Report to the 2004 Minnesota Legislature

Minnesota's Local Sales and Use Taxes

February 2004

MINNESOTA · REVENUE

This report was prepared by the Minnesota Department of Revenue.

The Department would like to acknowledge the assistance of Phillippa Doolan of Cambridge University in the preparation of this report.

Correspondence from those submitting written comments for the public hearings will be available upon request.

If you have questions about this report, call the Minnesota Department of Revenue at (651) 556-6003.

This report is available on our website:

www.taxes.state.mn.us.

January 30, 2004

The Honorable Lawrence J. Pogemiller
Chair, Senate Committee on Taxes
Room 235, State Capitol
75 Dr. Martin Luther King, Jr. Blvd.
St. Paul, Minnesota 55155

The Honorable Ron Abrams
Chair, House Committee on Taxes
Room 585, State Office Building
100 Dr. Martin Luther King, Jr. Blvd.
St. Paul, Minnesota 55155

Dear Senator Pogemiller and Representative Abrams:

This report examines four general aspects of local sales taxes in Minnesota: their use, the state and local approval requirements, the criteria for granting of state authority, and their compatibility with the multi-state Streamlined Sales Tax project.

In preparing this report, the department examined the history of the local option sales tax; identified the underlying principles and policy issues; and gathered comments from the public and elected representatives.

The department was asked to make specific recommendations about the role of local sales taxes in Minnesota's revenue system, and about the criteria and process that should be used when granting authority to impose local sales taxes.

Based on its research, the department finds that the current process for authorizing local sales taxes is essentially sound. However, this process could be improved through clarification and standardization of the approval criteria. This report outlines these findings.

This report was mandated under Minnesota Laws 2003, First Special Session, Chapter 21, Article 8, Section 19. Minnesota Statutes, Section 3.197, specifies that a report to the legislature must include the cost of its preparation. The approximate cost of preparing this report is $10,000.

Sincerely,

Daniel A. Salomone
Commissioner

cc: Secretary of the Senate
Chief Clerk of the House
Legislative Reference Library—6 copies

Minnesota's Local Sales and Use Taxes

a report to the 2004 Minnesota Legislature

Contents

Preface

The Minnesota legislature enacted, in 1971, a statewide prohibition on local sales and use taxes. In recent years, pressures on local finance have caused city and county governments to look beyond property tax and local government aid for additional revenue. As a result, in recent years there has been a continuous stream of local sales tax proposals coming before the legislature. Some of these proposals have received the necessary legislative authorization and some have not. In view of the increasing demand for local sales and use taxes, the legislature, in 2003, directed the Department of Revenue to conduct a study of local sales and use taxes and make recommendations in several areas.[1]

This review focuses largely on general sales and use taxes. The numerous lodging, food, liquor, and entertainment sales taxes are not the focus of this report.

Legislative Mandate

Legislative mandate

The 2003 session mandate directs the Minnesota Department of Revenue to report on four general aspects of local sales taxes in Minnesota (Laws 2003, First Special Session, Chapter 21, Article 8, Section 19—see appendix A):

1. Authorized uses of current and proposed local sales taxes
2. State and local approval requirements
3. Criteria for granting state authority for local sales taxes
4. Compatibility of local sales taxes with the multi-state Streamlined Sales Tax Project, currently under way.[2]

Further, the mandate asks the department to make specific recommendations about the appropriate role of local sales taxes in Minnesota's state and local system, and the criteria and process that should be used to secure state and local authority to impose local sales taxes.

This study is organized into five sections:

I History and Current Tax Review
II General Policy Principles and Issues
III Review of Public Meetings on Local Sales Tax
IV Recommendations
V Appendices

1. Laws 2003, First Special Session, Chapter 21, Article 8, Section 19. (See Appendix A for full text.)
2. The Streamlined Sales Tax Project is a multi-state effort to simplify and modernize sales and use tax administration in order to substantially reduce the burden of collecting Minnesota state and local sales and use taxes for Minnesota and non-Minnesota retailers.

Part I – History and Current Tax Review

History

History

Minnesota is a relative newcomer to state and local sales taxes, especially local sales taxes. About half the states adopted state sales taxes during the Great Depression, with most of the remaining states doing the same after World War II. It wasn't until 1967 that Minnesota adopted a state sales tax, becoming the second-to-last state to do so.

The main goal of the new 3 percent tax was to provide an additional source of revenue to replace rapidly rising, increasingly unpopular, local property taxes.

Increases in state aid to local governments and state budget problems largely explain the need for subsequent state sales tax increases. In 1971, the rate was increased to 4 percent as part of the "Minnesota Miracle"—a package of tax increases used to fund state aids to schools and other local jurisdictions. State budget problems in 1981, 1983, and 1991 boosted the state rate to 5, 6, and 6.5 percent, respectively.

Local sales tax prohibited

As part of the sweeping 1971 reforms, the legislature enacted a prohibition against new or increased local taxes on sales or income (M.S. 477A.016). This signaled a clear preference for reducing local property taxes with state aids instead of new local-option revenues, and for maintaining some measure of control over local fiscal disparities. Under the prohibition, new local sales taxes were limited to those specifically authorized by state legislation, except for the general authority pertaining to new lodging taxes.

At the time of the 1971 prohibition, five Minnesota cities had already adopted sales taxes on certain purchases. In 1969, by special law, Minneapolis had adopted a 3 percent tax on admissions, transient lodging, and amusements with live entertainment ("cabaret tax"), the proceeds of which could be used for general government purposes. In 1970, Bloomington, Duluth, and St. Paul adopted 3 percent transient lodging taxes by local ordinance or charter amendments. Bloomington also adopted a 3 percent tax on admissions to spectator events, and Rochester adopted a 3 percent tax on transient lodging in 1971.[3]

Until the 1990s, this prohibition meant few communities had revenue sources other than the property tax. In recent years, continued pressure for alternatives to local property taxes has increased the number of requests for legislation authorizing new local sales taxes.

---

3. Informational memorandum, Senate Counsel & Research, Jan. 22, 2001

Background

Relative to other states, Minnesota's local governments are significantly more dependent on local property taxes, less so on local sales and use taxes. Table 1, below, shows that in fiscal year 2000, the local property tax in Minnesota accounted for 94.2 percent of all local tax revenues, and 47.1 percent of revenues from all sources. This compares to 71.6 percent and 44.2 percent, respectively for all states. In contrast, Minnesota local sales and use taxes accounted for 2.8 percent of all local taxes and 1.4 percent of total revenues, compared to 17.2 percent and 10.6 percent, respectively for all states.

Today, general local sales taxes exist in only 10 of Minnesota's 853 cities, and in only one of our 87 counties—Cook County.

Table 1

Local dependence on major taxes—how do we compare?
Major local taxes as a percent of local taxes and revenues—FY2000

	Taxes		All revenue	
Tax type	**Minn.**	**All states**	**Minn.**	**All states**
Property	94.2	71.6	47.1	44.2
Sales and Use	2.8	17.2	1.4	10.6
Income	0.0	5.1	0.0	3.2
Corporate Franchise	0.0	1.1	0.0	0.7
Motor Vehicle Sales	0.1	0.4	0.0	0.2
Other taxes	2.9	4.6	1.5	2.9
Total	100.0%	100.0%	50.0%	61.8%

Source: U.S. Census Bureau

State policymakers have been reluctant to provide broad authority for local-option sales taxes or other local revenue sources out of concern over the uneven distribution of revenues across communities. Other policy concerns about administrative and compliance costs, accountability, inter-jurisdictional competition, and fairness might explain this reluctance to provide broader local revenue-raising authority.

The 2003 mandate to which this report responds is the latest attempt to review the policy and implementation aspects of granting expanded local sales authority.

The many policy issues surrounding general or project-specific local sales tax expansion will be described in this report.

Current Local Sales Taxes in Minnesota

Scope and Structure

Minnesota has 11 local general sales and use taxes, and 19 special local sales taxes (i.e., taxes on specific commodities).[4] Minnesota is notable for the relatively few authorized local sales and use taxes that have been implemented. A statutory prohibition on local sales and use taxes enacted in 1971 (M.S. 477A.016) provides that "No county, city, town or other taxing authority shall increase a present tax or impose a new tax on sales or income."

Current law allows cities to adopt transient lodging taxes of up to 3 percent if the proceeds are used for tourism promotion (M.S. 469.190). More than 60 cities and towns imposed this tax in calendar year 2001, collecting revenues of approximately $8 million statewide. Cities also have statutory authority to impose utility franchise fees. This report does not review local tourism taxes or utility franchise fees.

While only 10 of Minnesota's 853 cities and one county impose general sales and use taxes, approximately 20 percent of the state general sales tax base (including automobiles) is now subject to a local general sales tax—because these jurisdictions cover approximately 16 percent of the state population and 24 percent of the total statewide commercial/industrial tax base.

The remainder of this section provides information on eight aspects of local sales taxes outlined in the 2003 legislation mandating this study.

4. See Appendix C for a complete list of local sales taxes.

Authorized Uses of Current and Proposed Local Sales Taxes

Background

Local general sales and use taxes have been proposed and authorized in Minnesota since 1971. One county (Cook) has a local general sales and use tax. However, excluding St. Paul and Minneapolis, cities with local general sales and use taxes have mostly been larger regional cities with a particular project need.

Authorized uses of local general sales and use taxes vary and do not lend themselves to easy categorization. Current uses include a hospital, two airports, two water/sewer infrastructure projects, a park, and three civic/convention centers. See Appendix C for a more complete listing.

Authorized uses

There have been several projects where local sales tax was authorized by the legislature but not imposed. These projects included three convention centers, two community centers, one sewer project, one stadium project, and one economic development project. Reasons for not imposing the tax include: 1) the question was not put on the ballot (three times), 2) the city council did not pass the ordinance (once), and 3) the local referendum failed (six times). See Appendix G for an annotated listing.

Many more local sales and use taxes have been proposed than have been approved by the legislature. In general, there is no substantial difference between the types of projects approved and those not approved.

Responding to the growing number of proposed local sales and use taxes, and recommendations from a 1996 Sales Tax Advisory Committee, a standardized approval process and uniform local sales tax features were enacted by the 1997 Legislature (M.S. 297A.99).[5] The 1997 legislation provided that:

- a political subdivision may impose a general sales tax if permitted by special law,
- the political subdivision shall adopt a resolution prior to the legislative request,
- imposition after approval is subject to voter approval in the political subdivision,
- the local tax base be the same as the state tax base,
- a complementary local use tax be enacted,
- exemptions for the local tax parallel the state exemptions, and
- quarterly 'begin' and 'end' dates be used.

