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Powerful Cities(?): Limits on Municipal Taxing Authority and What to Do About Them

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.¹ Urbanization is not just a coastal phenomenon. Between 2011 and 2012, over half of the country's largest metropolitan areas saw greater population growth in core cities than in suburbs, including the metropolitan areas of Orlando, Denver, Columbus, Memphis, and Phoenix.² Cities are increasingly centers of regional economic development and wealth, driven by changing preferences for shorter commutes and proximity to the amenities of the city core (shopping, entertainment, restaurants, etc.). Such urban revitalization has prompted new thinking about the role of municipal government in fostering development in cities and delivering municipal services to urban populations.

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. Cities like Baltimore, St. Louis, and Indianapolis have yet to experience a "turnaround."

While the problems of cities like Baltimore may differ substantially from cities like San Francisco, the leaders of most cities share at least one challenge: limited authority.³ Local governments (including municipal governments) are creatures of the state law; as a consequence,

¹ The New York Times, for example, recently reported that real estate developers who were shifting to "smaller, more modestly priced units," which it described as in the \$8 million to \$10 million range."

<http://www.nytimes.com/2014/10/05/realestate/luxury-condos-dialing-it-down.html>.

<http://www.economist.com/news/united-states/21591187-californias-new-technological-heartland-struggling-its-success-growing-painss>

² Conor Dougherty, *Which Cities Are Growing Faster Than Their Suburbs*, WALL ST. J. June 28, 2012, available at <http://blogs.wsj.com/economics/2012/06/28/which-cities-are-growing-faster-than-their-suburbs/>.

³ GERALD E. FRUG & DAVID J. BARRON, CITY BOUND 98(2008).

their powers are limited to those enumerated in their state's constitution and laws. Municipal powers to regulate behavior within its borders, to spend money on public programs, to advance local policy objectives, and to tax and borrow funds to support these regulatory activities and spending programs are all circumscribed by state law.

Traditionally, states have granted local governments very limited revenue authority, even as compared to other home rule powers. Further, as the tax literature has frequently observed, state laws of general applicability, like California's Proposition 13 and Colorado's Taxpayer Bill of Rights, also limit local taxing authority. As a result, cities often lack the legal authority to enact meaningful tax reform, even when there is widespread agreement that such reform would be beneficial. This is especially true in the context of reforming local property tax bases.

Scholars like Gerald Frug, (now Judge) David Barron, and Clayton Gillette have recently begun to question the current allocation of fiscal authority between state and local governments, including the conventional wisdom surrounding state restrictions on municipal revenue authority (i.e., municipalities' ability to levy taxes). So far, however, neither scholars nor policymakers have made specific proposals for expanding such authority.

This Article argues that state law should grant municipal governments "presumptive taxing authority," similar to local governments' authority to regulate local affairs, which is often limited by express preemption provisions. This relatively small change may not significantly impact municipal revenue sources, but it would certainly open the door to more municipal revenue innovation. The intrinsic flexibility associated with such innovation would provide municipalities interested in expanding the range of services they offer residents an effective tool as they continue to face ever increasing cuts to intergovernmental aid.

Part I provides background on the current powers granted to local governments over spending and revenue. Part II outlines the benefits to expanding municipal taxing authority. Part III considers state interests in municipal tax policy and argues that giving municipalities presumptive taxing authority would not undermine those interests. Part IV concludes.

I. Home Rule Authority

Municipal government provides many of our most “basic” public goods and services.⁴ These are the kind of publically provided goods that are easily forgotten until problems arise. There is, for example, unlikely to be a headline about the sanitation department, unless sanitation employees strike. Similarly, while the opening of new public spaces may garner media attention, local politicians rarely campaign with the promise to efficiently maintain the city’s current capital infrastructure. These basic public services include sanitation (water treatment facilities, waste disposal); public safety (law enforcement, courts, jails); infrastructure (sewage, electric, and water lines, and roadway maintenance); and public spaces (parks, libraries, swimming pools, etc.). In addition, today’s municipalities also play important roles in public health, human services, regional transportation policy, and local economic development. The U.S. intergovernmental system asks a lot of its cities.

The American political tradition has long romanticized local government—the New England town hall meeting remains the civic course’s ideal of grassroots, accountable democracy. And yet, American political philosophy has remained deeply skeptical of

⁴ Some municipalities also fund elementary and secondary education. Because the majority of such local funding comes through property taxes imposed by independent school districts, this Article does not directly confront school financing questions, which involve both the question of what sources of revenue should be used *and* the question of who should be funding education services.

urbanization. These dual impulses understandably conflict and lead to pendulum-swinging grants of local government powers.

At the turn of the last century, state law reform pushed by progressive-era activists at gave municipalities much greater autonomy in the form of “home rule,” but this local authority remains subject to state law, often without even the modest protections against state encroachment that the federal constitution continues to provide to state law. As a result, home rule has delivered less than promised, especially when it comes to municipal tax authority.

This Part offers a general description of the policymaking authority typically given to municipalities under state law. The first subpart provides a general introduction to the legal framework of local government law. The second subpart 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 exercising, and spending and regulatory authority, which are much more liberally granted to municipalities. A third subpart provides some background on municipal own-source revenue.

