A Tax Menu for Local Government: *Yes* or *No?*

by Mike McLaughlin

Local government officials face a dilemma. The one source of tax revenue they can control—the property tax—is also the one consistently cited as least popular in public opinion polls.[1] Yet local government officials face increasing service demands from every direction. Population growth forces the construction of new schools and increased investment in roads and other infrastructure. Increasing caseloads drive up county Medicaid costs. Citizens demand that service levels be maintained or enhanced while their property tax bills remain unchanged or go down. Industries wishing to expand want local officials to pick up part of the cost through low-cost loans, job training, or other incentives—waving the threat of taking their property tax payments and the jobs their industries provide out of the local economy.

These conflicting demands leave local officials with two choices. They can do more with less, or find a way to get more. Local officials are proving themselves adept at doing both. To do more with less, they are shaving operating costs and turning to privatization of services. To get more, they have in-

Mike McLaughlin is editor of North Carolina Insight.

Demand for new schools to accommodate population growth is one force putting pressure on property tax rates in North Carolina.

Missy Bello

creasingly turned to user fees as a revenue source. Yet both avenues have their limitations. Local officials can only go so far with cost-cutting and privatization before running head on into citizen service expectations and employee morale problems. And true user fees should be assessed in proportion to services rendered and benefits received. They are difficult to administer fairly, and inappropriate for certain services that provide for the general welfare of the population—such as general law enforcement and public education.

"Taxes are what we pay for civilized society."

—OLIVER WENDELL HOLMES JR.

These limitations lead some local government officials to advocate for a third way—authority to pick and choose from a so-called menu of new local taxes to supplement the property tax. North Carolina local governments operate legally under Dillon's Rule rather than Home Rule, which means they have no authority other than that granted explicitly by the legislature. (For more on this issue, see "Dillon's Rule and Home Rule: Two Models for State-Local Government Relations, p. 34.) The property tax is the only general, broad-based taxing authority under the control of local officials,[2] and many local government officials would like to have more authority.

The tax menu approach has been backed both by the N.C. League of Municipalities and the Association of County Commissioners. It surfaced in 1991 legislation sponsored by Rep. Bill Hurley (D-Cumberland) in the House[3] and Sen. Fountain Odom (D-Mecklenburg) in the Senate[4] but quickly sank under the weight of opposition from groups that would have been affected. The 1991 legislation would have authorized four types of local-option taxes: an occupancy tax; a local land transfer tax; a prepared food and beverage tax; and an amusements tax. A fifth option—some type of local income tax—was recommended by a study committee but never made it into legislation, says Hurley.

Given the tension between increased service demands at the local level and resistance to property tax increases, the tax menu idea may well surface again in the General Assembly. Indeed, House Speaker Pro Tempore Carolyn Russell (R-Wayne) says the issue is likely to be considered by the State and Local Government Fiscal Relations and Trends Study Committee she chairs with Senate Appropriations Committee Co-Chair Beverly Perdue (D-Craven). "Additional revenue raising authority—a potential tax menu—is on the table," says Russell.

Perdue agrees that the legislature should take a close look at additional taxing authority for local government. She says citizens in her district fiercely resist higher property taxes. As a result, local officials are severely limited in their ability to raise funds for public needs such as water and sewer facilities and school buildings. "They can ignore their capital needs. . . float a bond issue—which is often turned down—or raise the property tax," says Perdue. One option for expanding the range of revenue choices for cities might be additional local sales tax authority in lieu of the property tax, says Perdue. "I just think there needs to be some discussion," she says.

That's music to the ears of local government officials like Ed Regan, deputy director of the N.C. Association of County Commissioners. "There's still very strong interest in a broader range of options for generating local revenue," says Regan. Lee Mandell, director of research and information technology for the N.C. League of Municipalities, adds that a tax menu would be of "tremendous benefit" to a number of municipalities, allowing them to tailor their tax structure to take into account the local economy and local politics.

But Mandell is quick to acknowledge that a tax menu—at least one as limited as the one laid out in the 1991 legislation—wouldn't help all municipalities. For example, a small town with only one restaurant could produce barely a burp in its revenue stream through a meals tax. An accommodations tax or an amusement tax would face similar limitations in revenue generating potential in small-town North Carolina, as would a real estate transfer tax. And unless a strong case could be made for the shortcomings of the present revenue-generating system, it's likely that a proposal for a tax menu would meet the same fate it did in 1991, when interest groups such as the N.C. Association of Realtors—which opposed the land transfer tax included in the menu—stopped it in its tracks.

