A Background Paper

The Commuter and the Municipal Income Tax

ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575
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M—51

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PREFACE

In this paper, *The Commuter and the Municipal Income Tax,* the Advisory Commission presents brief background material regarding the intergovernmental tension points inherent in this fiscal issue. This paper, the first of a new publication series of the Commission, is designed to present a brief factual over-view of a current intergovernmental topic.

Neither the present nor future papers in this series contain any policy recommendations. A topic appearing in this series might, however, be subsequently added to the Commission's work program for more comprehensive and in-depth treatment and the formulation of appropriate recommendations.

This Background Paper was approved for publication at the December 19, 1969 meeting of the Commission.

Robert E. Merriam
Chairman

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Richard Gabler, Senior Analyst on the Advisory Commission staff, prepared this Background Paper. The bibliography contained at the end of the paper is an up-dated version of an earlier one prepared by the Tax Institute of America; see *The Inevitability of City Income Taxes,* April-May 1967, by Mabel Walker.

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CONTENTS

	Page
Preface	iii
Acknowledgments	iv
Introduction and Summary	1
The Municipal Income Tax Movement	2
Local Income Taxes	2
Municipal Income Taxes	3
Reasons for Adoption	3
Fiscal Stringency	3
Rising Property Tax Loads	3
Taxing Nonresidents	5
Municipal Tax Treatment of Nonresidents	6
Legal Decisions	6
Characteristics of the Commuter Tax	6
(1) The Tax Base	6
(2) Rate Structures	7
Evaluation of Flat Versus Progressive Rates	8
Revenue Effect	9
Tax Overlapping and the Commuter	13
Residence and Employment Claims on Income	13
Tax Credits	15
Administrative Complexities and Techniques	16
Withholding Problems	16
Techniques of Tax Coordination	17
(1) Cooperative Tax Administration	17
(2) Coordinated Tax Bases and Local Tax Supplements	18
Inter-local Migration Effects	19
Conclusion	20
Bibliography	21

INTRODUCTION AND SUMMARY

The commuter tax, while possessing a distinct name and a singular set of intergovernmental tension points, has not in actuality led a life of its own. Thirty years ago, there was no such thing as a commuter tax; indeed, there was no such thing as a municipal income tax. Philadelphia, however, broke the ice in 1939 and the cause then is the cause now--the need for additional tax revenues. Today, there are more than 3500 jurisdictions--including villages, school districts, etc.--that levy a local income tax and the vast majority of such taxes are extended, where permitted by statute,[1] to nonresidents. Although the general practice calls for municipal income taxes to be applied to nonresidents at the same statutory rates levied on residents, several Michigan cities and New York City apply lower rates to the commuter.

Despite its name, the commuter tax is not a fiscal device peculiar to the big cities. Most local governments in the United States are small and because of the sheer weight of numbers, most localities that levy a commuter income tax therefore are small. Nonetheless, in terms of revenues collected and--more importantly--the proportion of various size localities that actually tax nonresidents, the commuter levy has a distinctly urban orientation. This is, of course, what would be expected.

The dire financial position of local government underpins the adoption of municipal income taxes capable of "reaching" the commuter. Despite the multiplicity of small fragmented local jurisdictions that force a substantial proportion of the labor force to live in one area and to work in another--the overwhelming majority flows toward the large central cities which remain the major employment areas. Thus, the commuter tax, while not the exclusive preserve of urban areas in any sense, has a distinctly urban--and big city--character.

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[1] In Pennsylvania, school districts cannot tax nonresidents.

The commuter tax bristles with intergovernmental fiscal issues. The commuter is in actuality a dual citizen--in his locality of residence and his area of employment. Apportionment of the commuter's tax liabilities among the two jurisdictions stands out as one of the most troublesome problems. A related--but distinct question--involves the fiscal devices that can both ease taxpayer compliance and reduce administrative costs as well as avoid possible double taxation of the commuters' income.

THE MUNICIPAL INCOME TAX MOVEMENT

Local Income Taxes. The Philadelphia tax of 1939 is the oldest municipal income tax still in existence today. Previous examples, however, were Charleston, South Carolina which in the early 19th Century taxed personal income but later dropped the levy because of administrative problems and New York City which enacted the tax in 1934, immediately postponed collection and then repealed the tax in 1935 without ever having processed a return. Thus the 1939 Philadelphia tax is taken as the beginning of the modern municipal income tax movement.

Today, income taxes are in effect in more than 3500 local jurisdictions. With the solitary exception of Bernalillo County, New Mexico, however, the local income tax is presently confined to the Eastern half of the United States. Indeed, 3458 of the local jurisdictions using an income tax are located in two States--Ohio (267) and Pennsylvania (3191). Moreover, some 3476 of the jurisdictions using the local income tax were of less than 50,000 population.