A. The Concept of Home Rule

Local governments have been termed mere creatures of the state⁵; as a consequence, their powers are limited to those enumerated in their state’s constitution and laws.⁶ For much of the nineteenth century, municipal governments were granted very little independent authority by the state. Progressive-era urban activists, fearing state legislatures would fail to respond to the

⁵ Dillon’s Rule.

⁶ See generally David J. Barron, *Reclaiming Home Rule*, 116 HARV. L. REV. 2255(2003) (discussing history of home rule).

increasing problems faced by growing urbanization and industrialization advocated for greater “home rule” authority. Home rule provisions are state laws that give local governments independent lawmaking authority over local affairs.⁷ Without such provisions, every action of a local government would require the explicit authorization of its state government.

Although the specific powers conferred by the state to local governments via home rule laws and constitutional provisions vary from state to state,⁸ the National League of Cities identifies four categories of home rule authority that may be granted: structural, functional, fiscal, and personnel authority.⁹ Structural authority allows a local government to design its own form of government. 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. 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.”¹⁰ Fiscal authority gives a local government the ability to raise revenue, either through taxation or borrowing. Personnel authority gives a local government the ability to set employment policies for their employees.

Generally speaking, municipalities have less authority over taxation than over other policy areas. Local governments have the greatest authority over structural and personnel decisions.¹¹ The degree of functional authority varies considerably amongst states.¹² According

⁷ See BLACK’S LAW DICTIONARY (9th ed. 2009) (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”).

⁸ See generally HOME RULE IN AMERICA: A FIFTY-STATE HANDBOOK (Dale Krane, Platon N. Rigos, & Melvin B. Hill Jr., eds) (2001) [hereinafter HOME RULE IN AMERICA] (surveying home rule authority in fifty states).

⁹ *Local Government Authority*, NAT’L LEAGUE OF CITIES, <http://www.nlc.org/build-skills-networks/resources/cities-101/local-government-authority>

¹⁰ *Id.*

¹¹ See HOME RULE IN AMERICA, *supra* note X at 476–77, tbl.A1 (showing that majority of states grants deferential authority to local governments on matters of structure and personnel).

¹² *Id.* (showing regulatory authority of government varies considerably).

to one recent summary of municipal home rule, only twelve states have laws that give local governments any fiscal control.¹³ Of those twelve, the survey classified five as granting only limited fiscal authority.¹⁴ Even in states which 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.”¹⁵

B. Specific Home Rule Provisions

Because every state home rule provision is different, it is worth exploring in detail a few specific states as examples of how authority is granted to municipalities. This section looks at the home rule laws of New York, Washington, and [more to come].

1. New York State

New York’s home rule provisions govern home rule municipal power in the state. The New York State Constitution gives local governments the power to pass and implement legislation that secures “government, protection, order, conduct, safety, health and well-being of persons or property.” In theory, this authority is expansive and gives cities broad authority to regulate in the public interest,¹⁶ but this authority is subject to supervision by New York State,

¹³ See HOME RULE IN AMERICA, *supra* note X, at 476–77 tbl.A1 (listing states with fiscal home rule authority).

¹⁴ *Id.* (listing extent of fiscal home rule authority in each state).

¹⁵ Clayton P. Gillette, *Fiscal Home Rule*, 86 DENV. U.L. REV. 1241, 1246 (2009).

¹⁶ For example, under its authority to secure the health and well-being of persons, New York City’s Department of Health passed the nation’s first ban on restaurant use of trans fats. HEALTH CODE, RULES OF THE CITY OF NEW YORK 24 § 81.08 (2007). See also DEPT. OF HEALTH, NEW YORK CITY, THE REGULATION TO PHASE OUT ARTIFICIAL TRANS FAT IN NEW YORK CITY FOOD SERVICE ESTABLISHMENTS, <http://www.nyc.gov/html/doh/downloads/pdf/cardio/cardio-transfat-bro.pdf>; Thomas J. Lueck & Kim Severson, *New York Bans Most Trans Fats in Restaurants*, N.Y. TIMES, Dec. 6, 2006, at A1. The Department of Health also required that chain restaurants make calorie counts more prominent. HEALTH CODE, RULES OF THE CITY OF NEW YORK, 24 § 81.50. The regulation applies to restaurants that serve food standardized by portion size and content and that are part of a chain of at least fifteen restaurants. See also DEPT. OF HEALTH, N.Y. CITY, THE REQUIREMENT TO POST CALORIE COUNTS ON MENUS IN NEW YORK CITY FOOD SERVICE ESTABLISHMENTS,, http://www.nyc.gov/html/doh/downloads/pdf/cdp/calorie_compliance_guide.pdf.

which can preempt local regulations.¹⁷ Although a literal reading of the statute suggests that the state's preemptive authority is limited when it seeks to restrict the activities of a particular jurisdiction,¹⁸ New York courts have interpreted state interest so broadly that, in practice, almost any legislation passed by New York City or other municipalities can be preempted by state legislative action.¹⁹

Even with these restrictions, however, New York municipalities' taxing authority is an order of magnitude weaker than their regulatory authority. 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."²⁰ 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."²¹ In other words, the Municipal Home Rule Law reasserts that New York State retains the power

¹⁷ N.Y. CONST. art. IX, § 2(c)(i) ("[E]very local government shall have power to adopt and amend local laws *not inconsistent* with the provisions of this constitution or any general law relating to its property, affairs or government."(emphasis added)).

