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ALTERNATIVE FORMULAS FOR ALLOCATING LOST REVENUE TO COUNTIES AND MUNICIPALITIES

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Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

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**Alternative Formulas for Allocating LOST Revenue
To Counties and Municipalities**

Table of Contents

Acknowledgments..... ii

Executive Summary iv

I. Introduction 1

II. The Present Allocation Status 4

III. Simplifying the Allocation Procedure..... 8

IV. Issues Regarding Alternative Allocation Formulas 10

V. Alternative Allocation Formulas..... 14

 A. Allocation Among Sub-County Units 14

 B. Allocation Between County and Sub-County Units 18

 C. Direct Allocation..... 27

VI. Conclusion 29

Sources 31

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

Executive Summary

The Local Option Sales Tax (LOST) is a one-percent joint county-city sales and use tax. Currently, 147 counties in Georgia impose a LOST on purchases within their county boundaries that is designed to be shared between the county and municipal governments.^A Only Cobb, DeKalb, Rockdale, Gwinnett, and Cherokee counties do not, at this time, have a LOST.^B In 2001, LOST revenues exceeded \$900 million statewide. County and municipal LOST revenues accounted for 26 percent and 24 percent of their budgets, respectfully.

LOST originally came into existence in 1975 as a county tax. Its initial purpose was to provide property tax relief. The law, at the time, stated that the LOST revenue was to be shared with the municipalities within the county for the purpose of providing tax relief for the residents. This legislation stipulated that revenues from LOST be allocated between the county and municipalities on the basis of the proportion of the county's population in the unincorporated area and in the municipalities of the county, respectively.

The LOST law was challenged in 1979 and deemed unconstitutional by the Georgia Supreme Court. The law was revised to set up 159 special districts corresponding to county boundaries and to make LOST a joint county-municipal tax in which the revenues could be shared between the qualified county and municipal governments. Under the new law, any government within the county was deemed qualified to receive a distribution of the LOST revenues if that government levied at least one tax in addition to the sales tax and provided at least three of the following six services: water, sewage, law enforcement, fire protection, garbage collection, or

^A Because it is a joint city-county tax, if the county has a LOST, it is imposed on all taxable sales within its borders. Eight counties currently impose a LOST in which the funds are earmarked for the county school system. Therefore, revenues from the LOST in these cases are not involved in any allocation debate. One county, Towns, imposes both a LOST for the school system and a LOST that is allocated between governments.

^B DeKalb and Rockdale counties levy a HOST, which is a county sales tax dedicated to county property tax relief for homeowners.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

libraries. Municipal governments that fulfill these conditions are allowed under the legislation to receive a share of the LOST revenues.^C

The new law did not, however, specify a new formula to be used in distributing the revenues between the county government and the qualified municipalities. In 1994, the law was further amended to require periodic renegotiation of the distributions between the county and municipalities, but still did not specify a formula for allocating the funds. The legislation did, on the other hand, provide a list of eight factors to be considered when determining the allocation of the LOST funds between governmental units. These eight factors are not well defined, or easily ranked in terms of importance, and in some cases either are not quantifiable or require information not currently collected by the Department of Revenue or other agencies. Therefore, these factors provide little guidance to the distribution discussions between the counties and their municipalities.

This lack of guidance in allocating the LOST revenues has become a significant problem for many counties and their municipalities. Many of the recent LOST agreements required outside mediation in order for an agreement to be obtained by the December 31, 2002 deadline. In many cases the agreed upon allocation of LOST revenues may not be in the best interest of all parties; it is thought that many county and municipal agents accepted less than optimal allocations in order to have easy negotiations and keep good relations, or because one of the parties has come to rely on LOST revenue.

The focus of our research is on the allocation of the LOST revenues between the county and municipal governments. This research reviewed various aspects of the LOST allocation and considered several alternative methods of distributing LOST revenues between the county and sub-county units. This is a complex problem with high stakes. Because the allocation is a zero-sum game, any change in the allocation is almost guaranteed to make one party worse off than under the current allocation.

^C Small qualified municipalities can choose a status referred to as “absent” municipality. As such they do not participate in the negotiation process but do receive a per-capita share of the LOST revenue allocated to all municipalities in the county. As long as the combined total population of all the absent municipalities is less than 50 percent of the total qualified municipal population, the county may still reach a lawful agreement.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

The real gains lie in both sides being freed from negotiations that are oftentimes long and costly in terms of staff time and outside consultants.

While there was no one perfect formula found to make this process free of all negotiation, in presenting these alternative allocation mechanisms, several standards come to light. First, the allocation mechanism should be relatively easy to compute and as free of debate as possible. That is, the necessary data should be easily available and noncontroversial. In order to produce a simple rule, it is necessary to resist the urge to use the allocation of LOST funds to solve existing intergovernmental fiscal problems. Solutions to issues such as double taxation or suburban use of municipal services and infrastructure require large amounts of complex data. Requiring governments to incorporate these data into their negotiations will probably overwhelm the process (as is most likely the case with the existing eight criteria), causing the talks to lag or causing the parties to seek a more straightforward guide.

A second standard is that the distribution be fair. While this sounds obvious, it is a hard goal to achieve. The difficulty lies in the fact that the LOST is collected from individuals and businesses but distributed to governments. A fair distribution in the eyes of the individuals may not result in a fair distribution in the eyes of the governments receiving a distribution. Therefore, when choosing an allocation formula, officials and policy makers should consider the “fairness” of the allocation from both perspectives.

Another important characteristic of any method of distribution is that it delineate between the county's responsibility to the unincorporated population and its responsibility to all county residents. By differentiating between those county services which serve all county residents and those designed to benefit mainly the unincorporated residents, the decision of which allocation formula to use can be made clearer.

Any new allocation mechanism also needs to incorporate a phase-in period. That is, when the new LOST distribution percentages become effective, they should do so over a two to three year period. While this characteristic is not necessary to achieve a simple rule, discussions with several experts involved in the recent LOST

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

negotiations have stated that allowing a phase-in period would facilitate smoother negotiations and result in more equitable distributions.

Lastly, the factor used to allocate the LOST revenue should be mutually exclusive between the government units receiving a distribution. As is discussed in the full report of this research, distribution rules based on population do not meet this criterion. Populations of the municipalities are not mutually exclusive from the county populations, since municipal residents are also county residents. Because population is not a mutually exclusive factor, distributions based on population are only applicable to sub-county governments, such as municipalities. In sub-county allocations population is a successful allocation mechanism. The necessary data is readily available, easy to compute, and the mechanism yields a fair distribution.

