The Surprisingly Strong Case for Local Income Taxes in the Era of Increased Remote Work

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Traditional theoretical literature on fiscal federalism urges cities to finance themselves with taxes on immobile sources. Thus, the literature sees real property taxes as the best source of local revenue; real property, after all, cannot be easily moved. This same literature eschews local income taxes because it is easy for a taxpayer to move, thus allowing exit from local income tax obligations.

Practice here seems to follow theory: cities do not tend to levy income taxes. However, this general trend has caused scholars to overlook important exceptions. In fact, many cities impose income taxes and have for a long time. In this Article, we argue these exceptions are not a vestigial mistake. The persistence of local income taxes suggests that the traditional fiscal federalism view is too absolute. Rather, local income taxes can play a useful role in the municipal revenue toolkit, provided that such taxes are not too administratively burdensome and levied at a low rate that considers the city's competitive position.

In this Article, we provide an account of local income taxes in practice. Because the existence of these taxes has been obscured by the theoretical dismissal of local income taxation, this account itself is a contribution to the existing local finance literature. We then argue that the traditional skepticism of local income taxes should be tempered. Evidence from agglomeration economics suggests some limits on the traditional mobility story; agglomerations make exit difficult for many industries and professions. Moreover, to the extent these agglomerations enable a segment of the population to earn more, it can be both fair and efficient to raise money through local income taxes.

We make this case for local income taxation well aware of increasing skepticism of local tax authority in an era of rising remote work. But the move to increased remote work does not doom local income taxes, either as a practical or legal matter. Remote work will not eliminate agglomerations so much as shift where they occur.

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TABLE OF CONTENTS

INTRODUCTION

The COVID-19 pandemic and associated recession brought dire revenue projections for state and local governments. In the end, states fared better than expected, particularly those states with income taxes.[1] This result was surprising, especially since reliance on the income tax was a driver of state fiscal distress during the Great Recession.[2] While income taxes are typically more responsive to economic declines than are sales taxes, the strange recession created by COVID-19—a recession with a thriving stock market and booming real estate prices—is far from typical. As a result, while recent experience hardly indicates that subfederal income taxes are perfect revenue sources, it does highlight the important role income taxation plays in balancing state budgets.

Unlike states, however, cities were battered by the COVID-induced recession. In particular, local governments that relied on sales and tourism taxes saw unprecedented declines in tax revenue at a time when the demand for local services—and the cost of providing those services—was increasing. Though local fiscal policy should not be designed to respond to the last crisis, recent events spotlighted the major weaknesses of current local revenue policy: the local revenue toolkit is too small. In this Article, we argue that local income taxes should play a more significant role in local budgets.

The classic accounts of fiscal federalism cast the absence of local income taxes as a positive feature of U.S. fiscal federalism. For example, in his "Fiscal Federalism" entry for *The Encyclopedia of Taxation and Tax Policy*, economist Richard Bird describes the conventional wisdom of the fiscal finance literature: it advises local governments to raise revenue through user charges and "local" taxes, especially the property tax, while reserving consumption taxes for states and the income tax to the central (federal) government.[3] These accounts argue that small subfederal jurisdictions cannot successfully impose progressive taxes, like income taxes, for fear that the rich will move away. But this view leaves local governments dependent on regressive revenue sources. As both a practical and political matter, this dependence limits local revenue options.

Despite these strong theoretical prescriptions, local governments with the legal authority to do so keep adopting income taxes. Depending on how one defines "income tax," such taxes are levied in as many as a third of the states.[4]

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1. Katherine Landergan, *States Faced Financial Ruin. Now They're Swimming in Cash*, POLITICO (July 7, 2021, 4:31 AM), https://www.politico.com/news/2021/07/07/states-financial-status-pandemic-498403; Lucy Dadayan & Kim S. Reuben, *Why States and Localities Need More Federal Aid*, TAX POL'Y CTR. (Feb. 22, 2021), https://www.taxpolicycenter.org/taxvox/why-states-and-localities-need-more-federal-aid.

2. Jared Walczak, *Income Taxes Are More Volatile Than Sales Taxes During an Economic Contraction*, TAX FOUND. (Mar. 17, 2020), https://taxfoundation.org/income-taxes-are-more-volatile-than-sales-taxes-during-recession/.

3. Richard M. Bird, *Fiscal Federalism*, *in* ENCYCLOPEDIA OF TAXATION AND TAX POLICY 151, 151 (Joseph J. Cordes et al. eds., 2d ed. 2005), https://www.urban.org/sites/default/files/publication/71081/1000529-Fiscal-Federalism.PDF.

4. JARED WALCZAK, TAX FOUND., LOCAL INCOME TAXES IN 2019 (2019), https://files.taxfoundation.org/20190730170302/Local-Income-Taxes-in-20191.pdf. The Tax Foundation's definition of an "income tax"

In six states, local income taxes represent more than 10% of local tax collections.[5] While income taxes in New York City and Philadelphia are levied at higher rates than other local income taxes, large urban areas are not the only jurisdictions that impose income taxes. Both rural and urban counties in Maryland and Indiana impose income taxes, as do 649 municipalities in Ohio and 2,506 municipalities in Pennsylvania.[6] And new jurisdictions continue to adopt income taxes. In 2019, Bridgeport, Ohio and Benton Harbor, Michigan imposed local income taxes for the first time.[7] East Lansing, Michigan began collecting its new local income tax in 2020.[8] Because of Michigan's Headlee Amendment, this local tax could only be imposed after it was directly approved by East Lansing's voters.[9]

It has been decades since legal scholarship has seriously explored the role of local income tax laws in municipal finance,[10] but the time is ripe for reconsideration. We argue that the persistence of local income taxes is not a mistake. The traditional theoretical argument discounts local income taxes too quickly. Local income taxes make sense in light of the logic of agglomeration economics. Agglomeration economics teaches that businesses and workers often achieve better economic results through agglomerating in space. Local governments are often essential to enabling such agglomerations and thus are

is quite broad. *See Taxable Income*, TAX FOUND., https://taxfoundation.org/tax-basics/taxable-income/ (last visited Feb. 23, 2023). It encompasses not only taxes that piggyback on the federal income tax system, but also taxes like San Francisco's Payroll Expense Tax, which is a 0.38% tax on payroll expenses on all taxpayers engaging in business within San Francisco for whom annual payroll exceeds $320,000. *Payroll Expense Tax (PY)*, CITY & CNTY. OF S.F., TREASURER & TAX COLLECTOR, https://sftreasurer.org/business/taxes-fees/payroll-expense-tax-py (last visited Feb. 23, 2023). The extent of taxation within states also varies widely. For example, San Francisco is the only city in California that levies an income tax, according to the Tax Foundation's definition. *See* WALCZAK, *supra* note 4, at 4. In other states, like Alabama and New York, local income taxes are levied only in a few jurisdictions. *See id.* at 7. On the other hand, they are ubiquitous in states like Pennsylvania, Maryland, and Ohio. *See id.* at 2.

5. WALCZAK, *supra* note 4, at 2.

6. *Id.*

7. Carri Graham, *Bridgeport Residents Upset over New Income Tax That Takes Effect Thursday*, THE INTELLIGENCER (July 31, 2019), https://www.theintelligencer.net/news/community/2019/07/bridgeport-residents-upset-over-new-income-tax-that-takes-effect-thursday/; *Benton Harbor Income Tax Due This Month*, 94.9 WSJM (Apr. 3, 2019), https://www.wsjm.com/2019/04/03/benton-harbor-income-tax-due-this-month/.

8. Megan Banta, *Filing a Tax Return in East Lansing? Here's What You Should Know*, LANSING STATE J., https://www.lansingstatejournal.com/story/news/local/2020/01/28/east-lansing-income-tax-what-to-know/4586945002/ (Jan. 28, 2020, 11:07 AM).

9. MICH. CONST. art. IX, § 31; *see also* Kevin C. Kennedy, *The First Twenty Years of the Headlee Amendmen*t, 76 U. DET. MERCY L. REV. 1031, 1032–33 (1999).

10. For a survey of the earlier literature, see, for example, Paul J. Hartman, *Municipal Income Taxation*, 31 ROCKY MTN. L. REV. 123, 123–24 (1958) (surveying earlier literature); Joe G. Davis, Jr. & Arthur J. Ranson, III, Note, *An Evaluation of Municipal Income Taxation*, 22 VAND. L. REV. 1313, 1313 (1969); Leonard Kirschner, *The Municipal Income Tax*, 20 U. CIN. L. REV. 343, 348 (1951) ("The most convincing argument in favor of the tax is that it will reach the non-resident using city facilities, who currently contributes nothing to the city government."). *See generally* ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., SR-10, LOCAL REVENUE DIVERSIFICATION: LOCAL INCOME TAXES (1988), http://www.library.unt.edu/gpo/acir/Reports/staff/SR-10.pdf (discussing municipal revenue sources); Gary Sperling, *Municipal Income Taxation and Home Rule*, 1 URB. LAW. 281, 281 (1969) (discussing municipal income tax feasibility under current home rule provisions).

justified in taxing a small portion of the benefit they provide to those who benefit from agglomerations. Moreover, the performance of state-level income taxes during the pandemic suggests that income taxes could play a stabilization role in local fiscal policy.

Local governments are increasingly searching for new sources of revenue, especially as they face increasing pension obligations and maintenance costs for aging infrastructure. Even before the COVID-induced recession began to wreak havoc on local finances, local budgets faced significant resource constraints. The problem was—and remains—acute in Chicago.[11] And in early 2020, civic leaders and politicians had already begun to think about the possibility of imposing an income tax to help address the city's struggling financial picture.[12] For those on the left, such a local income tax represents a progressive tax solution, but even some moderates appear to be taking the idea seriously. *Chicago Sun-Times* editorial writer Ed Zotti wrote a column suggesting that the income tax may be the best of Chicago's bad revenue options, or in his more colorful language: "Better a city income tax than slow suicide."[13]

It is time to think more broadly about what constitutes "appropriate" local revenue sources. This is not to say that we should abandon efforts to improve the property tax or attempt sensible reforms to the sales tax base. However, in an era of increasing concern about income inequality, we are likely to see calls for more progressive taxation at all levels of government, and it is likely that at least some jurisdictions will impose such taxes.

The traditional fiscal federalism critique is often treated as ending the conversation on local income taxes: "Yes, they may be enacted, but they are bad policy." In this Article, we argue that given the structures of our existing fiscal federalist system, there are good reasons for local governments to have the authority to impose an income tax and for them to exercise this authority. Some

11. *See, e.g.*, Gregory Pratt, *Chicago Facing 'Extraordinary Financial Challenges,' Lightfoot Says After Latest Audit*, CHI. TRIB. (July 5, 2019, 3:17 PM), https://www.chicagotribune.com/politics/ct-chicago-financial-report-20190705-uvmpic7esje6zl5jpeobhnfp5m-story.html.

12. JOSEPH M. FERGUSON, REPORT OF THE INSPECTOR GENERAL'S OFFICE: BUDGET OPTIONS FOR THE CITY OF CHICAGO 18 (2011), https://igchicago.org/wp-content/uploads/2011/09/IGO-2011-Budget-Options-September-27-2011-Final.pdf#page=18; *A City of Chicago Income Tax?*, THE CIVIC FED'N (Apr. 12, 2019), https://www.civicfed.org/civic-federation/blog/city-chicago-income-tax; Edward McClelland, *Could Chicago Stomach a City Income Tax?*, CHI. MAG. (Oct. 8, 2019, 11:13 AM), http://www.chicagomag.com/Chicago-Magazine/November-2019/Could-Chicago-Stomach-a-City-Income-Tax/; Greg Hinz, *Household Income over 100k? You'll Want To Read This*, CRAIN'S CHI. BUS. (Feb. 17, 2019 5:00 AM); https://www.chicagobusiness.com/greg-hinz-politics/household-income-above-100k-youll-want-read.

13. Ed Zotti, *A Chicago City Income Tax Could Be in Our Future Because Other Alternatives Are Worse*, CHI. SUN-TIMES (Nov. 22, 2019, 9:00 AM), https://chicago.suntimes.com/crossroads/2019/11/22/20971340/chicago-city-income-tax-municipal-pension-budget-crisis-property-taxes-zotti-city-crossroads. Of course, in 2020 Illinois voters rejected a constitutional amendment allowing the state to impose a progressive income tax, making the prospect of Chicago's adoption even more remote as a matter of state law. Amanda Vinicky, *Illinois Voters Reject 'Fair Tax' Amendment*, WTTW NEWS (Nov. 4, 2020, 10:41 AM), https://news.wttw.com/2020/11/04/illinois-voters-reject-fair-tax-amendment.

of our arguments are of the "best-of-bad choices" variety, but others suggest a stronger affirmative case for local income taxes.

In Part I, we ground our argument for the possible role of local income taxes by providing an overview of local tax and revenue policies. This overview also makes the case that existing revenue options are insufficient. Part II discusses the law of local income taxes, describing both the state and local legal framework for existing local income taxes and the legal barriers to expanding local income taxes in other jurisdictions.

Part III then offers a normative argument for local income taxes and addresses concerns both arising from the fiscal federalism literature and elsewhere. In particular, we explain that localities can and should tax income because of the agglomerations they enable. Further, unless one believes that current trends toward remote work will eliminate agglomerations altogether, then there will be room for local income taxes, properly designed, for at least some localities. Finally, the Article concludes with suggestions for both reforming current taxes and for proposals to adopt new local income taxes.

I. THE LOCAL INCOME TAX IN PRACTICE (AND OUT)

To assess the strength of the case for local income taxes, it helps to understand something about the kinds of local income taxes jurisdictions currently impose. Thus, this Article begins by offering a descriptive account of existing local income taxes. In the first Subpart, we explain our choice to define "income tax" broadly. The second Subpart offers a more detailed description of current local income tax design choices. This descriptive account is central to the Article's normative argument for two reasons. First, it highlights the existence of local income taxes. Such taxes—and the legal authority to enact them—have not been seriously discussed in the legal tax literature for decades and have received minimal attention in economics, political science, and public administration literatures. Second, the design of current local income taxes inform our argument that such taxes should be a more ordinary part of the local fiscal toolkit and suggest some possibilities for improvement. In the final Subpart, we discuss the practical impediment for expansion of local income taxes: state laws that restrict local income tax authority.

A. DEFINING LOCAL INCOME TAXES

Local income taxes reflect a broad array of design choices. In fact, the Tax Foundation report on local "income taxes" includes not only taxes that broadly resemble state and federal income taxes, but also taxes on wages and payroll.[14] This descriptive Subpart casts a similarly broad net, exploring not only local jurisdictions imposing traditional broad-based income taxes, but also jurisdictions that tax a narrower subset of income, most commonly wage and

14. WALCZAK, *supra* note 4, at 6.

business income. We also survey local taxes imposed on employer payroll, as we view that as a form of substitute taxation, with the employer standing in for employees working in the city. Most broadly, we also discuss local business taxes imposed on gross receipts. While such taxes also bear some resemblance to consumption taxes, we note them here because their persistence indicates that localities continue to push beyond taxing property and sales and look to find proxies for local economic activity.

We approach this descriptive work broadly for several reasons. First, the decision to employ a narrow income tax base (for example, a local income tax that applies only to wage income) may reflect traditional fiscal federalism concerns about local income taxes. Wages are less mobile than other forms of income,[15] and wages may also be less mobile than other traditional tax bases, like the location of sales.[16]

Second, local *wage* taxes have grown more similar to federal and state *income* taxes as federal and state income tax laws have adopted features that either exempt nonwage income from taxation or lower the rate on nonwage income.[17]

Income taxes also bear a similarity to local business taxes, which, like wage taxes, are hard to justify given the prescriptions of traditional fiscal federalism literature. Like local income taxes, local business taxes take many different forms. Many businesses are mobile, certainly over time, and hence can move or expand outside of the jurisdiction. Accordingly, many studies have found that such taxes can reduce business creation and employment within a city.[18]

And yet, like local income taxes, business taxes are common (likely more so). Indeed, they are not just common, but also sometimes substantial and often not very uniform.[19] As with local income taxes, there are at least two different ways to think about this divergence of theory and practice. First, this could be a story about the broken political economy of cities. This seems to us a too-easy explanation for a broad and persistent phenomenon. Second, and relatedly, one might think that cities muddle through because, in the end, the cost is not too

15. Musgrave, in giving the classic argument against local income taxes, makes this point as to the defensibility of local *wage* taxes. Richard A. Musgrave, *Who Should Tax, Where, and What?*, *in* TAX ASSIGNMENT IN FEDERAL COUNTRIES 2, 12 (Charles McLure ed., 1983).