Tim Minton, the association's lobbyist, notes that his trade group opposes the land transfer tax for three primary reasons: (1) it increases the cost of housing, which could be a burden for first time buyers; (2) it is an unstable revenue source that drops when the housing market cools; and (3) it targets a small portion of the population—those buying and

Missy Bello

Johnston County Manager Richard Self at site of new county water plant.

selling real estate—instead of spreading the tax burden across the entire population.

And since the tax menu last was proposed, a new election in which the Republican Party picked up 39 seats in the 170-member General Assembly left the body even less amenable to any action that could be perceived as a tax increase. Authorizing a tax menu would not directly raise taxes, but it would grant local elected officials additional flexibility so that *they* could raise taxes.

What's Wrong with the Property Tax?

In the face of such opposition, why even consider granting additional revenue raising authority? To make the case for a tax menu, one must first make the case that the present revenue options are inadequate to meet the growing demands on local government. Advocates for increased revenue authority argue that the property tax—local government's primary source of tax revenue—is too subject to political pressure to bear the full weight of funding local services. Indeed, the property tax is consistently found to be the least popular tax in public opinion polls. Yet those same polls indicate local government is the most popular level of government and the one most trusted to provide services. (See "What Polls Have Shown about Public Attitudes on Federalism," pp. 36–41, for more.) Thus, local governments face a whipsaw effect of increasing service demands and scarce tax dollars to provide those services. That problem will only worsen if state and federal officials deliver on their promise to return more responsibility to the local level.

Johnston County Manager Richard Self notes that legislative actions such as repeal of the inventory tax and exemption of household personal property such as furnishing and clothing have eroded the ability of the property tax to generate money. Meanwhile, service demands have mushroomed. Johnston County, for example, is increasingly becoming a bedroom community for neighboring Wake and the Research Triangle Park area. As a result, the county's population of school-aged children has exploded—requiring the equivalent of one new school every year to house all the new students. The county's share of Medicaid spending has grown from $500,000 in the 1989–90 fiscal year to $2.7 million in 1995–96.

Citizens opposed to tax increases in Johnston and elsewhere have become increasingly astute at bringing pressure to bear on the county commissioners and town council members who control the rates,

and the result has been increased reliance on fees and reluctance to raise taxes. In Johnston, county commissioners kept the property tax rate at the same level for seven years, then lowered it so the county would not receive a windfall when property was reevaluated for tax purposes in 1995–96. Such hold-the-line attitudes are becoming more and more typical. Indeed, at least 52 of North Carolina's 100 counties held their tax rate steady or decreased it for the 1995–96 fiscal year, compared to only 35 counties in 1993–94. Municipalities exhibited a similar trend. (See "Local Governments Face Increasing Service Demands, Tighter Budgets," p. 2, for a more detailed discussion of this trend. See particularly Table 4, p. 11.)

Why the reluctance to raise taxes, even in the face of growing demands? Eager-to-please politicians find that holding the line on taxes plays well with the public, and pleasing the voting public is what makes the difference between a candidate and an elected official. And the 1994 Republican revolution filtered down to the local level as well, where the GOP gained 56 seats on county boards of commissioners.[5] (See Table 2 on p. 5.)

Many of these local officials were elected on anti-tax themes that resonated with the public. Indeed, opinion polls indicate that the property tax ranks among the least popular taxes, rivaled only by the federal income tax.

So what don't people like about the property tax? David Crotts, the legislature's senior fiscal analyst, notes that one problem is the visibility of the tax. Property owners must list certain possessions in January, elected officials debate the rate in well-publicized meetings during May and June, property owners get their bills in late July, and the bills come due at the end of the year. Taxpayers are reminded of the tax at predictable intervals throughout the year.

And as Regan notes, the tax must be paid when many households are suffering a severe fiscal hangover from the holidays. "A lot of people pay through their mortgage, but you still have a significant number who get one bill and have to pay it right after Christmas—and it's a big chunk of money."

Still, no tax should be expected to win a popularity contest, and the property tax does have positive features. It is a true local tax in that it is raised from local residents to pay for local services. Local elected officials control the rate and these officials are held directly accountable to the tax-paying public. Crotts notes that the rate is relatively low compared to many states. And Charles D. Liner, the tax expert at the University of North Carolina's Institute of Government, argues that revenue sources local governments have been able to secure to supplement the property tax may shift the local tax burden from owners of large amounts of property to low- and moderate-income taxpayers. (See Charles D. Liner, "The Property Tax and the Search for New Revenue Sources," pp. 76–89, for more on this topic.)

