

Revenue Sources for Municipalities

Money puts the fun in governing. If your city or town has money you can do things. You can make people happy, and, when people are happy, you feel good about your office and you get reelected. As important as money is, many local officials still do not understand where the money comes from and the strings attached.

In Utah the legislature has given cities and towns very broad discretionary powers in many areas but not in the area of getting money. A city or town in general has the power to do anything that is reasonably related to the health, safety, and welfare of its residents and is not expressly prohibited by state or federal law, or preempted by state or federal law. One significant area which cities and towns are limited is in the area of raising and using money.

The legislature may trust you to be creative in controlling dogs but it does not trust you the area of raising revenue. When it comes to money, the rule is that if there is not a state law which specifically authorizes your proposed course of conduct, you probably cannot do it.

The legislature has authorized three basic revenue sources for cities and towns: They are property tax, sales tax, and utility (energy and telecommunications) tax. These generate money for the general fund of the city or town and can be used for any legitimate public purpose. There are also other limited money sources. They include development and other fees, utility rates, special assessments, business licenses and other miscellaneous fees and charges. These generate money that may be limited in use.

The authority for a property tax is established by the Fiscal Procedures Act for cities and towns.¹ The property taxing system is set out in the Property Tax Act.² Cities and towns are limited to a maximum property tax levy of .007 per dollar of taxable value of taxable property.³ This is a maximum levy for all purposes in any year including special taxes to retire bonds or indebtedness or any other property tax authorized by law.

The definitions of taxable value and taxable property are controlled by the state legislature in state law. The Property Tax Act defines what taxable value is and which property is taxable. Assessments of the property are also beyond the control of cities and towns. Some property is assessed by the Utah State Tax Commission. This is sometimes called centrally assessed property. Examples of centrally assessed property are property of public utilities and mining property.⁴ Revenue from centrally assessed property is apportioned to the taxing entities such as cities, towns, and counties based on factors such as the proportion of the utility line in the taxing entity area.⁵

¹ The Town Fiscal Procedures Act is in the Utah Code 10-5-101 et seq., and the City Fiscal Procedure Act is in Utah Code et seq.

² Utah Code 59-2-101 et seq.

³ For towns Utah Code 10-5-112, for Cities Utah Code 10-6-133.

⁴ Utah Code 59-2-201.

⁵ Utah Code 59-2-801.

Most property is assessed by the county assessor, and an assessment book is to be delivered to the county auditor who will compute the sums owing in the book and prepare assessment rolls. The tax is collected by the county treasurer. The city or town levy for property tax is to be included by the auditor on the assessment book at the rate established by the governing body of the city or town.⁶

A city or town must establish its levy at the time it makes its budget. This should be done no later than June 22nd of each year unless there is proposed to be a property tax increase.⁷ If there is going to be a property tax increase, the levy is delayed until August 17. To increase the property tax, the city or town must comply with the truth in taxation provisions of state law.⁸ The only exception is that if your total property tax receipts are less than \$15,000 per year, you do not need to comply with the truth in taxation law.

You cannot tell if you are proposing a property tax increase just by comparing rates from one tax year to another. The law holds the tax payer harmless from tax increases caused by inflation in property values. To do this, it creates what is called a certified tax rate. The certified rate is the tax levy that will provide the same revenue as was collected in the prior year plus new growth but excepting collections from redemptions, interest, and penalties.⁹ The certified tax rate for each city or town is transmitted by the county auditor to the city or town before June 8th of each year. It is computed from information given to the auditor by the county assessor and State Tax Commission.¹⁰ If you adopt the certified tax rate as your rate, then there is no tax increase. If you adopt a higher rate, you are increasing taxes even though the rate is the same rate that you may have adopted last year. This is the source of confusion to our resident tax payers. You may not have increased property taxes but their property tax may have increased. This is when assessments and the rates change each year the amount any individual pays will change even though there has been no general property tax increase.

If you propose a tax increase, you do not adopt your new tax levy in June, however, you still must adopt a budget by June 22. The city or town adopts a proposed levy and then holds a public hearing in August. The date of the hearing and the required publication is set by state law. You must comply with the law exactly as required. After the August public hearing, a resolution adopting the new tax levy may be passed. The resolution setting the new rate must be submitted to the county auditor by August 17. If it is not, the county auditor submits the certified tax rate as the rate for the city or town.¹¹

In addition to the property tax for the general fund, a city or town may have some special property tax assessment for particular funds and projects if authorized by law. For example, a third class city or town may have a levy of .001 per dollar of taxable value for

⁶ Utah Code 59-2-321.

