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Lawrence J. Rich*

What happens to taxes after we pay them? How do they find their way from governmental transfer to governmental transfer, and to final expenditure? The Ohio Local Government Fund is a very unusual and controversial transfer of funds from one governmental unit to another. The Fund is so much in a fog at times that the Ohio Supreme Court has tried eight times to interpret the statutes pertaining to the distribution of the Fund. The Ohio Board of Tax Appeals has been appealed to numerous times to settle disputes.

What is the Local Government Fund?

The Local Government Fund is a form of financial state support to the smaller governmental units of the state of Ohio. This type of support is found in most other states of the nation, but Ohio's distribution system is distinctive.

The Local Government Fund is made up of part of the state collected sales tax receipts and the state collected tax on "capital employed by financial institutions and dealers in intangibles." These funds are then transferred to the several counties proportionately for distribution to the local subdivisions. Thus,

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1 Ohio Rev. Code, Secs. 5739.21, 5739.22, 5739.23.
3 Ohio Rev. Code, Sec. 5705.37.
4 Id., 5739.21.
5 Id., 5725.24.
6 Id., 5739.22, 5739.23, Local subdivisions which may receive Local Government Funds are the county governments, municipal corporations, park districts, and townships (5739.20) and municipal universities.
the state has taken a novel approach in taxation by distributing the funds according to governmental units rather than functions. For instance, a distribution by function would be a return of gasoline tax funds to taxing districts in proportion to their miles of roads. A return to "governmental units" is a return of funds to a subdivision and not to reward a function. The Local Government Fund in Ohio has been marked with controversy and litigation.

This paper will briefly explain the history of the Local Government Fund in Ohio, trace its changes, examine the statutes involved as well as the court decisions, explain the position of other states in their distribution of sales tax monies, and examine possible shortcomings and possible improvements in the present system of distribution.

History

The Local Government Fund was created because of the depression of the early thirties and the damaging effect it had on local governments. Property tax payments were lagging far behind the actual levies. Funds were needed for poor relief. On top of all this in November 1933, the unvoted millage allowed local subdivisions was reduced by one third from 15 mills to 10 mills. Thus the local subdivisions were very hard pressed for funds. The General Assembly of Ohio in 1934 passed the Ohio Sales Tax Act.

Section 5739.02 of the Revised Code of Ohio states that one of the purposes of the sales tax law is "for the support of local government functions." Thus the General Assembly now had the problem of how to distribute these funds to the local subdivisions. They chose to send the funds back to the county budget commission and have the commission distribute them according to need, to the local subdivisions of the county.

At first only a certain per cent of the sales tax became part of the fund. It was 40% of what remained after everything else had been paid out. In and after 1939, a specific number of dollars was credited to the fund.

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7 Ohio Legislative Service Commission, Local Government Fund in Ohio 4, 8 (1957).
8 Ohio Rev. Code, Secs. 5705.27, 5705.32; the County Budget Commission consists of the county auditor, the county treasurer, and the prosecuting attorney.
9 Ohio Legislative Service Commission, Local Government Fund in Ohio 9 (1957).
October 1, 1947, saw a large increase in funds to the Local Government Fund. The tax on deposits in financial institutions and dealers in intangibles was added to the fund. Today throughout Ohio the tax on intangibles produces more money for the Fund than does the sales tax.

Section 5739.23 of the Revised Code was amended in 1957 to give credit to the participants in the Fund who helped themselves by levying voted taxes. The General Assembly in August of 1965, passed House Bill 376 which now transfers the welfare functions to the county government and takes part of the cost and functions away from the municipalities. The extra funds to help pay the counties' portion of the cost may be deducted from the municipalities' portion of the Local Government Fund by the budget commission.

The Local Government Fund in Operation

The State Government transfers the sales tax funds to the county budget commission in the proportion that the population and tax valuation of the county bears to the entire state. Every two years the General Assembly of Ohio appropriates a certain amount of money to be distributed using this formula as stated in the previous sentence. For the years 1964-1965 this amounted to $24,000,000 each year. The State collected taxes on deposits in financial institutions and on dealers in intangibles are returned entirely to the county where they were collected and then distributed as part of the Local Government Fund by the budget commission.