On the other hand, the research considered several formulas based on mutually exclusive factors such as property taxes or government expenditures that are appropriate for distributions between the county and the sub-county units of government. (The details are presented in the full report.) In the case of property taxes, two allocation formulas are devised based either on which group of individuals pays the tax (municipal or unincorporated) or which government levies the tax (municipal or county). Both formulas are shown to be easy to compute, require available data, and result in a fair distribution between governments. Use of government expenditures yields a similar result but incorporates a larger picture of the government's finances. A third proposal, referred to as the Equalization Fund, eliminates all need for future negotiations, but requires the imposition of an additional tax. The existing LOST revenue and the new revenue are combined to form a pool of funds that would then be split on a 50-50 basis between the municipal governments (as a group) and the county government. Another alternative is to allocate a fixed percent of the LOST revenues to the county government to be used for the benefit of all county residents. The remainder would be divided between the municipal governments and the unincorporated governments. This approach has the advantage of allowing a separate allocation to the unincorporated areas. The final alternative is an approach that distributes the LOST revenues directly to the county residents, thus bypassing the county and municipal governments altogether. Under

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

this approach, the LOST revenues are distributed such that all county residents receive an equal percentage “refund” on their property tax payments.

No single allocation mechanism was found to provide a perfect solution to the allocation difficulties. But there are large gains to be made by creating a well-organized process that is fair and recognizes the many difficult aspects of the relationship between the county and the sub-county governments.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

I. Introduction

The Local Option Sales Tax (LOST) is a one-percent joint county-city sales and use tax. Currently, 147 counties in Georgia impose a LOST on purchases within their county boundaries which is designed to be shared between the county and municipal governments.¹ Only Cobb, DeKalb, Rockdale, Gwinnett, and Cherokee counties do not, at this time, have a LOST.² In 2002, LOST revenues exceeded \$1 billion statewide. County and municipal LOST revenues accounted for 26 percent and 24 percent of their budgets, respectfully. This revenue source is second only to the property tax, which accounted for 47 percent of the county budgets and 24 percent of the municipal budgets statewide. While other revenues sources such as franchise taxes on utilities and hotel/motel taxes serve to supplement their budgets, these sources do not come close to the amount of revenue raised by the Local Option Sales Tax.

LOST originally came into existence in 1975 as a county tax. Its initial purpose was to provide property tax relief. The law, at the time, stated that the LOST revenue was to be shared with the municipalities within the county for the purpose of providing tax relief for the residents. This legislation stipulated that revenues from LOST be allocated between the county and municipalities on the basis of the proportion of the county's population in the unincorporated portion and in the municipalities of the county, respectively.

The LOST law was challenged in 1979 and deemed unconstitutional by the Georgia Supreme Court. The law was revised to set up 159 special districts corresponding to county boundaries and to make LOST a joint county-municipal tax in which the revenues could be shared between the qualified county and municipal governments. Under the new law, any government within the county was deemed qualified to receive a distribution of the LOST revenues if that government levied at

¹ Because it is a joint city-county tax, if the county has a LOST, it is imposed on all taxable sales within its borders. Eight counties currently impose a LOST in which the funds are earmarked for the county school system. Therefore, revenues from the LOST in these cases are not involved in any allocation debate. One county, Towns, imposes both a LOST for the school system and a LOST which is allocated between governments.

² DeKalb and Rockdale counties levy a HOST, which is a county sales tax dedicated to county property tax relief for homeowners.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

least one tax in addition to the sales tax and provided at least three of the following six services: water, sewage, law enforcement, fire protection, garbage collection, or libraries. Municipal governments which fulfill these conditions are allowed under the legislation to receive a share of the LOST revenues.³

The new law did not, however, specify a new formula to be used in distributing the revenues between the county government and the qualified municipalities. In 1994, the law was further amended to require periodic renegotiation of the distribution amounts between the county and municipalities, but still did not specify a formula for allocating the funds. The legislation did, on the other hand, provide a list of eight factors to be considered when determining the allocation of the LOST funds between governmental units. These eight factors are not well defined, or easily ranked in terms of importance, and in some cases either are not quantifiable or require information not currently collected by the Department of Revenue or other agencies. Therefore, these factors provide little guidance to the distribution discussions between the counties and their municipalities.

This lack of guidance in allocating the LOST revenues has become a significant problem for many counties and their municipalities. Many of the recent LOST agreements required outside mediation in order for an agreement to be obtained by the December 31, 2002 deadline. In many cases the agreed upon allocation of LOST revenues may not be in the best interest of all parties; it is thought that many county and municipal agents accepted inappropriate allocations in order to have easy negotiations and keep good relations, or because one of the parties has come to rely on LOST revenue.

The focus of this study is on the allocation of the LOST revenues between the county and municipal governments. As stated earlier, the legislation provides very little in the way of direction concerning the allocation of the LOST revenues. The original legislation based the allocation on population, while later changes to the

³ Small-qualified municipalities can choose a status referred to as “absent” municipality. As such they do not participate in the negotiation process but do receive a per-capita share of the LOST revenue allocated to all municipalities in the county. As long as the combined total population of all the absent municipalities is less than 50 percent of the total qualified municipal population, the county may still reach a lawful agreement

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

legislation outlined eight factors to be considered in the allocation decision. In an effort to simplify the process of allocating the revenues between governmental units, this report first clarifies the allocation problem and then presents several possible allocation formulas or procedures. The advantages and disadvantages of these formulas are discussed.

The report proceeds as follows. The next section contains a discussion of the difficulties in applying the factors listed in the 1994 legislation. This is followed by a discussion of why and how the process should be simplified. Section IV discusses issues associated with designing an allocation procedure. The final section presents alternative factors and procedures that might be used in determining an allocation of LOST revenue.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

II. The Present Allocation Status

The initial LOST legislation included a specific allocation formula for the distribution of the revenues between the county and municipal governments. This formula allocated revenues in proportion to the population residing in the unincorporated region of the county versus the municipalities. Although the original legislation was deemed unconstitutional, the allocation formula by which the funds were distributed was not specifically altered in the revised legislation.

In 1994, the LOST legislation was again revised to include a provision requiring periodic renegotiation of the allocation agreement. In addition, the new legislation included eight criteria to be considered when allocating LOST revenues. The purpose of this list was to provide a set of guidelines to be used when allocating the LOST funds between the municipalities and the county government. The goal was to create a set of factors which could be used in determining a “fair” allocation between the various qualifying governments.

