

POWERFUL CITIES?: LIMITS ON MUNICIPAL TAXING AUTHORITY AND WHAT TO DO ABOUT THEM

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Cities are once again on the rise and have become the site of major public debates, from income inequality and immigration policy to where and how Americans should live. While municipal leaders are often eager to fill the void in political leadership left by Congress and state elected officials, they are often hamstrung by state home rule laws, which define the powers states grant to municipalities. These laws limit, among other things, municipal taxing authority. Recently, local government scholars have wrestled with whether and how to grant municipalities more fiscal authority, but such scholarship has not provided a unified theory of municipal taxing authority.

This Article considers in detail whether and how to expand city taxing authority. It argues that state law should grant municipal governments “presumptive taxing authority.” This presumptive taxing authority would parallel municipal regulatory authority and be similarly subject to state preemption law. Such reform would open the door to more municipal revenue innovation, while ensuring that the state can vindicate its weighty policy interests.

INTRODUCTION	293
I. HOME RULE AUTHORITY	299
A. <i>The Concept of Home Rule</i>	301
B. <i>Municipal Revenues Generally</i>	303
C. <i>Specific Home Rule Provisions</i>	305
1. <i>Washington State</i>	306
2. <i>Wisconsin</i>	307
3. <i>Ohio</i>	308
II. THE CASE FOR MORE EXPANSIVE MUNICIPAL TAXING AUTHORITY: FREEING POLICY SPACE	312
A. <i>Limits on Revenue Authority Distort City Development Choices</i>	312
B. <i>Limits Make Lines of Accountability Unclear</i>	314
C. <i>Limits Restrict City Policy Innovation</i>	315

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- D. *Expanding Municipal Taxation*
 - Improves Regulatory Policy* 317
- III. THE STATE’S ROLE IN MUNICIPAL TAX POLICY 321
 - A. *Vertical Tax Competition* 321
 - B. *Horizontal Tax Competition* 324
 - C. *The State’s Fiscal Role in Municipal Affairs* 326
 - D. *Administrability of Local Tax Bases* 330
- IV. PRESUMPTIVE MUNICIPAL TAXING AUTHORITY 334
 - A. *The Proposal* 334
 - B. *Enacting Reform* 339
 - C. *Evaluating the Proposal* 340
- CONCLUSION 343

INTRODUCTION

Cities are once again on the rise and have become the site of major public debates, from income inequality and immigration policy to where and how Americans should live.¹ Municipal leaders are often

¹ On income inequality, see, for example, Eugene J. McCann, *Inequality and Politics in the Creative City-Region: Questions of Livability and State Strategy*, 31 INT’L J. URB. & REGIONAL RES. 188, 194–95 (2007), for a discussion of local concerns about gentrification and livability and suggesting particular urban solutions; Alan Berube, *How Mayors Can Grapple with Inequality*, BROOKINGS INST. (Dec. 5, 2013), <http://www.brookings.edu/blogs/the-avenue/posts/2013/12/05-mayors-inequality-berube>, for the suggestion that mayors can engage strategically to reduce systemic inequality within their cities; Annie Lowrey, *Cities Advance Their Fight Against Rising Inequality*, N.Y. TIMES (Apr. 6, 2014), <http://www.nytimes.com/2014/04/07/business/economy/cities-advancing-inequality-fight.html>, for a discussion of Seattle’s proposed minimum wage increase in the context of local action to reduce income inequality. On immigration, see, for example, Monica W. Varsanyi, *Immigration Policy Activism in U.S. States and Cities: Interdisciplinary Perspectives, in TAKING LOCAL CONTROL: IMMIGRATION POLICY ACTIVISM IN U.S. CITIES AND STATES* 1, 3–6 (Monica W. Varsanyi ed., 2010), noting that “[i]mmigration policy activism has . . . increased exponentially in cities across the United States”; Jennifer M. Chacón, *Managing Migration Through Crime*, 109 COLUM. L. REV. SIDEBAR 135, 138 (2009), for a discussion on the recent trend among states and localities to enact laws designed to enable criminal prosecutions of unauthorized migrants at the local level; Cristina M. Rodríguez, *The Significance of the Local in Immigration Regulation*, 106 MICH. L. REV. 567, 576–79 (2008), for a discussion on the proimmigrant character of many major cosmopolitan cities and contrasting it with newer, less traditional immigration destinations in which the local needs and responses are more varied; Juliet P. Stumpf, *States of Confusion: The Rise of State and Local Power Over Immigration*, 86 N.C. L. REV. 1557, 1596–600 (2008), for a description of local immigration policies in North Carolina; Rick Su, *A Localist Reading of Local Immigration Regulations*, 86 N.C. L. REV. 1619, 1655–78 (2008), for a description of local government action in regulation, but suggesting this response is not all related to national immigration politics. On public health, see, for example, Paul A. Diller, *Why Do Cities Innovate in Public Health? Implications of Scale and Structure*, 91 WASH. U. L. REV. 1219, 1220–24 (2014), for a description of local regulation to combat smoking and obesity and an argument that cities are uniquely positioned to innovate in the realm of public health; Paul A. Diller, *Local Health Agencies, the Bloomberg Soda Rule, and the Ghost of Woodrow Wilson*, 40 FORDHAM URB. L.J. 1859, 1862–67 (2013), for an examination of local

eager to fill the void in political leadership left by Congress and state-elected officials.²

At the same time, rapidly rising rents in metropolitan centers like New York, San Francisco, and Washington, D.C. have highlighted America's renewed interest in big-city living.³ And urbanization is not just a coastal phenomenon. Between 2010 and 2011, nearly one-half of the country's largest metropolitan areas saw greater population growth in core cities than in suburbs, including the metropolitan areas of Denver, Columbus, Memphis, and Phoenix.⁴

Cities are increasingly centers of regional economic development and wealth, changes driven in part by changing preferences for shorter commutes and proximity to the amenities of the city core (shopping, entertainment, restaurants, etc.).⁵ Such urban revitalization has prompted new thinking about the role of municipal government in fostering development in cities and delivering municipal services.⁶

government regulations that take on significant health problems—particularly obesity and smoking; Lainie Rutkow et al., *Local Governments and the Food System: Innovative Approaches to Public Health Law and Policy*, 22 ANNALS HEALTH L. 335, 367–71 (2013), for an argument for innovative health regulation at the local level.

² See Raymond H. Brescia, *On Public Plaintiffs and Private Harms: The Standing of Municipalities in Climate Change, Firearms, and Financial Crisis Litigation*, 24 NOTRE DAME J.L. ETHICS & PUB. POL'Y 7, 7 (2010) (discussing municipalities' use of state tort litigation as means of combatting climate change, firearms proliferation, and abusive subprime mortgage-selling practices); Laura L. Gavioli, Comment, *Who Should Pay: Obstacles to Cities in Using Affirmative Litigation as a Source of Revenue*, 78 TUL. L. REV. 941, 951–57 (2003) (discussing cities' use of litigation as means of regulating firearms); Gail Rubin, *Taking the Offensive: New York City's Affirmative Suits*, 53 N.Y. L. SCH. L. REV. 491, 495–98 (2008) (discussing municipal use of litigation in public health and immigration fields, among others).

³ The *New York Times*, for example, reported that real estate developers were shifting to “smaller, more modestly priced units,” which it described as being in the \$8 million to \$10 million range. Julie Satow, *Luxury Condos: Dialing It Down*, N.Y. TIMES (Oct. 3, 2014), <http://www.nytimes.com/2014/10/05/realestate/luxury-condos-dialing-it-down.html>; see also *Growing Pains*, ECONOMIST (Dec. 7, 2013), <http://www.economist.com/news/united-states/21591187-californias-new-technological-heartland-struggling-its-success-growing-pains> (describing record number of evictions in San Francisco as rents rise and increasing numbers of those working in tech sector move into city).

⁴ Conor Dougherty, *Which Cities Are Growing Faster Than Their Suburbs?*, WALL STREET J. (June 28, 2012), <http://blogs.wsj.com/economics/2012/06/28/which-cities-are-growing-faster-than-their-suburbs/>.

⁵ But see Zachary Liscow, *Are Court Orders Responsible for the “Return to the Central City”?: The Consequence of School Finance Litigation 3–6* (Dec. 1, 2013) (unpublished manuscript), http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=1025&context=student_legal_history_papers (suggesting that increased state-level funding explains about one-third of the growth in central cities and noting variety of other proffered explanations of this growth).

⁶ See, e.g., Rachel Dovey, *NYC, San Francisco on Different Paths to Pedestrian Safety*, NEXT CITY (Jan. 23, 2015), <http://nextcity.org/daily/entry/vision-zero-new-york-san-francisco-pedestrian-safety> (demonstrating role of local governments in solving local issues and comparing methods these governments employ, specifically in regards to pedestrian

Of course, municipal success is not a universal trend. Detroit is the most obvious outlier, but other, mostly older, industrial cities continue to lose population relative to their metropolitan areas.⁷ Cities like Baltimore, St. Louis, and Indianapolis have yet to experience a turnaround.⁸ While many of the problems of cities like Baltimore differ substantially from those of cities like San Francisco, the leaders of most cities share one challenge: municipalities are creatures of state law.⁹ As a consequence, their powers are limited to those enumerated in their state's constitution and laws.¹⁰ A city's power to regulate behavior within its borders¹¹ and to tax and borrow funds to support these regulatory activities and spending programs are all circumscribed by state law.¹²

safety); Emma Green, *Can Mayors Really Save the World?*, CITYLAB (Sept. 23, 2013), <http://www.citylab.com/politics/2013/09/can-mayors-really-save-world/6968/> (highlighting role of local leaders in development of innovation and problem solving at local level).

⁷ See, e.g., Terry Schwarz, *An Un-American Idea*, N.Y. TIMES (Mar. 28, 2011), <http://www.nytimes.com/roomfordebate/2011/03/28/the-incredible-shrinking-city/an-un-american-idea> (noting population of certain cities is shrinking and suggesting that we find methods to repopulate and retrofit them).

⁸ See William H. Frey, *A Big City Growth Revival?*, BROOKINGS INST. tbl.2 (May 28, 2013), <http://www.brookings.edu/research/opinions/2013/05/28-city-growth-frey> (showing greater suburban than core city center growth for Baltimore, St. Louis, and Indianapolis).

⁹ See Frank J. Goodnow, *Municipal Home Rule*, 10 POL. SCI. Q. 1, 1 (1895) (describing "absolute power" state legislatures have over municipal affairs); Lyle E. Schaller, *Home Rule—A Critical Appraisal*, 706 POL. SCI. Q. 402, 414 (1961) ("Possibly the biggest failure of the home rule concept is in the financing of municipal government. . . . [Local governments] have been granted a partial monopoly of an inadequate tax. All too often local governments have more home rule authority than they can finance through 'home rule' tax resources."). Other scholars have suggested expanding home rule authority more broadly. See also GERALD E. FRUG & DAVID J. BARRON, *CITY BOUND: HOW STATES STIFLE URBAN INNOVATION* 98 (2008) (decrying limited municipal power). This Article does not make such a sweeping claim, but rather focuses on tax authority.

¹⁰ See DANIEL R. MANDELKER ET AL., *STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM* 41–42 (5th ed. 2002) (detailing sources of local government authority).

¹¹ See, e.g., *Hawthorne v. Vill. of Olympia Fields*, 790 N.E.2d 832, 840–44 (Ill. 2003) ("Because it is a non-home-rule unit, Olympia Fields cannot adopt ordinances under a general grant of power that infringe upon the spirit of state law or are repugnant to the general policy of the state."); *Town of Conover v. Jolly*, 177 S.E.2d 879, 881–82 (N.C. 1970) (rejecting ordinance that sought to prohibit mobile homes within town because State only conferred "upon cities and towns the power to prevent and abate nuisances, but a mobile home is not a nuisance per se"). For a more expansive view of municipal authority, see *Inganamort v. Borough of Fort Lee*, 303 A.2d 298, 305–06 (N.J. 1973) (noting that New Jersey courts had interpreted municipality's ability to "legislate for the general welfare" to grant source of independent authority to cities).

¹² See DALE KRANE ET AL., *HOME RULE IN AMERICA: A FIFTY-STATE HANDBOOK* 2 (Dale Krane et al. eds., 2001) (introducing idea of home rule and state limitations upon local autonomy).

Traditionally, states have granted local governments¹³ very limited revenue-generating authority, even as compared to other home rule powers.¹⁴ Moreover, as the tax literature has frequently observed, state laws of general applicability, like California's Proposition 13 and Colorado's Taxpayer Bill of Rights (TABOR), also limit local taxing authority.¹⁵

As a result, cities often lack the legal authority to enact meaningful tax reform, including to the most important local tax, the property tax. In New Orleans, elected officials had to win statewide approval for a constitutional amendment simply to allow its residents to take their own vote on property tax increases, and in Texas, mayors worry that proposed state-level cuts to their property tax rates will hinder their ability to provide municipal services.¹⁶

¹³ Cities are but one of many forms of local government. See MANDELKER, *supra* note 10, at 32–41. Counties, towns, special districts, and school districts are all affected by similar limits on local power. *Id.* at 41. This Article's focus on cities is not to suggest these other limits pose no normative or practical problems. School districts, after all, provide perhaps the most important of local public goods. Rather, I have chosen to think about municipalities separately from these other forms of government for several reasons. First, the variation in state municipal home rule is already significant, and adding additional variation by considering other forms of local government adds greatly to the scope of the project. Second, the legal issues, revenue options, and normatively correct solutions of these different forms of government differ from those of municipalities. Counties are both local governments *and* administrative agents of the state, a dual status that suggests potentially different revenue authority. *Id.* at 33–34 (“Counties are ‘first of all local units for state purposes.’ . . . Counties provide a number of state-related services at the local level.” (internal citations omitted)). The literature on school finance is already legion in political science, economics, and law, while scholars have paid less attention to municipal revenue sources. Special districts rely on fairly different funding mechanisms more closely tied to the benefits they provide than municipalities, which are general-purpose governments. *Id.* at 34–35. I hope to consider other forms of local government in future work. Cities, however, seem a good place to start thinking about these problems.

¹⁴ See Richard Briffault, *Foreword: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 915 (2003) (discussing state constitutional limits on municipal borrowing authority).

¹⁵ See ARTHUR O'SULLIVAN ET AL., PROPERTY TAXES AND TAX REVOLTS: THE LEGACY OF PROPOSITION 13, at 6 (1995) (exploring how Proposition 13 radically reduced ability of local governments to set property tax rates within their district); Michael R. Johnson et al., *State Constitutional Tax Limitations: The Colorado and California Experiences*, 35 URB. LAW. 817, 817 (2003) (discussing implications of restrictions to local government's ability to tax, specifically in regards to Colorado's TABOR and California's Proposition 13); *Policy Basics: Taxpayer Bill of Rights (TABOR)*, CTR. ON BUDGET AND POLICY PRIORITIES (Aug. 13, 2015), <http://www.cbpp.org/cms/index.cfm?fa=view&id=2521> (defining TABOR as constitutional Taxpayer Bill of Rights measure meant to tie growth of state and local revenues to inflation rate and population change of state).

¹⁶ *Louisiana Orleans Parish Tax for Fire and Police Protection, Amendment 6 (2014)*, BALLOTPEdia, [http://ballotpedia.org/Louisiana_Orleans_Parish_Tax_for_Fire_and_Police_Protection,_Amendment_6_\(2014\)](http://ballotpedia.org/Louisiana_Orleans_Parish_Tax_for_Fire_and_Police_Protection,_Amendment_6_(2014)) (last visited Mar. 12, 2016); Mike Ward, *Big City Mayors to Leg: Don't Mess with Taxes*, HOUS. CHRON. (Feb. 16, 2015), <http://>

But property taxation is not the only area where state authority has blocked municipal tax reform. The New York State Legislature blocked both of New York City Mayor Michael Bloomberg's efforts to establish a congestion pricing system and stalled Mayor Bill de Blasio's proposed municipal income tax reforms.¹⁷ (Under New York law, the City can't even raise dog licensing fees without state approval.)¹⁸ Until recently, state legislation also blocked California municipalities from imposing bag fees, despite their interest in doing so.¹⁹ When Brookfield, Illinois tried to impose a tax on amusement activities, the Brookfield Zoo lobbied the state legislature to prohibit the tax.²⁰ And in Connecticut, local officials have complained that the legislature continues to foist increased costs on local governments without giving them the revenue sources to pay those costs.²¹ As more Americans seek to move back to inner cities, they will place increasing demands on public infrastructure, and municipalities will face new challenges, such as reviving public transportation, many of which will inevitably cost money to solve.

Traditionally, scholars have assumed that such limits on municipal power are good. Concerns about the administrative costs of municipal tax control coupled with concerns about municipal fiscal mismanagement justified these limitations on municipal fiscal authority.²²

www.chron.com/news/politics/texas/article/Big-city-mayors-to-Lege-Don-t-mess-with-taxes-6083909.php.

¹⁷ See Ross Barkan, *Bill de Blasio Says New Congestion Pricing Plan 'Has to Be Taken Seriously,'* OBSERVER (Feb. 19, 2015), <http://observer.com/2015/02/bill-de-blasio-says-new-congestion-pricing-plan-has-to-be-taken-seriously/> (describing de Blasio's comments that it was important to find long-term solution for MTA finances); Nicholas Confessore, *Congestion Pricing Plan Dies in Albany,* N.Y. TIMES: CITY ROOM (Apr. 7, 2008, 3:01 PM), http://cityroom.blogs.nytimes.com/2008/04/07/congestion-pricing-plan-is-dead-assembly-speaker-says/?_r=0 (describing New York State Assembly Speaker Sheldon Silver's decision not to hold vote authorizing Bloomberg's congestion pricing plan).

¹⁸ Erin Durkin & Glenn Bain, *State Legislature Is Blocking Hike in Cost of City's Dog Licenses,* N.Y. DAILY NEWS (Mar. 14, 2014), <http://www.nydailynews.com/news/politics/legislature-blocking-hike-cost-dog-licenses-article-1.1721285>.

¹⁹ *A Short History of Plastic Bag Laws in California,* PLASTICBAGLAWS.ORG, <http://plasticbaglaws.org/get-involved/plastic-bag-facts/a-short-history-of-plastic-bag-laws-in-california/> (last updated Feb. 2014).