State and Local Approval Requirements

Approval

Because of the statutory prohibition against new local sales taxes, special legislation is needed for authorization. The Minnesota sales and use tax law sets forth the requirements for approval of local sales taxes, unless the special law provides an exemption from the provisions (M.S. 297A.99). The requirements are that:

Approval requirements

- Before seeking legislative approval, the governing body (city council, county or township board) must adopt a resolution in support of the tax. It must include information on the proposed tax rate, how the revenues will be used, the total amount to be raised before the tax expires, and its estimated duration.
- If authorized by the legislature, the question must be put to a vote at a general (not special) election, which may be either a state or local general election.

5. This law change initially applied only to new authorizations, but beginning in calendar year 2000, the changes applied retroactively to existing local sales taxes. For more information see Local Sales Taxes in Minnesota, Information Brief, Minnesota House Research Department, October, 2003, at http://www.house.leg.state.mn.us/hrd/pubs/localsal.pdf.

Approval requirements

As noted, the enabling legislation may allow other methods of local approval. For instance, laws authorizing the Minneapolis, St. Paul, Bloomington, and Rochester (first authorization) sales taxes provided that the city council could impose the tax by ordinance.

Duration and Reauthorization

The special law for each jurisdiction provides for the duration of the tax. In most instances, duration is the time necessary for the tax to yield sufficient revenue to pay the debt of general obligation bonds issued to fund the project(s) authorized. Exceptions are the Duluth and Minneapolis taxes, which have no expiration date.

Two variations from the standard statutory duration language whereby the tax expires when sufficient revenues have been met are the Hermantown tax and the St. Cloud area sales tax. The Hermantown sales tax, authorized in 1996, expires either (1) when sufficient funds have been raised to pay for the specified projects, or (2) 10 years after imposition, whichever is later. The St. Cloud area sales tax began on January 1, 2003, and will expire on December 31, 2005. No bonding authority was granted. The proceeds are dedicated to pay all or part of certain improvements to the St. Cloud regional airport. Any revenues collected in excess of the amount needed for the airport project may be distributed among the participating cities for specified projects of regional significance.

Notably, when funds for the original purpose have been realized, special laws re-authorizing local sales taxes usually have also provided a specific amount of money to be raised for new uses (see Appendix D, Selected Historical Summaries for the Local General Sales Taxes). An example of this tendency toward reauthorization for other purposes is the Minneapolis sales tax, which is dedicated to operating and improving the Minneapolis Convention Center. In 1992, the legislature expanded the authorized use of this tax for neighborhood learning centers. However, the city has not yet used its city sales tax revenue for this purpose.

In jurisdictions that now have or have had local sales taxes, the full duration of the tax has been used to raise sufficient revenue for the authorized purposes.

Regional Benefits vs. Local Benefits

The department was also asked to review the authorized uses of the local sales tax to determine if they have been regional in nature or of more limited benefit. While the concept of "regional" may be somewhat imprecise, it seems reasonable to classify the current tax uses for airports, hospitals, and very large convention centers as regional, and general revenue, parks, police stations, fire stations, sewer systems, and streets as local. It can also be argued that public libraries could be considered as either regional or local, depending on the size of the city. See Appendix C for a listing of the full range of current uses, along with some proposed uses.

Although the definition of a regional center is open to interpretation, the League of Minnesota Cities's cluster analysis (at left) provides four city groupings that could be helpful in defining "large regional centers." The four groupings are: Metro central cities, Metro large cities, Greater Minnesota major cities and Greater Minnesota regional centers.

One view of regional centers*

Metro central cities
Minneapolis
St. Paul

Metro large cities
Apple Valley
Blaine
Bloomington
Brooklyn Park
Burnsville
Coon Rapids
Eagan
Eden Prairie
Edina
Maple Grove
Minnetonka
Plymouth

Greater Minnesota major cities
Duluth
Rochester
St. Cloud

Greater Minnesota regional centers
Albert Lea
Austin
Bemidji
Brainerd
Cloquet
Fairmont
Faribault
Fergus Falls
Hibbing
Hutchinson
Little Falls
Mankato
Marshall
Moorhead
New Ulm
Northfield
Owatonna
Red Wing
Virginia
Willmar
Winona
Worthington

*from the League of Minnesota Cities report, "Clustering Minnesota Cities" available at www.lmnc.org/pdfs/ClusteringMinnesotaCities0803.pdf

For a complete analysis of how cities in Minnesota are classified by the League of Minnesota Cities, visit the League's website: www.lmnc.org.

It should be noted that most of the local sales and use taxes, excluding St. Paul and Minneapolis, have been imposed in Greater Minnesota cities. City representatives have made the assertion that any benefits to these cities should be deemed regional because they are regional centers.

Criteria for Granting State Authority for Local Sales Taxes

Resident/Nonresident Impacts (Tax Exporting)

The department was asked to estimate what portion of revenue raised through the local sales and use taxes comes from residents of the tax jurisdiction, Minnesota residents outside the jurisdiction, and nonresidents. Unfortunately, the data needed to make such estimates are not readily available, and it is not possible to make good estimates of resident and nonresident shares of the local sales taxes levied in each of the 10 cities.

Local residents do seem to be concerned about how much of the tax will be borne by city residents. Conceptually, we know that communities export their local sales tax burden when nonresidents buy taxable items from local businesses—either directly by shopping in the community, or when local businesses ship products to nonresident purchasers. As a result, a community's ability to export its local sales tax burden will be directly correlated with (1) the relative number of residents in nearby jurisdictions, and (2) the relative strength of its own economic base.

The department's Tax Incidence Study indicates that initially about 44 percent of the state sales and use tax falls on businesses and 56 percent falls on individuals, and that a portion of these shares are paid by nonresidents. The study estimates that nonMinnesotans pay about 3.8 percent of Minnesota state sales tax collections.

However, these proportions will vary from community to community. As a preliminary step to estimating how the tax will be distributed, an estimate of the local portions paid by businesses (44 percent statewide) versus those paid by individuals (56 percent statewide) needs to be obtained. Further, each then needs to be divided into the exported and local portions.

Estimating tax exporting potential for every city requires population and economic data on neighboring communities for some relevant distance around the taxing jurisdiction. Unfortunately, the "relevant distance" depends on the drawing power of the taxing community and a host of other factors that might affect the decision to shop outside one's own community.

A crude estimate of a community's relative ability to export local sales taxes might be derived using its commercial and industrial (C/I) property tax base relative to its total property tax base. The larger the business share of the local property tax base, the more likely it is that the community will be able to export a greater share of its local sales taxes to nonresidents, who are likely to account for a greater share of local retail sales. Shares of C/I tax base for cities with population over 10,000 are shown in Appendix B.

Lacking the ability to make city-specific estimates of tax exporting, the department asked cities that currently have local sales and use taxes to identify resident/non-resident impacts of their local tax. Most often the city representatives did not cite specific statistics or studies. Some city officials referred to estimates done by consultants at the time of implementation. City-level survey data, not currently available, might be the best method for creating direct estimates of the real impact of local sales taxes. Collection of this data could strengthen a proposal to secure legislative and local approval of a new local sales tax request.

The general policy implications of tax exporting will be discussed in a later section of this report.

Local Revenue Raising Capacity and Alternative Revenue Sources

Local Revenue-Raising Capacity

Another area identified for evaluation was the ability of jurisdictions to raise revenue by other means, including the local property tax. The department was asked to provide comparative data on local capacity to raise revenue from various sources, including the property tax; local property tax rates (tax effort); and how communities without local sales taxes fund projects that are funded with local sales tax revenue in other communities.

Table 2

CY 2001 Revenues, cities over 2500

	Statewide total	percent
Total Revenues	**$3,433,265,890**	**100.0**
"Own source" revenue		
Local sales tax	85,559,245	2.5
Property taxes	837,890,401	24.4
Tax increments	297,415,538	8.7
Franchise taxes	72,724,954	2.1
Hotel/motel taxes	23,540,675	0.7
Gravel, gambling taxes	1,606,184	0.05
Special assessments	215,498,557	6.3
Licenses and permits	126,539,555	3.7
subtotal	**$1,660,775,109**	**48.4**
Intergovernmental revenues		
Federal grants	115,528,688	3.4
State grants	839,134,247	24.4
County grants	25,679,414	0.7
Local grants	36,561,580	1.1
subtotal	**$1,016,903,929**	**29.6**
Fees, fines, interest		
Fees, service charges	305,485,816	8.9
Fines and forfeits	35,979,912	1.0
Interest earnings	193,097,134	5.6
All other revenue*	221,023,990	6.4
subtotal	**$ 755,586,852**	**22.0**

***Includes donations, refunds, reimbursements, principal payments on loans receivable and sales of property.**

Source: Revenues, Expenditures, and Debt of Minnesota Cities Over 2,500 in Population, Minnesota Office of State Auditor, Year Ending December 31, 2001.

Table 2, at left, shows the composition of city revenue for all cities with populations over 2,500, taken as a group, and table 3 (facing page) shows how the revenue shares of each of the 10 cities with local sales taxes compare to those of the average city over 2,500 in population.[6] These tables provide a look at how local sales tax cities vary from other cities in regard to their dependence on different revenue sources.

Generally, table 3 shows that relative to the average city, cities with local sales taxes tend to be less dependent on local property taxes, tax increment revenue, and license and permit revenues, fines and forfeit revenue, and interest earnings. They depend more on state grants, and, of course, local sales taxes.

Capacity to Raise Revenue. Measures of local revenue raising capacity are found in many state aid formulas. They measure how much revenue would be raised locally if a standard, or uniform, tax rate is applied to the tax base or bases of each community. Depending on the policy context, this could be done for all tax bases such as taxable property, retail sales, resident income, and others, or for a specific tax base. For our purposes, it is useful to compare the spatial distribution of taxable retail sales to that of the local property tax. This is provided in table 4, on the next page.

6. *Revenues, Expenditures, and Debt of Minnesota Cities Over 2,500 in Population*, Minnesota Office of State Auditor, Year Ending December 31, 2001.