The criteria highlight several important issues which are of concern to county and municipal government officials but fall short of their intended goal for several reasons. First, there is no overall statement of what is fair when allocating the LOST funds. Second, several of the criteria focus on creating an allocation of the LOST funds that would mend existing inequities between the municipal and county governments. That is, the approach is to allocate the LOST revenues in the larger context of all service delivery and revenue issues between county and municipal governments. (These issues are also the subject of the service delivery plans required by HB 489.) This approach would use the LOST funds to offset any shortcomings in the service delivery agreements or other intergovernmental agreements, or to solve problems of double taxation. Third, many of the criteria are expressed with such vague language that they are very difficult, and in some cases impossible, to measure. Lastly, the guidelines are not prioritized in anyway so that even if they could be measured, the measures cannot be aggregated to reach a conclusion on the final distribution. In fact, the legislation, with respect to some of the criteria, only suggests that certain factors be considered in the allocation. Without a ranking system, these

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

factors could lead the allocation in several conflicting directions instead of to one common conclusion.

The first criterion stipulates that the allocation rule should take into account “the service delivery responsibilities of each political subdivision to the population served by the political jurisdiction and served during normal business hours, conventions, trade shows, athletic events and the inherent value to a community of a central business district and the unincorporated areas of the county and the obligation of all residents of the county for the maintenance and prosperity of the central business district and the unincorporated areas of the county”. This single criterion actually incorporates three different issues.

First, governments frequently serve a population other than their own residents. This argument typically relates to a central business district serving a working population that is much larger than its residential population. This is a long-standing matter that both municipal and county officials have struggled with for some time. Central business districts must provide and maintain infrastructure and services due to the additional workday nonresident population, but it has no means to tax this population without also taxing its own population. Thus, one impetus behind this criterion is to create a mechanism through which the non-municipal residents can compensate the municipal government for the provision of services to non-residents during the workday or special events.⁴ While this criterion does have some relevance to this debate over the allocation, the concept of daytime population is somewhat vague and cannot be measured with precision.

Second, an issue incorporated in this criterion has to do with recognizing the “inherent value” of both the central business district and the unincorporated areas. That is, proximity to the central business district adds value to the unincorporated (and other municipal) areas of the county and the existence of the unincorporated area gives value to the central business district.

Lastly, this first criterion states that all residents (municipal and county) have an obligation to support both the central business district and the unincorporated

⁴ There may also be a need to provide compensation between municipalities as well.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

areas of the county. While both of these last two issues may be true, neither is something that can be measured.

The second and third criteria consider the service delivery responsibility of each political subdivision. This draws the issue of “need” into the allocation decision, implying that the LOST be used as a redistribution instrument. That is, it implies that a government with more service responsibility should receive more of the LOST funds. Since the LOST revenues were not originally intended to be used for redistributive purposes, these guidelines expanded the purpose of the LOST allocation.

The fourth criterion considers the effect of a change in sales tax distribution on the ability of each political subdivision to meet its short-term and long-term debt. This criterion proposes continued reliance on the status-quo distribution and may lead to a distribution that is far from fair.

The fifth criterion states that the allocation should take into account the point of sale which generates the tax that is to be apportioned. This implies that tax revenue should be allocated on the basis of where it was paid as opposed to who paid it. At this time, the Department of Revenue does not collect data on the point of sale within a county. Furthermore, the point of sale may not be the appropriate basis for allocation of LOST, but rather it may be the point of residence, i.e., who pays the tax. In many counties, especially rural counties, consumers must purchase their goods and services inside the municipality due to a lack of commercial activity in the unincorporated area. In this case, it would seem to be inappropriate to credit all sales tax revenue generated in municipalities to the municipal government, even in the event that such data was collected. A further difficulty with this criterion is that a sale within a municipality is also a sale with the county. Thus, unless “county” is interpreted to mean the unincorporated portion of the county, this criterion cannot be applied.

Criteria six and eight focus on intergovernmental and service delivery agreements between political subdivisions. These agreements are governed by separated negotiations. These service agreements are linked to the sales tax only in that the sales tax revenues could be used to reimburse one government for services

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

provided by another. The amount of the compensation, though, should be preset at the time of the LOST negotiation. This amount should be determined at the time of the service delivery agreements and, therefore, not subject to debate during the LOST negotiations.

The last criterion deals with the use of property taxes and other revenue paid by some taxpayers to subsidize the cost of services provided only to other taxpayers of the levying government. This is a form of double taxation. The most common example of this is the case in which the municipal residents face the same county property tax rate as unincorporated residents but receive fewer services. This is another long-standing debate between the municipal and county governments. While this is a serious and difficult issue, the source of the problem lies with the property tax levy and not with the imposition of LOST. Therefore, it would be best to solve this conflict outside the context of the LOST negotiations since existence of the LOST tax is irrelevant to this debate.

Although these criteria bring to light many important factors to be considered, they provide no guide to measuring these factors or a method of weighting one factor against another. Because of this, many cities and county governments are without guidance on an appropriate allocation procedure. Experience has shown that many municipal and county governments, due to the absence of a clear and simple allocation rule, still loosely base their allocation, at least in part, on unincorporated and municipal population as stated in the original legislation.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

III. Simplifying the Allocation Procedure

At first blush, it would seem appropriate to consider using the LOST revenues as a tool to address all sorts of fiscal equity problems between the municipal and county governments. Seen in this context, the LOST revenues could be viewed as one of many revenue sources and expenditures that come together to form an allocation of revenue and services to the various jurisdictions. In this model, LOST revenues are the mechanism by which this allocation is made more palatable. That is, in this approach governments can use the LOST revenues for compensation for various inequities such as cases of double taxation, compensation for services provided by one government to another as defined by a service delivery agreement, or as compensation for use of municipal services and infrastructure by suburban commuters.

The downside to this model though, is that it has tremendous data requirements. For instance, in the case of double taxation, both parties must first agree that such an issue exists and then agree on how to quantify it. Neither are insignificant debates. Attempting to place a value on services received through a service delivery agreement so as to determine the correct amount of compensation is at least as, if not more, complex.

