Frequently Asked Questions: Transportation Sales Tax Districts

December 2020

> ***Disclaimer:*** *The contents of these Frequently Asked Questions (FAQs) do not have the force and effect of law and are not meant to bind the public in any way. These FAQs are intended only to provide information and clarity to the public regarding existing requirements under the law or agency policies. Value capture techniques and policies are often implemented outside of Federal funding or regulatory requirements.*

What is a transportation sales tax district?

A transportation sales tax district (TSTD) is a designated area in which an incremental sales tax is levied to raise revenues for a defined set of transportation facilities or services. The boundaries of the TSTD are intended to encompass those who will benefit from the new or improved transportation facilities or services. State authorizing statutes, where they exist, will indicate permissible uses, procedures for establishment, and possible duration limits (that may or may not be renewable).

Where are TSTDs being used and are there other names for this technique?

TSTDs are typically used in cities and counties where States have authorized them and the local legislative process (pursuant to State guidelines) has been accomplished. Because each sale generates only a small amount of revenue, TSTDs are usually created in areas that regularly generate a significant volume of taxable sales. They often encompass an entire city, county, or multiple jurisdictions.[i]

Sales tax districts have been used to support transportation investments in Illinois, Missouri, Kansas, and California, among other locations.[ii] In Illinois, TSTDs are called "special service areas." In Missouri and Kansas, they are called "transportation development districts." In California, they are called "local transportation sales taxes."[iii]

How does a TSTD exemplify value capture?

Typically, improvements to transportation facilities and services enhance economic activity by improving access to commercial establishments, facilitating the delivery of goods, and allowing employees to reach places of employment more easily. As a result, some people anticipate enhanced sales activities as a result of transportation improvements. A tax on sales is seen as a way of compensating the public sector for creating and maintaining the transportation infrastructure or services that makes these sales possible.

Do local governments have authority to implement a TSTD?

State constitutions and statutes will determine the taxes and fees that can be levied by component jurisdictions. If a jurisdiction has the authority to levy a sales tax, then changing the rate would merely be an exercise of its existing authority. However, if a sales tax increase will be imposed in only some portion of a jurisdiction, some legislative justification at both the State and local level will typically be provided to avoid a legal challenge regarding a lack of uniformity.

Even if a jurisdiction has the authority under State law to levy different sales tax rates in different areas, a local jurisdiction establishing a TSTD would need to adhere to any State substantive and procedural requirements for implementing legislation.

What are the potential advantages and disadvantages of TSTDs?

Advantages:
Assuming that there is robust sales activity within a TSTD, a small increase in the sales tax rate could yield substantial revenue. Equally advantageous is that if an increase in the sales tax rate is relatively small, it may not be noticeable enough to change customer behavior and may therefore have only a marginal impact on commercial activity.[iv] In addition, voters may be more accepting of an incremental sales tax when they know that it is time-limited and revenues will be dedicated to specific projects and services nearby, as is usually the case with a TSTD.

In some areas, a large share of retail sales is made by nonresidents of the taxing district. This is particularly true of tourist destinations and central cities that draw shoppers and workers from surrounding jurisdictions. It is also the case in sparsely populated resort areas, where visitors can account for most of the retail activity. Because nonresidents cause significant transportation impacts in these areas, a transportation sales tax is a way of getting them to share in the cost of needed improvements.[v]

Disadvantages:
Unlike some other value capture techniques like user fees and access fees, sales taxes create no incentives for beneficial changes in travel behavior or land development.[vi] In some instances, if the public becomes aware that sales taxes are lower in an adjacent area, they might alter their consumption behavior by traveling to the area with the lower sales tax rate.[vii] If this happens, it could create an additional burden on the transportation system while reducing sales (and sales tax revenues) in the area with the higher sales tax rate. In addition, when an economic downturn occurs, sales (and sales tax revenue) typically decline.[viii]

Equity Considerations:
In terms of revenue equity based on benefits received or costs imposed, a sales tax falls short. Value capture techniques typically obtain revenues from people or organizations that benefit from transportation infrastructure or from those who impose costs upon it (e.g., truck fees based on weight). A sales tax bears little or no relationship to benefits received or costs imposed by the entity paying the tax. Sales taxes are imposed on all making purchases within the district, regardless of where they live, work, or travel, and regardless of the transportation impact of the delivery of the goods purchased.

In terms of equity based on "ability to pay," sales taxes are generally viewed as regressive, meaning that sales taxes represent a higher percentage of income for low-income households than for affluent households. In part, this stems from the fact that poor people spend a higher percentage of income on consumer goods, whereas affluent people typically save or invest large portions of their income.