Table 3

Comparison of local sales tax cities to large cities without local sales tax — average percent share of total revenue, CY 2001

	Mpls	St.P	Roch.	Duluth	St. Cld area	Mankto	New Ulm	Hermtn	Proctor	Two Hrbrs	Non-sales tax cities avg.
Local "Own Source" Revenue	**50.5%**	**40.9%**	**45.3%**	**35.4%**	**52.1%**	**48.8%**	**40.9%**	**61.6%**	**30.2%**	**23.1%**	**48.5%**
Local Sales Tax	7.3	3.9	9.3	11.8	1.3	9.5	4.4	20.7	3.2	4.5	0.0
Property Taxes	22.1	18.1	21.4	8.7	18.8	20.5	23.2	24.3	16.3	12.5	27.5
Tax Increments	11.4	5.4	4.9	8.2	6.2	3.6	5.1	5.8	5.8	3.6	8.6
Franchise Taxes	4.2	5.6	1.1	1.6	3.0	0.5	0.4	0.5	0.8	0.7	1.0
Hotel/Motel Taxes	0.5	0.8	2.2	2.2	1.1	0.0	0.6	0.0	1.1	0.4	0.2
Gravel,Gambling Taxes	0.05	0.1	0.0	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.04
Special Assessments	1.7	4.7	3.4	2.2	18.6	11.8	6.0	7.7	2.0	0.1	7.9
Licenses, Permits	3.4	2.3	3.1	0.6	3.1	2.8	1.1	2.5	1.1	1.3	4.3
Intergovernmental Revenues	**32.0%**	**35.8%**	**23.8%**	**44.0%**	**31.6%**	**37.6%**	**44.9%**	**27.3%**	**60.9%**	**52.7%**	**29.6%**
Federal Grants	5.5	4.0	3.2	5.8	11.6	2.1	0.1	0.3	2.1	0.0	2.1
State Grants	25.0	30.5	19.3	36.6	19.5	32.6	33.6	27.1	58.8	50.4	23.0
County Grants	0.1	0.4	1.3	1.1	0.2	0.0	0.1	0.0	0.0	2.2	1.0
Local Grants	1.4	0.8	0.0	0.3	0.4	2.9	11.1	0.0	0.0	0.2	1.0
Fees, Fines, and Interest Revenue	**17.4%**	**23.4%**	**30.9%**	**20.6%**	**16.4%**	**13.6%**	**14.2%**	**11.1%**	**8.9%**	**24.2%**	**23.4%**
Fees, Service Chges	7.1	10.5	9.6	5.0	4.8	4.5	5.9	0.8	3.0	18.1	9.9
Fines and Forfeits	1.5	1.0	0.5	1.0	1.4	0.8	0.8	1.0	1.0	0.4	0.9
Interest Earnings	2.3	5.4	7.9	4.6	5.4	2.5	6.3	4.4	4.1	2.5	6.5
All Other Revenues	6.5	6.5	12.9	10.1	4.8	5.8	1.2	4.9	0.7	3.1	6.0

Table 4

Sales and Use Tax Base and Property Tax Base Per Capita of Selected Cities (Local Sales Tax Cities in Bold)—Highest to Lowest

City	Est. Sales Tax Base Per Capita, 2003	City	Property Tax Capacity Per Capita, 2003
Alexandria	$44,564	**Rochester**	$864
Grand Rapids	40,883	**Minneapolis**	813
Grand Marais	32,778	Grand Marais	777
Brainerd	32,475	**St. Paul**	766
Bemidji	28,034	**Hermantown**	735
Mankato	25,930	Alexandria	730
Rochester	21,343	Grand Rapids	724
Fergus Falls	20,612	**St. Cloud Area***	723
Marshall	19,584	**Mankato**	596
St. Cloud Area*	16,753	Fergus Falls	558
Minneapolis	16,690	Int'l Falls	545
Willmar	16,500	Marshall	521
Hibbing	15,086	Faribault	517
Hermantown	14,681	Brainerd	499
Duluth	14,502	**New Ulm**	489
Worthington	13,386	**Duluth**	489
Int'l Falls	12,257	Albert Lea	482
Albert Lea	11,598	**Two Harbors**	479
New Ulm	11,062	**Proctor**	466
Faribault	11,049	Fairmont	445
St. Paul	10,741	Willmar	444
Two Harbors	10,579	Bemidji	427
Fairmont	10,388	Hibbing	413
Crookston	7,528	Worthington	380
Proctor	7,143	Crookston	245
Minnesota	**$16,137**	**Minnesota**	**$823**

*St. Cloud, St. Augusta, Sartell, Sauk Rapids

For the cities shown, the estimated sales tax bases range from about 44 percent of the statewide average to nearly three times as much. By contrast, local property tax bases range from 30 to 105 percent of the statewide average, reflecting in part state policies designed to equalize local property tax capacity.

Local property tax rates

Local Property Tax Rates (Tax Effort). In this section, we compare actual use of the base, or level of effort made to raise revenue from the local tax base, specifically the property tax base, as requested by the mandate.

Fortunately, tax effort is easily measured by use of the local tax rate.[7] Two communities with the same tax base will be able to raise the same revenue with the same level of effort (tax rate). If one exerts a greater effort (applies a higher rate), it will raise more revenue.

Table 5, below, compares the city portion of local property tax rates and the total property tax rate (all jurisdictions) for cities with sales taxes, and for cities without sale taxes. Generally, cities with local sales taxes, with the exception of St. Paul, Duluth and Hermantown, have higher property tax rates than non-sales tax cities in the same population range. This could mean that sales tax cities have higher expenditure needs, greater demand for public services, and smaller tax bases; or that they receive less state aid than non-sales tax cities. The same is true of Cook county's tax rate relative to those of other counties.

Note that all sales tax cities, with exception of St. Paul, have property tax rates greater than the statewide average for all non-sales tax cities. Cook county also has a tax rate that is lower than that of other counties.

Table 5

Local sales taxes and local property tax effort (CY 2003)*

(Cities with local sales taxes compared to all cities in the population group)

Population Range	Jurisdiction Population	Tax Capacity Rate (all jurisdictions)	Tax Capacity Rate (city only)**
0–5,000			
All cities		109.0	39.6
Two Harbors	3,633	116.5	53.8
Proctor	2,841	143.7	43.4
5,001–10,000			
All cities		104.8	33.8
Hermantown	8,178	116.7	22.6
10,001–15,000			
All cities		99.6	30.1
New Ulm	13,543	125.5	55.3
15,001–40,000			
All cities		99.6	30.1
Mankato	33,362	100.8	32.1
40,001–100,000			
All cities		102.5	27.7
St. Cloud area	86,281	106.7	31.6
Duluth	86,044	105.4	23.0
Rochester	91,264	104.4	33.0
Over 100,000			
All cities		99.4	35.4
Minneapolis	382,700	110.7	44.3
St. Paul	288,000	83.3	23.0
County comparison			
7-county metro average	2,484,107	98.6	29.1
Greater MN county average	1,361,870	112.5	39.5
Cook County	3, 024	64.9	45.9

* Local property tax is measured by the local property tax rate (tax capacity rate)

** Tax capacity rate is the total property tax revenue divided by the net tax capacity (market value times class rate), adjusted for current market conditions.

How Communities without Local Sales Taxes Fund Similar Expenditures

The department was asked to determine how jurisdictions that do not have a local sales tax raise revenue to fund projects similar to those currently funded by local sales taxes. Our review covered projects authorized but not implemented, current library projects, and convention center construction.

Projects authorized but not implemented

Of the 23 local general sales taxes that have been authorized, 10 have not been imposed. In most cases, the projects were carried out, though sometimes to a lesser extent than originally planned, and frequently with the aid of state grants. See Appendix G for a summary of the projects where the tax was not imposed.

Public Libraries

There are approximately 380 public libraries in cities in Minnesota (853 cities). From 1991-2000, approximately 60 Minnesota cities built public libraries. The

7. Local property tax effort is measured by the local property tax capacity rate defined as local levy divided by local tax capacity (estimated market values multiplied by statutory class rates).

Rochester library (1995) and the Willmar library (1997) used the local sales tax for funding, while the other 58 libraries used other funding sources, with most projects using local bonding. Libraries in greater Minnesota may rely more on state funds. Metropolitan area libraries largely bond and use county property tax money to make the bond payments.

Similar observations can be made for municipal fire stations, airport expansions, parks, and sewer projects. In other words, cities without local sales taxes undertake the same types of projects as cities with local sales taxes, but fund them from different sources.

Convention Centers

Funding civic/convention/community centers is a popular use of local sales taxes. While these centers can vary substantially in size and expected uses, they are similar when referring to a separate building or buildings to include meeting rooms for a variety of uses often extending to tourism.

The list of proposed centers is substantial. A limited list is below, at right:

Convention centers proposed and/or authorized

City	Authorized Use
Currently imposed local sales taxes:	
Minneapolis	Convention Center
New Ulm	Civic/Community Center
Proctor	Community Center
St. Paul	Civic Center
Previously authorized but not enacted proposals:	
Bemidji	Convention Center
Detroit Lakes	Community Center
Hutchinson	Community Center
St. Cloud Area	Central Minnesota Events Center
Thief River Falls	Convention (Tourism) Center

Similarly, the Mankato Civic Center and the Rochester Civic Center used local sales tax funds (previously imposed sales taxes). The Duluth Entertainment and Convention Center likely benefited from the Duluth general fund local sales tax as well.

Centers in the top 15 cities, by population, include the Minneapolis Convention Center, St. Paul RiverCentre, Rochester Civic Center, Duluth Entertainment and Convention Center, and the Midwest Wireless Civic Center in Mankato. Other venues among these 15 large cities include the Bloomington Convention and Visitors Bureau, Eagan Community Center, Coon Rapids Civic Center, and St. Cloud Civic Center.

Some cities do not have large-scale meeting facilities. Bloomington, for example, refers convention business to St. Paul and Minneapolis while encouraging participants to stay in Bloomington near the airport. In contrast, Burnsville's convention bureau lists 23 properties with 900 rooms, and Brooklyn Park offers public facilities for meeting rooms. An Internet search identifies about 20 large-venue meeting facilities in Minnesota with about half of them being private enterprises. The larger casinos in the state provide auditoriums and meeting facilities as well.

The Office of Tourism at the Department of Employment and Economic Development oversees approximately $8 million of lodging taxes allowed under M.S. 469.190. Use of these monies is restricted; cities may fund a local convention or tourism bureau for the purpose of marketing and promoting the city as a tourist or convention center. The convention/tourism bureau often provides promotional and sales support to local convention or civic centers, but little if any of these funds would be used for capital expenditures.

In summary, funding for civic/convention/community centers for larger cities has largely relied on local sales tax funds. However, some smaller cities that have used other funding for their facilities, and private facilities are part of the market as well.

Compatibility of Local Sales Taxes with the Multi-state 'Streamlined Sales Tax Project'

The Streamlined Sales Tax Project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax administration. The project incorporates uniform definitions within tax bases, simplified audit and administrative procedures, and emerging technologies to substantially reduce the burdens of collecting Minnesota state and local sales taxes for Minnesota and non-Minnesota retailers. Minnesota has been an active participant in the Streamlined Sales Tax project.