A group of three county officials designated as the budget commission, then have the responsibility of allocating these funds to the participating subdivisions. The budget commission is composed of the County Auditor, the County Treasurer, and the Prosecuting Attorney. The taxing districts entitled to partici-
pate in the allocation by the budget commission are the cities, villages, townships, park districts, municipal universities, and the county government itself.\textsuperscript{17} The budget commission allocates these funds among the above mentioned taxing districts according to \textit{need}.\textsuperscript{18} This is done once each year. The job is to be completed by September 1, but the budget commission may receive an extension of time from the Board of Tax Appeals of the Department of Taxation for a good cause.\textsuperscript{19}

\ldots \ldots \textit{the commission shall apportion the estimated amount of the undivided local government fund of the county among the subdivisions in which need for additional revenues has been found, in proportion to the amount of the needs of each as so determined. \ldots} \textsuperscript{20}

The budget commission cannot act until each subdivision has been extended "an opportunity to be heard and considering all the facts and information presented to it by the auditor."\textsuperscript{21} One of the other pieces of information required is the annual tax budget of each taxing district. This budget must be filed with the county auditor by the July 20th of the year preceding the year for which the budget commission will be allocating the Local Government Fund.\textsuperscript{22} The budget carries with it the subdivision's official request for Local Government Funds. Many of the requests in actuality are quite optimistic. Others are understated.

The funds received from the Local Government Fund by the local subdivisions are to be used for current operating purposes.\textsuperscript{23} Section 5705.01 of the Revised Code of Ohio defines this as an expenditure which does not have an estimated life of over 5 years. The statute sets a maximum allocation to county governments and a minimum to townships.

House Bill 376 passed in August of 1965, directs the budget commission to add another factor to its final determination of need. The budget commission must subtract from the cities' allocation and add to the county governments' allocation certain welfare costs. The budget commission, after determining how

\textsuperscript{17} Id., 5739.23, as defined in 5739.20.
\textsuperscript{18} Id., 5739.23.
\textsuperscript{19} Id., 5705.27.
\textsuperscript{20} Id., 5739.23.
\textsuperscript{21} Id., 5739.23.
\textsuperscript{22} Id., 5705.30.
\textsuperscript{23} Id., 5739.23.
much each participating subdivision needs, notifies the subdivision of the commission's decision.

Appeals from the Action of the Budget Commission

The Ohio Statutes provide in Section 5739.25 that the Board of Tax Appeals shall be the first step in the appeal from the action of the budget commission. Section 5705.37 of the Ohio Revised Code provides as follows:

The taxing authority of any subdivision which is dissatisfied with an action of the budget commission may, through its fiscal officer, appeal to the Board of Tax Appeals within thirty days after the receipt by such subdivision of the official certificate or notice of such action of said commission. * * * The Board of Tax Appeals shall forthwith consider the matter presented to the commission, and may modify any action of the commission with reference to the budget, the estimate of revenues and balances, or the fixing of tax rates. The finding of the board of tax appeals shall be substituted for the findings of the commission, and shall be certified to the county auditor and the taxing authority of the subdivision affected, * * *. 24

The Ohio Supreme Court in Board of County Commissioners of Clark County vs. Budget Commission of Clark County stated:

The Board of Tax Appeals in considering 'the matter or matters presented to the budget commission' may consider any evidence which is proper in order to arrive at a true factual conclusion as to the apportionment of the local government fund of the county. In determining the needs of the subdivision, the Board of Tax Appeals can not go beyond the 'matter or matters' that were within the power of the budget commission to hear and determine. It is not the intent of the statute, however, that the Board of Tax Appeals on such an appeal shall be limited in the scope of its inquiry to facts actually adduced before the budget commission. 25

The Ohio Supreme Court stated in the first syllabus in Budget Commission of Lorain County v. Board of Tax Appeals, 26 that:

