.

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[69] O'Toole, James, "City's 2-Tier Tax Grew Out of Ideas of Progressive Era," Pittsburgh Post-Gazette, January 17, 2001, p. A-1.

[70] Ackerman, Jan, "Council Pulls Plug on City's Two-Tier Tax System; Plan Sets 10.8-Mill Rate, $10,000 Exemption," Pittsburgh Post Gazette, February 10, 2001.

[71] See Robert M. Schwab and Amy Rehder Harris, "An Analysis of the Graded Property Tax," Taxing Simply; Taxing Fairly, The District of Columbia Tax Revision Commission, September 1998, pp. 228-30 for a further discussion of these experiences.

[72] Joan M. Youngman and Jane H. Malme, An International Survey of Taxes on Land and Buildings, Kluwer Law and Taxation Publishers, Boston, 1994, pp. 13-4.

[73] Roy W. Bahl and Johannes F. Linn, Urban Public Finance in Developing Countries, published for the World Bank by Oxford University Press, 1992, p. 99.

[74] Roy W. Bahl, op.cit.

From a policy perspective, there seems to be an apparent disconnect between the theoretical and administrative arguments in favor of a land, or split rate, tax and actual local property tax practices. There are a number of possible explanations. For example,

- As discussed above, the administrative advantage of reducing the costs for valuing individual properties, since information on improvements does not have to be collected, stored, and maintained, only applies to a strict land tax – it is not a benefit for a city with a split rate tax.

- In cities like Baltimore, where the state is responsible for assessing property, administrative cost savings would not accrue to the city.

- Also on the administrative front, there are practical difficulties in valuing land for tax purposes where comparable sales data on vacant land is either non-existent, as in many developed urban areas, or not reliable as is the case in many developing countries.

- In depressed neighborhoods, improvement costs may exceed total assessed values, resulting in calculated land values of zero.

- Finally, elected officials may find it useful to sacrifice theoretical economic advantages (both efficiency and equity benefits) for the practical benefits of expanding the tax base in order to reduce the tax rate while generating more revenue in what is perceived to be a more politically palatable manner.

The bottom line is that there are important trade-offs that must be made between the perceived benefits and limitations of such a tax, and those trade-offs have to be made at the local government level. The next section of this paper looks at the legal framework for a split rate tax in Baltimore and then examines the distributional implications of shifting from the current tax equally applied to land and improvements and a split rate tax that taxes land more heavily than improvements.

Implications of a Split Rate Tax for Baltimore

The first question to be addressed when considering the possibility of shifting from the current property tax, which taxes land and improvements at the same rate, to a split rate tax which taxes land more heavily than improvements, is a legal one. Specifically, would such a split rate tax on property be legal in Baltimore, or would the State Legislature have to pass enabling legislation to allow such a change in the nature of the local property tax?

A detailed analysis of this complex legal question is beyond the scope of this paper. However, reference is made to a recent opinion from the Maryland Attorney General concerning these, and related, issues. [75]

[75] The following discussion is drawn directly from Office of the Attorney General Opinion No. 95-002 (January 25, 1995) 1995 Md. AG LEXIS 4

Originally, Article 15 of the State Constitution of 1776 stated that

> "every . . . person in the State . . . ought to contribute his proportion of public taxes for the support of the government according to his actual worth in real or personal property."

So worded, Article 15 was interpreted to mean that all property must be uniformly taxed.

In Chapter 779 of the Laws of Maryland 1912, the General Assembly established a commission to review the entire property taxation scheme in the State. That review resulted in Chapter 390 of the Laws of Maryland 1914, including an amendment to Article 15 permitting classification:

> "[T]hat the General Assembly shall, by uniform rules, provide for separate assessment of land and classification and subclassifications of improvements on land and personal property, as it may deem proper"

The purpose of this amendment was to permit classification – primarily with a focus on treating personal and real property differently.

Further changes were made to Article 15 in 1960 in response to efforts by the General Assembly to tax farmland according to use value while taxing other land according to highest and best use. Specifically, Article 15 was amended by Chapter 64 of the Laws of Maryland 1960 to its present form, reading:

> "[T]hat the General Assembly shall, by uniform rules, provide for the separate assessment, classification and subclassification of land, improvements on land and personal property, as it may deem proper; and all taxes thereafter provided to be levied by the State for the support of the general State Government, and by the Counties and by the City of Baltimore for their respective purposes, ***shall be uniform within each class or sub-class of land, improvements on land and personal property*** which the respective powers may have directed to be subjected to the tax levy…" [emphasis added]

This 1960 amendment removed the bar against land classification. Accordingly, the creation of a two-tier taxation scheme would have to be effectuated by the creation of separate classes. Once appropriate classifications were codified, the members of each class could be treated differently as to rate, assessment percentage, or method of valuation. The only test would be the reasonableness of the classification.

Along those lines, the law has required the separate assessment of land and improvements to land at least since 1929. Consequently, the distinction between land and improvements has long been recognized and would seem to provide an acceptable criterion for a classification if that distinction were necessary to promote an appropriate government policy. Thus, this opinion concludes that the State Legislature could create land as a separate class and allow it to be taxed differently than improvements.

However, the issue of concern here is whether or not the City of Baltimore has the right to do that on its own, without special legislation by the State. The TAX-PROPERTY article of the Annotated Code of Maryland provides that municipal corporations "may set special rates for any class of property that is subject to the municipal corporation property tax."[76] However, for counties, the same article explicitly prescribes a single rate for all property, with the exception of intangible personal property and different rates in municipalities within counties.[77] For purposes of the property tax article, county is defined as "a county of the State and, unless expressly provided otherwise, Baltimore City."[78] Therefore, in order to implement a split-tax system, the City would need a change in state law.

The Distribution of Property Tax Burdens Across Classes of Property and Neighborhood

How would a shift from the current tax to a split rate tax affect the distribution of the property tax burden across property types and neighborhoods? In this section we explore the distributional implications of shifting from the current property tax to one that taxes land more heavily than structures. Specifically, we want to address the fundamental question: Who would bear the burden of a split rate property tax in Baltimore?

The City of Baltimore made available assessment data for some 225,000 individual properties in Baltimore. These data provided information on total assessed value in the current year for each property, and disaggregated that value into separate land and improvement components. We aggregated these data and present total assessed value, total land value, and total improvement value for 55 neighborhoods in Baltimore and for 14 different land use types.