Regarding the 11 general sales taxes, the provisions of M.S. 297A.99 (Local Sales Taxes) are in compliance with the current Streamlined Sales Tax Agreement. Key provisions include conformity of local sales taxes with the state sales tax base, state administration of local sales taxes, and 60 days minimum notice of local rate or boundary changes. These provisions are effective after December 31, 2005. With the exception of Duluth, all local sales taxes are or have been state administered. Under current law, the Duluth tax will switch from city to state administration by the above date. In Minnesota, state base changes are already automatically incorporated into local base changes.

The 19 local selective sales taxes (see Appendix C) are not subject to the streamlined conformity requirement.

Part II – General Principles and Issues

Here is a review of key tax policy principles as they might apply to local sales taxes, and a list of the policy issues that an expanded local sales tax would engender.

General Principles

General principles

Public finance economists use a nearly universal set of five principles to evaluate tax policies and policy proposals. The principles say that taxes should be:

- **Simple and Understandable.** Taxpayers and tax administrators should be able to discern who is responsible for the tax and have some basic knowledge of how their tax liability was determined. Simplicity reduces suspicion, increases voluntary compliance, and increases accountability.
- **Fair.** Taxes should distribute the burden of public spending in a manner consistent with acceptable standards of fairness as articulated through the political process. Fairness can be defined in terms of benefits received, that is, how well the distribution of tax burden matches that of the benefits received from public expenditures, or in terms of ability to pay, measured both horizontally (are equals taxed equally) and vertically (expressed by the pattern of effective tax rates over ranges of income—progressive, proportional, or regressive).
- **Competitive.** Taxes should not create a competitive disadvantage for selected industries or for Minnesota businesses relative to those in other states.
- **Stable and Adequate.** Tax liabilities and tax revenue should be stable and predictable, particularly in relation to the spending programs they are designed to fund, and should provide sufficient amounts of revenue.
- **Efficient.** Taxes should be both administratively efficient (low cost of compliance and administration) and not disturb market-based decisions, unless the tax is explicitly designed to affect behavior.

Key Policy Issues

Key policy issues

These principles can be applied to a discussion of the policy issues associated with expanding and administering local option taxes, and are summarized in a 1997 report of the National Conference of State Legislatures (NCSL) entitled *Critical Issues in State-Local Fiscal Policy – A Guide to Local Option Taxes.*

The NCSL review asserts that "State and local taxes should be considered together because they are so interdependent, and because state legislators play an important role in determining the composition of both state and local revenues."[8]

State revenue collections have dominated local tax collections for the 30 years from 1970 to 2000. The percentage of state and local revenues raised by the state in 1970 was 60.1 percent. By 2000, this percentage increased to 73.4 percent.

[8] *Critical Issues in State-Local Fiscal Policy, A Guide to Local Options Taxes.* National Conference of State Legislatures. November 1997. p. 33.

The primary advantage of centralized tax collection is that it gives the state the ability to equalize tax burdens and services across the state. This outcome has long been pursued in Minnesota. NCSL suggests that while centralization may improve horizontal equity—taxpayers with similar means paying taxes at similar levels—it can reduce local control, flexibility and accountability. Some argue that, within limits, local taxpayers and their elected officials should be allowed to determine their own service and tax levels and bear the burden of their own decisions.

Expecting that states will continue to look for ways to hold down property taxes, including local revenue diversification, NCSL provides a list of issues that need to be considered in evaluating local option taxes. Those issues are discussed below.

Local accountability and flexibility

As noted above, local option revenue sources can improve accountability by bringing local spending and tax decisions closer to the people, and by forcing both spending and tax decisions to be made by the same set of policymakers who are accountable to the same taxpayers. Directly, or indirectly through elected representatives, voters would be able to choose to increase their taxes to pay for services that state taxpayers or legislators might not be willing to fund. But these benefits will not be fully realized if the spending programs have significant "spillover" effects outside the local jurisdiction, or if, through tax exporting, local taxing jurisdictions succeed in shifting the cost of local government to nonresidents, as may be the case with the local option sales tax.

Limits on state revenue options

Once a local sales tax is in place, removing or modifying it may be difficult due to local revenue implications.

A local option sales tax may lead to local competition for sales tax revenue. Enacting a state sales tax rate increase could be more difficult because taxpayers may resist the change if the combined state and local rate becomes unacceptable. Knowing this, local governments will have an incentive to accelerate the adoption of local sales taxes, or to increase the tax rate when state rate increases are anticipated. The state might be similarly motivated to make preemptive state tax changes. This interdependence creates a potential "crowding-out" effect.

Once a local sales tax is in place, removing or modifying it may be difficult due to local revenue implications. Since current law requires that local sales taxes use the state tax base, local governments will likely oppose state sales tax reforms involving new exemptions, and become advocates for tax base expansion. While this dynamic would serve to stem the erosion of the sales tax base, it could preclude needed tax reforms, including those associated with the Streamlined Sales Tax Project.

Administrative and compliance costs

If not properly designed, local sales taxes can add significant complexity and cost to the tax system. However, in Minnesota, the uniformity provisions enacted in 1997 (limited authority over rates, required use of state tax base, required state tax administration) and others contained in the Streamlined Sales Tax Project (simplified audit and administrative procedures, clear sourcing rules, application of use taxes) ensure that the additional administrative and compliance costs of local sales taxes in Minnesota will be minimized.

Tax system balance and responsiveness to growth

Conventional wisdom favors the balanced use of income, sales and property taxes (taxes on income, consumption, and wealth) in state and local revenue systems. This "three-legged stool" approach promotes stability and minimizes the tax rates of each tax type. Currently, Minnesota's "three-legged stool" has income taxes at 37 percent of the total, sales taxes at 28 percent, and property taxes at 35 percent.

In addition to balance, taxes may be evaluated with respect to how responsive their revenue streams are to changes in the economy (usually measured by growth in personal income). Taxes that produce revenue growth greater than that of the economy are called "elastic" sources. Conversely, inelastic revenues grow slower than the economy.

Generally, inelastic tax sources should not be used to fund programs that tend to grow faster than the economy. Over-reliance on elastic tax sources can result in excessive instability in revenues, and magnify budget problems in bad times.

Tax base disparities

Minnesota policymakers have long recognized the need to fully or partially equalize disparities in local tax bases, especially for local funding having statewide significance, such as K-12 education. In some states, the courts have mandated or imposed equalization schemes for local education expenditures.

If the geographical distribution of retail sales is more uneven than that of taxable property, expansion of local sales taxes will increase tax base disparities among communities.

The most direct way of accomplishing such equalization would be to add each community's local sales tax revenue, calculated using a uniform tax rate, to existing measures of property tax capacity that currently exist in various state aid formulas.

If local sales tax proceeds are dedicated to large capital projects not likely to be funded by local general revenues, the case for general equalization aid is weakened.

Inter-local competition

Local sales taxes could increase competition between local communities for retail development, and create a bias for retail development over other types of economic development activity. Property-rich communities may be in a better position to adopt local sales taxes with lower rates than property-poor communities. Studies indicate that a 0.5 percent local sales tax could cause a loss in gross sales of 1.5–5 percent, excluding the stimulative effects of new tax-supported spending.[9]

Heightened competition may reduce community willingness to enter into cooperative service agreements and joint provision of services.

Widening the geographic area in which the local tax is applied can minimize these competitive effects, but may require some distribution scheme to share tax proceeds among jurisdictions in the wider area.

Fairness of the overall state and local tax system

Widespread use of local sales taxes will raise questions about the vertical and horizontal fairness of the total state and local tax system. Since sales taxes tend to be regressive, greater use of them will make the tax system more regressive.

Minnesota closely tracks fairness using the Department of Revenue's Tax Incidence Study. The study contains detailed estimates of the degree of progressivity associated with most state and local tax sources, and the combined progressivity of the overall state and local tax system. While there is no consensus on the desired degree

---

[9] Due, John F. and Mikesell, John L. *Sales Taxation: State and Local Structure and Administration*. The Urban Institute Press, second edition, 1994. p. 314-316.

of progressivity, the study is used to evaluate state and local tax changes, including the impact of local sales taxes.

The study indicates that sales taxes are more regressive than the property tax, but less so than many excise taxes, such as the taxes on motor fuels and cigarettes.

However, these formal measures of fairness differ from popular notions of fairness based on what ordinary people think. While studies show sales taxes to be regressive, surveys indicate that many people consider the sales tax to be fair, simply because the tax is collected only at the time of purchase. This straightforward definition of fairness and its relative simplicity (to the layperson, at least) may explain why the sales tax tends to be the least disliked of all tax types.

Federal deductibility

State and local sales taxes are not deductible on federal income tax returns. But local income and property taxes continue to be deductible from federal gross income. As a result, a portion of every dollar of local income or property tax revenue paid by local residents is exported to taxpayers in other states through the federal tax system (though Minnesotans likewise pay a portion of other states' income and property taxes). In contrast, the resident portion of local sales tax is fully borne locally.

The extent to which this deductibility issue might affect taxpayer attitudes regarding the selection of local revenue options is not clear.

Summary of Issues

A report by the National Conference of State Legislatures provides a concise summary of the issues described above:

> Local option taxes allow local people to have more control over tax decisions and improve local flexibility to meet regional service needs. However, they may create local accountability problems, hamper state flexibility and impose additional administrative and compliance costs on businesses and individuals. They also may affect the balance and fairness of the state-local system and create harmful competition between local governments. [10]

Observing that there is no ideal mix of taxes, each state is advised to weigh the trade-offs in the context of their history, geography, competitive position, and tax system characteristics.

[10] *Critical Issues in State-Local Fiscal Policy, A Guide to Local Options Taxes.* National Conference of State Legislatures. November 1997. p.1

Part III – Review of Public Comments

The Department of Revenue conducted three public meetings in 2003 to solicit comments on local sales taxes. The meetings were held September 16 in Brainerd, September 17 in Rochester, and September 18 in St. Paul. The meetings were well attended and various city and county officials, legislators, individual citizens, business organizations, and associations representing cities and counties provided comments. The comments can be roughly divided into three categories: criticism of the current process, local sales tax as a component of state and local revenues, and issues raised by the prospect of wider local authority for sales taxes. They are summarized below.

Criticism of the Current Process

The current process

It is apparent that there is discontent with the current process of authorizing local sales taxes. Legislators and public witnesses felt the process could be significantly improved. The uniform theme was that no consistent or objective criteria are available upon which to base a decision to authorize a local sales tax. The clear feeling was that the current process is too uncertain and subject to the vagaries of the political process. Without published criteria for approval or any public explanation for decisions to approve or disapprove requests, communities are unsure as to how to make a proposal to the legislature, or even whether to go to the considerable expense to put a proposal together in the first place. Communities whose proposals do not receive legislative approval are without guidance as to what aspect of their proposals did not meet with the legislature's approval and whether or not to attempt the process again.