Part of this phenomenon—as Liner discusses within these pages—could be described as user fee creep. Elected officials reluctant to take the heat for raising property tax rates turn to a broad range of user fees, some of which are actually regressive taxes that do not vary with the amount of services consumed. Examples Liner cites include solid waste disposal fees billed on a per-household basis, motor vehicle registration fees, impact fees charged on new home purchases, and a fee of up to $1 per month local governments are authorized to bill all local residents on their phone bill for 911 service.

A positive feature of the property tax, Liner notes, is that it taxes most directly the people who receive local services. Most taxes that have been discussed for a tax menu would in some way export the tax burden to people outside the local community. And Liner argues that many supplemental taxes, such as the local option sales tax, are regressive.

But whether a tax is regressive is not the issue to local elected officials. "Our elected officials don't hear from the experts," says David Dear, Cleveland County Finance Officer. "They hear from the taxpayers who feel they're bearing an unfair share of the burden." Dear says elderly citizens and those who have no school-age children are particularly vocal in their opposition to the property tax. "They call it a school tax," Dear says, and they wonder why they have to pay it since they don't have any children in school.

Former Wake County Commissioner Jack Nichols says user fees that supplement the property tax are not always regressive. He says in some instances fees that vary according to benefits received and ability to pay represent a preferable alternative to increasing the property tax to pay for the service. Nichols offers several examples where fees may be appropriate: inspection of private water treatment facilities at subdivisions; excessive calls for false alarms due to a faulty burglar alarm; fees for cleanup of a spill of hazardous materials; and sliding-fee scales for public health, mental health, and substance abuse services. "I believe that the common denominator in these common sense forms of taxation is the close nexus between

"It is not a tax bill but a tax relief bill providing relief not for needy but for the greedy."

—FRANKLIN DELANO ROOSEVELT
1944 TAX BILL VETO MESSAGE

the service provided and the cost of the service," says Nichols. "In each case, the user is paying for his or her pro rata share of the service. In some cases, the payment is imposed as a consequence of their actions. . . . What could be more fair?"

Richard Self, Johnston County manager, argues that the property tax has a disparate impact on senior citizens, people with disabilities, and people on a fixed income. "I never have thought it was a fair tax," says Self. The Johnston County Commissioners sought additional taxing authority in the 1995 General Assembly to meet the county's mushrooming school needs. Self says the county wanted authority for a real estate transfer tax; an impact fee on new homes, mobile homes, and apartments; and an additional 1 percent local sales tax. "The bill never got out of committee," says Self.

Nevertheless, the N.C. League of Municipalities and the N.C. Association of County Commissioners make a strong case for a tax menu. A menu would ease some of the pressure on the property tax, and with the exception of a local income tax, all of the taxes these groups advocate have been authorized for at least some units of local government, according to a list maintained by the legislature's Bill Drafting Division. The groups argue that what is fair for the units that have won legislative approval for these taxes seems fair for the remainder. Local elected officials could pick and choose from the menu, and no one would be required to implement any tax against the wishes of their constituents.

The tax menu items advocated by the League and the Association include:

The hotel/motel occupancy tax. Already authorized for 66 counties and 33 municipalities across North Carolina, this tax is levied on overnight accommodations. The tax typically is limited to 3 percent of the cost of those accommodations, although it rises as high as 6 percent in some places. Revenue from the tax often is restricted to promotion of travel and tourism, although this isn't always the case. While both the League and the Association would include the tax on their menu, the organizations acknowledge that most local governments that would benefit from the tax already have it in place.

The local land transfer tax. A total of seven counties have been authorized to implement a local land transfer tax—all located in the northeast corner of the state. These counties are Dare, Currituck, Chowan, Camden, Pasquotank, Perquimans, and Washington. Assessed at 1 percent of the value of any real estate conveyance, the tax is a proven revenue generator in high growth counties. Dare County, for example, raised $2.2 million through the tax in the 1994–95 fiscal year. The county's general fund property tax produced about $15 million in revenue during the same year, says Finance Director David Clawson, so the land transfer tax provided a hefty supplement. The tax has been authorized for Dare County since 1985 with little apparent impact on growth. The county led the state in population growth in the 1980s, with its population increasing by 70 percent. Its growth rate is projected to lead the state in the 1990s as well, with the increase pegged at 42.5 percent. Dare County is, however, a coastal county where growth rates are driven by desire to be near the ocean. This does not mean that a land transfer tax would have no impact on housing demand in a non-coastal county with a more typical growth rate.