The 55 "neighborhoods" are actually clusters of census tracts developed for analytical purposes by the Baltimore City Data Collaborative with support from the Baltimore City Planning Department. A wide variety of data on each neighborhood cluster can be viewed at the interactive website of the Baltimore Neighborhood Indicators Alliance, http://www.bnia.org. A map of the neighborhoods is included at the end of this chapter as **Figure VII-1.**

Three caveats are important at this point:

- First, we use the real property files data on state-conducted assessments, which are used by the City to compute tax liability. While the total assessed value is generally a reliable estimate of market value, we must view with caution efforts to allocate that total value into land and improvement components. While state law in Maryland has required such a division for a number of years, the partitioning has no impact on the amount of property tax revenues collected since each component is taxed at the same rate. Therefore, one might expect that if a split rate tax were actually adopted and implemented in Baltimore, much more attention would have to be focused on how land values were determined by the state's assessors. Recent events in Pittsburgh highlight this issue.

[76] § 6-303 (a) (2).
[77] § 6-302 (b)
[78] § 1-101 (g)

- Second, we are looking at the distribution of the tax burden across neighborhoods and land use types. We do not look at the ultimate ***economic incidence*** of the property tax after any tax shifting. For example, taxes on businesses may ultimately be paid by customers, or taxes on owners of apartment buildings may be borne by renters.

- Finally, we look at gross property tax burdens by neighborhood and land use type before any credits, exemptions, or other adjustments are made to the property tax liability actually assessed against a specific property.

The objective of this analysis is to identify which neighborhoods and which land use types are winners or losers as a result of a shift from the current property tax system to a split rate system. Therefore, the analysis holds the total amount of property taxes collected constant across each scenario and examines what happens to the distribution of the burden across neighborhoods and land use types when the tax scheme is changed.

The current system is considered the baseline scenario. Total assessed value for the City of Baltimore FY2001 is estimated to be $18.1 billion, of which $13.1 billion is the value of improvements and $5 billion the value of land. Under the baseline scenario, total assessed value, and the assessed value of land and improvements, is multiplied by the current statutory property tax rate ($2.328 per $100 of assessed value) to determine total property tax liabilities and the portion attributed to land and improvements separately, by neighborhood and land use type. The total property tax liability under this baseline scenario is $421.6 million – with 72 percent of this total attributable to improvements and 28 percent attributable to land.

Under the split rate alternative scenario, total tax liabilities are kept constant at $421.6 million. However, in this alternative scenario, we have set the tax on land to be five times the tax on improvements. Thus, for the purposes of simulating property tax liabilities by neighborhood and land use type under the split rate alternative, we use a tax rate of $1.11 per $100 assessed value of improvements and $5.54 per $100 assessed value of land. Under this split rate scenario, 66 percent of the total property tax liability is attributable to land and 34 percent to improvements.

Property Type. To determine the distributional impact of shifting from the current system of property taxes to a split rate system taxing land at five times the rate of improvements, we first look at total property tax liabilities by property type. **Table VII-1** lists 14 different land use types, the tax liabilities of each land use type under the current and split rate property tax systems, the change in liability resulting from the shift from the current system to a split rate system, and the share of taxes paid by each land use type under each system.

Table VII-1 Tax Liabilities by Land Use Type

Land Use Type	Tax liability under current system	Tax liability under split rate property tax system	Share of liability under current system	Share of liability under split rate property tax system *(incr – /decr – %)*
RESIDENTIAL				

Condominiums	$15,470,159	$13,642,490	3.68%	3.24%	***¯ 12%***
Multi-Family Homes	19,460,580	18,470,945	4.62%	4.39%	***¯ 5%***
Single-Family Homes	229,645,120	226,973,713	54.58%	52.94%	***¯ 5%***
Other Residential	2,604,652	2,058,670	0.62%	0.49%	***¯ 21%***
BUSINESS					
Apartments	24,089,714	21,772,735	5.73%	5.17%	***¯ 10%***
Business Services	13,161,814	14,147,771	3.13%	3.36%	***- 7%***
FIRE*	23,551,514	22,941,177	5.60%	5.45%	***¯ 3%***
Hotel	$10,124,677	$8,257,000	2.41%	1.96%	***¯ 19%***
Personal Services	6,792,035	6,785,807	1.61%	1.61%	***no change***
Retail Trade	20,839,096	23,832,459	4.95%	5.66%	***- 14%***
Wholesale Trade	3,584,409	4,184,019	0.85%	0.99%	***- 16%***
Manufacturing	10,267,275	12,059,001	2.44%	2.87%	***- 18%***
Business: All Others	33,314,734	35,849,616	7.92%	8.52%	***- 8%***
Vacant Land	7,874,875	9,805,073	1.87%	2.33%	***- 25%***

**Finance, insurance, real estate*

The same amount of revenue is raised under each scenario so the differences we observe represent a shift in the property tax burden. According to the data in **Table VII-1**, all residential land uses experience a decline in property tax share as a result of the shift to a split rate tax. In total, residential properties would bear 61.1 percent of the property tax under the alternative scenario, compared to 63.5 percent currently. Single-family homes is the largest land use class, accounting for approximately 54.6 percent of the total assessed value and total property tax liabilities under the current property tax system. Its share of total tax liabilities declines modestly under the split rate tax – to approximately 52.9 percent. Condominiums, on the other hand, experience a 12 percent decline in their property tax share, as might be expected since they clearly have a higher improvement-to-land value ratio. "Other residential" uses include public housing, group quarters such as rooming and boarding houses, dormitories, retirement homes, and religious quarters, most of which are tax exempt. Their small share of property tax liability would decline 21 percent under a split tax scenario.

Some business land uses also experience declines in their tax liabilities as a result of a shift to a split-rate tax. For example, apartments, which again have a high improvement-to-land value ratio, experience a 10 percent decline in their property tax liabilities. But generally, business land uses experience increases in property tax liabilities under a split rate tax – implying that they have a relatively lower improvement-to-land value ratio. For example, manufacturing properties, in the aggregate, experience a 17.6 percent increase in property tax liabilities; wholesale trade experiences a 16.4 percent increase; and, as expected, vacant land experiences a nearly 25 percent increase in property tax liabilities.

In the aggregate, both business services (up 7.3 percent) and retail trade (up 14.4 percent) experience increases in property tax liabilities as a result of the shift to a split rate tax. Finally, finance/insurance/real estate land use experiences a modest decline in property tax liabilities (2.5 percent) and personal services is essentially unaffected by the shift to a split rate tax.