This great number of small and independent local jurisdictions levying an income tax--particularly in Ohio and Pennsylvania--reveals a basic State policy favoring a high degree of decentralized government and local autonomy. As a result, this proliferation of local income taxes perpetuates and reinforces the political fragmentation of metropolitan areas. The State government of Missouri, however, avoids this consequence by restricting the use of the income tax to large cities (over 750,000 population). In sum then, localities of all sizes levy local income taxes--from New York City to school districts and villages with a few hundred residents. Nonetheless, this levy is both more noticeable and of greater revenue significance in the large cities--particularly the commuter tax element of the levy.

Municipal Income Taxes. Following Philadelphia, Toledo was the next big city (over 50,000) to levy an income tax--in 1946--one of eleven such municipalities to adopt the tax between 1946 and 1949 (see Table 1). An additional 11 cities imposed local income taxes during the decade of the fifties. The movement has further picked up in pace since 1960 as some 26 cities of 50,000 or more population added a local income tax to their revenue structure; 18 such cities doing so in 1966 or later. In sum then, 49 cities of 50,000 or more population now levy a local income tax. The tax has also been under consideration in several other major cities--such as Atlanta, Boston, Chicago, Dallas, Fort Worth, Minneapolis and San Francisco--though not as yet adopted. Indeed, the city and county of San Francisco sought to levy a one percent tax on earnings of nonresidents only to take effect January 1, 1969. This tax, passed by the State legislature, was nonetheless held invalid by the court because it was to affect only commuters and not residents as well.[1]

Reasons for Adoption

Fiscal Stringency. As might be expected, financial stringency has been a leading cause for adoption of municipal income taxes. When it enacted its levy in 1939, Philadelphia had an outstanding bonded indebtedness more than $40 million in excess of the Constitutional restriction for cities in Philadelphia's class and real estate delinquencies of nearly $25 million. The same theme of acute financial distress runs through Cincinnati and Pittsburgh (each of which needed about $6 million to balance their budgets), St. Louis ($8 million) and Detroit ($19.5 million in debt from operations plus a $15 million obligation to its various retirement systems). There can be little doubt that the need for additional tax revenues extends far beyond these examples as a motivating force for levying a municipal income tax--particularly in the big cities today.

Rising Property Tax Loads. A second force, the heavy and increasing property tax load was also a significant contributor to the search for more diversified tax structures. The prime source of local revenue, the property tax has been marked by steadily increasing rates, reaching the limits of taxpayer toleration--if not

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[1] *County of Alameda, et. al. v. City and County of San Francisco,* Sonoma County Superior Court, November 7, 1968.

TABLE 1

CHRONOLOGICAL LISTING OF CITY INCOME TAX ADOPTIONS
(Cities with 50,000 or more inhabitants in 1960)

Year	City	Rate 12/31/69 (percent)
1939	Philadelphia, Pennsylvania	3.0
1946	Toledo, Ohio	1.5
1947	Columbus, Ohio	1.0
1948	Altoona, Pennsylvania	1.0
	Erie, Pennsylvania	1.0
	Johnstown, Pennsylvania	1.0
	Louisville, Kentucky	1.25
	Scranton, Pennsylvania	1.0
	Springfield, Ohio	1.0
	St. Louis, Missouri	1.0
	Youngstown, Ohio	1.5
1949	Dayton, Ohio	1.0
1952	Lexington, Kentucky	1.5
	Warren, Ohio	1.0
1954	Canton, Ohio	1.4
	Cincinnati, Ohio	1.0
	Pittsburgh, Pennsylvania	1.0
1956	Covington, Kentucky	2.0
	Gadsden, Alabama	2.0
1957	Bethlehem, Pennsylvania	1.0
1958	Allentown, Pennsylvania	1.0
1959	Lima, Ohio	1.0
	Lancaster, Pennsylvania	0.5
1960	Hamilton, Ohio	1.0
1962	Akron, Ohio	1.0
	Detroit, Michigan	2.0
1964	Kansas City, Missouri	0.5
	Penn Hill Township, Pennsylvania	1.0
1965	Flint, Michigan	1.0
	Saginaw, Michigan	1.0
	York, Pennsylvania	1.0
1966	Baltimore, Maryland	50% of State tax
	Chester, Pennsylvania	1.0
	Harrisburg, Pennsylvania	1.0
	New York City, New York	0.4-2.0
	Wilkes-Barre, Pennsylvania	0.5
1967	Cleveland, Ohio	1.0
	Cleveland Heights, Ohio	1.0
	Euclid, Ohio	1.0
	Grand Rapids, Michigan	1.0
	Parma, Ohio	1.0
1968	Abington Township, Pennsylvania	1.0
	Kettering, Ohio	1.0
	Lakewood, Ohio	1.0
	Lansing, Michigan	1.0
	Lorain, Ohio	1.0
	Pontiac, Michigan	1.0
1969	Reading, Pennsylvania	1.0
	Wilmington, Delaware	0.25 or 0.50

statutory or Constitutional ceilings. Moreover, the property tax has long been under attack for a variety of reasons--poor administration, hitting hardest at the less affluent, a sluggish response to economic growth and proliferating exemptions. Such inequities, never defensible, escalate sharply the desire to play down reliance on this tax source--a desire that many cities have fulfilled by adopting the municipal income levy. Indeed, the "selling" of a municipal income tax is frequently packaged with a property tax reduction program--examples being Flint and Saginaw, Michigan as well as Toledo, Ohio. A recent analysis concluded that pressures on property taxes were, in fact, reduced as a result of the imposition of the local income tax.