16. And, as a matter of theory and practice, as locating sales has become trickier, this makes the case for local income taxes stronger, especially if there is a higher-level tax to work from. Charles E. McClure, Jr., *The Tax Assignment Problem: Ruminations on How Theory and Practice Depend on History*, 54 NAT'L TAX J. 339, 354 (2001).

17. *See generally* Edward J. McCaffery, *The Death of the Income Tax (or, the Rise of America's Universal Wage Tax)*, 95 IND. L.J. 1233 (2020).

18. *See generally* Charles Swenson, *City Business Taxes: More Than You Think*, 82 TAX NOTES STATE 75 (2016); Charles Swenson, *Empirical Evidence on the Impact of City Taxes*, 4 APPLIED ECON. & FIN. 65 (2017) (citing other analyses).

19. *See generally, e.g.*, Steven N.J. Wlodychak, *Work from Home – Local Business Taxes, the Next Big Headache*, TAX NOTES (Apr. 20, 2021), https://taxnotes.com/tax-notes-today-state/local-taxation/work-home-local-business-taxes-next-big-headache/2021/04/20/43p6n.

great relative to the revenue raised. This explanation, however, undermines the traditional critique of local income taxes.

Why is the cost not too great? Even if the tax is low, why should a business not just move to a locality with no tax? Perhaps the cost is not too great because businesses are getting something from the localities imposing the tax. Put in terms of traditional tax policy, these businesses are benefiting from the tax, and so they treat it like a price—a price they are willing to pay. Thus, beneath the confused reality of local business activity taxes, there is a rationale for their persistence. There is also a small amount of literature on how localities might best design their business activity taxes in light of their theoretical justification.[20]

In the remainder of this Article, we will do much the same for local income taxes, broadly considered. We will show that they persist despite what theory suggests. We will then argue why a closer look at theory reveals that these taxes do have a role, and finally we will consider how this theory would, ideally, change the current practice of local income taxes.[21]

The remaining Subparts illustrate the variety of ways in which state laws authorize (and fail to authorize) local income tax.

B. Local Income Taxes in Practice

This Subpart describes key features of enacted local income taxes. Pennsylvania's local income tax, which we explore in some depth, is a wage tax, though it is supplemented with separate taxes on business income in some local jurisdictions. Ohio's municipal net profit tax sweeps further than a wage tax, but it is more limited than federal income taxes. Maryland and Indiana's county income taxes, as well as New York City's income tax, are much more like federal and state income taxes. We also consider the history of local payroll and gross profit taxes in California to highlight the variety of ways that income-like taxes are imposed at the local level.

1. Pennsylvania's Local Income Taxes

Pennsylvania leads the nation in the number of jurisdictions imposing an income tax, and so that is where we begin. Of the 4,964 jurisdictions that the Tax Foundation identifies as imposing local income taxes, more than half are in Pennsylvania.[22] These taxes represent 8.27% of local tax collection in the state and 7.53% of local revenue.[23] In this survey of the variety of local income tax

20. *See generally, e.g.*, Richard M. Bird, *A New Look at Local Business Taxes*, 30 Tax Notes Int'l 695 (2003); Richard M. Bird, *A Better Local Business Tax: The BVT*, 18 Inst. on Mun. Fin. & Governance 1 (2014).

21. One final note is that there is a complex relationship between local income taxes and local business activity taxes. At the theoretical level, there are at least three questions that we will, briefly, return to in a later work. First, does it make sense for localities to levy both kinds of taxes? If so, when and how? Empirically, we will see that localities levy one or both kinds and sometimes switch from one to the other.

22. Walczak, *supra* note 4, at 2.

23. *Id.* at 4.

designs, Pennsylvania offers an example of jurisdictions imposing narrow income taxes that focus on taxing wage income.

Philadelphia, the state's largest city, has more expansive taxing authority than other jurisdictions in the state, allowing it to impose its tax on nonresidents, giving it more flexibility in setting tax rates, and giving it additional authority to tax business income. As a result, Philadelphia's earned income and business net profit taxes represent about 45% of its general fund revenue,[24] making the city more dependent on local income taxes than any other jurisdiction in the country.

Philadelphia administers its own wage tax, which imposes significant filing obligations on employers.[25] As a result, wage earners do not need to file local tax returns unless they are seeking refunds or are employed by an out-of-state employer.[26] While the city's tax withholding rate is flat, there is a modest adjustment in the tax rate based on income and family size. For example, a single-wage earner with no dependents would face a slightly lower tax rate if her annual income was below $8,750 in 2019.[27] For the first six months of 2019, this would reduce this taxpayer's tax rate to 3.809% and then for the second six months to 3.3712%. This reduced rate is not the same as a tax exemption. The wage tax at the lower rate is still imposed on the first dollar earned.

As previously mentioned, Philadelphia also imposes a net profits tax on noncorporate business income through its "Business Income & Receipts Tax" and "Net Profits Tax." Both residents who earn business income and nonresidents who operate businesses in Philadelphia must pay this tax.[28] Residents pay the same tax rate on net business income as they do on wage income, while nonresidents face a slightly lower tax rate on net business income.[29] As it does for its wage tax, Philadelphia provides a reduced net income tax rate for low-income taxpayers.[30]

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24. DEP'T OF REVENUE, CITY OF PHILA., FY 2020 YEAR IN REVIEW 5 (2020), https://www.phila.gov/media/20201201144201/Department-of-Revenue-Annual-Report-FY-2020.pdf.

25. *See Wage Tax (Employers)*, CITY OF PHILA., https://www.phila.gov/services/payments-assistance-taxes/business-taxes/wage-tax-employers (Jan. 11, 2023) (discussing employer responsibility to withhold and pay city wage tax).

26. Philadelphia now allows residents to claim a refund to the extent their wages were earned from sources outside of Pennsylvania and that these wages were taxed by a non-Pennsylvania local government. This change was required by the U.S. Supreme Court's decision in *Comptroller of the Treasury of Maryland v. Wynne*, in which the Court found that such a credit was required by the dormant Commerce Clause. 575 U.S. 542, 545 (2015).

27. *Income-Based Wage Tax Refund Petition 2019*, CITY OF PHILA. DEP'T OF REVENUE, https://www.phila.gov/media/20191220111558/Income-based-Wage-Tax-refund-petition-2019-v2.pdf (last visited Feb. 23, 2023).

28. *See EIT / PIT / LST Tax Registers (Real-Time)*, PA. DEP'T OF CMTY. & ECON. DEV., https://munstats.pa.gov/Reports/ReportInformation2.aspx?report=EitWithCollector_Dyn_Excel&type=R (last visited Feb. 23, 2023) (providing a sortable list of all municipality and school district tax rates).

29. *Net Profits Tax*, CITY OF PHILA., https://www.phila.gov/services/payments-assistance-taxes/business-taxes/net-profits-tax/ (Jan. 11, 2023).

30. *Id.*

Outside of Philadelphia, both Pennsylvania municipalities and school districts also impose wage taxes, known as "local earned income taxes."[31] In most cases, state law caps the local earned income tax rate at 1%[32] and requires overlapping municipalities and school boards to split this 1% rate evenly.[33] There are, however, numerous exceptions to the 1% rate limit.[34]

State law requires cities to credit residence-based local earned income taxes against source-based taxation.[35] As 95% of Pennsylvania municipalities impose an earned income tax,[36] this rule limits commuter tax revenue substantially.[37] Outside of Philadelphia, these local wage taxes are administered by the state.

At one time, state law authorized local governments to impose a business gross receipts tax in addition to an earned income (wage) tax.[38] That authorization was repealed in 1988. Local governments then imposing the tax were grandfathered in,[39] and the legislature has made additional exceptions for specific jurisdictions.[40] As a result, a handful of Pennsylvania jurisdictions impose a gross receipts tax.

2. *Maryland's County Income Tax*

In contrast to Pennsylvania, Maryland allows its counties to raise revenue from a broad-based income tax that is entirely administered by the state. Thus, Maryland offers an example of the ways piggybacking on state tax law and enforcement can simplify local income tax administration and allow local governments to tax a broader base.

Maryland's local governments are more reliant on local income taxes than any other state's local government. A third of Maryland's local tax collections are generated by local income taxes, representing almost 18% of total local

31. *Local Income Tax Information: Frequently Asked Questions About Act 32 and Local Earned Income Tax*, PA. DEP'T OF CMTY. & ECON. DEV., www.https://dced.pa.gov/local-government/local-income-tax-information/ (last visited Feb. 23, 2023).

32. 53 PA. CONS. STAT. § 6924.311(3) (2023).

33. *Id.* § 6924.311(12).

34. For example, the Pennsylvania Public School Code allows Pittsburgh to essentially avoid the revenue-sharing requirement and impose a combined 2% tax rate. 24 PA. STAT. AND CONS. STAT. § 6-652.1(a)(2)(i) (West 2023). Additionally, the Municipalities Financial Recovery Act allows distressed local governments to exceed the 1% rate as part of their economic recovery plan. 53 PA. STAT. AND CONS. STAT. § 11701.123 (West 2023). Other examples include the Municipal Pension Plan Funding Standard Recovery Act, which allows local governments that have distressed pension systems to impose a higher local earned income tax rate under a pension recovery plan. 53 PA. STAT. AND CONS. STAT. § 895.607(f) (West 2023). Also, the Land Preservation for Open Space Uses Act (1996) allows local municipal governments to impose a small increase in the local earned income tax rate to fund open spaces. 32 PA. STAT. AND CONS. STAT. § 5007.1 (West 2023). Finally, Act 50 of 1998 allows school districts to impose higher local earned income tax rates in exchange for reducing other taxes. 53 PA. CONS. STAT. § 8402 (2023).

35. 53 PA. STAT. AND CONS. STAT. § 6924.317 (West 2023).

36. GOVERNOR'S CTR. FOR LOC. GOV'T SERVS., COMMONWEALTH OF PA., TAXATION MANUAL 29 (2022), https://dced.pa.gov/download/taxation-manual/?wpdmdl=56385&refresh=5f84c345109581602536261.

37. State law, to be clear, exempts Philadelphia from this crediting requirement.

38. 53 PA. STAT. AND CONS. STAT. § 6924.301.1(f)(2) (West 2023).

39. 72 PA. STAT. AND CONS. STAT. § 4750.533(b) (West 2023).

40. *See supra* note 34.

revenue.[41] While nominally a "county-level tax," it is authorized under state law, collected by the state, and treated as a state tax liability under state law.[42] Individual Maryland counties, however, choose the tax rate within the band set by the state.[43] The revenue collected by the state from the tax is transferred to the taxpayer's county of residence.[44] State administration reduces compliance costs.

Like Maryland's state income tax, the county-level tax is imposed on the income of Maryland residents, regardless of where the money is earned.[45] The tax is imposed on Maryland taxable income,[46] which includes wages as well as business income and returns to savings. The county-level tax ranges from a high of 3.2% to a low of 2.25%.[47]

Taxpayers who are not Maryland residents, but who earn income in Maryland, pay an equivalent tax. Because such taxpayers are not residents of a Maryland county, the state assesses their county-level tax liability at the lowest rate imposed by any Maryland county, and the state keeps this revenue.

3. Ohio's Municipal Net Income Taxes

Ohio's local income tax raises revenue from both individuals and corporations. Thus, it offers an example of the ways local income taxes can target business income. Moreover, Ohio's local income taxes are based on both source and residence, generating significant revenue from commuters.

In terms of local tax authority, Ohio is an outlier. Its supreme court has interpreted the Ohio Constitution's "home rule" provision as encompassing the authority to tax.[48] Perhaps as a result of this rare fiscal home rule, Ohio is also one of the handful of states for whom local income taxes form a significant part of the local tax base. According to the Tax Foundation, at one point, local income taxes represented over a quarter of local tax receipts and over 9% of local revenue.[49] As we will see, the Ohio experience illustrates the potential for

41. WALCZAK, *supra* note 4, at 4.

42. *See* Frey v. Comptroller of the Treasury, 29 A.3d 475, 492 (Md. 2011) ("Furthermore, . . . we affirm the Court of Special Appeals's conclusion that the county tax levied under T.G. § 10-103 and § 10-106 is a State tax.").

43. MD. CODE ANN., TAX–GEN. §§ 10-103, 10-106 (2023).

44. MD. CODE ANN., TAX–GEN. § 2-608 (2023).

45. *See* Comptroller of the Treasury v. Wynne, 575 U.S. 542, 545–46 (2015) (describing the structure of the tax).

46. TAX–GEN. §§ 10-103, 10-106.

47. *Maryland Income Tax Rates and Brackets*, COMPTROLLER OF MD., https://www.marylandtaxes.gov/individual/income/tax-info/tax-rates.php (last visited Feb. 23, 2023).

48. Ohio's home rule provision is broad: "Municipalities shall have authority to exercise all powers of local self-government and to adopt and enforce within their limits such local police, sanitary and other similar regulations, as are not in conflict with general laws." OHIO CONST. art. XVIII, § 3. In Ohio, courts have made clear that "all powers" includes the power to tax. *See* Cincinnati Bell Tel. Co. v. Cincinnati, 693 N.E.2d 212, 214 (Ohio 1998) (citing State *ex rel.* Zielonka v. Carrel, 124 N.E. 134, 136 (Ohio 1919)) ("There can be no doubt that the grant of authority to exercise all powers of local government includes the power of taxation.").

49. WALCZAK, *supra* note 4, at 4. However, the Tax Foundation does not clarify over which period this is true.

state and local conflict over local income tax collection, as the legislature retains the power to preempt local tax authority[50] and extensive authority to regulate the administration of local taxes.[51]

Ohio law authorizes a 1% income tax on resident and nonresident individuals and corporations. Cities can impose a higher rate with voter approval.[52] The individual income taxes are commonly referred to as the "individual resident tax" (for residents) and the "commuter tax" (for nonresidents).[53] The local income tax on resident and nonresident corporations is known as the "net profits tax." While Ohio imposes an individual income tax, it does not tax corporate income at the state level, limiting the opportunity for local government to piggyback on state corporate tax administration.[54]

Ohio's income tax applies to a broader base than simply wages. The tax also covers rental income and business profits, among other income items.[55] However, Ohio does not allow localities to tax intangible income, including interest, dividends, and capital gains.[56] State law grants other exemptions, as well.[57] For nonresidents, the tax applies to income "earned or received by the nonresident for work done, services performed or rendered, or activities conducted in the municipal corporation."[58]

Historically, Ohio cities administered local income taxes for themselves. The state's largest cities, like Columbus, Cincinnati, Akron, and Toledo, continue to do so, but many smaller jurisdictions have joined regional tax collaborations.[59] Ohio's individual taxpayers file local income tax returns at the city level, or with the appropriate regional collaboration; there is no consolidation with state returns.

Business groups complained for years about the municipal net profit tax and especially the difficulties multijurisdictional businesses faced with compliance obligations in each jurisdiction in which they conducted business.[60] In 2014, Ohio passed municipal net income tax reform to address these concerns,

50. OHIO CONST. art. XVIII, § 13.

51. Athens v. McClain, 168 N.E.3d 411, 421 (Ohio 2020).

52. OHIO REV. CODE ANN. §§ 715.013(c), 718.04(C)(2) (West 2023).

53. *Id.* §§ 715.013(c), 718.04(C)(2).

54. Ohio instead imposes a Commercial Activity Tax (CAT) on gross receipts of businesses operating in the state. OHIO ADMIN. CODE 5703-29-02(F) (2021).

55. REV. § 718.01(B)(1)(a).

56. *Id.* § 718.01(C)(2), (S).

