The Florida Senate

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Committee on Fiscal Resource Senator Jim Horne, Chairman

REVENUE SHARING WITH LOCAL GOVERNMENTS: EXAMINATION OF ALTERNATIVES

SUMMARY

Taxes on cigarettes, intangibles, and sales are the main sources of state revenue shared with local governments that can be used with few or no restrictions. The Revenue Sharing Act of 1972 established formulas for sharing cigarette and intangibles taxes with municipalities and counties, and in 1982 the legislature raised the sales tax rate from 4 to 5 cents, with one-half of the increase to be shared with local governments. Even though a significant amount of state revenue is shared through these programs, Florida has no clear policy on revenue sharing; neither the amount of state revenue to share nor the division of shared revenue between counties and cities has been purposefully discussed and debated. This report points out how this lack of policy has affected the amount of revenue shared and the experiences of municipalities and counties.

Cigarette, intangibles, and sales taxes have not proved equally successful as revenue sources for local governments. Cigarette taxes are shared primarily with municipalities through the Municipal Revenue Sharing Trust Fund and the Municipal Financial Assistance Trust Fund. Since 1972, shared revenue from cigarette taxes has fallen by 68 percent in real terms. The tax is based upon physical units of consumption instead of the value of consumption, which means that revenue will not increase with the cost of cigarettes, and cigarette consumption itself has decreased. Revenue shared with counties from the tax on intangible personal property has more than doubled in real terms since 1972, but will drop significantly in fiscal year 1999-2000 because the tax rate was decreased in the 1999 legislative session. The half-cent sales tax has proved to be a growing and fairly stable source of shared revenue for municipalities and counties.

When the tax rates for cigarettes, intangibles, and sales have been increased, the formulas by which they are shared with local governments have been revised to direct the additional revenue away from local governments; the benefit of these tax increases has accrued entirely to General Revenue or various state trust funds. The percentage of these tax sources shared with local governments has fallen from 83 to 36 percent for taxes on cigarettes and other tobacco products, from 45 to 32 percent for intangibles tax, and 9.5 to 8.3 percent for sales tax.

Because of the underlying weakness in the tax on cigarettes and the historic robustness of intangibles tax, municipalities and counties have had very different experiences with respect to revenue sharing. The difficult position created for municipalities by falling cigarette tax revenue has been highlighted by several studies performed by the Legislative Committee on Intergovernmental Relations and its forerunner, the Florida Advisory Council on Intergovernmental Relations. The reduction in the intangibles tax rate and proposals to repeal the tax entirely create doubt about the future of this revenue source.

BACKGROUND

Since the 1940's, Florida municipalities and counties have received funds from state revenue sources. In 1941, 25 percent of intangible tax revenue was distributed to the county in which it was collected. In 1949, cities were authorized to impose a tax on cigarettes sold or used in their territories, up to the same amount as the state cigarette tax. To the extent that any municipal tax was imposed on cigarettes, a credit was allowed against the state tax. The 1972 Revenue Sharing Act provided new formulas by which these revenue sources would be shared with municipalities and counties. It also tied revenue sharing to the performance of specific actions by local governments, so it increased the control exercised by the state over local government finances.

Florida first imposed a general sales tax in 1949, but did not share sales tax revenue with local governments until 1982. The sales tax rate was increased from 4 cents to

5 cents, and one-half of the increase was distributed to local governments in the county where the sales tax was collected. This shared revenue could be used for city- or county-wide programs or for property tax relief.

In 1990 the Florida Constitution was amended to limit the ability of the legislature to reduce the percentage of a state tax shared with counties and municipalities. In practice, however, this provision has done little to prevent the erosion of shared revenue for local governments. For municipalities, cigarette tax revenue has declined because consumption has declined and the tax is based upon physical units of cigarettes and not on their value. Counties will experience a loss of intangibles tax revenue because the legislature reduced the tax rate, but not the percentage shared with counties.