¹⁸ The Constitution places limits on "special legislation," i.e. laws that only affect a particular jurisdiction. Special legislation can only be passed at the request of the local government under a home rule message or in emergency situations. N.Y. CONST. art. IX § 2(b)(2). Home rule messages must be passed by a majority of a municipality's legislature and endorsed by the city's mayor or passed with the support of two-thirds of the municipality's legislature. N.Y. CONST. art. IX § 2(b)(2)(a). *See also* Laura D. Hermer, *Municipal Home Rule in New York: Tobacco Control at the Local Level*, 65 BROOK. L. REV. 321, 333 n.53 1999 ("A home rule request is a message from the governing body of an affected municipality giving the legislature the municipality's consent to enact the legislation." And even this emergency exemption does not apply to laws applicable only in New York City. N.Y. CONST. art. IX § 2(b)(2)(b). For an example of the specific content of such a home rule message, see *supra* note X (describing home rule message on congestion pricing).

¹⁹ In practice, however, these restrictions on special legislation are limited by the judiciary's willingness to defer to legislative judgments as to what constitutes an issue of statewide concern and therefore qualifies as general, and not special, legislation. For example, in *Patrolmen's Benevolent Association v. City of New York*, 767 N.E.2d 116 (N.Y. 2001), the court held that the safety of New York City residents was an issue of statewide concern and, as a result, the state legislature had authority to pass laws affecting New York City's contact with its police union, limiting the City's bargaining power and preempting the City's own mediation laws for negotiating with public employee unions.

²⁰ N.Y. CONST. art. XVI § 1.

²¹ *Id.*

to review actions taken under the authority delegated to local government. In contrast, more general legislative authority on a range of local issues remains primarily under local control.²²

This system obviously limits local fiscal autonomy. As Richard Briffault has observed, taxation is simply not a home rule power in New York.²³ As a result, any time a local authority wants to levy any kind of tax, it has to have explicitly delegated authority from the State.²⁴

In contrast to its limited ability to impose taxes, home rule cities in New York have broad authority to enact fees that are quid-pro-quo payments for services provided. Under New York State law, local governments are given presumptive authority to assess usage fees.²⁵ Localities can, for example, charge for municipal utility services, impose licensing fees and otherwise pay for services on cost-of-provision basis.²⁶

2. 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

²² N.Y. MUN. HOME RULE LAW § 10 (Consol. 2011).

²³ Briffault, *supra* note X, at 102 (“Home rule concepts do not apply to local taxation and borrowing.”).

²⁴ *See, e.g.*, N.Y. GEN. CITY LAW § 20(4) (Consol. 2010) (providing general authorization for municipalities to “levy and collect taxes on real and personal property for any public or municipal purpose”); N.Y. TAX LAW § 1301 (Consol. 2010) (authorizing municipal personal income tax in all cities with population over 1 million people, i.e. only New York City); N.Y. TAX LAW § 1201-06 (authorizing variety of taxes for individual cities in New York State).

²⁵ N.Y. MUN. HOME RULE LAW § 10(1)(ii)(a)(9-a) (2011); *see also* Jason Burge, Note, *Rethinking Fees and Taxes in Light of the New York City Health Care Security Act*, 61 N.Y.U. ANN. SURV. AM. L. 679, 695–96 (2006) (observing that there is no need for state enabling legislation to impose a fee).

²⁶ Generally, such user fees are limited to the cost of providing a service. For example, in determining whether or not the State University Agricultural and Technical College of Canton, a generally tax-exempt government institution, could be subject to a water assessment fee imposed by the Village of Canton, the court distinguished between a water tax, which would have been imposed whether or not the University used the local water system, and a water fee, which was levied based on the amount of water the institution used. *State University of New York v. Patterson*, 346 N.Y.S.2d 888, 891 (Sup. Ct. App. Div. 1973). The line between a user fee and a tax, however, is not statutorily defined in New York, and it can be difficult to tell user fees apart from taxes. *See* Burge, *supra* note X, at 697–702 (discussing inconsistent New York jurisprudence).

regulations as are not in conflict with general laws.”²⁷ The state constitution does not provide similar protection for its fiscal authority, and as a result, “a local government does not have the power to impose taxes without statutory or constitutional authority.”²⁸

Cities can, however, impose user fees on services provided by the city. 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 state 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 declaration is sham, and that the ordinance is, in reality, a revenue measure.”²⁹

The Washington state legislature has provided municipal governments with a wide variety of revenue sources, including the property tax and a local option sales tax whose tax rate is coordinated between counties and the municipalities within them. Washington also has several smaller, local option taxes to raise municipal revenue for specific purposes authorized by the state. For example, cities can enact two different local option transportation taxes to fund regional transportation infrastructure in excess of what would be done via general revenue and state support alone.³⁰ The state, however, can also take away municipal taxing authority. For example, Initiative 776 revoked local vehicle license fees.