57. For example, military pay is not subject to the tax. *Id.* § 718.01(C)(1).

58. *Id.* § 718.01(B)(2).

59. One large collaboration, the Central Collections Agency (CCA), is run by the Cleveland Division of Taxation. Forty-eight jurisdictions have delegated authority to the CCA to collect their taxes. *2019 Individual Municipal Income Tax Forms*, CITY OF CLEVELAND DIV. OF TAX'N: CENT. COLLECTION AGENCY http://ccatax.ci.cleveland.oh.us/taxforms/Y2020/citytaxfrm.pdf (last visited Feb. 23, 2023). Another collaboration, Regional Income Tax Authority (RITA), represents over 300 members. *About RITA*, REG'L INCOME TAX AGENCY, https://www.ritaohio.com/About/Home/Timeline (last visited Feb. 23, 2023).

60. Jeremy Pelzer, *Municipal Income Tax Reform Bill Set To Move Ahead Despite Opposition from Local Governments*, CLEVELAND.COM, https://www.cleveland.com/open/2013/11/municipal_income_tax_reform_bi.html (Nov. 11, 2013, 10:32 PM).

despite vociferous objections by Ohio's cities. The reforms provided businesses (including corporations, partnerships, and other pass-through entities, but not sole proprietorships) the opportunity to file a combined municipal net profits tax return with the state's Department of Revenue.[61]

Of course, centralization of tax administration has many benefits in terms of decreasing compliance burdens, and states frequently take responsibility for the collection of both state and local sales taxes.[62] When state and local governments share a tax base, they also share enforcement priorities.[63] Yet Ohio's move to centralize the administration of the municipal net profits tax lacked this opportunity for shared enforcement activity because Ohio does not impose a state corporate income tax. Ohio's municipalities therefore fear that state administration will reduce municipal revenues on business income taxes.

Moreover, the reforms do not provide an automatic right for local governments to audit taxpayers who opt into Ohio's centralized filing system. Rather, local governments must ask the state for audits of these taxpayers, and municipal revenue departments worry that the state may not share its enforcement priorities. Giving the state sole discretion also leaves cities vulnerable to petty bureaucratic politics where state assistance on enforcement is contingent on the personal relationships between municipal and state tax officials. Ohio's cities lost their state constitutional challenge to these provisions; the Ohio Supreme Court held that centralized administration was consistent with home rule authority.[64] Thus, Ohio's net profits taxes can be filed at the state level, even though the taxes are locally imposed.

4. Indiana's County-Level Income Taxes

Indiana offers an additional example of how state law can coordinate local income taxes. Like Maryland, all counties in Indiana impose a county income tax, though Indiana's county taxes are much smaller as a percentage of local revenue.[65] These local income taxes account for only 6.3% of local tax collections.[66]

All ninety-two of Indiana's counties impose what is known as the Local Income Tax (LIT),[67] which applies a single tax rate to both residents and

61. REV. § 718.82(A).

62. INST. FOR PROS. IN TAX'N, LOCALLY ADMINISTERED SALES AND USE TAXES 3 (2016), https://www.ipt.org/iptdocs/Files/MiscForms/CompleteStudy.pdf.

63. *Cf.* Erin Adele Scharff, *Laboratories of Bureaucracy: Administrative Cooperation Between State and Federal Tax Authorities*, 68 TAX L. REV. 699, 712–20 (2015) (discussing advantages of cooperative tax enforcement between the states and the federal government).

64. Athens v. McClain, 168 N.E.3d 411, 423–25 (Ohio 2020).

65. *Indiana IT-40 Full-Year Resident Individual Income Tax Booklet*, IND. DEP'T OF REVENUE, https://www.in.gov/dor/tax-forms/2020-individual-income-tax-forms/ (last visited Feb. 23, 2023).

66. WALCZAK, *supra* note 4, at 4. The local taxes represent only 4.32% of total local revenue. *Id.*

67. H.B. 1485, 119th Gen. Assemb., Reg. Sess. (Ind. 2015).

nonresidents.[68] State law sets the initial tax rate for counties,[69] and the legislation forbids counties from increasing their tax rate by more than 1% per year.[70] Local governments, however, do have some control over rates, though state law of course limits this discretion.[71] Local governments, for example, can reduce property tax rates and replace property tax revenue with income tax revenue.[72] Moreover, local governments can adopt special purpose rates to fund a variety of infrastructure improvements.[73] The LIT is a tax on "adjusted gross income," as defined by state income tax law.[74] For nonresidents, "the term includes only adjusted gross income derived from the taxpayer's principal place of business or employment in Indiana."[75]

5. *California's Experience with Payroll and Gross Receipts Taxes*

California governments are historically less reliant on local income taxes than the states previously discussed. We include them here, however, because California cities have imposed related taxes that suggest the breadth of local income tax trends. Many cities in California, including both Los Angeles and San Francisco, impose a form of gross receipts tax on businesses. Both cities once imposed payroll taxes *and* gross receipts taxes,[76] though no business was subject to both taxes.[77] In Los Angeles, the newer gross receipts tax only applied to businesses that did not already pay the payroll tax.[78] In San Francisco, the taxpayer paid the higher of the two taxes.[79] In the late 1990s, both cities' tax schemes were challenged as violating the internal consistency test under the dormant Commerce Clause, and both cities lost.[80] At that point, Los Angeles

68. IND. CODE § 6-3.6 (2023).

69. *Id.* § 6-3.6-1-1.

70. *Id.* § 6-3.6-3-4.

71. In setting the tax rate going forward, counties consider three components, which affect both the total LIT rate and limit how the funds raised can be used. The three components are the expenditure rate, the property tax relief rate, and the special purpose rate. *Indiana Local Income Taxes Reorganized*, WOLTERS KLUWER (June 3, 2015), http://news.wolterskluwerlb.com/news/indiana-local-income-taxes-reorganized/ [https://web.archive.org/web/20160411052147/http://news.wolterskluwerlb.com/news/indiana-local-income-taxes-reorganized/]. The expenditure rate, which cannot exceed 0.25% of adjusted gross income, is used to fund school corporations and civil taxing units. IND. CODE § 6-3.6-6-3 (2023). In Marion County, the county in which Indianapolis is located, the expenditure rate cannot exceed 2.75% of adjusted gross income. *Id*. § 6-3.6-6-2.

72. The maximum property tax relief rate is 1.25% of adjusted gross income. IND. CODE. § 6-3.6-5 (2023).

73. Counties must adopt an ordinance finding a revenue need to adopt a special purpose rate. *Id*. § 6-3.6-7. Approved infrastructure projects include courts, detention centers, hospitals, education centers, and fire departments. *Id.*

74. *Id.* § 6-3.6-2-2 (referring to *id.* § 6-3-1-3.5).

75. *Id.*

76. Susan Ferlianto & Patrick Kennedy, *Open for Business Updated: Los Angeles Pioneers Local Tax Reforms in a Challenging Economic Environment*, 19 TAX MGMT. WEEKLY STATE TAX REP. 1, 2 (2012).

77. *Id.*

78. *Id.*

79. *Id.*

80. *See generally* Union Oil Co. v. City of Los Angeles, 94 Cal. Rptr. 2d 81 (Cal. Ct. App. 2000); Macy's Dep't Stores, Inc. v. City of San Francisco, 50 Cal. Rptr. 3d 79 (Cal. Ct. App. 2006).

chose to retain its gross receipts tax, while San Francisco chose to retain its payroll tax.

Starting in 2014, San Francisco imposed a gross receipts tax on businesses that was supposed to replace its payroll tax,[81] which the city worried was depressing employment.[82] The city sought to increase collection on the gross receipts tax as the payroll tax withered, but the gross receipts tax never generated enough revenue to replace the payroll tax, and so for many years employers paid both. In 2020, the city's voters approved a ballot measure that ended the payroll tax and increased the gross receipts tax.[83] The payroll tax ended in December 2020.

San Francisco's and Los Angeles's experiences capture much of the complexity of real-world experiences with local income taxes. First, they are additional examples of the persistence of local taxes beyond the traditional property and sales tax recommended and tolerated by the traditional fiscal federalism literature. Second, these business activity taxes suggest that as a matter of political economy, there is support for taxing profit generated within a jurisdiction. Such support, however, does not coalesce around the particular form or incidence of the levy. Finally, the flaws in the design of these local business activity taxes illustrate the ways that cities contort the design of revenue tools to comply with both state and federal law. California law preempts city income taxes, so cities adopt "non-income taxes" like payroll and business receipt taxes.[84] These newly designed taxes, however, must be designed to comply with federal law, which, among other things, forbids overly fine distinctions that may disadvantage out-of-state businesses. Thus, new legal challenges brought about changes in the form of business activity taxation.

6. *New York City's Personal Income Taxes*

In cataloging local income taxes, we would be remiss in omitting a brief discussion of New York City's personal income tax. The city's local income tax is far more progressive than that imposed by other jurisdictions. New Yorkers, of course, consider their city sui generis, but we think New York City's experience indicates that other large cities could levy progressive income taxes.

81. *California: San Francisco Business Tax Overhaul Measure (and Others) Approved by Voters*, KPMG (Nov. 12, 2020), https://home.kpmg/us/en/home/insights/2020/11/tnf-california-san-francisco-business-tax-overhaul-measure-and-others-approved-by-voters.html [https://web.archive.org/web/20220813213948/https://home.kpmg/us/en/home/insights/2020/11/tnf-california-san-francisco-business-tax-overhaul-measure-and-others-approved-by-voters.html] [hereinafter *S.F. Business Tax Overhaul*].

82. *See generally* CITY & CNTY. OF S.F., CONTROLLER'S OFF. OF ECON. ANALYSIS, ENACTING A GROSS RECEIPTS TAX, AND PHASING-OUT THE PAYROLL EXPENSE TAX: ECONOMIC IMPACT REPORT (2012), https://sfcontroller.org/sites/default/files/FileCenter/Documents/3426120681_economic_impact_final_corrected.pdf.

83. *S.F. Business Tax Overhaul*, *supra* note 81.

84. CAL. REV. & TAX CODE § 17041.5 (West 2023). A payroll tax was found not to be an income by the California Supreme Court in *A.B.C. Distrib. Co. v. City of San Francisco*, 542 P.2d 625 (Cal. 1975).

State law authorizes New York City to impose its tax using a progressive rate structure allowing the city to impose its tax on a comprehensive income tax base.[85] The city's tax is residence-based only.[86]

The city's tax rate varies between 2.55% and 3.4%, depending on income level and filing status.[87] A number of refundable tax credits further increase the progressivity of the tax.[88] The state collects New York City's income tax; filers can file their state and city tax returns jointly.[89] Despite the relatively broad base and relatively high rate of tax, personal income taxes are not a dominant source of revenue for the city, accounting for less than 14% of city revenue in 2016.[90] Real estate taxes, a category that includes property taxes, represented more than twice that percentage of revenue.[91]

C. Limits on Local Governments Adopting Income Taxes

As the proceeding discussion indicates, a surprising number of states authorize local income taxes in one form or another. However, it is far more common for states to restrict local governments' authority to enact such taxes. State law restricts the enactment of local income taxes in two different ways. First, in many states, local governments (including home rule local governments) cannot impose any tax without state-enabling legislation, which is uncommon. Second, even in states that delegate greater taxing authority to local governments, it is still common for state law to preempt local income taxes.

85. N.Y. Tax Law § 1301 (McKinney 2018) (authority to impose personal income tax); *id.* § 1303 (defining the tax base with reference to the state's income definitions); *id.* § 1304 (setting out tax rates).

86. *See* James B. Stewart, *Tax Me If You Can*, New Yorker (Mar. 12, 2012), https://www.newyorker.com/magazine/2012/03/19/tax-me-if-you-can (chronicling one billionaire's efforts to avoid being classified as a New York City resident); Corinne Ramey, Deanna Paul & Rebecca Ballhaus, *Trump Organization, CFO Allen Weisselberg Charged with Tax Crimes*, Wall St. J. (July 1, 2021, 6:00 PM), https://www.wsj.com/articles/trump-organization-cfo-allen-weisselberg-surrenders-to-authorities-11625138416 (discussing allegations of criminal evasion with less effort put into compliance). The City once had a commuter tax imposed only on out-of-state commuters. Howard Chernick & Olesya Tkacheva, *The Commuter Tax and the Fiscal Cost of Commuters to New York City*, Rsch. Gate (2002), https://www.researchgate.net/publication/228130200_The_Commuter_Tax_and_the_Fiscal_Cost_of_Commuters_to_New_York_City. When this structure was found to violate the dormant Commerce Clause because it discriminated in favor of in-state commuters from Long Island, Westchester, and Rockland Counties, the state revoked authority for source-based taxation completely. *See generally* City of New York v. State, 94 N.Y.2d 577 (2000).

87. *See* N.Y. State, Dept. of Tax'n & Fin., Instructions for Form IT-2105 11–12 (2022), https://www.tax.ny.gov/pdf/current_forms/it/it2105i.pdf (providing tax tables).

88. *See New York City Credits*, N.Y. State Dep't of Tax'n & Fin., https://www.tax.ny.gov/pit/credits/new_york_city_credits.htm (Dec. 15, 2022) (listing tax credits).

89. *See Taxes*, NYC Dep't of Fin., https://www1.nyc.gov/site/finance/taxes/taxes.page (last visited Feb. 23, 2023) ("New York City residents must pay a Personal Income Tax which is administered and collected by the New York State Department of Taxation and Finance.").

90. Andrew Perry, *Personal Income Tax Revenues in New York State and City*, Citizens Budget Comm'n Blog (Aug. 13, 2019), https://cbcny.org/research/personal-income-tax-revenues-new-york-state-and-city.

91. The City of N.Y., Comprehensive Annual Financial Report of the Comptroller (2020), https://comptroller.nyc.gov/wp-content/uploads/2020/10/7-General-and-Capital-Fund-Detailed-Schedules-of-Revenues-and-Expenditures-2020.pdf.

In most jurisdictions, fiscal authority is not part of a state's grant of home rule power. In many states, these limits are explicitly part of the state's constitution.[92] In other states, courts have concluded that the police powers granted under the state's home rule provisions do not include taxing authority.[93] However, even in states where the home rule has been construed to include taxing authority, like Arizona, local income taxes are often explicitly preempted.[94]

Further, while the literature on state-imposed tax and expenditure limitations focuses on the role these policies have played in undermining the property tax, such limits also affect local governments' ability to enact income taxes. For example, while Michigan cities can levy income taxes, they are subject to the Headlee Amendment, which prohibits local governments levying new taxes or increasing their rates "without the approval of a majority of the qualified electors of that unit of Local Government voting."[95]

As a result of these limits on local income taxes, new local income taxes tend to be adopted in jurisdictions that already authorize such taxes. The barriers to adoption in new states have generally proven too steep.

II. RECONSIDERING LOCAL INCOME TAXES

We recognize that it is, perhaps, an odd time to be reconsidering local income taxes.[96] State tax authorities have been much criticized for trying to tax

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92. *See, e.g.*, GA. CODE ANN. § 36-35-6(a)(3) (West 2023); IOWA CONST. art. III, § 38A. Under the New York State Constitution, for example, "[t]he power of taxation shall never be surrendered, suspended or contracted away, except as to securities issued for public purposes pursuant to law. Any laws which delegate the taxing power shall specify the types of taxes which may be imposed thereunder and provide for their review." N.Y. CONST. art. XVI, § 1.

93. *See, e.g.*, City of Plymouth v. Elsner, 135 N.W.2d 799, 801–02 (Wis. 1965).

94. *See, e.g.*, ARIZ. REV. STAT. ANN. § 43-201 (2023) ("The area of income taxation is preempted by the state, and a county, city, town or other political subdivision of this state shall not levy an income tax, so long as the urban revenue sharing fund is maintained as provided in § 43-206.").

95. The Headlee Amendment also reduces local governments' ability to increase revenue by broadening the tax base, because if revenue is increased due to such measures, "the maximum authorized rate of taxation on the new base in each unit of Local Government shall be reduced to yield the same estimated gross revenue as on the prior base." MICH. CONST. art IX, § 31.