An alternative approach is to consider the problem of allocating the LOST funds in isolation. That is, to resist the temptation to use the LOST revenues to solve existing issues between governments and focus only on how to equitably distribute a pool of revenue between various governments or various sets of residents. This approach allows for a simpler allocation rule, several of which are discussed later in this paper, with far few data requirements. Not only will this allow for smoother, less contentious negotiations over the LOST allocation, but depending on the exact formula chosen, it will allow the allocation to be periodically updated without the need for new negotiations. This approach means reverting back to the allocation environment in the pre-1994 era. That is, an environment which is not dependent on the relationship between the governments

The current legislation also specifies that the allocation is set for ten years and then once renegotiated, the new allocation takes effect all at once. With an allocation

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

that will last 10 years, the outcome of the negotiation takes on great importance and thus each party will press its case as strongly as possible. In addition, with this revenue stream set in place for ten years, the government becomes reliant on it. If, over time, the conditions on which the previous negotiation were based change substantially, then the new agreement would likely yield a very different allocation. This can leave a government in a serious predicament. In fact, in discussions with LOST mediators, there have been times when the final agreement is softened in favor of the government that has become reliant on LOST revenue during the previous ten-year period. Employing a simpler allocation rule, with data requirements that could be easily updated, would allow the allocation to change more frequently than every 10 years as the values of the factors in the formula change. This would prevent potentially harmful shocks to the budget seen in the current locked-in approach.⁵ In fact, during the 2002 negotiations several county and municipal governments worked around this 10-year rule by filing LOST certificates with multiple effective dates. With these certificates, the allocation percentages would change over the ten-year period as negotiated by the parties.

⁵ It will also increase uncertainty in the local budgeting process as the LOST revenue funds will not be known exactly from year to year.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

IV. Issues Regarding Alternative Allocation Formulas

Before proceeding further in the design of an alternative formula, it is useful to clarify several key concepts. The first of these is the issue of fairness. Clearly a desired characteristic of any allocation rule is that it create a fair distribution of revenues between the parties. A fair distribution requires that equal parties be treated equally and that unequal parties be treated in a manner that reflects that inequality. In case of the LOST revenues, though, there are several ways of defining equity or fairness. Furthermore, it is not even clear which are the relevant parties, individuals or governments, to be considered in the equity decision. Thus in this situation, fairness is a somewhat complex concept.

Philosophers have discussed for centuries what is a fair allocation to individuals. We have a general understanding in principle of what it means to have a fair distribution across individuals, although there will be substantial disagreement on what basis should be used in order for a distribution to be considered fair. For example, if we were to allocate a pot of sales tax revenue among individuals, some people might argue that an equal amount should be allocated to each individual, while others might say it should be based on sales taxes paid, and still others might suggest the allocation be inversely related to income. There is no similar philosophic discussion or common understanding about what it means for an allocation across governments to be fair. Consideration of equity among governments is crucial in this debate because while individuals and businesses pay the LOST, the allocation is under current law a distribution to municipal and county governments.

Depending on the allocation rule applied, a fair distribution to governments may or may not result in an equitable distribution to individuals. For example, current law states that one criterion for allocating LOST revenue is that it be returned to the jurisdiction in which the sales tax revenue was collected. This criterion implies that such a basis for an allocation among governments is fair. However, suppose that this is considered in terms of an allocation to individuals. Assume there is an amount of sales tax revenue to be distributed to individuals and it was suggested that the funds be allocated based on the location of the sale. It is hard to imagine that this result would be considered fair to individuals. This is particularly true in cases of

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

where the majority of the commerce takes place in the municipal boundaries. Such a rule would allocate the majority of the sales tax revenue to the municipality even though some amount of the revenue was raised from the purchases of unincorporated businesses and residents who may not have the opportunity to shop in the unincorporated areas of the county.

The point of this discussion is twofold. First, to note that there is no agreement on what is fair. Second, to point out that what might be considered fair for an allocation across individuals is not the same as what might be considered fair for an allocation across governments.

A second issue to be clarified is the apparent confusion over the use of the term “county”. It is important to distinguish between the county government and the unincorporated area of the county. The original LOST legislation made such a distinction, and in fact allocated revenue to the municipalities and to the unincorporated area, with the payment to the later being made to the county government. The 1994 legislation confused the issue, with some of the criteria suggesting that the county government’s share of LOST be based on conditions in the unincorporated area, while other criteria implying an allocation directly to the county government for the benefit of the entire county population.

It is important to distinguish between an allocation to the county government for countywide taxes or services, and an allocation to the county government on behalf of the unincorporated area. Thus, in the discussion that follows we distinguish between the following: 1) municipal governments; 2) the county government in its role of providing countywide services; 3) the county government in its role of providing municipal services (e.g., police) to the unincorporated area of the county.⁶

A further issue arises regarding the use of an allocation to the county on behalf of the unincorporated area. When a special service district (i.e., a district in which a separate property tax is levied for the services provided) exists to provide municipal services to the unincorporated area, such a district should be treated the same way as a municipality, with the LOST allocation used to reduce the special

⁶ For the purposes of allocating the funds, any unqualified municipality would be combined with the unincorporated population.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

service property tax or increase services in the special service district.⁷ When no such special service district exists, a question arises regarding the use of the LOST allocation to the county government on behalf of the unincorporated area. If the revenue is used to reduce county taxes countywide, residents of the unincorporated area argue that the municipal residents benefit from the share of LOST revenue that is suppose to benefit residents of the unincorporated area. Municipal residents counter that they are being double taxed since countywide taxes are disproportionately used to finance services in the unincorporated area. This leads to an argument regarding fiscal equity, a matter that HB 489 was suppose to resolve. If the LOST allocation procedure is to avoid getting into all matter of fiscal equity issues, then it would certainly seem that LOST revenue allocated to the county on behalf of the unincorporated area be used for the exclusive benefit of the unincorporated area, and leave the other issues of fiscal equity to a different venue. It would be up to the county government to determine how to allocate the unincorporated area's share so that the unincorporated area benefits from the allocation. On the other hand, an allocation to the county government for countywide purposes should be used to benefit all county residents.

Thus, the allocation of LOST revenue across governments can be thought of as two separate decisions. First is an allocation to the county government in its role of providing countywide services. This allocation should be used for the benefit of all county residents, either in the form of reduced property taxes or increased services. Making the county allocation first, guarantees that both the municipalities and the unincorporated areas contribute to the operation of the county government. Second is the allocation among all of the qualified municipalities and the county on behalf of the unincorporated area. This in effect puts the unincorporated area on an equal footing with the municipalities. The original legislation, in effect, provided a zero allocation to the county in its role of providing countywide services. The 1994 legislation implies a non-zero allocation, but is unclear as to how that allocation should be determined.