The important point, it would seem, is that there is no opportunity for a community to learn from success or failure. This leads to repeated unsuccessful attempts by some communities, which frustrates both the community and the legislators. It also leads to unrealistic expectations by successful communities that all their future proposals or extensions will also be successful.

Another problem caused by lack of clear and objective criteria is the perception, particularly among unsuccessful communities, that the approval process is driven by power politics rather than by merit. While legislators and nonpartisan staff may disagree, the perception is quite real and not one that builds confidence in the legislative process.

Local Sales Tax as a Component of Local Public Finance

There appears to be quite a significant range of opinion regarding the proper role of local option sales taxes as a component of the state and local revenue system. First, some communities believe that a local sales tax has become (or in some cases, should become) a necessary additional stream of general fund revenue for cities or counties. This view is prevalent among, though not confined to, jurisdictions with a low property tax base and those with relatively high overburden due to tourism or the regional center nature of their community.

A second group feels quite strongly that a local sales tax is properly limited to funding for unusual capital projects that are vital to the region but cannot be supported through other financing mechanisms.

Yet others are uncertain that local sales taxes are anything more than an attempt by the "haves" to get more at the expense of the "have nots." These communities tend to be smaller cities or suburbs with a limited retail base that could be overshadowed by larger neighbors with significant potential for retail sales tax capacity.

While the majority of the comments fell into the second category, there was no unanimity on the appropriate role of local sales tax as a revenue tool.

Issues Raised by Prospect of Broader Local Authority

The third category of issues brought out by the public meetings is a catch-all of cautions to be considered if it becomes the policy of the state to expand the current role of local sales taxes.

Broader local authority

The first issue is one of equalization between communities that have significant capacity for local sales tax revenue and those that do not. Many of those without significant capacity for local sales tax revenue also have a very limited property tax base. Significant expansion of the local sales tax as a revenue mechanism could lead either to the problem of "winners and losers" or to increased pressure on the state legislature to expand funding for local government aid or development of a new fiscal disparity equalization mechanism.

A caution was raised concerning the possibility of criteria for authorization based on a net tax capacity measure. There were mixed feelings about whether there should be criteria that limit local authority to those communities that lack other revenue capacity. In general, there was sentiment that such a criterion might be useful if the local sales tax was to be used for general revenue purposes but not if used for "significant capital projects." There was little support for reducing state aids for communities that have authority for a local sales tax.

General support existed for criteria requiring passage of a referendum prior to authorization. There was no support expressed for a reverse referendum if an initial referendum passed. However, several witnesses endorsed the idea of an expiration date after which further authorization and referendum would need to be obtained. A return to the voters and to the authorization process was also suggested for shifts of a tax from one project to another upon completion of the first project.

It was also suggested that for local taxes that would be paid primarily by those who live outside the taxing jurisdiction, the referendum be a regional one rather than confined to the taxing jurisdiction.

Considerable comment was made regarding the need to encourage cross-border cooperation on regional projects. The suggestion was offered that criteria might favor multi-jurisdictional applications and projects of a regional benefit. A caveat, however, was that no one seems to have the same view of "regional benefit," or even of what a definition for region might be.

Finally, the legislature should consider that if local sales taxes are to be expanded significantly, the opportunities for modernization, streamlining and reform of the sales tax generally will become more problematic. As more jurisdictions become dependent upon a relatively stable source of revenue, any proposed changes to that revenue system, however important for tax policy or statewide reasons, will be viewed with extreme caution if not resistance by local governments. This will tend to lock in our current system and discourage attempts to improve it.

Part IV – Recommendations

1. Appropriate Role for Local Sales Taxes

Given Minnesota's historical policy preference for equalization between communities and recent bipartisan efforts to increase efficiency in government, it seems clear that a major shift to general authority for local sales tax without some restrictions is inadvisable.

As currently constituted, the local sales tax is not a major component of the overall state and local revenue mix. The recent economic downturn and consequent budget crisis, coupled with reductions in local government aid has, however, caused cities, counties and other local units of government to search for additional revenue sources. Now the question is whether new or increased local sales tax authority is an appropriate answer, at least in part.

Generally speaking, taxing and spending decisions should be as close to those affected as practical. This general principle stems from the notion that there should be a high degree of accountability to those affected for spending and taxing. Having local control also responds to the need for flexibility. The more local the taxing and spending decisions are, the better able (in theory) they are to respond to the unique situation and environment of those who are affected by them.

Ranged against this general principle are a host of practical concerns. For example, the sales tax is a comparatively regressive tax. Adding a significant proportion of sales tax revenue to a base of local revenue now composed primarily of property tax which is also regressive would exacerbate the regressivity of taxation for local spending.

Broadening of local sales tax authority risks negative competition between communities, and can lead to a perception of "winners versus losers."

Centralization of taxation at the state level, while diminishing to some degree the accountability and flexibility, does mean better equalization between communities. Centralization of sales tax is also less of an administrative burden than attempting to administer hundreds of individual local sales taxes. The cost of the administrative burden diminishes the return to the taxing authority and diverts taxpayer dollars to nonproductive uses. Significant broadening of local sales tax authority also risks negative competition between communities leading to a perception of "winners versus losers."

What, then, is the appropriate role of local sales taxes? Given Minnesota's historical policy preference for equalization between communities and recent bipartisan efforts to increase both the administrative and allocation efficiency in government, it seems clear that a major shift to general authority for local sales tax without some restrictions is inadvisable. General authority for local sales taxes without restriction as to use would lead to significant issues with equity, allocation efficiency, administrative costs and competition between the state and local governments for the same resources. These issues as outlined in Part I would draw Minnesota farther from the ideal revenue system.

Recent reform of the property tax system reaffirmed the principle of property tax as the cornerstone of local government financing. Local sales tax should not be looked to as a replacement for, nor as a significant offset of, property taxes. Local sales taxes can, under certain circumstances, however, be a useful tool for generating revenue for purposes that exceed the community's ability to raise property taxes. These purposes have traditionally been major capital projects that are of critical importance and affect the vitality of a region greater than just the community imposing the tax. An example is the flood control project for which the original local sales tax in Rochester was authorized.

This model seems to have worked well in providing a regional benefit by raising capital for an important project that would not otherwise have been funded. The use of local sales tax for nonessential projects or for general fund revenue, however, introduces a "creep" effect which is difficult to control and may lead inexorably to a broad, general use of sales tax as a replacement for all or part of the property tax system. The public comments to the department recognized this concern, which was also evident in repeated requests for establishment of a list of approved projects. This kind of a safe harbor list would reduce the creep effect and provide guidance to communities that are considering a proposal for a sales tax.

Another vehicle for restraining the "creep" toward general expense funding through sales tax is to have criteria for sales tax authority based on the ability of the community to fund the project from existing resources. In other words, the legislature could consider imposing criteria on the granting of new sales tax authority that would measure the existing tax base of an applicant and limit new authority only to a community that cannot otherwise afford the proposed project. Such criteria would need to be limited to new proposals and not retroactive to existing authority so as not to cause defaults or other unanticipated financing problems well after a project has begun. The legislature might also wish to consider exceptions from the criteria for extraordinary expenses or circumstances.

The legislature could consider imposing criteria that would measure the existing tax base and limit new authority only to a community that cannot otherwise afford the proposed project.

A third concern with regard to the appropriate role of local sales tax is the incidence of the tax. To the extent that a significant portion of the local sales tax falls on consumers who do not reside in the locality imposing the tax, the tax is being paid by taxpayers who have no voice in its imposition and possibly no benefit received for its payment. The dimension of this problem will differ from project to project and locale to locale. It raises however, an issue for legislative consideration. To what extent does the exporting of a local sales tax reflect allocation efficiency, i.e., spillover costs to pay for spillover benefits? What amount of exporting in what situations is fair and acceptable? Should a sales tax imposed by a city, for example, need approval by referendum of the surrounding county?

2. Evaluation Criteria

A. Regional Nature of Projects

The department recommends that regional benefit per se not be an explicit criterion. Rather, the objectives of such a criterion could be obtained by designing better criteria pertaining to the types of projects that are eligible for local sales tax funding and by requiring those surrounding communities that will pay a large share of the sales tax to participate in the referendum.

The topics of "regionality" and "regional benefit" were discussed extensively during the public meetings. While many participants supported having a regional benefit criterion, the wide difference in what "region" means to different people also became apparent. For example, one city defined its region as a five-state area. Another city stated that since it was considered a regional center, anything it did with sales tax revenue that benefited the city, by definition also benefited the region. These comments, while possibly extreme, point out the difficulty of using regional benefit as criteria.

Any definition of region will end up being too inclusive for some and too limiting for others. Communities surrounding a taxing jurisdiction will often have conflicting views about the benefit to their community from a project in another city.

Since a significant portion of local sales taxes are exported to communities surrounding the taxing jurisdiction, there should be some benefit to those communities.

At the heart of the "regionality" issue is the desire for the benefit from a local sales tax to have broad impact. Since a significant portion of local sales taxes are exported to communities surrounding the taxing jurisdiction, there should be some benefit to those communities. The difficulties inherent in defining "region" and "regional benefit" raise the question of whether a regional criterion *per se* is the best way to accomplish that objective.

The department therefore recommends that "regional benefit" *per se* not be an explicit criterion. Rather, the objectives of such a criterion could be obtained by designing better criteria pertaining to the types of projects that are eligible for local sales tax funding, and by requiring that the surrounding communities, whose citizens will pay a large share of the sales tax, participate in the referendum. These concepts will be discussed in more detail below.

B. Capital Projects

The department recommends that a criterion for approval of local sales tax authority should be that funds be used for extraordinary capital projects. This would prevent communities from using local sales tax revenue to replace general fund revenue (property tax revenue) normally used to fund ordinary capital projects.

Although there was some discussion of using a local sales tax for general revenue purposes, most of those who commented during the public hearings supported a requirement that the sales tax be used for extraordinary capital projects. The department also recommends that this be a criterion for approval of local sales tax authority. As mentioned earlier, it is the policy of this state that the property tax be the mainstay of local government finances. Without criteria regarding the use to which sales tax revenue may be put, it would be too easy for communities to supplant property tax revenue with sales tax revenue. The effect of this, should the practice become widespread, would be to undermine the current property tax, local government aids and the fiscal disparities system. Without limits, local government aid calculations would need to reflect the additional revenue raising capacity, thus reducing aid to some communities so as to maintain equalization. It is important, therefore, that local sales tax authority be limited to capital projects.