Neighborhood. We next looked at total property tax liabilities by neighborhood. We calculated the total property taxes that would be raised in each neighborhood under the current

system and compared that liability with the taxes each neighborhood would contribute under the split rate property tax alternative.[79] Poverty rates were included in our analysis to help to determine whether the impacts would improve or worsen equity.

Of the 54 neighborhoods examined in Baltimore, 18 would experience increases in their tax liabilities as a result of the shift from the current property tax to a split rate property tax system taxing land five times more than improvements. Thirty-two would experience decreases, and four neighborhoods would have essentially no change in their property tax liabilities. **Table VII-2** lists the 18 neighborhoods experiencing increases in their property tax liabilities as a result of a shift from the current property tax system to one that taxes land more heavily. In the aggregate, the property tax share paid by these 18 neighborhoods increases modestly from 48.1 percent under the current property tax system to 51.2 percent under a split rate system. On average, the property tax liabilities of these neighborhoods increase 5.5 percent under the split rate system compared with the current system. However, only four neighborhoods experience increases in their property tax liabilities of more than 5.5 percent – Brooklyn/Curtis Bay/Hawkins (25.6 percent), Midtown (11.7 percent), Inner Harbor/Fells Point (9.9 percent), and South Baltimore (9.1 percent). Fourteen of these eighteen neighborhoods have lower than city average poverty rates.

Table VII-2 Neighborhoods experiencing increases in property tax liabilities under split rate property tax scenario

Neighborhood	Original share of taxes*	New share of taxes*	1997 poverty rate**
Beechfield/Ten Hills/West Hills	1.70%	1.73%	7.5
Brooklyn/Curtis Bay/Hawkins Point	2.68%	3.36%	18.7
Canton	3.61%	3.73%	12.0
Cedonia/Frankford	2.87%	2.94%	8.9
Cherry Hill	0.62%	0.63%	42.8
Claremont/Armistead	1.83%	1.90%	31.8
Fells Point	2.45%	2.52%	19.7
Greater Roland Park/Poplar Hill	3.64%	3.72%	2.2
Hamilton	1.64%	1.73%	3.8
Harford/Echodale	2.87%	2.96%	5.9
Inner Harbor/Federal Hill	7.24%	7.96%	14.9
Lauraville	2.38%	2.54%	4.7
Midtown	2.01%	2.25%	26.5
Morrell Park/Violetville	1.86%	1.89%	8.0
North Baltimore/Guilford/Homeland	5.08%	5.31%	4.5
Orangeville/East Highlandtown	1.42%	1.49%	12.4
South Baltimore	3.37%	3.67%	11.6
Westport/Mt. Vinans/Lakeland	0.87%	0.91%	18.5

*Tax shares are presented as a percentage of total tax liability in Baltimore City
**City average 18.8% (Source: Data Collaborative)

[79] These estimates are based on current land use patterns in each neighborhood. It is likely that over time future land use patterns within individual neighborhoods might change as a result of the shift from the current tax system to a split rate property tax system.

For the most part, the list contains the expected neighborhoods – places that have lower density and locations with high "buyer appeal" quite independent of the attractiveness of improvements. In general, it appears that the split-tax would not fall more heavily on poorer neighborhoods. Several anomalies appear, however, in Cherry Hill, Claremont/Armistead, and Midtown, areas that include neighborhoods of above-average poverty and, in some cases, substantial density. We also do ***not*** find on the list some neighborhoods that are similar to the majority of those that are – particularly Mt. Washington, Glen/Falstaff, Cross Country/Cheswolde in the northwest and Chinquapin/Belvedere, Loch Raven, and Northwood in the north/northeast, and Dickeyville/Franklintown in the west. Clearly, we need to look more deeply to understand what neighborhood attributes affect the way a split property tax would change assessments.

Table VII-3 lists the 32 neighborhoods experiencing a decrease in their property tax liabilities under a split rate system compared with the current system. These neighborhoods account for 42.8 percent of property taxes under the current system, and an estimated 39.6 percent under a split rate system taxing land five times higher than improvements. On average, these 33 neighborhoods experience a 7.5 percent decrease in their property tax liabilities under a split rate system compared with the current system. Seven neighborhoods experience declines in their property tax liabilities of more than 10 percent – Jonestown/Oldtown (17.9 percent), Penn North/Reservoir Hill (13.3 percent), Cross Country/Cheswolde (13.1 percent), Greater Govans (11.2 percent), Poppleton/The Terraces/Hollins Market (11.1 percent), Southern Park Heights (10.7 percent), and Madison/East End (10.1 percent). Fifteen of these communities have higher than city average poverty rates.

Table VII-3 Neighborhoods experiencing decreases in property tax liabilities under split rate property tax scenario

Neighborhood	Original share of taxes*	New share of taxes*	1997 Poverty rate**
Allendale/Irvington/South Hilton	1.85%	1.77%	14.4
Belair Edison	2.13%	2.07%	6.7
Cross County/Cheswolde	1.99%	1.72%	7.1
Dorchester/Ashburton	1.30%	1.22%	9.1
Downtown/Seton Hill	5.73%	5.72%	32.6
Edmondson Village	0.85%	0.80%	12.2
Forest Park/Walbrook	1.78%	1.68%	14.7
Glen/Falstaff	2.67%	2.52%	5.9
Greater Charles Village/Barclay	2.36%	2.32%	21.8
Greater Govans	0.99%	0.88%	11.7
Greater Mondawmin	1.14%	1.04%	17.2
Greater Rosemont	0.96%	0.91%	16.5
Greenmount East	0.61%	0.58%	38.5
Jonestown/Oldtown	2.07%	1.70%	60.2
Loch Raven	1.68%	1.61%	3.9
Madison/East End	0.36%	0.32%	30.2
Medfield/Hampden/Woodberry/Remington	3.01%	2.88%	11.7
Midway/Coldstream	0.70%	0.69%	20.9
Mt. Washington/Coldspring	1.70%	1.59%	1.8

Northwood	2.53%	2.39%	6.4
Patterson Park N/E	1.33%	1.26%	16.2
Penn North/Reservoir Hill	0.69%	0.60%	34.8
Perkins/Middle East	0.31%	0.29%	34.7
Pimlico/Arlington/Hilltop	0.87%	0.85%	18.5
Poppleton/The Terraces/Hollins Market	0.31%	0.27%	58.0
Sandtown-Winchester/Harlem Park	0.67%	0.61%	41.5
Southeastern	1.23%	1.19%	27.4
Southern Park Heights	1.22%	1.09%	29.0
Southwest Baltimore	1.20%	1.12%	35.2
The Waverlies	0.56%	0.52%	18.5
Upton/Druid Heights	0.84%	0.80%	45.6
Washington Village	1.42%	1.41%	29.0

*Tax shares are presented as a percentage of total tax liability in Baltimore City
**City average 18.8% (Source: Data Collaborative)

The neighborhoods that would contribute smaller shares to the total property tax pool under a split-tax regime present more heterogeneous socio-economic characteristics. About half (16) of them have higher-than-city-average poverty rates and half have lower-than-average poverty rates. Seven are of the leafy large-lot type of neighborhood missing from **Table VII-3**.

