Facing financial challenges, three cities in Illinois turned to city officials, who raised the local sales tax rate to generate funds in order to help the local school districts.

Good schools are an important component of a strong community. Therefore, it is in the best interest of both city government officials and school district officials for the local school district to perform well, both financially and academically. But does that mean that a city should be willing to share its tax revenues if school district officials request financial assistance from the city government?

When called upon to answer that question, three small to mid-sized cities in Illinois decided to increase their sales tax rates and share the revenues with their local school districts. Their experiences provide useful lessons for other jurisdictions under similar circumstances.

THE THREE CITIES

The cities of Carbondale, Mt. Vernon, and East Peoria, Illinois, were among the first in the state to share city sales tax revenue with one or more local school districts. Carbondale (population 26,000) and Mt. Vernon (population 16,000) are home-rule cities located in southern Illinois, and East Peoria (population 23,000) is a non-home-rule city located in central Illinois.

In Illinois, home-rule cities can raise the local sales tax in quarter percentage-point increments without obtaining voter approval. Non-home-rule cities must obtain voter approval to raise the sales tax, are constrained to a maximum rate of 1 percent, and must use the funds for public infrastructure or property tax relief. The non-home-rule sales tax statute did not originally include public schools as public infrastructure; however, the statute has been revised to include public schools for at least two communities that requested this change. The local sales tax is imposed on top of the state sales tax, which is currently 6.25 percent on most items.

THE REQUEST, AND THE RESPONSE

After two failed voter referendums for the construction of a new high school, school district officials in Carbondale approached the city government in the late 1990s requesting financial assistance for the proposed new facility. After a number of options were explored, the city proposed the idea of raising its home-rule sales tax to help finance a new school. At that time, the school district also was eligible for a construction grant from the state government.

The school district held another voter referendum for the construction of a new high school, and this time the referendum passed. Although the city sales tax increase was not mentioned in the referendum, local officials noted that the city’s role was well publicized prior to the referendum.

In 1999, the City of Carbondale raised its home-rule sales tax rate by a quarter of a percentage point, to 1 percent, bringing the total sales tax rate in Carbondale to 7.25 percent. The city agreed to give the school district...
$800,000 a year over the 20-year life of the bonds that were issued to finance the new school facility. This constituted more than half (57 percent) of the annual debt service on the $16 million bond issue.

About five years later, a similar situation occurred in East Peoria when officials from several school districts approached city officials requesting financial assistance. The grade school district wanted help in financing a new school facility, and two other districts wanted assistance with operational costs. The local high school was faced with a budget deficit and was trying to avoid cuts in staffing and extracurricular activities. After considering alternatives, city officials agreed to increase the non-home-rule sales tax and use the revenues to assist four local school districts (the fourth district was added prior to the final agreement).

East Peoria is a non-home-rule community; however, as a result of special state legislation that was previously passed in relationship to a tax increment financing (TIF) issue, East Peoria is allowed to raise its non-home-rule sales tax rate without voter approval. A school referendum was not necessary since the local elementary school district put its facility plans on hold when the state failed to appropriate funds for the state school construction grants program. The city and school districts held public meetings to discuss the proposal and to allow input from the public.

The East Peoria school districts initially asked for a sales tax increase of half a percentage point, but the city officials decided on a quarter percentage-point increase, which was expected to generate $800,000 a year. This increase brought the total sales tax rate in East Peoria to 8 percent, comparable to the rate in neighboring cities. The increase was imposed for 2.5 years, and the revenue was allocated among the four local school districts using a formula based on enrollment that was developed by the school districts.

In the City of Mt. Vernon, officials from the local high school district asked the city government for assistance to help address the district’s financial problems. The district had been experiencing an operating deficit in its education fund for several years. To obtain public input, the city held an advisory referendum on a proposal to increase the city’s home-rule sales tax by a quarter of a percentage point for a period of two years to assist the school district. The referendum passed, and the sales tax rate was increased in July 2003. The city agreed to share the sales tax revenues with the school district up to a maximum of $450,000 per year and to use the rest of the tax revenues for city purposes. (See Exhibit 1 for a summary of the three tax-sharing agreements.)

USE OF FUNDS

In Carbondale, the school district’s use of city funds was restricted to the debt service on the bonds for the new school facility. As of 2007, the quarter percentage-point city sales tax was generating about $1.1 million, so the extra $300,000 was being used for city purposes.