The next question is whether there should be limits on the kinds of projects. Local revenue dollars are fungible. If sales tax revenue can be used for any capital project, it is impossible to prevent the shifting of general fund revenue. General funds, raised by property taxes, can be shifted away from normal capital projects to non-capital spending. The resulting gap in capital spending would then be made up through local sales tax revenue. This, then, is a backdoor method of general funding through sales tax.

To avoid such shifting, the uses to which local sales tax can be put should be limited to large projects that would otherwise not be able to be funded by other means. These projects should have broad benefit and encourage multi-jurisdictional cooperation. Projects that cross boundaries or will be utilized by surrounding communities are examples of proposals that meet this criteria. While this may sound like another name for "regional benefit," the focus here should be on the scope of the project and the inability to fund it from other sources.

The uses to which local sales tax can be put should be limited to large projects that would otherwise not be able to be funded by other means.

A suggestion made by many in the public hearings was to have an "approved list" of projects that would qualify for sales tax authorization. Such a safe harbor list would provide some guidance to communities that are considering a local option sales tax. Any such list however, should not be regarded as comprehensive. A comprehensive list would limit creativity and not be responsive to the need for flexibility.

C. Ability to Raise Revenue

We recommend that there be a criterion relating to strength of an applicant's tax base. A community that has a sufficiently robust property tax base should look to that as its initial source of revenue. Only if the property tax base is insufficient to handle the demands of the capital project, should the sales tax be authorized.

In order to limit the effects of fungibility of dollars and the temptation to shift resources, we recommend that there be a criterion relating to strength of an applicant's tax base. A community that has a sufficiently robust property tax base should look to that as its initial source of revenue. Only if the property tax base is insufficient to handle the demands of the capital project should the sales tax be authorized. Using property tax capacity plus local government aid (plus taconite aid where appropriate) as a measure of the capacity to fund capital projects gives the approving authority a relatively stable and comparable basis for relating one proposal to another.

To encourage creativity and preserve flexibility, the criteria suggested above should be viewed together in the context of the whole proposal rather than as a purely mechanical checklist. For example, a proposal that funds a large capital project benefiting multiple jurisdictions and that has the support of those communities as evidenced by a successful referendum which includes those communities identified in a study of the incidence of the tax would be a strong proposal. The proposal would be further strengthened if the property tax capacity plus aid indicated an inability to fund the project through other means.

Conversely, a single city whose proposal supports a primarily local project with little benefit for other jurisdictions would be a weaker proposal. It would be further weakened if the required referendum was passed only in that city, although the tax was exported to a significant degree to surrounding communities. If that city also demonstrated a high property tax plus aid capacity, the criteria would indicate a high likelihood of failure for that proposal. Such a system could be an incentive for communities to compete positively by cooperating.

3. Approval Process

It is the Department of Revenue's view that the approval process can remain with the legislature and still reach the goals of being more objective and less political. First, by setting out published, objective criteria for approval, communities will have some standard by which to measure the merits of their proposals. Second, to compare proposals, provide a more open discussion of proposals, and reduce the uncertainty and expense associated with preparing proposals, the legislature could set aside specific hearing days in the respective committees, devoted to local sales tax authority proposals.

The third recommendation requested by the legislature regards the feasibility of authorizing the commissioner of revenue to approve or deny local sales tax proposals. It is certainly feasible to create within the Department of Revenue a capability for review and decision on local sales tax proposals if a uniform set of criteria could be agreed upon by the legislature. The department has expertise in gathering and analyzing the type of data necessary to make such decisions. Although some minor costs would be incurred in setting up and staffing this function, it would not impose an undue burden, nor be beyond the department's capability. Indeed, during the public meetings, the suggestion that the department do so was made several times. Those supporting the proposal expressed the hope that a departmental approval process would be less political and more objective.

In the department's view, the approval process can remain with the legislature and still reach the goals of being more objective and less political. First, by setting out published, objective criteria for approval, communities will have some standard by which to measure the merits of their proposals. Second, the legislature could set aside specific hearing days in the respective committees, devoted to local sales tax authority proposals. This would promote better "apples to apples" comparisons and demonstrate more openness in the system. It would also reduce the uncertainty and expense of waiting for an opportunity in the general mix of tax bill hearings. Third, by requiring that a community come to the legislature after having held a successful referendum, the legislature will have a better indicator of local support and possibly fewer proposals to review. Finally, the committees could issue a report that explains their decisions in terms of the stated criteria. This would provide a valuable guide to future proposals, and could reduce the number of unsuccessful proposals.

With some minor changes to existing process and practice, we believe the legislature can address the public concerns about the authorization process.

With some minor changes to its existing process and practice, we believe the legislature can address most of the public concerns about the authorization process. It is our view that it will be preferable to have the reformed process remain with the legislature. We come to this recommendation because it is our view that the granting of local sales tax authority has broad policy implications that should, more properly, reside within the purview of the legislature. While the department stands ready to accept this role if the legislature so chooses, we feel that granting local sales tax authority is less an administrative function and more a policy function.

4. Summary and Conclusions

Local sales tax plays a valuable but supporting role in the larger picture of state and local government financing. The local sales tax is best used as a mechanism for the financing of large, special, multi-jurisdictional capital projects rather than as a replacement for property tax revenue to fund general expenses of local government. The current process for authorizing new or extending previously approved local sales taxes is widely perceived as being too subjective and political. To reduce the number of unsuccessful applications for local tax authority and to demonstrate a more objective decision making process, there should be objective criteria and a more straightforward process for consideration of these proposals.

The local sales tax is best used as a mechanism for the financing of large, special, multi-jurisdictional capital projects.

The criteria should include a requirement that the tax be used to fund a capital project. The community or communities proposing the tax should demonstrate a need for the tax as indicated by an insufficient property tax plus aid revenue base, and that the project would not otherwise have the funding to be accomplished. A proposal would be considered much stronger coming from a multi-jurisdictional compact. A proposal should have already been approved in a referendum. A strong proposal would include an incidence study of the tax and a referendum passed by jurisdictions substantially affected both by the benefit and the incidence of the tax.

New proposals and proposed extensions of existing authorizations should have a clearly defined ending date after which a referendum must be held and reauthorization granted. This requirement should obviate the need for a reverse referendum. The legislature should consider applying a sunset to existing authorizations as well.

Finally, the authorization of local sales tax proposals should remain with the legislature. While an administrative process within the Department of Revenue could be developed, there would still be the need for legislative review of that process and clear policy guidance to the department. If some or all of the recommendations contained herein are adopted, the quality of local sales tax proposals should improve, and the number of proposals may decline. This would reduce the burden now experienced by the tax committees and their staffs. Furthermore, the number of local sales taxes and the uses to which they should be put are significant policy issues that are best debated and decided in a legislative arena.

Appendices

Appendix A

Legislation authorizing this report

Sec. 19 [STUDY OF LOCAL SALES TAX]

(a) The commissioner of revenue shall study the local sales taxes in Minnesota and provide a written report and recommendations to the legislature, in compliance with Minnesota Statutes, sections 3.195 and 3.197, by February 1, 2004. The study must report on:

(1) the authorized uses of revenue from local sales taxes in effect, and the proposed uses of revenue from local sales taxes recently proposed but not enacted;
(2) the local approval requirements for local sales taxes;
(3) the duration of local sales taxes and whether the full duration authorized in law was necessary to provide sufficient revenue for the authorized uses of the local sales tax;
(4) if the authorized uses of the local sales tax revenues are regional in nature or limited in benefit to the jurisdiction in which the tax is imposed;
(5) the estimated portion of revenue raised through the local sales taxes that comes from
(i) residents of the jurisdiction in which the tax is imposed;
(ii) Minnesota residents who live outside the jurisdiction; and
(iii) non-Minnesota residents;
(6) the ability of jurisdictions to raise revenue by other means, including the local property tax, and the extent to which the jurisdictions assess property taxes in comparison to other similar jurisdictions, and the state average, expressed in terms of levy as a percent of adjusted net tax capacity;
(7) how jurisdictions that do not impose local sales taxes raise revenue to fund projects similar to those funded through local sales taxes; and
(8) the compatibility of local sales taxes with the policies underlying the streamlined sales tax project.

(b) The study must make recommendations on:
(1) the appropriate role of local sales taxes as a part of Minnesota's state and local revenue system, including:
(i) the appropriate uses of local sales taxes; and
(ii) whether local sales taxes should be limited to jurisdictions that do not meet minimum thresholds of raising revenue through other means, including local property tax;
(2) criteria to be used in evaluating local sales tax proposals, designed to direct the use of local sales taxes toward:
(i) projects that are regional in nature;
(ii) projects that require capital expenditures; and
(iii) projects in jurisdictions with inadequate fiscal capacity to fund the projects through other means; and
(3) the feasibility of authorizing the commissioner of revenue to approve or deny local sales tax proposals based on a uniform set of criteria, including the advisability of requiring local approval by referendum or revocation by reverse referendum, and if the referendum should be a criterion necessary for a proposal to be considered for authorization or should occur after authorization but as a condition of the tax being implemented.

Appendix B

Business Share of Local Property Tax Valuation for Cities with Populations over 10,000 (Proxy for Relative Ability to Export Local Sales Taxes)

C/I share is total commercial/industrial estimated market value as a percent of total city market value (2002). Boldface indicate the 10 current cities (3 are added with population under 10,000) with a general local sales tax, and italics indicate the two cities that previously had a general local sales tax.

