Council Comments

Citizens Research Council of Michigan

810 FARWELL BUILDING DETROIT 26

203 BAUCH BUILDING LANSING 23

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THE MUNICIPAL INCOME TAX

The development of the municipal income tax is, for the most part, a post World War II phenomenon. In 1940, Philadelphia enacted a local income tax and with it developed the initial local income tax pattern which has served as a model for other municipalities adopting the tax. Seven of the 41 large cities (Washington, D.C. excluded) with 1950 populations over 250,000 (Philadelphia, Pittsburgh, St. Louis, Cincinnati, Columbus, Toledo, and Louisville), currently use this revenue source. Philadelphia is the only city exceeding one million population that imposes the levy. Population aside, the number of municipalities levying the tax exceeds 440.

The tax itself assumes a variety of forms and many variations of legal and popular names are used to describe it; for example, earnings tax, payroll tax, wage tax, earned income tax, wage and income tax, occupational license tax, gross license tax, income and net profits tax, and income tax. Taxation experts generally agree, however, that its general characteristics would be best described were it titled a "gross earnings and net profits" tax.

The tax is most commonly a low flat-rate tax on the earned income of individuals and the net profits of businesses and professions. An employer withholding system is almost always used as a collection device. Inter-jurisdictional tax crediting or reciprocity arrangements have been developed and are commonly used to cope with potential problems of double taxation. The experience of other large cities indicates that the tax can be economically and effectively administered and is a productive source of revenue.

Tax Base

Tax on Individuals—All the municipal income taxes in use apply to gross wages, salaries and other earned income of resident and non-resident individuals. All of the cities mentioned above, with the exception of Louisville, tax the total earned income of *residents* regardless of where the income was earned. Louisville, on the other hand, taxes only that income of residents which was earned within the city. All of the cities listed above tax *non-residents* for only that portion of their income earned within the taxing city.

Exemptions and deductions are rarely provided under the tax on individuals and are not provided by any of the above cities. However, restriction of the tax to earned income necessarily excludes from taxation the various types of unearned income such as dividends, interest, rents, etc. Pensions and unemployment compensation are other specific types of income commonly exempted.

Net Profits Tax—For businesses and professions the tax base is net profits. In Pennsylvania, only the net profits of unincorporated businesses and professions are taxable, while elsewhere corporate profits are also taxable. Non-profit organizations not engaged in business activities are usually excluded from the tax.

Taxable profits are determined in basically the same way for both unincorporated and corporate business. The ordinances of all the seven larger cities provide for deductions of all ordinary and necessary expenses, similar to those allowed by the federal government. Taxes based on income are not deductible in determining taxable net income in any of these cities.

A property-sales-payroll allocation formula is used by the cities in determining the portion of net profits of a corporation or non-resident unincorporated business or profession that is to be attributed to sources within the city. The allocation is based on averaging the following ratios:

1. The percentage which the average book value of the real and personal property of the enterprise located within the city bears to such property wherever located.

2. The percentage which the gross receipts of the enterprise within the city bear to the total of such receipts.

3. The percentage which payrolls paid within the city bear to the total payroll.

Only gross receipts and payrolls are considered in the Louisville allocation formula.

Tax Rate

Municipal income tax rates vary from one-half of one percent to one and one-half percent in the above cities. No municipal government makes use of graduated rates. For the most part, municipalities are either statutorily required to levy a fiat-rate tax or a uniformity provision of the state constitution apparently precludes any but a flat-rate levy.

Yield

The actual tax yields from the income tax in the seven cities in 1958 are shown in the following table.