> Income tax cities are characterized by lower property taxes as a percent of total taxes, lower per capita property taxes, and lower per capita total taxes. In addition, both per capita property taxes and per capita total taxes have increased at a lower rate in the income tax cities.
>
> While income taxes usually have been introduced under conditions of severe financial stress, with the primary objective the capture of additional revenue, the evidence suggests that in practice the income tax has to some degree acted as a substitutive rather than supplemental source of revenue, and in particular has taken some of the pressure off the property tax.[1]

Taxing Nonresidents. A third factor in the municipal income tax movement is the very practical--and defensible--consideration of having the tax applied to nonresidents. This levy, when extended to commuters, broadens the jurisdictional reach of the locality--part of the "home taxes" can then be directly exported to others who, in the absence of such a tax, would make no contribution to their jurisdiction of employment. To some, this practice is further justified as a sort of compensating move, particularly by the large central cities to counter-balance the restrictive zoning practices of neighboring jurisdictions which force the "high cost" citizen to reside in the central city. In sum then, high and rising property tax rates coupled with the need for further municipal revenues and the desire to reach the commuting population have together spurred the municipal income tax movement.

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[1] Elizabeth Deran, "Tax Structure in Cities Using the Income Tax," *National Tax Journal,* Vol. XXI, No. 2, June 1968, p. 152.

Legal Decisions. Levying a municipal income tax on nonresidents has been taken to--and approved by--the courts. Initially, the United States Supreme Court, ruling in the 1895 case of Pollack v. Farmers Loan and Trust Company,[1] held that "a tax on income is a tax on land"--thereby prohibiting a tax on nonresident income since it would be a tax on property outside the city jurisdiction. This decision was reversed, however, in the 1936 case of New York v. Graves,[2] where the Supreme Court held that nothing in the fourteenth amendment precluded taxation of income simply because it was derived from outside sources and that income and land were distinct taxing interests. In Ohio, the issue was settled by a 1950 ruling of the State Supreme Court (Angell v. Toledo) which held that "the city...does afford to plaintiff not only a place to work but a place to work protected by a municipal government..."[3]. This decision then makes explicit a benefits received-burden imposed doctrine as the basic justification for applying a municipal income tax to the commuter.

Characteristics of the Commuter Tax. Virtually all taxes on commuters, like the municipal income levies of which they constitute a part, are relatively simple fiscal instruments. Subject to exceptions in each particular, the general practice is both to limit the nonresident levy to wages and salaries or other compensation earned within the city confines and to apply the same flat rate to the income of both the commuters and residents.

(1) *The Tax Base.* Because of the large number of independent jurisdictions that levy taxes on nonresidents, each of the above statements has its exceptions. The Michigan commuter tax, for example, is applied to a broader base than "payroll" income. Nonresidents must also pay the tax on "unearned" income from dividends, interest and capital gains, though the commuter would not pay any tax on dividends or interest received from banks. Similarly, the resident portion of the Maryland, Michigan cities, and New York City levies are applied to all income, not just earnings.

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[1] 157 U. S. S. 429 (1895).

[2] 30 U. S. 308 (1936).

[3] 88 N. E. 2d 595 (Ohio Com. Pl. 1948) aff'd 153 Ohio SS. 179, 91 N. E. 2d 250 (1950).

While achieving greater equity, these broadened income tax bases tend to both complicate administration of the local income tax, thereby eating into the additional revenues generated. These adverse effects take on added significance because the inequities of the more narrow based levies can be largely contained by the low prevailing rates--most frequently one percent. Furthermore, inclusion of "unearned" income may exacerbate adverse migration effects since residents with large amounts of such income have greater freedom in their choice of residence--not requiring a location near to an employment site. Moreover, the more "equitable" levy may make the levying jurisdiction less attractive to in-migration of middle and upper income groups.

Where permitted, most cities also tax corporate and noncorporate business income, the major exception being Pennsylvania cities which are pre-empted by a State levy from taxing corporate--but not unincorporated--business income.

(2) *Rate Structures.* As to rate structures applied to nonresidents, Michigan cities have rates set by State statute that are 1.0 percent for residents [1] and 0.5 percent for nonresidents, with residents being allowed a credit for taxes paid elsewhere in the State. New York City, when it enacted its municipal income tax in 1966, further broke from the established pattern of equivalent tax rates--a pattern that grew up in part because of constitutional and statutory requirements. The New York City tax on commuters is entirely different from that for residents, with the rate being markedly lower. Instead of personal deductions, an exclusion related to income level is allowed. For income up to $10,000, the exclusion is $3,000, this drops to $2,000 for income over $10,000, to $1,000 for income between $20,000 and $30,000, and vanishes for income over $30,000.