City	C/I Share	City	C/I Share
Bloomington	34.5	Mendota Heights	17.8
Roseville	34.0	Coon Rapids	17.3
Bemidji	32.7	Moorhead	17.1
Fridley	32.6	Northfield	17.0
Mankato	**32.0**	Maple Grove	16.7
Golden Valley	29.6	**Duluth**	**16.4**
Marshall	29.4	Stillwater	16.4
Maplewood	28.0	Austin	16.2
Minneapolis	**27.4**	Sauk Rapids	16.1
Brainerd	27.2	New Brighton	15.8
St. Cloud	**26.7**	Hibbing	15.8
Cloquet	26.6	Faribault	15.5
Shakopee	26.6	Richfield	15.3
Brooklyn Center	25.6	Chanhassen	15.0
Worthington	25.4	West St. Paul	15.0
Minnetonka	24.8	Rosemount	14.7
St. Louis Park	24.8	White Bear Lake	14.7
Hopkins	24.4	Forest Lake	14.6
Statewide Average	24.3	Sartell	14.5
Anoka	24.1	Oakdale	14.2
New Hope	23.1	Buffalo	13.9
Eden Prairie	23.0	Woodbury	13.9
Willmar	*22.8*	Red Wing	13.2
Hutchinson	22.7	Ramsey	12.4
Chaska	22.7	South St. Paul	12.0
Plymouth	22.7	Shoreview	11.5
Rochester	**22.6**	North St. Paul	11.2
Eagan	22.5	**Proctor (<10,000)**	**11.2**
Vadnais Heights	22.1	Hastings	11.1
Fergus Falls	22.0	Crystal	10.7
Burnsville	21.3	Cottage Grove	10.3
Winona	*21.0*	Columbia Heights	10.3
St. Paul	**20.9**	Inver Grove Hgts	10.2
New Ulm	**20.7**	Apple Valley	9.5
Owatonna	20.5	Lakeville	9.1
Mounds View	20.5	Savage	8.8
Fairmont	20.2	Champlin	8.4
Edina	19.3	Ham Lake	8.3
Blaine	19.1	Robbinsdale	8.0
Hermantown (<10,000)	**19.0**	Elk River	6.8
North Mankato	18.9	St. Michael	6.1
Brooklyn Park	18.9	Farmington	5.4
Lino Lakes	18.4	Prior Lake	4.0
Albert Lea	18.0	East Bethel	3.2
Two Harbors (<10,000)	**18.0**	Andover	2.9

Appendix C

MINNESOTA LOCAL SALES TAX STUDY

September 15, 2003

Local Sales Tax Inventory

	Rate	Year Enacted	Date Change	Original Citation	Approval Requirements	Funding/Amts	Authorized Use	Local/ Regional	State Admin.	Streamlined Sales Tax
GENERAL SALES TAX										
Currently Imposed										
Cook County	1.0%	1993	1997	Ch 375, Art 9, Sec 45	Referendum	Bonds - $4M	Hospital/Clinic	Regional	Yes	Yes
Duluth	1.0%	1973	1980	Ch 461	City Council	-	General Revenue	Local	No	Pending
Hermantown	0.5%	1996	-	Ch 471, Art 2, Sec 29	Referendum	Bond Pmts	Water/Sewer/Fire Station	Local	Yes	Yes
Mankato	0.5%	1991	1998	Ch 291, Art 8, Sec 27	Reverse Referendum	Bonds - $25M	Riverfront/Airport	Regional	Yes	Yes
Minneapolis	0.5%	1986	-	Ch 396	City Council	Bonds - $118M	Convention Center	Regional	Yes	Yes
New Ulm	0.5%	1999	-	Ch 243, Art 4, Sec 17	Referendum	Bonds - $9M	Civic Center	Local	Yes	Yes
Proctor	0.5%	1999	-	Ch 243, Art 4, Sec 18	Referendum	Bonds - $3.6M	Streets/Community Center	Local	Yes	Yes
Rochester	0.5%	1983	1998	Ch 342, Art 19	Referendum	Bonds - $16M	Flood Control/Parks	Local	Yes	Yes
St. Cloud area (authorized for six cities and enacted by four)	0.5%	2002	-	Ch 377, Art 11, Sec 2	Referendum	1/1/03 - 12/31/05	Regional Airport	Regional	Yes	Yes
St. Paul	0.5%	1993	1998	Ch 375, Art 9, Sec 46	City Council	Bond Pmts	Civic Center / Other	Local	Yes	Yes
Two Harbors	0.5%	1998	-	Ch 389, Art 8, Sec 45	Referendum	Bonds - $20M	Sewer/Harbor	Local	Yes	Yes
Previously Imposed, Now Expired										
Willmar	0.5%	1997	-	Ch 231, Art 7, Sec 41	Referendum	$4.5M Bonds (1/1/02)	Public Library	Local	Yes	n/a
Winona	0.5%	1998	-	Ch 389, Art 8, Sec 46	Referendum	$4.0M Bonds (1/1/03)	Lake Dredging	Local	Yes	n/a
Authorized but Not Imposed										
Bemidji	1.0%	1998	n/a	Ch 389, Art 8, Sec 38	Referendum	Bonds - $25M	Convention Center	Local	n/a	n/a
Bloomington	1.0%	1986	n/a	Ch 391	City Council	Bond Pmts	Stadium Site Redesign	Regional	n/a	n/a
Detroit Lakes	0.5%	1998	n/a	Ch 389, Art 8, Sec 39	Referendum	Bonds - $6M	Community Center	Local	n/a	n/a
Ely	1.0%	1992	n/a	Ch 511, Art 8, Sec 31	Referendum	Bonds - $20M	Gateway Project	Local	n/a	n/a
Fergus Falls	0.5%	1998	n/a	Ch 389, Art 8, Sec 40	Referendum	Bonds - $9M	Project Reach Out	Local	n/a	n/a
Garrison	1.0%	1993	n/a	Ch 375, Art 9, Sec 47	Referendum	Bond Pmts	Sewer	Local	n/a	n/a
Hutchinson	0.5%	1998	n/a	Ch 389, Art 8, Sec 41	Referendum	Bonds - $5M	Community Center	Local	n/a	n/a
Owatonna	0.5%	1998	n/a	Ch 389, Art 8, Sec 42	Referendum	Bonds - $5M	Economic Development	Local	n/a	n/a
Central Minnesota cities (authorized for five cities)	1.0%	1998	n/a	Ch 389, Art 8, Sec 44	Referendum	Bonds - $50M	Central MN Events Center	Local	n/a	n/a
Thief River Falls	0.5%	1992	n/a	Ch 511, Art 8, Sec 32	Referendum	Bonds - $15M	Tourism / Convention Ctr	Local	n/a	n/a
TAX / VEHICLE SALE AT RETAIL										
Mankato	$ 20	1991	-	Ch 291, Art 8, Sec 27	Reverse Referendum	Bonds - $25M	Riverfront/Airport	Regional	No	Yes
New Ulm	$ 20	1999	-	Ch 243, Art 4, Sec 17	Referendum	Bonds - $9M	Civic Center	Local	No	Yes
Rochester	$ 20	1983	-	Ch 342, Art 19	Referendum	Bonds - $16M	Flood Control/Parks	Local	No	Yes
Proctor (not imposed)	$ 20	1999	n/a	Ch 243, Art 4, Sec 18	Referendum	Bonds - $3.6M	Streets/Comm. Center	Local	n/a	n/a
Two Harbors (not imposed)	$ 20	1998	n/a	Ch 389, Art 8, Sec 45	Referendum	Bonds - $20M	Sewer/Harbor	Local	n/a	n/a

MINNESOTA LOCAL SALES TAX STUDY

Local Sales Tax Inventory

	Rate	Year Enacted	Date Change	Original Citation	Approval Requirements	Funding/Amts	Authorized Use	Local/ Regional	State Admin.	Streamlined Sales Tax
ADMISSIONS / AMUSEMENTS										
Bloomington	3.0%	1970	-	City Ordinance	Pre-1971	Indefinite	City General Fund	Local	No	Excluded
Minneapolis	3.0%	1969	-	Ch 1092	City Council	Indefinite	City General Fund	Local	Yes	Excluded
Enacted and Repealed										
Scott County (per admission)	25¢	1987	-	Ch 285	Bd of Commissioners	1996	Bloomington Ferry Bridge	Local	n/a	n/a
LODGING										
Bloomington	7.0%	1970	2002	City Ordinance	Pre-1971	Indefinite	Stadium Site Redesign (current)	Regional	No	Excluded
Cook Cty (Lutsen, Schroeder, Tofte)	2.0%	1987	-	Ch 168, Sec 2	Referendum	Indefinite	Recreational Facilities	Local	No	Excluded
Duluth										
More than 30 Rooms	5.5%		1998	Ch 389, Art 8, Sec 25+	City Council	Bond Pmts	Tourism / Arena / Spirit Mtn	Local	No	Excluded
Other	3.0%	1970	1980	City Charter, Sec 54(d)	Pre-1971	Bond Pmts	Tourism / Arena / Spirit Mtn	Local	No	Excluded
Minneapolis	3.0%									
More than 50 Rooms	5.0%	1986	2001	Ch 396	City Council	Bonds - $118M	Convention Center	Regional	Yes	Excluded
Other	3.0%	1969	2001	Ch 1092	City Council	Indefinite	City General Fund	Local	Yes	Excluded
Newport	4.0%	2003			City Council	Indefinite	Economic Development	Local	No	Excluded
Rochester	4.0%	1971	2002	City Ordinance	Pre-1971		Convention Bureau (current)	Local	Yes	Excluded
St. Cloud	5.0%	1979	1986	Ch 197	City Council	Indefinite	Convention Center (current)	Local	No	Excluded
St. Paul										
More than 50 Rooms	6.0%	1986	1991	Ch 463, Sec 28	City Council	Indefinite	Ramp Pmts / G.F. / Convention Ctr	Local	No	Excluded
Other	3.0%	1970	1982	Ch 523, Art 25, Sec 1	Pre-1971	Indefinite	Ramp Pmts / G.F. / Convention Ctr	Local	No	Excluded
Two Harbors	1.0%	1994	-	Ch 587, Art 9, Sec 11	City Council	Indefinite	Preservation of Tug Boat	Local	No	Excluded
Winona	1.0%	1991	1995	Ch 291, Art 8, Sec 28	City Council	Indefinite	Steamboat / Local Improvements	Local	No	Excluded
Authorized but Not Imposed										
Roseville	2.0%	1992	n/a	Ch 511, Art 8, Sec 27	Referendum	Indefinite	Speed Skating Facility	Local	Yes	n/a
FOOD / BEVERAGES										
Duluth	1.5%	1977	1998	Ch 438	City Council	Bonds Pmts	Tourism / Arena / Spirit Mtn	Local	No	Excluded
Little Falls	0.5%	1996	-	Ch 471, Art 2, Sec 30	City Council	15 Year Length	Tourism / Convention Bureau	Local	No	Excluded
Minneapolis - Downtown	3.0%	1986	-	Ch 396	City Council	Bonds - $118M	Convention Center	Regional	Yes	Excluded
St. Cloud	1.0%	1986	-	Ch 379	City Council	Bond Pmts	Convention Center	Local	Yes	Excluded
Authorized but Not Imposed										
Brooklyn Center	1.0%	1992	n/a	Ch 511, Art 8, Sec 30	Referendum	Indefinite	Low Income Housing	Local	n/a	n/a
ON-SALE LIQUOR AND BEER										
Bloomington (authorized at 5%, enacted at 3%)	3.0%	1986	-	Ch 391	City Council	Indefinite	Stadium Site Redesign	Regional	No	Excluded
Minneapolis - Downtown	3.0%	1986	-	Ch 396	City Council	Bonds - $118M	Convention Center	Regional	Yes	Excluded
St. Cloud	1.0%	1986	-	Ch 379	City Council	Bond Pmts	Convention Center	Local	Yes	Excluded

Table excludes information on cities/towns imposing a lodging tax of up to 3% to be used for tourism promotion (MN Statute, Sec. 469.190) - over 70 locations currently.

