

TO: ZACHARY Q. JACKSON, INDIANA STATE BUDGET DIRECTOR
FROM: JACOB ALDER, TAX ANALYST
DATE: APRIL 5, 2022
RE: LOCAL OPTION SALES TAXES, A REVIEW

This memorandum reviews local option sales taxes (LOST) in the United States.¹ I divide the review into two parts: first, motivation; second implementation. I conclude with a brief look at tax policy based on the 2018 Supreme Court *Wayfair* ruling.

MOTIVATION

Thirty-eight U.S. states extend unique taxation privileges to local governments, collectively called “local option taxes.”² Figure 1, adapted from the Tax Foundation shows current tax rates as of January 1, 2022: six states have average local tax rates greater than 4 percent, and 28 more than 1 percent, and eight states have max local sales tax rates greater 5 percent.

Given that only 12 states, plus Washington, D.C. do not collect a local sales tax, the majority of U.S. citizens pay local taxes (e.g., town, city, county) in addition to state and federal taxes. In 20 states, citizens face multi-tiered taxes—a unique combination of all of the above (Burge and Rogers, 2011). When states do allow local jurisdictions to administer additional taxes, they introduce a new level of complexity, in exchange for a theoretically more representative tax system. Citizens increased voice sounds at the ballot: citizens can vote for measures to determine local tax rates to raise (or lower) revenue and fund public services.

For example, the City of Pateros, WA (pop. 565), located at the scenic base of the Cascade range on US-97, recently voted to increase its sales and use tax two-tenths of one percent (.002) to fund transportation services, bringing the LOST to 2.1 percent.^{3,4} In combination with the Washington sales tax (6.5 percent), items purchased in Pateros face an 8.6 percent sales tax. On the other end of the country, Miami-Dade County, FL (pop. 2.6 million), imposes a 1 percent sales tax, in addition to Florida’s 6% sales tax.^{5,6}

Retail taxes have the benefit of high transparency—taxpayers can directly see the tax they pay on any sales receipt. States most often enable LOSTs to supplement local revenue and increase local

¹ The U.S. has long respected right of each state to tax its citizens. The Tenth Amendment to the United States Constitution outlines states’ rights: “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”

² While local option taxes may include the full range of taxes (e.g., taxes on retail sales, personal income, corporate income, real property, transportation, utilities, school) this memo concentrates solely on retail sales taxes (RST) at the local level.

³ City of Pateros, Home. Web. Accessed 4/5/2022. <http://www.pateros.com/>

⁴ Department of Revenue, Washington. “Local sales & use tax rates and changes, effective January 1, 2022.” Web. Accessed 4/2/2022. https://dor.wa.gov/sites/default/files/2022-02/LSUFlyer_22_Q1.pdf?uid=624c5e5deb063

⁵ U.S. Census, “Miami-Dade Count, FL, QuickFacts.” <https://www.census.gov/quickfacts/fact/table/miamidadecountyflorida,FL/PST045221>

⁶ Department of Revenue, Florida. “Florida Tax and Interest Rates.” Web. Accessed 4/5/2022. https://floridarevenue.com/Pages/forms_index.aspx#discretionary

autonomy. Sales taxes comprise an important source of revenue: the U.S. Census reports over \$500 billion in state and local sales taxes for 2021, seasonally-adjusted (*see* Figure 2).

IMPLEMENTATION

Jurisdictional taxation autonomy introduces challenges to both tax administrators and taxpayers. Tax administrators and elected officials (and staff), in coordination with attorneys, economists, and tax experts determine what they deem to be a tolerable level of taxation for the jurisdiction (i.e., state, county, municipality). In a 2014 primer on taxes, Justin Ross wrote that (1) Economic efficiency, (2) Equity, (3) Transparency, (4) Collectability, and (5) Revenue production, constitute a set of criteria generally acceptable to economists for evaluating tax policy (Ross, 2014). LOSTs generally rank high in all aspects except for equity.