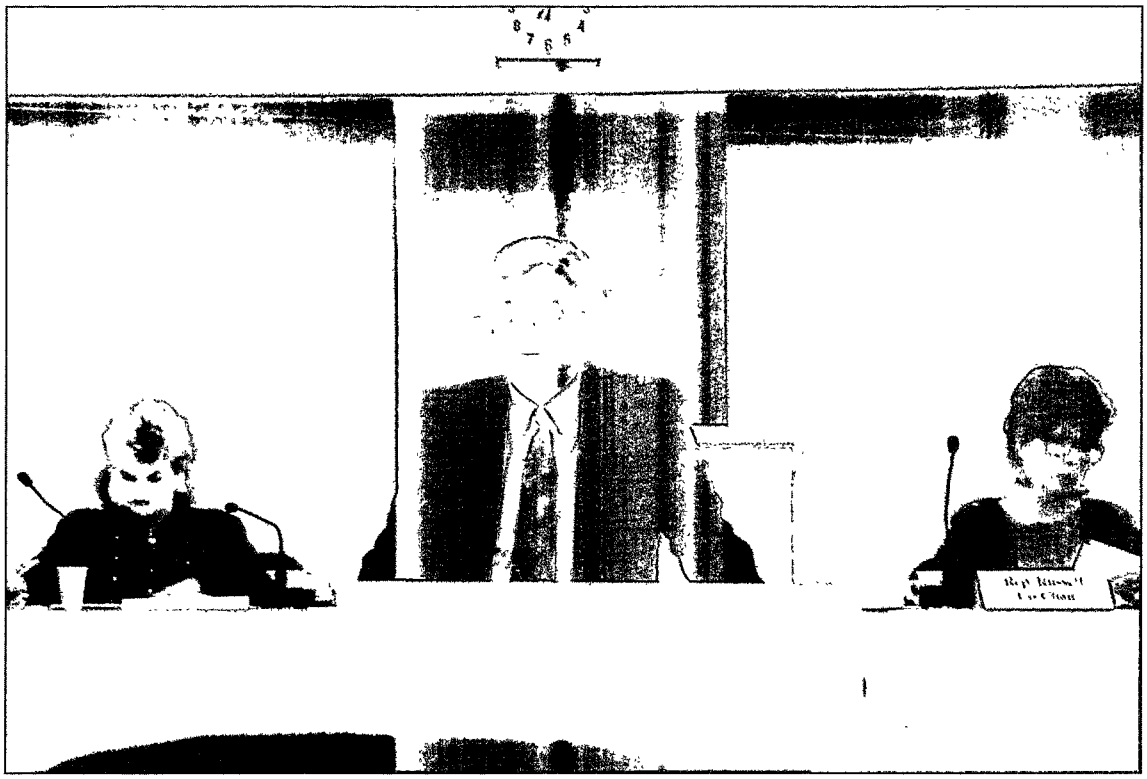
The prepared food and beverage tax. Six units of government have been authorized to charge a 1 percent prepared food and beverage tax. They are: the city of Charlotte; the town of Hillsborough; and Cumberland, Dare, Mecklenburg, and Wake counties. This tax can be a significant revenue generator in urban areas, but many smaller towns and less populated counties do not have enough restaurants to see much benefit. Charlotte, the state's largest city, generated more than $7 million in revenue through its prepared meals and beverage tax during the 1993–94 fiscal year, according to the Department of the State Treasurer. Hillsborough, on the other hand, produced just over $29,000. Proceeds typically are restricted to tourism promotion or to capital projects that might encourage restaurant business, such as convention centers,

museums, and sports facilities.

Amusement. This is among the least tested of any of the taxes on the proposed tax menu. According to Martha Harris, a staff attorney in the legislature's Bill Drafting Division, only two amusement taxes have been authorized in North Carolina, and only one has been implemented. The one that has been implemented allows for a charge of up to $1 a seat on events at the Greensboro Coliseum. Known locally as the ACC Tournament tax, the surcharge was authorized to help expand the coliseum and lure back the famed Atlantic Coast Conference Basketball Tournament, which had migrated down Interstate 85 to Charlotte. An amusement tax also is authorized for Cabarrus County, home of the Charlotte Motor Speedway, but the tax has never been implemented. Like the prepared food and beverage tax, the amusement tax has limited appeal for less populated counties and small towns with few amusements.