Table VII-4 lists the four neighborhoods where the tax liability is essentially unchanged as we move from the current tax system to a split rate property tax system. These four neighborhoods account for 7.85 percent of total property tax liabilities under each scenario and each individual neighborhood's share of total tax liabilities is unchanged also.

Table VII-4 Neighborhoods experiencing no change in property tax liabilities under split rate property tax scenario

Neighborhood	Share of taxes under either system*	1997 Poverty rate**
Chinquapin/Belvedere	1.65%	8.6
Dickeyville/Franklintown	0.33%	9.5
Highlandtown	0.25%	11.5
Howard Park/West Arlington	1.32%	7.9

Tax shares are presented as a percentage of total tax liability in Baltimore City
***City average 18.8% (Source: Data Collaborative)*

Searching for explanations. The distributional consequences across neighborhoods of shifting from the current property tax to a split rate property tax are really net impacts that depend on at least three things:

- The composition of the property tax base within each neighborhood;
- How each land use is affected by the shift from the current tax to a split rate property tax; and

- How each individual property within each land use class is affected as a result of its improvement-to-land value ratio.

Given the first two factors and the knowledge that the split tax falls more heavily on certain types of land uses than on others, we compared land uses in each neighborhood seeking a relationship between use patterns and the tax results we have seen in the rough simulations presented above. If this explanation holds power, we should see increased shares of the property tax coming from neighborhoods with larger than average business services, retail trade, wholesale trade, manufacturing, and miscellaneous business land uses. Conversely, we would expect to see decreased shares of the property tax coming from neighborhoods made up primarily of all types of residential uses, particularly dense uses like condominiums and apartments. We should see the greatest increases in neighborhoods with relatively large percentages of vacant land. **Table VII-5** tests this explanation.

Table VII-5
Tax Liability of Land Uses in Neighborhoods

Neighborhood	**Should increase share of property tax** ***(above city average % of:)****						**Should decrease share of property tax** ***(above city average % of:)****						
	Bus Svcs	Ret Trade	Whlsle Tr	Mfg	Misc Bus	Vacant land	Condos	Apts	Multi-Fam	Single-Fam	Other Resl	FIRE	Hotel
Split tax would INCREASE neighborhood share of tax liability													
Beechfield/Ten Hills/West Hills						+		2x		+			
Brooklyn/Curtis Bay/Hawkins Point	2x		3x	3x	1.5x	3x							
Canton	3x	+	+	3x	+								
Cedonia/ Frankford		+						+		+			
Cherry Hill	3x	2x	+	+		2x		2x					
Claremont/ Armistead	3x	2x		3x	+				+				
Fells Point	2x	+			+		3x	+	+				
Greater Roland Park/ Poplar Hill							3x			+			
Hamilton		+							+	1.5x			
Harford/Echodale								+	+	1.5x			
Inner Harbor/ Federal Hill		+			2x		1.5x					3x	3x
Lauraville									+	1.5x			
Midtown	+	+	+		+		2x	2x	2x			+	
Morrell Park/ Violetville	3x					3x						+	

Neighborhood	Should increase share of property tax *(above city average % of:)**						Should decrease share of property tax *(above city average % of:)**						
	Bus Svcs	Ret Trade	Whlsle Tr	Mfg	Misc Bus	Vacant land	Condos	Apts	Multi-Fam	Single-Fam	Other Resl	FIRE	Hotel
N Baltimore/ Guilford/ Homeland							2x			+			
Orangeville/East Highlandtown	3x	+	3x	3x		2x			+				
South Baltimore	+			+	+		+			+			
Westport/Mt. Winans/Lakeland	2x	+		2x						+			
Split tax would DECREASE neighborhood share of tax liability													
Allendale/Irving-ton/S Hilton								+		+			
Belair Edison									+	1.5x			
Cross Country/ Cheswolde							3x	3x		+			
Dorchester/ Ashburton									3x	+	3x		
Downtown/ Seton Hill		2x	+		2x	3x						2x	3x
Edmondson Village										1.5x			
Forest Park/Walbrook								+	2x	+			
Glen/Falstaff		2x	2x				+	2x					
Greater Charles Village/Barclay		+					+	2x	2x			+	
Greater Govans									+	1.5x			
Greater Mondawmin		2x							2x	+			
Greater Rosemont									+	1.5x			
Greenmount East	2x			3x							3x		
Jonestown/ Oldtown		+	2x		3x	3x	2x				3x		
Loch Raven								2x		+			
Madison/East End			+						3x	+			
Medfield/Hamp - den/Woodberry/ Remington		+		2x				+		+			
Midway/ Coldstream	3x	+	3x							+			
Mt. Washington/ Coldspring					+		2x			+			
Northwood										1.5x			
Patterson Park N & E			2x						+	1.5x			
Penn North/ Reservoir Hill								3x	3x		3x		

Perkins/Middle East		3x	+			+							
Neighborhood	**Should increase share of property tax *(above city average % of:)****						**Should decrease share of property tax *(above city average % of:)****						
	Bus Svcs	Ret Trade	Whlsle Tr	Mfg	Misc Bus	Vacant land	Condos	Apts	Multi-Fam	Single-Fam	Other Resl	FIRE	Hotel
Pimlico/Arlington/ Hilltop					+			+	+	+			
Poppleton/Terraces /Hollins Mkt		+	+			+		+	+				
Sandtown-Winchester/ Harlem Pk						2x		+	2x	+			
Southeastern	3x			3x		3x							
Southern Park Heights				+				+	+	+	3x		
Southwest Baltimore	+	2x	3x	+					+	+			
The Waverlies			+					+	+	+			
Upton/Druid Heights								1.5x	2x		3x		
Washington Village	3x		3x	3x		3x							
Split tax would NOT CHANGE neighborhood share of tax liability													
Chinquapin/ Belevedere			+					+	2x	+			
Dickeyville/ Franklintown								3x		+			
Highlandtown		2x		+						+			
Howard Park/ W Arlington								+	2x	+			