Similarly while flat rates are the general rule, graduated rates are also used. The Wilmington, Delaware levy does not apply to income less than $4,000; a tax of one-quarter of one percent is applied to income from $4,000 to $6,000 while income over $6,000 is taxed at one-half of one percent. [2] Maryland counties and Baltimore city apply "piggy-back" rates to the State income levy which, in effect, introduces progression to the commuter and resident rates. By means of the vanishing exclusion, the New York

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[1] The rate in Detroit was raised to 2 percent from October 1, 1968 to December 31, 1970.

[2] The Wilmington levy is applied at the specified rate to all income; it does not have graduated marginal rates within a given tax bracket.

City tax--as applied to nonresidents--also effectively provides a degree of progression; graduated rates of from 0.4 to 2.0 percent are applied to New York City residents.

Evaluation of Flat Versus Progressive Rates. By using deductions, exemptions and in some cases explicit graduated rates, then, some of the more recent municipal income taxes have introduced a degree of progression into their rate structures. It should be noted, however, that there is no compelling case for graduated rates at the local level--either for nonresidents or residents. The use of exemptions facilitates administration since it reduces the number of forms that have to be processed; because it reduces the tax base, however, it requires the imposition of higher rates on remaining income to secure an equivalent yield. Moreover, even without exemptions, the municipal income tax is more equitable than the property levy where rate pressures are reduced--at least from what they would be in the absence of an income tax. These same arguments apply with even greater force to the explicit use of graduated rates. If exemptions are permitted, the effective tax rate will be progressive and the shift from property to income taxation will in itself introduce more progression into the municipal tax structure than the additional use of graduated rates. Indeed, progressive rates complicate administration since their use alone eliminates no processing of forms and invites income and expense shifting where possible by the taxpayer.

Perhaps more basic, however, is the fact that graduated rates and the use of exemptions are designed to introduce a redistributive element into the local tax structure. This, however, is a function that localities are ill-equipped to perform because their limited jurisdictional reach encourages taxpayer avoidance. The redistribution of income then is far more efficiently performed by the Federal Government. Further concerns for equity effects of a flat rate tax--which generally center on their application to low-income groups--can be partially resolved by the fact that the actual rates used at present are low, though the various jurisdictions, of course, apply different rates. Among cities 50,000 and over, the range on flat rate taxes is from 0.5 percent in Kansas City, Missouri to 3.0 percent in Philadelphia; the comparable rates for smaller localities range from 0.2 percent in some Pennsylvania areas to 2.0 percent in Newport, Kentucky.

No strong case then can be made for the use of deductions,

exemptions or graduated rates on local income taxes--either for residents or nonresidents. On the contrary, equity is easiest to defend by the use of equivalent rates. The introduction of progression into the tax requires the defense not of the concept of progression (which in itself is of limited applicability at the local level) but the defense of a specific graduated structure. If commuters were to be taxed at higher rates than residents such a differential tax policy via progression would further exacerbate metropolitan fiscal and political tensions--certainly between affluent suburbs and the poorer central cities.

Revenue Effect. Today, extending the municipal income tax to nonresidents is a virtual concomitant of adopting the municipal levy. There are, of course, exceptions--Washington, D. C. and five small Pennsylvania cities (Baldwin Borough, Brentwood, Columbia, Lancaster and Waynesboro) while school districts in Pennsylvania are not permitted--by statute--to tax nonresidents. There are few, however, who take the position that the commuter has absolutely no tax liability to his jurisdiction of employment.

Extension of the municipal income tax to nonresidents has a considerable revenue punch, particularly for large central cities. Indeed, the flow of individuals into the central city is about three times the reverse movement. Few cities, however split up the revenue yield between residents and nonresidents. Nonetheless, data from Cincinnati for the year 1964 indicate that 37 percent of the returns filed and 39 percent of the revenues collected came from nonresidents, who paid the same rate as residents. While the Washington, D. C. income tax is probably best considered as a State--rather than local--levy, it has been estimated that extension of this levy to nonresidents (now presently excluded) would yield about $40 million, or just about 60 percent of estimated 1969 personal income tax collections.

Despite the fact that the nonresident portion of municipal income yields is not generally available, it is nevertheless clear that where employed, the municipal income tax can account for a significant portion of municipal tax collections. Canton, Columbus, Springfield and Youngstown, Ohio, for example, all raise over 70 percent of their taxes via the municipal income tax; Hamilton, Lima, Toledo and Warren, Ohio, raise over 60 percent--while Gadsden, Alabama; Louisville, Kentucky; Flint and Saginaw, Michigan; Akron and Dayton, Ohio; as well as Altoona, Pennsylvania raise more than half their revenue from the municipal income tax (see Table 2). Depending on the rates

TABLE 2. CITY INCOME TAXES, RATES AND COLLECTIONS
(Dollar amounts in thousands)