The regressive nature of a sales tax could be remedied, in part, by exempting necessities that constitute a large percentage of low-income household purchases (e.g., groceries). In addition, jurisdictions might extend sales tax liability to goods and services (e.g., architectural, legal, and accounting services) that are typically consumed by more affluent households.

What types of infrastructure projects could be supported?

The types of infrastructure that could be funded by a TSTD are only limited by the State or local authorizing statutes and implementing ordinances. TSTDs have been used to fund both highway improvements and transit operations.[ix]

Could TSTDs be used to raise revenues for construction, operations, and maintenance?

The types of activities that TSTDs could fund are governed by the State or local statute that authorizes TSTD formation, as well as the local statute or ordinance that establishes a particular TSTD.[x] TSTDs have been used to fund both capital and operational expenditures.[xi]

What is the timing of revenues from a TSTD?

Once a TSTD has been created and its surcharge rate approved, these taxes are collected as part of the host jurisdiction's sales tax collection process for as long as the TSTD is authorized. Sales taxes are paid by retailers according to local laws and regulations.[xii]

How long do TSTD revenues last?

TSTD revenues last as long as the TSTD is authorized to exist. The duration of the TSTD is typically established in the ordinance that creates the TSTD.

Are TSTD revenues constant or do they change over time?

Because TSTD revenues are a percentage of taxable sales within the district's boundaries, they will fluctuate as the value of taxable sales changes over time. Sales activity will typically fluctuate from season to season, from year to year and from the boom phase of the business cycle to the bust phase. The value of sales will also vary according to changes in consumer demand and in the ability of stores within a TSTD to meet that demand.

What types of financing tools could be supported by TSTD revenues?

TSTDs produce a stream of revenue over their duration. Typically, revenue streams could be used to support financing mechanisms such as revenue bonds, state infrastructure bank loans, or other debt instruments. However, using TSTD revenue to support a financing mechanism depends on the following conditions: First, State authorization. TSTD authorizing statutes typically will specify if TSTD revenues can be pledged for financing mechanisms. Second, the local ordinance establishing a particular TSTD also needs to allow sales tax revenues to be used for financing. Third, the providers of financing (Federal agencies, States, or private lenders) will determine if the TSTD revenue stream is sufficiently robust and certain (based on all the applicable risk factors) to support a loan product with a reasonable interest rate.

Are TSTDs better suited for urban, suburban, or rural areas?

There are two key factors governing the suitability of an area for a TSTD. First is the volume and regularity of taxable sales. A TSTD is probably not feasible in an exclusively or predominantly residential area, because of the relatively low volume of taxable sales in those areas. Likewise, a rural area with only farms and housing would not be a good candidate for a TSTD. However, a rural area with a shopping mall or commercial district might suffice if sales volumes were sufficient.

The second factor is the rate of sales tax surcharge necessary to generate a desired level of revenue. If consumers notice that rate, and if nearby commercial areas outside of the proposed TSTD are easily accessible and perceived as more affordable, then a TSTD in the proposed area could drive consumers to make purchases outside of the TSTD. This could generate longer shopping trips and increase the strain on the region's transportation system, while simultaneously depressing sales and sales tax revenues within the TSTD.[xiii]

How do market conditions impact a TSTD?

Market conditions will influence household disposable income, tourism activity (if applicable), and the availability and desirability of commercial enterprises to satisfy the consumption demands of both residents and visitors. Even if commercial activity is robust when a TSTD is established, a change in the business cycle or other unforeseen events could affect the future volume and value of taxable sales. This presents risks for both capital and operating projects funded by TSTDs.

Although transportation investments might be necessary in an area with a declining economy, consumers making purchases within a particular TSTD must be willing and able to pay the additional sales tax. If consumer spending is weakened by an economic downturn, a TSTD might not make sense as a funding mechanism in the short term.

Can TSTDs fund an entire project or only a portion of it?

Given consumer sensitivity to prices, opportunities for a significant sales tax surcharge might be limited. Thus, TSTD revenue will likely need to be mixed with revenues from other sources to adequately fund a specific package of transportation facilities or services.

What is the legislative process for implementation?[xiv]

State Level:

A jurisdiction that levies a sales tax must have plenary authority over its sales tax process so that it might impose a sales tax surcharge in a defined area with revenues associated with the surcharge dedicated to a particular transportation project, service, or agency. If a city, town, county or township lacks such authority, it must be obtained from the State. State law determines whether such authority can be vested in the local legislature or whether it must be approved by voters directly through a referendum or initiative.

