

Institute of Transportation Studies
University of California at Berkeley

**Local Option Transportation Taxes in the United States
(Part One: “Issues and Trends”)**

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About the Institute of Transportation Studies

ITS Berkeley is a multidisciplinary research institute that has supported transportation research since 1948, when it was established by the University with funding from the California Department of Transportation. Today, about 40 faculty members, 40 staff researchers and 100 graduate students are involved the Institute's research and technology transfer programs. The Institute is home to one of the world's largest transportation libraries, and leading research programs on intelligent transportation systems, pavements, and aviation operations. ITS Berkeley has sister institutes on the Davis, Irvine and Los Angeles campuses.

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The University of California Transportation Center (UCTC) supports research and education throughout the University of California system. It provides fellowships that support U.C. Berkeley graduate students along with those on the Davis, Irvine and Los Angeles campuses. It also funds major research projects in transportation policy that are directed by UC faculty members. As one of 13 federally-chartered transportation centers established by congressional mandate in 1988, the center is funded equally by the U. S. Department of Transportation and the California Department of Transportation.

Local Option Transportation Taxes in the United States

Executive Summary

This study examines the extent to which states have devolved one of the most fundamental decisions in transportation policy—whether to use taxation powers to fund transportation improvements—to local and regional governments. The purpose of the study is to generate a baseline of knowledge on “local option transportation taxes” in all fifty states, including the relevant legislative authority for these taxes, the extent to which local areas have adopted them, and the roles they play within their states’ overall transportation finance frameworks. A local option transportation tax is any tax that varies from place to place within a state, is controlled at the local or regional level, and is earmarked for transportation-related purposes.

For the past decade, a central focus of transportation policy has been *devolution*—the de-centralization of control over transportation planning and decision-making to more localized levels of government. The federal government and some states have passed sweeping reforms aimed at providing lower levels of government with more authority and flexibility to make transportation investment decisions reflective of local objectives.

During the same period, local option taxes continued a three-decade pattern of rapid growth around the country. During the 1990s, at least 20 states adopted new laws authorizing local option transportation taxes, or saw local enactments of these taxes spread to new areas. Driving this trend in part have been efforts by many mid-sized cities to build public transit systems, particularly light rail, and a continuing reluctance by state legislators to raise statewide gasoline taxes.

The share of transportation funds raised by local option taxes remains small, but their significance far overshadows their scale. The decision to increase taxes for any purpose is always a difficult one, and is rarely done lightly. In transportation, it tends to be done when the public believes there is a pressing local need that cannot be met with existing resources, either because these funds are in short supply, or because they cannot be used for the types of investments an area wishes to make.

Local option taxes have emerged as important levers by which local governments ensure their priority projects get built. Yet the adoption and implementation of these taxes typically occurs outside the traditional metropolitan planning process. Understanding the legal and political landscape for local option taxes is important if we wish to know what directions future transportation finance is likely to take.

Key varieties of local option taxation

A wide range of different taxation options is available to local governments around the country. Each variety of tax has a unique set of characteristics, in terms of the magnitude of revenues it can generate, its fairness to different taxpayer groups, and its appropriateness as a funding source for transportation projects. Below are some key findings about how these individual tax options are being used around the country.

Fuel taxes

Local taxes on motor vehicle fuels, such as gasoline, are authorized in 15 states, and have been adopted in ten. In states where they are in widespread use (e.g. Alabama, Florida, Hawaii, Nevada), the funds support the operating budgets of county road departments, much like state gasoline taxes that are passed down to the local level in other states. In suburban Northern Virginia, a regional sales tax on gasoline funds a variety of public transit and road investments. In Alabama and New Mexico, revenues from local gasoline taxes are often used for non-transportation purposes, such as education or health care. In most

states, local gasoline taxes have not been adopted at high enough levels to fund major new capital investments.

