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LOCAL OPTION TAXES

By: Rute Pinho, Associate Analyst

You asked (1) which states allow local governments to impose local taxes on income, sales, or hotel charges (i.e., local option taxes); (2) how these taxes work; and (3) whether the states or local governments administer them. You also asked for a discussion of the advantages and disadvantages of allowing Connecticut municipalities to impose local option taxes.

SUMMARY

Nearly all states authorize local government entities (municipalities, counties, or school districts) to impose local taxes on income, sales, or hotel charges, but they vary considerably in how they structure and administer these taxes.

Thirteen states allow one or more of their local governments to levy income taxes. As with state income taxes, local income taxes are typically paid through payroll withholding, individual quarterly estimated payments, or annual returns. Some are imposed as a percentage of salaries or wages, while others are figured as a percentage of state tax liability or are a flat amount. In more than half of the states, local taxing jurisdictions administer and collect the taxes. Only five states (Indiana, Iowa, Maryland, New York, and Ohio (school districts only)) administer and collect the tax on the local government's behalf and periodically remit revenues back to them.

Thirty-eight states authorize local sales taxes, which generally follow the same structure as the underlying state sales tax. Although local sales tax rates are in many cases low (often 1% to 2%), some states authorize more than one type of local government to levy a tax, resulting in combined sales tax rates that are substantially higher than the state's base rate. Over half of the states authorize both counties and municipalities to levy the taxes, while the others authorize a mix of counties, municipalities, and other local entities to do so. Most of the states (32) administer the taxes at the state level and remit the revenues back to the localities.

All but five states (Connecticut, Delaware, Hawaii, Maine, and New Hampshire) authorize or require local governments to levy hotel taxes, which often apply in addition to state sales and hotel taxes. We were unable to locate a list of local hotel taxes across the states, but we examined 10 states in the Northeast and Mid-Atlantic and found seven that authorize counties, municipalities, or both to levy the taxes. Three of the states (Massachusetts, Rhode Island, and Vermont) administer the taxes on behalf of the local governments, while in three others (Maryland, New York, and Pennsylvania) the local governments administer the taxes themselves. New Jersey differs in that the state administers municipal occupancy taxes, but individual municipalities administer city hotel taxes.

Among the advantages to local option taxes is that they provide cities and towns with greater revenue diversification and autonomy. They can reduce a municipality's reliance on the property tax and state aid and potentially shift some of the tax burden off of residents and onto nonresidents who come into town to work, shop, or vacation.

One of the disadvantages to local option taxes is that they increase the combined tax rates in an area. This could hurt the state's competitiveness in the region and limit its ability to raise tax rates in the future. Local taxes could also (1) create disparities among cities and towns, (2) encourage municipalities to make land use decisions to maximize local revenues, (3) increase administrative and compliance costs for taxpayers and government, or (4) make cities and towns more vulnerable to economic downturns.

LOCAL INCOME TAXES

Table 1 below provides information on local income taxes in the 13 states that authorize them. For each state, it shows (1) the type and number of local taxing jurisdictions, (2) the tax rate and base, (3) how the state treats resident and nonresident taxpayers, and (4) the level at

which the tax is administered. For purposes of this report, the table excludes California, New Jersey, Oregon, and West Virginia, which authorize local income taxes (or payroll taxes) on employers only, not employees living in a local jurisdiction.

In four states (Indiana, Iowa, Maryland, and Pennsylvania), local income taxes apply in most or all parts of the state. All 92 counties in Indiana, for example, impose an income tax. In five other states (Alabama, Kansas, Kentucky, Michigan, and Ohio), local income taxes are widespread, but do not apply to the entire state. In the remaining four (Colorado, Delaware, Missouri, and New York), the taxes apply in one or a few municipalities. In New York, for example, only New York City and Yonkers impose a tax.

As with state income taxes, local income taxes are typically paid through payroll withholding, individual quarterly estimated payments, or annual returns. Some are imposed as a percentage of salaries or wages, while others are figured as a percentage of state tax liability or are a flat amount. Although not included in the table, local income taxes may also apply to resident trusts and estates within the local taxing jurisdiction.

The states vary in their relative treatment of resident and nonresident income earned in the local jurisdictions. In most of the states, the tax rates that apply to nonresident taxpayers are the same or lower than those that apply to residents. In Pennsylvania, however, some local jurisdictions have higher rates for nonresidents than for residents. In contrast, local income taxes in Iowa and New York City apply only to residents.