C. Municipal Revenues

²⁷ Wash. Const. Art. XI, § 11.

²⁸ *Okeson v. City of Seattle*, 150 Wash. 2d 540, 551, 78 P.3d 1279, 1285 (2003)

²⁹ 7 Wn.2d 372 (1941)

³⁰ <http://www.mrsc.org/publications/rgcity2009.pdf>

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 than grant municipalities and that, in addition, cities vary in the tax policy choices they make. 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 is the most important source of own-source revenue for municipalities generally.³¹ About half of municipal governments also receive some sales tax revenue, while the National League of Cities estimates that only about 10% of municipalities receive revenue from income or wage taxes.³² This pattern 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 (mostly in Ohio and Pennsylvania) have income tax authority. Even against this pattern, of course, there are outliers. Mesa, Arizona, for example, is the largest city in the United States without a property tax. It elects to impose high utility fees instead. Several Alaskan boroughs rely on sales taxes instead of property taxes.

Second, state regulation of the property tax has limited local control in many states. The debate over assessment limitations like Proposition 13 in California dominates criticism of property tax law. However, scholars of property tax law also note that the property tax base has

³¹http://www.nlc.org/Documents/Find%20City%20Solutions/Research%20Innovation/Finance/Final_CFC2013.pdf;
<http://www.itep.org/pdf/guide7.pdf>
http://books.google.com/books?id=59qSbfoQY2kC&pg=PA375&lpg=PA375&dq=increasing+reliance+on+user+fees&source=bl&ots=uVv-TTfQXG&sig=HDznzslYXn2Z1D_k0_h6bFs7bMk&hl=en&sa=X&ei=ZrY1VnKSCoOE8gXC2IDoBg&ved=0CDMQ6AEwAzgK#v=onepage&q=increasing%20reliance%20on%20user%20fees&f=false

³² Id.

long been hamstrung the state's eagerness to grant property tax exemptions and other state restrictions on local assessment.³³

Third, since the 1980s, local government has shifted toward a greater reliance on user fees rather than general revenue taxes to support local spending.³⁴ As scholar Dick Netzer has noted, a portion of this increase is attributable to increasing use of services traditionally associated with user fees.³⁵ But municipalities have also shifted to user fees to supplement general tax revenue in the wake of property tax assessments and other restrictions on the local property tax base. 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.³⁶

While user fees have increasing throughout the country, there are some regional patterns. Western and southern states took the lead initially in creating user fees.³⁷ Robert Tannenwald has suggested New England lagged behind on this trend in part because local governments there spent less money on the types of services that readily lead themselves to user fees.³⁸

II. The Case for More Expansive Municipal Taxing Authority: Freeing Policy Space

Limits on cities revenue authority hamper city policymaking for a number of reasons. First, as Gerald Frug and (now Judge) David Barron observe, 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 local voters fail to

³³ Add cites to scholarship.

³⁴ <http://www.library.unt.edu/gpo/acir/Reports/staff/SR-6.pdf>

³⁵ <http://www.library.unt.edu/gpo/acir/Reports/staff/SR-6.pdf>, fn 9.

³⁶ <http://legis.wisconsin.gov/lab/reports/04-0userfeesfull.pdf>

³⁷ [tp://www.library.unt.edu/gpo/acir/Reports/staff/SR-6.pdf](http://www.library.unt.edu/gpo/acir/Reports/staff/SR-6.pdf)

³⁸ <https://www.bostonfed.org/economic/neer/neer1990/neer190d.pdf>

hold state politicians responsible for their role in limiting local fiscal options. Third, limits on local revenue authority stifle innovation at the local level. Fourth, limits on municipal taxing authority also restrict municipal regulatory choices in ways that can lead to bad policy choices. This Part will consider each of these arguments in turn.

A. Limits Discourage Diversity in City Development Patterns

Limits on municipal revenue options restrict cities' economic development options. As Gerald Frug and (now Judge) David Barron observe “[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.”³⁹ For example, state-based tax restrictions can determine the type of development local governments pursue, a development strategy termed the “fiscalization” of land use law. In California, property tax limits have encouraged municipal governments to increase land zoned for retail development so as to increase local sales tax revenue.⁴⁰ Retail zoning crowds out other kinds of development that residents might otherwise prefer, including more residential development. Because state-based restrictions inhibit or distort local policy innovation, Barron and Frug argue that states should grant localities greater fiscal authority.

B. Limits Restrict Local Accountability

Lack of fiscal authority at the municipal level also weakens democratic accountability. When local voters are unhappy with the fiscal decisions of their elected officials, they naturally seek to hold those elected officials accountable. Local voters may think a greater portion of the

³⁹ Id. at 98.