96. *See* Ian Cross, *Lawsuit Claiming Widespread Double-Taxation of Ohioans Heads to Settlement Through Mediation*, NEWS 5 CLEVELAND (Aug. 25, 2021, 3:48 PM), https://www.news5cleveland.com/news/local-news/lawsuit-claiming-widespread-double-taxation-of-ohioans-heads-to-settlement-through-mediation; Susan Tompor, *You Might Be Able To Get out of Local Income Tax in 24 Michigan Cities*, DETROIT FREE PRESS (Mar. 6, 2021, 3:27 PM), https://www.freep.com/story/money/personal-finance/susan-tompor/2021/03/03/detroit-income-tax-remote-work/4548479001/; Liz Farmer, *Supreme Court Won't Hear New Hampshire's Remote Workers Case. But This Tax Fight Is Far From Over*, FORBES (June 29, 2021, 11:48 AM), https://www.forbes.com/sites/lizfarmer/2021/06/29/supreme-court-wont-hear-remote-new-hampshires-workers-case-but-this-tax-fight-is-far-from-over/?sh=7551dade3d72; Darien Shanske, *Agglomeration and State Personal Income Taxes: Time To Apportion*, 48 FORDHAM URB. L.J. 949, 950 (2021) (arguing that the Supreme Court should not impose a rule requiring physical presence for local individual income taxation); Erin Scharff, *Cities on Their Own: Local Revenue When Federalism Fails*, 48 FORDHAM URB. L.J. 919, 930 (2021) (explaining that most local governments have no authority to levy income taxes); Yunji Kim, *Limits on Property Taxes and Charges: City Revenue Structures After the Great Recession*, 55 URB. AFFS. REV. 185, 185 (2019) (finding that financially stressed cities rely more on charges than property tax revenue).

mobile workers during the pandemic.[97] Moreover, the fallout from the congressional decision to cap the state and local tax deduction to $10,000 continues to plague public officials at the state and local levels.[98]

And yet, in another sense, the time seems right for thinking about new tax policies at the local level. In Part I, we made the case that local governments need additional broad-based revenue sources, and that local income taxes, broadly construed, remain surprisingly common both as levies on businesses and individuals, despite the conventional policy wisdom that suggests they should not exist.

In this Part, we argue that the staying power of local income taxes is not simply vestigial, nor should these local income taxes be explained away by stories of dysfunctional political economies at the local level. Rather, we argue that the fiscal federalism critique of local income taxes ignores three rationales for taxing income at the local level. First, agglomeration economics justifies a local income tax and mitigates the danger of tax-induced exit. Second, there is increasing evidence that revenue diversity promotes fiscal stability at the local level. Third, the local income tax is more progressive than other non-property tax revenue options and likely more progressive than the property tax both in theory and, especially, in practice. In some locations, these three rationales may be overlapping; in others, not all rationales will apply.

To focus on the theoretical issues, we abstract from the administrative issues, which we admit can be substantial (and which we plan to address in a separate work). For present purposes, our discussion concerns local income taxes of relatively uniform design and levied at relatively low rates. The assumption that local income taxes will be imposed at low rates reflects the general pattern in existing local income taxes. An unfortunate lack of coordination exists in the design and administration of some local income taxes, and so the design assumption is more normative than descriptive. It is our hope that focusing more on local income taxes as a policy option will strengthen their design. Administering a local tax that piggybacks on state or federal income tax is an easy, not unrealistic option, and would likely reduce compliance burdens substantially for employees and small employers.

We will conclude this Part by addressing some of the concerns implicated by our arguments and what might be described as lingering hesitancies about local income taxation.

97. *See generally, e.g.*, Young Ran Kim, *Taxing Teleworkers*, 55 U.C. DAVIS L. REV. 1149 (2021).

98. 26 U.S.C. § 164. *See generally* Jeffrey A. Cooper, *Red States, Blue States: Lesson from the State Death Tax Credit and the "SALT" Deduction*, 73 TAX LAW. 341 (2020) (explaining how the state and local tax (SALT) deduction impacted conflicts between liberal and conservative states' approaches to state taxes); Alak Mehta, *SALT, Subsidies, and Subnational Spending*, 54 COLUM. J.L. & SOC. PROBS. 219 (2021) (explaining how the SALT deductions affect state and local governments differently).

A. AGGLOMERATION ECONOMICS

Agglomeration economics has already been well summarized in the legal literature,[99] and so our discussion will be brief. As is so often the case with the best ideas, agglomeration economics makes explicit something that has long been obvious: there are benefits to people living in proximity to one another. However, this obvious insight had been hidden by scholarship that emphasized competition and exit.[100] From the perspective of a competitive model of economic activity, it might seem perplexing that people would pay more to live in proximity to others with similar talents, or that restaurants would locate near other similar restaurants. Agglomeration economics highlights the economic reason for these decisions to co-locate: it increases earnings.

Agglomeration produces three distinct benefits for those co-locating: it increases the ability to share, match, and learn.[101] Through agglomeration, businesses and individuals can share, and receive the benefits of, the same infrastructure, such as roads, airports, and public schools. The term "sharing" refers to the ways that agglomeration allows businesses or individuals to benefit from the same infrastructure, like roads, airports, and public schools. Though both individuals and businesses can benefit from agglomeration, they do not necessarily benefit from the *same* agglomerations. Heavy industry might benefit from aggregating near a major rail hub, while commuters might benefit from living near a commuter line. To the extent an agglomeration provides both benefits, a jurisdiction could plausibly tax both separately. That is, one might think that local governments should tax heavy industry itself (rather than its workers) on this agglomeration benefit *and* that tax lawyers commuting into the city should be taxed on the urban wage premium they receive from the city.

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99. *See, e.g.*, David Schleicher, *Local Government Law's "Law and ___" Problem*, 40 FORDHAM URB. L.J. 1951, 1958 (2013) (reviewing literature); Daniel B. Rodriguez & David Schleicher, *The Location Market*, 19 GEO. MASON L. REV. 637, 641–43 (2012) (reviewing literature). *See generally* Lee Anne Fennell, *Agglomerama*, 2014 BYU L. REV. 1373; KATHLEEN BOLTER & JIM ROBEY, AGGLOMERATION ECONOMIES: A LITERATURE REVIEW (2020), https://research.upjohn.org/cgi/viewcontent.cgi?article=1256&context=reports.

100. To be clear, the competitive model has much to be said for it, but it is just part of the story. For the seminal article on the competitive model, see generally Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956). *Cf.* Darien Shanske, *Above All Else Stop Digging: Local Government Law as a Cause (and Solution) to the Current Financial Crisis*, 43 U. MICH. J.L. REFORM 663, 672–73 (2010) (providing additional discussion and context of the Tiebout model). For a very influential development of the model, see generally WILLIAM FISCHEL, THE HOMEVOTER HYPOTHESIS: HOW HOME VALUES INFLUENCE LOCAL GOVERNMENT TAXATION, SCHOOL FINANCE, AND LAND-USE POLICIES (2001). For critique of the model in light of agglomeration economics, see generally Schleicher, *supra* note 99.

101. These categories are distilled here: Gilles Duranton & Diego Puga, *Micro-Foundations of Urban Agglomeration Economies* (Nat'l Bureau of Econ. Rsch., Working Paper No. 9931, 2003); Genevieve Giuliano, Sanggyun Kang & Quan Yuan, *Agglomeration Economies and Evolving Urban Form*, 63 ANN. REG. SCI. 377–98 (2019) (using these categories). There are other related frameworks. For instance, agglomeration enables the sharing of goods, labor, and ideas. *See generally* Giuliano et al., *supra*. Again, evidence supports agglomeration for all three reasons. *See generally id.*; Glenn Ellison, Edward L. Glaeser & William R. Kerr, *What Causes Industry Agglomeration? Evidence from Coagglomeration Patterns*, 100 AM. ECON. REV. 1195 (2010).

Matching refers to the role agglomeration plays in facilitating connections between individuals, firms, and beneficial opportunities.[102] Population density increases the possibility of finding a job best suited to a worker's skills. Thus, a lawyer can find a job, not simply as a lawyer, or even a tax lawyer, but as a tax lawyer that specializes in the taxation of cross-border intangible assets. Matching also benefits firms, both by increasing the talent and specialization of the workforce and by creating specialization opportunities for the businesses themselves.[103] A specialized legal practice or consulting firm needs multiple clients that require those specialized skills.

Finally, density encourages learning, which again benefits both individuals and businesses. For individuals, density is associated with greater earnings, with one study finding that about half of the greater earning potential follows the employee even upon leaving the denser jurisdiction.[104] In other words, there is evidence that urban agglomerations make permanent contributions to at least some workers' human capital and particularly those with higher initial ability.[105] As a result, we think that agglomeration economics provides a rationale for local business activity *and* local income taxes.

Consistent with the benefits of agglomeration, the economics literature estimates that the urban wage premium may be as great as 33%.[106] Indeed, there is strong evidence that the wage divergence actually understates the benefits provided by urban agglomerations to workers, as the places they agglomerate to became more desirable and the workers themselves became more productive.[107] There is an intuitive logic to this interconnectedness; more productive workers demand higher wages *and* more amenities.

Agglomeration economics therefore suggests an efficiency case for local income taxation, so long as the overall tax rate is set well below the urban wage premium (or the productivity boost provided by agglomeration).[108] If this is the

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102. *See, e.g.*, Giuliano et al., *supra* note 101, at 380.

103. *See generally, e.g.*, Ellison et al., *supra* note 101; Mikaela Backman & Janet Kohlhase, *The Influence of Diversity on the Formation, Survival and Growth of New Firms* (Econ. & Inst. of Innov., Working Paper No. 337, 2013).

104. *See generally* Jorge De La Roco & Diego Puga, *Learning by Working in Big Cities*, 84 REV. ECON. STUD. 106 (2017).

105. *See id.*

106. *See generally* Edward L. Glaeser & David C. Maré, *Cities and Skills*, 19 J. LAB. ECON. 316 (2001).

107. *See* Rebecca Diamond, *The Determinants and Welfare Implications of US Workers' Diverging Location Choices by Skill: 1980-2000*, 106 AM. ECON. REV. 479, 480 (2016) ("Despite local wage changes being the initial cause of workers' migration, I find that cities which attracted a higher share of college graduates endogenously became more desirable places to live and more productive for both high and low skill labor."); Edward Glaeser & Matthew Resseger, *The Complementarity Between Cities and Skills*, 50 J. REG'L SCI. 221, 242 (2010) ("In this paper, we document that agglomeration effects are much stronger for cities with more skills. This finding points to agglomeration theories that emphasize knowledge accumulation in big cities, rather than theories that emphasize natural advantage or gains from speedy movement of basic commodities.").

108. Others have already suggested that it can be efficient for certain cities to tax employment income. *See* David R. Agrawal, William H. Hoyt & John D. Wilson, Tax Competition with Mobile Labor, Residents, and Capital 29 (June 13, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3394617 ("We find that with commuting, employment-based taxes are preferred in jurisdictions who receive

case, even after local taxes, the wage premium still ensures that workers' after-tax income is higher in the urban area than it would be elsewhere. It is not unusual for states and localities to take advantage of their position in this way. Both severance taxes and transient occupancy taxes impose a tax burden on activity that is not easily shifted elsewhere. While the current fiscal federalism literature has assumed that individuals have significant mobility, such mobility may be overstated. In the United States, mobility has been on the decline in the past forty years.[109] The reasons for this decline are manifold, but agglomeration certainly reduces the incentives to exit a metropolitan region.

If tax rates vary widely within a region, however, there are opportunities for a tax exit while maintaining the wage premium. At the same time, intraregional moves often impose other costs, not least of which is potentially longer commutes. Thus, localities seeking to justify an income tax on agglomeration alone may face difficult design choices.

In thinking about these choices, it would be helpful to have some empirical evidence on the magnitude of the impact of local income taxes on mobility. Recent research on *interstate* mobility in recent years has pushed back on a narrative of significant tax-induced mobility by individual taxpayers.[110] Unfortunately, the impact of local income taxes on mobility has not been thoroughly explored. As recently as 2017, the *National Tax Journal* observed that "there is no literature estimating the tax base elasticity to local income tax rate changes in the United States."[111] That article looked at Indiana's county taxes and found taxpayers relatively unresponsive to the tax, or at least small changes in the tax rate. This suggests, consistent with findings as to many other taxes, that a small tax, and small variations in taxes between localities, should not cause too much economic distortion.[112] This is consistent with the agglomeration economics story. Localities tax the urban wage premium efficiently because agglomeration benefits are sticky, and businesses and their employees accept this because they like the higher urban wages and other associated advantages and amenities.[113]

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commuters, providing them the opportunity to 'tax export.'"). Note that we would not agree that taxing commuters for the benefits provided by agglomeration amounts to tax exporting for the level of taxes we are discussing. Rather, these taxes are, roughly, benefit taxes. Gillette has argued that agglomeration effects can help explain why cities are able to engage in redistribution. CLAYTON P. GILLETTE, LOCAL REDISTRIBUTION AND LOCAL DEMOCRACY: INTEREST GROUPS AND THE COURTS 96–102 (2011).

109. Patrick J. Purcell, *Geographic Mobility and Annual Earnings in the United States*, 80 SOC. SEC. BULL., no. 2, 2020, at 1, https://www.ssa.gov/policy/docs/ssb/v80n2/v80n2p1.pdf.

110. *See generally* Charles Varner, Cristobal Young & Allen Prohofsky, Millionaire Migration in California: Administrative Data for Three Waves of Tax Reform (2018) (unpublished manuscript), https://inequality.stanford.edu/sites/default/files/millionaire-migration-california-impact-top-tax-rates.pdf; Cristobal Young, Charles Varner, Ithai Z. Lurie & Richard Prisinzano, *Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data*, 81 AM. SOCIO. ASS'N 421 (2016).

111. Lang Yang & Bradley T. Heim, *Responsiveness of Income to Local Income Taxes: Evidence from Indiana*, 70 NAT'L TAX J. 367, 368 (2017).

112. For further discussion of mobility issues, see discussion *infra* Part II.

113. *See, e.g.*, Diamond, *supra* note 107.

Put another way, and perhaps surprisingly, a local income tax can be justified as a kind of benefits tax. Under the benefit principle, taxes reflect, albeit indirectly, benefits that government provides to the taxpayer through agglomeration. The benefit principle has traditionally been a cornerstone of local tax theory, as taxes justified by the benefit principle should reduce the incentive for tax exit. The taxpayer is, after all, receiving something in exchange for the tax payment, specifically the benefits provided by agglomeration.

The benefits principle fits neatly with the types of public goods traditionally offered by local governments, which primarily benefit residents and local businesses. And the benefits principle does a good job of justifying local property taxes, the most typical local government levy. Under this view, local property taxes represent an investment in local government goods and services, which increases the value of privately held land. For example, consider the increase in land value created by the public investment in good schools.

Income taxes are more commonly justified on an ability-to-pay principle, which suggests that taxpayers' tax burdens should correlate with their ability to contribute to the public welfare. Such taxes are generally seen as particularly appropriate for those benefits that do not lend themselves to taxation through the benefit principle. As economists Joel Slemrod and Jon Bakija quip: "Imagine how you would respond if you received a survey from the IRS in the mail asking you to estimate how much the Department of Defense is worth to you."[114]

Yet a local income tax, especially one that is aimed at capturing the urban wage premium, is an example of an income tax that seems well justified under the benefit principle. The benefits of agglomeration exist because of the possibility of co-location, and that possibility exists because of the physical landscape of the city and metropolitan region, the zoning and transportation policy decisions made by local governments, and the infrastructure investments local governments make to pay for population growth. Local governments, in this sense, provide a governance structure for this shared space, and so we can extend the benefits principle beyond traditional public goods to include the costs of these investments more broadly.

To the extent this benefit should be taxed, the agglomeration rationale indicates that local income best measures this benefit. The agglomeration benefit is, after all, directly correlated with productivity and wages,[115] and it is provided to those who work in the region, not simply those who live there. As a result, the property tax is a poor proxy for these benefits. Moreover, the benefit is likely roughly proportional to income. Low-wage service-sector workers benefit less from agglomeration than highly compensated professionals, as the benefits of agglomeration redound less to such workers, who must also bear the increased cost of living imposed by concentrations of highly compensated workers.

114. JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 62 (4th ed. 2008).

115. *See supra* notes 91–99 and accompanying text.

We are not the only ones who have surmised that agglomerations can be efficiently taxed; economists have tested this hypothesis and found some evidence that it is true. For example, one study from Switzerland found that firms in more concentrated industries responded significantly less to corporate tax burdens.[116] Another study from Switzerland found evidence of cities taxing agglomerations and tax competition between cities.[117] That study suggested that jurisdictions with agglomerations imposed higher taxes, though it additionally noted that the physical size of the jurisdiction also impacted tax rates.[118] The authors conclude that the ability of a jurisdiction, say a central city, to tax rent is constrained by the ability of taxpayers to move to nearby lower-tax jurisdictions where they can enjoy the same agglomerations.[119]

B. The Value of Revenue Diversity

Adding income taxes to the local revenue toolkit increases the diversity of revenue sources available at the local level. Traditional fiscal federalism has often considered the problem of revenues in a federal system as a problem of allocation: what level of government should specialize in what tax.[120] It was this theory that often assigned the least mobile tax base, property, to the local government.[121]

While revenue allocation has clear advantages in reducing tax competition, it has never been practiced as theory recommended. Local governments have long supplemented the property tax with diverse revenue streams. For example, the Arizona mining town of Bisbee collected significant licensing fees from its saloons and brothel fees at the turn of the century,[122] and by the 1870s local business occupation taxes were authorized by South Carolina law.[123] Today, large municipalities have all but abandoned revenue specialization as the erosion of the property tax base has forced many larger jurisdictions to seek revenue

116. To be precise, see Marius Brülhart, Mario Jametti & Kurt Schmidheiny, *Do Agglomeration Economies Reduce the Sensitivity of Firm Location to Tax Differentials?*, 122 ECON. J. 1069, 1090 (2012) ("Firms in sectors with an agglomeration intensity within the fifth quintile of the sample distribution are less than half as responsive to a given difference in corporate tax burdens as firms in sectors with an agglomeration intensity within the twentieth percentile."); *see also generally* Hyun-Ju Koh, Nadine Riedel & Tobias Böhm, *Do Governments Tax Agglomeration Rents?*, 75 J. URB. ECON. 92 (2013) (showing similar findings).

117. Eva Luthi & Kurt Schmidheiny, *The Effect of Agglomeration Size on Local Taxes*, 14 J. ECON. GEOGRAPHY 265, 283 (2014).

118. *Id.*

119. *Id.*

120. *See* Richard Bird, Bernard Dafflon, Claude Jeanrenaud & Gebhard Kirchgässner, *Assignment of Responsibilities and Fiscal Federalism*, 32 POLITORBIS 58, 63–65 (2003). *See generally* CTR. FOR RSCH. ON FED. FIN. RELS., TAX ASSIGNMENT IN FEDERAL COUNTRIES (Charles E. McClure, Jr. ed., 1983); Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LITERATURE 1120 (1999). Traditional fiscal federalism has also recognized a different model, sometimes called the German model, in which the central government plays a much more critical role in distributing revenue to subfederal governments. Bird et al., *supra*, at 63.

121. *See, e.g.*, Oates, *supra* note 120, at 1126.

122. KATHERINE BENTON-COHEN, BORDERLINE AMERICANS: RACIAL DIVISIONS AND LABOR WAR IN THE ARIZONA BORDERLANDS 114 (2009).

123. William J. Quirk, *Nature of a Business License Tax*, 32 S.C. L. REV. 471, 473–74 (1981).

from multiple sources,[124] especially as federal and state authorities have devolved more responsibility to local governments.[125]

Income taxes offer an additional way for local governments to diversify their revenue. Moreover, such diversification offers more than just a stream of additional funding. First, such diversification can provide greater budget stability. Second, diversification allows the rate across different revenue tools to be lower, which makes the individual tax bases less distortive and may reduce incentives to game tax rules.

1. Stability

Local governments provide vital services. Many of these services, like trash and recycling services, must continue during an economic downturn. Other services become even more important during recessions. For example, public libraries become an important source for job seekers needing internet access, free entertainment,[126] and job-training and business-incubator programs helping residents emerge from a downturn with new skills and ideas.[127] The more cyclical, i.e., dependent on the economic cycle, local revenue is, the more difficult the choices local governments face during recessions become.

Furthermore, local governments face both legal and economic constraints to borrowing. States frequently impose debt limits on local governments.[128] States also vary considerably in the ease with which local governments can evade these limitations.[129] Even when local governments can legally borrow, local government borrowing is probably only a good idea in limited situations

124. *See supra* text accompanying notes 52–72.

125. *See generally* Austin M. Aldag, Yunji Kim & Mildred E. Warner, *Pragmatic Municipalism or Austerity Urbanism? Local Government Responses to Fiscal Stress in New York*, 51 ENV'T & PLANNING A: ECON. & SPACE, No. 6, 2019, https://www.journals.sagepub.com/doi/10.1177/0308518X19844794.

126. KEITH CURRY LANCE, LINDA HOFSCHIRE & JAMIE DAISEY, THE IMPACT OF THE RECESSION ON PUBLIC LIBRARY USE IN COLORADO 5 (2011), https://files.eric.ed.gov/fulltext/ED520930.pdf; THE LIBR. RSCH. CTR., UNIV. OF ILL. AT URBANA CHAMPAIGN, PUBLIC LIBRARY USE AND ECONOMIC HARD TIMES: ANALYSIS OF RECENT DATA (2002), https://www.ala.org/tools/sites/ala.org.tools/files/content/librarystats/public/economichardtimestechnicalreport.pdf.

127. *See, e.g.*, Eduardo Porter, *Job Training Works. So Why Not Do More?*, N.Y. TIMES (July 5, 2016), https://www.nytimes.com/2016/07/06/business/economy/job-training-can-work-so-why-isnt-there-more-of-it.html (explaining that job training programs must overcome a bad reputation even though studies show these programs increase participant job acquisition and pay); Kevin Canfield, *State, Local Officials Tout Importance of 36 Degrees North's Business Incubator*, TULSA WORLD (Sept. 8, 2021), https://tulsaworld.com/news/local/govt-and-politics/state-local-officials-tout-importance-of-36-degrees-norths-business-incubator/article_a449626c-1018-11ec-b443-8b93a306f893.html; EMILY ROBBINS, FOOD-BASED BUSINESS INCUBATOR PROGRAMS 2 (2016), https://www.nlc.org/wp-content/uploads/2020/09/Food-Based_Business_Incubator_Programs.pdf (providing local governments with guidance to create food-based incubator programs to "promote local entrepreneurship and strengthen local food systems").

128. *See* RICHARD BRIFFAULT, LAURIE REYNOLDS, NESTOR DAVIDSON, ERIN SCHARFF & RICK SU, CASES AND MATERIALS ON STATE AND LOCAL GOVERNMENT LAW 867–70 (9th ed. 2022) (describing and discussing state limits on local borrowing).

129. RICHARD BRIFFAULT & LAURIE REYNOLDS, CASES AND MATERIALS ON STATE AND LOCAL GOVERNMENT LAW 826–31 (8th ed. 2016).

because local jurisdictions have limited tax bases.[130] In the absence of borrowing capacity, and with limited revenue options, local governments often choose to defer maintenance and pensions payments to close budget gaps in the current year. But doing so simply pushes such expenses down the road and can increase their costs. When even such deferrals do not close the budget gap, local governments face the hard choice of cutting services despite the heightened needs of residents. Moreover, such cuts exacerbate the local economic situation by directly reducing employment.

Thus, policymakers stress that local revenues need to be stable, an argument that has often privileged property taxation in local revenue discussions.[131] Income taxes are often considered the most cyclical of revenue sources, while property tax is considered the most stable.[132] However, in the most recent recession, it was sales tax revenue that was most affected by the downturn.[133] While a public health recession is no doubt sui generis, income inequality may be creating different pressures on the stability of local revenue sources. After all, higher-income earners recovered more quickly from the Great Recession than middle- and low-income taxpayers,[134] and sales tax revenue recovered less quickly from the Great Recession, though some of that change is attributable to laws that at that time made it difficult to tax online sales.[135]

Though we hope future recessions are unlikely to unfold like the 2020 downturn, to the extent that an income tax better captures the fortunes of the most economically successful, there may be more revenue opportunity in income taxation going forward. More broadly, reliance on multiple revenue sources provides local governments with a hedge against future changes to the economy that may challenge a particular source of revenue, much like how online sales threatened sales tax growth for much of the beginning of the twenty-first century.

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130. *Id.* at 914–15. This is not to say that current law is not too restrictive, just that it is unlikely to change and that there is good reason for cities not to be able to borrow for operating expenses as a general matter.

131. With respect to progressivity, the stability of the property tax comes with its own drawbacks.

132. John E. Anderson & Shafiun N. Shimul, *State and Local Property, Income, and Sales Tax Elasticity: Estimates from Dynamic Heterogeneous Panels*, 71 NAT'L TAX J. 522, 544 (2018) (finding that property tax systems are more stable than income and sales tax systems).

133. Mary Williams Walsh, *Virus Did Not Bring Financial Rout That Many States Feared*, N.Y. TIMES (Mar. 1, 2021), https://www.nytimes.com/2021/03/01/business/covid-state-tax-revenue.html (showing that state sales tax was affected most by the pandemic and has not yet returned to pre-pandemic levels); *see also* Barb Rosewicz, Justin Theal & Alexandre Fall, *Pandemic Drives Historic State Tax Revenue Drop*, PEW (Feb. 17, 2021), https://www.pewtrusts.org/en/research-and-analysis/articles/2021/02/17/pandemic-drives-historic-state-tax-revenue-drop.

134. Emmanuel Saez, *Income and Wealth Inequality: Evidence and Policy Implications*, 35 CONTEMP. ECON. POL'Y 7, 16 (2017) (explaining that while the incomes of the bottom 90% of people decreased significantly, top earners were impacted less and recovered more quickly).

135. Andrew Soergel, *Higher Sales Tax May Have Surprised Holiday Shoppers in Some States*, U.S. NEWS (Dec. 24, 2019, 6:00 AM), https://www.usnews.com/news/best-states/articles/2019-12-24/most-states-now-tax-online-purchases (reporting that many states took advantage of the outcome of *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018), and started charging sales tax for online sales within the state).

2. *Efficiency*

Diversifying revenue offers its own efficiency advantage as well. It is more efficient to impose many small taxes that tax people in different ways than to impose a single tax at a high rate. A jurisdiction does not want its sales or property tax rates to be too much higher than that of its neighbors because these differential rates might induce taxpayers to do their shopping or buy their house in the jurisdiction next door. Such horizontal tax competition limits the rate of property and sales taxes, even in jurisdictions where such rates are under local control. If the jurisdiction also has a small income tax, then it has another revenue option on which to impose a low-rate tax.

Scholar David Gamage has argued that there are strong reasons that multiple tax instruments are better for deterring tax gaming, at least at the federal level.[136] Gamage, however, notes the uncertainty of administrative costs in adopting such a proposal.[137] It is likely that taxes imposed *and collected* on the local level would increase administrative cost. Yet local income taxes need not be administered at the local level, and to reduce administrative costs, many local governments already rely on preexisting state income tax rules.[138] We will address compliance issues in more detail in a separate work, but for now, it is worth noting that local governments now manage a vast array of taxes and user fees, very few of which allow much collaboration with state revenue authorities, let alone federal authorities. Authorizing a broad local income tax base may allow some reduction in the use of these miscellaneous local revenue sources.

C. Progressivity

Perhaps one does not accept as a matter of theory or fact that agglomeration provides a strong argument for local income taxes, or perhaps one fears the increased administrative costs of an additional local tax. Even so, the local income tax may hold an advantage over current, more common sources of local revenue. A local income tax is significantly more progressive. The traditional fiscal federalism literature sees this as a flaw, concerned as it is that progressive taxation at the local level might drive exit.[139] Without minimizing this concern entirely, we believe that our argument based on agglomeration indicates that a modestly progressive tax can be levied effectively.

Moreover, the possibility of a local income tax's progressivity offers some advantages. For one, the residents of some jurisdictions may have a "taste for redistribution," and thus a local income tax is an important revenue tool for communities that have made that choice. This preference, if it is shared widely

136. *See generally* David Gamage, *The Case for Taxing (All of) Labor Income, Consumption, Capital Income, and Wealth*, 68 TAX L. REV. 355 (2015).

137. *Id.* at 368–69.

138. *See, e.g.*, IND. DEP'T OF REVENUE, HOW TO COMPUTE WITHHOLDING FOR STATE AND COUNTY INCOME TAX (2021), https://www.in.gov/dor/files/dn01.pdf.

139. *See supra* Part II.A.

enough, could justify an income tax that goes beyond recouping a benefit and thus likely induces at least some mobility response.[140] Because support for redistribution may be concentrated in jurisdictions or regions of a state, allowing localities to express such preferences may be consistent with theories of residential sorting. Such taxes may be especially sensible when progressive reforms to state income tax are politically difficult. For example, residents of both Seattle and surrounding King County have supported a variety of tax increases that have failed to garner majority support statewide.[141] In fact, income inequality may itself exacerbate demand for public goods, like affordable housing and job-training programs that increase support for redistribution at the local level.

Second, though progressive revenue sources may be more cyclical, they also may offer a more attractive revenue option during a recession. As previously mentioned, local governments face borrowing constraints. If all the available levies are relatively regressive, then raising taxes to maintain services for people facing poverty may face political hurdles, even if, on balance, the benefits outweigh the costs. As a response to high economic inequality, a progressive income tax may offer an important source of revenue during periods of economic growth, but in periods of economic decline, such progressivity may be even more important. A moderately progressive local income tax that helps prevent steep cuts to the most vulnerable during a downturn would have a very progressive effect.[142]

This remains true even when considering alternative policy reforms to make the property tax more progressive. To be clear, we don't believe the property tax is as regressive as is sometimes assumed.[143] Nevertheless, the property tax has certain regressive features that, as a political matter, have been difficult to resolve.

Property taxes are generally not modulated with ability to pay, a design with positive and negative consequences. On the positive side, this feature ensures stability in the property tax. But it comes at a cost to illiquid taxpayers, especially during a downturn. Low- and middle-income homeowners may struggle to pay property taxes in periods of individual economic uncertainty, such as sudden job loss, and these struggles become a challenge for whole

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140. Clayton P. Gillette, *Local Redistribution, Living Wage Ordinances, and Judicial Intervention*, 101 NW. U. L. REV. 1057, 1070–71 (2007).

141. *Washington Initiative 732 – Create Carbon Emission Tax – Results: Rejected*, N.Y. TIMES (Aug. 1, 2017, 11:27 AM), https://www.nytimes.com/elections/2016/results/washington-ballot-measure-732-create-carbon-emission-tax; *Initiative Measure 1098 Concerning Establishing a State Income Tax and Reducing Other Taxes. – County Results*, NOV. 02, 2010 GEN. ELECTION RESULTS, https://results.vote.wa.gov/results/20101102/initiative-measure-1098-concerning-establishing-a-state-income-tax-and-reducing-other-taxes_by county.html (Nov. 29, 2010, 9:49 AM).

142. David Gamage, *Preventing State Budget Crises: Managing the Fiscal Volatility Problem*, 98 CALIF. L. REV. 749, 791 (2010).

143. *See generally* Wallace E. Oates & William A. Fischel, *Are Local Property Taxes Regressive, Progressive, or What?*, 69 NAT'L TAX J. 415 (2016).

communities during economic downturns.[144] Scholars have suggested that the divergence between property tax liability and income flows fueled support for policies that restricted property tax growth,[145] the very policies that now make local government finances so difficult.

Of course, these problems are solvable. States can adopt progressive rates or circuit breakers that prevent the property tax burden from diverging too much from income growth.[146] We think that these solutions should be adopted, and, if they are, the standalone argument for local income taxes based on progressivity would be weaker.