*Key:
+ = 1 to 49 percent above city average percent of tax liability
1.5x = 50 to 100 percent above city average percent of tax liability
2x = at least 2x city average percent of tax liability
3x = at least 3x city average percent of tax liability

The impact of a split tax on neighborhoods can be primarily attributed to land use mix in less than half the communities: Brooklyn, Canton, Claremont, Morrell Park, Orangeville, and Westport among those that would experience higher tax liability; and Allendale, Belair Edison, Cross Country, Dorchester, Edmondson Village, Forest Park, Greater Charles Village, Greater Govans, Greater Rosemont, Loch Raven, Madison, Northwood, Patterson Park, Penn North, Southern Park Heights, The Waverlies, and Upton among those that would experience lower tax liability; and none among the "no-change" neighborhoods.

We decided to focus on those neighborhoods that would experience higher ***residential*** tax liabilities, since many of them cannot be explained by land use mix, and they would be of primary interest to city policymakers considering a split tax. The neighborhoods listed in **Table**

VII-6 are many of the same found in **Table VII-2**, but do not include those where the higher share can be attributable to large amounts of vacant land or business uses.

Table VII-6
Neighborhoods Where Residential Tax Liability Would Increase Under a 5:1 Split Tax

Neighborhood	Estimate of Increased Tax Liability ($)
Beechfield/Ten Hills/West Hills	187,699
Brooklyn/Curtis Bay/Hawkins Point	216,785
Cedonia/Frankford	104,092
Dickeyville/Franklintown	5,224
Downtown/Seton Hill	64,789
Greater Roland Park/Poplar Hill	236,395
Hamilton	264,368
Harford-Echodale	273,000
Howard Park/West Arlington	34,933
Inner Harbor/Federal Hill	138,810
Lauraville	611,937
Midtown	154,399
North Baltimore/Guilford/Homeland	918,174
South Baltimore	309,891
Washington Village	102,395
Total	**3,622,890**

When we looked at the third factor that is hidden in the overall impact of adoption of a split tax – that is, the land-to-improvement ratio in the valuation of properties – we found that land in these neighborhoods was without exception assessed at higher values relative to improvements than the city average (26/74). None was less than 28 percent land, the highest was 44 percent land (Downtown/Seton Hill), the average was 30.2 percent land , or 29.2 percent land if Downtown/Seton Hill were removed. These neighborhoods include the ten census tracts with the highest median sales prices in 2001[80] except for one in Mt. Washington/Coldspring, which poses a continuing conundrum. But the list also includes neighborhoods of more modest houses with high rates of homeownership, such as Beechfield/Ten Hills/West Hills, Hamilton, Harford/Echodale, and Lauraville.