Continued on Page 4

MUNICIPAL INCOME TAXES IN CITIES WITH POPULATIONS OVER 250,000

City	*Philadelphia*	*Pittsburg*	*St. Louis*	*Cincinnati*	*Columbus*	*Toledo*	*Louisville*
Rates on individuals, businesses, professions		½ of 1%	1%	1%	1%	1%	1 ¼ %
Tax on individuals							
On wages and salaries On other earned income	Taxable Taxable	Taxable Taxable	Taxable Taxable	Taxable Taxable	Taxable Taxable	Taxable Taxable	Taxable Taxable
On pensions, unemployment compensation, etc. On property or unearned income	Not taxable Not taxable	Not taxable Not taxable	Not taxable Not taxable	Not taxable Not taxable	Not taxable Not taxable	Not taxable Not taxable	Not taxable Not taxable
Exemptions:							
Personal Credits for dependents Deductions	None None None	None None None	None None None	None None None	None None None	None None None	None None None
Liability of individuals Residents of taxing unit	On all earned income regardless of source of origin.	On all earned income regardless of source of origin.	On all earned income regardless of source of origin.	On all earned income regardless of source of origin.	On all earned income regardless of source of origin.	On all earned income regardless of source of origin.	Only on income earned within the city.
Non-residents	On earned income earned within taxing city.	On earned income earned within taxing city.	On earned income earned within taxing city.	On earned income earned within taxing city.	On earned income earned within taxing city.	On earned income earned within taxing city.	On earned income earned within taxing city.
Reciprocity	Not Provided	Provided	Not Provided	Provided	Provided	Provided	Not Provided
Tax on business, professions, associations, etc.							
On unincorporated business On corporations	Taxable Not taxable	Taxable Not taxable	Taxable Taxable	Taxable Taxable	Taxable Taxable	Taxable Taxable	Taxable Taxable
On non-profit organizations not engaged in business activities	Not taxable	Not taxable	Not taxable	Not taxable	Not taxable	Not taxable	Not taxable
Coverage:							
Gross Receipts Net Profits	Not taxable Required base	Not taxable Required base	Not taxable Required base	Not taxable Required base	Not taxable Required base	Not taxable Required base	Not taxable Required base
Deductions:	All necessary expenses.	All necessary expenses.	All necessary expenses.	All necessary expenses.	All necessary expenses.	All necessary expenses.	All necessary expenses.
Liability: Resident unincorporated business, professions, etc.	All net profits regardless of where earned.	All net profits regardless of where earned.	All net profits regardless of where earned.	All net profits regardless of where earned.	All net profits regardless of where earned.	All net profits regardless of where earned.	All net profits regardless of where earned.
Resident and non-resident corporations and non-resident unincorporated business, professions, etc.	(sorry, cannot read!)	Same as in Philadelphia	Same as in Philadelphia (Payroll figures exclude general executive officers)	Same as in Philadelphia	Same as in Philadelphia (Payroll figures exclude general executive officers)	Same as in Philadelphia (Payroll figures exclude general executive officers)	Same as in Philadelphia except allocation of net profits considers only two factors: 1. Gross receipts 2. Payrolls (Payroll excludes general executive officers)

MUNICIPAL INCOME TAXES IN MAJOR CITIES IN 1958

City (a)	Population (1958 Estimate in thousands)	Income Tax Rate Percent	Income Tax Collections (in thousands)	Collections Per Capita
Philadelphia	2,209.0	1.50%	$67,775	$30.68
St. Louis	870.0	.5*	9,684*	11.13*
Pittsburgh	685.1	.5	5,420	7.91
Cincinnati	550.3	1.0	12,983	23.59
Columbus	451.6	1.0	10,939	24.22
Louisville	415.1	1.25	10,176	24.51
Toledo	335.5	1.0	7,711	22.98

(a) An income tax in Washington, D.C. is similar to that employed in the states.

*Estimated $20,100,000 for 1960-61 due to a rate increase from M of 1 percent to 1 percent.
Source: U. S. Bureau of the Census, *Compendium of City Government Finances in 1958* (Washington, 1959).

Many factors affect the per capita yield of the municipal income tax. Rate variations are a most obvious reason for differences in the tax yield. The economic composition of the community, including income levels, also accounts for significant differences. Furthermore, per capita yield figures are distorted by variations in collections from non-resident taxpayers.

Reciprocity

The municipal tax on income, by its very nature, has resulted in problems of jursidictional priority. In metropolitan areas, particularly, it poses a threat of double taxation for those taxpayers who live in one community and earn their income in another. Pennsylvania law gives priority to the community of residence to prevent double taxation of the same income, except in Philadelphia where the place of employment has priority. However, the jurisdiction of employment may tax the income of nonresidents at a rate representing the difference between the tax levied in the individual's place of residence and the maximum rate permitted by Pennsylvania law.

In Ohio, the place of employment is given preference over the place of residence. In most cases a taxpayer may claim credit for taxes paid another community to the extent of the tax imposed on his income by his place of residence. Toledo will split the tax collected from non-residents with any city which extends the same benefit to residents of Toledo.

St. Louis has no problem of this kind as yet. The Missouri enabling law permits only cities with over 750,000 population to levy the tax and only St. Louis qualifies.

Since Louisville taxes only that income earned within the city, it is not faced with such interjurisdictional tax crediting problems.

Cost of Administration

The cost of municipal income tax administration is relatively low. The ratio of the cost of administration to the yield is in almost every case less than 5 percent. The 1959 cost-yield ratio was 2.3 percent in Cincinnati; 2.0 percent in Louisville; 2.0 percent in St. Louis; 2.3 percent in Columbus, and 4.6 percent in Toledo. Data are not available for Philadelphia and Pittsburgh.

Experience indicates that a high ratio of large industry employment materially eases a city's administrative problems through the device of employer withholding. Hence, it is generally held that industrial communities find an income tax easier to administer than do non-industrial.