⁷ Utah Code 10-5-112 and 10-6-133.

⁸ Utah Code 59-2-919 through 59-2-923.

⁹ Utah Code 59-2-924.

¹⁰ Utah Code 59-2-924.

¹¹ Utah Code 59-2-920.

purposes of a public hospital,¹² special districts may be created with the power to tax property for some services and improvements, and any city or town may have a levy not to exceed .0001 to pay for judgments against the city or town.¹³

Sales tax is in many ways a much less complicated tax. Cities and towns are authorized to assess a 1 percent sales and use tax on goods or services sold within the community.¹⁴ This is known as the local option sales and use tax. It is not mandatory that a city or town have this tax, but, if it does, it must be as outlined by state law. The goods and services subject to the tax are set forth by the state legislature as well as the exemptions. To enact the tax, the city or town must pass an ordinance in a form approved by the State Tax Commission and contract with the commission for the collection of the tax currently all cities and towns in Utah assess this tax.¹⁵

The tax is collected by the retailer and remitted to the State Tax Commission. Both retailer and the commission receive a portion of the tax for their costs of collection. The commission distributes the tax to the city or town based on a formula. Currently 50 percent of the tax is distributed to the entity in which the tax was collected and 50 percent is pooled and distributed to all cities and towns based on the population of the city or town.

There are other special sales taxes that a city or town may assess. You can impose a one percent transient room tax.¹⁶ This is sometimes called the hotel/motel tax. It is a tax on room rents for short term (less than 30 days) rentals. This is enacted by ordinance and can be collected either by the city or town itself or through the State Tax Commission at the city's or town's option. There is a special provision which allows an additional 5 percent transient room tax for a city or town that had a business license gross receipts tax on transient rooms prior to January 1, 1996 and had pledged the proceeds of that tax to bond repayment.¹⁷ Prior to January 1, 1998 a city or town could use its business licensing power to raise revenue. Several cities had motel taxes under this authority. The legislature took this and other business licensing revenue authority away from cities and towns and replaced part of it with this transient room tax.

In addition to the other sales and use taxes, a community that meets the definition of a resort community can impose an additional 1.1 percent sales tax. A resort community is one in which the transient room capacity exceeds 66 percent of the permanent census population.¹⁸ This sales tax is also collected for the city or town by the State Tax Commission and is subject to all the regular exemptions and restrictions and has a special exemption for the sales of motor vehicles, aircrafts, water crafts, and other large items.

¹² Utah Code 10-8-91.

¹³ Utah Code 63G-7-704.

¹⁴ Utah Code 59-12-203.

¹⁵ Utah Code 59-12-204.

¹⁶ Utah Code 59-12-352.

¹⁷ Utah Code 59-12-353.

¹⁸ Utah Code 59-12-401.

Resort communities may increase the tax by an additional .5 percent by holding an election authorizing the additional tax. This is started by a resolution approving the tax and then a vote at a general or municipal election.¹⁹ The only exception to this voter approval requirement is if the city or town had a gross receipts business license tax on all businesses prior to January 1, 1996. This is another bone the legislature threw to those cities that were relying on business licenses as a source of general revenue before the legislature took the authority away.

Cities and towns within transit districts can, after voter approval, impose an additional sales tax of .30 percent for public transportation and an additional .25 percent sales tax for fixed guide way (rail and light rail) and expanded transportation systems. These levies require an election. It can be either at a special or general election.²⁰ Both of these levies were allowed and meant to be specific for limited circumstances and projects so the law contains very convoluted definitions and descriptions of how and what it applies to. The short way to understand these potential tax levies is to just consider them as a way that Utah County and Salt Lake County, along with the UTA, are financing rail and highway construction projects.

Cities and towns not in a public transit district may, after voter approval, impose an additional sales tax of .30 percent for the purpose of highway construction and maintenance. The election must be either the general election or municipal general election. If approved, the tax becomes effective after an ordinance is passed and notice is given to the State Tax Commission. The notice must be given at least 30 days before the commission is to start collecting the tax. The tax begins only at the first day of a calendar quarter. Once again, the voter approval requirement is waived for those cities and towns who had a gross receipts business license fee on all businesses prior to January 1, 1996.²¹

Towns that had a gross receipts business license fee prior to January 1, 1996, may also enact an additional one percent sales tax as a substitute for the lost revenue from the change in business licensing power.