⁴⁰ PAUL G. LEWIS & ELISA BARBOUR, CALIFORNIA CITIES AND THE LOCAL SALES TAX (1999).

property tax should fall on commercial rather than residential property, for example. Or they may not like city officials' decisions to cut the budgets for local human services or the city police force.

On some of these decisions, city officials have alternate policy options. They may be able to find alternate budget cuts or propose a bond override that would increase the city's borrowing capacity. However, if revenue drops precipitously, city officials in many states lack the authority to consider options other than budget cuts. And in many states, localities do not control the assessment ratios of commercial to residential property. Such decisions rest with the state legislature and, in the case of constitutional taxing decisions, the statewide voting population.

Because the role of state policy in limiting the options of local elected officials is less salient than the choices those elected officials make, local voters may fail to hold state officials accountable for state-level policy choices. And, in a similar vein, voters may find their own role in limiting local fiscal options obscure, failing to realize that many of the limits placed upon local officials were imposed by constitutional reform at the ballot box.⁴¹ State control of local finances reduces democratic accountability for fiscal choices.

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 revenue authority might lead to greater municipal mismanagement, Clayton Gillette suggests that there is little reason to believe

⁴¹ FRUG AND BARRON.

that state actors are likely to be more fiscally responsible than municipal governments.⁴² In fact, because mismanagement may lead to quicker exit at the local level than the state level, he suggests municipal actors are likely to be more fiscally responsible than state actors would be. As a result, Gillette concludes that 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 just published a lengthy report detailing its ideas for “progressive local policies to rebuild the middle class,” including municipal revenue options. Unfortunately, one has to turn to the 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 recommended [in the policy paper] 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.”⁴³ Whether or not one agrees with these ideas, limited home rule authority restricts municipal ability to pursue innovative revenue policies.

Innovations in municipal finance are desirable for two reasons. First, municipalities, like states, face lingering pension obligations that without additional revenue sources or revenue flexibility may necessitate further cuts to services. Providing additional revenue options for

⁴² “Who Should Authorize a Commuter Tax?”

⁴³ CAP Report.

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.

D. Municipal Taxation as Regulatory Tool

In addition to allowing municipalities' greater authority over their fiscal lives and thus the development decisions they wish to make, there is another advantage of allowing greater municipal taxing authority. In certain situations, a tax-based approach may be the best policy choice, but current limits on municipal taxing authority strongly discourage local officials from pursuing such solutions. Tax-based approaches risk rejection by the state, and politicians and policymakers do not want to waste time and political capital on proposals when success is beyond their control. As a result, policymakers may take tax-based solutions off the table despite their potential efficacy and efficiency. This section identifies situations when taxation should be considered as a policy option. When taxation is the right tool, policymakers should be able to tax.

When a municipality chooses to subsidize certain products, investments, or behaviors, policymakers should ask whether that subsidy is better administered as a tax or through another

agency.⁴⁴ Administrative costs and other issues of “institutional design” should affect this policy choice.⁴⁵

There are at least two situations where municipal policymakers should strongly consider implementing a policy via taxation. First, a tax solution makes sense when combating a local externality.⁴⁶ Second, a tax often makes sense as a policy to curb undesirable behavior that may not be a purely local externality, but is nevertheless amenable to local control.⁴⁷ While these situations may not be the only ones in which a municipality should consider tax-based solutions, an examination of these two categories highlights the cost of denying such taxing authority to municipal officials.

When confronting a local externality, cities should be able to decide whether cost internalization is better accomplished through regulation or taxation. Regulations, if not tailored perfectly, can fail and sometimes exacerbate the problem that they are supposed to solve.⁴⁸

⁴⁴ See generally David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955 (2004) (arguing that question of “institutional design” should dominate decision of how to best implement subsidy policy).

⁴⁵ *Id.* Scholars have also noted that tax-based solutions may be preferable in certain situations at the federal level. See, e.g., Eric J. Toder, *Tax Cuts or Spending—Does It Make a Difference?*, 53 NAT’L TAX J. 361, 368–69 (2000) (suggesting situations when tax provisions might be better than direct spending).

⁴⁶ See N. Gregory Mankiw, *Smart Taxes: An Open Invitation to Join the Pigou Club* 5–6 (2008) (unpublished manuscript), available at http://www.economics.harvard.edu/files/faculty/40_Smart%20Taxes.pdf (discussing role of Pigovian taxation in combating market failure due to externality problem).

⁴⁷ E.g., smoking. Sin taxes like cigarette taxes are not trying to force smokers to internalize the cost of their smoking to society but rather raise the cost of smoking to make more salient their own costs of smoking.

⁴⁸ 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 SYSTEMATIC, INC., *supra* note X at ES-2 (“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.*

Taxes also often serve as a policy tool to curb undesirable behaviors that are not externality problems.⁴⁹ Cigarette taxes, for example, have kept tobacco costs high and are thought to have played an important role in reducing teen smoking. As another example, the consumption of high-sugar beverages is a leading cause of the United States' obesity epidemic, and some scholars believe that soda taxes will promote healthier eating habits.⁵⁰ Berkeley, California just passed the first municipal soda tax (in the form of a business license tax on retailers of soda). If Berkeley's tax proves successful, other municipalities may be interested in adopting similar policies.