State and City	Rate 12/31/69 (percent)	Municipal tax collections, 1967-68		
		Total tax collections	Income tax collections	
			Amount	As % of total collections
Alabama:				
Gadsden	2.0	$ 4,420	$ 2,548	57.6
Delaware:				
Wilmington	¼ of 1% or ½ of 1% [1]	11,778 [2]	[3]	[3]
Kentucky:				
Covington	2.0	3,326	1,225	36.8
Lexington	1.5	8,939	4,292	48.0
Louisville [4]	1.25	31,248	16,428	52.6
Maryland:	% of State tax			
Baltimore City	50%	176,886	30,211	17.1
Michigan:				
Detroit	[5] [6]	165,600	47,337	28.6
Flint	[5]	16,681	8,764	52.5
Grand Rapids	[5]	13,082	4,243	32.4
Lansing	[5]	8,243	[3]	[3]
Pontiac	[5]	6,053	[3]	[3]
Saginaw	[5]	6,693	3,367	50.3
Missouri:				
Kansas City	0.5	45,345	11,531	25.4
St. Louis	1.0	89,326	30,351	34.0
New York:				
New York City	0.4-2.0 [7]	2,680,466	430,191	16.0
Ohio:				
Akron	1.0	21,723	11,138	51.3
Canton	1.4 [8]	5,944	4,459	75.0
Cincinnati	1.0	48,293	20,365	42.2
Cleveland	1.0	68,447	9,676	14.1
Cleveland Heights	1.0	3,546	[3]	[3]
Columbus	1.0	25,467	18,282	71.8
Dayton	1.0	25,227	14,751	58.5
Euclid	1.0	5,438	913	16.8
Hamilton	1.0	3,380	2,034	60.2
Kettering	1.0	2,245	[3]	[3]
Lakewood	1.0	3,358	[3]	[3]
Lima	1.0	2,418	1,613	66.7
Lorain	1.0	3,166	[3]	[3]
Parma	1.0	4,120	[3]	[3]

TABLE 2. CITY INCOME TAXES, RATES AND COLLECTIONS (cont'd)
(Dollar amounts in thousands)

State and City	Rate 12/31/69 (percent)	Municipal tax collections, 1967-68		
		Total tax collections	Income tax collections	
			Amount	As % of total collections
Ohio (cont'd)				
Springfield	1.0	4,154	2,966	71.4
Toledo	1.5	25,987	17,043	65.6
Warren	1.0	3,194	2,182	68.3
Youngstown	1.5	10,235	7,236	70.7
Pennsylvania:[9]				
Abington Township	1.0[10]	2,499	[3]	[3]
Allentown	1.0[10]	5,685	1,044	18.4
Altoona	1.0[11]	2,684	1,483	55.3
Bethlehem	1.0[10]	4,326	541	12.5
Chester	1.0[12]	3,289	1,611	49.0
Erie	1.0[10]	8,010	1,593	19.9
Harrisburg	1.0[10]	4,411	935	21.2
Johnstown	1.0[11]	2,259	412	18.2
Lancaster	0.5[13]	2,222	596	26.8
Penn Hill Township	1.0[11]	1,763	652 est.	37.0
Philadelphia	3.0[12]	265,016	126,247	47.6
Pittsburgh	1.0[10]	55,374	11,237	20.3
Reading	1.0[12]	4,858	[3]	[3]
Scranton	1.0[10] [14]	5,113	1,048	20.5
Wilkes Barre	0.5[10]	3,325	1,195	35.9
York	1.0[10]	2,286	523	22.9

Note: Includes only cities with 50,000 or more inhabitants in 1960. Excludes Washington, D. C., which has a graduated net income tax that is more closely akin to a State tax than to the municipal income taxes. Also excludes the Denver Employee Occupational Privilege Tax of $2 per employee per month, which applies only to employees earning at least $250 per month.

[1] If total annual wages or net profits are $4,000 or less there is no tax liability. On income between $4,000.01 and $6,000.00 the rate is ¼ of 1%; on income of $6,000.01 or more ½ of 1%. The tax rates apply to total income, not merely to the proportion of income falling within a given bracket. In this sense the tax is not a typical graduated levy.

[2] Fiscal year 1967 collections.

[3]Tax went into effect after reporting period.

[4]A taxpayer subject to the 1.25 percent tax imposed by the City of Louisville may credit this tax against the 1.75 percent levied by Jefferson County.

[5]Under the Michigan "Uniform City Income Tax Act," the prescribed rates are 1.0 percent for residents and 0.5 percent for nonresidents. A resident is allowed credit for taxes paid to another city as a nonresident.

[6]The rate for residents in Detroit is increased from 1 percent to 2 percent from October 1, 1968 to December 31, 1970.

[7]New York City residents' rate ranges from 0.4 percent on taxable income of less than $1,000 to 2.0 percent on taxable income in excess of $30,000. An earnings tax of 0.25 percent of wages or 3/8 of 1 percent on net earnings from self-employment, not to exceed that which would be due if taxpayer were a resident, is levied against nonresidents.

[8]The Canton rate is 1.4 percent from January 1, through December 31, 1969; and 1.5 percent thereafter.