²⁰ Victoria Pierce, *Bill to Block Zoo Tax Clears Legislature,* CHI. TRIB. (Jan. 9, 2011), http://articles.chicagotribune.com/2011-01-09/news/ct-met-zoo-tax-0110-20110107_1-brookfield-zoo-amusement-tax-zoo-officials.

²¹ Keith M. Phaneuf, *For Cities, Towns: Does Blocking Mandates Trump New State Aid?,* CONN. MIRROR (May 27, 2015), <http://ctmirror.org/2015/05/27/for-cities-towns-does-blocking-mandates-trump-new-state-aid/>.

²² See Clayton P. Gillette, *Fiscal Home Rule,* 86 DENV. U. L. REV. 1241, 1252–53 (2009) (discussing problems with local officials' fiscal management decisions); John L. Mikesell, *International Experiences with Administration of Local Taxes 9* (unpublished manuscript), <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.199.304&rep=rep1&type=pdf> (describing decision to allow local governments to administer taxes as

Recently, local government scholars have wrestled with whether and how to grant municipalities more taxing authority,²³ but this scholarship has not provided a unified theory of municipal taxing authority.²⁴

This Article argues that state law should grant municipal governments “presumptive taxing authority.” This presumptive taxing authority would parallel municipal regulatory authority and be similarly subject to state preemption law. Under a presumptive authority approach, a city would be free to establish a tax or regulation as long as the tax or regulation did not conflict with state law. Such reform would open the door to more municipal revenue innovation, while ensuring that the state can vindicate its weighty policy interests.

In arguing for more municipal authority over revenue, this proposal pushes back against the current conventional wisdom on local tax policy and especially local sales tax design. State policymakers and scholars have increasingly sought more uniformity in taxation between states and local governments and between states relative to each other.²⁵ In part, this effort reflects concerns about the costs of administering separate tax rules in each jurisdiction,²⁶ along with the hope that, with greater uniformity, Congress will be persuaded to expand state authority to tax internet sales.²⁷ This Article argues that a properly structured grant of greater taxing authority would still leave room for state uniformity in the sales tax base while providing more revenue options to municipalities.

decision between “indifference and incompetence,” though generally suggesting local taxing authority does not have to include local administration (citation omitted)).

²³ See, e.g., FRUG & BARRON, *supra* note 9, at 75–87 (discussing various methods used by cities to raise tax revenue); Richard Briffault, *Home Rule for the Twenty-First Century*, 36 URB. LAW. 253, 269–70 (2004) (arguing that giving local governments power to tax strengthens home rule and thus improves democratic accountability); Clayton P. Gillette, *Who Should Authorize a Commuter Tax?*, 77 U. CHI. L. REV. 223, 235–39 (2010) (arguing that local governments are able to effectively represent the interests of both local residents and commuters in deciding whether and how to implement commuter tax); Gillette, *supra* note 22, at 1246 (discussing increasing importance of fees as source of local revenue and arguing that allowing local governments to charge fees can be economically efficient).

²⁴ *But see* Darien Shanske, *Local Fiscal Autonomy Requires Constraints: The Case for Fiscal Menus*, 25 STAN. L. & POL’Y REV. 9, 28–29 (2014) (suggesting some reforms of municipal taxing authority).

²⁵ See, e.g., DAVID BRUNORI, *STATE TAX POLICY: A POLITICAL PERSPECTIVE* 125–26 (2d ed. 2006) (urging state policymakers to coordinate to draft more uniform tax laws and discussing favorably the Multistate Tax Compact for taxation of business activity).

²⁶ See *infra* Section III.D for a more detailed discussion of these administrative issues.

²⁷ See Marketplace Fairness Act, S. 698, 114th Cong. § 2 (2015) (conditioning greater sales tax authority on greater state uniformity); Andrew J. Haile et al., *A Potential Game Changer in E-Commerce Taxation*, 67 ST. TAX NOTES 747, 748–49 (2013) (describing number of bills considered during 113th Congress to reform and coordinate collection of state taxes on internet sales).

Part I provides background on the current powers granted to local governments over spending and revenue and gives a brief description of current municipal revenue sources. Part II outlines the benefits to expanding municipal taxing authority, examining the ways restricted taxing authority limits city economic development options and local accountability as well as the ways that expanded authority could increase municipal revenue innovation and improve regulatory policy. Part III considers state interests in municipal tax policy. Part IV discusses the presumptive taxation proposal in detail.

I

HOME RULE AUTHORITY

Municipal governments provide many of our most basic public goods and services, including much of our sanitation (water treatment facilities and waste disposal); public safety (law enforcement, courts, and jails); infrastructure (sewage, electric, and water lines, and roadway maintenance); and public spaces (parks, libraries, and swimming pools).²⁸ These are the sorts of publically provided goods that are easily forgotten until problems arise. There is unlikely to be a headline about the sanitation department unless sanitation employees strike. Similarly, while the opening of a new road or public space may garner media attention, local politicians rarely campaign on a promise to efficiently maintain the city's current infrastructure. In addition, today's municipalities also play important roles in public health,²⁹

²⁸ HOWARD CHERNICK & ANDREW RESCHOVSKY, *LOST IN THE BALANCE: HOW STATE POLICIES AFFECT THE FISCAL HEALTH OF CITIES* 3 (2001), <http://www.brookings.edu/~lmedia/research/files/reports/2001/3/cities-chernick/chernick.pdf>. Of course, this list excludes perhaps the most important public good provided at the local level: elementary and secondary education. While some school systems are under the direct control of municipal government, the majority of school systems are under the authority of independent school districts. There are 13,051 independent school districts in the country, but only 1510 school systems that are part of other local or state governments. *Local US Governments*, NAT'L LEAGUE OF CITIES, <http://www.nlc.org/build-skills-and-networks/resources/cities-101/city-structures/local-us-governments> (last visited Mar. 12, 2016). Mayoral control of school districts has received significant press and policy attention in recent years. See Frederick M. Hess, *Looking for Leadership: Assessing the Case for Mayoral Control of Urban School Systems*, 114 AM. J. EDUC. 219, 221–23 (2008) (discussing attention paid to mayoral control as mechanism of education reform). Because only a handful of districts are subject to mayoral control, this Article does not directly address the literature regarding school funding. See *List of Mayor-Controlled Public Schools*, NAT'L LEAGUE OF CITIES, <http://www.nlc.org/build-skills-and-networks/resources/cities-101/city-officials/list-of-mayor-controlled-public-schools> (last visited Feb. 20, 2015) (listing public school systems subject to mayoral control). Recent research, however, suggests more centralized funding of public schools may have played an important role in the recent growth of central cities. See Liscow, *supra* note 5, at 4.

²⁹ See Betty Bekemeier et al., *Local Health Department Food Safety and Sanitation Expenditures and Reductions in Enteric Disease, 2000–2010*, 105 AM. J. PUB. HEALTH

human services,³⁰ regional transportation policy,³¹ and local economic development.³²

The American political tradition has long romanticized local government—the New England town hall meeting remains the civic discourse’s ideal of grassroots, accountable democracy.³³ And yet, American political philosophy has remained deeply skeptical of urban local government. These dual impulses understandably conflict and lead to the pendulum-swinging treatment of local government powers.

At the turn of twentieth century, state law reform pushed by progressive-era activists gave municipalities much greater autonomy in the form of “home rule.”³⁴ However, home rule has delivered less than promised, especially when it comes to municipal tax authority.³⁵

This Part offers a general description of the policymaking authority typically given to municipalities under state law. The first section provides a general introduction to the legal framework of local government law. The second section provides some background on municipal revenue. The third section examines specific state home rule provisions in detail. As this Part will show, there is a considerable discrepancy between tax authority, which cities are restricted from

(SUPPLEMENT 2) S345, S345 (2015) (discussing role of public health and sanitation departments in preventing food-borne illness); Thomas R. Frieden et al., *Public Health in New York City, 2002–2007: Confronting Epidemics in the Modern Era*, 37 INT’L J. EPIDEMIOLOGY 966, 968–74 (2008) (discussing New York City’s efforts to address chronic disease control); Robert H. Lustig et al., *The Toxic Truth About Sugar*, 482 NATURE 27, 29 (2012) (discussing San Francisco’s effort to ban toys from fast food meals as step toward public health policies that prevent chronic disease).

³⁰ See, e.g., Margaret Weir, *Building the Local Social Safety Net in an Era of Fiscal Constraint*, in METROPOLITAN RESILIENCE IN A TIME OF ECONOMIC TURMOIL 21, 24–27 (Michael A. Pagano ed., 2014) (discussing multitude of roles local government takes in social welfare programs).

³¹ See Bev Perry & Christiana McFarland, *Local Roles in Integrating Transportation and Land Use*, NAT’L LEAGUE OF CITIES 1 (Nov. 2008), <http://www.nlc.org/documents/Find%20City%20Solutions/Research%20Innovation/Infrastructure/local-roles-integrating-transportation-land-use-mag-nov08.pdf> (discussing role of municipalities in transportation policy).

³² See, e.g., Michael I. Luger, *The Role of Local Government in Contemporary Economic Development* 1 (Lincoln Inst. Land Pol’y, Working Paper, 2007), https://www.lincolnst.edu/pubs/dl/1254_Luger%20Final.pdf (discussing role local government plays via land use and other decisions).

³³ See Amy Crawford, *For the People, by the People*, SLATE (May 22, 2013, 2:17 PM), http://www.slate.com/articles/news_and_politics/politics/2013/05/new_england_town_halls_these_experiments_in_direct_democracy_do_a_far_better.html (discussing history of New England town meetings).

³⁴ See David J. Barron, *Reclaiming Home Rule*, 116 HARV. L. REV. 2255, 2279, n.69 (2003) (providing citations to historical literature on home rule).

³⁵ See Goodnow, *supra* note 9, at 17 (noting that court decisions have not “fulfilled the expectations of those who advocated for their [home rule] message”).

exercising, and spending and regulatory authority, which are much more liberally granted to municipalities.

A. *The Concept of Home Rule*

Local governments have been termed mere creatures of the state;³⁶ as a consequence, their powers are limited to those enumerated in their state's constitution and laws.³⁷ For much of the nineteenth century, states granted municipal governments very little independent authority.³⁸ Progressive-era urban activists, fearing state legislatures would fail to respond to the increasing problems faced by growing urbanization and industrialization, advocated for greater home rule authority, at least over some policy decisions.³⁹ Home rule provisions are state laws that give some local governments independent lawmaking authority over local affairs.⁴⁰ Without such provisions, much of the activity of local government required the explicit authorization of its state government.⁴¹

Although the specific powers conferred by the state to local governments via home rule laws and constitutional provisions vary from state to state,⁴² the National League of Cities identifies four categories of home rule authority that may be granted: structural, personnel,

³⁶ See 1 JOHN FORREST DILLON, COMMENTARIES ON THE LAW OF MUNICIPAL CORPORATIONS 448–49 (5th ed. 1911) (“It is a general and undisputed proposition of law that a municipal corporation possesses and can exercise the following powers, and no others: First, those granted in express words; second, those necessarily or fairly implied in or incident to the powers expressly granted; third, those essential to the accomplishment of the declared objects and purposes of the corporation, not simply convenient, but indispensable,” quoted in Clayton P. Gillette, *In Partial Praise of Dillon’s Rule, or, Can Public Choice Theory Justify Local Government Law?*, 67 CHI.-KENT L. REV. 959, 963 n.12 (1991)); *Local Government Authority*, NAT’L LEAGUE OF CITIES, <http://www.nlc.org/build-skills-and-networks/resources/cities-101/city-powers/local-government-authority> (last visited Mar. 12, 2016) (discussing Dillon’s Rule and which states still operate under it).

³⁷ See generally Barron, *supra* note 34 (discussing history of home rule).

³⁸ See Barron, *supra* note 34, at 2280–81 (discussing early approaches to municipal authority).

³⁹ See *id.* at 2291 (discussing motives of early home rule advocates).

⁴⁰ See *Home Rule*, BLACK’S LAW DICTIONARY (10th ed. 2010) (defining home rule as “[a] state legislative provision or action allocating a measure of autonomy to a local government, conditional on its acceptance of certain terms”).

⁴¹ While Dillon’s Rule establishes a presumption that a municipality would need the state’s explicit grant of authority, it has often been interpreted to give local governments the necessary and proper powers to effect grants of explicit permissions. See Gillette, *supra* note 36, at 963 (“As formulated by its author—judge and treatise writer John F. Dillon—the doctrine limits localities to exercise of those powers expressly delegated to them by the state legislature or necessary to implement or necessarily implied from express legislative grants.” (footnote omitted)).

⁴² See generally KRANE ET AL., *supra* note 12 (surveying home rule authority in fifty states).

functional, and fiscal authority.⁴³ Structural authority allows a local government to design its own form of government.⁴⁴ For example, structural authority gives a local government the ability to choose how to allocate power between the mayor and members of the city council. Personnel authority gives a local government the ability to set employment policies for their employees.⁴⁵ Functional authority gives a local government the ability to pass laws and, more generally, the “power to exercise local self-government in a broad or limited manner.”⁴⁶ Functional authority would allow a city to pass an ordinance regulating street vendors within city boundaries, for example. Fiscal authority gives a local government the ability to raise revenue, either through taxation or borrowing.⁴⁷

Home rule municipalities have the greatest authority over structural and personnel decisions.⁴⁸ The degree of functional authority varies considerably amongst states.⁴⁹ Generally speaking, home rule municipalities have less authority over fiscal affairs than over other policy areas.⁵⁰ According to one summary of municipal home rule, only twelve states have laws that give local governments any fiscal control.⁵¹ Of those twelve, the survey classified five as granting only limited fiscal authority.⁵² Even in states that grant more expansive fiscal authority to local governments, “state constitutional provisions . . . restrict the set of fiscal policy choices and the set of fiscal tools [local governments] are able to employ.”⁵³

States differ in how they grant home rule authority. In most states, only “larger” cities are eligible for home rule, and these cities must enact a home rule charter to legislate with home rule authority. For example, only Texas cities with populations over 5000 can elect to pass home rule charters in a general municipal election.⁵⁴ About a quarter of Texas cities have adopted home rule charters,⁵⁵ including

⁴³ *Local Government Authority*, *supra* note 36.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ Erin Adele Scharff, Note, *Taxes as Regulatory Tools: An Argument for Expanding New York City's Taxing Authority*, 86 N.Y.U. L. REV. 1556, 1572 (2011).

⁴⁸ See KRANE ET AL., *supra* note 12 at 476–77 tbl.A1 (showing that majority of states grants deferential authority to local governments on matters of structure and personnel).

⁴⁹ See *id.* (showing regulatory authority of government varies considerably).

⁵⁰ See *id.* (describing greater powers states grant in areas other than home rule).

⁵¹ *Id.* at 476–77 tbl.A1 (listing states with fiscal home rule authority).

⁵² *Id.* (listing extent of fiscal home rule authority in each state).

⁵³ Gillette, *supra* note 22, at 1246.

⁵⁴ TEX. CONST. art. XI, § 5; TEX. MUN. LEAGUE, LOCAL GOVERNMENT IN TEXAS 7, 10 (2015), <https://www.tml.org/pdf/texts/HRHChapter1.pdf>.

⁵⁵ See TEX. MUN. LEAGUE, *supra* note 54, at 7, 10 (showing 329 of 1196 cities had adopted home rule charters); *Cities in Texas*, BALLOTPEDIA, <http://ballotpedia.org/>

all of the state's largest cities. In Minnesota, by contrast, any city (no matter the size) can adopt a home rule charter,⁵⁶ but only about twelve percent of Minnesota cities have done so.⁵⁷

Section III.C will provide illustrative examples of different states' home rule provisions with a focus on the fiscal, and especially taxing, authority granted to home rule municipalities. In thinking about how states provide these grants of authority, however, it is useful to understand a bit more about municipal revenue sources. The next section provides some background on how cities raise revenue.

B. *Municipal Revenues Generally*

One of the challenges of discussing "local government" generally, and municipal finance in particular, is that states vary a great deal in the revenue options they grant to municipalities. In addition, cities vary in the tax policy choices they make. However, some general observations can be made about municipal "own-source revenue," i.e. revenue the city receives from user fees and taxes as opposed to money from intergovernmental grants or municipal borrowing.

First, the property tax provides municipalities with their largest source of own-source revenue.⁵⁸ This pattern of tax utilization reflects state grants of municipal revenue authority. While virtually all municipalities are authorized to impose property taxes, fewer have sales tax authority, and only a fraction of cities have income tax authority.⁵⁹ As a result, about half of municipal governments receive sales tax revenue, while the National League of Cities estimates that only about

Cities_in_Texas (last visited Mar. 12, 2016) (specifying number of home rule cities in relation to total municipalities in Texas).

⁵⁶ MINN. STAT. § 410.04 (2015); see also LEAGUE OF MINN. CITIES, HANDBOOK FOR MINNESOTA CITIES 3 (2014), <http://www.lmc.org/media/document/1/chapter04.pdf?inlinetrue> (summarizing Minnesota home rule law).

⁵⁷ See LEAGUE OF MINN. CITIES, *supra* note 56, at 4 (stating that only 107 of 852 cities have adopted home rule charters).

⁵⁸ *State and Local Tax Policy: What Are the Sources of Revenue for Local Governments?*, TAX POLICY CENTER, http://www.taxpolicycenter.org/briefing-book/state-local/revenues/local_revenue.cfm (last visited Mar. 12, 2016). Mining data on municipal revenue sources is a tricky business, however. There are some authorities who believe user fees now eclipse property taxes. Michael A. Pagano, *United States of America*, in LOCAL GOVERNMENT AND METROPOLITAN REGIONS IN FEDERAL COUNTRIES 363, 375 (Nico Steytier & John Kinkaid eds., 2009).