Business licenses were a good source for general revenue until January 1, 1998. Prior to that date, cities and towns could license businesses for purposes of revenue or regulation. The revenue received was revenue that could be used for any purpose. In 1997, the legislature severely limited the use of business licenses as a revenue source. For revenue purposes, you can now tax energy companies under the energy sales and use tax provisions,²² some parking services businesses, businesses that cause disproportionate costs to municipal services, or businesses that require an enhanced level of municipal services,²³ and telecommunication companies.²⁴ You can still license all other businesses for purpose of regulation but the license fee must be reasonably related to the cost of the regulation.

¹⁹ Utah Code 59-12-402.

²⁰ Utah Code 59-12-501 and 502.

²¹ Utah Code 59-12-1001.

²² Utah Code 10-1-301 et seq.

²³ Utah Code 10-1-203.

²⁴ Utah Code 10-1-401.

Before you impose the fee on business that cause disproportionate costs or require enhanced services, you must conduct a study to justify the services and the fee and then pass an ordinance with sufficient specifics to justify the additional business license fees. This is similar to what is required for impact fees. The service and cost analysis can be very expensive to do correctly but is necessary if you are going to use business licenses as revenue sources. The municipal energy sales and use tax does not require any service or cost analysis.

In the past, many municipalities used either franchise agreements or a gross receipt tax on utilities as a source of general fund revenue (or a combination of both). In 1996, the Utah Legislature enacted the Municipal Energy Sales and Use Tax Act.²⁵ This changed the manner in which a municipality can collect revenue from the sales and use of energy. This act authorizes a municipality to levy a tax on the sale or use of energy in an amount not to exceed six percent of the delivered value of the energy. This tax is in addition to the local option sales and use tax. The Municipal Energy Sales and Use Tax Act does not require a city to levy the tax but only authorizes it to do so.

If a city has an existing franchise agreement that requires the energy supplier to pay a fee, the city can continue to collect the fee for the remaining term of the agreement but must credit the agreed upon fee payment against any municipal energy sales and use tax paid by the energy supplier.

A municipality that has been collecting a gross receipts utility franchise fee by ordinance rather than by agreement must levy this new energy sales and use tax to continue to receive the revenue. The municipal energy sales and use tax must be levied by ordinance. The ordinance must have certain minimum provisions which are found in Utah Code 10-1-305. These include provisions similar to those required for the local option sales and use tax including a provision which requires the municipality to contract with the State Tax Commission for the collection and remittance of the energy tax (with certain limited exceptions). This contract must be entered into before the effective date of the ordinance. The tax is remitted to the municipality based upon the point of sale or point of use of the energy (less the Tax Commission's administrative fee).

An energy tax levied by a municipality can be effective only on the first day of July, October, January, or April following the effective date of the ordinance levying the tax. This energy sales and use tax is better than the old business license fee or franchise agreement system for the municipalities in many respects. It is a benefit to most municipalities to have the State Tax Commission collect and remit the tax as it relieves the municipality from the burden of auditing and collecting. It precludes big users of energy from avoiding paying the old franchise fees by buying the energy outside the municipality (as some did) by taxing the use of the energy.

There are some important rules that must be followed in levying this tax. There must be an ordinance (A model ordinance can be obtained from the Utah League of Cities and

²⁵ Utah Code 10-1-301 et seq.

Towns office). The tax levied must be equal for all energy suppliers (the tax on electricity must be the same as that for natural gas). The levy cannot exceed six percent including any fee that you receive as under any existing franchise agreement. If the municipality is in the energy business, it must levy the tax on its own sales if it levies a tax on private energy suppliers.

The Municipal Telecommunications License Tax Act²⁶ allows a city or town to tax telecommunication companies. This tax is limited to 3.5 percent of what is defined by the law to be “telecommunication services.” Like the energy sales and use tax, a very specific ordinance is required (Again, a model ordinance is available at the ULCT office).²⁷ This tax is also collected and distributed through the State Tax Commission.