III. Presumptive Taxation as Municipal Tax Authority Reform

Innovative cities need the authority to act independently of the state. This Part explores what such expanded revenue authority could look like. The first subpart explores the state interests in municipal taxing authority. Any proposal to expand municipal taxing authority should account for these state interests. The next subpart suggests one option for expanding municipal authority, giving cities presumptive taxing authority, subject to state preemption.

A. State Interests in Municipal Taxation

In its most expansive form, greater municipal taxing authority could resemble the state's sovereign taxing authority. In other words, 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

⁴⁹ See *supra* note X 47–48 (discussing taxes as tools to incentivize behavior outside of externality context).

⁵⁰ See e.g., RUDD CENTER FOR FOOD POLICY AND OBESITY, *SOFT DRINK TAXES: A POLICY BRIEF* (2009), available at <http://www.yaleruddcenter.org/resources/upload/docs/what/reports/RuddReportSoftDrinkTaxFall2009.pdf> (discussing role of soft drink taxes in promoting healthier eating).

in municipal tax policy. This sub-Part considers these state interests: vertical tax competition, horizontal tax competition, administrability of local taxation, and ultimate fiscal responsibility. The subsequent proposal is informed by the limits suggested by these state interests.

1. Vertical Tax Competition

The state has a direct revenue interest in municipal taxing authority to the extent municipal taxes compete with the state base. 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.⁵¹

A simplified example illustrates the vertical tax competition concern.⁵² 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. 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 of revenue. Illinois may find that it has to reduce its tax rate in order to increase revenue collection from the tax, a result that limits its ability to raise taxes because of Chicago's policy choice. 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.⁵³)

⁵¹ 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).

⁵² See also Clayton P. Gillette, *Who Should Authorize a Commuter Tax?*, 77 U. CHI. L. REV. 223, 244–45 (2010) (discussing vertical tax competition with respect to implementing commuter tax).

⁵³ Cite literature on state opposition to the adoption of a federal VAT.

Cross-base vertical tax competition may also exist. That is, local property tax rates may limit state income tax revenue. A retail store owner, for example, must increase prices (or decrease profits) to account for property taxes (directly or in the form of higher rent) in the same way that it must account for sales and income taxes. Such cross-base tax competition may suggest that the state also has an interest in reducing municipal tax collection more generally. The state's concern here, to my mind, has less force because in all states local governments must rely on own-source revenue for a portion of local expenditures. States could reduce this cross-base competition by increasing intergovernmental grants or directly fund services currently administered by local governments.⁵⁴ However, providing municipal governments with their own revenue authority ensures that local spending and taxation preferences are honored.

2. Horizontal Tax Competition

States may also have an interest in minimizing horizontal tax competition between local governments. For example, when local governments offer tax incentives to encourage intra-state business relocation, the state as a whole does not benefit from any new development, and often such business-specific tax policies lead to other economic distortions. To the extent local government tax competition encourages a tax-favorable business environment that encourages the development of new businesses or interstate relocations, however, states may be less concerned about regulating local government behavior.

3. Administrability of Local Tax Bases

⁵⁴ I tend to think that states should be responsible for a greater portion of one large local government expense, elementary and secondary education.

States have an interest in reducing the administrative costs of state and local tax compliance and thus an interest in minimizing differences in tax bases across jurisdictions. Not only do differing tax rules impose compliance costs on taxpayers, but such differences in tax bases also increase enforcement costs for municipal governments.⁵⁵ And because municipal tax departments are often underfunded, such complexity also makes non-compliance more difficult to detect. In fact, recent state reforms suggest there may be renewed interest in greater state coordination of local tax administration. Arizona, for example, is finally reforming its sales tax system, which for years required retailers to navigate separate tax codes for individual cities in addition to the state sales tax rules. Ohio is currently considering reforms to simplify and coordinate the administration of its municipal income taxes.

4. The State's Fiscal Role in Municipal Affairs

The state also has a more general interest in municipal finance decisions because the state is ultimately responsible for municipal fiscal health. Municipal fiscal mismanagement may leave the state responsible for city debts and also may raise the cost of borrowing for the state's other localities. As a result, the states' powers over municipal fiscal affairs often expand in times of fiscal crisis. States, for example, must approve any plan for municipal bankruptcy under Chapter 9. Many states have laws allowing states significant involvement in municipal governance in times of fiscal crisis, with some allowing state trusteeship.⁵⁶

Further, the formulas the states use to determine state grant-in-aid to municipalities are often based on projected local tax revenues. It is possible that changes to the municipal tax

⁵⁵ See generally Ruth Mason, *Delegating Up*, 62 DUKE L.J. 1267 (2013) for a discussion of these issues of conformity at the federal/state level.

⁵⁶ See generally Gillette, *Dictatorships for Democracy*, 114 Colum. L. Rev. (forthcoming).

structure may necessitate changes to such formulas to better match grant money to municipal need.

Given these important state interests in municipal tax policy, 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.