⁵⁹ See NAT'L LEAGUE OF CITIES, CITIES AND STATE FISCAL STRUCTURE 16 tbl.1A (2015), http://www.nlc.org/Documents/Find%20City%20Solutions/Research%20Innovation/Finance/NLC_CSFS_Report_WEB.PDF (summarizing available municipal taxing authority).

ten percent of municipalities receive revenue from income or wage taxes.⁶⁰

Second, state regulation of the property tax has limited local control in many states. The debate over assessment limitations like Proposition 13 in California often dominates criticism of property tax law.⁶¹ These assessment limits prevent local authorities from taxing the full market value of property. In addition to assessment limits however, the state restricts the local property tax base in other ways, including liberally granting local property tax exemptions.⁶²

Third, since the 1980s, local governments have begun to rely more and more on user fees rather than general revenue taxes.⁶³ User fees are charges residents pay for services provided, as opposed to taxes levied to provide public services generally, whether or not those particular public services are used by individual taxpayers. As Dick Netzer has noted, a portion of this increase is attributable to increasing use of services traditionally associated with user fees.⁶⁴ But municipalities have also shifted to user fees to supplement general tax revenue in the wake of property tax assessment limits and other restrictions on the local property tax base.⁶⁵

One driving force in the shift to user fees is that local governments have a much greater authority to impose such charges without explicit state authorization.⁶⁶ While user fees have increased

⁶⁰ MICHAEL A. PAGANO & CHRISTIANA MCFARLAND, CITY FISCAL CONDITIONS IN 2013, at 3 (2013), http://www.nlc.org/Documents/Find%20City%20Solutions/Research%20Innovation/Finance/Final_CFC2013.pdf.

⁶¹ See *supra* note 15 (providing citations to examples of this literature).

⁶² See DAVID BRUNORI, LOCAL TAX POLICY: A FEDERALIST PERSPECTIVE 66–67 (2d ed. 2007) (discussing other state policies that also restrict property tax revenue authority).

⁶³ ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, SR-6, LOCAL REVENUE DIVERSIFICATION: USER CHARGES 10 (1987), <http://www.library.unt.edu/gpo/acir/Reports/staff/SR6.pdf>; see also Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the "Get What You Pay For" Model of Local Government*, 56 FLA. L. REV. 373, 386 (2004) (noting that dues are becoming more popular among local governments since the early twenty-first century).

⁶⁴ ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *supra* note 63, at 57 n.9.

⁶⁵ Reynolds, *supra* note 63, at 392.

⁶⁶ See, e.g., JOINT LEGISLATIVE AUDIT COMM., BEST PRACTICES REPORT: LOCAL GOVERNMENT USER FEES 9–11 (2004), <http://legis.wisconsin.gov/lab/reports/04-0userfeesfull.pdf> (discussing ability of Wisconsin municipalities to impose user fees more easily than taxes). At the local level, the benefits principle of taxation (i.e., the idea that taxes represent a payment by a resident for a bundle of public goods) plays a much greater role in policy design than it does at the state and federal levels, where the ability to pay principle has generally carried the day. See JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 227–29 (4th ed. 2008) (providing overview of both theories); see also AJAY K. MEHOTRA, MAKING THE MODERN AMERICAN FISCAL STATE: LAW, POLITICS AND THE RISE OF PROGRESSIVE TAXATION, 1877–1929, at 193–96 (2013) (providing historical account of rise of “ability to pay” principle at state and federal levels). Nevertheless, many scholars have criticized increasing

throughout the country, there are some regional patterns. Western and southern states took the lead initially in creating user fees.⁶⁷ Robert Tannenwald has suggested that New England lagged behind on this trend in part because local governments there spent less money on the types of services that readily lend themselves to user fees.⁶⁸

Finally, a city's own-source revenue is only one component of municipal revenue. In addition to local taxes and user fees, cities also receive funding through state grants-in-aid and federal grant programs.⁶⁹ And cities also use borrowed funds, ideally, though not always, to make investments in capital infrastructure.

C. *Specific Home Rule Provisions*

Because every state home rule provision is different, it is worth exploring in detail specific states as examples of what authority is granted to municipalities. This section looks at the home rule laws of Washington, Wisconsin, and Ohio. Of the three, Washington offers an example of the typically limited powers of local government over revenue. Wisconsin offers an example of the ways that even seemingly broad delegations of authority can end up being quite restrictive. Finally, Ohio offers an example of what more expansive revenue authority for municipalities might look like.

In all three states, municipalities have greater authority over user fees than taxes. This is the general trend in municipal law. Traditionally, municipalities were given greater control over user fees. Such fees were understood to provide their own checks on excessive utilization, as they can typically only be charged for the cost of a service and

reliance on user fees as taking the benefits principle too far. See Suellen M. Wolfe, *Municipal Finance and the Commerce Clause: Are User Fees the Next Target of the "Silver Bullet"?*, 26 STETSON L. REV. 727, 785 (1997) (stating concern that user fees may be targeted for constitutional scrutiny).

⁶⁷ See ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *supra* note 63, at 12–13 (depicting user-charge intensity ratio by region in 1972 as compared to later years).

⁶⁸ See Robert Tannenwald, *Taking Charge: Should New England Increase Its Reliance on User Charges?*, NEW ENG. ECON. REV., Jan.–Feb. 1990, at 56, 56–66, <https://www.bostonfed.org/economic/neer/neer1990/neer190d.pdf> (explaining that user charges are better to finance services that are private in nature, while New England spends more on collective services).

⁶⁹ See *State Aid to Local Governments*, NAT'L CONFERENCE OF STATE LEGISLATURES, <http://www.ncsl.org/research/fiscal-policy/state-aid-to-local-government-update.aspx> (last visited Mar. 12, 2016) (discussing state aid to local governments); CONG. BUDGET OFFICE, PUB. NO. 4472, *FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS 1* (2013), https://www.cbo.gov/sites/default/files/43967_FederalGrants.pdf (describing federal grants to local governments).

residents (and nonresidents) can choose whether or not to utilize that service.⁷⁰

1. *Washington State*

In Washington, the home rule provision of the state constitution provides that local government “may make and enforce within its limits all such local police, sanitary and other regulations as are not in conflict with general laws.”⁷¹ The constitution’s very next provision, however, makes clear that the state retains taxing authority, which it may grant to local governments by general rule.⁷² As a result, “[a] local government does not have the power to impose taxes without statutory or constitutional authority.”⁷³

However, cities can impose user fees on services the city provides. They also can impose fines and other fees if the revenue generated is incidental to a regulatory purpose. Thus, in *Kimmel v. City of Spokane*, the Washington Supreme Court upheld Spokane’s parking meter regulations, noting that “since the declared purpose of the ordinance is regulatory, the court will not go behind the legislative declaration in the absence of evidence tending to show that the

⁷⁰ 16 EUGENE MCQUILLIN, *THE LAW OF MUNICIPAL CORPORATIONS* § 44:24 (3d ed. 2013). For a discussion of the trends that have encouraged municipalities to rely more significantly on user fees, see generally Reynolds, *supra* note 63, at 407–15, 430.

⁷¹ WASH. CONST. art. XI, § 11. Such sweeping language granting broad police power has typically not been construed as granting taxing power. This is likely the case for two reasons. First, as is the case in both New York and Washington, such sweeping language is sometimes followed by specific language explicitly granting taxing authority to the state and not the municipalities except by delegation. See, e.g., N.Y. CONST. art. XVI, § 1; WASH. CONST. art. XI, § 12. Second, the police power was generally understood to be regulatory in nature. See *Police Power*, BLACK’S LAW DICTIONARY (10th ed. 2014) (defining “police power” as “inherent and plenary power of a sovereign to make all laws necessary and proper to preserve the public security, order, health, morality, and justice”).

⁷² WASH. CONST. art. XI, § 12 (“The legislature shall have no power to impose taxes upon counties, cities, towns or other municipal corporations, or upon the inhabitants or property . . . for county, city, town, or other municipal purposes, but may . . . vest in the corporate authorities . . . the power to assess and collect taxes for such purposes.”). Similarly, New York State’s constitution specifically limits municipal taxing authority in its home rule provisions. The New York State Constitution declares that “[t]he power of taxation shall never be surrendered, suspended or contracted away, except as to securities issued for public purposes pursuant to law.” N.Y. CONST. art. XVI, § 1. The constitution allows the legislature to delegate its taxing authority, but requires the legislature to specify in that delegation “the types of taxes which may be imposed thereunder and provide for their review.” *Id.* In other words, the Municipal Home Rule Law reasserts that New York State retains the power to review actions taken under the authority delegated to local government. In contrast, the more general legislative authority over regulatory matters is considered to be primarily under local control. See N.Y. MUN. HOME RULE LAW § 10 (Consol. 2011) (providing for review of authorized taxes by State where permitted).

⁷³ *Okeson v. City of Seattle*, 78 P.3d 1279, 1285 (Wash. 2003).

declaration is sham, and that the ordinance is, in reality, a revenue measure.”⁷⁴

While the default grant under Washington law is narrow, the state legislature has provided municipal governments with a number of specific grants of taxing authority, including the property tax and a local option sales tax. A local option sales tax allows localities to opt into the state sales tax base, in adding a municipal or county surcharge on top of the state-level sales tax. Washington also has several smaller, local option taxes to raise municipal revenue for specific purposes authorized by the state. For example, cities can enact local option transportation taxes to fund regional transportation infrastructure in excess of what would be done via general revenue and state support alone.⁷⁵ The state, however, can also take away this municipal taxing authority through legislation or the referendum process.

2. *Wisconsin*

Wisconsin’s constitution grants cities the power to “determine their local affairs and government, subject only to this constitution and to such enactments of the legislature of statewide concern as with uniformity shall affect every city or every village.”⁷⁶ The constitution further allows cities to issue direct taxes to cover interest and principal for any debts.⁷⁷ However, there are strict limits on how much debt a city can take on.⁷⁸

The Wisconsin Supreme Court has found that state legislation unconstitutionally interferes with “local affairs and government” when it seeks to regulate either matters that are purely of local concern or matters that are a “mixed bag” of local and state concern, but where the local concern is predominant.⁷⁹ Despite this apparently broad authority granted to municipalities, the court has only held a handful of legislative enactments to violate the local affairs delegation under the constitution.

Other constitutionally delegated powers are also subject to state control. Perhaps most significantly, the state legislature has the exclusive authority to approve changes to charters.⁸⁰ Further, the

⁷⁴ 109 P.2d 1069, 1070 (Wash. 1941).

⁷⁵ See JOINT TRANSP. COMM., WASH. STATE, TRANSPORTATION RESOURCE MANUAL 132 (2013), http://leg.wa.gov/JTC/trm/Documents/TRM_1315Update/Updated_TRM_AllFilesCombined.pdf (summarizing available transportation taxes).

⁷⁶ WIS. CONST. art. XI, § 3, cl. 1.

⁷⁷ WIS. CONST. art. XI, § 3, cl. 3.

⁷⁸ WIS. CONST. art. XI, § 3, cl. 2.

⁷⁹ State *ex rel.* Michalek v. LeGrand, 253 N.W.2d 505, 506–07 (Wis. 1977).

⁸⁰ See WIS. CONST. art. XIV, § 13 (“Such parts of the common law as are now in force in the territory of Wisconsin, not inconsistent with this constitution, shall be and continue

Wisconsin Supreme Court's public policy doctrine limits municipalities' ability to spend tax-collected dollars outside its geographic confines.⁸¹ This can affect or even prohibit joint projects between municipalities or between other levels of government.⁸² The Wisconsin constitution also limits municipalities' taxing authority by delegating certain tax decisions to the state legislature.⁸³ For example, cities are not permitted to designate tax exemptions, because the authority to do so is vested in the legislature.⁸⁴

As in Washington, cities are granted more authority to levy fees. The revenue generated by fees can only be used to cover the enforcement costs of the regulation imposed by the fees and cannot be used as general revenue for the municipality,⁸⁵ though enforcement of the regulation can encompass reasonably related activities to the purpose of the fee.⁸⁶

3. Ohio

Washington and Wisconsin offer examples of the typical pattern of fiscal home rule, i.e., very limited fiscal home rule power. Ohio, on the other hand, offers a model of much greater fiscal home rule. Ohio's home rule provision provides that "municipalities shall have authority to . . . adopt and enforce within their limits such local police, sanitary and other similar regulations as are not in conflict with general laws."⁸⁷ Because Ohio courts have interpreted general law

part of the law of this state until altered or suspended by the legislature."); *State ex rel. Mueller v. Thompson*, 137 N.W. 20, 23 (Wis. 1912) (describing power to grant, change, and repeal corporate charters as "a legislative function at common law" and further stating that "[w]hile power, in general, was reserved to the Legislature to change the common law it was withheld in case of reservation to the Legislature of exclusive authority in a particular field, as that of granting, amending and repealing municipal charters").

⁸¹ See Michael E. Libonati, "Neither Peace nor Uniformity": *Local Government in the Wisconsin Constitution*, 90 MARQ. L. REV. 593, 604 (2007) ("[T]he doctrine has been an obstacle to legislation impacting on intergovernmental fiscal arrangements.").

⁸² *Id.* For example, in *Buse v. Smith*, 247 N.W.2d 141, 155 (Wis. 1976), the court struck down a school district revenue-sharing plan.

⁸³ See Libonati, *supra* note 81, at 603–07 (discussing the incorporation of precise fiscal policies into the Wisconsin Constitution).

⁸⁴ See Libonati, *supra* note 81, at 605. Thus, in *University of Wisconsin La Crosse Foundation v. Town of Washington*, 513 N.W.2d 417, 420 (Wis. Ct. App. 1994), the court found that the legislature's express grant of authority to cities to determine tax exemptions was unconstitutional.

⁸⁵ See *Rusk v. City of Milwaukee*, 727 N.W.2d 358, 363 (Wis. Ct. App. 2006) (discussing cases where Wisconsin cities were authorized to levy charges).

⁸⁶ See *id.* at 362 (holding that registration fee does not become tax if revenue is used for purposes that are reasonably related to fee (citing *State v. Jackman*, 211 N.W.2d 480, 487 (Wis. 1973))).

⁸⁷ OHIO CONST. art. XVIII, § 3 (Home Rule Amendment).

narrowly, Ohio municipalities have significant regulatory authority.⁸⁸

Further, Ohio courts have interpreted this grant of authority to include the power to tax.⁸⁹ As a result, Ohio municipalities have general taxing authority, and under Ohio law, there is no conflict preemption of local taxing authority.⁹⁰ Instead, the Ohio courts have held that the taxed entity may be taxed by both the state and the municipality.⁹¹ Although this would appear to give municipalities unchecked taxing power, the constitution also gives the General Assembly the power to limit municipal taxing authority.⁹²

Because Ohio's statutory home rule regime is similar to the presumptive municipal taxing reform proposed in Part IV, it is worth discussing in detail the state's experience with more expansive municipal taxing authority. This expansive taxing authority has led to one major difference between Ohio's municipal revenue and other states: Ohio's municipalities impose municipal income taxes.⁹³

⁸⁸ See *City of Canton v. Van Voorhis*, 22 N.E.2d 651, 652 (Ohio Ct. App. 1939) (permitting city to prohibit private refuse collections as not in conflict with general laws on refuse collection). Further, Ohio law construes "general law" narrowly. For a state legislative enactment to constitute "general law," it must meet a four-part test. First, the general law must be part of a statewide and comprehensive legislative enactment. Second, the general law must apply to all parts of the state alike and operate uniformly throughout the state. Third, the general law must set forth police, sanitary, or similar regulations. Fourth, the general law must apply to citizens generally, and not to municipal bodies. See, e.g., *Ohioans for Concealed Carry, Inc. v. City of Clyde*, 896 N.E.2d 967, 973 (Ohio 2008); *Mendenhall v. City of Akron*, 881 N.E.2d 255, 261 (Ohio 2008); *City of Dublin v. State*, 909 N.E.2d 152, 156–67 (Ohio Ct. App. 2009); 16 OHIO JUR. 3D *Constitutional Law* § 223, Westlaw (database updated Nov. 2015).

⁸⁹ *Cincinnati Bell Tel. Co. v. City of Cincinnati*, 693 N.E.2d 212, 214 (Ohio 1998) (holding municipality's power to tax valid); *State ex rel. Zielonka v. Carrel*, 124 N.E. 134, 136 (Ohio 1919) ("There can be no doubt that the grant of authority to exercise all powers of local government includes the power of taxation." (citation omitted)); see also C. Emory Glander, *The Uniform Municipal Income Tax Act*, 18 OHIO ST. L.J. 489, 489–90 (1957) (discussing history of Ohio's municipal income tax authority).

⁹⁰ See *Cincinnati Bell Tel. Co.*, 693 N.E.2d at 218 (holding that public utility excise tax does not impliedly preempt municipalities from enacting tax on net profits of public utility company that can be attributed to business activity of that company within that municipality).

⁹¹ See *id.* ("[T]he Constitution presumes that both the state and municipalities may exercise full taxing powers . . .").

⁹² See OHIO CONST. art. XIII, § 6 ("The General Assembly shall provide for the organization of cities, and incorporated villages, by general laws, and restrict their power of taxation . . . so as to prevent the abuse of such power."); OHIO CONST. art. XVIII, § 13 ("Laws may be passed to limit the power of municipalities to levy taxes and incur debts for local purposes . . ."); *City of Franklin v. Harrison*, 170 N.E.2d 739, 742 (Ohio 1960) (finding that General Assembly has authority to limit municipal taxing power under Ohio Constitution).

⁹³ See Joseph Henchman & Jason Sapia, *Local Income Taxes: City- and County-Level Income and Wage Taxes Continue to Wane*, TAX FOUND. (Aug. 31, 2011), <http://>

Ohio's local income taxes were enacted in the wake of the Great Depression, as declining property values shrunk the property tax base.⁹⁴ In the postwar era, as white flight shrank the population of cities, municipal income taxes offered municipalities an opportunity to capture some of the costs imposed on the city by suburban commuters by taxing the income they earn within the municipality.⁹⁵

As a policy matter, economists are generally skeptical of municipal income taxes.⁹⁶ At the local level, opportunities for exit and evasion are higher than they are at the national (or even state) level, leading to relatively inefficient revenue collection.⁹⁷ In Ohio, local administration of the municipal income also increases the compliance burden on taxpayers, i.e., the cost above and beyond the tax paid of complying with tax laws.⁹⁸ Research also suggests the municipal income tax may be partly capitalized in property tax values, reducing property tax collection.⁹⁹

Despite these concerns, Ohio municipalities continue to vigorously defend their income tax base.¹⁰⁰ Over the years, state regulation

taxfoundation.org/article/local-income-taxes-city-and-county-level-income-and-wage-taxes-continue-wane (noting that although most U.S. cities do not impose local income tax, 593 municipalities in Ohio have such a tax).