[9]Except for Philadelphia, Pittsburgh, and Scranton, the total rate payable by any taxpayer is limited to 1 percent. For coterminous jurisdictions, such as borough and borough school district, the maximum is usually divided equally between the jurisdictions unless otherwise agreed. However, school districts may tax only residents. Thus, if a borough and a coterminous school district each have a stated rate of 1 percent, the total effective rate for residents is 1 percent (½ of 1 percent each to the borough and school district) and the tax on nonresidents is 1 percent, the stated rate imposed by the borough.

[10]The school district rate is the same as the municipal rate.

[11]The school district rate is 0.5 percent.

[12]There is no school district income tax.

[13]The school district rate is 1.0 percent.

[14]Combined city and school district rate may not exceed 2.0 percent.

imposed and the scope of the tax base--whether it is a "payroll" tax or includes investment income--sizeable portions of these revenues undoubtedly result from extension of the municipal income tax to commuters; this is particularly true for the large cities where the in-flow of nonresidents far exceeds the reverse movement.

TAX OVERLAPPING AND COMMUTER

Residence and Employment Claims on Income. Judging by actual experience, most cities that have adopted the municipal income tax have also decided that the commuter should pay some tax to the area in which he works--the claim of "taxation without representation" to the contrary notwithstanding. The commuter tax then raises a basic point of intergovernmental tension--living in one area, working in another, and taxable in both (at least potentially), how can his tax liability be apportioned fairly between the two jurisdictions?

Localities justify taxing the nonresident--and the Courts have sanctioned their position--because they are forced to provide additional services due to the presence of the commuter--most obviously police and fire protection, use of streets and water facilities--as well as offering the opportunity for the nonresident to earn his income. The Commission in its report, *Urban and Rural America: Policies for Future Growth* presented data from three States--New Jersey, Ohio and Texas--showing that per capita expenditures and employment for various public functions tended to be higher in the large cities (population 250,000 and over) than in cities of size 25,000 to 250,000. Part of these additional costs seem likely to result from the greater use that commuters--as well as shoppers and visitors--make of the larger central cities.

Although established in legal opinion, considerations of this sort do not take local policymakers very far in determining the "fair share" of taxes to be borne by the commuter. Should the commuter pay a share of all expenditures incurred by the city where he works including the most expensive functions of education and welfare or just those of certain services more or less directly consumed by him? Can the extra costs attributed to the presence of commuters be isolated fairly well? What is the value of employment opportunity to the commuter? Should not other taxes paid by commuters--such as sales tax on lunch and purchases--be considered as well as other local business and

property taxes that are shifted forward to him in the form of higher product or service prices?

If it is a difficult matter to price out the costs of serving the commuter, a recent suggestion to deal with this problem--horizontal tax-overlapping--stresses that the time spent in various jurisdictions might be applied. Under this proposal, the right of jurisdictions to tax would be divided on the basis of the amount of time the individual and his family spend in each (governments with which the individual and his family have minimal contact would as a practical matter be excluded).[1] Refinements could then modify this ratio--educational expenditures, for example, would be excluded and the interjurisdictional incidence of other local taxes would be accounted for. These expenditure adjustments and tax refinements would tend to make this approach a rather complicated procedure--particularly as the interjurisdictional incidence of local taxes is both difficult to compute and will not remain constant from year to year as tax structures are altered.

A second proposal carries the time-orientation basis of a commuter tax even further. Viewing the commuter as a dual citizen, Melvin White has suggested that based on his fractional attachment to both area of residence and area of work, this fraction--in the neighborhood of 50-50--be applied to all taxes that both jurisdictions levy on residents: "Setting aside legal and administrative problems, this might require that he (the commuter) would pay half of the property tax and half the income tax of his home community and one-half of the income and property tax which the city where he works levies on its own full time citizens."[2] Whatever the legal and administrative complexities such a proposal introduces would seem minor compared to the political opposition that would be engendered. In terms of economic effects alone, the proposal merely assumes the commuter benefits from all services provided by the city of employment without explicit consideration of the actual benefits received from particular services. Interjurisdictional tax incidence is also simply ignored.

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[1] George F. Break. *Intergovernmental Fiscal Relations,* The Brookings Institution (Washington, D. C.), p. 50-52.

[2] Melvin I. White, "Economic Evaluation of the Municipal Income Tax" in Proceedings of the Academy of Political Science, Vol. XXVIII, No. 4, January 1968, p. 42.

Comparing the actual practice of cities with the above proposals then reveals a wide gamut of answers to the question of a commuter's tax liability to his place of employment. In those areas lacking a municipal income tax, the commuter gets off scot free; where there is such a levy, the commuter is taxed at the same or preferential rates compared to the resident--the rates being applied to the income earned (generally wages and salaries) in the area of employment. For example, Michigan has taken the 50-50 approach. By means of reciprocal local tax credits the commuter's income tax payment is divided evenly between his place of residence (the suburb) and his place of employment (the central city).