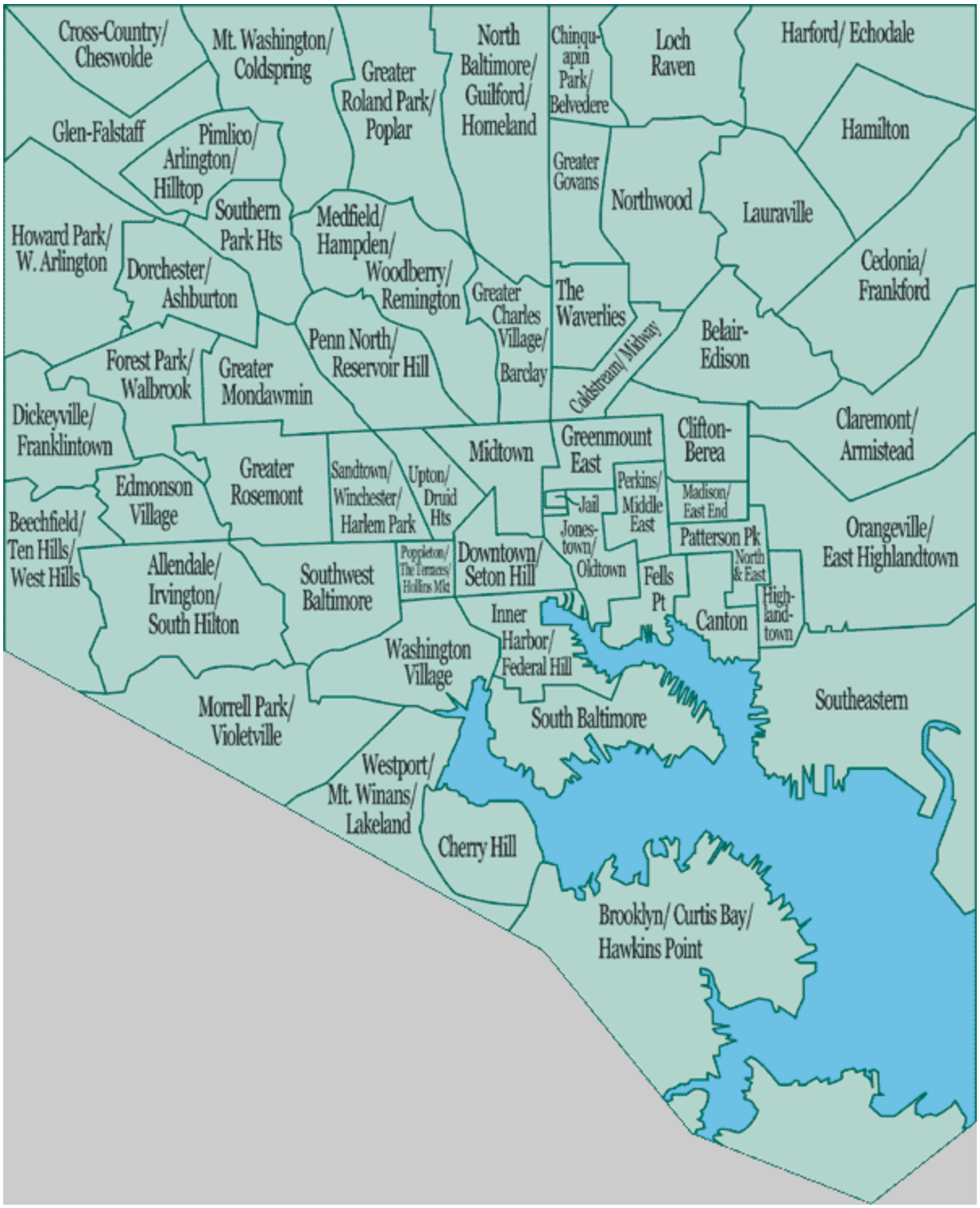
Conclusions

A split-tax scheme in which land is valued at five times improvements shifts the burden of property taxes slightly from residential to business uses. We estimate that residential relief would be approximately $6 million, an amount approximately equal to city revenues foregone through the homestead tax credit this year (see **Chapter II**). It is also clear that the change in tax structure would be progressive, generally falling more heavily on higher income areas than on less affluent neighborhoods. However, many of the communities where residential property tax liabilities would increase are those that the City has targeted in its Healthy Neighborhoods and

[80] Baltimore City Planning Department, preliminary data.

other initiatives for preservation and stabilization in order to stem the outmigration of middle and upper income families. If residents who experienced increased taxes were held harmless under the split property tax scheme, the amount that would have to be shifted to other classes of taxpayers would be higher. Since it does not generate new revenue for the city and would dramatically depart from the history and culture of the State of Maryland, it is unlikely that this approach would be worth the significant education effort that would be required to pass legislation to implement it.

Figure VII-1. Neighborhoods Map



Source: Family League of Baltimore, Baltimore City Data Collaborative

VIII. Conclusions

The goals of this project were to explore revenue-raising options for Baltimore City that: 1) reduce disparities between city and suburban property tax rates, 2) maintain or enhance equity, and 3) increase revenue to Baltimore City government. While the scale of the City's fiscal stress and disparities will require a mixture of solutions that include intergovernmental aid, the parameters of this paper are limited to own-source revenue possibilities. It is exploratory in nature and limited in scope, seeking to highlight options that warrant deeper analysis. In each case, even an overview quickly focuses on the tradeoffs between the city's human development, community development, and economic development goals on the one hand, and the need to generate more revenue on the other.

To select options that are worth exploring in greater detail, the project team was guided by the following general principles:

- Ease of implementation - can be done within existing law if possible
- Productivity – generates the largest revenue increases
- Relief – has the potential to reduce property tax rates
- Burden shifting – avoids or mitigates the effects on those negatively affected by a change in revenue structure

Options the City Can Pursue Unilaterally

Current charges are revenues received from the public for performance of specific services that benefit the person charged. These charges are not license taxes, which are charges for a privilege or to finance regulatory activities. The most recent National League of Cities survey found that almost 40 percent of the largest cities had increased the level of fees or charges, by far the most popular own-source revenue action taken in FY 2001. Over 11 percent instituted new fees and charges. Almost 18 percent increased the number or level of impact or development fees.

Current charges are best used when the benefits of the good or service accrue principally to identifiable consumers. The Advisory Commission on Intergovernmental Relations standards for appropriate use of current charges find them inadvisable in cases where pricing would cause inequities to lower-income groups. Baltimore's relatively poor population makes this a central concern in weighing new user charges or increases in existing charges.

According to Census data, Baltimore is generating relatively less revenue from parks and recreation, sewerage, and solid waste management charges than the average for the comparison cities. We have not included sewerage charges in our analysis, since in Baltimore these revenues are realized by the Waste Water Utility Fund, not the General Fund, and it is unclear how Census treats these revenues, which are required by law to equal expenditures.

This overview of other cities and Baltimore's experience suggests that substantially increasing recreation and parks fees would not be useful for four reasons. First, these amenities are particularly important to a low-income population that lacks disposable income for other

commercial leisure pursuits. Second, these activities can legitimately be included in a public safety strategy, since they offer safe alternatives for youth that may reduce not only the commission of crimes, but also youth victimization. Third, every city seeks to retain and attract "knowledge workers" as a centerpiece of its economic development strategy, and there is increasing recognition that these residents value active outdoor recreational opportunities highly. Finally, it is clear from the City's experience that the potential for raising substantial revenue from this source is severely limited.

Solid waste management, which accounts for 3.3 percent of the City's General Fund expenditures, poses a different set of conundrums. On the collection side, fees for trash pick-up like Seattle's would fall heavily on poor residents and owners of marginal properties who have already shown a distressing propensity to abandon properties. With regard to disposal, higher fees might well exacerbate the problem of illegal dumping. Over the last decade, the City has reduced by over 40 percent its reliance on General Fund revenues for solid waste disposal. The Census data, which dates from 1997, may not reflect recent changes. Still, it appears that Indianapolis and Jacksonville manage to recover a larger percentage of their solid waste management costs without charging citizens for trash collection, and would be worth exploring more extensively.

Baltimore City is in a unique position among cities because it owns some of the conduits through which utilities run their cables. Enabling legislation passed in FY2000 has set the stage for setting more realistic fees. This is the user charge option that is likeliest to produce significant revenue as part of a more comprehensive restructuring of utility taxes and right-of-way revenues.

It is also worth exploring an impact fee scenario for new development in high-demand areas of the City. With the active encouragement of the Greater Baltimore Committee, the City is taking steps to manage its entire waterfront as one primary asset. Impact fees could be a source to recover costs of waterfront infrastructure, services, and amenities within a framework of sensible development regulation.

The various forms taken by **utility taxes** include revenues from selective sales taxes on public utilities, gross receipts taxes, gross and net income taxes, and franchise taxes applied directly, and solely, to public utilities. The 55 comparison cities over 300,000 population we examined generated 4.9 percent of their general own-source revenues from taxes on public utilities in 1997. According to the Census data, Baltimore generated 2.9 percent of its general own-source revenues from this source. The eight cities that generated more than 10 percent of their combined city and school district revenues from utility taxes were examined in greater depth.

Miami-Dade was eliminated because utilities are an important revenue source only in the unincorporated areas of the consolidated city-county. The California cities'[81] "utilities user taxes" have the broadest base, encompassing not only gas, electric, and standard telephone, but also cable television and cellular telephone. Chicago, Wichita, Kansas City, and Baton Rouge

[81] Sacramento, Los Angeles, and Santa Ana.

levy taxes (variously called utility taxes or franchise fees) on the gross receipts of gas, electric, and telephone companies. In Chicago, a "franchise fee" of three to five percent is levied against "qualifying revenues" of cable television companies and fiber optics companies that use the public right of way.