24 Id., 5705.37.
25 Board of County Commissioners of Clark County v. Budget Commission of Clark County, supra note 2.
26 Budget Commission of Lorain County v. Board of Tax Appeals and City of Oberlin, supra note 2.
... the board (of tax appeals) hears and considers the controversy *de novo* and may make such modifications and changes in the allocations to the county and the various subdivisions thereof as the evidence discloses should be made upon a consideration of the relative additional needs of the governmental units affected and other relevant and controlling factors. 27

The next step in appeal after the Board of Tax Appeals is either to the Supreme Court or to the Court of Appeals of Ohio. 28 In dealing with an appeal to a higher court it was determined that:

On appeal, a final decision, entered by the Board of Tax Appeals in a case within the limits of its jurisdiction will be reversed or modified only where the record clearly discloses that such decision is unreasonable or unlawful. 29

A very important decision on questions of procedure and jurisdiction on appeal was expounded by the Ohio Supreme Court in *Brooklyn v. Budget Commission*. A thorough reading of this case is recommended. Briefly the court said that since the Board of Tax Appeals hears a case *de novo* all subdivisions entitled to participate in the fund must be made a party to an action for appeal. In this case only twenty-one of the sixty-one subdivisions were made parties, thus the Board of Tax Appeals had no jurisdiction to hear this matter and the Board's decision was unreasonable and unlawful. The Supreme Court then went on in detail to explain that it had jurisdiction to decide the above question. The court did not rule on the merits of the case. 30

**Criteria for Determining Need**

The courts have made some attempts to help the Budget Commissions determine need. Section 5739.23 of the Revised Code of Ohio pertains to the allocation by the budget commission. This statute was amended three times in 1957. The Ohio Supreme Court in *City of Troy v. Miami County* 31 construed this statute and stated that:

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27 Ibid.

28 Ohio Rev. Code, 5717.04.


Where the General Assembly enacts the same section of the Revised Code by three separate acts, effective at the same time, . . . and which acts, considering the purpose of each are not in conflict with each other, each act of the General Assembly must be given equal effect, and such amended section of the Revised Code must be taken and construed as a composite of all three acts.\(^\text{32}\)

The court constructed the statute as reading in the pertinent parts as follows:

The auditor shall present to the commission, when so convened, the certificate of the board, the annual tax budget and estimates, and the records showing the action of the commission in its last preceding regular session. The commission, after extending to each subdivision an opportunity to be heard, and considering all the facts and information presented to it by the auditor, shall determine the amount needed by each subdivision for current operating expenses for the last six months of ** * 1957 in addition to revenues available from all other sources, except those revenues which a subdivision receives from an additional tax or service charge voted by its electorate, in order to enable it to carry on its essential local governmental functions. ** *

The commission shall apportion the estimated amount of the undivided local government fund of the county among the subdivisions in which need for additional revenues has been found, in proportion to the amount of the needs of each.\(^\text{33}\)

This case also established that in determining need the budget commission shall disregard levies voted by the people from its determination of need. Thus the court would not prevent a subdivision from getting Local Government Funds just because its electorate helped themselves by voting an additional tax.\(^\text{34}\)

In determining needs of a subdivision, the budget commission must in determining current operating expenses look beyond the expenses shown in the "general operating fund portion of a political subdivision's annual tax budget."\(^\text{35}\) Thus, the reviewing court or the Board of Tax Appeals or the budget commission must look at other funds, other than the General Fund, such as

\(^{32}\) Ibid.

\(^{33}\) Id. at 424.

\(^{34}\) City of Troy v. Miami County Budget Commission, supra note 2.

\(^{35}\) City of Lancaster v. Fairfield County Budget Commission, supra note 2, at 165.
a Fire Fund, Street-Lighting Fund, or a Police Fund. The courts have also said:

The fact that a political subdivision has a balance at the close of a fiscal year in the fund which may lawfully be used for current operating expenses, or in a special levy fund out of which disbursements are made and which disbursements are properly payable from the general fund does not affect the amount needed for current operating expenses. The court went on to say, the funds are to be distributed on the basis of need for a given period of time without reference to the special tax revenues and without deduction for balances acquired by the economical operation of these small governmental units.\textsuperscript{36}

Thus, the court has come to the conclusion that in determining need a local subdivision should not be "penalized for assuming an additional tax burden."\textsuperscript{37}