Local Level:

A jurisdiction that levies a sales tax and has authorization from a State to create a TSTD must create such a TSTD according to State law. In some places, that requires a petition by local property owners and a referendum. In other places, an ordinance may be enacted by a local legislature. Such a local ordinance typically will justify and define the TSTD boundary and establish a sales tax surcharge rate. This ordinance generally establishes that retailers within this area are to levy the additional sales tax and remit the proceeds in accordance with established protocols. It also typically establishes that the locality's treasury or department of finance will allocate surcharge revenue amounts to a dedicated account and spend it only for purposes defined in the ordinance.

Is a TSTD permanent or does it expire?

This depends on both the authorizing legislation and implementing ordinance. When a TSTD is designed to fund the debt service on a capital project, it typically expires when the debt is retired.

What type of analysis is necessary prior to selecting this funding technique?

Most States require uniformity either as a provision of the State constitution or by statute. Therefore, under State law, to treat some sales within the taxing jurisdiction different from others (through the imposition of a sales tax surcharge for transportation), there must be a legislative finding to satisfy judicial review in the event of a legal challenge. Thus, the legislative history of implementing ordinances typically reflect a process determining that economic activity within the proposed TSTD boundary receives a direct and special benefit from a proposed transportation project or service to be paid for, at least in part, by a proposed sales tax surcharge.

- **How are TSTD boundaries established?**
  TSTD boundaries are typically established according to criteria in State authorizing law. To generate sufficient revenue, TSTDs tend to be large geographically. As a result, they are often established to fund projects of jurisdictional or regional significance.

- **How is the TSTD surcharge determined?**
  Determining both the TSTD surcharge rate and boundaries typically involves balancing political, technical, and legal considerations. At a technical level, the desired revenue is divided by the total value of taxable sales to derive a tax rate. State statutes often establish a maximum surcharge rate. The boundaries of the TSTD need to be large enough that the technical calculation derives a tax rate that is within State-sanctioned limits.

  At a political level, taxpayers often object to tax increases unless they believe that they derive a direct benefit. To facilitate acceptance, TSTD boundaries are typically limited so that those affected by the higher tax will benefit from the facilities or services being paid for. On the other hand, if the surcharge is noticeable to consumers, consumers might be motivated to make purchases outside of the TSTD to save money. To keep the surcharge rate small and minimize tax avoidance, TSTD boundaries could be expanded.

- **Are there tests for constitutionality?**
  Courts typically require that State and local legislatures demonstrate reasons for enacting legislation. This is known as the "rational basis test."[xv]

  However, regarding taxes or fees, aggrieved parties may claim that there was a "taking" of their property without compensation or a lack of uniformity (discrimination). These claims prompt courts to undertake a higher standard of review. .To satisfy this standard of review, the legislative findings of TSTD implementing ordinances will typically reflect a process determining that economic activity within the proposed TSTD boundary receives a direct and special benefit from a proposed transportation project or service to be paid for, at least in part, by a proposed sales tax surcharge. This entails showing that a "rational nexus" between the transportation project or service and the benefits bestowed upon sales activity within the TSTD boundary and that the sales tax levy is proportional to (and does not exceed) the benefits conferred. [xvi]

  As with all value capture techniques, practitioners are advised to consult with legal counsel familiar with the case law in their State.

- **Are the analyses described above performed once or updated periodically?**
  This is determined by both State authorizing legislation and local implementing ordinances. Typically, because sales volume and value will vary over time, rates might need to be adjusted. Typically, State authorizing legislation imposes a limit on incremental increases and a maximum rate that cannot be exceeded.
  As with all value capture techniques, practitioners are advised to consult with legal counsel familiar with the relevant statutory and case law in their State.

Is a transportation sales tax simply another tax?

Yes, a transportation sales tax is a tax, not a fee. All those making taxable purchases within the TSTD must pay the additional sales tax, unless there are exemptions for particular types of goods or services.

How does a TSTD relate to a jurisdiction's capital improvement plan?

A capital improvement plan (CIP) is a State or local planning document containing all the individual capital projects, financial plans, and major studies for a State or local government. A CIP looks beyond a federally required, fiscally constrained plan and includes projects outside of the fiscally constrained plan. Construction and completion schedules can also be included. The plan provides a working blueprint for sustaining and improving the community's infrastructures. It coordinates strategic planning, financial capacity, and physical development.