⁷ Because special service districts do not meet the qualifications to receive their own LOST distribution, their allocation is included in the county's.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

A final issue concerns the factors that are used as the basis for determining distribution of the LOST revenue. Since the percent distributions need to sum to 100 percent so that all funds are distributed, the sum of the value of the factor across all governments receiving a distribution must equal the total of that factor. This means that the factor must be mutually exclusive between the jurisdictions that are to receive a distribution. For instance, the populations of two municipal governments are mutually exclusive in that a resident can only claim one principal residence. On the other hand, the populations of the county and the municipalities are not mutually exclusive since a resident of a municipality is also a resident of the county. Because population is not a mutually exclusive base, it is not possible to use the county's total population to calculate the allocation for the county government and the municipalities in one formula. This characteristic of allocation bases implies that some allocation bases are best suited for the allocation between sub-county units (i.e., municipalities and the unincorporated area), while others are best suited for the allocation between the county for countywide purposes and the sub-county units in aggregate.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

V. Alternative Allocation Formulas

This section presents several possible factors or formulas that might be used for allocating LOST revenue. We first consider factors that are appropriate for allocation among sub-county units, i.e., municipalities and the unincorporated area, and then turn to a discussion of factors that are appropriate for allocation both between the county and the sub-county units and among sub-county units.

A. Allocation Among Sub-County Units

1. Population

As has just been discussed, population is an appropriate choice for allocating funds at the sub-county level, i.e., between the municipal governments and the county government on behalf of the unincorporated area. Many county and municipal governments use population as a starting point and as a checkpoint in their LOST negotiations. Population was also the basis for the allocation prescribed in the original LOST legislation. Its popularity as an allocation factor makes it a convenient starting place for the discussion of alternative solutions.

The use of population as a basis for distributing revenues has several appealing qualities. First, the necessary data is readily obtainable and easy to use. While the allocation agreement currently uses the population figures from the decennial Census, population estimates are available for intervening years allowing the allocation shares to vary over the 10-year period. However, these are less accurate than the Census data and may lead to disagreements regarding the correct value of current population. Second, an allocation based on population tends to return the tax to those who paid it, which is one measure of equity between individuals.⁸

⁸ This assumes that all residents contribute equally to the tax revenues or consume at the same amount. If a distinct income disparity exists between the unincorporated population and the municipal population, then an allocation based on population may not be considered fair. For instance, if one municipal population is small relative to the unincorporated population but has a higher average income, they may be contributing more to tax revenues, but because the allocation rule is based on population, the municipality will be receiving fewer funds than their contribution.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

To illustrate the use of population consider Example A, where LOST funds are distributed on the basis of population in each sub-county unit (i.e., the municipalities and the unincorporated area) relative to total county population. In this case the unincorporated area is considered to be equivalent to a municipality, and while the county government receives an allocation, it is on behalf of the unincorporated area. The county government as a provider of countywide services receives a zero allocation.

Example A.

Municipality A population = 20,000

Municipality B population = 30,000

Unincorporated area population = 50,000

Total county population = 100,000

Distribution allocation –

County share = unincorporated population/(total county population) = 50 percent

Municipality A = (Municipality A pop.)/(total county pop.) = 20 percent

Municipality B = (Municipality B pop.)/(total county pop.) = 30 percent

In this formulation, each individual in the county is credited with an equal amount of the LOST revenue. That is, everyone in the county “earns” an amount equal to total LOST revenue divided by the county population. Each sub-county unit (municipalities and the unincorporated area) within the county thus receives an amount equal to the per capita sales tax revenue times the unit’s population.

One of the potential problems that arises from this distribution concerns how the funds allocated to the county on behalf of the unincorporated area are used. The basic premise of the population-based allocation is that every individual in the county will benefit equally, either in terms of property tax relief or increased service provision since every sub-county unit receives an equal per capita amount of the LOST revenue. If there is a special service district in the unincorporated area, and if the LOST funds allocated to the unincorporated area are used for the exclusive use of individuals in the unincorporated area, then this fairness is achieved. However, if the county uses the LOST funds for countywide property tax relief or service provision, the LOST allocation to the unincorporated area benefits all county residents, both

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

those living in municipalities and in the unincorporated area. Residents of the unincorporated area view this as unfair. On the other hand, if the county uses the county allocation to finance “municipal services” in the unincorporated area, then municipal residents view the use of the unincorporated area’s LOST allocation to provide tax relief or additional services just to the unincorporated area as unfair. Establishing special service districts to fund services provided in the unincorporated area would negate this issue. But in any case this should be the subject of HB 489 discussions.

Population is not an appropriate factor for determining the allocation between the county for countywide purposes and the sub-county units. The crux of the problem is that every resident of a municipality is also a county resident. One might suggest a population-based allocation formula that treats all residents as county residents while also recognizing that they are residents of municipalities and the unincorporated area. This suggests adding the population of the county and the sub-county units. Examples B and C illustrate two different ways this might be implemented.

Example B.

Total County population = 100,000
Municipality A population = 20,000
Municipality B population = 30,000
Unincorporated area population = 50,000

Distribution allocation:

County share = $\text{county pop.} / (\text{total county pop.} + \text{total muni. pop.}) = 67$
percent

Municipality A = $(\text{muni. A pop.}) / (\text{total pop. of county} + \text{total Municipal population A \& B}) = 13$ percent

Municipality B = $(\text{muni. B pop.}) / (\text{total pop. of county} + \text{total Municipal population A \& B}) = 20$ percent

Example C.

Total County population = 100,000
Municipality A population = 20,000
Municipality B population = 30,000
Unincorporated area population = 50,000

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

Distribution allocation –

County share = $\frac{\text{county pop.} + \text{unincorp. pop.}}{\text{total pop. of county} + \text{total Municipal pop. A\&B} + \text{total unincorp. pop.}} = 75 \text{ percent}$

Municipality A = $\frac{\text{muni. A pop.}}{\text{twice total pop. of county}} = 10 \text{ percent}$

Municipality B = $\frac{\text{muni. B pop.}}{\text{twice total pop. of county}} = 15 \text{ percent}$

The formula in Example B is a commonly proposed formula for allocating the funds. In Example B just the residents of the municipalities are added to the countywide population to form the base population. While in Example C, residents of both municipalities and the unincorporated area are added to the county population to form the base.

These alternative formulas do have a serious disadvantage in that they guarantee that the county government will receive at least 50 percent of the LOST revenues.⁹ That is, even in the absence of an unincorporated population, the county government will receive 50 percent of the LOST revenues regardless of the size of the county government. If the unincorporated population is zero, there is a zero allocation to the county on behalf of the unincorporated area, but the county still receives a 50 percent allocation for the benefit of all county residents.

Since the county population is not a mutually exclusive group, using population as an allocation rule between the county and municipal governments does not work especially well. Other allocation rules discussed below are shown to be much more appropriate for the allocation between the county for countywide purposes and the sub-county units that still adhere to the ease of use standard.