Appendix D

Selected Historical Summaries for Local General Sales Taxes

City	Rate	Background
Duluth	1.0%	The tax has no expiration date. Used for the city general fund—city municipal operations, maintenance, and capital improvements. Duluth has been specifically exempted from the statutory provision requiring tax collection/administration by the state and they currently administer their own tax, but it is set to transfer to the Department of Revenue on 1/1/06 (2001 Sp. Session, Ch. 5).
Hermantown	0.5%	Expires at the later of 10 years, or when sufficient funds have been met for the projects. Enacted for a sewer interceptor line, improvements to the municipal water system, and construction of a police/fire station.
Mankato	0.5%	Set to expire after $25 million for the Riverfront 2000 urban revitalization project (civic center, arena, park, & support facilities). Extended in 1996 to expire after an additional $4.5 million is raised for the airport.
Minneapolis	0.5%	The tax has no expiration date. Enacted in 1986 for convention center construction and maintenance. Augmented by 3% lodging tax, 3% downtown restaurant tax, and 3% downtown liquor tax. In 1992 the authorization was expanded to use proceeds for neighborhood early learning centers. Has not been implemented.
New Ulm	0.5%	The tax expires when sufficient funds to pay for up to $9 million in bonds for the civic and community center and recreational facility.
Proctor	0.5%	The tax expires when sufficient funds to pay for up to $3.6 million in bonds for the community center and street improvements.
Rochester	0.5%	This tax has been renewed three times (1989, 1992, and 1998). Initially enacted at 1% to raise $16 million for improvements to city park and recreation center and $16 for flood control improvements. Previously funded capital improvements to the fire hall, city hall, and public library facilities. The rate was lowered to 0.5% in 1992 (effective 1/1/93). The last extension in 1998 allows the city to raise another $76 million for several capital projects.
St. Paul	0.5%	The tax was originally set to expire when the civic center bonds were paid off. Funded renovation of Civic Center and neighborhood revitalization project. Amended to fund demolition of existing arena and construction of St. Paul RiverCentre Arena and expiration reset to 12/31/30.
Two Harbors	0.5%	Expires at the later of 10 years, or when sufficient funds have been met for the three projects. Enacted for sanitary sewer preparation, wastewater treatment, and harbor refuge development projects.
County		
Cook	1.0%	Enacted in 1993 and originally set to expire when $4 million was raised for the North Shore hospital. Extended in 1997 to allow an additional $2.2 million to be raised for the North Shore care center.

Note: M.S. 297A.48 (1997 legislation) required all jurisdictions (except Duluth) to have a complementary use tax, effective 1/1/2000.

Appendix E: LOCAL SALES TAX COLLECTIONS

CITY	Tax Base	Rate	CY 2000	CY 2001
Bloomington	Lodging	6%	$10,216,485	$9,342,837
	Liquor	3%	$1,393,098	$1,363,540
	Admission	3%	$941,599	$863,650
	Total		$12,551,182	$11,570,027
Duluth	State sales & use tax base	1%	$10,682,319	$10,891,461
	Certain food & beverages	1%	$1,320,436	$1,354,488
	Hotel/Motel	3%	$1,110,474	$1,153,034
	Add'l Hotel	2%	$682,163	$713,689
	Add'l Hotel	1%	$370,156	$384,350
	Add'l food & beverage	0.50%	$170,541	$178,422
	Add'l Hotel	0.50%	$660,218	$677,243
	Total		$14,165,548	$15,352,687
Hermantown	Sales tax	1%	$842,582	$829,360
	Use Tax	1%	$32,201	$37,541
	Total		$874,783	$866,901
Little Falls	Restaurant food and beverages	0.50%	$58,957	$58,883
Mankato	Sales tax	0.50%	$2,915,304	$3,006,248
	Use tax	0.50%	$237,218	$152,958
	Per vehicle excise tax	$20	$163,300	$158,130
	Total		$3,315,822	$3,317,336
Minneapolis	Sales tax	0.50%	$23,676,417	$24,432,675
	Use tax	0.50%	$4,088,470	$3,316,210
	Lodging	2%	$3,114,065	$3,011,634
	Entertainment	3%	$7,231,840	$7,068,814
	Downtown liquor	3%	$2,769,212	$2,773,742
	Downtown restaurants	3%	$8,192,127	$7,769,374
	Total		$49,072,131	$48,372,449

CITY	Tax Base	Rate	CY 2000	CY 2001
New Ulm	Sales tax	0.50%	$0	$447,613 *
	Use tax	0.50%	$0	$40,742 *
	Total		$0	$488,355
Proctor	Sales tax	0.50%	$55,626 *	$87,956
	Use tax	0.50%	$2,246 *	$5,727
	Total		$57,872	$93,683
Rochester	Sales tax	0.50%	$6,583,760	$6,919,163
	Use tax	0.50%	$1,047,027	$1,058,787
	Lodging	3%	$2,110,585	$2,029,696
	Per vehicle excise tax	$20	$344,940	$368,840
	Total		$10,086,312	$10,376,486
St. Cloud	Lodging	5%	$960,774	$962,423
	Certain food & beverages (liquor)	1%	$138,529	$138,920
	Certain food & beverages (food)	1%	$900,849	$893,466
	Total		$2,000,152	$1,994,809
St. Paul	Sales tax	0.50%	$11,749,344	$12,082,966
	Use tax	0.50%	$1,660,572	$1,658,473
	Lodging	3% & 6%	$2,746,161	$2,843,772
	Total		$16,156,077	$16,585,211
Two Harbors	Sales tax	0.50%	$157,129	$176,395
	Use tax	0.50%	$4,824	$4,667
	Lodging	1%	$16,547	$16,925
	Total		$178,500	$197,987
COUNTY				
Cook	Sales tax	1%	$758,237	$839,439
	Use tax	1%	$63,935	$26,743
	Lodging (Lutsen, Tofte, Schroeder)	2%	$301,034	$304,375
	Total		$1,123,206	$1,170,557

* Partial year collections only

Appendix F

Classification of Revenues for Cities under 2,500

Governmental Funds for the Year Ended December 31, 2001 as Reported by Office of State Auditor (OSA)

	Statewide Total	Percent Share
Total Revenues	**$333,139,618**	**100.0**
Local "Own Source" Revenue		
Local Sales Tax	$0	0.0%
Property Taxes	76,642,207	23.0%
Tax Increments	10,527,332	3.2%
Franchise Taxes	759,684	0.2%
Hotel/Motel Taxes	263,810	0.1%
Gravel and Gambling Taxes	90,703	0.03%
Special Assessments	16,829,443	5.1%
Licenses and Permits	6,373,720	1.9%
Subtotal	**$111,486,899**	**33.5%**
Intergovernmental Revenues		
Federal Grants	$15,337,269	4.6%
State Grants	112,497,919	33.8%
County Grants	2,841,773	0.9%
Local Grants	2,386,819	0.7%
Subtotal	**$133,063,780**	**39.9%**
Fees, Fines, Interest		
Service Charges	$29,669,939	8.9%
Fines and Forfeits	2,007,397	0.6%
Interest Earnings	14,514,451	4.4%
All Other Revenue*	42,397,152	12.7%
Subtotal	**$88,588,939**	**26.6%**

* 'All Other Revenue' includes donations, refunds, reimbursements, principal payments on loans receivable, and sales of property.

Appendix G

Cities that Received Authorization for a Local General Sales Tax but did not Implement Tax

City	Year	Project
Bemidji	1998	The city council did not put the tax to the required vote. The tax was intended to fund construction of a regional convention center. The center has not been built.
Bloomington	1986	The city council did not pass an ordinance to impose the tax (no referendum was required). The proceeds were intended to pay for highway and other public improvements on and around the site of the former Metropolitan Stadium, now site of the Mall of America. Bloomington uses its lodging and liquor selective sales taxes to fund site improvements.
Central Minnesota Cities	1998	This proposal would have allowed the cities of St. Cloud, Sauk Rapids, Sartell, Waite Park, and St. Joseph to impose a local sales tax to fund construction and operation of the Central Minnesota Events Center. The cities could have used any surplus revenue for specified projects of a regional nature. The tax did not take effect because it was defeated by referendum in four of the five cities. The Central Minnesota Events Center has not been built.
Detroit Lakes	1998	The tax was defeated by referendum. The proceeds were to fund construction of a community center. A scaled-down project went forward with money raised from donations by businesses and nonprofit organizations and from a state grant to the local school district, which provided an unused school building for the project.
Ely	1992	The tax was defeated by referendum. It was intended to fund the Gateway Project, which involved building certain structures along highways. This project has not gone forward with funds from other sources.
Fergus Falls	1998	The tax was defeated by referendum. The proceeds were intended to fund Project Reach Out, a series of construction projects and improvements including a regional conference center, regional park and recreational facilities, tourism-related development, and a community center. A scaled-down project went forward instead. Financing came from a state grant, a grant from Children, Families and Learning (now the Minnesota Department of Education), private donations, and a city enterprise fund. The planned community center, aquatic park, and campground improvements were not done. Modest improvements to playgrounds were paid for from the city general fund.
Garrison	1993	The city council did not put the tax to the required vote, although it still has authority to do so. The proceeds were to fund construction of a new sewer system. That project is nearing completion at this time. Funding has come from the state Wastewater Infrastructure Program. Also, the city and the Mille Lacs band tribal government formed a sanitary district in which the tribal government built a sewage treatment plant with the help of federal funds and owns the facility. The project is awaiting approval by the federal Environmental Protection Agency and the Minnesota Pollution Control Agency.
Hutchinson	1998	The tax was defeated by referendum. The proceeds were intended to fund construction of a community and events center. The project went forward with a state bonding grant and a city matching amount. Half of the state money was used for acquisition of property (a shopping center) and half for renovations of buildings on the property to house the community center. The city's portion included money for property acquisition from its municipal hospital fund and a higher amount from the city capital projects fund for building renovation.
Owatonna	1998	The tax was defeated by referendum. The proceeds would have funded the Owatonna Economic Development 2000 project and related facilities, which involved improvement of the Owatonna regional airport, including roads and utility infrastructure, and other improvements for economic and tourism purposes. The airport upgrade was funded chiefly by a grant from the Aeronautics Division of the Minnesota Department of Transportation and a lesser amount from the city general fund. Park projects were paid for by both private donations and the city general fund.
Thief River Falls	1992	The city council did not put the tax to the required vote. It was intended to fund construction and operation of the Area Tourism-Convention Facilities, including a convention center with a tourist park and riverfront improvements. The project did not go forward. In 1992, the school district planned an excess levy referendum and the city deferred to the district by not placing the sales tax on the ballot.