A Transportation Improvement Program (TIP) is a four-year, fiscally constrained document required for metropolitan planning organizations (MPOs). The TIP lists all transportation projects in an MPO's metropolitan planning area that use Federal transportation funding. Detailed requirements for TIPs and the MPO transportation planning process are located in 23 CFR part 450. There are similar requirements, also found in 23 CFR part 450, for State Transportation Improvement Programs (STIPs).

Sales tax revenues are a source of funds that could be used to fund capital projects, including transportation projects, partially or in their entirety. They could also be a source of matching funds for grants from other levels of government.

Are there any special accounting procedures associated with a TSTD?

When a TSTD is created and its sales tax surcharge rate determined pursuant to the authorizing statute and local ordinances, the local tax authority instructs affected retailers to adjust the sales tax they collect. The tax authority will typically use its own accounting system to calculate the TSTD revenues as a portion of revenue received from affected retailers. The tax authority will then deposit the TSTD revenue into a special bank account. Accumulated revenues will be spent on projects or distributed to agencies pursuant to requirements in the implementing ordinance.

What are some examples of TSTDs?

Missouri: Missouri allows counties and districts to impose special sales taxes dedicated to transportation projects or transit services.[xvii] A TSTD was used to expand U.S. Highway 63 from two to four lanes between Kirksville and Macon. Project costs were $37.4 million. Roughly 30 percent of the project cost was covered by sales tax revenues of approximately $11.5 million, which were used to meet debt obligations. The remaining funding was provided by the Missouri Highway and Transportation Commission. The sales tax revenues were collected by the city of Kirksville and paid through the Highway 63 Transportation Corporation, giving taxpayers confidence that the funds were dedicated only to the project. Sales tax revenues began coming in before construction. The duration of the sales tax was 10 years, ending in 2013. By using this revenue source, local sponsors were able to avoid a 20-plus-year delay caused by statewide funding constraints.[xviii]

Georgia: In 2010, the [Transportation Investment Act][xix] provided an opportunity for regions throughout Georgia to impose a special-purpose, local-option sales tax (TSPLOST) to fund transportation improvements within their respective regions.[xx] Only three of the 12 regions were successful in passing the tax in 2012. To provide another transportation funding option, the Georgia legislature passed a single-county TSPLOST in 2015.[xxi] The single-county TSPLOST allows individual counties that are not part of a regional effort to levy a sales tax solely dedicated for transportation purposes. To implement a TSPLOST, a county must hold a referendum and obtain approval from voters.[xxii]

Illinois: Sales taxes imposed by mass transit districts and collected and distributed by the Illinois Department of Revenue are an important source of funding for local public transportation providers. State law establishes two regional transit sales tax districts:

- Metro-East Mass Transit District[xxiii]
- Regional Transportation Authority (Chicago)[xxiv]

Kansas: State law authorizes cities and counties to create TSTDs, which are called transportation development districts. The law also authorizes cities or counties to issue revenue bonds payable from sales tax revenues.[xxv] Kansas also directs approximately 16 percent of the revenues from the State sales tax to the State

Highway Fund.[xxvi] Therefore, the entire State could be considered to be a TSTD.

Virginia: A 2013 State law made significant changes to how transportation is funded in Virginia. Among other changes, the law increased the State sales tax from 5 percent to 5.3 percent. Of this increase, 0.175 percent is dedicated to highway maintenance and operations, 0.05 percent is reserved for intercity rail, and 0.075 percent is reserved for mass transit. The law also imposed an additional 0.7-percent sales tax in the counties and cities of the Northern Virginia Transportation Authority and the Hampton Roads region. The law requires that revenues from the additional sales tax be spent only on transportation projects in those areas.[xxvii] Another State law enacted in 2020 created a similar TSTD for the Richmond area.[xxviii]