Yet tinkering with state property tax limitation regimes in a progressive way is not very likely in many states. For one, many state constitutions contain uniformity clauses that limit the adoption of progressive property tax rates. Because so much of state property tax law is constitutionalized, for jurisdictions that currently authorize both local income taxes and local property taxes, it may be easier to reform local income taxes. For similar reasons, it is at least possible that there are states where expanding authorization for local income taxes is more likely than property tax reform. California may well be such a state, as changing California's property tax regime would require a constitutional amendment while permitting localities to impose an income tax would only require a statutory change.[147]

Our argument that local tax progressivity could be accomplished through the adoption of local income taxes is not simply about the likelihood of such reform, however. There is substantial overlap between a progressive property tax and a local income tax. After all, most progressive property tax policies rely on income as the measure of progressivity. In this way, even the existing fiscal federalism literature suggests some support for local taxes based on income when there is support for circuit breakers, i.e., limits on property tax increases based on household income. It is also likely that a progressive property tax would still impose some tax even on low-income property owners. Thus, combining a property tax burden kept low by a property tax limitation regime with a progressive local income tax would, in many cases, impose a similar burden as a progressive property tax standing alone.

While the property tax is likely progressive even without these improvements,[148] the same cannot be said of other sources of revenue, such as

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144. Andrew T. Hayashi, *Countercyclical Property Taxes*, 40 VA. TAX REV. 1, 5 (2020); Andrew T. Hayashi & Ariel Jurow Kleiman, *Property Taxes During the Pandemic*, 96 TAX NOTES STATE 1461, 1462 (2020).

145. Isaac William Martin & Kevin Beck, *Property Tax Limitation and Racial Inequality in Effective Tax Rates*, 43 CRITICAL SOCIO. 221, 222 (2017) (explaining that state legislatures have implemented property tax limits "as a way to preserve housing affordability, to protect low-income homeowners from displacement, or to prevent racial discrimination in tax assessment").

146. For one such proposal, see generally Darien Shanske, *Revitalizing Local Political Economy Through Modernizing the Property Tax*, 68 TAX L. REV. 143 (2014).

147. See, in particular, CAL. REV. & TAX CODE § 17041.5 (West 2023).

148. *See* Oates & Fischel, *supra* note 143. The incidence, and thus the distribution, of the property tax burden, will, of course, depend on local conditions. *Id.*

user fees, to which local governments have turned. Many user fees are clearly regressive. Scholar Laurie Reynolds offered an early critique of local governments' increasing shift to a user-fee model, arguing that such a shift made it harder for local governments to provide services for those with a lower ability to pay, even when such services enhanced the whole community.[149]

The recent popular and scholarly attention focused on criminal justice fines and fees has highlighted local reliance on such revenue to close budget gaps.[150] Because these fees are often flat, they are necessarily regressive; they will represent a larger share of income for low-income payors than higher-income payors. Because the payors of such fines and fees reflect the broader inequities in the criminal justice system, they are disproportionally low-income and Indigenous, Black, and Latino, rendering the overall system even more regressive.

Moreover, even less troubling local revenue options are likely to be quite regressive. While tax scholars are forever proposing reforms to make the sales tax more progressive, consumption taxation continues to impose a greater burden (as measured by share of income) for low-income than high-income taxpayers.

Local income taxes are thus likely more progressive than budget cuts to local services or raising revenue from sales taxes, property taxes, or fees. They can also be more progressive in the overall state budget funding context. As we have discussed, states remain a large source of funding for cities, and this funding often contracts during recessions. But some of those cities, say a Chicago or San Francisco, would need less help if they had more revenue tools. This would ease the burden on the state to make state-level cuts and would, ideally, help the state send more aid to those localities less able to weather the storm.

We should acknowledge, however, that the current design of many local "income taxes" makes them much less progressive than their state, and especially federal, counterparts. This is not simply because the tax is imposed at a flat rate. The base of many local income taxes is more regressive than federal tax law. Ohio's municipal net profits tax, for example, excludes interest and dividend income, types of income earned disproportionally by high-income earners. Pennsylvania's wage tax is even more regressive.[151]

149. *See generally* Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the "Get What You Pay For" Model of Local Government*, 56 FLA. L. REV. 373 (2004).

150. While this Article focuses on local finances, we should be clear that states also impose these regressive fees to fund their own budgets. *See* Katherine Beckett & Alexes Harris, *On Cash and Conviction: Monetary Sanctions as Misguided Policy*, 10 CRIM. & PUB. POL'Y 509, 512–15 (2011) (describing state role in fines and fees).

151. Pennsylvania policymakers are limited in their ability to craft a more progressive local income tax because the state's Supreme Court has consistently suggested that many features of a progressive income tax violate the Pennsylvania Constitution's Uniformity Clause. *See How Pennsylvania's Uniformity Clause Affects Property and Wage Taxes in Philadelphia*, PEW (Mar. 9, 2022), https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2022/03/how-pennsylvanias-uniformity-clause-affects-property-and-wage-taxes-in-

Pennsylvania law authorizes local governments to exempt those earning less than $12,000 year from the local earned income tax.[152] However, unlike the federal standard deduction, which exempts the first several thousand dollars of earnings for *all taxpayers*, this exemption only applies to those making less than the $12,000 threshold. Those making over the threshold, even by a small amount, owe the full amount on all their earnings. And the exemption level allowed by law is set quite low. The *poverty-level* wage for a *single individual* in Pennsylvania is $12,875, so the exemption does not add significant progressivity to the design of the local wage tax.[153] Philadelphia offers no exemption from the wage tax, though it does, as discussed previously, offer a reduced tax rate for those earning below the threshold set by household size.[154]

Thus, to the extent support for local income taxation rests on these arguments about progressivity, the details of the tax base matter.

D. Responding to Concerns

Taken together, the preceding three Subparts argue that the traditional skepticism regarding local income taxation is unwarranted. Agglomeration economics, the importance of diverse revenue streams, and support for progressive tax policy are reasons for policymakers to take more seriously imposing or expanding a local income tax as a policy option. Recognizing that we are flying in the face of much conventional wisdom, this Subpart addresses some of the practical concerns that our proposal may raise. We respond here to what we think are the most compelling concerns about our proposal and offer a preliminary response to how such a tax should be designed. First, we address concerns that the rise of remote work undermines the case for local income

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philadelphia. The Clause provides that "[a]ll taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws." PA. CONST. art. VIII, § 1. While many state courts interpret similar uniformity clauses to apply only to property taxes, Pennsylvania's courts have viewed this language as all forms of taxation, including income taxes. *See* Nextel Commc'ns of Mid-Atl., Inc. v. Commonwealth, Dep't of Revenue, 171 A.3d 682, 697 (Pa. 2017) ("In accordance with this principle, our Court has consistently viewed as unconstitutional tax laws which, although applicable to an entire class of taxpayers, wholly exempt some of those taxpayers from paying the tax. Such statutes are generally structured so that some taxpayers whose total income or value of their property falls below the maximum value of the exemption are required to pay no taxes at all, whereas other taxpayers with income or property value in excess of the exempted amount are required to pay taxes on the value of the non-exempted income or property, thus shouldering the entire tax burden."). The Pennsylvania Constitution does allow state and local tax authorities to "[e]stablish as a class or classes of subjects of taxation the property or privileges of persons who, because of age, disability, infirmity or *poverty*, are determined to be in need of tax exemption or of special tax provisions." PA. CONST. art. VIII, § 2 (emphasis added).

152. 53 PA. STAT. AND CONS. STAT. § 6924.301.1(b) (West 2023).

153. *See Living Wage Calculation for Pennsylvania*, MIT LIVING WAGE CALCULATOR, https://livingwage.mit.edu/states/42 (last visited Feb. 23, 2023) (showing that a poverty-level wage is $6.19 an hour for a single person with no dependents in the state, which is $12,875 a year, assuming forty hours of work a week for fifty-two weeks).

154. There has been a proposal to offer a wage tax credit to change this policy that has earned the support of the Philadelphia City Council, but this policy was pocket-vetoed by the mayor. *See* Jon Geeting, *Making Work Pay*, PHILA. CITIZEN (Mar. 2, 2020), https://thephiladelphiacitizen.org/kenney-wage-tax-philadelphia/.

taxation. Second, we address concerns that many of our goals might be better accomplished by making *state* income taxes more progressive and expanding intergovernmental aid.

1. Exit-Based Concerns

We are proposing that a relatively uniform low-rate income tax be imposed in rough proportion to the benefit derived from the locality. Put this way, we think the answer as to whether such a tax would lead to massive flight answers itself. The limited empirical literature supports this view. Careful work does reveal some mobility response, particularly at higher tax rates on high-income and highly mobile workers (e.g., athletes). However, even this response does not suggest that a local income tax would automatically put a locality on the edge of a Laffer curve or even significantly depress economic activity.[155] A recent study of the effect of enabling Spanish regions to impose relatively higher income taxes found that "[a]lthough the migration response is significant, the taxable income responses are likely small."[156] A leading study of U.S. municipal-level taxes by economists David R. Agrawal and William H. Hoyt found similar results:

> For the top 5% of households, a one percentage point increase in the marginal tax rate has no significant effect in no-reciprocity MSAs [metropolitan areas, in effect, taxing on source], but raises commutes by 0.24 minutes in MSAs with reciprocity. In general, although the effect of mtr [Marginal Tax Rate] is often statistically significant, the economic effect of marginal tax rates on the shape of the MSA is relatively small. These effects may be small because marginal tax rates may not be salient.[157]

We think that this small effect is not simply the result of low salience,[158] but rather reflects taxpayers accepting the payment as reasonable or, at the very least, part of a bundle with other amenities they are willing to pay for. Another

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155. *See generally* David R. Agrawal, William H. Hoyt & John D. Wilson, *Local Policy Choice: Theory and Empirics*, 60 J. ECON. LITERATURE 1378 (2022), https://www.aeaweb.org/articles?id=10.1257/jel.20201490.

156. David R. Agrawal & Dirk Foremny, *Relocation of the Rich: Migration in Response to Top Tax Rate Changes from Spanish Reforms*, 101 REV. ECON. & STATS. 214, 232 (2019). Note that this finding is broadly consistent with other findings in the United States. *See generally, e.g.*, Yang & Heim, *supra* note 111; Young et al., *supra* note 110; Cristobal Young & Charles Varner, *Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment*, 64 NAT'L TAX J. 255 (2011).

157. David R. Agrawal & William H. Hoyt, *Commuting and Taxes: Theory, Empirics and Welfare Implications*, 128 ECON. J. 2969, 2990–91 (2018). Note the finding of no "significant effect" for taxes levied on the source principle, as we think that taxing local income only on the basis of source is a design many localities should consider.

158. Though note that we think it is acceptable if part of the effect is salience related. The choice of where to work is a market decision that we generally do not want distorted by taxation. If this were a large tax or it were to be levied upon taxpayers living on the edge of poverty, this might change the analysis, but we are considering more mobile taxpayers who are likely to have more income, and we are discussing an income tax levied at a low rate. David Gamage & Darien Shanske, *Three Essays on Tax Salience: Market Salience and Political Salience*, 65 TAX L. REV. 19, 60–79 (2012).

recent study by economists Sohjani Fatehin and David L. Sjoquist found a *positive* relationship between taxes and high-income employment.[159] Fatehin and Sjoquist argue that these findings suggest that "high-wage workers . . . put relatively greater weight at the margin on public services, amenities, and nonwage characteristics of their job than on their net-of-tax wages."[160] This implies that high-wage workers, as they make location decisions, are relatively less sensitive to tax rates than other workers.

All that said, we emphasize again that we are talking about taxes imposed at a low rate in a nonburdensome way. Of course, local governments should think about mobility response in designing an income tax. This does not mean, however, that the ideal local income tax rate is zero in all local jurisdictions, and probably not even in most of them.

a. Does the Rise of Remote Work Undermine the Case for Local Income Taxes?

A more sympathetic critique of our project might concede that in 2019 outright exit was not a likely response to a version of a local income tax along the lines that we are proposing. This critique, however, would suggest that the COVID-19 pandemic has wrought permanent economic change, undercutting the premise of our argument about agglomeration.

After all, in 2019, there was concern about supercities, such as New York, aggregating too much talent and wealth. Now, as we recover from the worst of the COVID-19 pandemic, New York City may worry about insufficient incentives to aggregate.[161] Workers already wary of returning to downtown offices may see local income taxes as another reason to stay home.[162] Indeed, since the substantial completion of this Article, two leading scholars of tax-induced mobility, Cristobal Young and Ithai Lurie, published a paper finding a significant increase in migration post-pandemic.[163] This is especially notable because Young and Lurie's prior work has found that tax-induced exit is generally low.[164] And two other important scholars, David Agrawal and Kirk Stark, have just made the argument that this increased mobility threatens

159. Sohani Fatehin & David L. Sjoquist, *State and Local Taxes and Employment by Wage Level*, 35 ECON. DEV. Q. 53, 56 (2021) (citing the important work of Diamond, *supra* note 107).

160. *Id.* at 54.

161. *See generally* Lukas Althoff, Fabian Eckert, Sharat Ganapati & Conor Walsh, *The Geography of Remote Work*, 93 REG'L SCI. & URB. ECON., No. 103770, 2022 (showing that big cities saw much larger fractions of their workforce move to remote work during the pandemic compared to smaller cities).

162. Note that the reduction in the need to commute is not likely evenly distributed, and hence shifting the tax burden onto traditional commuters is likely regressive. *See generally* Hayes Holderness, *Changing Lanes: Tax Relief for Commuters*, 40 VA. TAX REV. 453 (2021) (arguing that commuting expenses should be deductible in light of changes to the nature of work and commuting).

163. Cristobal Young & Ithai Lurie, Taxing the Rich: How Incentives and Embeddedness Shape Millionaire Tax Flight 1 (July 27, 2022) (unpublished manuscript), https://equitablegrowth.org/working-papers/taxing-the-rich-how-incentives-and-embeddedness-shape-millionaire-tax-flight/.

164. *See* Kim, *supra* note 97.

progressive taxation *at the state level*.[165] If progressive state income taxes are in danger from remote work, then it would seem a fortiori that local income tax would be, too. It is easier to leave a locality than a state, after all, though it should be noted that the lower rates we recommend for local income taxes should dampen this effect somewhat.

First, we should note that Agrawal and Stark don't contest the argument that agglomerations can and do permit more progressive taxation.[166] Thus, we share a basically similar theoretical orientation. Further, we agree that there clearly will be more work flexibility in the future, at least for certain jobs, and this, as Agrawal and Stark argue, clearly puts some new constraints on progressive taxation.[167] Third, we concede that if huge swathes of workers become "digital nomads," then that creates a significant, new constraint. But we do not think this "digital nomad" lifestyle will be widely adopted by U.S. workers, and we are not sure that Agrawal and Stark do either.

As the primary evidence cited by Agrawal and Stark shows, the shift to remote work appears likely to be significant but modest. The primary study they cite predicts "20% of full workdays will be supplied from home after the pandemic ends" and "a long-term decline of about 5 to 10 percent of economic activity, due to less workers spending money on goods, services, and meals in the city."[168] Such evidence of a significant but moderate impact,[169] at least in the aggregate, strikes us as consistent with underlying theory, earlier work, and common sense. As for theory, matching and training are clearly aided by at least some physical presence, as suggested in our initial discussion of the benefits of agglomerations. This is also true of many residential amenities, like museums and restaurants. Thus, the benefits of aggregating are not going to disappear, even if there will be many more work-from-home days and fewer business lunches. Note that this underlying persistence of aggregation effects was reflected in pre-pandemic empirical work.[170]

165. *See generally* David R. Agrawal & Kirk J. Stark, *Will the Remote Work Revolution Undermine Progressive State Income Taxes?* (Glob. Lab. Org., Working Paper No. 1119, 2022), https://www.econstor.eu/bitstream/10419/260551/1/GLO-DP-1119.pdf.

166. *Id.* at 6 ("As the lure of cities increases, so too does the 'tenable range' of policy options available to state and local lawmakers. In the presence of powerful agglomerative effects, which make people and firms less mobile than in their absence, state and local governments possess a greater ability to carry off progressive tax policies beyond what might have been possible in the absence of these effects.").