B. Presumptive Municipal Taxing Authority

1. The Proposal

One option for reform is what this Article calls “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 was 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. 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”⁵⁷ but does not provide similar protection for municipal taxing authority, requiring every municipal tax ordinance to be sanctioned by specific

⁵⁷ Wash. Const. Art. XI, § 11.

state authorization. Other states have similar restrictions. And some, like New York, have constitutional home rule provisions that specifically, and separately, limit municipal taxing authority.

Giving cities presumptive taxing authority equivalent to their regulatory authority would not give them full control over revenue decisions. It would, however, expand municipal authority and allow cities to innovate in several areas. For example, cities could impose taxes on bases untapped by the state without waiting for state legislative approval. In Connecticut, for example, such a shift could allow local governments to impose excise taxes on retailers of soda, candy, or high caloric foods. Of course, the state would retain the right to ban such local “fat taxes,” or establish an exclusive, state-wide tax, 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, under such expanded authority, cities could experiment with imposing municipal consumption taxes on services. The omission of services from the state (and local) sales tax base is mostly an historic accident that has been criticized as both making sales tax regimes less efficient (because the inclusion of services within the base would allow governments to raise similar amounts of revenue with lower rates) and more regressive (because those with higher incomes spend a greater proportion of their consumption dollars on services). Estimates suggest that service purchases account for almost 60% of total consumer expenditures.⁵⁸

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

⁵⁸ William F. Fox, *The Ongoing Evolution of State Revenue Systems*, 88 Marq. L. Rev. 19, 41 (2004).

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.⁵⁹ Such an attempt to impose a city-based service tax would, of course, present administrative challenges for the municipality. Cities would have to enforce such consumption taxes without the help of state audits, and cities would have to craft potentially complex sourcing rules to determine whether the service was sold within the relevant municipality.⁶⁰ Perhaps few cities 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 states.⁶¹

Cities would also be free to experiment with certain types of Pigovian taxation. For example, cities could enact ordinances imposing storm water remediation fees. In municipal areas where much of the ground surface is covered by water-impervious materials (roofs, roads, parking structures, etc.), storm water runoff can cause increased flooding and environmental degradation to local water sources. Storm water remediation fees have been imposed in some urban counties in Maryland and in Philadelphia to compensate for the additional water management costs that accompany such runoff. Policymakers hope that these fees will encourage property owners to switch to penetrable surfaces in the building of road, parking lots, and other structures. When such surfaces can absorb rainwater, there is less runoff and thus less

⁵⁹ Of course, in a state where the courts of interpreted the legislature's preemptive authority quite broadly, it is possible the existence of a state sales tax that fails to tax services could be interpreted as a decision by the state not to tax sales.

⁶⁰ One especially tricky issue would be how to coordinate with state sales tax exemptions for items "sold for resale," which typically exempts from retail sales taxes items that will be subject to the tax would resold to the ultimate consumer. Cities could decide to 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.

⁶¹ A handful of states (notably Hawaii and New Mexico) include many services within their sales tax base.

pollution of local water sources.⁶² Absent specific state authorization, most local governments could not impose these fees under current law.

This policy would acknowledge the state's clear interests in municipal tax policy by providing the state with an opportunity to preempt local tax ordinances. Thus, 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 in the status quo.

While presumptive tax authority leaves the state with the ability to block municipal tax innovations, such a reform should still expand municipal tax options. As a matter of political economy, this reform shifts the onus onto to the state to act to block municipal tax ordinances. It is always harder to pass legislation than it is to block it, as recent observers of Washington's political dysfunction often note.

In the status quo, if a city wants to enact a new tax or make a change to its existing tax structure that is not authorized by state law, the city must convince the state legislature to approve that change. Rarely are the city's interests directly represented in state houses. In most states, municipal boundaries are not relevant to state legislative districts, resulting in state legislators who represent only a portion of the municipal population and state legislators who represent constituents both within and outside municipal boundaries. Thus, the policy views of the municipal electorate as a whole are unlikely to be directly represented in the legislature.

⁶² The "fees" imposed, however, rarely attempt to approximate the actual costs of managing the runoff, thus these fees under most state laws would be treated as taxes and not quid quo pro payments for services.

Further, the majority of legislators will not represent that city's constituents at all, and in many states rural delegations wield legislative authority disproportionate to their share of the population. As a result, it may be difficult for cities to get such legislative authorization. The political economy of blocking municipal taxing authority works in the opposite direction. In order 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 on the scope of such a restriction.

Before evaluating the strengths and weaknesses of this proposal, three details of a legislative proposal to grant cities presumptive tax authority deserve more attention. First, should the proposal be enacted as a reform to constitutional or legislative home rule provisions? Second, what should be the scope of the state's preemptive authority going forward, and third, relatedly, what preemptive effect should such reform grant existing tax legislation.

The majority of states have home rule provisions in their state constitutions, though many of those constitutional provisions require the state to pass enabling legislation to grant specific home rule authority to municipalities.⁶³ (In the eight remaining home rule states, home rule legislation granted home rule.⁶⁴) States can, of course, augment their constitutional home rule provisions with additional legislative grants of authority, though such reforms have been rare.