2. Source of Sales Tax Revenue

Using population as an allocation rule is based, at least in part, on equity being defined by who pays the sales tax. An alternative basis for equity is where the sales tax is collected. If each municipality and the unincorporated area had their own sales tax, then the revenue would go to the respective governments on the basis of

⁹ As one can see from the formulas that as the unincorporated population decreases to zero (contained in the county population figure), both formulas reduce to ½. If the unincorporated population increases then only the county receives additional funds.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

where the tax was collected. As with population, such a factor only works for allocation at the sub-county level, and not for the allocation between the county and the sub-county governments. Since any sale made in a municipality is also made in the county, there is no logical basis for allocating the sales between the county and the municipality. The major difficulty with using this factor is that the information on where sales are made is not available, although potentially the Department of Revenue could be required to collect this information.

B. Allocation Between County and Sub-County Units

Workable formulas that use population or sales tax receipts essentially imply that the allocation to the county government is on behalf of the residents of the unincorporated area, and in the absence of any unincorporated area, the county would receive a zero allocation. While not explicitly stated in the original legislation, that was what was implied. If the county government in its capacity of providing countywide services is to receive an allocation of LOST revenue, then different factors have to be used. We discuss four ways of approaching this issue. Note that these factors could be used to allocate LOST revenues among sub-county units even if the share to the county for countywide purposes is zero.

1. Property Tax Receipts

Another commonly proposed form of the allocation formula is based on property taxes paid. The rationale for the use of this factor for the allocation stems from one of the two stated purposes of the LOST, i.e. the provision of property tax relief. It is also related to the service responsibilities of the various governments, such as those driven by large daytime populations.

This allocation formula distributes the LOST revenues according to residents' property tax payments. Note that the allocation should be based on property tax revenues prior to any rollback. Since county property taxes are mutually exclusive from municipal property taxes, this rule is appropriate for both the county and sub-county unit allocation and for the allocation among sub-county units. Because the

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

allocation rule focuses on the relative size of governments, this formula achieves equity between qualified governments as well as between individuals.

The use of property tax revenue as a base for allocating the LOST revenue has two particular strong points. First, the necessary information, property tax revenues, is readily available, making the formula easy to compute. Second, the amount allocated to each government can be adjusted annually since property tax revenues change annually. This will reduce discrepancies that can build up over time between the allocation based on the current value of the factor and the negotiated allocation amount.

One way to implement this option is to calculate each government's property tax revenue as a share of total property tax paid in the county. If a special service district exists, LOST revenue would be allocated to the special service district. This is illustrated in Example D. In Example D, the distribution formula allocates funds based on which government levied the tax. This formula credits the county with all the property taxes it levies. The municipal government is credited with only the property taxes it levies, as opposed to all the property taxes paid by its residents.

Unlike the formulas illustrated in Examples B and C, this formula does not result in a minimum distribution of 50 percent to the county government because property taxes between the county and municipal governments are mutually exclusive. Even in the absence of an unincorporated area, this formula does not guarantee the county 50 percent of the LOST revenues. If the unincorporated population is small relative to the municipal population, then it is expected that the county government would be relatively smaller due to the presence of a larger municipal government. In this case, use of the formula would allocate a relatively smaller share of the LOST revenues to the county government, as would be appropriate.

Example D.

County property tax revenue from unincorporated residents only = \$100,000
County property tax revenue Municipal A residents only = \$50,000
County property tax revenue Municipal B residents only = \$50,000
Municipal A property tax revenue = \$100,000
Municipal B property tax revenue = \$200,000
Total property tax revenue = \$500,000

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

Distribution allocation –

County share = Total County tax payments/(Total County +
Municipal property tax payments) = 40 percent

Municipality A = Muni. A tax payments/(Total County + Municipal
property tax payments) = 20 percent

Municipality B = Muni. B tax payments/(Total County + Municipal
property tax payments) = 40 percent

The issue of what the county does with its LOST allocation does not arise here. Fairness is based on taxes paid, and everyone is credited, or “earns” a LOST allocation equal to the property taxes he or she paid relative to all property taxes paid in the county. If there is a special service district, then tax payments from this district would be included in the formula and it would receive its own allocation just like the municipalities. If not, then the residents of the unincorporated area get credit for the taxes they pay to the county government in the same way that residents of the municipalities do. Each resident of the county receives the same per-capita share of taxes paid. If the county for countywide purposes is not to share in the LOST allocation, then county property taxes for countywide purposes would be excluded from the formula and the LOST would be divided between the municipalities and any special service district

An alternative approach is for municipalities to receive a distribution in proportion to the total property taxes paid (including county taxes) by the municipal residents compared to county and special service district property taxes paid by unincorporated residents in the county. This formula is illustrated in Example E. In this example, everyone gets “credit” for his or her share of the total property taxes collected in the county, but the allocation is made just to the sub-county units. That is, this allocation rule assumes that the county government receives a zero allocation from the LOST fund.

Example E

County property tax revenue from unincorporated residents only =
\$100,000

County property tax revenue Municipal A residents only = \$50,000

County property tax revenue Municipal B residents only = \$50,000

Municipal A property tax revenue = \$100,000

Municipal B property tax revenue = \$200,000

Total property taxes = \$500,000

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

County share = unincorporated property tax payments/total property tax payments of all county residents = 20 percent

Municipality A share = municipal plus county property tax payments/total property tax payments of all county residents = 30 percent

Municipality B share = municipal plus county property tax payments/total property tax payments of all county residents = 50 percent

There are several disadvantages to using property tax revenues as a base for the allocation formula. First, not all municipalities levy a property tax. In order to be a “qualified” municipality for purposes of receiving LOST funds, the municipal government must levy at least one tax in addition to the sales tax but many levy a hotel/motel tax instead of a property tax.

Second, the size of the allocation awarded to a governmental entity under this formula is directly influenced by the amount of property taxes levied. This provides an incentive to each government to impose higher property taxes and rewards inefficiency, although it is unlikely to be a significant influence on the level of property taxes. This problem could be alleviated by using the property tax digest instead of property tax revenues, although using the digest would undermine the goal of property tax relief. Without the actual tax rates, the true tax burden cannot be determined. In fact, it is easy to imagine instances where jurisdictions might need to impose higher property tax rates to offset their low property values and other jurisdictions may be allowed to impose lower rates because they enjoy high valued property. In such a case, using the property tax digest as a base would allocated more funds to the jurisdiction with the high valued property and aggravate the tax burden of the low property value jurisdiction by reducing their LOST allocation.