⁹⁴ See *id.* (explaining that declining property tax revenues caused by rising foreclosures during the Great Depression forced local governments, including Ohio, to look for other ways to raise revenue); see also Elizabeth Deran, *An Overview of the Municipal Income Tax*, 28 PROC. ACAD. POL. SCI. 19, 19–24 (1968) (discussing contemporaneous state of municipal income tax).

⁹⁵ Paul J. Hartman, *Municipal Income Taxation*, 31 ROCKY MTN. L. REV. 123, 123–24 (1958); Joe G. Davis, Jr. & Arthur J. Ranson, III, Note, *An Evaluation of Municipal Income Taxation*, 22 VAND. L. REV. 1313, 1313 (1969); see Deran, *supra* note 94, at 25 (“[T]he income tax has not been supplemental so much as substitutive, and has taken some of the pressure off the property tax.”); Leonard Kirschner, *The Municipal Income Tax*, 20 U. CIN. L. REV. 343, 348 (1951) (“The most convincing argument in favor of the tax is that it will reach the non-resident using city facilities, who currently contributes nothing to the city government.”). See generally ADVISORY COMM’N ON INTERGOVERNMENTAL RELATIONS, SR-10, LOCAL REVENUE DIVERSIFICATION: LOCAL INCOME TAXES (1988), <http://www.library.unt.edu/gpo/acir/Reports/staff/SR-10.pdf> (discussing municipal revenue sources); Gary Sperling, *Municipal Income Taxation and Home Rule*, 1 URB. LAW. 281 (1969) (discussing municipal income tax feasibility under current home rule provisions).

⁹⁶ See, e.g., Richard M. Bird, *Fiscal Federalism*, in THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY 147, 147 (Joseph J. Cordes et al. eds., 2005) (discussing consensus).

⁹⁷ *Id.*

⁹⁸ See *Lawmakers, Business Owners Demonstrate Need for Municipal Tax Reform*, MUN. TAX REFORM COAL. (Apr. 15, 2013), <http://munitaxreform.org/new-blog/2013/4/15/lawmakers-business-owners-demonstrate-need-for-municipal-tax-reform> (discussing proposals to reduce compliance burdens on taxpayers in Ohio).

⁹⁹ See generally William J. Stull & Judith C. Stull, *Capitalization of Local Income Taxes*, 29 J. URB. ECON. 182 (1991).

¹⁰⁰ See, e.g., Letter from Susan J. Cave, Exec. Dir., Ohio Mun. League, <http://www.omlohio.org/130th%20General%20Assembly/HB5/OML%20Letter%20of%20Opposition%2011%2012.pdf> (summarizing Ohio municipal

of the property and sales tax bases have left Ohio municipalities dependent on income taxes as an important stream of revenue.¹⁰¹ Recently enacted state-level reforms have increased uniformity in municipal income tax law and should reduce some compliance costs, especially for businesses.¹⁰²

Ohio's experience with municipal income tax suggests that providing cities with independent taxing authority can lead to some revenue innovation, but it also highlights the fact that increased authority does not guarantee such innovation. Aside from the municipal income tax, Ohio cities have not taken full advantage of their municipal taxing power to experiment with other streams of revenue.

However, it seems hardly surprising that Ohio has not been at the center of municipal innovation in recent years. Ohio built its prosperous, midcentury economy on a manufacturing industry that has been under tremendous pressure for decades.¹⁰³ Some politicians blame local tax policy for inhibiting economic growth.¹⁰⁴ However, the structural economic issues the state faces far outweigh its fiscal problems, at either the state or local level.¹⁰⁵

Ohio's experience also highlights both the opportunities and challenges of giving cities more power to choose their revenue sources. Because Ohio law gave cities the ability to enact taxes presumptively (without seeking prior state approval), cities developed a new tax base. Despite the fact that the state has the legal authority to regulate this base, however, municipal interest in defending the existing base has made reform challenging. Of course, state legislative action limiting other sources of revenue has increased municipal interest in the income tax base. Had the state allowed greater municipal control over

opposition to reform subsequently passed by Ohio legislature due to concern for impact on municipal budgets).

¹⁰¹ See generally MEGHAN SULLIVAN & MIKE SOBUL, PROPERTY TAX AND SCHOOL FUNDING 3–6 (2010) (discussing current structure of Ohio property tax system including limits); Richard K. Desmond & Paul F. Sefcovic, *Municipal Debt and Tax Limitations*, 33 OHIO ST. L.J. 606 (1972) (summarizing state-imposed debt and tax limits on eve of “Tax Revolt”).

¹⁰² See *Ohio Enacts Municipal Tax Reform* DELOITTE (2014), <http://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-mts-alert-ohio-enacts-municipal-tax-reform-12222014.pdf> (discussing recent legislation imposing uniform standards on all Ohio municipalities).

¹⁰³ NAT'L RESEARCH COUNCIL OF THE NAT'L ACADS., BEST PRACTICES IN STATE AND REGIONAL INNOVATION INITIATIVES: COMPETING IN THE 21ST CENTURY 111–13 (Charles W. Wessner ed., 2013), http://www.ncbi.nlm.nih.gov/books/NBK143000/pdf/Bookshelf_NBK143000.pdf.

¹⁰⁴ See, e.g., *id.* at 113 (stating that local tax policy creates confusion for businesses).

¹⁰⁵ See, e.g., Letter from Susan J. Cave, *supra* note 100 (summarizing Ohio municipal opposition to reform subsequently passed by Ohio legislature due to concern for impact on municipal budgets).

property and sales tax law, the politics of municipal income tax reform might be different.

In looking at the home rule provisions of a sample of specific states, a few patterns emerge. First, the language of the grants of home rule authority bears some striking similarities to one another. Second, as the examples of Washington and Wisconsin suggest, most states have significantly restricted municipalities' independent taxing authority. Third, Ohio's broad grant of municipal revenue authority makes it an outlier with regards to typical home rule grants of authority across the country.

II

THE CASE FOR MORE EXPANSIVE MUNICIPAL TAXING AUTHORITY: FREEING POLICY SPACE

Limits on city revenue authority hamper city policymaking for a number of reasons. First, such limits encourage specific types of development patterns in cities over other (perhaps preferable) options for growth. Second, limits on local revenue authority hamper democratic accountability, as the state's role in limiting local fiscal options may be obscure to voters, or at least less salient than the decisions local officials make within the parameters offered under state law. Third, limits on local revenue authority stifle revenue innovation at the local level. Fourth, limits on municipal taxing authority also restrict municipal regulatory choices in ways that may discourage cities from making optimal policy choices. This Part will consider each of these arguments in turn.

A. Limits on Revenue Authority Distort City Development Choices

Limits on municipal revenue options distort cities' economic development choices because state-level restrictions on a city's sources of revenue will encourage a city to develop those sources of economic activity from which it derives the most revenue.¹⁰⁶ For example, state-based tax restrictions can distort local governments' zoning decisions, a development strategy termed the "fiscalization" of land use law. Studies in California suggest that the state's constitutional limits on the property tax have encouraged municipal governments to increase land zoned for retail development so as to increase local sales tax revenue, at the expense of other kinds of develop-

¹⁰⁶ FRUG & BARRON, *supra* note 9, at 98 ("[E]xisting rules about revenues and expenditures tend to push cities to favor some ideas about their future over others, regardless of the desires of their citizens or their elected leaders.").

ment.¹⁰⁷ As longtime city planner Peter Pollock observes, “[Y]ou are what you eat, but in local government you develop what you tax.”¹⁰⁸ Pollock decries the inevitable result of this maxim on city planning in Colorado, as cities chase retail sales tax dollars with a “boom/bust cycle of mall developments and a general overbuild of retail.”¹⁰⁹

As Richard Briffault and others have noted, nationally, the growth in tax increment financing (TIF) across the country reflects the broader fiscalization trend.¹¹⁰ Municipalities create tax increment financing districts to spur local economic development and fund increased public services in those districts with the (hopefully forthcoming) increases in property tax revenue created by rising property values there.¹¹¹ Critics of TIF note that such development is often zero-sum, shifting economic investment that might have occurred elsewhere in the municipality to a location inside the TIF instead of encouraging new economic development.¹¹² The fiscalization of land use creates economic development patterns that crowd out other kinds of development, including development that residents (or prospective residents) might otherwise prefer, including more residential development.¹¹³

¹⁰⁷ See PAUL G. LEWIS & ELISA BARBOUR, *CALIFORNIA CITIES AND THE LOCAL SALES TAX* iv (1999) (analyzing effects of California’s point-of-sale or situs-based sales tax on land-use decisions and evaluating how California cities vary in benefits they receive from the tax).

¹⁰⁸ Peter Pollock, *A Comment on Making Sustainable Land-Use Planning Work*, 80 U. COLO. L. REV. 999, 1011 (2009). *But see* WYO. STAT. ANN. § 39-15-211 (West 2015) (providing example of revenue-sharing encouraging local cooperation in retail development).

¹⁰⁹ Pollock, *supra* note 108, at 1012.

¹¹⁰ See Richard Briffault, *The Most Popular Tool: Tax Increment Financing and the Political Economy of Local Government*, 77 U. CHI. L. REV. 65, 86 (2010) (“TIF also fits in well with the growing fiscalization of municipal land use decisions.”); *see also* Paul Kantor, *The Dual City as Political Choice*, 15 J. URB. AFF. 231, 237 (1993) (considering fiscalization’s role on capital infrastructure development).

¹¹¹ See Richard F. Dye & David F. Merriman, *Tax Increment Financing: A Tool for Local Economic Development*, LAND LINES, Jan. 2006, at 2, https://www.lincolnst.edu/pubs/dl/1076_Jan2006-Final.pdf (using empirical studies to rebut argument that TIF benefits entire municipality). Every state but Arizona allows some form of TIF. COUNCIL OF DEV. FIN. AGENCIES & INT’L COUNCIL OF SHOPPING CTRS., *TAX INCREMENT FINANCE BEST PRACTICES REFERENCE GUIDE 1* (2007), <http://pipta.org/wp-content/uploads/2014/06/TIF-Best-Practices-Reference-Guide.pdf>.

¹¹² See Dye & Merriman, *supra* note 111, at 4–7 (arguing that “tax increment financing is an alluring tool”).

¹¹³ See FRUG & BARRON, *supra* note 9, at 108–10 (analyzing limits of fiscal tool adopted in urban land development).

B. *Limits Make Lines of Accountability Unclear*

When local voters are unhappy with the fiscal decisions of their elected officials, they naturally seek to hold them accountable. Local voters may think a greater portion of the property tax should fall on commercial rather than residential property, for example. Or they may not like city officials' decisions to cut the budget for local human services or the city police force.

On some of these decisions, city officials have other policy options. They may be able to find alternate budget cuts or propose a bond that would increase the city's borrowing capacity. However, if revenue drops precipitously, city officials in many states have few options other than budget cuts. While many (though not all) states imposing property tax limits allow tax limit overrides, state law often limits the amount of the override, may require the override to be time-limited, and may also require additional votes for an override to continue, or may provide some combination of all three restrictions. For example, under Massachusetts's Proposition 2 ½, levy overrides cannot exceed a set levy ceiling unless they are used for very limited purposes.¹¹⁴ And in many states, localities do not control the assessment limits or the assessment ratios of commercial-to-residential property.¹¹⁵ Assessment limits reduce the value of property being taxed below its market value. Assessment ratios fix the relationship between commercial and residential property valuations for purposes of applying property tax rates. Such decisions rest with the state legislature and, in the case of constitutional tax limits, the statewide voting population.

Many of the limits placed upon local officials were imposed by constitutional reform at the ballot box.¹¹⁶ Nevertheless, voters may still hold local elected officials responsible for the limited set of policy

¹¹⁴ DIV. OF LOCAL SERVS., MASS. DEP'T OF REVENUE, *LEVY LIMITS: A PRIMER ON PROPOSITION 2 ½*, at 12 (2007), <http://www.mass.gov/dor/docs/dls/publ/misc/levylimits.pdf>.

¹¹⁵ In states as different as New York and Arizona, it is the state legislature that sets the assessment ratios, though in New York the state only provides the classifications for New York City, under a very arcane system. See ARIZ. REV. STAT. ANN. §§ 42-15001 to -15010 (2015) (providing assessment ratios for Arizona's multiple property classifications); FURMAN CTR. FOR REAL ESTATE & URBAN POLICY, *DISTRIBUTION OF THE BURDEN OF NEW YORK CITY'S PROPERTY TAX 12-15* (2011), http://furmancenter.org/files/sotc/Distribution_of_the_Burden_of_New_York_Citys_Property_Tax_11.pdf (discussing history of New York City's property classification systems and role of state legislature in determining these classifications).

¹¹⁶ See FRUG & BARRON, *supra* note 9, at 75-80 (using Boston to illustrate how state law exerts control of local budget). Of course, this may be a natural feature of multilevel governance, but the problems here may be exacerbated by the low level of salience as to the responsible political actors. I address whether these state restrictions on local autonomy may serve their own policy purpose in Section III.A.

options, failing to recognize their own role in limiting local fiscal options. Voters may also find their political choices further restricted as local candidates conform their policy platforms to the limits of state law. (Of course, candidates could always campaign promising to enact policies the state has prohibited, but those candidates would have little to show when up for reelection.) It would be quite difficult for public officials and political candidates to educate the electorate about these different divisions of responsibility, especially on technical matters such as assessment ratios, and such education would inevitably fall short. Moreover, local voters may fail to hold statewide officials accountable for their role in limiting local policy options.¹¹⁷

Further, even absent concerns about the salience of decision-making at different levels of government, there is reason to believe that local elected officials may be better fiscal agents for local voters. Responding to traditional concerns that greater fiscal authority might lead to greater municipal mismanagement, both Clayton Gillette and Richard Briffault have noted that local exit may check these concerns.¹¹⁸ As Briffault writes, “The ability of mobile residents and firms to flee a high-tax jurisdiction to a low-tax neighbor, along with local electoral control, provides a significant check on local taxing decisions.”¹¹⁹ It is therefore “far from clear whether the extra constraint of state legislative and gubernatorial approval is necessary or desirable.”¹²⁰ In other words, local market mechanisms—including the exit concerns triggered by tax hikes—may be a better way of regulating municipal finance.

C. *Limits Restrict City Policy Innovation*

There are some good ideas (and some pretty bad ones) about how cities can improve their fiscal futures. The Center for American Progress, for example, published a lengthy report detailing its ideas for “progressive local policies to rebuild the middle class,” including municipal revenue options.¹²¹ Unfortunately, one has to turn to the

¹¹⁷ Cf. *New York v. United States*, 505 U.S. 144, 169 (1992) (“Accountability is thus diminished when, due to federal coercion, elected state officials cannot regulate in accordance with the views of the local electorate in matters not pre-empted by federal regulation.” (internal citations omitted)).

¹¹⁸ See Gillette, *supra* note 22, at 1254–55 (arguing that home rule will not encourage local officials to deviate from taxpayers’ preferences); Briffault, *supra* note 23, at 270 (arguing that home rule shall include “state fiscal support”).

¹¹⁹ Briffault, *supra* note 23, at 270.

¹²⁰ *Id.*

¹²¹ See JOEL ROGERS & SATYA RHODES-CONWAY, *CITIES AT WORK: PROGRESSIVE LOCAL POLICIES TO REBUILD THE MIDDLE CLASS* 1–4 (2014), https://cdn.americanprogress.org/wp-content/uploads/2014/01/COW_00FullReport1.pdf.

endnotes to find a warning that “local tax policy is an area more heavily circumscribed by federal and, especially, state law than many, so many of the approaches [we] recommend[] are subject to state authorization and may not be options in a given locality depending on the vagaries of state tax law in that state.”¹²² Whether or not one agrees with the recommendations in the report, it is clear that limited home rule authority restricts municipal ability to pursue innovative revenue policies.

Innovations in municipal revenue are desirable for three reasons. First, many municipalities need new sources of revenue. In most states, state aid to local governments is declining, while at the same time municipalities are confronting budget shortfalls in their pension obligations.¹²³ At the same time, statewide electorates have shown only minimal interest in reforming property tax limits which have weakened municipal control over a major source of local revenue. Providing additional revenue options for cities will be important if the electorate prefers to sustain current municipal service levels (or even see them expanded).

Second, municipal revenue innovation may spur ideas for reform at the state level. Just as states can serve as laboratories of democracy at the federal level, cities can experiment with policy (including tax policy) that may be appropriate for later adoption at the state level or by other cities.¹²⁴ As Richard Briffault observes, “[I]f the fifty states are laboratories for public policy formation, then surely the 3,000 counties and 15,000 municipalities provide logarithmically more opportunities for innovation, experimentation and reform.”¹²⁵

¹²² *Id.* at 167 n.2.

¹²³ See Alexis Stephens, *Which Cities Should Be Most Worried About Pension Funds?*, NEXT CITY (Sept. 3, 2014), <http://nextcity.org/daily/entry/cities-pension-funds-worries> (discussing municipal pension-funding shortfalls and responses).

¹²⁴ See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (“It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.”). See generally Harriet Bulkeley & Vanesa Castán Broto, *Government by Experiment? Global Cities and the Governing of Climate Change*, 38 TRANSACTIONS OF THE INST. OF BRITISH GEOGRAPHERS 361, 368–72 (2013) (cataloging city innovation and experimentation in climate-change policy); Charles R. Shipan & Craig Volden, *Bottom-Up Federalism: The Diffusion of Antismoking Policies from U.S. Cities to States*, 50 AM. J. POL. SCI. 825 (2006) (discussing ways antismoking policies moved from local to state governments). But see generally Brian Galle & Joseph Leahy, *Laboratories of Democracy?: Policy Innovation in Decentralized Governments*, 58 EMORY L.J. 1333, 1339–40, 1346–60 (2009) (suggesting claims of laboratories are overstated); Susan Rose-Ackerman, *Risk Taking and Relection: Does Federalism Promote Innovation?*, 9 J. LEGAL STUD. 593 (1980) (same).