Additional sales tax authority. Counties already have the authority to levy a local option sales tax of two cents on the dollar, and all 100 counties levy the full amount. Local government would like to have an additional penny. A primary reason is that the sales tax is a potent revenue raiser that generates fewer complaints by the taxpaying public than the property tax. David Crotts, the legislature's senior fiscal analyst, estimates that a penny increase in the sales tax would generate more than $650 million in the 1996–97 fiscal year. If the revenue were distributed on a per capita basis, it would help counties with fewer resources and activities to tax, such as restaurants, amusements, and land transfers. According to Liner, the sales tax is somewhat regressive but less so than certain other fees and taxes that have been used to supplement the property tax, such as per household fees that do not vary with the amount of services consumed. Moreover, Liner notes that shifting from property taxes to sales taxes results in significant shifts in tax burdens from property owners and businesses to the public at large. Aside from these issues, a sales tax increase would push the North Carolina tax higher than that of neighboring states, potentially hurting sales in border counties.

Rocky Mount Mayor Fred Turnage advocates a local government tax menu before the State and Local Government Fiscal Relations and Trends Study Committee. Also pictured are the committee's co-chairs, Sen. Beverly Perdue (D-Craven) at left and Rep. Carolyn Russell (R-Wayne).



Mike McLaughlin

"I have only one thing to say to the tax increasers: Go ahead and make my day."

—RONALD REAGAN

The local income tax. No North Carolina unit of government has a local income tax. Proponents of a tax menu do not believe that is likely to change in the near future. Nevertheless, they put the local income tax on the list of taxes they'd like to see on a menu. Why? A local income tax could be structured so that is would be more progressive than many alternative local taxes. And it would provide some help for local governments that have relatively few amusements, restaurants, hotels, or real estate transfers, although such a tax would not solve the problems of North Carolina's poorest counties. (It would probably take direct revenue sharing by the state to achieve this end.)

To ease administration at the local level, a local income tax could be pegged as a percentage of the state income tax bill and collected by the state. Currently 7.75 percent at its highest rate, the N.C. Constitution limits the state income tax to no more than 10 percent of income.[6] Regan and Mandell agree the legislature would be reluctant to share its authority to tax income, and local elected officials might be reluctant to implement the tax even if authorized. Nevertheless, they include the tax on the menu as a possible means of helping all of North Carolina's towns and counties—not just those with taxable amenities and pastimes.

What are the prospects for such a menu in the legislature? In the short term, probably not very good. "I can't see us doing anything in taxes now," says Senate President Pro Tempore Marc Basnight (D-Dare). The 1995 General Assembly, in fact, was more interested in cutting taxes than authorizing new ones, enacting a $362.8-million tax cut package during the 1995 session. (For more on this session of the General Assembly, see "In the Legislature: Republican Lawmakers Work to Deliver on Their Contract," pp. 102–118.) A special 1996 session of the legislature convened to cut unemployment insurance taxes in late February, and the 1996 short session will consider rollbacks of both the sales tax on food and the corporate income tax. While Basnight supports some of the items on the tax menu for local governments, he believes counties and municipalities can win additional authority on a case-by-case basis through local bills.

And every tax on the menu has constituents that could be aroused against it. Rep. Hurley notes that local real estate agents are still mad at him for sponsoring a 1991 bill that included the land transfer tax. William G. "Gerry" Hancock, a Raleigh lawyer who represents the N.C. Travel and Tourism Coalition, says the organization supports the hotel/motel tax only if the proceeds are used to promote a particular area as a tourist destination—not as a means to help pay for general government needs. Hancock opposes a tax menu because he believes it singles out only a few types of businesses and requires them to pay more for general government services than other types of businesses. "There may be and probably is a need for new revenue sources at the local level," says Hancock, "but it would be mindless to suggest that one industry ought to pay for it as opposed to society as a whole. If society as a whole benefits, society as a whole ought to pay for it."

Harris, the staff attorney in the legislature's Bill Drafting Division, notes that there are several issues for the General Assembly to consider regarding a tax menu. For example, would an array of local taxes that vary across county lines be difficult for business and hurt recruitment of new industry? Might citizens or businesses in one county that adopts a local-option tax flee to another jurisdiction that does not impose the tax? Would a menu make for more complexity in complying with tax laws and create extra bureaucracy? "These are issues that have to be dealt with," says Harris.