2. Government Expenditures

The use of government expenditures as an allocation base is the mirror image of the property tax formula with a bit more inclusion because government expenditures are financed by more than just property tax revenues. Because of this, many of the same advantages and failings of the property tax as an allocation factor apply. Like the previous approach, this approach is designed to achieve a fair

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

distribution between governments and is not necessarily concerned with providing a fair allocation between populations. Under this approach, the governmental unit with the larger expenditures is ranked higher and receives a larger share of the LOST funds. As an allocation method, this approach meets the ease of use standard as expenditure data is readily available and legislation can be written to define the relevant components. Because county expenditures are mutually exclusive from municipal expenditures and municipal expenditures are mutually exclusive from other municipalities, this approach is applicable to both the county/sub-county units allocation and the allocation among sub-county units.

Unlike the two previous approaches, the expenditure-based approach can only take one form. This formula allocates the LOST funds as a percentage of all expenditures of the qualified governments. Therefore, if municipal expenditures were 30 percent of the sum of all qualified governments' expenditures for that county, then the municipal government would receive 30 percent of the LOST funds. In the property tax model, alternative formulas were available due to the two possible manners in which to treat the county taxes paid by municipal residents. In the case of expenditures, except when there is a special service district the county expenditures for countywide services versus expenditures for unincorporated residents are not identified. Therefore, just one form of this allocation formula exists.

This approach has the potential to be manipulated by the governments. Under this approach, a governmental unit can increase its allocation by increasing expenditures in any manner. To the extent that the county increases expenditures that primarily benefit unincorporated residents as opposed to all county residents, the county creates a situation whereby the municipal residents subsidize the unincorporated residents. On the face of it, this allocation rule also produces an incentive for larger and inefficient government spending because it rewards large government budgets, although this is not likely to be a significant force since it would require large excessive spending to influence the allocation in any significant manner. Lastly, as with property taxes, basing the allocation on expenditures reflects the service demands of the government, including the service requirements associated

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

with a large daytime population. Expenditures should probably be measured net of grants received.

3. Fixed Percentage Allocations

An alternative approach is to set a fixed percentage of the LOST revenues to be allocated to the county government for countywide purposes. This money would be earmarked for the provision of countywide services designed to benefit all county residents, such as county courts. This percentage could be legislated by law and be the same for all counties. The remaining revenues would be divided between the unincorporated residents and the municipal residents based on population, government expenditures or property tax revenue. The difficulty of course lies in deciding the share to be allocated to the county government.

A possible approach to determining the county share is to allocate LOST revenue to the county for countywide purposes based on its expenditures on mandated services such as courts and sheriff. An amount of LOST revenue per dollar of expenditures paid from non-grant revenue could be set. For example, \$2.30 for every \$100 spent on these services could be allocated to the county. In this way, counties that had large service responsibilities would receive a large dollar allocation.

The remaining LOST funds can be divided between the municipal population and the unincorporated population on the basis of population or property tax revenues. In this way, all citizens of the county contribute to the county government because their contribution is based on expenses of services designed to service all county citizens. Furthermore, it separates the unincorporated population from the county government and allows them to have a status equal to that of the municipal residents. Of course, county governments with above average expenditures are penalized under this approach to some degree as their expenditures above the average do not contribute to their LOST distribution amount. County governments with below average expenditures receive a windfall in the sense that they receive funds based on expenses they do not incur.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

4. Lost Equalization Fund

In the minds of many public officials and policy makers, the primary purpose of LOST is to relieve the existing pressure on property taxes, either reducing property taxes or increasing spending without an increase in property taxes. If all of the LOST revenue was allocated to the county and the county used the revenue for property tax relief, then every taxpayer would get a reduction in property taxes. On the other hand, if all of the LOST revenue were allocated to sub-county units on a per capita basis and used for property tax reduction, all taxpayers would get a reduction in property taxes. In both cases, property taxpayer would, on average, get the same property tax reduction. Differences would exist because of differences in per capita property tax bases among sub-county units. But essentially, taxpayers would be indifferent between the two allocations. However, the county and sub-county units are clearly not indifferent as to how LOST revenues are allocated. One of the reasons why is that the government that gets the LOST revenue can have lower property taxes.

It is believed that there would be less friction and less contentious debate between the county and municipalities over the LOST distribution if there were some reassurance that, say the county, would not be seen as having increased property taxes if its LOST allocation was less. None of the solutions discussed above addresses this problem associated with the allocation between the county for countywide purposes and the sub-county units.

One way to accomplish this is through the following option. Under this option, a special entity called the Equalization Fund would levy a property tax on all property within the county that raised the same amount of revenue as the LOST. Thus, two separate but equal pots of money are available for allocation, the LOST revenues and the special property tax revenue, henceforth referred to as the Equalization Fund. These two pots of money are combined and allocated to the county government and to the sub-county units. The shares to the county for countywide purposes from the LOST and the Equalization Fund would sum to 100 percent, i.e., if the county received 30 percent of the LOST revenue, it would receive 70 percent of the Equalization Fund revenue.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

The following gives an example of how this would work. For simplicity we assume no unincorporated area and that the allocation between municipalities is based on population. Consider a county with two municipalities, denoted Municipality A and Municipality B. They have a population of 500 and 250 respectively, for a total county population of 750. Given the property tax bases and millage rates, Municipality A collects \$500,000 in property taxes. Municipality B collects \$150,000, and the County government collects \$560,000. Residents of City A pay 17 mills of property tax (10 for the City and 7 for the County), while residents of City B pay 12 mills (5 for the City and 7 for the County). Assume that the LOST yields \$75,000, or \$100 per capita. The Equalization Fund would thus have to generate \$75,000, which would require a millage rate of 0.9375 levied on all residential and business property in the county. We assume full rollback of the property tax rate for the LOST revenue received as well as for any allocation received from the Equalization Fund, just as in the current law. Jurisdictions would be free to increase their millage rate so that part of the LOST revenue is used for expanded services.

Consider Allocation Alternative I, in which the County government gets all of the LOST revenue. The county government can lower its millage rate by 0.9375, from 7.000 to 6.0625, or by 13.4 percent. City A would get \$50,000 from the Equalization Fund and City B would get \$25,000, since we are assuming that the allocation across municipalities is based on population. Thus, City A can reduce its property tax rate to 9 mills (from 10 mills), or by 10 percent, and City B can reduce its property tax rate to 4.1667 mills (from 5 mills), or by 16.7 percent.

Total revenue (after the rollback) of all three jurisdictions are the same as without the LOST. (Recall we assume a full rollback, although the jurisdictions could increase property tax rate beyond the rollback rate.) Property taxes per capita are \$100 less than without the LOST, which is the LOST revenue per capita. All three governments have reduced their millage rate (after the rollback and before any increase in service levels.)