¹²⁵ Briffault, *supra* note 23, at 259.

Third, such innovations may discourage municipal innovation in borrowing. Recent experience with municipal finance innovation has suggested that city officials (and the municipal electorate) lack the technical expertise to monitor more sophisticated borrowing arrangements, and this has led to inefficient municipal borrowing practices.¹²⁶ Tax innovations are likely to be easier to understand and encourage more successful monitoring by local voters who are directly and immediately affected by new tax policies. Providing more revenue options for cities would lower the temptation to turn toward municipal borrowing to balance the budget.¹²⁷

Expanded municipal taxing authority does not guarantee innovation. For example, Ohio's significant grant of revenue authority to its municipalities has not created significant revenue innovation.¹²⁸ Such innovation requires other necessary conditions, like innovative local leaders and interested in-state policymakers. However, absent expanded revenue authority, even with good leadership, such innovation would not happen. And not all innovation is good. Certainly, expanded authority will also give municipalities the power to make poor policy choices; not all municipal revenue policies are equal.

D. Expanding Municipal Taxation Improves Regulatory Policy

In addition to allowing municipalities greater authority over their fiscal affairs, expanding municipal taxing authority could also improve municipal regulatory policy. By regulatory policy, I mean incentives and sanctions designed to change behavior, in contrast to traditional revenue policies, which ought to be designed so as to raise revenue while minimizing impacts on taxpayer behavior.

Current limits on municipal taxing authority distort local regulatory policy because they prevent local officials from pursuing many tax-based regulatory policies. In a number of situations such tax-based solutions may be more effective and more efficient than traditional

¹²⁶ See ANDREW ANG & RICHARD C. GREEN, LOWERING BORROWING COSTS FOR STATES AND MUNICIPALITIES THROUGH COMMONMUNI 15–17 (2011), http://www.brookings.edu/~media/Research/Files/Papers/2011/2/municipal-bond-ang-green/02_municipal_bond_ang_green_paper.PDF (arguing for using CommonMuni to establish “best practices for municipal bond issuers and to provide advice directly to municipalities”).

¹²⁷ See also James M. Poterba & Kim Rueben, *State Fiscal Institutions and U.S. Municipal Bond Market*, in FISCAL INSTITUTIONS AND FISCAL PERFORMANCE 181, 204–05 (James M. Poterba ed., 1999) (finding that tax limits also increase borrowing costs). See generally James C. Clingmayer & B. Dan Wood, *Disentangling Patterns of State Debt Financing*, 89 AM. POL. SCI. REV. 108, 115–16 (1995) (discussing role of revenue limits in increasing borrowing).

¹²⁸ See *supra* Section I.C.3 (discussing Ohio's municipal income tax).

regulatory approaches. When taxation is the right tool, policymakers should be able to use it.

There are at least two situations where municipal policymakers should strongly consider implementing a regulatory policy through tax tools. First, a tax solution makes sense when combating an externality.¹²⁹ Second, a tax often makes sense as a policy to curb undesirable behavior that is not purely an externality.¹³⁰

When confronting an externality, cities should be able to decide whether cost internalization is better accomplished through regulation or taxation. Governments can design taxes that address negative externalities, such as pollution and congestion. Such taxes force agents to consider the “uncompensated cost[s] that [they] impose[] on others.”¹³¹ Economists call such taxes Pigovian taxes, after the English economist Arthur Pigou, who first developed the idea of imposing a tax equal to the magnitude of the harm caused by the externality.¹³²

Congestion pricing is a good example of a Pigovian tax. Generally, public roads are nonrival goods; without congestion, one car’s enjoyment of a roadway is not hindered by additional cars. However, when the number of cars on a road exceeds capacity, a road can become a “congestible public good[.]”¹³³ Congestion impedes the normal flow of traffic, imposing costs on other drivers measured in time delays and the increased wear-and-tear on vehicles in stop-start traffic.¹³⁴ While drivers experience the costs congestion imposes on them directly, they do not internalize the cost of their presence on

¹²⁹ See N. Gregory Mankiw, *Smart Taxes: An Open Invitation to Join the Pigou Club*, 35 E. ECON. J. 14, 19–20 (2009), <http://scholar.harvard.edu/mankiw/publications/smart-taxes-open-invitation-join-pigou-club> (discussing role of Pigovian taxation in combating market failure due to externality problem).

¹³⁰ Consider, for example, smoking. Sin taxes like cigarette taxes make the costs smokers bear more salient in addition to requiring smokers to internalize the costs society bears because of their smoking. The costs to the smokers themselves is likely higher than the cost to society as a whole. See Ted O’Donoghue & Matthew Rabin, *Studying Optimal Paternalism, Illustrated by a Model of Sin Taxes*, 93 AM. ECON. REV. 186, 188–89 (2003); see also Kamhon Kan, *Cigarette Smoking and Self-Control*, 26 J. HEALTH ECON. 61, 79 (2007) (providing evidence of time-inconsistent preferences of smokers).

¹³¹ PAUL KRUGMAN & ROBIN WELLS, MICROECONOMICS 437 (2009).

¹³² *Id.* at 443–44.

¹³³ Jonathan Remy Nash, *Economic Efficiency Versus Public Choice: The Case of Property Rights in Road Traffic Management*, 49 B.C. L. REV. 673, 686 (2008) (quoting Clayton P. Gillette & Thomas D. Hopkins, *Federal User Fees: A Legal and Economic Analysis*, 67 B.U. L. REV. 795, 802 n.23 (1987)).

¹³⁴ P’SHIP FOR N.Y.C., GROWTH OR GRIDLOCK?: THE ECONOMIC CASE FOR TRAFFIC RELIEF AND TRANSIT IMPROVEMENT FOR A GREATER NEW YORK 3–4 (2006), <http://www.pfnyc.org/publications/Growth%20or%20Gridlock.pdf> (finding time-delay cost between \$5 billion and \$6.5 billion and that fuel and wear-and-tear costs added additional \$2 billion to cost of congestion).

others.¹³⁵ Raising the costs of driving, by increasing or imposing tolls on congested roadways, or increasing parking costs, would counter this problem.¹³⁶ The increased cost would require drivers to partially internalize the costs their driving imposes on others, which, in turn, would decrease the number of cars on the streets.

Of course, congestion, like other private market failures, can also be combated via regulation. For example, a government could limit the types of cars that can enter congested areas or use congested roadways. Regulations, however, can create perverse incentives that price-based solutions like Pigovian taxes can often avoid.¹³⁷

While current municipal authority may allow cities to combat congestion by increasing the cost of parking, cities rarely have the authority to impose other price-based solutions to congestion. While

¹³⁵ Nash, *supra* note 133 (quoting Tirza S. Wahrman, *Breaking the Logjam: The Peak Pricing of Congested Urban Roadways Under the Clean Air Act to Improve Air Quality and Reduce Vehicle Miles Traveled*, 8 DUKE ENVTL. L. & POL'Y F. 181, 196 (1998)). The best way to understand this is to think about two drivers. One driver, Jane, is a plumber, and she drives because her tools are too heavy for her to carry on the subway. Her customers prefer that she come before or after work, so she makes more money going to their homes during rush hour. The more homes she visits during these peak periods, the more money she earns. Not only does Jane have no easy substitute for driving, the delays cost her and her clients. The other driver, Joe, is a Manhattan office worker who lives in the Bronx. In the mornings, he could take the subway to Manhattan from the Bronx, or he can drive to work, which takes longer due to rush hour congestion. He likes driving, however, and has his routine. The congestion certainly is an opportunity cost for Joe since he could be using the extra time on the road to sleep for an extra hour or meet with clients. However, he does not lose any business as a result of being on the road. When Joe chooses to drive during rush hour, he only considers his own costs (in terms of time and gas) in the calculation; he does not take into account that his presence on the road costs Jane and her clients.

¹³⁶ As discussed below, the opportunity for drivers to avoid local gas taxes by purchasing their gas outside a municipality may make such taxes an inefficient means of reducing congestion. I mention it here only to suggest the range of pricing-based solutions to the congestion problem.

¹³⁷ For example, primarily to reduce air pollution, Mexico City restricted access to a central business corridor to cars with certain license plate numbers during peak travel hours each weekday. So, for example, license plate numbers that end in two and five could not enter the corridor on Wednesdays. Policymakers implemented this restriction to reduce the number of cars on the road. However, the plan backfired, as wealthier drivers responded to these regulations by buying additional cars with alternate license plate numbers. See CAMBRIDGE SYSTEMATICS, INC., CONGESTION MITIGATION COMMISSION TECHNICAL ANALYSIS: LICENSE PLATE RATIONING EVALUATION, at ES-2 (2007), <https://www.dot.ny.gov/programs/repository/Tech%20Memo%20on%20License%20Plate%20Rationing.pdf> (“Mexico City became a net importer rather than net exporter of used vehicles from the rest of the country, meaning that residents sought to evade the restrictions by becoming multi-vehicle households (with variably coded license plates) . . .”). Many of these newly purchased cars are older models with significantly worse emissions controls, exacerbating Mexico City’s long-standing air pollution problems. *Id.*

gas taxes and tolls may seem akin to user fees, restrictive definitions of user fees at the state level limit municipal authority in this area.¹³⁸

In addition to their role in combating externalities, taxes can also serve as a policy tool to curb undesirable behaviors that are not solely (or even primarily) externality problems.¹³⁹ Cigarette taxes, for example, have kept tobacco costs high and are thought to have played a role in reducing teen smoking.¹⁴⁰ Soda and other “fat taxes” may play a similar role in combatting the obesity epidemic.¹⁴¹ Berkeley and Chicago both have municipal soda taxes.¹⁴² If these taxes prove successful, other municipalities may seek to adopt similar policies.

While these policies could also be adopted at the state or federal level, there are three reasons to give municipalities the opportunity to act independently of state and federal actors. First, there may be majorities at the municipal level that support policies that may lack statewide support, and such local majorities should be allowed to pursue their policy preferences absent concerns about these preferences imposing external costs on nonresidents. Second, experimenta-

¹³⁸ State law generally requires user fees to be charged for a particular service and also requires the charge to relate to the cost of providing such a service. Pigovian taxes are hard to conceptualize under this framework as the charge does not relate to a service provided by the municipality but rather a cost a certain behavior imposes on the public generally. In Florida, for example, user fees (as distinct from taxes) must be “charged in exchange for a particular governmental service.” *I-4 Commerce Ctr., Phase II, Unit I v. Orange Cty.*, 6 So. 3d 134, 136 (Fla. Dist. Ct. App. 2010). In Michigan, “[f]ees charged by a municipality must be reasonably proportionate to the direct and indirect costs of providing the service for which the fee is charged.” *Kircher v. City of Ypsilanti*, 712 N.W.2d 738, 744 (Mich. Ct. App. 2005). While Michigan courts grant municipalities considerable deference in determining proportionality, *see id.* (describing presumption of reasonableness of fees), congestion pricing fees are not based on the costs of providing a service at all. For a discussion of the judicial confusion surrounding user fees in Washington, *see* Hugh D. Spitzer, *Taxes vs. Fees: A Curious Confusion*, 38 GONZ. L. REV. 335, 343–45 (2003).

¹³⁹ *See* N. Gregory Mankiw, *Raise the Gas Tax*, WALL STREET J. (Oct. 20, 2006, 12:01 AM), <http://www.wsj.com/articles/SB116131055641498552> (arguing for higher gas taxes in part on Pigovian tax grounds, pointing to externalities of road congestion, environmental harm, and national security costs of foreign oil dependence); *cf.* Michael J. Licari & Kenneth J. Meier, *Regulation and Signaling: When a Tax Is Not Just a Tax*, 62 J. POL. 875, 882–83 (2000) (showing that post-tax reduction in cigarette consumption is explained partly by price changes and partly by tax’s role in communicating danger of cigarette use).

¹⁴⁰ Christopher Carpenter & Phillip J. Cook, *Cigarette Taxes and Youth Smoking: New Evidence from National, State, and Local Youth Risk Behavior Surveys*, 27 J. HEALTH ECON. 287, 288 (2008).

¹⁴¹ *See, e.g.*, Kelly D. Brownell et al., *The Public Health and Economic Benefits of Taxing Sugar-Sweetened Beverages*, 361 NEW ENG. J. MED. 1599, 1602–03 (2009); RUDD CTR. FOR FOOD POL’Y AND OBESITY, *SOFT DRINK TAXES: A POLICY BRIEF* (2009), <http://www.yaleruddcenter.org/resources/upload/docs/what/reports/RuddReportSoftDrinkTaxFall2009.pdf> (discussing role of soft drink taxes in promoting healthier eating).

¹⁴² CHL., ILL., MUN. CODE §§ 3-45-040, -060 (2015); Heather Knight, *Why Berkeley Passed a Soda Tax and S.F. Didn’t*, S.F. CHRON. (Nov. 7, 2014), <http://www.sfgate.com/bayarea/article/Why-Berkeley-passed-a-soda-tax-and-S-F-didn-t-5879757.php>.

tion at the local level may encourage (and inform) state and federal reforms. Third, to the extent that the externalities are local, locally imposed Pigovian taxes are the most efficient ways to price the cost and, even for externalities that are not purely local, the magnitude of the externality may differ by city, so that the optimal level of the tax is different in different cities.

III

THE STATE'S ROLE IN MUNICIPAL TAX POLICY

Innovative cities need the authority to act independently of the state. In its most expansive form, greater municipal taxing authority could resemble the state's sovereign taxing authority. Cities would have the power to tax subject only to the limits of federal law. While such a law would be easy to craft, it is not a serious reform option because it does not provide a way for the state to vindicate its myriad of interests in municipal tax policy. This Part considers these state interests: vertical tax competition, horizontal tax competition, ultimate fiscal responsibility, and administrability of local taxation. Of these interests, the state concerns about administrability present the most important limit on expanded municipal taxing authority. The subsequent proposal is informed by the limits suggested by these state interests.

A. *Vertical Tax Competition*

Vertical tax competition is tax competition between two concurrent taxing jurisdictions (e.g., state and local governments) that seek to tax the same, or an overlapping, revenue base.¹⁴³ Vertical tax competition reflects the fact that overlapping tax jurisdictions create externalities. In other words, the tax rate of a locality will affect the revenue that can be collected by the state, and the tax rate of the state will affect the tax revenue that can be collected by the locality. As a result, states have a direct revenue interest in municipal taxing authority to the extent municipal taxes compete with the state base.

A simplified example illustrates the vertical tax competition concern.¹⁴⁴ Assume Illinois wants to levy a five percent tax on retail sales. If Chicago decides to implement an additional local sales tax of three percent, the total tax rate on retail goods becomes eight percent. This

¹⁴³ See Timothy J. Goodspeed, *Tax Competition, Benefit Taxes, and Fiscal Federalism*, 51 NAT'L TAX J. 579, 581 (1998) (discussing difference between vertical and horizontal tax competition).

¹⁴⁴ See also Gillette, *supra* note 23, at 244–45 (discussing vertical tax competition with respect to implementing commuter tax).

increased tax means that for consumers, the cost of the good has gone up. For goods with relatively elastic demand, purchases will decrease, resulting in lower revenue from the tax itself.¹⁴⁵ The higher tax rate may also increase incentives for evasion.¹⁴⁶ Further, if combined state and local retail tax rates in Indiana or Wisconsin are only six percent, consumers are going to shift some of their purchase of retail goods to these other states, thus depriving Illinois (and Chicago) of revenue. If Illinois reduces its tax rate, some of this lost revenue stream may return, but it will not fully offset the revenue it would be able to collect if only a state sales tax was imposed. To the extent that the state wants to make use of a specific tax base, it has an interest in minimizing local government's use of the same base. (The state, of course, also has a corresponding interest in preventing the federal government from using that base.)¹⁴⁷

Much of the work on vertical tax competition has looked at competition in federal systems of government between the central government and subnational governments.¹⁴⁸ More recently, theoretical and empirical economists have begun to think about vertical tax competition between subnational and local governments.¹⁴⁹ As the

¹⁴⁵ Even if some of the demand elasticity causes retailers to lower their prices, this will still result in less revenue collected from the sales tax as the sales tax rate applies to the retail sales price.

¹⁴⁶ Cf. Mark Stehr, *Cigarette Tax Avoidance and Evasion*, 24 J. HEALTH ECON. 277 (2005) (discussing opportunities and incentives for evasion and avoidance of cigarette taxes and measuring cigarette tax avoidance and evasion).

¹⁴⁷ See generally Harley Duncan & Jon Sedon, *Coordinating a Federal VAT with State and Local Sales Taxes*, in THE VAT READER 139 (2011), [http://www.taxanalysts.com/www/freefiles.nsf/Files/VATReader.pdf/\\$file/VATReader.pdf](http://www.taxanalysts.com/www/freefiles.nsf/Files/VATReader.pdf/$file/VATReader.pdf) (discussing challenges of coordinating federal (VAT) and state (sales) consumption taxes); CHARLES E. MCLURE, JR., COORDINATING STATE SALES TAXES WITH A FEDERAL VAT: OPPORTUNITIES, RISKS, AND CHALLENGES (2005), http://www.taxadmin.org/FTA/FS_Symposium/mclure.pdf (discussing opportunities, risks, and challenges for states with federal adoption of value added tax); William R. Brown, *Is There a VAT in Your Future?*, J. ST. TAX'N, Winter 1991, at 1, 4-5 (discussing pros and cons of value added/single-business taxes).

¹⁴⁸ See, e.g., Goodspeed, *supra* note 143, at 582 (referencing research describing government responses to vertical tax competition); Michael Keen, *Vertical Tax Externalities in the Theory of Fiscal Federalism*, 45 IMF STAFF PAPERS 454, 459-60 (1998) (describing data detailing territories in which the central and subnational government have concurrent tax authority); Michael J. Keen & Christos Kotsogiannis, *Tax Competition in Federations and the Welfare Consequences of Decentralization*, 56 J. URB. ECON. 397 (2004) (analyzing impact of vertical tax externalities between state and federal government); John Douglas Wilson & David E. Wildasin, *Capital Tax Competition: Bane or Boon*, 88 J. PUB. ECON. 1065, 1067 (2004) (defining vertical tax competition).