RESOURCES

FHWA EDC-5 Value Capture: Capitalizing on the Value Created by Transportation

https://www.fhwa.dot.gov/innovation/everydaycounts/edc_5/value_capture.cfm

FHWA Center for Innovative Finance Support – Value Capture

https://www.fhwa.dot.gov/ipd/value_capture

FHWA Center for Innovative Finance Support – Sales Tax Districts

https://www.fhwa.dot.gov/ipd/value_capture/defined/sales_tax_districts.aspx

---

[i] Sharada Vadali, "*Using the Economic Value Created by Transportation to Fund Transportation*," NCHRP Report 429, 2012, page 21.
[ii] FHWA, "Value Capture Implementation Manual," Section 6.4.2 at https://www.fhwa.dot.gov/ipd/value_capture/resources/value_capture_resources/value_capture_implementation_manual/ch_6.aspx#6_4
[iii] Id.
[iv] FHWA Value Capture Implementation Manual, https://www.fhwa.dot.gov/ipd/value_capture/resources/value_capture_resources/value_capture_implementation_manual/ch_6.aspx#6_4 . In particular, see section 6.4.5.
[v] Todd Goldman and Martin Wachs, "A Quiet Revolution in Transportation Finance: The Rise of Local Option Transportation Taxes," Transportation Quarterly, Vol. 57, No.1, Winter 2003 (19–32).
[vi] Rick Rybeck, "Funding Infrastructure to Rebuild Equitable, Green Prosperity," in *Revitalization News*, Issue #7, July 15, 2015 at https://www.justeconomicsllc.com/pdfs/Revitalization%20News%20-%20Funding%20Infra%20To%20Rebuild%20Equitable%20Green%20Prosperity%20July%2015%202015.pdf .
[vii] FHWA Value Capture Implementation Manual, https://www.fhwa.dot.gov/ipd/value_capture/resources/value_capture_resources/value_capture_implementation_manual/ch_6.aspx#6_4 . In particular, see section 6.4.5.
[viii] Ibid.
[ix] Ibid. In particular, see section 6.4.2.
[x] Ibid.
[xi] Ibid.
[xii] FHWA Value Capture Implementation Manual, https://www.fhwa.dot.gov/ipd/value_capture/resources/value_capture_resources/value_capture_implementation_manual/ch_6.aspx#6_4 . In particular, see section 6.4.5.
[xiii] FHWA Value Capture Implementation Manual, https://www.fhwa.dot.gov/ipd/value_capture/resources/value_capture_resources/value_capture_implementation_manual/ch_6.aspx#6_4 . In particular, see section 6.4.5.
[xiv] FHWA Value Capture Implementation Manual, https://www.fhwa.dot.gov/ipd/value_capture/resources/value_capture_resources/value_capture_implementation_manual/ch_6.aspx#6_4. In particular, see section 6.4.3.
[xv] Black's Dictionary of Law, Abridged Fifth Edition, (West Publishing Co.) 1983, p. 655. While the rational basis test is a low bar, it is higher than no bar. On the one hand, the U.S. and State constitutions protect individuals from arbitrary and capricious laws. On the other hand, courts do not want to second-guess the wisdom or rationality of elected legislators, generally deferring to the judgement of voters in this regard. However, the courts do look to see if the legislature has provided some basis for their action.
[xvi] These concepts come from case law, including the U.S. Supreme Court decisions in Koontz v. St. Johns River Water Management District, 570 U.S. 595, 614 (2013), Nollan v. California Coastal Commission, 483 U.S. 825 (1987), and Dolan v. City of Tigard, 512 U.S. 374 (1994). These cases refer to development impact fees and exactions, but their concepts have also been applied to special assessment districts. A TSTD is similar to a special assessment district except for the fact that sales taxes are used as the revenue source in lieu of the property tax. The "rational nexus" test requires that the local government demonstrate a reasonable connection between the need for the additional infrastructure investment, the cost of that additional infrastructure, and the benefit that accrues as a result of the additional infrastructure. The "rough

For additional information, please contact:

Stefan Natzke
FHWA Office of Planning, Environment, and Realty
(202) 366-5010
Stefan.Natzke@dot.gov

Thay Bishop
FHWA Center for Innovative Finance Support
(404) 562-3695
Thay.Bishop@dot.gov

proportionality" test requires demonstrating that the additional sales tax charged is proportional to (and does not exceed) the infrastructure benefits deemed to result in increased sales.

[xvii] Missouri Department of Revenue, Local Government Tax Guide, Form 4890, revised July 2020, https://dor.mo.gov/forms/4890.pdf.

[xviii] FHWA has written a short case study about this project; it is available at: https://www.fhwa.dot.gov/ipd/pdfs/value_capture/case_studies/us_63_missouri_sales_tax_district.pdf.

[xix] http://www.ga-tia.com/Home/

[xx] O.C.G.A Title 48, Chapter 8, Article 5. More information about the Georgia Transportation Investment Act is available at: http://www.ga-tia.com/.

[xxi] O.C.G.A Title 48, Chapter 8, Article 5A.

[xxii] O.C. G. A. § 48-8-269.24.

[xxiii] 70 ILCS 3610/5.01 *et seq*.

[xxiv] 70 ILCS 3615/4.03 *et seq*.

[xxv] KSA 12-17,140 *et seq*., as amended.

[xxvi] KSA 2016 Supp. 79-3620.

[xxvii] Virginia 2013 Uncodified Acts, Chapter 766.

[xxviii] Va. Code Ann. 33.2-3700 *et seq.*