Yet North Carolina cities and counties face increasing service demands, and the trend toward returning responsibility to the local level is likely to continue.[7] Rep. Carolyn Russell (R-Wayne), House speaker pro tem and the legislature's State and Local Government Fiscal Relations and Trends Study Committee co-chair, believes local government will need more resources to meet the demands. "I think local government is probably going to need additional sources of revenue," says Russell. "They're caught between a rock and a hard place. . . . I suspect that what they have is not adequate. I believe it would be prudent at this stage of the game to look at what options they have and give them some other revenue sources for their use."

Much of the discussion about counties has centered on their school construction needs. Cities are burdened by infrastructure needs such as street improvements and water and wastewater treatment plant expansions. Rep. Gene Arnold (R-Nash), co-

Mike McLaughlin

Local government officials consider testimony at a public hearing by the State and Local Government Fiscal Relations and Trends Study Committee.

chairman of the House Finance Committee, suggests creation of a trust fund to meet some of these needs. "The trust may be funded by a state bond issue, corporate taxes, and/or excess funds not allocated in the budget process," says Arnold. "Counties would then have funds made available from the trust for school construction on a loan or grant basis." Cities also could be included in such a trust, using loans or grants to pay for infrastructure needs such as street improvements and water and sewer plant expansion.

Rep. Leo Daughtry (R-Johnston), the House majority leader, is less enthusiastic about a tax menu than about other options for aiding cities and counties. Daughtry notes that some of the items on the menu—particularly the real estate transfer tax—would be difficult to sell to the General Assembly. Authorization for a 1-cent increase in the local option sales tax might have a better shot, Daughtry notes, particularly if part of the revenue were earmarked for school construction. Such an increase would be a hefty revenue generator, producing some $650 million to meet local service needs. Yet Daughtry says the legislature could get bogged down on whether the revenue should be distributed based on where the sales occurred or on population. In addition, the legislature may want to reserve the extra penny on the sales tax for its own revenue needs or move in the opposite direction and cut the sales tax on food.

Another option, and one Daughtry characterizes as more likely than increased revenue raising authority, would be to approach the local government funding crunch from the cost side by relieving counties of responsibility for expenditures for the local share of Medicaid, Aid to Families with Dependent Children (AFDC), and Special Assistance for Adults. This would relieve counties of some $330 million in mandated expenses and would particularly benefit low-wealth counties with proportionately high social services caseloads. It also would help to assure uniform statewide delivery of these services in an era of decreased regulatory oversight.

"As majority leader, I'm looking for something with a consensus—that I can sell [to the legislature]," says Daughtry. Relieving mandated social service payments would sell better than increasing the taxing authority of local government, he notes. "It's a tax cut for the counties, rather than having it go straight down to the people," says Daughtry.

One obstacle to assuming full responsibility for

the non-federal share of Medicaid is that the state would be taking greater responsibility for one of the fastest growing areas in state and local budgets and one which already stretches the state's ability to pay. Sen. Perdue observes that with the federal government returning responsibility for social programs to the states, local governments are likely to end up with even higher social services costs and responsibilities. Granting local government additional sales tax authority might be a better bargain for the state, Perdue notes, although she says she does not believe the total tax burden should increase. "I'm a single mother," she says. "It doesn't matter if it's a federal tax, a local tax, or a state tax," she says. "Ultimately, it all comes out of my wallet."

But if the means are yet to be determined, a number of ranking lawmakers agree on the end: some type of aid for local government to ease a severe case of fiscal distress. "Clearly we've got to do something for the counties—take some responsibilities off or give them more money," says Daughtry. "I'm not sure how we're going to do it."

Table 1. Key Arguments For and Against a Tax Menu for Local Governments

Pros of a Tax Menu

1. Towns and counties could tailor their tax structure to the strengths of the local economy.
2. Many menu items already are in place in some cities and counties.
3. Granting additional flexibility would be consistent with the trend toward returning authority to the local level.
4. Local government is closest to the people so that voters can more easily hold elected officials accountable for taxing decisions.
5. Political constraints work against using property tax increases to meet rising service demands.
6. In lieu of raising the property tax, cities and counties are turning to user fees that are more regressive than the menu items in the way they distribute the tax burden.

Cons of a Tax Menu

1. Some of the menu items—such as the meals tax, the hotel/motel tax, the amusements tax, and the land transfer tax—would not help some of the less populated and poorer rural counties that need help most.
2. The meals tax, the hotel/motel tax, the amusements tax, and the land transfer tax target specific industries or types of businesses, which raises a fairness issue.
3. Some of the menu items—such as the local option sales tax—are regressive and would shift the tax burden away from wealthy individuals and businesses with large amounts of property.
4. The menu gives local officials additional authority to raise taxes at the local level, which flies in the face of anti-tax sentiments.
5. The state may be less willing to share revenue with local governments if it grants additional taxing authority, which could hurt poorer towns and counties that have fewer resources to tax.
6. Local officials already have broad constitutional authority to raise property taxes to meet their revenue needs.