¹⁴⁹ See Rebecca Hendrick et al., *Tax Competition Among Municipal Governments: Exit Versus Voice*, 43 URB. AFF. REV. 221, 222 (2007) (referencing research measuring vertical tax competition between local and state government); Federico Revelli, *Reaction or Interaction? Spatial Process Identification in Multi-Tiered Government Structures*, 53 J. URB. ECON. 29, 30-31 (2003) (describing method for measuring vertical fiscal externalities at local level); Yonghong Wu & Rebecca Hendrick, *Horizontal and Vertical Tax*

example above suggests, vertical tax competition is likely to be a greater problem near state borders, and recent work by economist David Agrawal supports this intuition. Agrawal explores the extent to which a municipality's proximity to a bordering county with a different tax rate accounts for changes in the municipality's own tax rate.¹⁵⁰ Using local sales tax data, Agrawal models the ways municipal and county sales taxes interact. His findings suggest that "[w]hen the neighboring county changes its tax rate, towns bordering it will react to this change and adjust their tax rates accordingly."¹⁵¹ In other words, vertical tax competition limits municipal tax rates.

The economic literature on vertical tax competition has generally explored competition between overlapping jurisdictions imposing taxes on the same base. However, cross-base vertical tax competition may also be a problem.¹⁵² For example, local property tax rates must act as a limit on state income tax revenue. To take a simple example, think about a small retailer who owns her own retail location. In determining the prices she charges customers, she considers all of her costs, including the property tax she pays on the retail location. If her property taxes go up, she will either increase her prices to reflect the increased costs of selling the good or decrease her own profits. If she increases prices, her price increase will have an impact on consumer demand, and, as a result, the state sales tax will collect less revenue. If she simply accepts lower profit margins, perhaps because demand for her products is relatively elastic, she will earn less income and thus state income tax revenue shrinks. The lower price may also reduce state sales tax collection.

Such cross-base tax competition suggests that the state has a direct revenue interest in the taxing decisions of municipalities even when there are not overlapping tax bases at stake. Taken to its extreme, this vertical tax competition story suggests that states have an interest in minimizing local revenue collection.¹⁵³ After all, local

Competition in Florida Local Governments, 27 PUB. FIN. REV. 289, 290 (2009) (discussing recent growth in empirical studies measuring vertical tax competition between state and local government).

¹⁵⁰ David R. Agrawal, *Inter-Federation Competition: Sales Taxation with Multiple Federations*, J. URB. ECON. (forthcoming 2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2212234.

¹⁵¹ *Id.* (manuscript at 13).

¹⁵² To the best of my knowledge, neither the economic nor the legal tax literature has considered this type of tax competition. I will explore this type of competition in further work.

¹⁵³ Recent work by David Gamage suggests that there may also be reasons that taxing authorities should consider using multiple tax bases. Gamage suggests that the use of multiple bases can eliminate some tax gaming because many tax gaming efforts can only reduce tax liability along one base. See David Gamage, *The Case for Taxing (All of) Labor*

governments would have no effect on state revenue collection if local governments imposed no taxes. States could reduce vertical tax competition by increasing intergovernmental grants or directly funding services currently administered by local governments. However, in the current fiscal climate, states have moved in the opposite direction, decreasing grants.¹⁵⁴ These state policies have increased the need for more local revenue options.

But it's not just shrinking state support that justifies local revenue autonomy. Providing municipal governments with their own revenue authority ensures that some level of government can honor local spending and taxation preferences. As discussed in Part II, expanded local revenue authority allows local governments to better reflect local demand for services and may also encourage more efficient government administration.

While vertical tax competition does suggest a legitimate state interest in local tax policy, this concern should be balanced with the recognition that there are competing values, especially local autonomy, that justify limits on the state's power to fully vindicate this interest.

B. *Horizontal Tax Competition*

States may also have an interest in minimizing tax competition between local governments. Such competition is known as horizontal tax competition.¹⁵⁵ Much of the concern about local government tax incentives focuses on economic development tax incentive packages offered to businesses. Such packages can include reductions in property taxes and sales tax rates as well as other subsidies designed to encourage business generally or specific businesses to relocate. To the extent these tax incentives encourage out-of-state businesses to relocate in-state, such programs may be good for the state.

Income, Consumption, Capital Income, and Wealth, 68 TAX L. REV. 355, 357–58 (2015). His argument does not directly address concerns about the cross-base vertical tax competition because he argues that even a single government could benefit from levying from multiple bases. *See id.*

¹⁵⁴ I am generally critical of this trend of balancing state finances on the backs of local government, but as a practical matter, I think we will see states continue to cut local government aid. On the trend of reducing state aid, see generally, PEW CHARITABLE TRS., THE LOCAL SQUEEZE: FALLING REVENUES AND GROWING DEMAND FOR SERVICES CHALLENGE CITIES, COUNTIES, AND SCHOOL DISTRICTS (2012), http://www.pewtrusts.org/~media/assets/2012/06/pew_cities_local-squeeze_report.pdf.

¹⁵⁵ *See* John Douglas Wilson, *Theories of Tax Competition*, 52 NAT'L TAX J. 269, 289 (1999) (arguing that horizontal tax competition occurs when "governments doing the competing are all at the same level").

However, a number of scholars and policymakers have concluded that these programs often only encourage intrastate business relocation, which does not benefit the state as a whole.¹⁵⁶ Further, some studies suggest that many businesses would make the same location decisions even absent local tax incentives, turning these programs into windfalls for these businesses to the detriment of local revenue and other taxpayers.¹⁵⁷

For these reasons, scholars have criticized local tax incentives as inefficient.¹⁵⁸ Because such tax incentive programs create competition for local development, it becomes hard for local governments to resist offering tax incentives on their own, as there is political pressure for politicians to encourage economic development and attract new businesses and jobs to the locality. As a result, calls for state-level restrictions on local government authority to offer such programs are common.¹⁵⁹ In effect, these proposals argue that it is local control over the property tax base that fuels this inefficient competition. (Of course, this is local control authorized by state statute. In almost every state the incentive packages offered by localities are authorized under state law.) Few states have adopted such restrictions,¹⁶⁰ in part because tax incentives are still incredibly popular among the business community and elected officials at both the state and local level.¹⁶¹

In the absence of state reform, some policymakers have argued that regional cooperation is the best way to curb the excesses of such horizontal tax competition. Local governments in the Denver-metropolitan area, for example, have reached an agreement between themselves to limit competition.¹⁶² The seventy cities, counties, and economic development organizations that are members of the Metro Denver Economic Development Corporation adopted a shared “Code of Ethics” in the mid-1980s.¹⁶³ Among other promises, the members

¹⁵⁶ See DAPHNE A. KENYON ET AL., *RETHINKING PROPERTY TAX INCENTIVES FOR BUSINESS* 29 (2012), https://www.lincolinst.edu/pubs/dl/2024_1423_Rethinking%20Property%20Tax%20Incentives%20for%20Business.pdf (noting evidence that such incentives encourage businesses to move around within state but do not significantly increase new development within state).

¹⁵⁷ *Id.* at 4–5.

¹⁵⁸ See, e.g., *id.*, at 29, 52; BRUNORI, *supra* note 25, at 28–37 (explaining inefficiency of targeted tax incentives); Peter D. Enrich, *Constraining State Business Tax Incentives: The Commerce Clause’s Role*, 46 *STATE TAX NOTES* 157, 157 (2007) (identifying dangers of “parochial” tax incentives for national economy).

¹⁵⁹ See generally Enrich, *supra* note 158 (arguing that Dormant Commerce Clause should restrict such developments).

¹⁶⁰ See KENYON ET AL., *supra* note 156, at 59 (finding property tax incentives are “widespread”).

¹⁶¹ *Id.* at 5–6.

¹⁶² *Id.* at 54.

¹⁶³ *Id.*

of the corporation pledged to notify a local community if a business is considering relocating within the metropolitan area and to prevent solicitation of other localities' business prospects.¹⁶⁴ Programs like the one implemented in the Denver-metropolitan area minimize the harms of horizontal tax competition.

Of course, local governments can also engage in other forms of horizontal tax competition, for example, by offering lower sales tax rates. To the extent such tax cuts produce a race to the bottom, with local governments setting taxes below their residents' preferences for taxes and spending programs, this competition is not good either.¹⁶⁵ On the other hand, this type of tax competition may limit local officials' ability to increase tax rates to fuel unwanted government spending.

While state action could significantly reduce horizontal tax competition, so far it has failed to significantly address these issues. Some states have tried to discourage local tax incentives by penalizing localities which offer such programs. Arizona, for example, reduces its intergovernment aid to local government in proportion to tax revenue they lose due to the grant of tax incentives.¹⁶⁶ Many states, however, actively facilitate such programs, often by increasing intergovernment aid to replace lost tax revenue.¹⁶⁷

Granting greater municipal taxing authority poses the risk of exacerbating existing problems in local economic development. On the other hand, the existing distribution of taxing authority has not curbed tax incentive programs, and in many cases state policy actively facilitates this negative competition. States should retain the legislative power to curb horizontal tax competition and should exercise that power more frequently than they do now. States considering granting municipalities greater taxing authority should consider simultaneously restricting the ability of localities to offer tax incentives for business relocation.

C. *The State's Fiscal Role in Municipal Affairs*

In addition to its direct interest in minimizing vertical tax competition and its more indirect interest in limiting horizontal tax competition, the state also has a broader interest in municipal finance decisions. State stewardship over municipal financial conditions has

¹⁶⁴ *Id.*

¹⁶⁵ See Wilson, *supra* note 155, at 288–89 (discussing modeling assumptions for such races to the bottom to occur).

¹⁶⁶ See KENYON ET AL., *supra* note 156, at 59–60 (describing policy toward local governments in Phoenix area).

¹⁶⁷ *Id.* at 59.

long been a key justification for limiting local taxing authority. Some of this concern has been fueled by distrust of the “urban populace” that reflects the nativism and racism of the turn-of-the-century Progressive Movement.¹⁶⁸ But part of this concern reflects the real state interests implicated in local financial affairs.

State officials legitimately worry about “contagion.” Clayton Gillette describes the threat of contagion as “the possibility that local distress is indicative of more general fiscal difficulties or that unresolved local distress will cause disruption in other markets, because the risks of one are interconnected with risks elsewhere.”¹⁶⁹ Concerns about contagion have led state lawmakers to ensure that the states’ powers over municipal fiscal affairs often expand in times of fiscal crisis.

Nineteen states have laws allowing states to intervene in municipal governance in times of fiscal crisis, and other states have intervened in a more ad hoc fashion.¹⁷⁰ For example, Pennsylvania’s Act 47 allows the State’s Department of Community and Economic Development to appoint a private-firm recovery coordinator if a local government becomes “fiscally distressed” according to any of eleven statutorily defined categories.¹⁷¹ The coordinator then works with local officials to improve financial governance, and the law provides additional authority to cities (including additional taxing authority) to help manage the distress.¹⁷²

State interventions can also include direct financial aid to local governments, either by issuing state-backed bonds for the benefit of

¹⁶⁸ As David Barron has discussed, home rule was crafted to “restore the idealized small-scale, low-tax, low-debt, highly privatized (and thus incorruptibly public) ideal of local government” Barron, *supra* note 34, at 2294; see also Richard Briffault, *Local Government and the New York State Constitution*, 1 HOFSTRA L. & POL’Y SYMP. 79, 90–96 (1996) (discussing role of city fiscal mismanagement in the Tweed era on city fiscal limitations); Lewis A. Grossman, *James Coolidge Carter and Mugwump Jurisprudence*, 20 L. & HIST. REV. 577, 595–601 (2002) (discussing concerns about political corruption in New York City).

¹⁶⁹ Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 281, 302 (2012).

¹⁷⁰ PEW CHARITABLE TRS., THE STATE ROLE IN LOCAL GOVERNMENT FINANCIAL DISTRESS 4, 7 (2013), http://www.pewtrusts.org/~media/Assets/2013/07/23/Pew_State_Role_in_Local_Government_Financial_Distress.pdf. For a discussion of these laws from the perspective of democratic accountability, see generally Clayton P. Gillette, *Dictatorships for Democracy: Takeovers of Financially Failed Cities*, 114 COLUM. L. REV. 1373 (2014).

¹⁷¹ STEPHEN D. EIDE, DEFEATING FISCAL DISTRESS: A STATE RESPONSIBILITY 7 (2013), http://www.manhattan-institute.org/pdf/cr_78.pdf.

¹⁷² *Id.*

the local government,¹⁷³ providing loans directly, or accelerating or providing additional intergovernment transfers.¹⁷⁴ One state, North Carolina, takes an even more hands-on approach to local financing even prior to distress. Its localities must seek approval from the State's Local Government Commission before any general obligation debt is issued.¹⁷⁵

Other states are decidedly more hands-off. California, for example, provided very little in the way of oversight or aid to any of the three California local governments (Stockton, San Bernardino, and Orange County) that filed for Chapter 9 bankruptcy in the 1990s.¹⁷⁶ States worry that intervention may encourage fiscal mismanagement, as local decision makers (and possibly the bond markets) may rely on potential state bailouts. Studies suggest, however, that well-designed state intervention can improve the fiscal health of a state's local governments, and North Carolina's hands-on approach has led to some of the lowest state and municipal bond rates in the country.¹⁷⁷

States have justified limiting municipal taxation and borrowing authority as an additional check on local finances. Recent scholarship, however, has persuasively argued that the state may not reliably serve this accountability function. For example, Clayton Gillette argues that market mechanisms better serve to check the potential excesses of local officials. State lawmakers may not have the interest or ability to

¹⁷³ For example, in response to New York City's near bankruptcy in the 1970s, New York State created the Municipal Assistance Corporation for the City of New York (MAC), which was authorized to issue state-backed bonds as a form of bridge financing for the City. See Donna E. Shalala & Carol Bellamy, *A State Saves a City: The New York Case*, 1976 DUKE L.J. 1119, 1127-28 (1976).

¹⁷⁴ Pennsylvania contributed \$3.6 million to Harrisburg's budget ahead of schedule when it came close to defaulting in September 2010. Michelle Kaske, *Pennsylvania Gov. Steps into Harrisburg Political Standoff to Prevent Default*, BOND BUYER (Sept. 12, 2010), <http://www.bondbuyer.com/news/-1017177-1.html>; see also PEW CHARITABLE TRS., *supra* note 170, at 19 (noting that emergency financing measures includes both loans and grants).

¹⁷⁵ Stephen C. Fehr, *North Carolina Agency Is Local Government Lifeline*, PEW CHARITABLE TRS.: STATELINE (June 6, 2012), <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2012/06/06/north-carolina-agency-is-local-government-lifeline>; *Local Government Commission*, N.C. DEPT' OF STATE TREASURER, <https://www.nctreasurer.com/slg/Pages/Local-Government-Commission.aspx> (last visited Mar. 12, 2016).

¹⁷⁶ See EIDE, *supra* note 171, at 6 (attributing bankruptcies to states' "traditional disinclination to call for or pursue intervention" in local finances); MOODY'S INVESTOR SERVICE, *WHY SOME CALIFORNIA CITIES ARE CHOOSING BANKRUPTCY 1* (2012), <http://www.cacities.org/Resources-Documents/News/News/2012/August/Moody-s-Report-Why-Some-California-Cities-Are-Choo.aspx> (discussing reasons for California bankruptcies, including "the state's hands off 'home rule' policy").

¹⁷⁷ See Fehr, *supra* note 175 (describing effects of North Carolina's interventions on the state's bonds).

appropriately judge the risk factors of municipal fiscal distress.¹⁷⁸ And reforms to the municipal bond market could improve the market's ability to regulate by increasing transparency in municipal finance.¹⁷⁹

State limits on municipal fiscal authority have also been justified by concerns about the potential for special interests to capture local officials. Off-cycle municipal government elections have lower turnout than state elections, suggesting that state officials may be accountable to a broader portion of the electorate,¹⁸⁰ and in some (especially rural) areas, there may be less media coverage of local government decisions. On the other hand, local residents may find changes to local public service quality more salient than changes to spending programs at other levels of government. Further, local residents have repeatedly demonstrated that they are aware of their property tax burdens and willing to take political action should that burden become too great.¹⁸¹ Indeed, in some respect it is the high salience of local government revenue that has created many of the limits imposed by state law on property taxation. And state lawmakers have not shown themselves to be free of either capture or corruption.¹⁸²

Further, giving municipalities greater control over city revenues could improve municipal fiscal health. Studies suggest that municipalities have become more reliant on bonds as their ability to control tax revenue has decreased,¹⁸³ and this increased interest in borrowing has encouraged municipalities to issue more complex debt instruments.¹⁸⁴ These complex debt instruments, which have interest rates tied to a variety of market mechanisms and ballooning interest payments, have

¹⁷⁸ See Gillette, *supra* note 22, at 1255, 1260–61 (arguing that market mechanisms are true checks on levels of municipal debt).

¹⁷⁹ See ANG & GREEN, *supra* note 126, at 2, 5 (proposing that a not-for-profit advisory firm increase transparency and information flow in municipal bond market).

¹⁸⁰ See Zoltan L. Hajnal & Paul G. Lewis, *Municipal Institutions and Voter Turnout in Local Elections*, 38 URB. AFF. REV. 645, 646 (2003) (discussing problems with low voter turnout in local elections).

¹⁸¹ The political salience of property taxes and the resulting “taxpayer revolt” in the 1970s is the subject of an extensive literature. For a critical assessment of the lessons learned from this revolt, see generally ISAAC WILLIAM MARTIN, *THE PERMANENT TAX REVOLT: HOW THE PROPERTY TAX TRANSFORMED AMERICAN POLITICS* 75–79, 98–100 (2008). Specifically, Martin suggests that accidents of timing led in part to the success of the conservative property tax reform movement and the existence of the parallel progressive property tax movement. *Id.*

¹⁸² See, e.g., Edward L. Glaeser & Raven E. Saks, *Corruption in America*, 90 J. PUB. ECON. 1053, 1054–55 (2006) (discussing reasons for state-level corruption).