Tax Credits. The use of the same tax instrument by several different governments raises the possibility of excessive taxation for the individual commuter. At the outset, however, it must be noted that since municipal tax rates are low, much of the steam is taken from the argument. Moreover, the use of reciprocal city tax credits is prevalent--certainly among the big cities--so that nonresidents can credit the taxes paid to one jurisdiction in figuring their tax liabilities to another and, of course, State and local income taxes can be deducted from the Federal tax liability.

Nonetheless, use of the tax credit among localities is a device established by intergovernmental comity, not law. Back in 1953, when there were only 276 local income taxes, Robert Sigafoos warned that should constitutional or legislative restrictions on the use of local income taxes be removed "then one of the most complicated and confused problems of intergovernmental tax coordination and equity is bound to appear on a major scale. The present limited pattern serves notice that attempts at Federal, State, and local tax coordination might be drastically sabotaged if municipal income taxation expands further and if complete authority and control over administration are vested locally."[1]

Timely then, the warning is even more relevant now--as local income taxes have spread more than tenfold in number. There are several possible alternatives to avoid "double taxation." The State can declare either the place of residence or the place of employment as the tax situs or preferably make the use of tax credits mandatory. Even with steps such as these, however, the tax credit device avoids only the "double taxation" of the same tax

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1 Robert A. Sigafoos, "The Municipal Income Tax–A Janus in Disguise" *National Tax Journal,* Vol. VI, No. 2, June 1953, p. 188.

source; it does not benefit those commuters who work in high income tax localities and live in high property and sales tax jurisdictions.

Indeed, use of the tax credit device is rather narrow compared to its potential; it lacks both an inter-tax and rebate dimension. For example, the tax credit could be employed to minimize the "tax take" from those who both live and work in the central city. This could be accomplished by permitting the central city resident to credit part or all of his municipal income tax payment against his residential tax liability. In the case of the central city renter, who has no residential tax, a "negative" tax credit situation would arise necessitating a cash rebate. This positive and negative tax credit approach is currently under consideration in San Francisco. The same general scheme might be worked out between central city and suburb regarding the commuter. For example, the central city could collect its income tax revenues from the commuter and share these with the area of residence which in turn could permit a credit against the commuter's property tax liability or in the case of a renter, give a cash rebate.

ADMINISTRATIVE COMPLEXITIES AND TECHNIQUES

Withholding Problems. Basic to the effective enforcement of a commuter tax, and indeed the resident levy, is the ability to withhold the tax at the source. This, of course, has been noted by others: "Without withholding of the tax from wages and salaries, it is doubtful that an income tax at the local level would be feasible;"[1] and "The power to require employers to withhold the tax on wages and salaries is an absolute necessity if a municipal income tax is to be administered effectively.[2]

The commuter aspect of the municipal income tax, however, introduces two problems regarding withholding. Since some residents of an income tax locality work outside this jurisdiction, the power to withhold is not commensurate with the power to tax. As one discussant of this topic has noted,

> Considering the low rates of most of the local income taxes, there is no doubt that the potential administrative

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1 Milton C. Taylor, "Local Income Taxes After Twenty-One Years," *National Tax Journal,* Vol. XV, No. 2, June 1962, p. 118.

2 Charles F. Conlon, "Enforcement of the Municipal Income Tax," in Proceedings of the Academy of Political Science, Vol. XXVIII, No. 4, January 1968, p. 481.

costs incurred in the effective enforcement of the non-withheld segments of the tax base would be quite high relative to the revenue produced. The general view is that enforcement efforts vary considerably among local governments and that in some of them the administration of the non-withheld segment leaves much to be desired.[1]

The second withholding problem stems from the fact that cities cannot force agencies of the Federal or State government to withhold employee taxes--whether the employee is a resident or nonresident. This is a particularly sensitive area for the large central cities with their heavy concentrations of Federal and State employees. A permissive State law authorizing local income taxes can, however, ensure withholding from State employees and there also have been bills before the Congress which direct Federal agencies to withhold Federal income taxes from their employees.

Techniques of Tax Coordination

There are various devices by which States and localities can coordinate their tax systems so as to reduce compliance costs and at the same time achieve more efficient administration. The use of these devices, however, has not been fully explored by States and localities.

(1) *Cooperative Tax Administration.* Most municipal income taxes are of the local option variety that authorizes the individual jurisdiction to levy and administer its own tax. In these situations then, each levying jurisdiction acts independently of the other and no coordination need take place. This is particularly pernicious in the small localities where administrative inefficiencies seem most likely to result. In Pennsylvania, however, joint collection agreements are specifically authorized by statute and are, in fact, rather common. In view of the absence of a State income tax that localities can "climb on" and the very large number of small jurisdictions in Pennsylvania that use the local income tax--3175 with populations less than 50,000--the use of joint collection agreements seems a virtual administrative necessity. Where there is a State income tax, sharing of income tax information is another avenue of administrative efficiency--though only New York and Kentucky specifically authorize this. Indeed, the sharing of tax

[1] *Ibid.*, p. 482.

information could well involve all three governmental levels--Federal, State, and local.