Options for State Action

Local governments are groaning under increasing service demands while citizens moan about the chief means to pay—the property tax. Yet there is no easy answer to this dilemma. A tax menu such as that advocated by the N.C. League of Municipalities and the N.C. Association of County Commissioners would provide additional flexibility for raising funds at the local level, yet the political climate is largely one of considering tax cuts. There are clear pros and cons to adopting a tax menu for local governments.

Among the **pros** of a tax menu are these: towns and counties could tailor their tax structure to the strength of the local economy; many menu items already are in place in at least some cities and counties; additional flexibility would be consistent with the trend toward returning authority to the local level; local government is closest to the people so that voters can more easily hold elected officials accountable for taxing decisions; political constraints work against using property tax increases to meet rising service demands; and cities and counties—hamstrung in their ability to raise the property tax—are turning to user fees that are even more regressive than the menu items in the way they distribute the tax burden.

The **cons** of a tax menu include the following: some of the menu items—such as the meals tax, the hotel/motel tax, the amusements tax, and the land transfer tax—would not help some of the less populated and poorer rural counties that need help most; these same taxes target specific industries or types of businesses, which raises a fairness issue; some of the menu items—such as the local option sales tax—are regressive and would shift the tax burden away from wealthy individuals and businesses with large amounts of property; the menu gives local officials additional authority to raise taxes at the local level, which flies in the face of anti-tax sentiments; the state may be less willing to share revenue with local governments if it grants additional tax authority, which could hurt poorer towns and counties that have fewer resources to tax; and, finally, local officials already have broad constitutional authority to raise property taxes to meet their revenue needs.

While the case is less than clear for a tax menu, the N.C. Center for Public Policy Research believes the case *has* been made for a severe fiscal crunch at the local level brought on by tension between rising service demands and stable or declining property tax rates. Local governments are the most popular level of government in poll after poll, but their chief revenue source, the property tax, is the least popular. And federal and state governments plan to send more responsibility to the local level, but little talk is heard about sending more revenue. The Center believes the General Assembly should consider the problem, and sees at least four clear options for addressing it.

Option 1. The N.C. General Assembly could authorize a tax menu for local government that includes authority to levy one or more of the following: a hotel/motel occupancy tax, a local land transfer tax, a prepared food and beverage tax, an amusement tax, a 1-cent increase in local sales tax authority, and a local option income tax. A broad tax menu could provide something for every unit of government in North Carolina. Poorer counties with fewer taxable amenities such as hotels and restaurants could turn to the local option sales tax or the local income tax. (This would not entirely solve their revenue needs since they also have relatively less sales and income.) The hotel-motel tax already is in place in 66 counties and 33 municipalities in North Carolina. Seven counties have the local land transfer tax. Nine units of government have a prepared food and beverage tax. Two units of government are authorized to levy an amusement tax. The menu would authorize these items for the remaining counties and municipalities. The more broad-based taxes on the menu—the local option sales tax and the local income tax—could provide significant additional revenue for local officials willing to implement them. And authorization for a local option income tax would give at least one option to local officials who want a progressive rather than a regressive local tax. The disadvantage of this option is that the current political climate is not conducive. The legislature might not be willing to authorize a menu, and, if it did, some units of government might find the additional revenue not worth the political fallout from enacting a new tax. For poor counties and municipalities, a tax menu could ease pressure on the state to share revenue without providing a full solution to their financial needs.

Option 2. The legislature could authorize a 1 cent increase in the local option sales tax and forgo the remainder of the tax menu. If adopted statewide, a 1 cent increase in the local option sales tax could provide more than $650 million in annual revenue to local governments (1996–97 fiscal year estimate). That amount of revenue would go a long way toward addressing the revenue needs

Missy Bello

of local governments. The legislature could earmark a portion of the proceeds for specific local needs—such as school construction for the counties and infrastructure improvements for municipalities—or it could allow local officials to make their own decisions about how best to use the money. While somewhat regressive, the sales tax is not as regressive as some of the user fees that are being used locally to supplement the property tax. One problem with granting additional sales tax authority to local governments, however, is that the state may want to reserve the extra penny for its own revenue needs, or it may want to grant sales tax relief through repeal or partial repeal of the sales tax on food.