Vehicle taxes

A wide range of taxes on motor vehicles is used to fund transportation investments around the country. The most important varieties are license or registration taxes, which tend to be either flat fees based on vehicle type, or variable taxes based on a vehicle's value. Thirty-three states authorize some form of local vehicle taxes. Many of these allow these taxes to be used as a general revenue source. We identified 22 states where at least some local option vehicle taxes are earmarked for transportation-related purposes. In most of these, the revenues are intermingled with other revenue streams in a county road fund or the budget of a transit agency. As with local option gasoline taxes, these taxes typically fund pay-as-you-go programs of routine maintenance and operations work. However, a few places do earmark these taxes for specific, major capital investments. In some states, the revenues are earmarked for transportation-related environmental or public safety programs.

Property taxes

Property taxes are the most important and universal local revenue source in the United States. Their primary function is to fund services that are administered at the most local levels of government, such as street maintenance and public transit operations. While local property taxes are authorized in all 50 states, there are many different traditions as to whether transportation activities receive an explicit earmark as part of an area's total property tax rate. Because there are few centralized sources of data on property taxation, we were only able to get a partial picture of how these taxes are used around the country. But we did find at least 17 states with dedicated property taxes for street and road investments, and 14 with dedicated property taxes for public transit services. Several states have highly differentiated local road systems, with each functional level supported by a different property tax.

Sales taxes

Although property taxes may raise more revenue overall, the sales tax has become as the most important local option tax for funding major new transportation initiatives. In many states, it has become known as the most politically feasible option for local areas looking to finance major new transportation investments. The reason is simple: more than any other tax option, taxpayers have been willing to approve sales taxes on a scale that makes major new infrastructure projects possible. There are 33 states that have authorized local option sales taxes for transportation purposes (or for more general purposes that include transportation, such as capital improvements or economic development). Of these, local governments in at least 21 states have adopted sales taxes for road projects, and in 18 states for public transportation. In 14 cities nationwide, voters have approved sales taxes to fund the construction or expansion of light rail or rapid rail transit systems.

Income, payroll, and employer taxes

Sixteen states authorize local taxes on income (paid by individuals based on their salary), payroll (paid by employers based on the total wages they distribute), or number of workers employed at a business. Local areas have adopted payroll taxes (or income/payroll combinations) to fund transportation investments in four of these states (Indiana, Kentucky, Ohio, and Oregon), and have adopted flat, per-employee fees in Washington. These taxes generally fund programs aimed at facilitating peak-hour commutes into central cities, including public transit services, vanpools, and other projects aimed at congestion relief.

Other taxes

Several other types of taxes are important in just a few states around the country. In four states, local taxes on natural resource extraction (severance taxes) fund rural road construction and maintenance. Five states allow local governments to derive transportation revenues from taxes on the sale of property (known as mortgage recording taxes or real estate transfer taxes). Many states allow local governments to

tax tourists to fund infrastructure and facilities that they use heavily; local governments in at least three states are using these taxes to build major transportation projects. Finally, in a growing number of states, development impact taxes are being used to fund road construction at the metropolitan fringe.

Observations and Policy Issues

Shift from user taxes to sales taxes

A long-term trend in local transportation finance has been an ongoing rise in the use of local option sales taxes in both road and transit finance. At the same time, the number of areas levying user taxes, such as gasoline and vehicle taxes, has remained roughly constant. In a handful of areas, the prevalence of user taxes has even declined, as some states have abolished value-based vehicle license taxes, and some governments have used sales tax revenues to eliminate tolls.

Although gasoline and vehicle taxes have not been popular over the past decade, the use of other taxes targeting particular transportation user groups has been growing. Many areas around the country have also adopted taxes targeted at tourism, mining, and real estate development to fund transportation infrastructure that serve these industries. While these are not “user taxes” in the traditional sense, they are similar from a benefit equity perspective.

Fiscal and competitive pressures

Two major factors in the rise of local option taxes have been the decline in inflation-adjusted funding for transportation investments from higher levels of governments, and the shrinking fiscal capacity of many local governments due to voter-enacted property tax limitation measures. These fiscal pressures have prompted many local governments to lobby their state legislatures for the powers to enact local option transportation taxes.