167. *Id.* at 68.

168. *Id.* at 16–17 (citing Jose Maria Barrero, Nicholas Bloom & Steven J. Davis, *Why Working from Home Will Stick* (Nat'l Bureau Econ. Rsch., Working Paper No. 2020-174, 2021), https://bfi.uchicago.edu/wp-content/uploads/2020/12/BFI_WP_2020174.pdf).

169. Young and Lurie also find moderate evidence—so far: "As a fraction of the millionaire population, tax flight during the pandemic was modest in magnitude—the highest tax states lost one-half of one percent of their millionaire base." Young & Lurie, *supra* note 163, at 28.

170. *See* discussion *supra* Part II.A (detailing benefits of agglomeration); *see also* Giuliano et al., *supra* note 101 (finding persistence and stability of agglomeration effects in Los Angeles over last three decades, though the study is pre-pandemic, despite steady increase in potential of remote work); Gregory H. Shill, *The Puzzle and Persistence of Biglaw Clustering*, 23 THEORETICAL INQUIRIES L. 191, 201–03 (2022) (same and citing additional sources). It is also worth noting that not only have agglomeration economies turned out to be resilient,

And we should add here—and we will provide some data points shortly—that a more limited shift seems more likely to us. As workers in an industry that in effect has long allowed remote work, and as parents of young children, we see the benefits of remote work. And so of course workers who can now work from home some days will take the chance. And yet as parents of young children, as well as teachers and happy participants in the intellectual lives of our schools, we see clearly that remote work has fundamental limitations. It seems unlikely that jobs that are 100% remote will dominate the professional job market.

And this is why some of the evidence cited by Agrawal and Stark, which at first appears paradoxical, makes sense to us. How, after all, can both agglomerations[171] *and* remote work increase productivity?[172] These results make sense because they reflect the tradeoff of costs and benefits created by agglomeration. For example, there may be some value in sharing an office—it may be possible that the productivity benefits of co-locating with coworkers do not require daily commutes, which are themselves costly. Thus, agglomeration benefits may be conferred even with the option to work from home two days a week. It is of course possible we are wrong, but we believe that urban policymakers can reasonably assume some continued benefits of agglomeration.

But this assumption of persisting agglomeration benefits does not mean the benefits cannot be reduced, nor that the pattern of benefits will remain the same. Hence, some nimbleness on the part of cities would be ideal both in nurturing and taxing agglomerations. For example, it does seem entirely possible that smaller cities will be better able to provide competitive amenity bundles and thus create new agglomerations.[173] Indeed, some smaller cities might be creating

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but also that some geographical dispersions, say of corporate headquarters, have already occurred. *See* Shill, *supra*, at 192. Thus, at least some big law firms have *already* chosen to remain in big cities despite a strong economic case for less expensive locations (as convinced many of their clients) or more remote work. *Id*. Of course, the future is unpredictable, but even a leading commentator discussing how big law may shift in response to the pandemic is skeptical that remote work and decentralization are the future of legal practice. *Id.* at 194 n.14 ("[T]he author's personal view is that a substantial deconcentration of Biglaw is unlikely and in fact that the opposite—increased concentration—is more likely."); *see also* Agrawal & Stark, *supra* note 165 at 45 ("Despite the state being one of the most vulnerable in terms of ensuing mobility from telework, [California] has—at least prior to the pandemic—been able to increase income tax rates on top earners relative to lower-income households.").

171. Agrawal & Stark, *supra* note 165, at 54 (citing Stuart S. Rosenthal & William C. Strange, *The Attenuation of Human Capital Spillovers*, 64 J. URB. ECON. 373 (2008)); Antonio Ciccone & Robert E. Hall, *Productivity and the Density of Economic Activity*, 86 AM. ECON. REV. 54, 56 (1996).

172. *See* Ciccone & Hall, *supra* note 171 (citing Nicholas A. Bloom, James Liang, John Roberts & Zhichun Jenny Ying, *Does Working from Home Work? Evidence from a Chinese Experiment*, 130 Q.J. ECON. 165 (2015)); *see also* Jose Maria Barrero, Nicholas Bloom & Steven J. Davis, *Why Working from Home Will Stick* 31 (Nat'l Bureau Econ. Rsch., Working Paper No. 2020-174, 2021), https://bfi.uchicago.edu/wp-content/uploads/2020/12/BFI_WP_2020174.pdf ("We also estimate that higher levels of [work from home] will boost productivity by about 4.8 percent.").

173. *See* David Schleicher, *Exclusionary Zoning's Confused Defenders*, WIS. L. REV. (forthcoming) (manuscript at 41), https://ssrn.com/abstract=3917621. Schleicher is another leading scholar who is skeptical that the phenomenon of remote work will have a big effect. *Cf.* Eric Scigliano, *Covid Means Remote Workers Can Live Anywhere. So Where's Anywhere*, POLITICO (Oct. 26, 2021), https://www.politico.com/news

agglomerative advantages of a sort by featuring *less* remote work.[174] There is also already evidence, consistent with our intuitions, of remote work encouraging donut-shaped dispersal. That is, remote work encourages workers to move from the central city and central suburbs outward, around the more urban city core. More remote work allows workers to live farther away from their place of employment, but the persistence of the need to agglomerate keeps them from moving too far.[175]

For a central city without an income tax, like San Francisco, a possible reduction in the strength of agglomeration effects indicates that it should impose a lower income tax in 2023 than it might have considered in 2019. Further, if a big part of the future for a city like San Francisco or New York is as an aggregator of residential versus commercial amenities, then how a city expends resources is surely something to consider, say in making downtown commercial districts better places to work and play.

There is also the possibility of strategically shifting a local income tax's design.[176] Consider a more distant town at the edge of the donut of a metropolitan area that has suddenly become more desirable because of the rise of remote work. Perhaps this is because the town has access to beautiful nature and good schools. It is residence in this town that is most attractive, and so it would stand to reason that the town should impose a low-rate income tax based on the residence principle and eschew source-based taxation altogether.[177] We will consider such different options in future work, but for now our point is to note that localities can adapt in order to get the most out of the agglomerations that they have.

Finally, we note that a reordering of workspaces will also weaken existing sales and property tax bases,[178] and thus any critique of local income taxes needs to address the question of "compared to what?" If the sales tax base is in decline and a city needs the revenue to sustain itself as an attractive place to live and work, should it raise sales tax rates or impose a small local income tax? Our central thesis is that this is not an easy question to answer, despite traditional

/2021/10/21/covid-americans-cities-remote-work-515998. Superstar cities may also become more attractive because remote work reduces congestion costs. *See id.* For an economic model predicting a shift in agglomerations, along with some preliminary data that it is occurring, see Jan Brueckner Matthew E. Kahn & Gary C. Lin, *A New Spatial Hedonic Equilibrium in the Emerging Work-from-Home Economy?* 1 (Nat'l Bureau of Econ. Rsch., Working Paper No. 28526, 2021).

174. Emma Goldberg, *What Remote Work Debate? They've Been Back at the Office for a While*, N.Y. TIMES (Aug. 1, 2022), https://www.nytimes.com/2022/08/01/business/return-to-office-battles.html.

175. Arjun Ramani & Nicholas Bloom, *The Donut Effect of Covid-19 on Cities* 2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 28876, 2021), http://www.nber.org/papers/w28876.

176. As Agrawal and Stark recount, the current shape of local income taxes has already been shaped by strategic behavior, particularly by New York. *See* Agrawal & Stark, *supra* note 165, at 20–26.

177. And such a choice would be constitutional. *See generally* Bradley W. Joondeph, *The States' Multiple Taxation of Personal Income*, 71 CASE W. RES. L. REV. 121 (2020).

178. *See, e.g.*, OFF. OF THE N.Y. CITY COMPTROLLER, THE IMPACT OF HYBRID WORK ON COMMUTERS AND NYC SALES TAX 1 (2021), https://comptroller.nyc.gov/reports/the-impact-of-hybrid-work-on-commuters-and-nyc-sales-tax/.

fiscal federalism's eschewing of local income taxes. From a revenue-need perspective, it is thus a good time to think about new sources of local revenue. This, however, does not respond to concerns that a local income tax on remote work is administratively impractical, unconstitutional, and, in any event, bad policy. We address each in turn.

b. *Administrability*

Administrability is the boogeyman of the local income tax. The persistence of local income taxes suggests that they can raise revenue despite these concerns, but designing the local tax to reduce administrative and compliance costs is important to facilitating more widespread adoption. We will return to this design question in more detail in subsequent work. For now, however, we focus only on design issues as they concern taxing remote workers.

The following stylized example will be helpful in illustrating our discussion of the design choices facing local governments. Imagine a technology company with a New York City office space with capacity for 100 full-time employees. Because of flexible work scheduling policies, 200 employees actually report to the office.[179] None of these employees come to the office more than three days a week, and a handful come in no more than once a month.

The arguments for local income taxation sketched above support imposing a city-based income tax on these employees. We may presume that the company is paying a premium for its New York City–based office space for a reason, and that many (if not more) of its employees are highly paid in part because of the productivity increases created by the agglomeration economy that the city provides. Moreover, we see no difficulty in requiring the company to withhold local income tax from its employees who report to the New York City office.

In an era of remote work, however, more complex arrangements are also possible. Take the employee who only comes into the office once a month. Perhaps the employer could assign that employee to an office in Florida, a state without an income tax. If the company has an office in Florida from which the remote employee meaningfully works, then such an assignment should be respected because the remote employee is not truly taking advantage of the New York City agglomeration in any sustained way.

But what if the shift to the Florida office is merely nominal? That is, what if the employee is paid out of an office in Florida, but meaningfully reports to the New York City office. In this case, cities can piggyback on existing state law, at least to some extent.[180] State law already exists to determine where

179. *See* Matthew Haag, *Manhattan Emptied Out During the Pandemic. But Big Tech Is Moving In.*, N.Y. TIMES (Sept. 21, 2021), https://www.nytimes.com/2020/10/13/nyregion/big-tech-nyc-office-space.html.

180. The payroll factor for purposes of state corporate income tax apportionment is also built on these statutes. UNIF. DIV. OF INCOME FOR TAX PURPOSES ACT § 14 & cmt. (UNIF. L. COMM'N 1966).

employees are located for purposes of the state unemployment system.[181] Under these statues, which are coordinated by the cooperative federal unemployment system, workplace location is determined by asking whether "(A) the individual's base of operations is in this state; or (B) if there is no base of operations, the place from which such service is directed or controlled is in this state."[182] Thus, a company is subject to New York state unemployment tax for employees meaningfully directed from the New York City office, and local jurisdictions could use such laws to determine that these employees are also subject to the local income tax.[183]

Work arrangements, however, could get even more complicated. Suppose that those employees who only come into the New York City office once a month are equally directed from company headquarters in the California and New York City offices. If the company knows a particular employee has been assigned 50% to the New York City team and 50% to the California team, then a fifty-fifty split is the right result. If the ordinary course of business does not yield that answer, then a simple pro-rata division is sufficient. This is, roughly, the approach taken by the Multistate Tax Commission in its regulations concerning locating sales to multistate businesses.[184]

Note that Agrawal and Stark don't seem to consider such divisions possible. They worry that an apportionment formula will either give all the income to the state of physical presence or location of the office, which would mean that 100% of an employee's income can be taxed in two states.[185] Again, we don't think it likely or necessary that such all-or-nothing rules predominate, especially given how market-based apportionment rules currently work.

Agrawal and Stark also worry, by analogy with the longstanding practice of corporate tax apportionment, that no uniform system will emerge, a result they believe would be burdensome and unfair.[186] While we agree at the margins with their critique of current corporate tax apportionment rules, we believe that the current system generally works. For the most part, the current rules impose

181. *See, e.g.*, CAL. UNEMP. INS. CODE §§ 602–603 (codifying U.S. DEP'T OF LAB., UNEMPLOYMENT INSURANCE PROGRAM LETTER NO. 20-04, ATTACHMENT 1: LOCALIZATION OF WORK PROVISIONS, https://oui.doleta.gov/dmstree/uipl/uipl2k4/uipl_2004a1.htm).

182. U.S. DEP'T OF LAB., UNEMPLOYMENT INSURANCE PROGRAM LETTER NO. 20-04, ATTACHMENT 1: LOCALIZATION OF WORK PROVISIONS, https://oui.doleta.gov/dmstree/uipl/uipl2k4/uipl_2004a1.htm.

183. Note that the federal guidance would not locate remote workers in New York in our example, but in their residence states. *See id.* Localities should clearly piggyback on the concepts of these statutes and not this interpretation. The interpretation is defensible in the unemployment context because the consequence is that the remote employee is therefore part of the unemployment system of their resident state rather than the source state. This is a very different result from a local income tax resulting in complete tax exemption in the source state.

184. *See* MULTISTATE TAX COMM'N, MODEL GENERAL ALLOCATION & APPORTIONMENT REGULATIONS WITH AMENDMENTS SUBMITTED FOR ADOPTION BY THE COMMISSION 80–81 (2017), https://www.mtc.gov/getattachment/Events-Training/2017/Special-Meeting/FINAL-APPROVED-2017-Proposed-Amendments-to-General-Allocation-and-Apportionment-Regulat.pdf.aspx (regulating and apportioning income based on proportion of payroll).

185. Agrawal & Stark, *supra* note 165, at 61.

186. *Id.*

the most complexity on the biggest taxpayers, who have the resources to address this complexity. Furthermore, many of these complexities are themselves the result of tax-motivated planning.

A narrower version of Agrawal and Stark's concerns might focus on imposing this corporate tax regime on individual taxpayers. This is without doubt an issue, which is why we advocate simple, piggybacking, (mostly) low-rate taxes. Furthermore, our expectation is that a local income tax will be withheld by employers,[187] with reconciliation to be done when employees file their taxes, as under current law at the state and federal levels. As the employer has all the relevant information on which office an employee worked "out" of, the employer could be required to file an end-of-year form with the city that would also be provided to the employee. The form would be subject to audit at the employer level, and the law could be designed to allow employee reliance on this certification.

As for the firms themselves, capacity should also track complexity. A small firm with one office is going to source a remote worker to that office. If the firm has three offices, it probably knows enough to make a rough allocation, but if not, there will be a default pro-rata rule. For a big multistate business, say a national accounting firm, it does not seem too much to ask for it to keep track of which office an employee is primarily directed by, something it likely does anyway for its own purposes. Failing that, a reasonable pro-rata rule will still at least partially reflect the agglomeration benefits. Perhaps for a large multistate company with a large cadre of truly floating employees, that is the best that can be done.

There might even be an upside to apportionment for localities. Suppose states or localities remain in an all-or-nothing paradigm. Going back to our original example, under an all-or-nothing rule, 200 employees could have been sourced to an office that houses only half of them at any one time. We think that this is defensible as a matter of law and policy. For Agrawal and Stark, the danger of such a rule would be that the tax burden exceeds the benefits of agglomeration, inducing either employer exit or downsizing.[188] Sourcing only 50% of the income of the 200 employees could be seen as a reasonable accommodation to firms and employees that are particularly flexible.

Though our proposed design leaves room for gaming, it is not overly porous. An employer might have some incentive to shave off hours in the office in the "high-tax" state,[189] but presumably not a lot of incentive to engage in fraud or wastefully start a "dummy" office in Florida. And despite the complexity of this source-based taxation system, in some ways it is easier to administer than a

187. For similar analysis, see generally Rick Handel, *Income Taxation of Mobile Employees*, TAX NOTES (Feb. 12, 2020), https://www.taxnotes.com/tax-notes-today-state/employment-taxes/income-taxation-mobile-employees/2020/02/12/2bqt2.