(2) *Coordinated Tax Bases and Local Tax Supplements.* Two other devices used by at least some municipalities are coordinated tax bases and local tax supplements. The Michigan Uniform City Income Tax Ordinance of 1964 made general the Detroit practice of closely tying its income tax base to that of an upper governmental level--in this case, the Federal definition of adjusted gross income. A high degree of coordination was achieved when the New York City income tax was closely geared to the State tax base which, in turn, generally follows the Federal definition.

Local income tax supplements are both used and mandated in Maryland; each county and Baltimore City levies a separate rate as a percentage of the State income tax; this is also true in Bernalillo County, New Mexico. These Maryland "piggy-back" local tax supplements permit the locality to set its own rate--from a mandatory minimum of 20 percent to 50 percent of the State tax, thereby leaving the local jurisdiction free to vary its rate in accord with its financial requirements. The local tax is collected by the State (along with its own tax) and returned to the source of origin obviating the need for separate local administrative staffs. As a result, taxpayers fill out only one tax form, thereby simplifying compliance problems. For the nonresident, however, an additional step is required--an allocation of his income according to some agreed upon formula between jurisdiction of residence and employment. Once this is achieved, the State can apply the relevant local rates to each portion of the commuter's income and return the proper amount to both his place of residence and that of employment.

These devices then are obviously beneficial both to the resident and nonresident, whose compliance task is eased, and to the localities in the form of radically reduced administrative costs. Conformity with an upper governmental level tax base is not without its costs, however. Is there an equitable tax base at the State or Federal levels that localities can use? While this is not the place to discuss the matter, the current movement for tax reform in the Congress has clearly revealed wide cleavages of opinion regarding the equity of the Federal tax structure--followed rather closely by the Michigan municipalities. Use of the State tax base runs into similar difficulties. Nonethéless, the advantages of a policy of close conformity to the Federal or State tax base can swamp any equity gains that might flow from a decision to deviate substantially given the use of an upper-governmental tax base.

INTER-LOCAL MIGRATION EFFECTS

Grounded in the fact that commuters do impose additional costs on the area of employment and spurred by the pervasive need for additional tax revenues, the commuter tax has the further desirable feature of extending the fiscal reach of central cities beyond their jurisdictional boundaries. As such, inter-local tax-differentials between central city and suburb are less than would be the case if there were no commuter levy and any adverse economic effects on the jurisdiction initiating the municipal levy--resulting from an outflow of business and individuals to escape the resident tax--are somewhat mitigated.

Migration effects, of course, are not eliminated by extension of a municipal income tax to commuters. Some nonresidents may simply decide to change their place of employment as a result of the commuter levy. Moreover, the extension of a municipal income tax to nonresidents as practiced in New York City still leaves an incentive for residents to migrate. Under the New York City provision, where residents and nonresidents are taxed on completely different bases, the average liability of the single nonresident taxpayer compared to his resident counterpart varies from rather miniscule percentages for low-income groups (around $3000) to a healthy--but rare--42 percent of the resident's liability. with 20 to 25 percent being the most typical figure. For a married taxpayer with two children and typical itemized deductions, however, the effects at the $4000 income level are a tax liability of $2.88 for residents versus $2.50 for his commuter counterpart. At higher income levels, the nonresident position improve substantially; at the $30,000 income level, a New York City resident pays about $260 while the nonresident liability is about $75.

While inter-local tax differentials can be a swing item in the decision of individuals and/or business to relocate, the actual response to such situations is not known. The point must be emphasized, however, that any additional local tax can have adverse migratory effects--not just the municipal or commuter income tax. Further, there are many additional considerations besides taxes that influence the locational decision.

The tax can, of course, be restructured to prevent the acceleration of adverse migration trends. Under the Michigan Uniform City Income Tax Ordinance, for example, rates on nonresidents are set at 0.5 percent and 1.0 percent for residents. Since the resident can credit local income taxes paid elsewhere,

however, the result is a division of 50-50 between city of residence and city of employment--thereby neutralizing any migratory effects. This provision it should be noted, is applicable only to cities.

CONCLUSION

While a commuter tax extends the fiscal reach of the enacting jurisdiction, it can by no means be claimed that this is the instrument of first choice for this purpose. The ultimate, of course, is metropolitan financing governments but realities indicate that this movement moves--when it does--at a glacial pace. Similarly, increased State financial assistance for programs of heavy "spillover" benefits--education being the prime example--seem clearly preferable to the commuter tax, indeed to the municipal income tax itself. Lacking progress on these fronts, however, local policymakers are confronted with the choice of raising needed additional revenues from an income tax or the property levy. In this situation--the typical fiscal dilemma--the local income tax has shown itself capable of raising substantial amounts of additional revenue at economical administrative costs. It is more responsive to the growth of the economy and less regressive in impact than the property tax. Indeed, it permits some relief to those bearing already high property tax rates. Judging by these objectives--and their rapid spread--the local income tax appears far more likely to spread than to wither away.

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