Legislative Intent With Regard to Revenue Sharing

In 1949, ch. 26230 allowed municipalities to impose a tax on cigarettes purchased within their borders, and provided a credit against the state cigarette tax equal to the city tax. This legislation specifically recognized that cities lacked sufficient revenue to "carry out and perform the various duties imposed upon them,..., which duties are primarily the obligations of the State of Florida" and provided that "the State of Florida should provide financial aid to assist in performing state functions which are and may be performed by said municipal governments(.)" The Revenue Sharing Act of 1972 was enacted in part to provide revenue for local governments in response to the ten-mill ad valorem tax cap imposed by the 1968 Constitution. In fact, however, the Revenue Sharing Act redistributed revenue that was already being allocated to local governments, but changed the allocation method.

The half-cent sales tax distribution to local governments was enacted with two explicit goals. The first, simply stated, was to share state funds with cities and counties in order to provide general fiscal relief to the local tax system. It was understood that the shared funds were to be used to provide city-wide or county-wide programs or tax relief. The second goal was to alleviate the fiscal strain experienced by smaller, more rural counties, through the emergency tax distribution.

METHODOLOGY

This report analyses three sources of shared revenue: cigarette tax, intangibles tax, and sales tax. Revenue from these sources can be used by local governments with few restrictions, and was intended by the Legislature to provide for local tax relief or fund city-wide or county-wide programs. The report considers how each source has performed, how the revenue-sharing experience of counties and municipalities have differed, and how much revenue is shared by the state as a proportion of its own General Revenue. The analysis is based upon data reported by the Florida Consensus Estimating Conference, the Legislative Committee on Intergovernmental Relations, and the Florida Department of Revenue.

FINDINGS

Cigarette Tax

Cigarette tax revenue shared with municipalities and counties has failed to maintain its real value, and has barely maintained its nominal value since the Revenue Sharing Act of 1972. In real terms (adjusted for inflation), the value of shared cigarette tax revenue has fallen by 68 percent. Cities have borne the brunt of this decline, since shared cigarette tax goes primarily to them. Shared cigarette tax as a percent of total tobacco taxes has fallen from 85 percent to 36 percent because several tax increases have been imposed on cigarettes and other tobacco products, but all additional revenue has been directed to General Revenue or various trust funds.

Intangibles Tax

Shared intangibles tax revenue provided growing but unstable funding for counties from 1973 through 1999. The tax base grew throughout the 1980s and 1990s, but the tax rate decrease enacted in 1999 will reduce shared revenue from this source. The percent of total intangibles tax shared with local governments fell from over 50 percent in FY 1972-73 to just over 30 percent in FY 1999-2000, because two tax rate increases were not shared with local governments.

Sales Tax

The half-cent sales tax distribution to local governments is the largest source of shared revenue for general government purposes, and has grown in relation to cigarette and intangibles tax distribution since its inception. As a percent of total sales tax collections, the half-cent distribution fell from approximately 9.5 percent to 8.4 percent when the tax rate was increased from 5 cents to 6 cents.

Shared Revenue as a Percent of General Revenue

In FY 1972-73, the first year after enactment of the Revenue Sharing Act of 1972, shared cigarette and intangibles taxes equaled 9.5 percent of General Revenue. This percentage dropped steadily until FY 1981-82, when it was 5.9 percent. This decrease is entirely attributable to the poor performance of cigarette tax revenue and the cigarette tax rate increase in 1977 that was not shared with local governments. The half-cent sales tax distribution enacted in 1982 raised the size of local shared revenue as a percent of General Revenue to over 12 percent for three years. Since then it has fallen gradually to an expected level of 8.9 percent in FY 1999-2000.

Cities' and Counties' Revenue Sharing Experiences

The revenue sharing experiences of municipalities and counties have differed profoundly. Because of the revenue sources historically allocated to municipalities and counties -- cigarettes taxes to cities and intangibles taxes to counties -- counties have received an increasing proportion of shared state resources. In FY 1972-73 counties received 29 percent of shared revenue from cigarette and intangibles taxes. By FY 1981-82 the county share had risen to 37 percent. The half-cent sales tax distribution of 1982 further increased the county proportion of shared revenue to 49.3 percent in FY 1982-83, and it has grown steadily to 68.5 percent in FY 1998-99. The county share of total shared revenue is expected to decline slightly in FY 1999-2000 to 67.1 percent because of the intangibles tax rate cut enacted in 1999.