188. Agrawal & Stark, *supra* note 165.

189. This is akin to how taxpayers currently have incentives to dampen sales in higher-tax states for corporate tax apportionment.

residence-based local tax system. After all, for remote employees, employers know much more about which office they report to than where they are actually doing their work. Additionally, employer withholding is a key feature of administrative simplicity in the income tax. Note that remote workers have not only complained about income taxation based on source (i.e., the location of their employer), but also residence-based taxation. Roving remote employees who enjoy the Airbnb lifestyle can end up subjecting themselves (and maybe their employers) to tax in multiple jurisdictions. Thus, whatever complexities may be caused by source-based taxation should be compared to the alternative.[190]

In this sense, employees are the easy case, but what about independent contractors? We believe local income taxes can also capture their income. To begin, a portion of independent contractors are not truly independent. Consider, for example, a law firm based in New York City that decides to save money on salary by primarily working with attorneys who are independent contractors. The contractors they hire, however, work exclusively for the firm. These contractors should be considered part of the unitary business of the New York City firm, and as such, payments to these lawyers should be sourced to New York City, the jurisdiction where the benefit was received under market-based sourcing rules. This, roughly, was the holding of a recent (controversial) adjudication, *Blair S. Bindley*, decided by California's Office of Tax Appeals.[191]

But what about truly independent contractors? What about the accounting firm a New York City law firm hires? In that case, we can rely on existing rules for nexus and apportionment. That is, the firm from outside the jurisdiction will only need to worry about a local income tax if it does a substantial amount of work in the jurisdiction. If that threshold is crossed, then the taxpayer needs to pay tax in the local jurisdiction using the kind of apportionment formula that any business would use. And this is the right result. Think of an out-of-state accounting firm that does a lot of business in New York City because it specializes in work for big law firms. That accounting firm is benefiting from New York City's agglomeration and should pay a small, apportioned tax to the city.

What about an independent individual accountant? We think the answer here is the same, though it makes sense to adjust the nexus and apportionment rules to make things easier on individuals. Setting the threshold higher for individuals, for example, would subject fewer of them to apportionment.

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190. It should be noted that many local income taxes currently tax on the basis of source and residence, and so the cost-benefit analysis would be different based on the design of the tax. We will consider such design issues in our next piece.

191. Blair S. Bindley, OTA Case No. 18032402, 2019 WL 3804280 (Cal. Off. Tax. App. May 30, 2019).

c. Constitutional Concerns

Of course, designing a system for taxing remote work only makes sense if that system is constitutional. We think the constitutional concerns, however, are even weaker than the administrative concerns. One of us has more fully developed the constitutional argument elsewhere,[192] and so we outline that argument here and respond to objections.[193]

Neither the Due Process Clause[194] nor the dormant Commerce Clause[195] currently require physical presence to impose a tax. So long as the nexus rules imposed by the locality are fair and require substantial contact, then they should pass muster. We think that in most cases these rules will not pose a major issue. Our fictional tech company employees directed out of the New York City office clearly have a nexus to New York City, and those are the employees that we are most concerned about. Yet there will still be fuzzy lines drawn. Does a paralegal who worked remotely on a contract for two months for a New York City law firm have a sufficient nexus? We recommend that the statutory threshold for the nexus for truly individual independent contractors be set high enough so as to avoid these close cases.

Once a city has established nexus, the question is whether some form of apportionment rule is permitted. The law of apportionment is very deferential to reasonable attempts to divide up the tax base,[196] and, as already noted, it is the existing standard of practice for business taxpayers to be asked to divide up their income in part based on the location of their employees.[197] It is also not unusual for individuals to be asked to divide up their income in this way in special situations. The most common example of this involves professional athletes apportioning their income to the states in which they play.[198]

All our proposal does is take some of the formulas for the location of employees used by businesses and then ask those same businesses to use those formulas, or something like them, to determine what portion of income is subject to local withholding. As already explained, this would not seem overly burdensome and would appear to be at least as reasonable, and hence constitutional, as are the practices on which it is based.

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192. *See generally* Shanske, *supra* note 96.

193. *See* Agrawal & Stark, *supra* note 165, at 35 ("Given the abandonment of the physical presence standard in these contexts, is there any reason to believe that it has any continuing significance in the personal income tax setting?"); Hayes Holderness, *Individual Home-Work Assignments for State Taxes*, WASH. L. REV. (forthcoming), https://ssrn.com/abstract=4009277. Holderness makes similar arguments and, in particular, places the argument permitting taxation of remote workers into the broader context of the Supreme Court's modern dormant Commerce Clause jurisprudence.

194. Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 308 (1992).

195. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018).

196. Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 170 (1983).

197. *See* sources cited *supra* note 171.

198. Timothy P. Noonan & Doran J. Gittelman, *Taxing Times To Be a Telecommuter: Convenience Rules During COVID-19*, TAX NOTES (Sept. 17, 2020), https://www.taxnotes.com/featured-analysis/taxing-times-be-telecommuter-convenience-rules-during-covid-19/2020/09/17/2cyh2.

Professor Ed Zelinsky, a leading state and local tax scholar, has critiqued the earlier version of our analysis.[199] Many of Zelinsky's concerns relate to the particular way that New York apportions the income of commuting employees. Defending this specific approach is beyond the scope of this Article,[200] but defending income taxation of remote workers generally is central to our argument. As we read Zelinsky's critique, his objection is a mixed factual and legal claim. Zelinsky claims that it would not be administrable to have a system in which remote workers are taxed in every state where they have a "virtual presence."[201] Nevertheless, Zelinsky acknowledges that the physical presence of the agglomeration—say the tech company office in New York City in our example (or Zelinsky's law school in his example)—provides an administrable limiting principle.[202] For Zelinsky, this serves to reify physical presence; if physical presence is determinative, then it is the worker's state of residence that matters because that state provides the "principal public services" to the worker. There is no room for taxation based on source.

We agree, of course, that the location of the principal office does point the way to an administrable limiting principle. We also agree that the residence jurisdiction has a strong claim to tax residents, and, in fact, we would add that agglomeration economics makes that case stronger in many instances, since many more mobile taxpayers move to attractive amenity bundles.[203] Where we differ from Zelinsky is in our argument that the source jurisdiction (city) is providing a separate benefit to the employee by providing an agglomeration for the employer, and that the source jurisdiction is entitled to tax *that* benefit. In the end, Zelinsky does see that this is the essence of our argument, but offers a handwaving counter:

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199. *See generally* Edward A. Zelinsky, *Taxing Interstate Remote Workers After* New Hampshire v. Massachusetts*: The Current Status of the Debate*, FLA. TAX REV. (forthcoming), https://ssrn.com/abstract =3934566. For a similar critique, see Kim, *supra* note 97.

200. The New York "convenience of the employer" rule governs a state-level tax, and so it is higher than the local taxes we are proposing. *See* N.Y. COMP. CODES R. & REGS. tit. 20, § 132.18 (2023). Further, though the New York rule is an apportionment rule, it will often result in more apportionment than the model we are advancing. Thus, one might agree with Zelinsky that there is something troubling as a policy matter, and maybe even a legal matter, about the New York approach while also accepting our argument for, and approach to, local income taxes.

201. Zelinsky, *supra* note 199, at 23–24.

202. *Id.* at 24.

203. Fox and Goldin argue for a residence rule with a "sliding scale [and] a de minimis exception" on the grounds that it "could well be more efficient than either a pure sliding scale or a sharp line." Edward Fox & Jacob Goldin, *Sharp Lines and Sliding Scales in Tax Law*, 72 TAX L. REV. 237, 292–95 (2020). The efficiency here primarily relates to taxpayer behavior but also to implementation. Elkins argues for a scalar notion of residency because it more accurately reflects "societal association." *See generally* David Elkins, *A Scalar Conception of Tax Residence for Individuals*, 41 VA. TAX REV. 149 (2020). We support apportioning the source of income for remote workers based on agglomeration, but only beyond a certain threshold, and we think such apportionment based on agglomeration is supported by both pragmatic (Fox and Goldin) and philosophical (Elkins) justifications for apportioned residence rules. Note that Zelinsky himself has proposed apportioning residence. *See generally* Edward A. Zelinsky, *Apportioning State Personal Income Taxes To Eliminate the Double Taxation of Dual Residents: Thoughts Provoked by the Proposed Minnesota Snowbird Tax*, 15 FLA. TAX REV. 533 (2014).

> Benefits are a traditional doctrine for allocating income among different taxing jurisdictions. But, in the context of the states, the concept of benefits has conventionally been linked to state-provided services which are physically furnished within the boundaries of the taxing state. Is it meaningful to say that the government of Massachusetts provides the agglomerations of the Greater Boston area in the same way that the city of Boston provides police and fire services to commuters physically present in downtown Boston? I am skeptical.[204]

As a policy matter, this skepticism is unwarranted. For one, the benefit principle animating state and local taxation has never required strict accounting. Instead, we would argue the historical discussion has focused on services "physically furnished within the boundaries of the taxing state"[205] because historically that accounted for a significant share of the benefits the state conferred. Moreover, in the corporate tax context, courts and legislatures often acknowledged that the right to tax was based on the state's grant of a privilege to engage in business, wholly apart from any specific benefits conferred by the state.[206]

As we have already explained, there is now a substantial amount of evidence to the effect that employees benefit from agglomerations. As the actual advantages of locating in a particular jurisdiction change, so too should the concept of benefit for purposes of taxation. At the same time, we understand that measuring the scope of benefits provided by agglomeration is difficult; however, such measurement challenges should not lead to the conclusion that local income taxation is inappropriate. Rather, we propose that taxes levied on remote workers should be set at a low rate and be designed to minimize compliance costs.[207]

As a legal matter, we do not think there is a constitutional bar to taxing the income of remote workers under sourcing principles. Almost forty years ago, the Supreme Court held that intangible sharing of expertise or credit between corporations could create a unitary business, even if the physical assets of the separate businesses were in some ways quite distinct.[208] As a result, a state in which only one of the businesses operated had a claim to a proportional share of the income of the whole corporation.[209] Of course, every sharing of knowhow between corporations does not result in the creation of a unitary business subject to tax wherever any discrete part operates. Nor does this mean that any particular state's approach to the unitary business principle is well advised as a policy or legal matter. What this line of authority does indicate is that the Supreme Court

204. Zelinsky, *supra* note 199, at 27.

205. *Id.*

206. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 628–29 (1981).

207. The higher the rate, of course, the greater the likelihood that the tax not only recoups the benefit of agglomeration but exceeds it, thus increasing the possible mobility response.

208. Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 173, 178 n.17, 179 (1983).

209. *Id.* at 184–85.

has not established, and is not likely to establish, as a principle of constitutional law that jurisdictions cannot tax based on agglomerations.

2. *Where Is the State?*

Another set of concerns focuses not simply on the immediate practicalities of the proposal, but rather on its merit relative to other ways of financially assisting local governments. In particular, to the extent we concede some problems with mobility and administration of local income taxes, one might ask: Why not just raise the revenue at the state level and distribute it?

More direct state aid for local governments, and in particular, more state aid funded by progressive taxes, would be good. For one thing, while progressive local taxes can aid with redistribution within communities, it cannot address regional and statewide income disparities. In fact, the very agglomeration economics that we suggest justifies some form of local income taxation likely leaves other regions and local governments behind.

Moreover, agglomeration may have helped New York City, Seattle, and Nashville, but its benefits have been less clear for Newark, New Jersey; Youngstown, Ohio; and Shreveport, Louisiana. These smaller regional cities may lack the fiscal capacity to benefit much from local income taxes, and thus expanding local taxing authority may do little to help close budget gaps in such cities. State aid may be a better alternative. But state aid formulas use a variety of metrics to distribute funds, and not all of these metrics reflect local capacity to generate revenue. While we would support changes that increased the portion of state aid distributed on this basis, we think that state aid is only a partial solution to this problem. For one, the relatively greater fiscal capacity means nothing if jurisdictions cannot use that capacity; hence, the significance of our proposal. Permitting higher capacity jurisdictions greater ability to look after themselves through use of local income taxes should free more resources at the state level to aid those jurisdictions with fewer resources.

Further, framing the question as a choice between more state aid and greater local revenue capacity obscures problems with increasing local dependence on state aid. For one, recent history suggests that state aid also lacks stability. In economic downturns, reliance on state aid leaves local governments vulnerable to budget cuts that cannot be addressed because they lack sufficient fiscal authority.

Moreover, preferences about income taxation likely track urbanization. Because urban areas are underrepresented at the state level through a variety of mechanisms,[210] as a matter of political expedience or simply constituent

210. *See* Emily Badger, *As American as Apple Pie? The Rural Vote's Disproportionate Slice of Power*, N.Y. TIMES (Nov. 20, 2016), https://www.nytimes.com/2016/11/21/upshot/as-american-as-apple-pie-the-rural-votes-disproportionate-slice-of-power.html. *See generally* Paul Diller, *Reorienting Home Rule: Part 1—the Urban Disadvantage in National and State Lawmaking*, 77 LA. L. REV. 287 (2016).

preferences, it may make sense to allow a portion of the state to impose a tax that does not have a statewide majority.

3. Hitting the Target?

One might concede the force of our individual points, but worry about their operationalization. For instance, surely not all workers in a city benefit from agglomerations, and yet a local income tax applies to all of them. Even worse, it is likely true that property values already reflect the benefit of agglomerations to some extent and so, to the extent these taxes are passed on to renters, some workers are already paying for agglomerations they are not benefiting from. There are (at least) two possible issues here. First, taxing workers who do not benefit from agglomerations is unfair and likely regressive. Second, accidentally overtaxing agglomeration benefits could trigger a larger mobility response than one might otherwise expect.

As a matter of policy design, we think these concerns are likely to be addressed by ensuring local income taxes remain relatively low. Moreover, creating a generous exemption level for local income taxes would meaningfully address regressivity concerns. As for the benefits justification, we think agglomeration likely offers benefits to many taxpayers, particularly those likely to pay most of the tax, and, in any event, there are other reasons that a modest local income tax can be justified.

Moreover, our anecdotal sense of local politics is that mobile taxpayers are very good at reminding local officials that tax changes can induce mobility responses.[211] As a result, it seems to us there is at least as great a risk of cumulatively undertaxing the benefit as overtaxing. Moreover, changing local tax authority in the vast majority of states will require state legislative action, allowing such taxing authority to come with guardrails, like maximum tax rates.[212] State authorization with limits strikes as a fiscal policy far more consistent with respect for local democracy than current law, which prophylactically takes the local income tool off the table in too many jurisdictions.

CONCLUSION

It is time to reconsider local income taxes and the role they could play in meaningful local tax reform. As progressive advocates in cities like Seattle and Chicago push for the adoption of local income taxes, scholars have a role to play in helping design these new income taxes, but that means first rejecting the conventional wisdom against local income taxes.

211. *See* Clayton P. Gillete, *Who Should Authorize a Commuter Tax?* 77 U. CHI. L. REV. 223, 237 (2010) (discussing the "voice" option for local businesses opposed to commuter taxes and for whom agglomeration makes exit a more difficult option).

212. For some development of this argument, see Darien Shanske, *Local Fiscal Autonomy Requires Constraints: The Case for Fiscal Menus*, 25 STAN. L. & POL'Y REV. 9, 29 (2014).

Our discussion and consideration of the challenges posed by imposing a local income tax is only a sketch. There are many more issues to consider. For instance, we assume that the local income taxes will be designed to impose a tax based on residence *and* source, with priority given to the source jurisdiction to avoid double taxation. As a matter of policy, however, it might make sense for certain jurisdictions (say a bedroom community) to instead impose an income tax only based on residence. We also think constitutional law would permit it. It would also clearly mitigate exit concerns if income taxes were to be levied regionally so that a taxpayer would need to leave not just a jurisdiction (e.g., San Francisco), but a whole regional agglomeration (e.g., the Bay Area).[213] Other design issues to consider are the importance of base conformity within a state, whether all localities should be required to levy a base level of income tax (like the sales tax), and whether there might be revenue sharing across jurisdictions and how to design such sharing.

All of these are critical questions, which we plan to address in future work. Our goal in this Article was at once more modest and bolder: to convince the reader that these design questions are in fact important because local incomes taxes are not merely vestigial, but may also be the way of the future.

213. Kirk Stark makes a proposal along these lines. Kirk J. Stark, *Regional Taxation in State Tax Reform*, 58 WASH. UNIV. J.L. & POL'Y 117, 146 (2019).

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