¹⁸³ See Clingmayer & Wood, *supra* note 127, at 116 (“Tax and expenditure limitations may actually increase growth in state debt, as self-interested politicians evade formal constraints through alternative means of financing.”); see also Poterba & Rueben, *supra* note 127, at 204 (finding that tax limits also increase borrowing costs).

¹⁸⁴ See ANG & GREEN, *supra* note 126, at 10 (highlighting downsides of complex municipal debt instruments).

proven unsound for many municipal debtors.¹⁸⁵ Innovation on the revenue rather than the borrowing side of municipal finance could improve municipal fiscal health.¹⁸⁶

States have a legitimate interest in reducing municipal fiscal distress. However, restricting local revenue authority is not necessary to vindicating this interest. As the preceding discussion suggests, expanded revenue authority may, in fact, reduce municipal fiscal distress. (Of course, for cities already in the throes of fiscal problems, additional revenue authority may come too late.)¹⁸⁷

D. *Administrability of Local Tax Bases*

In tax policy discussions, administrative concerns can sometimes get pushed aside as second-order concerns.¹⁸⁸ In the context of federal tax policy debates, this decision may be reasonable. Even an underfunded IRS¹⁸⁹ has the budget for staff economists, technical advisors, lawyers, and auditors, and the administrative costs of enforcing the federal tax code are spread out among all U.S. taxpayers. Further, the United States imposes relatively high income tax rates as compared to state and local governments. As a result,

¹⁸⁵ See *id.* at 10, 16 (noting common practice of including derivatives in municipal bond transactions can flout accounting rules to appear cheaper today but require higher interest payments in future).

¹⁸⁶ See *supra* Section II.C.

¹⁸⁷ Detroit's problem, for instance, is not that taxes are too low. In fact, because of declining property tax collection and declining property values, tax rates were high relative to neighboring jurisdictions. See Gary Sands & Mark Skidmore, *Making Ends Meet: Options for Property Tax Reform in Detroit*, 36 J. URB. AFF. 682, 697 (2013) (analyzing challenges of property taxation in Detroit). Fewer and fewer residents, however, found the services provided by the city justified the tax rates imposed, increasing out-migration, and creating a spiral that meant additional taxation would not solve Detroit's problems. See *Living in Detroit: Surprisingly Expensive*, ECONOMIST (Feb. 4, 2015, 2:45 PM), <http://www.economist.com/blogs/democracyinamerica/2015/02/living-detroit> (exploring costs and challenges of living in Detroit). A study by the Brookings Institution was similarly critical of a Pennsylvania program for fiscally distressed cities because it gave additional revenue authority only during periods of fiscal distress, making it difficult to encourage cities to leave the program as they would forgo this extra source of revenue. METRO. POLICY PROGRAM, BROOKINGS INST., COMMITTING TO PROSPERITY: MOVING FORWARD ON THE AGENDA TO RENEW PENNSYLVANIA 29–30 (2007), <http://www.brookings.edu/~media/research/files/reports/2007/3/pennsylvania-metro/committingtoprosperity.pdf>.

¹⁸⁸ See Michael A. Livingston, *Radical Scholars, Conservative Field: Putting "Critical Tax Scholarship" in Perspective*, 76 N.C. L. REV. 1791, 1796 (1998) ("A fourth area, simplicity, is perpetually on the back burner.").

¹⁸⁹ The problems of funding at the IRS have received widespread media attention. *E.g.*, Michelle Singletary, *Don't Expect Help from the Underfunded IRS*, WASH. POST (Jan. 16, 2015), http://www.washingtonpost.com/business/2015/01/15/79d9ec8e-9d03-11e4-bcfb-059ec7a93ddc_story.html.

enforcement costs are not that high, especially as a percentage of revenue collected.¹⁹⁰

Even at the state level, governments often lack the resources necessary to support compliance with, and enforce, complex tax laws.¹⁹¹ This is why many states choose to piggyback on the federal income tax system.¹⁹²

At the local level, these concerns are magnified; administrative concerns are of primary importance in evaluating local tax systems. Local government tax rates are low as compared to the federal and state rates, meaning that administrative costs will always represent a greater portion of revenue collected. As a result, local governments may lack the resources to provide guidance to assist taxpayers in compliance with complex tax laws, let alone the funding necessary to detect noncompliance and take enforcement action.

Further, as the Supreme Court has noted repeatedly in its Dormant Commerce Clause jurisprudence,¹⁹³ the sheer number of local jurisdictions in the United States means that local taxation has significant compliance costs. The more the tax laws of these jurisdictions differ from each other, the more costly it is for multijurisdictional taxpayers to comply.

As a result, the conventional wisdom is that both state and local governments should attempt to minimize tax base differences. For example, Daniel Shaviro has suggested that state control over the tax rate structure should be sufficient to ensure policy autonomy and has therefore advocated greater conformity of tax bases.¹⁹⁴

Because it is administrative costs, and not just pure efficiency concerns, that are animating this conventional wisdom, scholars have been much less concerned about differential rates between jurisdictions with similar tax bases.¹⁹⁵ Rate differentials also increase compli-

¹⁹⁰ Erin Adele Scharff, *Laboratories of Bureaucracy: Administrative Cooperation Between State and Federal Tax Authorities*, 68 TAX L. REV. 699, 708 (2015).

¹⁹¹ See *id.* (noting studies of compliance for states is between three and eight times greater than for federal government).

¹⁹² See *id.* at 703–04 (explaining piggybacking); see also *id.* at 708 (discussing advantage of piggybacking).

¹⁹³ See, e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 n.6 (1992) (“Thus, absent the *Bellas Hess* rule . . . a corporation whose telephone sales force made three calls into the State . . . would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation’s 6,000-plus taxing jurisdictions.” (citation omitted)).

¹⁹⁴ See Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 979 (1992) (“A more ambitious set of proposals—plainly desirable under the analysis in this article, but politically less likely—would involve prescribing the content of entire tax bases. States that levy income taxes could be required to use the federal income tax base, possibly with . . . specified allowable variations.”).

¹⁹⁵ See *id.* at 967–99 (arguing for smoothing of tax bases between jurisdictions).

ance costs for taxpayers, as they encourage tax planning to take advantage of lower rates. Further, these rate differentials (like economic development incentives) also encourage inefficient horizontal tax competition.¹⁹⁶ However, it is much easier for taxpayers to keep track of rate differentials on a common base than to keep track of multiple bases.

This is true as long as the bases are fairly broad, a policy most scholars would favor even absent administrative concerns.¹⁹⁷ If jurisdictions adopt similar tax laws but rely on multiple, narrow bases subject to separate tax bases, the easy distinction between rate and base complexity may prove harder to maintain. For example, if a state's municipalities imposed different tax rates on different types of business activity (construction, auto sales, general retail sales, printing, etc.), the opportunities for tax planning, record keeping, and compliance costs for businesses engaged in multiple business lines across multiple jurisdictions, and enforcement costs within each jurisdiction, all rise.

Arizona, for example, has long allowed its municipalities significant autonomy in designing their local consumption tax bases. Arizona is one of a handful of states that imposes a consumption tax that applies to more than simply retail sales transactions. At the state level, Arizona's Transaction Privileges Tax¹⁹⁸ reaches not only retail sales but also restaurant and bar sales, hotel stays, and advertising, among other activities.¹⁹⁹

Arizona law allows local governments to impose their own, separate transaction privilege taxes.²⁰⁰ State law allows local governments to impose transaction privilege taxes on the activities the state taxes as well as a state-created menu of additional activities.²⁰¹ Further, state

¹⁹⁶ See *supra* Section III.B.

¹⁹⁷ See, e.g., JOHN F. DUE & JOHN L. MIKESSELL, SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION 15–16 (2d ed. 1994) (suggesting broad base for consumption taxes like retail sales taxes); SLEMROD & BAKIJA, *supra* note 66, at 216–18 (discussing support for broad base in income tax context).

¹⁹⁸ Arizona's Transaction Privilege Tax, unlike most state retail sales taxes, does not impose on the consumer the legal obligation to pay. For the most part, this is a legal distinction without import. The main difference is that because Arizona's tax is on the business and not the consumer, sales to the federal government are still taxable. See DUE & MIKESSELL, *supra* note 197, at 29 (surveying state sales taxes).

¹⁹⁹ *Transaction Privilege Tax (TPT)/Licensing (Commonly Referred to as a Sales, Resale, Wholesale, Vendor or Tax License)*, STATE OF ARIZ. DEP'T OF REVENUE, <http://www.azdor.gov/Business/TransactionPrivilegeTax.aspx> (last visited Mar. 12, 2016).

²⁰⁰ See MODEL CITY TAX CODE App. III (ARIZ. DEP'T OF REVENUE 2015), http://modelcitytaxcode.az.gov/models/Appendix_III.htm (explaining transaction privilege tax options available to municipalities).

²⁰¹ See *id.* § 400(a)–(b) (ARIZ. DEP'T OF REVENUE 2015), http://modelcitytaxcode.az.gov/Index/Article_IV.htm (laying out provisions of code for Arizona municipalities).

law allows Arizona municipalities to deviate from state base definitions as long as those deviations are part of an approved menu of variations.²⁰²

Businesses operating in the state have long complained that this patchwork system creates needless administrative complexity.²⁰³ In addition to requiring businesses to understand differences between localities' tax bases, Arizona also allowed localities to separately administer their own transaction privileges tax (TPT).²⁰⁴ The largest municipalities took advantage of this flexibility, and businesses thus had to file separate TPT returns for sixteen different sales taxes (one for the state of Arizona and the municipalities which relied on state enforcement and fifteen separate municipal tax forms).²⁰⁵

As a result of recent reforms, the State will soon begin to administer all local consumption taxes.²⁰⁶ This change was part of an effort to simplify transaction privilege tax compliance and bring Arizona in compliance with the Streamlined Sales and Use Tax Agreement (SSUTA). The SSUTA is a voluntary effort to provide more uniformity between state sales tax bases and thus hopefully convince Congress to allow states to require out-of-state retailers to collect sales and use taxes on goods purchased by state residents.²⁰⁷ The proposed Marketplace Fairness Act, which would increase state authority to tax internet and catalog sales, would provide this increased

²⁰² See *id.* (noting that taxes imposed under local options are in addition to other state levies, while those that vary in base are noted in model code).

²⁰³ See Ariz. Gov. Exec. Order 2012-01 (May 11, 2012), <http://azmemory.azlibrary.gov/cdm/ref/collection/execorders/id/714> (creating task force to simplify transaction privilege tax regime); Glenn Hamer, *It's Complicated*, ARIZ. CHAMBER OF COMMERCE & INDUSTRY (Dec. 7, 2012), <http://www.azchamber.com/news-and-resources/bottom-line/2012/12-07-2012.html> (noting business community complaints concerning complexity).

²⁰⁴ See *Arizona - Significant Transaction Privilege Tax Changes Enacted*, PRICEWATERHOUSECOOPERS 1 (June 27, 2013), http://www.pwc.com/en_US/us/state-local-tax/newsletters/mysto/assets/pwc-arizona-significant-transaction-privilege-tax-changes-enacted.pdf (explaining that prior to amendment certain cities collected their own transaction privilege taxes).

²⁰⁵ See *TPT Non-Program Cities*, STATE OF ARIZ. DEP'T OF REVENUE, <http://www.azdor.gov/Business/TransactionPrivilegeTax/NonProgramCities.aspx> (last visited Mar. 12, 2016) (listing "Non-Program Cities" that administered their own transaction privilege taxes).

²⁰⁶ The state takeover of local TPT administration has been more complicated than anticipated. As of now, it has been delayed two years. See *TPT Simplification*, STATE OF ARIZ. DEP'T OF REVENUE, <http://www.azdor.gov/TPTSimplification.aspx> (last visited Mar. 12, 2016) (informing taxpayers that Non-Program Cities will continue to administer their own taxes for calendar year 2016).

²⁰⁷ See John A. Swain & Walter Hellerstein, *The Political Economy of the Streamlined Sales and Use Tax Agreement*, 58 NAT'L TAX J. 605, 609-11 (2005) (providing background on SSUTA); see also Brian Galle, *Designing Interstate Institutions: The Example of the Streamlined Sales and Use Tax Agreement ("SSUTA")*, 40 U.C. DAVIS L. REV. 1381, 1400-11 (2007) (discussing challenges of implementing SSUTA).

authority only to those states which had adopted the SSUTA or similar reforms.²⁰⁸ Arizona's simplified administration moves it one step closer to SSUTA compliance. While Arizona cities have attempted to jealously guard their (now more limited) authority over the TPT base, this increased authority comes at the cost of significant administrative costs for businesses operating within the state and the inability of the state to benefit from the SSUTA.

As the example of Arizona suggests, any proposal that grants local government greater taxing authority must be sensitive to the competing demands on the state to create more uniform tax law in order to improve the administration of state taxes. Given this important interest, states should maintain a role in defining the limits of municipal revenue options. As will be discussed in the next section, cities can gain more autonomy while allowing the state to retain some role in regulating municipal fiscal affairs.

IV

PRESUMPTIVE MUNICIPAL TAXING AUTHORITY

A. *The Proposal*

One option for reform is what this Article terms "presumptive taxing authority." Presumptive taxing authority would allow cities to enact tax ordinances without prior state permission as long as the ordinances did not conflict with state law. Thus, if state law expressly prohibited municipalities from imposing an income tax, a municipal ordinance authorizing a local income tax would not be enforceable. But if state law were silent as to municipal income taxation, such an ordinance would be a valid exercise of the municipality's home rule authority.

Such a grant of taxing authority would expand municipal taxing authority in almost every state.²⁰⁹ For example, as discussed above, Washington State's constitution grants local government the authority to "make and enforce within its limits all such local police, sanitary and other regulations as are not in conflict with general laws"²¹⁰ but does not provide similar protection for municipal taxing authority.²¹¹

By granting only presumptive taxing authority, such a reform acknowledges the state's clear interests in municipal tax policy. State lawmakers can still override local taxing authority to vindicate these

²⁰⁸ Marketplace Fairness Act, S. 698, 114th Cong. § 2 (2015).

²⁰⁹ Ohio is virtually the only state that truly treats taxation as a home rule power. See *supra* Section I.C.3.

²¹⁰ WASH. CONST. art. XI, § 11.

²¹¹ *Id.* § 12.

interests. Even under a presumptive taxation system, if the state legislature thought that a city tax ordinance was encroaching on a state tax base, it could pass legislation restricting the city's use of that base. Or, if the state wanted to harmonize the sales tax base across jurisdictions to minimize horizontal tax competition or to reduce tax compliance costs, it could require cities to comply with the state sales tax base, as is true currently.

Presumptive municipal taxation would effectively change the default rule with regard to municipal taxing authority. This reform shifts the onus onto the state to act to block municipal tax ordinances. Because it is always harder to pass legislation than it is to block it, municipalities should find that the shift in the default rule expands their municipal taxing power.

Under the current distribution of power, cities may have trouble marshaling the political support to get needed legislative approval through the state legislature. In some states, the city's interests are not directly represented in state houses because state legislative districts cross municipal boundaries,²¹² resulting in fewer lawmakers who represent only constituents in a single municipality. And even when district lines do not cross municipal boundaries, state representatives will often represent only a portion of the city, rather than a city at large. Thus, the policy views of the municipal electorate as a whole are unlikely to be directly represented by any member of the state legislature.

Further compounding the problems of effective municipal representation in the state capital is the disproportionate influence of rural interests. As a result of having more unified voting patterns than their colleagues from urban and suburban areas and greater seniority, studies suggest that lawmakers from rural areas are more likely to be legislatively successful than their urban counterparts.²¹³ Big city delegations seem to be especially ineffective at marshaling their size to further legislative success.²¹⁴ The mayor of New York City, Bill de Blasio, campaigned on a program to pay for preschool education

²¹² While forty-two states require state legislative districts to follow political boundaries, in fourteen of those states, the relevant political boundary is the county line, not the municipal boundary. Jason Levitt, *Where the Lines Are Drawn - State Legislative Districts*, ALL ABOUT REDISTRICTING, <http://redistricting.lls.edu/where-tablestate.php> (last visited Mar. 12, 2016).

²¹³ See Alan Greenblatt, *Rural Areas Lose People but Not Power*, GOVERNING (Apr. 2014), <http://www.governing.com/topics/politics/gov-rural-areas-lose-people-not-power.html> (explaining phenomenon).

²¹⁴ See Gerald Gamm & Thad Kousser, *No Strength in Numbers: The Failure of Big-City Bills in American State Legislatures, 1880-2000*, 107 AM. POL. SCI. REV. 663, 663-64 (2013) (exploring why big cities have had disproportionately low legislative clout).

expansion by raising income taxes on the city's wealthiest residents, but his tax program was a nonstarter in Albany, whose approval the city would need to enact the mayor's proposal.²¹⁵ As a result of these political forces, it may be difficult for cities to get such legislative authorization.

Presumptive taxing authority would flip this political economy. To restrict municipal taxing ordinances, a majority of the legislature would have to decide that a potentially local issue was worth the expense of legislative capital *and* reach agreement on the scope of such a restriction. Thus, the vetogates that right now could block municipal requests for expanding taxing authority would instead block efforts to reduce municipal authority. Weak representation of municipal interests in state legislative bodies matters less if, by default, municipalities have the power to decide for themselves whether to exercise taxing authority.

In addition to providing municipalities with better revenue options, presumptive taxation may also improve state lawmaking in this area. If presumptive taxation gives local officials more taxing authority than state lawmakers find desirable, the reform gives them an incentive to explicitly weigh the tradeoffs of state preemption and expanding municipal taxing authority. The current scheme of state-municipal power discourages meaningful debate about municipal authority precisely because the legislature does not have to act to prevent municipal taxation.

