SOURCE: 1977 Wisconsin Department of Revenue; Bureau of Local Fiscal information and analysis; Reference Publication - "State & Local Finance"

LOCAL INCOME TAXES
IN OTHER STATES

Before attempting to evaluate various local income tax proposals in terms of the criteria defined in Part I, it would be useful to review local income taxes as they have been used in other states and to identify the key dimensions along which they vary. The oldest city income tax is Philadelphia's adopted in 1939. Their success, in terms of raising revenue, led to numerous other localities adopting the tax since that time. There are currently ten states (plus the District of Columbia) where local units of government levy income taxes.

Within these states, over 4,200 jurisdictions levy the tax. However, all but 100 or so of these jurisdictions are in two states: Ohio and Pennsylvania. The percentage of state population covered by local income taxes varies from 100% in Pennsylvania and in Maryland (where it is mandatory) and 65% in Ohio, to a quarter of the population or less in Missouri, Indiana and Alabama.

Local income taxes can be very productive of revenue. In Canton and Springfield, Ohio, they produced about 80% of all local tax revenues in 1971-72. For other localities, the proportion is typically in the 25% to 50% range. The term "local income tax" is used in this paper, and in most discussions elsewhere, rather loosely to refer to all varieties of local taxes on earnings or income, variously defined. In fact, the typical tax is not on full income but rather is a proportional tax on earned income only, or "earnings," which is usually defined as wages and salaries and other employee compensation plus the net income of unincorporated enterprises, including the income of self-employed professionals, small businesses, and rental income of property owners. Excluded are dividends, interest and capital gains.

The principle feature of local income taxes as practiced in the 10 states and the District of Columbia are summarized in Table 1 on the following page. The seven major features about which decisions on options must be made are labeled (A) through (G): (A) the type of jurisdictions levying the tax and receiving the revenues, (B) the tax base, (C) the tax rate structure, (D) the degree of local choice with respect to rates, (E) the taxation of non-residents, (F) the level of government administering the tax, and (G) the taxation of corporate income. These are discussed below.

(A) The Type of Jurisdictions Levying the Tax. In most states, the tax is levied by municipalities. Pennsylvania permits school districts to levy the tax as well. In Maryland the tax is levied by county governments (for their own use). In Indiana, the county government levies the tax but the revenues are distributed to all local governments within the county (including school districts and special districts) in proportion to the local units' share of total property tax revenues collected by all local governments in the county. The local income tax in Indiana is part of a state tax program aimed at providing property tax relief, and is combined with levy limits which freeze the property tax rate or property tax revenues at the 1973 level.

Some other options might be: (1) a tax levied by county governments and shared by the county and the constituent municipalities, (2) a municipal income tax adopted by county referendum at uniform county-wide, rates, and (3) a county-wide income tax returned to school districts on basis of origin or a redistributive formula.

(B) Taxation of Corporations. The Local Income Tax in five states and the District of Columbia includes a tax on the net income of corporations. In four states corporate income is not taxed, and in Ohio the practice varies, there being no uniform state requirement. Where the tax on individuals is a flat rate (applied to earnings or income) the same rate is generally applied to corporate income.

Where a corporation doing business in a state is taxed by local governments within that state, the net income of the corporation allocated to that state as a whole must then be further allocated amongst the localities in order to determine

the local tax liability. Most states use the same formula to apportion income amongst localities as the state uses to apportion the income amongst states of corporations doing business in more than one state. In most cases this is a three- factor allocation formula--the share of income attributed to a locality is a simple average of three ratios. The factors are usually payroll, property, and sales; the ratios, then, are found by dividing the corporation's payroll in that locality by its total payrolls in the state, and similarly for property and sales.

For example, suppose a multi-state corporation with plants in million of which was allocated to Wisconsin under the state's three Milwaukee and other Wisconsin cities had a net income of $10 million, $5 million of which was allocated to Wisconsin under the state’s three-factor formula (with sales weighted doubly). If 40% of the corporations Wisconsin payrolls were paid out to employees in Milwaukee, 50% of its Wisconsin property were located there, and 35% of its Wisconsin sales, then 40% of its Wisconsin net income, or $2 million, would be apportioned to Milwaukee.

With a 1% earnings tax, the corporation would then owe 1% of $2 million to Milwaukee. With a 20% surcharge on state tax liability, the corporation would owe 20% times 40% of its total Wisconsin state income tax liability to Milwaukee.

(¼ x .40 + ¼ x .50 + ½ x .35) = .40 or 40%..