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

⁶³ The Community Environmental Legal Defense Fund provides a useful overview chart. <http://celdf.org/home-rule-in-the-states>

⁶⁴ Six states have no home rule powers, meaning any exercise of municipal power must be authorized by the state law.

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, in order for New York to revoke previously granted municipal authority, the state constitution requires two successive, separate calendar year votes on the proposal.⁶⁵ In states that allow constitutional ballot measures, it is not obvious that a constitutional amendment to state home rule authority would be any harder to pass than a legislative reform, though obviously in states that require constitutional conventions, such constitutional change would be more difficult. As a result, enacting presumptive municipal taxation as a constitutional reform seems like the best option where such reform is politically feasible.

In answering the second set of questions about the preemptive authority of state tax legislation, it is useful to consider the existing approach to conflicts between state law and home rule authority. Presumptive taxing authority, in effect, seeks to grant municipalities taxing authority that parallels their police powers, and in the regulatory context, municipal home rule laws invariably condition home rule authority on the state's power to preempt through state legislation. Municipal regulatory ordinances are thus routinely challenged as preempted by state law, and state courts have typically interpreted the state authority to preempt local regulation quite broadly. The federal statutory canon that suggests a presumption against preemption, after all, is based in the federal court's concerns about offending state sovereignty, concerns that are entirely absent in the context of the state court interpreting the state's grant of authority to municipalities.

⁶⁵ N.Y. CONST. art. IX, § 2(b)(1).

As to the preemptive effect of state legislation, my views are still developing, but I am inclined to argue that legislation adopting presumptive municipal taxing authority should direct courts to interpret state tax preemption narrowly. The goal of the reform proposal is to expand municipal authority and to force state-level actors to pay greater attention to state-level policies that restrict municipal authority. Granting broad preemptive authority to state tax legislation would limit the scope of the reform proposal. State legislation could affect municipal taxing authority even in the absence of evidence that the legislature specifically intended to restrict the scope of municipal taxation or even evidence that the state legislature was aware of the issue at all.

The state could limit its future preemptive authority by requiring that subsequent tax legislation would need to explicitly and directly state its intent to preempt municipal taxing authority. A separate question, of course, is what to do about existing state legislation governing municipal taxing authority. Very few existing general state tax laws will directly preempt municipal taxing authority because such a legislative statement would not have been needed prior to the proposed reform.

In the property tax context and the local option sales tax context, detailed state law regarding the base and local tax collection could reasonably be interpreted by courts as a detailed state scheme that reflects a legislative intent to restrict local autonomy. As a policy matter, I am torn about the prudence of state policy controls in this area. On the one hand, state control of the local sales tax base strikes me as a good decision. Allowing local jurisdictions to vary the sales tax base, as Arizona currently does, creates an additional compliance burden for taxpayers that raises the costs of sales tax administration. Further, by establishing a uniform

base, it is easier for states to assist local governments in sales tax administration. State control over the local property tax base offers fewer advantages to local government and local taxpayers. Because property tax bills are prepared for individual property owners, the administrative and compliance costs of the property tax fall primarily on government and not on taxpayers. The main administrative cost of the property tax is property assessment, and that cost is almost always borne at the local level. As a result state laws about the property tax base do not offer much in the way of administrative costs savings to local government.⁶⁶ But state restrictions on assessment and state law property tax exemptions and abatements make it harder for local governments to rely on the property tax base.

These conflicting policy concerns do not lead to a clear normative intuition about how presumptive taxing authority should affect existing tax legislation. In an ideal world, legislation authorization presumptive municipal taxation could be coupled with property tax reform. In the absence of that ideal, I am still inclined to grant prior taxing authority preemptive effect as I think that most accurately reflects legislative intent. It seems to clearly reflect legislative intent at the time of the initial enactment of the legislation, and a failure to explicitly address the intent in presumptive tax authority legislation would suggest that the legislative intent has not changed with respect to these previously enacted state tax laws.

2. 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 the municipal tax

⁶⁶ The exception is railroad, utility property, etc. whose value may be determined with reference to property in multiple jurisdictions.

policy. The proposed reform strikes this balance by giving states the ability to override municipal taxing authority through general state laws. Such a reform, without additional legislative changes would have a limited effect on existing municipal tax bases, which are currently controlled by detailed provisions of state law.

As a result, presumptive municipal taxation cannot, by itself, address major challenges of existing municipal revenue sources. Presumptive municipal taxation would not repeal Proposition 13 in California or TABOR in Colorado, for example. Nevertheless, presumptive municipal taxation would improve municipalities' ability to respond to changing fiscal conditions with new sources of revenue. As discussed above, municipalities could consider a variety of taxes that they currently lack the authority to impose, like bag taxes and storm water remediation fees.

There is, of course, no guarantee that municipalities will take advantage of these new powers. Certainly 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 authorize localities to impose at their option). City officials prefer increases in state intergovernmental

grants. Further, because municipal revenue capacity varies widely,⁶⁷ 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. Presumptive taxation is not without its risks, but it is a reform worth serious consideration.

IV. 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.

⁶⁷ Cite Boston Fed report.