Using gross receipts as a base, a very low rate can potentially generate a significant amount of revenue, and the utilities pass on the tax to all customers -- residential, commercial and institutional. In recognition of the regressivity of the tax, Los Angeles exempts households with poor elderly or poor disabled residents, and Kansas City is on a multi-year course to reduce electric and telephone taxes on residential users.

It should be noted, however, that further investigation of several large cities reveals that the Census data significantly understates the revenue derived by cities from public utility services.[82] A limited examination of the summary budget documents and websites of several of the cities not shown by the Census Bureau to have any public utility revenues revealed that either the fiscal structure had changed since 1997, or that the revenues were included in other general taxation categories. In Ft. Worth, "other local revenue" in FY00 included $8 million in revenue from a telephone gross receipts tax, primarily a franchise fee paid by Southwestern Bell. "Licenses and permits" included franchise fees totaling $24 million realized from electric utility and other communications companies. These two sources generated 9.8 percent of general fund revenues. Street rental to cable television service providers yielded another $2.5 million.

In Philadelphia, regulated industries such as financial institutions and public utilities pay the business privilege tax (BPT -- the general fund's third largest revenue source). The BPT is a composite tax and varies depending on industry classification. The current standard rates for non-regulated industries are 0.2525 percent on gross receipts plus 6.5 percent on net income. Regulated industries are taxed at the ***lesser*** of either 0.2525 percent of receipts ***or*** 6.5 percent of net income.

The State of Ohio shares revenues from state income, sales, corporate franchise, and ***public utility excise taxes*** with localities through "local government funds." Cleveland's second largest general fund revenue source is the "Local Government Fund" and "Local Government Revenue Assistance Fund." It was estimated that the City of Cleveland would receive $57.8 million from this source in FY2000, 13 percent of its general fund revenues. These revenues, which have grown 14 percent since 1997, are shown in the city's intergovernmental revenue account. The Ohio public utilities excise tax is levied on utility companies that provide electrical, gas, and telephone service; rates range from 4.75 to 6.75 percent of gross receipts of business in the state. Revenues from this source made up 4.2 percent of the Local Government Fund.

[82] These data reflect revenues raised from what the Census Bureau classifies as Public Utility Taxes. That is, these are revenues from taxes only on public utilities. Some local governments may have gross receipts taxes or selected sales or business privilege taxes that apply to all businesses, including public utilities. In such cases, these tax revenues are not included by the Census Bureau in the category of public utility taxes; rather they are included under the appropriate category of general taxes. In addition, local governments may also receive property tax revenues from public utilities. These revenues are included with total property tax revenues and are not reflected in public utility tax revenues.

While Baltimore City's energy tax rates are computed on a unit basis, they are calculated to yield the same revenue as an eight percent tax on the sales price of energy, so revenues increase as prices go up. However, because they are levied on units of energy delivered, the City does not receive revenue from tax-exempt organizations. An attempt last year to extend the base to include these entities was vigorously resisted by the nonprofits with the largest potential tax liability, mostly health and higher education institutions. The bill now pending in the Baltimore City Council[83] to repeal the City's telecommunications and energy taxes and replace them with a five percent gross receipts tax on the producers of utility services would capture this base through a tax on producers.

This is an extremely difficult issue for the City and the institutions. Arguably, the large nonprofits, particularly the universities but also hospitals that serve regional, national, or international markets, are among the City's major economic engines, some of the few that have grown in the past decade. Yet the City fisc has been unable to capture a share of this growth directly. On the other side, the institutions, which need to devote the maximum amount of their "revenues" to the pursuit of their worthy causes, are equally concerned about the City's ability to deliver the kind of quality of life that will ensure their continued success in attracting employees, students, and patients. Continuing and intensive dialogue about constructive approaches to achieving these shared objectives will be necessary to avoid eleventh hour "quick fixes" that do not resolve the underlying issue.

Expanding the City's telecommunications tax to include cellular service could add a fast-growing revenue source to its portfolio, but if imposed unilaterally might add to the fiscal disparities between Baltimore and its neighbors. Since the state already levies a tax on cellular service, it may be preferable (and possibly appealing to other cash-strapped local governments) to pursue enabling legislation for a local-option piggyback on the state tax, which could also simplify tax administration.

While it has not been explored in this paper, the current movement toward a receipts-based **parking tax** will bring Baltimore City into line with other major cities and generate additional returns to the General Fund. It also provides an opportunity to strengthen registration, regulation, and auditing of parking lots and garages to ensure that visitors and workers receive value for the price paid, and that the City realizes the full potential of this revenue source.

It is unclear whether the city has the power to adopt a graded or **"split" property tax**. But since it does not generate new revenue for the city and would dramatically depart from the history and culture of the State of Maryland, it is unlikely that this approach would be worth the significant educational effort that would be required to pass legislation to implement it.

Options Requiring State Enabling Legislation

[83] CC 570, introduced October 4, 2001 by Councilman Abayomi.

The other options explored here would require state legislation that would enable the City to gain access to a new tax base (sales tax) or to change the ways in which existing taxes are levied (income and property taxes). Given the economic downturn that has left the current state budget out of balance, already requiring the second of what will surely be numerous budget cuts in the current year, the likelihood of new intergovernmental revenues is remote. However, since the possibilities being explored are for bootstrapping self-help rather than expanded handouts, the state's door might not be completely closed.

A **regional sales tax** to fund regional cultural and leisure assets in the Baltimore metropolitan area would bring Baltimore City significant benefits if structured on the Allegheny Regional Assets Districts model. Half the revenues from a one-cent sales tax would be used to fund cultural and leisure assets and half distributed to the region's localities for tax relief. The approach holds the possibility of not only stanching the bleeding of City-supported cultural institutions, but also of enhancements to them and relief for taxpayers. In addition, because the surrounding counties' primary leisure assets are environmental and active recreation areas, the City would benefit from proximity to high quality outdoor amenities. These assets are of increasing importance to the young mobile workers that all cities covet. Conversely, the suburban counties would be able to rely on the continued health of the major cultural institutions in the City that help make their localities attractive places to live, and would enjoy new revenues to relieve their general funds. All the region's jurisdictions might be able to expand recreation-related after-school activities.