In most of the states, the local taxing jurisdiction collects and administers the tax. Only in Indiana, Iowa, Maryland, and New York does the state collect the tax on the local government's behalf. In these states, taxpayers pay their local income tax when they file their state income tax forms. In Ohio, cities and towns administer municipal income taxes and the state administers school district income taxes. Pennsylvania differs from the other states in that it requires municipal and school district income taxes to be collected and administered on a regional basis by designated tax collection districts.

Table 1: Local Income Tax Rates and Administration By State

State	Number and Type of Local Taxing Jurisdictions	Rate(s) and Base	Resident and Nonresident Treatment	Administration
Alabama	Approximately 28 jurisdictions (27 municipalities and one county)	Ranges from 0.5% to 3% of gross receipts or compensation	Same	Local
Colorado	5 municipalities (Aurora, Denver, Glendale, Greenwood Village, and Sheridan)	Ranges from \$2 per month to \$5.75 per month of compensation over a certain threshold amount (from \$250 to \$750 per month)	Same	Local
Delaware	1 municipality (Wilmington)	1.25% of applicable wages and earned income	Same	Local
Indiana	All 92 counties (Lake County's tax takes effect October 1, 2013)	<p>Three different income tax programs available with varying rates (ranging from 0.1% to 3.13%) and parameters for their use (i.e., county adjusted gross income tax (CAGIT), county option income tax (COIT), and county economic development income tax)</p> <p>Supplemental rates for property tax relief and public safety (applicable only to counties that impose the CAGIT or COIT)</p> <ul style="list-style-type: none"> • Up to 1% to provide property tax relief • Up to 1% in counties that have adopted a property tax freeze • Up to 0.25% to fund police protection and various emergency response services 	Nonresidents taxed at lower rate, though they may not be taxed	State
Iowa	297 school districts (82% of total districts) and one county (Appanoose County)	<p>School districts may levy an income tax surtax of up to 20% of state income due</p> <p>Counties may levy an income tax surtax of up to 1% to fund emergency medical services (cumulative income surtax imposed on any taxpayer in a county may not exceed 20%)</p>	Residents only	State
Kansas	29 counties (of 105 total counties), 101 cities, and 382 townships	<p>Tax on gross earnings received from intangible property, such as savings accounts, stocks, bonds, accounts receivable, and mortgages</p> <p>Maximum rate of (1) 0.75% tax for counties and (2) 2.25% tax for cities and townships</p>	Same	Local (county collects and distributes the tax revenue, on forms the Kansas Department of Revenue prescribes)

Table 1 (continued)

State	Number and Type of Local Taxing Jurisdictions	Rate(s) and Base	Resident and Nonresident Treatment	Administration
Kentucky	Over 200 cities, counties, and school districts	Tax on salaries, wages, commissions, and other compensation earned by people within the jurisdiction Levied either on a flat-rate schedule (e.g., \$1 per taxing district for work performed or rendered there (certain cities and counties also impose a tax on business net profits from activities conducted week) or as a percentage of gross wages (ranging from 0.05% to 2.5%)	Some jurisdictions tax nonresidents, others do not; rates are the same in those that do	Local
Maryland	All 23 counties and Baltimore	Tax ranges from 1.25% to 3.20% of taxable income	Same	State
Michigan	22 cities	Tax applies to (1) resident income, (2) nonresident income arising from sources in the taxing city, and (3) corporate net profits attributable to business activity in the city. <ul style="list-style-type: none"> • Generally, the tax rate is 1% for residents, 0.5% for nonresidents, and 1% for corporations • In Detroit, the rate is 2.4% for residents, 1.2% for nonresidents, and 2% for corporations • In Grand Rapids and Saginaw, the rate is 1.5% for residents, 0.75% for nonresidents, and 1.5% for corporations • In Highland Park, the rate is 2% for residents and 1% for nonresidents 	Nonresidents taxed at lower rate	Local
Missouri	2 cities (Kansas City and St. Louis)	1% tax on (1) residents' earnings, (2) nonresidents' earnings from services performed in the city, and (3) net profits of businesses and the self-employed doing business in the city	Same	Local
New York	2 cities (New York City and Yonkers)	In New York City, the tax rate varies by income and filing status <ul style="list-style-type: none"> • Rates range from 2.907% to 3.876% In Yonkers, the tax is 15% for residents and 0.5% for nonresidents, of net state tax liability	Residents only (New York City) Nonresidents taxed at lower rate (Yonkers)	State

Table 1 (continued)