Of course, by flipping the presumption and requiring the state to act to block municipal taxation, the reform also makes it more difficult for state lawmakers to block local tax reform successfully. Legislation blocking municipal taxing authority will be subject to the same vetogates that currently face legislative efforts to expand municipal taxing authority. Further, by allowing cities to be first movers with regard to revenue policy, presumptive taxing authority may make it more difficult to reach a statewide agreement about municipal tax reform. The difficulties encountered by Ohio and Arizona lawmakers

²¹⁵ John Cassidy, *Bill de Blasio's Pre-K Plan Is No Gimmick*, NEW YORKER (Aug. 22, 2015), <http://www.newyorker.com/news/john-cassidy/bill-de-blasios-pre-k-plan-is-no-gimmick> (describing plan); Jeanne Sahadi, *De Blasio's Plan to Tax the Rich*, CNNMONEY (Jan. 8, 2014, 12:04 PM), <http://money.cnn.com/2014/01/08/pf/taxes/new-york-tax-de-blasio/> (describing Albany's veto power over tax). De Blasio eventually moved forward on his early education proposal without the tax increase, securing additional state education financing instead. See HALLEY POTTER, LESSONS FROM NEW YORK CITY'S UNIVERSAL PRE-K EXPANSION: HOW A FOCUS ON DIVERSITY COULD MAKE IT EVEN BETTER 7 (2015), http://www.tcf.org/assets/downloads/TCF_LessonsFromNYCUniversalPreK.pdf (sketching out Governor Cuomo's opposition to raising taxes and eventual budget compromise).

as they have sought to reform their respective municipal income and municipal sales tax regimes suggest that city policies can be serious obstacles to reform.²¹⁶

Presumptive taxing authority would allow cities to impose taxes on bases untapped by the state without waiting for state legislative approval. As a result, presumptive taxing authority would expand municipal revenue options, allowing cities to explore new revenue sources and create more effective tax policy. For example, the reform would make it easier for cities to experiment with soda and other “fat taxes.” The reforms would also make municipal Pigovian taxation more likely. Such reforms would allow cities to explore more fundamental tax changes, like including services in their consumption tax base. These possibilities are discussed in more detail below.

Presumptive taxation would make it easier for municipal governments to impose taxes on soda and other “fats.” New York City’s now-failed soda ban came in the wake of the state’s refusal to consider a soda tax that might have been better targeted.²¹⁷ There is some evidence to suggest that such fat taxes might improve health outcomes,²¹⁸ and more municipal experimentation with such taxes could provide valuable information about their effectiveness (or lack thereof).²¹⁹

In many states, however, such a tax could not be imposed at the municipal level without state legislation. Connecticut law, for example, does not provide the authority for municipal experimentation in this area.²²⁰ Of course even under presumptive taxation, the state would retain the right to ban local fat taxes or include the tax in

²¹⁶ See *supra* Section I.C.3 (discussing Ohio’s municipal income tax); Section III.D (discussing Arizona’s municipal Transaction Privileges Tax).

²¹⁷ See Michael M. Grynbaum, *Court of Appeals, Ruling 4-2, Ends City’s Fight to Limit Size of Sugary Drinks*, N.Y. TIMES, June 27, 2014, at A24 (describing court ruling against ban); Alice Park, *The New York City Soda Ban, and a Brief History of Bloomberg’s Nudges*, TIME (May 31, 2012), <http://healthland.time.com/2012/05/31/bloombergs-soda-ban-and-other-sweeping-health-measures-in-new-york-city/> (describing New York City’s actions on ban following State’s refusal to act).

²¹⁸ See, e.g., Kelly D. Brownell & Thomas R. Frieden, *Ounces of Prevention—The Public Policy Case for Taxes on Sugared Beverages*, 360 NEW ENG. J. MED. 1805, 1806 (2009) (summarizing research suggesting that tax on sugared beverages would improve health outcomes).

²¹⁹ See Lisa M. Powell et al., *Associations Between State-Level Soda Taxes and Adolescent Body Mass Index*, 45 J. ADOLESCENT HEALTH S57, S57 (2009) (suggesting that current soda tax levels are not changing adolescent consumption of soda or health outcomes but that significantly higher taxes might).

²²⁰ See Rachel Chinapen, *New Haven’s Mayor Toni Harp Touts Tax on Soda*, NEW HAVEN REG. (Feb. 8, 2014, 9:48 AM), <http://www.nhregister.com/general-news/20140208/new-havens-mayor-toni-harp-touts-tax-on-soda>; J.R. Reed & Hannah Schwarz, *Harp Proposes CT Soda Tax*, YALE DAILY NEWS (Feb. 13, 2014), <http://yaledailynews.com/blog/2014/02/13/harp-proposes-ct-soda-tax/>.

a statewide base, but cities would not have to wait for a statewide majority to act before putting such a policy in place.

Other municipal tax reforms could have the potential to raise even greater revenue. For example, cities could experiment with imposing municipal consumption taxes on services. Scholars have criticized the exemption of services from sales taxes on the grounds that it is both inefficient (because it raises the cost of goods as opposed to services)²²¹ and regressive (because those with higher incomes spend a greater proportion of their consumption dollars on services).²²² Estimates suggest that service purchases account for almost sixty percent of total consumer expenditures.²²³

Because most state sales tax bases do not tax services (or at least the majority of the services) sold in the state, such consumption taxes would not directly compete with the state's sales tax base, and a plausible argument could be made that municipal taxation of such services would not conflict with most existing state sales tax laws.²²⁴ Such an attempt to impose a city-based service tax would, of course, present significant administrative challenges for the municipality and for businesses subject to the tax.²²⁵ Cities would have to enforce such consumption taxes without the help of state audits, and would have to craft potentially complex sourcing rules to determine whether the service was sold within the relevant municipality.²²⁶ Perhaps few cities

²²¹ See Kirk J. Stark, *The Uneasy Case for Extending the Sales Tax to Services*, 30 FLA. ST. U. L. REV. 435, 448 (2003) (discussing efficiency case for including services in base).

²²² See DUE & MIKESSELL, *supra* note 197, at 91; Stark, *supra* note 221, at 449–50.

²²³ William F. Fox, *The Ongoing Evolution of State Revenue Systems*, 88 MARQ. L. REV. 19, 41 (2004) (collecting data as of 2002).

²²⁴ In a state where the courts have interpreted the legislature's preemptive authority quite broadly, it is possible that the existence of a state sales tax that fails to tax services could be interpreted as a decision by the state not to tax services.

²²⁵ Many cities have the authority and have chosen to levy "business license fees" or "business activity taxes" that are measured by gross receipts or gross payroll. See 16 McQUILLIN, *supra* note 70, at § 44:248; TASK FORCE ON BUS. ACTIVITY TAXES AND NEXUS, AM. BAR. ASS'N, *Report of the Task Force on Business Activity Taxes and the Nexus of the ABA Section of Taxation State and Local Taxes Committee*, 62 TAX LAW. 935, 936 & n.2 (2009). These kinds of taxes often mimic the effect of a sales tax on services. And to the extent cities are able to successfully implement these taxes, they suggest that administrative concerns may be surmountable. As implemented, however, they still ensure that retail sales are taxed at higher rates (even at the local level) than the sale of services because these types of local taxes are generally imposed in addition to (rather than in lieu of) retail sales taxes. See, e.g., TREASURER & TAX COLLECTOR, CITY & CTY. OF S.F., SAN FRANCISCO'S NEW GROSS RECEIPTS TAX AND BUSINESS REGISTRATION FEES 2–4 (2013), http://sftreasurer.org/sites/sftreasurer.org/files/migrated/FileCenter/Documents/Business_Zone/GRP_Summary_7_15_13.pdf (laying out San Francisco's gross receipts tax).

²²⁶ One especially tricky issue would be how to coordinate with state sales tax exemptions for items "sold for resale," which typically exempt from retail sales taxes items that will be subject to the tax when resold to the ultimate consumer. Cities could decide to

would be interested in imposing such taxes given these challenges. But even a few cities experimenting with local service taxation might spur interest among other municipalities or (as would be desirable from an administrative efficiency perspective), the state itself.

B. Enacting Reform

In most states, presumptive taxing authority could be established as a matter of either statutory or constitutional law. Providing an explicit grant of taxing authority in the state's constitutional home rule provisions would secure such a grant against a changing legislative majority. A legislative grant of additional taxing authority could be overturned by a vote of the legislature, though some states do require additional legislative action to revoke previously granted authority. For example, for New York to revoke previously granted municipal authority, the state constitution requires two successive votes on the proposal in separate calendar years.²²⁷

Further, in states with a constitutional initiative process, it is possible that constitutional revision would be as easy as (or even easier than) statutory reform.²²⁸ Obviously in states that require constitutional conventions, such constitutional change would be more difficult, though in such states a successful constitutional amendment is less likely to be later overturned.²²⁹ While a constitutional approach might be preferable, the choice between statutory reform and constitutional amendment is likely a strategic choice about which pathway seems more promising, and as a result, the choice will differ depending on both state law and state politics.

Before evaluating the strengths and weaknesses of this proposed reform, one additional detail deserves more attention: What should be the scope of the state's preemptive authority?

Presumptive taxing authority, in effect, seeks to grant municipalities taxing authority that parallels their police powers. Municipal regu-

impose a lower tax rate on services as a measure to alleviate potential double taxation. Such double taxation, of course, is already endemic in the retail sales tax base.

²²⁷ N.Y. CONST. art. IX, § 2(b)(1).

²²⁸ For a useful summary of the initiative process, see David B. Magleby, *Let the Voters Decide? An Assessment of the Initiative and Referendum Process*, 66 U. COLO. L. REV. 13, 13, 21–31 (1995). See also Timothy Besley & Stephen Coate, *Issue Unbundling via Citizens' Initiatives* 2–3 (Nat'l Bureau of Econ. Research, Working Paper No. 8036, 2000), <http://www.nber.org/papers/w8036> (theorizing why elected representatives' voting patterns may diverge from public voting via ballot initiative).

²²⁹ See *Initiative and Referendum States*, NAT'L CONFERENCE OF STATE LEGISLATURES, <http://www.ncsl.org/research/elections-and-campaigns/chart-of-the-initiative-states.aspx> (last updated Dec. 2015) (showing states that allow constitutional amendment by initiative).

latory ordinances are routinely challenged as preempted by state law, and state courts have typically interpreted state authority to preempt local regulation quite broadly.²³⁰ States should not invent a new preemption doctrine for local government tax powers. Instead, the judiciary should draw on existing state preemption doctrine to interpret the scope of municipal taxing authority and the effect of state legislation on this authority. Under the preemption doctrine of many states, the existing, detailed statutory enactments concerning local property and sales taxes would be given some preemptive effect. In an ideal world, a reform expanding local revenue authority would be coupled with other state-level property tax reforms.

C. *Evaluating the Proposal*

As a policy change, presumptive municipal taxation would give municipalities additional revenue flexibility while still respecting the significant interests states have in municipal tax policy. The proposed reform strikes this balance by giving states the ability to override municipal taxing authority through general state law. Such a reform, without additional legislative changes, would have a limited effect on existing municipal tax bases, which are currently controlled by detailed state law provisions.

As a result, presumptive municipal taxation cannot, by itself, address the major challenges facing existing municipal revenue sources. Presumptive municipal taxation would not repeal Proposition 13 in California or TABOR in Colorado, for example.²³¹ Nevertheless, presumptive municipal taxation would improve municipalities' ability to respond to changing fiscal conditions with new sources of revenue.

²³⁰ See *supra* Section I.C for a discussion of the preemptive authority of state law under Washington, Wisconsin, and Ohio home rule provisions. The federal statutory presumption against preemption, after all, is based in the federal judiciary's concerns about offending state sovereignty. See, e.g., *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 533 (1992) (Blackmun, J., concurring in part, concurring in the judgment in part, and dissenting in part) ("The principles of federalism and respect for state sovereignty that underlie the Court's reluctance to find pre-emption where Congress has not spoken directly to the issue apply with equal force where Congress has spoken, though ambiguously," *quoted in* Ernest A. Young, "*The Ordinary Diet of the Law*": *The Presumption Against Preemption in the Roberts Court*, 2011 SUP. CT. REV. 254, 273 (2012)). Such sovereignty concerns are absent in the context of a state court interpreting the state's grant of authority to municipalities that lack any claim to sovereign authority. Some state courts have nevertheless applied something akin to the presumption against preemption in considering challenges to local laws under state law. See Briffault, *supra* note 14, at 909 ("There is an enormous gap between the written provisions of state constitutions and actual practice. State legislatures and local governments have repeatedly sought to expand the scope of 'public purpose' and to slip the restraints of the tax and debt limits.").

²³¹ See *supra* note 15 and accompanying text.

As discussed above, municipalities could consider a variety of taxes that they currently lack the authority to impose.

There is, of course, no guarantee that municipalities will take advantage of these new powers. City officials may be reluctant to impose new local taxes, and they may lack the administrative and technical resources to implement such tax reforms. However, even if only a handful of municipalities take advantage of their new legal authority, it would be a major change.

Perhaps the greatest challenge of the proposal is the possibility that cities (or at least city officials) would rather not have this authority in the first place. There is some evidence that city officials are not particularly enamored of local option taxes (i.e., taxes the state authorizes localities to impose at their option). City officials often prefer increases in state intergovernmental grants, which provide funds from the entire state tax base and therefore do not require them to take the potentially unpopular step of proposing new taxes or tax increases on local residents or businesses.²³²

Further, municipal revenue capacity varies widely.²³³ As such, expanded revenue authority will assist some municipalities more than others, and the additional revenues may flow to more resource-rich localities. If offering municipalities greater revenue autonomy were to decrease state aid to local governments, the measure could leave some cities worse off. However, in the status quo, states are already reducing their intergovernmental aid, and cities need additional revenue options to make up this shortfall. While it is possible that giving cities more taxing authority could accelerate this trend, it is also possible that providing cities with opportunities to create more own-source revenue will allow state aid to better target jurisdictions that are revenue poor.

In addition, a city's revenue capacity may not map neatly onto revenue need. Thus, in the Boston Federal Reserve's detailed report on how the benefits of expanding a local option tax in Massachusetts would benefit the state's local governments, it noted that the beneficiaries included not just wealthy suburbs, but also Boston and other commuting centers in the state.²³⁴

²³² See Alvin D. Sokolow, *The Changing Property Tax and State-Local Relations*, 28 *PUBLIUS* 165, 185–86 (1998) (explaining this phenomenon).

²³³ See Bo Zhao, *The Fiscal Impact of Potential Local-Option Taxes in Massachusetts* 12 (New England Pub. Pol'y Ctr., Working Paper No. 10-2, 2010), <https://www.bostonfed.org/economic/neppc/wp/2010/neppcwp102.pdf> (describing variability of local tax capacity in Massachusetts).

²³⁴ *Id.*

For the reasons discussed above, the cities most able to take advantage of this greater taxing authority are likely to be larger cities in major metropolitan areas. These cities are more likely to have the capacity to both generate innovative ideas for municipal revenue and to administer these programs. Presumptive taxing authority would not save Detroit—or necessarily even help it—but it might offer a city like Seattle, St. Paul, or Phoenix a way to meet increasing pension obligations without cutting social service budgets. And while problems of poverty certainly are not limited to core urban areas, these cities are likely to have a greater share of regional poverty than the average municipality, and thus are more likely to need additional sources of revenue.²³⁵

Finally, as scholars like Richard Briffault have noted, local control is not an unmitigated good. Rather, it can contribute to the “pervasive privatism that is the hallmark of contemporary American politics.”²³⁶ For example, localities have used zoning rules to restrict (or actually prohibit) homebuilders from developing residential real estate for lower and middle-income households.²³⁷ And greater local control may also hamper efforts to encourage more regional planning and economic development.

In addition, scholars and policymakers may worry that municipal autonomy hampers efforts to encourage regional urban planning and economic development. For at least a quarter of a century, scholars have suggested that both cities and suburbs would benefit from more regional cooperation.²³⁸ Regional solutions are even suggested to address problems created by state restrictions on local autonomy. For example, city planner Peter Pollock suggests that greater municipal revenue sharing might help local governments address the distortions in local development decisions caused by Colorado’s state-imposed

²³⁵ See Liscow, *supra* note 5, at 3–4 (identifying school financing as one area where this occurs).

²³⁶ Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1, 1–2 (1990).

²³⁷ See JONATHAN ROTHWELL, HOUSING COSTS, ZONING, AND ACCESS TO HIGH-SCORING SCHOOLS 5 (2012), http://www.brookings.edu/~media/research/files/papers/2012/4/19-school-inequality-rothwell/0419_school_inequality_rothwell.pdf (relating history of exclusionary zoning litigation in recent decades); William T. Bogart, ‘What Big Teeth You Have!’: *Identifying the Motivations for Exclusionary Zoning*, 30 URB. STUD. 1669, 1669–72 (1993) (discussing motivations for exclusionary zoning); Richard Briffault, *The Local Government Boundary Problem in Metropolitan Areas*, 48 STAN. L. REV. 1115, 1134–35 (1996) (listing costs of exclusionary regulation).

²³⁸ For more recent work in the area that surveys the history of calls for regional economic development, see generally PETER DREIER ET AL., PLACE MATTERS: METROPOLITICS FOR THE TWENTY-FIRST CENTURY (3d ed. 2014); MYRON ORFIELD, METROPOLITICS: A REGIONAL AGENDA FOR COMMUNITY AND STABILITY (1997).

limits on local taxation.²³⁹ Such cooperation has not been common however, and it does not address the common need cities have for stable, own-source revenues that they control.

Presumptive municipal taxation is not a panacea for the fiscal challenges facing municipal governments, and as the preceding discussion suggests there are real risks and limits to this proposal. However, the current division of municipal taxing authority rests too much authority with state legislatures, who are often unresponsive to the revenue needs of municipalities. Presumptive taxation would open the door to more innovation in revenue sources at the local level and might offer a pathway to a more fiscally sound future for municipalities, with more efficient revenue sources that better reflect the needs and strengths of the locality.

CONCLUSION

Cities currently lack the home rule authority to implement many changes to their revenue system. Such extreme limits on municipal taxing authority are unjustified, and states can address their interest in municipal tax policy even while granting municipalities more taxing authority. States should consider amending their home rule provisions to include taxation as a home rule power. Presumptive taxation is not without its risks, but it is a reform worth serious consideration.

²³⁹ See Pollock, *supra* note 108, at 1011–12 (noting incentives for retail sales development in Colorado and contrasting that with Wyoming’s experience). Pollock praises Wyoming’s approach, where local sales tax funds are collected by the state and then redistributed to cities, towns, and counties based on their respective populations, as opposed to the location of the sale. *Id.* at 1012; see also WYO. STAT. ANN. § 39-15-211 (West 2015).