Since the term need is so nebulous, the Supreme Court of Ohio was called on again in 1964 to determine need. It said:

\textit{Relative} additional need is the criterion, and the allocation to all governmental units affected is to be made with such governing criterion in mind.\textsuperscript{38}

The Board of Tax Appeals in the case of \textit{Budget Commission of Lorain County v. City of Oberlin} said it considered these factors in determining need:

\begin{itemize}
  \item prior years general fund expenditures, tax duplicate valuations, anticipated revenues from other sources, population increases, annexations, items of capital or permanent improvements contained in the proposed expenditures from the general fund as set out in the budgets, inflated estimates of needs contained therein, self-help by way of voted levies outside the ten-mill limitation for current operating funds by the electors of some of the subdivisions, prior years economical operations as indicated by general fund balances on January 1, 1963, and all other pertinent factors.\textsuperscript{39}
\end{itemize}

The argument was also brought up in \textit{Budget Commission of Lorain County v. Board of Tax Appeals} questioning whether need should take into consideration, "revenues which have not been tapped as resources but are permitted under the laws of the

\textsuperscript{36} Ibid.
\textsuperscript{37} Id., at 166.
\textsuperscript{38} Budget Commission of Lorain County v. Board of Tax Appeals, City of Oberlin, \textit{supra} note 2.
\textsuperscript{39} Id., at 102.
state of Ohio." The court had rejected this contention in similar cases in finding that:

The trouble with this argument is that the statute expressly refers to revenues available, and such expression can hardly be enlarged to include revenues which could or might be made available by the levy of additional taxes. It is not the function of the budget commission or the Board of Tax Appeals upon appeal to go back of the findings of the relative needs of the various subdivisions and attempt to ascertain and determine whether faulty financing or administration brought about or augmented such need.

The question has arisen whether or not the budget commission may use a formula in arriving at need. The Supreme Court stated that:

Neither the budget commission nor the Board of Tax Appeals can be controlled by any set formula in apportioning a local government fund. Formulas may be employed where helpful so long as its decision is neither unlawful nor unreasonable.

Thus a formula can be used as long as it brings an allocation which is equitable.

The Brooklyn case was very interesting. The plaintiffs on appeal to the Board of Tax Appeals only entered into evidence the tax budgets and a worksheet based on a formula drawn up by a tax consultant. (I was the representative of the Cuyahoga County Auditor's office and testified to the validity of the tax budgets.) The defense offered no evidence at all. The plaintiffs contended that the worksheet which contained a formula for allocating the local government funds was the correct allocation. The Board of Tax Appeals upheld the budget commission. The Supreme Court never ruled on the value of the formula because of the question of jurisdiction discussed above. If the court had discussed the merits and demerits of the formula, the budget commission of Ohio would have had more criteria upon which to base their allocations.

40 Id.
41 Id., at 103.
42 Thatcher v. Columbus, supra note 2, at 477.
43 Clark County v. Budget Commission of Clark County, supra note 2, at 639.
44 Brooklyn v. Cuyahoga County Budget Commission, supra note 2.
Distribution of Sales Tax in Other States

I have examined the laws of all other states pertaining to their distribution of sales tax monies. I have not found any which use the novel approach which Ohio uses in allocating state support to smaller governmental units by a discretionary committee. At the present time forty states and the District of Columbia levy sales taxes. Forty-two states and the District of Columbia pay the sales tax monies directly into the general operating fund of their state to be mixed with other revenue. Thus, these funds are not segregated in any way and are not committed to any specific purpose.

Three of the states commit the sales tax funds directly into categories other than a general purpose fund. Pennsylvania has the funds committed for public education. Oklahoma earmarks the funds for state assistance to the needy. Colorado pays the funds directly into the State Public Welfare Fund.

Six states direct part of the funds to their state general fund and allocate the remainder for other purposes. The funds are sent back to the cities and villages based on a formula. Funds

45 Prentice-Hall, Sales and Use Taxes—All States, 92,903 (1965).

46 Ark. Stat. 84-1918.
    Ga. Code Annot. 92.3443 A.
    Ill. (Smith-Hurd) Annot. Stat. 120/442.
    Ind. (Burns) Stat. 64-2621.
    Mo., V. A. M. S./144.180.
    Nev., R. S. 372-785.
    So. Dak., S. D. C. 57.3103.
    Tex., Taxation, Art. 20.13.