State	Number and Type of Local Taxing Jurisdictions	Rate(s) and Base	Resident and Nonresident Treatment	Administration
Ohio	592 (of 932) municipalities and 184 (of 614) school districts	<p>Municipal income taxes apply to residents, nonresidents, and businesses that have earned profits within the municipality</p> <ul style="list-style-type: none"> • Rate is determined locally, but the maximum rate without voter approval is 1% • In 2011, rates ranged from 0.4% to 3% of income <p>School district taxes apply to individuals residing in the district</p> <ul style="list-style-type: none"> • District sets rates, with voter approval, in increments of 0.25%; In FY 12, rates ranged from 0.25% to 2% • In most districts, the tax applies to Ohio taxable income; select districts apply the tax only to earned income (i.e., wages and compensation) 	Same	<p>Local (municipal taxes)</p> <p>State (school district taxes)</p>
Pennsylvania	2,492 (of 2,562) municipalities and 469 (of 500) school districts	<p>Municipalities may impose an earned income tax of up to 1% on wages and net profits, except for home rule cities (e.g., Philadelphia, Pittsburgh, and Scranton), which have no limit</p> <ul style="list-style-type: none"> • Rates range from 1% to 3.93% • If both a municipality and its school district impose the tax, the maximum rate for the two together is 1% 	May be imposed on either residents only or both residents and nonresidents; Nonresident rates may be higher or lower than resident	Regional (69 tax collection districts collect local income taxes on behalf of municipalities and school districts)

Source: State and local government websites; CCH *State Tax Guide*; Mikesell, John L. "[The Contribution of Local Sales and Income Taxes to Fiscal Autonomy](#)," paper presented at the Lincoln Institute of Land Policy's 2009 Land Policy Conference; Henschman, Joseph and Jason Sapia, "[Local Income Taxes: City- and County-Level Income and Wage Taxes Continue to Wane](#)," Tax Foundation, August 31, 2011.

LOCAL SALES TAXES

Table 2 lists the 38 states that authorize local sales taxes. For each state, it indicates the (1) types of local taxing jurisdictions, (2) state tax rate, (3) range of local tax rates, and (4) level at which the tax is administered.

As the table shows, local option sales taxes vary considerably across the states. Thirty-five of the 37 states specify a sales tax rate or range local governments may levy, while three do not specify a limit. In 22 of the states, counties and municipalities (and in some cases other local governments) are authorized to levy the taxes. Five states (Alaska,

Mississippi, Montana, Nebraska, and Vermont) authorize only municipalities to levy a sales tax, while five others (Florida, Hawaii, Idaho, North Carolina, and Wyoming) authorize only counties to do so. The remaining six states (Louisiana, Ohio, South Carolina, South Dakota, West Virginia, and Wisconsin) authorize a mixture of counties, cities, and other local governments to levy sales taxes (e.g., special taxing districts and transit authorities).

Most of the states (32) administer the local sales taxes at the state level. With the exception of Alaska and Montana, all of the states listed also impose a state sales tax.

Table 2: Local Sales Tax Rates and Administration By State

State	Types Of Local Taxing Jurisdictions	State Sales Tax Rate (%)	Local Sales Tax Rate(S)	Administration
Alabama	Cities, counties	4	0.25% - 5%	State, local jurisdictions, or third-party vendors
Alaska	Cities, boroughs	No tax	No statutory limit	Local
Arizona	Cities, counties	5.6	No statutory limit	State administers county taxes; Municipalities may either have the state administer the taxes or administer them locally
Arkansas	Cities, counties	6.5	Up to 3% for counties and up to 3.5% for cities.	State
California	Cities, counties, special districts	7.5	Up to 1%	State
Colorado	Cities, counties, certain special districts	2.9	No statutory limit	Home rule cities administer their own taxes; State administers the taxes for statutory cities and all counties
Florida	Counties	6	Up to 1.5%	State; Counties may administer certain taxes after adopting an ordinance
Georgia	Cities, counties, transit authorities	4	Up to 2%	State
Hawaii	Counties	4	0.5% (Honolulu county surcharge)	State
Idaho	Counties	6	Up to 0.5% for county sales tax; no limit for resort city sales tax	Local jurisdiction or state
Illinois	Cities, counties, transit authorities, certain special districts	6.25	Rate increases in increments of 0.25% allowed	State, with some exceptions
Iowa	Counties, cities	6	Up to 1%	State
Kansas	Cities, counties, transportation districts	6.15	Up to 2%	State
Louisiana	Cities, parishes, school districts, certain special districts	4	For counties, up to 6%; For cities, up to 5.99%	State

Table 2 (continued)