Another source of revenue similar to the energy and telecommunications taxes are franchise fees. Franchises are the right to use the public ways for private businesses. You grant franchises to public utilities and others to use roads and easements to provide service to the residents. As discussed above, franchise fees with the energy and telecommunication companies must be coordinated with the municipal energy sales and use tax and the telecommunications tax. The maximum a city or town can receive is 6 percent or 3.5 percent respectively, regardless of whether it is by way of franchises or license taxes.

Cable TV franchises are not covered by state law. They are regulated by federal law and can be very complicated. The franchise agreement you have with your cable company will contain a fee. Whether this fee can be increased by a city or town without the agreement of the company depends on the specific agreement. This can be very complicated, and you will want to retain a very good expert when you are either renewing or entering into a cable franchise agreement. The money raised from all these franchise fees can be used for any purpose.

Other fees and charges are generally not to be a source of general fund revenue. All cities and towns receive a portion of the gasoline tax. This is often called the B&C Road Fund. The C roads are the city and town roads²⁸. Twenty-five percent of the state gasoline tax (motor fuels tax) is distributed to the B&C Road Fund. The money in the fund is distributed between city and county based on a formula including road miles and population. The money received is to be used only for maintenance and building roads. The motor fuels tax is intended to be a user fee and not a source of general fund revenue. This is not a problem to most cities and towns as the cost of building and maintaining the roads exceeds their annual allotment of fuel taxes.

Other user type fees include garbage collection fees, building permit fees, inspection fees, and water and sewer rates. Water, sewer, and garbage fees are usually not included in the general fund but in the enterprise funds. This precludes the use of these monies for purposes other than supplying the service. Many cities and towns have methods of

²⁶ Utah Code 10-1-401 et seq.

²⁷ Utah Code 10-1-404.

²⁸ Utah Code 72-3-104.

appropriating money from their enterprise funds to the general fund to cover the water or sewer systems share of general fund expenditures. These appropriations are legal if you can make a reasonable justification of the amount to be appropriated and what the money is to be used for.

The problem with all fees for services are that they are subject to challenge if they are too high. The city or town must be prepared to answer any challenge to its fees by showing some rational basis for the amount charged. A good example of this is the relatively old case of *Weber Basin Home Builders v. Roy City*.²⁹ In this case, the court found an increase in building permit fees from \$12 to \$112 to be unconstitutional. The court distinguished a fee from a tax and found the amount of the permit fee was in excess of the costs of regulating or providing the service and was, therefore, really a tax for the purpose of raising general revenue. While this is a relatively old case, it still appears to be good law. If you set your fees too high, they may be subject to challenge. The real problem with using fees as a substitute for taxes is that they are one-time money. If you use these fees to fund general fund expenses such as public safety, you are going to eventually go broke. On the bright side, this will probably be the problem of a future city council and you won't have to share in the blame for the needed tax increases.

Impact fees are now a very special case. Because of the actual and perceived abuses of these fees by cities and towns, the legislature has severely controlled them.³⁰ The fees you can assess, the way you go about establishing them, the way you account for them, and the time period in which you have to use them are now all set out in state law. You must comply with this law. An impact fee includes any payment of money you require as a condition of development activity with the exception of the building permit fee, hook up fees, taxes, special assessments, and reasonable application and permit fees. The building permit fee is limited to the amount authorized by the building code adopted by the state as the uniform building code, and the hookup fee must be only the actual cost of the utility connection.³¹ If you are collecting money from builders and developers, you need to make sure that it is either an exception to the impact fee definition or that the impact fee was legally enacted.

This is only a brief summary of impact fees. These types of fees are discussed in a little more detail in the next section of this handbook. If you are collecting impact fees, make sure they are appropriately imposed and that you use the money in the limited way allowed. Needless to say, impact fees of any sort are not a source of general fund revenue.

It is not easy to increase the amount of revenue a city or town has that can be spent. This usually means raising taxes. User fees are easier on politicians and the public because people are seeing the service they receive for their fee and there is an element of consent to the fee -- if they use the service, they know they will pay the fee. User fees that are so high that they supplement the general fund rather than just pay for the service rendered

²⁹ 487 P.2d 866 (1971).

³⁰ Utah Code 11-36-101 et seq.

³¹ Utah Code 11-36-102.

are subject to challenge. Fees which are really taxes on a distinct class of residents, such as new move ins, are also subject to challenge. Unfortunately, there really is no creative way of bringing in new general fund revenue that will not result in a tax increase of some kind to the citizens of your city or town.