Alternative Revenue Sharing Schemes

There is no evidence that the 1972 Legislature intended to provide for cities and counties in dramatically different ways, but that has been the practical effect of funding municipalities with cigarette taxes and funding counties with intangibles taxes. If, instead of earmarking cigarette taxes mainly for cities and intangibles taxes solely for counties, the Legislature had combined the two sources and provided for them to fund a single trust fund, to be distributed on the basis of population, the outcome for cities and counties would have been much different. Municipalities would receive 84 percent more revenue in 1999-2000 under this hypothetical scheme, and counties would receive 40 percent less.

Neither the taxes shared under the 1972 Revenue Sharing Act and the half-cent sales tax distribution have maintained a stable level of state support for local governments. Despite the addition of the half-cent sales tax to the revenue sharing mix in 1983, a smaller proportion of General Revenue is shared with local governments in FY 1999-2000--8.9 percent-- than the 9.5 percent that was shared in FY 1972-73.

RECOMMENDATIONS

The revenue sharing programs covered in this report all provide significant resources for local governments, but they have not provided comparable rates of growth and stability. The cigarette tax, which is distributed to the Municipal Revenue Sharing and Municipal Financial Assistance Trust Funds, has failed to maintain even its nominal value in the past decade, and in real terms has fallen to less than one-half its original value. The tax on intangibles, which funds the County Revenue Sharing Trust Fund, has shown healthy but unstable growth over its history, but the reduction in the tax rate enacted in 1999 significantly reduced this source, and potential future cuts create doubts about its viability as a source of county revenue. The half-cent sales tax has provided a fairly stable revenue source for municipalities and counties, subject to minor downturns but mirroring the state's economic activity level.

The revenue sharing pattern established by the Revenue Sharing Act of 1972--cigarette tax money funding municipalities and intangibles tax money funding counties--has resulted in a substantial redistribution of state resources away from municipalities to counties. This redistribution has not been the result of an overt policy decision; it has come about because the revenue sources chosen to fund municipalities and counties have turned out so differently. The problems inherent in using cigarette tax as the source of municipal revenue sharing have been pointed out in reports prepared by the Florida Advisory Council on Intergovernmental Relations or its successor, the Florida Legislative Committee on Intergovernmental Relations, in 1981, 1987, and 1999. Legislation was introduced in 1999 in each chamber to address the problems created by basing municipal revenue sharing on cigarette taxes (S 1416, S 1720, H 1913, and H 1873) but only one of these bills was heard in committee, and none received extensive debate.

Until 1999, counties had been the beneficiaries of robust growth in intangibles tax revenue. Even though they received no benefit from tax rate increases imposed in 1990 and 1992, the underlying value of financial assets had grown significantly since the Revenue Sharing Act of 1972. The intangibles tax rate reduction enacted by the 1999 legislature (Ch 99-242, L.O.F.) substantially reduces this revenue source, however, and the proposed repeal of the tax poses further losses to counties.

Based on this report's findings, Fiscal Resource Committee staff recommend that the legislature review its policy regarding revenue sharing with local governments. Such a policy should provide guidance regarding legislative intent on several points:

C What is the purpose of revenue sharing, i.e., for what are local governments expected to use shared revenue?

C What criteria must be met in order to qualify for revenue sharing?

C What is the state's level of commitment to revenue sharing? Should it be based upon a particular revenue stream or should it be funded out of general revenue as a function of population and inflation?

C If revenue sharing is to be changed, how will a transition from current-law distribution formulas be achieved?

Under current law and proposed changes, it is possible (and likely for municipalities) that the only stable and growing source of revenue sharing for general government purposes will be the half-cent sales tax distribution.

COMMITTEE(S) INVOLVED IN REPORT ***(Contact first committee for more information.)***
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