If the state collected the tax and passed it on each year to the regional assets district body established for this purpose for distribution, administration would be relatively streamlined and low cost. While the one percent additional tax might drive some to travel north to Delaware, where there is no sales tax, or south to the Washington metropolitan area, particularly for large purchases, the net effect would still be new revenues to local governments in the region.

A **selective sales tax** levied by only the City on food and beverage sales would generate very modest revenues. While it is attractive because it would primarily burden non-residents, its low productivity may not warrant risking the possible dampening effect on the appeal of the City as an entertainment destination for individuals from elsewhere in the region and conventions from around the country. A **general sales tax** enabled by state local-option legislation, earmarked perhaps for education (as has been done elsewhere), would worsen fiscal disparities if no other localities adopted it, and could have a negative impact on the City's tourism industry. If all Maryland counties adopted the tax, it would not improve the City's ***relative*** fiscal position, though it would provide additional funding to enhance its human capital, which holds the greatest promise in the long run for reducing fiscal disparities. Sales taxes are regressive unless broad exemptions for basic purchases are made.

A mobile tax base of about $6.7 billion annually leaves the City as commuters return home. **Taxing earnings** one percent where they are earned as well as through the income tax at the residence of the worker recognizes the benefits and costs that commuters carry from home to workplace. Safety of their persons and their property must be protected in both places. Their travel imposes infrastructure maintenance and solid waste costs on the destination jurisdiction. On the other hand, ready availability of an expanded regional labor pool is attractive to

businesses in each "receiving" locale. A metropolitan job market provides wider economic opportunity for the region's citizens.

An earnings tax would benefit the City, the region, and the state, which shoulders much of the cost of transportation infrastructure. The City would bolster its anemic income tax base. And, if an approach similar to one used by many cities in Ohio were adopted, all localities would be given an incentive to encourage people to live ***and*** work in the same jurisdiction, thus reducing the costs of sprawl. An earnings tax of one percent combined with local income tax credits for earnings taxes paid would make Baltimore City one of the seven jurisdictions that would experience a net increase in revenues. It is estimated that the net increase in earnings tax revenues would be $32 million, an addition of 22 percent to current income tax revenues. Counties with small business bases and low percentages of unearned income would not favor this option. However, in the last decade, significant commercial development in suburban counties have made them less "bedroom" communities and less likely to experience dramatic losses under this scenario.

If structured carefully, the split property tax could provide very modest benefit to residential property tax payers, but only after contortions to hold the line in the very neighborhoods where the City would most like to deliver tax relief. Administration would be a continuing challenge, since there are very few vacant land sales for assessors to use as comparables. The Pittsburgh experience should be viewed as a cautionary tale of what can happen when honorable people disagree about the proper valuation of urban land. Under the scenario explored herein, no new revenues would be generated by this approach.

Conclusion

In sum, the most difficult-to-implement sales and wage tax options hold promise for significantly enhancing revenues and offering a chance of tax relief for Baltimore citizens. However, several unilateral options, most notably utility-related fees and taxes (including cellular telephone taxes), may hold the potential for appreciable revenue gains. Alternative approaches to utility taxation, including gross receipts-based levies as well as charges for usage of public right-of-ways, meet the tests that have guided this investigation, and warrant further analysis. Though more difficult to implement, regional sales tax and general or selected local sales taxes, particularly those dedicated to a specific purpose, also hold promise.

A bill (HB 1) adopted by the House of Delegates with the support of its leadership establishes the Commission on Maryland's Fiscal Future. It calls for a 17-member commission to:

- Review and evaluate the State's budget and fiscal structure;
- Make recommendations on changes to the State budget process
- Make recommendations on changes to the State tax structure;
- Make recommendations on methods to address certain funding needs for education, transportation, and health care;
- Make recommendations for addressing certain inefficiencies and improvements in State government services and operations

The Commission's study of the state tax structure will be complete in December, 2002, and should provide an opportunity to explore the options raised in this paper, as well as other approaches.

APPENDIX A

Large (over 300,000 population) cities without hospital responsibility in 1997

Albuquerque, New Mexico
Atlanta, Georgia
Baton Rouge, Louisiana
Buffalo, New York
Charlotte, North Carolina
Chicago, Illinois
Cincinnati, Ohio
Cleveland, Ohio
Columbus, Ohio
Dallas, Texas
Detroit, Michigan
El Paso, Texas
Fresno, California
Fort Worth, Texas
Honolulu, Hawaii
Houston, Texas
Jacksonville, Florida
Kansas City, Kansas
Las Vegas, Nevada
Long Beach, California
Los Angeles, California
Memphis, Tennessee
Mesa, Arizona
Milwaukee, Wisconsin
Minneapolis, Minnesota
New Orleans, Louisiana
Oakland, California
Oklahoma City, Oklahoma
Philadelphia, Pennsylvania
Phoenix, Arizona
Pittsburgh, Pennsylvania
Portland, Oregon
Sacramento, California
San Antonio, Texas
San Diego, California
San Jose, California
Santa Ana, California
Seattle, Washington
St. Louis, Missouri
Toledo, Ohio
Tucson, Arizona
Tulsa, Oklahoma
Virginia Beach, Virginia
Wichita, Kansas

Appendix B

Cultural/Leisure Entities Serving Regional Markets
(in Baltimore City budget FY 2000)

State Library Resource Center
Baltimore Symphony Orchestra
Natural History Society of Maryland
Star Spangled Banner Flag House Association
Center Stage Associates
Maryland Academy of Sciences
USF Constellation Committee
Baltimore's Festival of the Arts
The Walters Art Gallery
Baltimore Opera Company, Inc.
Children's Theatre Association, Inc.
Arena Players, Inc.
Young Audiences, Inc.
Maryland Historical Society
Baltimore Choral Arts Society, Inc.
Baltimore Theatre Project, Inc.
Handel Choir
Baltimore Zoo
Baltimore Museum of Industry
Baltimore Center for the Performing Arts (Mechanic Theater)
Defender's Day Committee
World Trade Center Institute
Maryland Day Committee
The Baltimore Metropolitan Council
Baltimore Area Convention and Visitors Association
Greater Baltimore Alliance
Preakness Celebration
Convention Center Operations (General Fund)
Baltimore Arena Operations
Baltimore Museum of Art
War Memorial Commission