State	Types Of Local Taxing Jurisdictions	State Sales Tax Rate (%)	Local Sales Tax Rate(S)	Administration
Minnesota	Cities, counties, transit improvement districts	6.875	Up to 1%	State
Mississippi	Cities	7	0.25%	State
Missouri	Cities, counties, certain special districts	4.225	0.5% - 6.625%	State
Montana	Cities	No tax	Up to 3% in certain resort communities and areas	Local
Nebraska	Cities	5.5	Up to 1.5% for counties, municipal counties, and cities of a metropolitan class; Up to 2% for an incorporated municipality	State
Nevada	Counties, Carson City	6.85	Up to 1.25%	State
New Mexico	Cities, counties	5.125	Up to 1.25%	State
New York	Cities, counties	4	Up to 3%	State
North Carolina	Counties	4.75	Up to 3%	State
North Dakota	Cities, counties	5	Up to 2%	State
Ohio	Counties, transit authorities	5.75	Up to 1.5% for counties; up to 1.5% for transit district	State
Oklahoma	Cities, counties	4.5	Up to 2% for county and special taxing jurisdiction taxes	State
Pennsylvania	Cities, counties	6	2% in Philadelphia; 1% in Allegheny County	State
South Carolina	Counties, school districts, Indian tribe	6	Up to 1%	State
South Dakota	Cities, special jurisdictions (Indian tribes)	4	Generally up to 2% (cities may impose additional tax under certain conditions)	State
Tennessee	Cities, counties	7	Up to 2.75%	State
Texas	Cities, counties, special purpose districts, transit authorities	6.25	Up to 2% (combined rate of all local levies may not exceed 2% in any location)	State
Utah	Cities, counties	4.7	1%	State
Vermont	Cities	6	1%	State
Virginia	Counties, independent cities	4.3	Up to 1%	State
Washington	Cities, counties, regional transit authorities	6.5	Up to 1%	State
West Virginia	Cities, special districts	6	Up to 1% for municipal sales taxes; up to 6% for special district excise taxes	State
Wisconsin	Counties, certain special districts	5	Up to 0.5% (county and special district taxes)	State

Table 2 (continued)

State	Types Of Local Taxing Jurisdictions	State Sales Tax Rate (%)	Local Sales Tax Rate(S)	Administration
Wyoming	Counties	4	Up to 2% for general or special purpose tax; up to 1% for economic development tax (combined local rates in a county may not exceed 3%)	State

Source: CCH *Smart Charts*; Sales Tax Institute, [State Sales Tax Rates](#), October 1, 2013; NCSL, *Local Option Taxes*; Mikesell, John L. "[The Contribution of Local Sales and Income Taxes to Fiscal Autonomy](#)," paper presented at the Lincoln Institute of Land Policy's 2009 Land Policy Conference

LOCAL HOTEL TAXES

Every state, except Alaska and California, taxes room rentals, either through a general sales tax, excise tax on lodging (i.e., hotel tax), or both. All but five states (Connecticut, Delaware, Hawaii, Maine, and New Hampshire) authorize or require local governments to levy additional hotel taxes (Michel, Erica. [State Lodging Taxes](#), National Conference of State Legislatures (NCSL) Legisbrief, April 2012.) According to a 2011 report by the Center for Budget and Policy Priorities, hotel taxes are often earmarked for tourism promotion and related purposes (e.g., paying bonds issued for a convention center) (Mazerov, Michael. "[State and Local Governments Should Close Online Hotel Tax Loophole and Collect Taxes Owed](#)," April 12, 2011.)

Table 3 shows state and local hotel tax rates in selected states and, where applicable, indicates the types of local taxing jurisdictions and how the local tax is administered. As the table shows, seven of the 10 selected states allow counties, municipalities, or both to levy hotel taxes. The states vary in how they administer the local taxes. In Maryland, New York, and Pennsylvania, counties and municipalities generally administer the taxes themselves. In Massachusetts, Rhode Island, and Vermont, the state generally administers and collects the local taxes on behalf of municipalities. New Jersey differs in that the state administers municipal occupancy taxes, but individual municipalities administer city hotel taxes.