Option 3. The N.C. General Assembly could approach the fiscal needs of local government from the cost side by relieving local government of expenditures for the local share of Medicaid, Aid to Families with Dependent Children, and Special Assistance for Adults. House Majority Leader Leo Daughtry (R-Johnston) characterizes the state's assuming responsibility for the local share of Medicaid, AFDC, and Special Assistance as a tax cut to the counties. Local spending for these programs totaled more than $330 million in the 1994–95 fiscal year and likely will continue to increase.[8] By assuming the local share, the state would be relieving counties of a significant cost—one which is one of the fastest rising parts of their budgets and a cost over which local government has virtually no control. Such a move would not, however, directly help municipalities with revenue needs for such services as street maintenance, waste disposal, and crime prevention. A further obstacle to this approach is that the state may be unwilling to absorb the additional cost of assuming the local share.

Option 4. The legislature could opt to do nothing to increase flexibility or decrease responsibility at the local level, leaving local officials the current options of property taxes, user fees, and privatization or ignoring increased service demands in favor of lower taxes or no increase in taxes. This option is likely to lead to greater reliance on regressive user fees, increased privatization of services, and curtailment of some services due to reluctance of local officials to raise property taxes to meet rising costs. Ultimately, citizen service expectations and citizen willingness to pay property taxes might find their balance.

Citizens could express at the ballot box their pleasure or displeasure with the course of events.

One disadvantage of this approach is that the current trend toward regressive user fees could unfairly shift the burden of who pays for local services to those less able to pay. A further danger is that human needs could go unmet, schools go unbuilt, and public roads and buildings decline. In addition, the current desire to shift more responsibilities and decisions to the local level could be halted in its infancy.

"When there is an income tax, the just man will pay more and the unjust less on the same amount of income."

—PLATO

The unpopularity of the property tax has placed clear constraints on the ability of local officials to raise revenues. County commissioners and city councils have found alternative ways to meet their needs through a combination of budget cuts, privatization of services, and increased reliance on user fees. Yet some services—such as crime prevention and police work—are not appropriate for fees, and fees that do not vary with either the level of service consumed or with ability to pay are probably the most unfair taxes of all. There may be a limit to how far citizens are willing to go with user fees, privatization, and the curtailment of services that continual budget-cutting ultimately requires. Whether to grant additional revenue-raising authority to local government or to assume some responsibility for local government costs ultimately is a dilemma for the legislature. And, as the complaints of local government officials wrestling with rising service demands and stagnant revenue sources make clear, the stakes are very high.

[1] Survey by the Gallup Organization, for the U.S. Advisory Commission on Intergovernmental Relations (ACIR), June 17–July 6, 1994. The survey was based on personal interviews with 1,003 adults nationwide. The results, weighted for demographic variables, carried a margin of error of +/- 3 percent. Participants responded to the question, "Which do you think is the worst tax—that is, the least fair: federal income tax, federal Social Security, state income tax, state sales tax, or local property tax?" A plurality (28 percent) responded that the local property tax was the least fair. The biennial poll has consistently produced similar results, except that the federal income tax has sometimes supplanted the property tax as least favorite. See Tom Mather, "What Polls Have Shown about Public Attitudes on Federalism," pp. 36–41 for more.

[2] N.C.G.S. 153A-149(c) for counties and G.S. 160A-209(d) for municipalities.

[3] H.B. 1221 in the 1991 General Assembly.

[4] S.B. 845 in the 1991 General Assembly.

[5] For more on this topic, see Mebane Rash Whitman, "The Evolution of Party Politics: The March of the GOP Continues in North Carolina," *North Carolina Insight*, Vol. 16, No. 2 (September 1995), pp. 81–97. See particularly Table 2, p. 89.

[6] Article V, Sec. 2 (6) of the N.C. Constitution.

[7] Whether this is a positive trend is a different issue. Charles D. Liner, the tax expert at the Insititute of Government, notes that "returning responsibility to local governments and asking them to finance their responsibilities through local taxes of any kind will guarantee disparities in service levels and tax burdens, and that is counter to the trend of the past 100 years. It is important in principle and in practice that local taxes should be used to finance only local services. Asking local governments to finance statewide programs will guarantee disparities and inequalities."

[8] Counties are responsible for 50 percent of local Medicaid administrative costs and 5.2 percent of the cost of payments to vendors. For AFDC, counties are responsible for 50 percent of local administrative costs and 16 percent of payments to recipients. Special Assistance for Adults is split on a 50-50 basis between the state and the counties.