The percent of household income spent on commonly taxed items, like food, generally declines as income increases, meaning that retail sales taxes on consumption tend to be regressive. Individuals pay close attention to tax differences. People in Paterson often drive an hour to Electric City, WA not only because there are more options, but because the option tax is lower: 8.1% vs. 8.6%. Note the “Welcome to Delaware... Home of Tax-Free Shopping” road sign to the left: the trip from Philadelphia, PA, (sales tax: 6%), to Wilmington, DE, is a popular half-hour drive for many. This demonstrates another example of the equity implication of LOSTs: people with insufficient mobility options will pay the higher tax.

Similarly, business owners must make strategic decisions when considering locating in a high sales-tax area.⁷ Often, they will locate in a bordering locale to attract customers who engage in “cross-border shopping.” This represents only one of many considerations, however; simply because an area has a lower tax does not guarantee attractive business retail. Product characteristic, total expense, and distance travel all factor into a consumer’s purchase decision. For example, customers may weigh sales tax more heavily when confronted with large, infrequent purchases, as opposed to weekly purchases like groceries (Cornia et al., 2010).

POST-WAYFAIR LOSTS

Many tax experts have commented on the effect online retail has on declining local sales tax revenue (Afonso, 2019; Bengali, 2021; Fox et al., 2021; Mikesell and Ross, 2019). When the Supreme Court ruled for South Dakota in the 2018 *Wayfair* case, it provided a constitutional avenue for local governments to tax entities based on economic presence (“nexus”). The ruling favored South Dakota’s “simple sales tax structure, which does not create undue burden for the collection of sales taxes by remote vendors” (Afonso, 2019). Given the relative newness of this law, many states have yet to re-interpret their laws or evaluate whether to modify their tax policy in a way that better accommodates economic nexus. No state rates have changed since April, 2019.

CONCLUSION

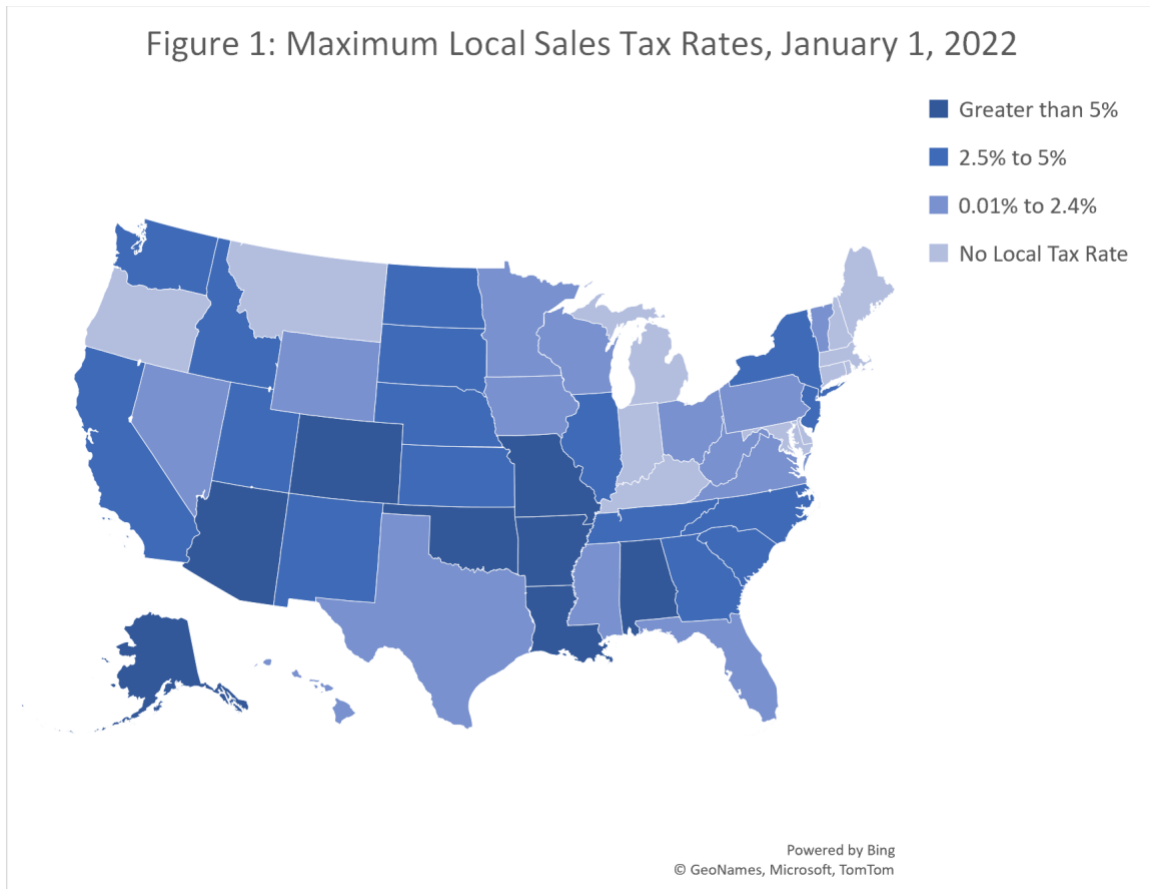
Sales tax provides a key source of revenue for local government operations, but can vary significantly depending on jurisdiction and state laws. State-by-state variation, and even county-to-city- variation affect consumer decisions, administration policy, and tax revenue.