Allocation Alternative II has the same outcome, except that the County government gets \$75,000 in Equalization Fund revenue while the municipalities share

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

the LOST revenue. Since the allocation to the governments is the same under Allocation Alternative II as under Allocation Alternative I, the results are the same. Thus, in both alternatives property tax rates for the municipalities and the county go down.

If the LOST revenue were split 60/40 with municipalities and the county, the result would still be the same, except that the LOST revenue would be allocated as follows: \$30,000 to the county, \$30,000 to City A, and \$15,000 to City B. The Equalization Fund would be allocated as follows: \$45,000 to the County, \$20,000 to City A, and \$10,000 to City B. The total each jurisdiction gets is the same as under Alternative I and Alternative II.

The key aspect of this solution is that it eliminates the zero-sum exclusive nature of the situation. Currently, the LOST allocation can be described as a zero-sum game. Gains to one government can be seen as losses to another. This solution, by creating a second pool of funds, eliminates this aspect of the allocation decision. This will result in easier and in all likelihood, quicker negotiations. While this approach does not explicitly provide rules for the allocation of the LOST revenues between the county and municipal governments, it is designed to always achieve a 50/50 split between the municipalities (as a group) and the county government of the combined pool of the LOST revenues and the Equalization fund. Because of this property, there ought to be little debate about the allocation since whatever amount is not obtained from the LOST funds are made up from the Equalization fund.

The downside to this approach is that it increases the tax burden of the residents of the county by imposing the second property tax necessary to fund the Equalization fund. Second, this solution will automatically allocate 50 percent of the sum of the LOST revenues and the Equalization fund to the county government and 50 percent to the municipal governments without any consideration of the services provided by either government. Lastly, this approach does not allow for the separate treatment of the unincorporated areas of the county. They are considered only in the context of the county government's allocation.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

C. Direct Allocation

On the opposite end of the spectrum from the previous approach, a method could be designed to refund the LOST revenues directly to the individuals of the county. Under this approach the governments, both county and municipal, are completely left out of the allocation decision. All funds are dispersed directly to the property tax payers, residents and business property owners, within the county. One approach to the allocation would be to base it on the amount of county (or county and municipal) property taxes paid. The allocation could be based on other factors, for example, an equal amount per capita.

If property taxes paid was the basis for the allocation, all LOST funds would be allocated to taxpayers so that all property tax payers in the county receive a reimbursement equal to some percentage of their county property tax payments. All taxpayers in the county would receive the same percentage reimbursement of their property tax, essentially an equal percentage rebate on property taxes paid. Because the county and municipal governments do not receive any LOST revenue under this approach, property taxes, either municipal or county, are not rolled back as they are under current law due to the receipt of LOST funds. This will keep the pressure on property taxes and may result in a reduction in government services as expenditures would now have to be funded through an increase in the property tax.

As an allocation approach, this method has several appealing characteristics. First, it eliminates the need for allocation negotiations between the county and municipal governments, as all allocations would be made directly by the state to the individual taxpayers. However, this may not be easy for the state to administer. Second, this approach maintains equity between the county and municipal property tax payers of the county. All property tax payers, whether municipal or unincorporated, are treated equally under this approach. The downside to this approach is that individuals may not view the reimbursement as a reduction in their property taxes. Essentially this approach reduces property taxes paid by the amount of the LOST revenue. But if individuals do not recognize the reimbursement as an indirect reduction in their property taxes, they may misunderstand the point of a sales tax that is returned to taxpayers. To the extent a taxpayer's property tax payment

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

does not match its LOST tax payment, this approach becomes a redistribution mechanism. For instance, a firm may pay little sales taxes but receive a large property tax rebate because it has large taxable property value.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

VI. Conclusion

This report has discussed various aspects of the LOST allocation and presented several alternative methods of distributing LOST revenues between the county and sub-county units. This is a complex problem with high stakes. Because the allocation is a zero-sum game, any change in the allocation is almost guaranteed to make one party worse off than under the current allocation. The real gains lie in both sides being freed from negotiations which are oftentimes long and costly in terms of staff time and outside consultants.

While there was no one perfect formula found to make this process free of all negotiation, in presenting these alternative solutions, several standards come to light. First, the allocation mechanism should be relatively easy to compute and as free of debate as possible. That is, the necessary data should be easily available and noncontroversial. In order to produce a simple rule, it is necessary to resist the urge to use the LOST funds to solve existing intergovernmental fiscal problems. Solutions to issues such as double taxation or suburban use of municipal services and infrastructure require large amounts of complex data. Requiring governments to incorporate this data into their negotiations will probably overwhelm (as is most likely the case with the existing eight criteria) the process, causing the talks to lag or causing the parties to seek a more straightforward guide.

A second characteristic is that the distribution be fair. While this sounds obvious, it is a hard criteria to fulfill. The difficulty lies in the fact that the LOST is collected from individuals and business but distributed to governments. A fair distribution in the eyes of the individuals may not result in a fair distribution in the eyes of the governments receiving a distribution. Therefore, when choosing an allocation formula, officials and policy makers should consider the “fairness” of the allocation from both perspectives.

Another important characteristic of any method of distribution is that it delineate between the county's responsibility to the unincorporated government and its responsibility to all county residents. By differentiating between those county services which serve all county residents and those designed to benefit mainly the

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

unincorporated residents, the decision of which allocation formula to use can be eased.

Any new allocation mechanism also needs to incorporate a phase-in period. That is, when the new LOST distribution percentages become effective, they should do so over a two to three year period. While this characteristic is not necessary to achieve a simple rule, discussions with several experts involved in the recent LOST negotiations have stated that allowing a phase-in period would facilitate smoother negotiations and result in more equitable distributions.

Lastly, the factor used to allocate the LOST revenue should be mutually exclusive between the government units receiving a distribution. As was discussed in this report, distribution rules based on population do not meet this criteria. Populations of the municipalities are not mutually exclusive from the county populations, since municipal residents are also county residents. Because population is not a mutually exclusive factor, distributions based on population are only applicable to sub-county levels. On the other hand, this report provided several formulas based on mutually exclusive factors such as property taxes or government expenditures which are appropriate for distributions between the county and the sub-county units of government.

No single allocation mechanism presented in this report incorporates all these recommendations. Nor does any one formula perfectly allocate the LOST. But there are large gains to be made by creating a well-organized process which is fair and recognizes the many difficult aspects of the relationship between the county and the sub-county governments.

Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

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Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

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Alternative Formulas for Allocating LOST Revenue To Counties and Municipalities

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