Table 3: State and Local Hotel Tax Rates In Selected States

State	Types of Local Taxing Jurisdictions	State Hotel Tax Rate (%)	Local Rates	Local Hotel Tax Administration
Connecticut	None	15	No tax	N/A
Maine*	None	7.0	No tax	N/A
Maryland*	Counties, municipalities	No tax	Counties may levy a hotel tax, from up to 3% or up to 9.5%, depending on the county and as specified by law; certain municipalities may levy an additional tax of up to 2%	Local
Massachusetts	Municipalities	5.7	Up to 6% (6.5% in Boston); Boston, Cambridge, Chicopee, Springfield, West Springfield, and Worcester may add a 2.75% convention center financing fee	State
New Hampshire	None	9	No tax	N/A
New Jersey*	Municipalities	5 (with a few exceptions)	Up to 3% municipal occupancy tax; Select municipalities are prohibited from enacting an occupancy tax because they already impose local hotel occupancy taxes, ranging from 1.85% to 9%	State collects municipal occupancy taxes along with the state occupancy fee; municipalities administer city hotel taxes
New York*	Municipalities	No tax	Up to 5.875% (New York City charges a daily hotel fee of \$1.50 per room)	Local, except that the state collects the \$1.50 daily hotel fee
Pennsylvania	Counties and Philadelphia	6.0	8.5% in Philadelphia; select counties authorized to levy an additional tax (generally 3%)	Local
Rhode Island*	Municipalities	5.0	1%	State, except that the city of Newport collects the tax locally and distributes it according to a statutory schedule
Vermont	Municipalities	9	1% (applies only in certain municipalities)	State

NCSL [State Lodging Tax Rates](#), April 3, 2012; CCH *State Tax Guide*; State and local tax department websites
 * Room rentals also subject to state sales taxes in Maine, Maryland, New Jersey, New York, and Rhode Island.

ADVANTAGES AND DISADVANTAGES OF LOCAL OPTION TAXES

Advantages

A major advantage to local option taxes is that they allow municipalities to diversify their revenue sources and subsequently reduce their reliance on the property tax. Currently, cities and towns faced with stagnant or depreciating property tax bases and rising public service costs are forced to either reduce or eliminate services or tax homeowners and businesses at higher rates to pay for them. The revenues from a local tax could help support a municipality's programs and services and consequently reduce the pressure to cut or eliminate them or increase property taxes to maintain them.

Local option taxes could also reduce municipalities' reliance on state aid. As the cost of municipal services has increased, cities and towns have turned to the state for assistance. In time, as state aid constitutes a growing share of municipal budgets, cities and towns become more vulnerable to the state's fiscal situation. Thus, by diversifying local revenues, cities and towns can be less dependent on the state's ability to fund municipal grants-in-aid.

Another advantage to local option taxes is the potential to levy taxes on a tax base that reflects an area's economic strengths, such as retail or tourism. For example, a local sales tax would allow a town that hosts a large number of retail outlets to capture revenue from retail sales. Similarly, a local hotel tax would allow municipalities in tourist areas to capture revenue from room rentals. This also allows municipalities to shift some of the tax burden off of residents and onto nonresidents who come into town to work, shop, or vacation.

Local option taxes could also increase local autonomy. They give municipalities and voters the option to levy a tax to pay for services that state taxpayers may be unwilling to fund. And because state funds often come with specific requirements or constraints, a local revenue source would give cities and towns more control over their spending decisions. This could also lead to greater accountability for taxing and spending decisions.

Disadvantages

One of the major disadvantages to local option taxes is that they increase the combined state and local tax rates in an area. The addition of local taxes could hurt the state's competitiveness in the region and limit the state's ability to raise tax rates in the future.

Local taxes could also create disparities among municipalities. While local taxes could help municipalities generate additional revenues from untapped sources (e.g., retail or tourism), the revenue generating capacity from these taxes is not evenly distributed across municipalities. On average, larger municipalities are likely to benefit more from local taxes than smaller ones. High-income, property-rich municipalities would gain more local option tax capacity than low-income, property-poor municipalities.

Another disadvantage is that local taxes could encourage municipalities to make land use decisions to maximize local revenues at the expense of promoting affordable housing or preserving open space (commonly referred to as the "fiscalization of land use"). For example, a local option sales tax could put pressure on a town to promote commercial developments over housing and other non-retail developments. This runs contrary to the state's policy of promoting regionalism and smart growth.

In addition, local taxes could increase administrative and compliance costs for taxpayers and government, particularly municipalities, which do not already have the capacity to administer an income or sales tax. Local taxes could also cause tax competition among cities and towns that want to attract new or expanding businesses.

Lastly, shifting the tax burden from property taxes to sales, hotel, or income taxes could make local governments more vulnerable to economic downturns. Property tax revenue is stable in economic good times and bad, and it grows roughly in line with population and inflation. Sales, hotel, and income tax revenue, however, is more cyclical and less predictable. Consequently, local option taxes could create fiscal difficulties for local governments during economic downturns if their revenue collections fall below their original forecasts (NCSL, *Local Option Taxes*, January 2008; Zhao, Bo. "[The Fiscal Impact of Potential Local-Option Taxes in Massachusetts](#)," New England Public Policy Center, 2010; Mikesell, John L. "[The Contribution of Local Sales and Income Taxes to Fiscal Autonomy](#)").

HYPERLINKS

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