⁷ Cammenga, J. “State and Local Sales Tax Rates, 2022” *Tax Foundation*. February 3, 2022. Web. Accessed 4/2/2022. <https://taxfoundation.org/publications/state-and-local-sales-tax-rates/>

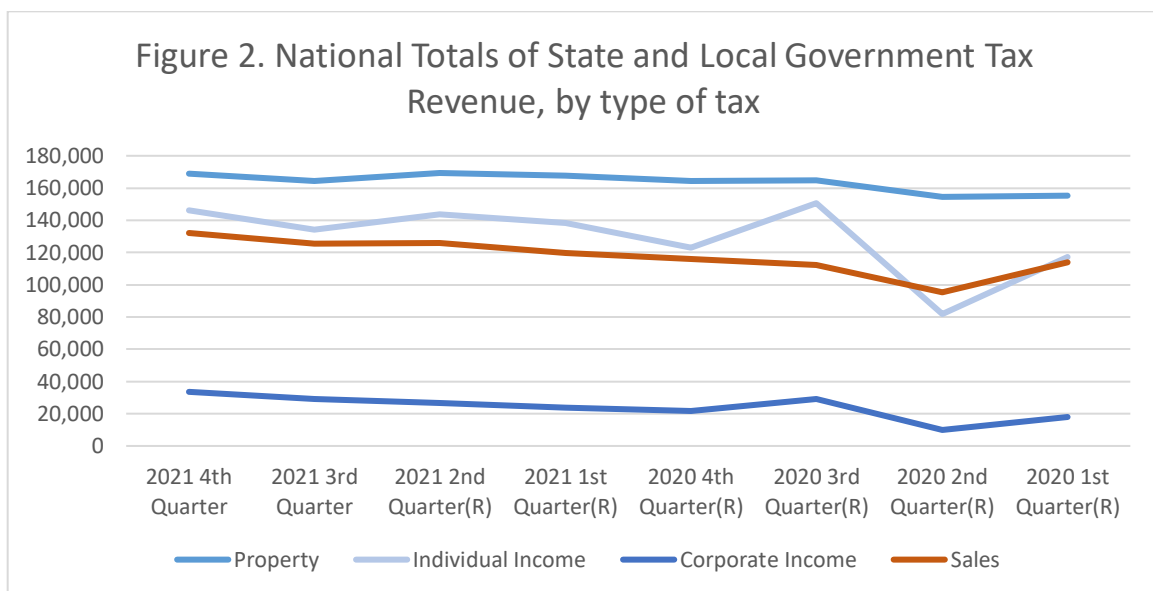
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APPENDIX



Note: Thirty-eight states allow municipalities to adopt additional taxes. This chart indicates the maximum local sales tax rates for each state, current as of January 1, 2022. Chart adapted from publicly-accessible data provided by the Tax Foundation.



Note: Dollar value, in millions, of four major taxes collected by state and local governments. (R) indicates “Revised from previously published amount.” Chart adapted from publicly-accessible data provided by the U.S. Census