Another set of motivations has come from economic competition. Economic development has always been a key goal of local transportation investments, from the days of canals and railroads, through the paving of farm-to-market roads. Over the past decade, a new pattern has emerged, as medium-sized cities have sought to strengthen their economic competitiveness by building light rail transit systems financed with local sales taxes. Local governments are also competing for jobs and new residents on the basis of quality of life, which has led to the diversification of local option tax programs to include open space, recreational trails, and other public amenities.

Divergent devolution of transportation powers

Local option taxes are an important example of the devolution of transportation planning and financing powers to the local level. However, in the course of this study, we found that state and federal governments are devolving these powers to very different types of agencies. At the federal level, Intermodal Surface Transportation Efficiency Act of 1991 shifted an unprecedented degree of authority over project selection to metropolitan planning organizations (MPOs), and mandated that they pursue regional coordination, reconciliation of transportation and clean air plans, and consideration of multiple policy objectives in their planning processes.

When state legislatures have delegated taxation powers, they have preferred to vest them in general-purpose local governments, because these are more directly accountable to the voters. As a result of these policies, cities, counties, and transit districts are taking the lead in determining the magnitude and forms of their transportation investments. With the powers given to them by state governments, they can choose their own levels of taxation and have relatively free reign over project selection (subject in many places to voter approval).

Although MPOs still determine funding from federal transportation funds, they are rarely granted a role in deciding how local option tax revenues will be used. Because the expenditure plans that accompany local option taxes tend to be drafted by elected officials, are often adopted into law with voter approval, and are backed by new financial resources, they can carry far greater political weight than plans developed by MPOs. As a result, the multiple planning objectives that MPOs were created to address risk being overlooked.

In the end, the process of metropolitan planning can end up being driven by polls and focus groups, as policymakers seek to maximize the chances that new transportation revenue sources can win voter approval. A few states have given MPOs a formal role in the oversight of transportation tax programs, in an attempt to promote different planning approaches in the project selection process.

Trade-offs between accountability and flexibility

In designing local option tax policies, one of the most difficult issues faced by state legislatures is the apparent trade-off between ensuring accountability and preserving flexibility. In order to win voter support, policymakers have developed a variety of ways to promote accountability in the implementation of new local option transportation taxes. These include time limits on the duration of tax, fixed revenue limits, legally binding project lists, supermajority voter approval, creation of reserve funds to manage risk, and investing tax revenues to meet future maintenance costs.

However, by constraining the options open to the public officials administering the tax, these practices can have unintended consequences. The use of project-specific earmarks, for example has occasionally proven too restrictive and inflexible in light of changing needs or more detailed study. Some places have found creative ways to maintain accountability to the voters, while also providing for greater flexibility in the implementation of local option tax expenditure programs. Some of these strategies include combining flexible project lists with requirements for long-term planning, consistency with regional plans, and citizen oversight.

Extent and quality of local finance data

Despite longstanding requests from the federal government, few states have created reliable reporting mechanisms for local transportation financial data. Many state departments of transportation either do not gather information on the activities of local governments within their states, or do so only with limited surveys. The data they do collect often ignores major investments being funded with local option transportation taxes, and leaves out transit finance completely.

When it prepares the local highway finance data for *Highway Statistics*, the Federal Highway Administration works to fill these data gaps and remove inconsistencies caused by the states' different financing structures and reporting methods. However, because the FHWA does not document how it arrives at its results, the resulting data tables are less meaningful and useful than they could be.

Given the trend toward devolution, there is a growing need for more accurate statistics on local transportation finance. It would be constructive for states to begin considering more systematic data collection efforts, so that they can understand and better assist local governments in their efforts to improve their transportation systems. It would also be helpful for FHWA to publish a road map of its understanding of the various state's systems of transportation finance, and how it arrives at its local highway finance estimates.