    Okla., 68 Okla. St. Annot. 1251 b.
    Penna., 72 P. S./3403—604.1.

48 Alaska, Stat./43.70-680.
    Conn., C. G. S. A. 12/427.
    Iowa, Code Annot. 422.62.
    W. Va., Code 999. (1) (30).
    Wis., Stat. Annot. 77.63.

49 Alaska, Wisconsin, supra note 48.
sent back to the school districts are based on per capita attendance.\textsuperscript{50}

The remainder of the states which levy a sales tax, distribute
the funds by formula for specific purposes.\textsuperscript{51} Thus, these funds
are earmarked, but there is no discretionary power as exists in
Ohio. The state legislatures of the various states have set specific
guidelines for the distribution of these funds. The formulas for
school purposes are generally based upon per pupil allocations.\textsuperscript{52}
Generally funds are distributed to cities and villages per capita.\textsuperscript{53}

\textbf{Should Ohio's System Be Changed?}

The Ohio system has many good, and many bad features. A
desirable feature of distribution on the basis of need is that ideally
a city which is highly industrialized would have a high tax
duplicate and need less funds from the local government. An
advantage of allocating the funds on the basis of need is the fact
that theoretically contingencies and inequities which are not able
to be overcome with a set formula will be corrected by the
budget commission appraising itself of the facts and not being
regulated by a formula. To do a good job, the budget commis-
sion must take a new look at the situation each year, noting
changes in population, tax duplicate, and other factors, and not
base its allocation on the previous year's allocation.

But, would inequities arise where two cities are somewhat alike, i.e. same population, tax rate, tax duplicate, and area, and one city performs more services for its constituents than does the other? Does the city which performs more services also need more Local Government Funds? Also, what are essential expenses? City X picks up rubbish and garbage from homes and

\textsuperscript{50} Arizona, \textit{supra} note 48.
\textsuperscript{51} Ala., Code, Tit. 51/784.
\textsuperscript{52} Florida, Michigan, New Mexico, South Carolina, \textit{supra} note 51.
\textsuperscript{53} Michigan, Washington, Tennessee, \textit{supra} note 51.
businesses twice a week. City Y picks up from homes only, once a month. Should City X's services be financed by the Local Government Fund? Does City X need more funds than City Y?

Another fault of the system seems to be that a municipal corporation is encouraged to levy more taxes to receive more Local Government Funds. The question also arises, of course, as to whether the Local Government Fund can become a political plum. For instance, if the budget commissioners are all of one political party, the municipal corporations which have administrations of the same party may be favored in the allocations. Also, the Local Government Fund may become a political shield. Recently a mayor running for reelection in a large city in Ohio promised the city employees that they would get a pay raise if the Local Government Fund allocation increased enough to cover the cost.

An example of the way the Local Government Fund may be abused is as follows: The city of North Olmsted on September 18, 1959, was allocated $611,040 by the Cuyahoga County Budget Commission. Section 5739.23 specifically states that funds are to be allocated for current operating expenses, yet these funds were allocated "to make capital improvements and for the construction of sewers." The Board of Tax Appeals also stated on appeal modifying the decision of the Budget Commission that it was "shocked to learn that the Cuyahoga County Budget Commission on September 18, 1959, allocated the 1960 Local Government Fund without having before it the officially adopted tax budgets," of Cleveland and Cuyahoga County. The Board of Tax Appeals reduced North Olmsted's allocation to $165,691.83.

In summary, I believe that Ohio's system is a good one. If the budget commissioners do a conscientious job, I believe their allocations are more equitable than those of a formula. It would, however, be desirable for the Ohio Supreme Court to set more definite guidelines in construing the word need.

54 City of Rocky River v. Cuyahoga Budget Commission and City of North Olmsted, Case No. 41659-41691, April 18, 1960.
55 Ibid.