In Mt. Vernon, the home-rule sales tax increase generated $1.6 million over the two-year period. The high school district received $900,000, and the city retained the rest of the revenues. There was no written plan or intergovernmental agreement regarding how the funds would be spent, but local officials said the school district used the money for operational purposes. One official said he did not think many changes were made during the tax-sharing period to address the financial problems of the high school district.

In East Peoria, the city initially included a list of provisions that the school districts would have to accept in order to receive the sales tax revenues. The city wanted the school district to agree to the following conditions: conduct a study on the consolidation of two of the grade school districts; not increase the property tax rate except for limited purposes; continue to support the city’s economic development efforts, including possible expansion of the enterprise zone; furnish financial and statistical information to the city; implement...
cost containment measures; provide an accounting showing how the city revenue was used; and work with the city and a Mayor-appointed committee to address how the financial condition of the school districts could be improved.

The committee was formed with representatives of the school district and community, with the superintendents and the city manager serving ex-officio. This committee recommended consolidating the two grade school districts, decreasing costs through joint purchases, and making the sharing of city tax funds contingent on test score improvements. The school districts objected to the conditions, with at least one school board member questioning if the city council could legally control the school district's spending decisions.\(^2\)

In the end, the conditions were not enacted, and the school districts had significant discretion in how the funds could be used. The districts used the money for energy efficiency projects, after-school programs, and counseling. Initially, the high school district used the money to replace student desks and textbooks, and to make repairs; however, the focus then shifted to the funding of a team-teaching approach that included the hiring of classroom aids.

**ADDITIONAL REQUESTS**

There has been additional interest in using tax-sharing agreements in the three cities. In Mt. Vernon, the high school district officials requested additional city assistance to help fund a local match for a state grant for the construction of a new high school. The city's share was not to exceed $800,000 per year for up to a maximum of 30 years. The city revenue source was not specifically identified; however, the two main options discussed were an increase in the sales tax or the fuel tax.

The city and school district held public meetings to discuss the proposal, followed by a voter referendum for a new high school facility in 2007. The referendum did not address the proposed agreement with the city; however, local officials noted that the city's role was widely publicized. The referendum failed. Local officials identified various factors that may have contributed to the defeat, including emotional attachments to the old high school facility, uncertainty regarding where the city funds would come from, questions regarding the appropriateness of using city funds, and dissatisfaction among some residents that there was not a separate referendum on the city's role in the financing.

The City of East Peoria also received a request from the local elementary school district and the high school district to extend the tax-sharing agreement to generate funds for constructing school facilities. After a series of meetings and presentations, the city decided to extend the city sales tax increase and use the revenues to pay debt service on bonds issued by the two school districts for facility additions and improvements. As part of the intergovernmental agreements, the school districts agreed to support an extension and expansion of TIF districts upon request by the city. The high school district also agreed to allow the city to use the high school district's stadium when it would not impose a conflict with events sponsored by the school district.

Downstate, Southern Illinois University Carbondale (SIUC), a university with enrollment of approximately 22,000, was undertaking fund raising for a project that would include replacing a sports stadium and reconstructing a basketball arena. The mayor of Carbondale proposed the idea of raising the city sales tax to provide financial assistance for this project. Although some city officials questioned whether the city should assist a state institution when the city had its own needs, in 2007 the city council voted 4 to 3 in favor of raising the city sales tax by half a percentage point and using half of the increase for city projects, and committing the other half to the debt service for the university initiative. The city has pledged $1 million per year to SIUC over a 20-year period.

**LESSONS LEARNED**

When approached for help, a city may be able to offer financially challenged school districts some type of assistance in the short-run, or help with the financing of a particular project, such as the construction of a new school facility. This is especially true when the city has access to a revenue source such as the local sales tax that is not directly accessible to school districts. If the public believes that the school district has legitimate needs, then raising the sales tax rate to support those needs can be more politically feasible than having the school district raise the property tax. The sales tax is less visible, is not paid in a lump sum, and part of the burden typically is borne by nonresidents. In one of the jurisdictions discussed in this article, the local paper estimated that about 70 percent of the sales tax is paid by nonresidents.\(^3\)

If a city is considering raising the sales tax rate to help the school district, it is important to check what is legally allowed within a particular state. States vary in terms of whether this type of agreement is allowed, the types of provisions that are allowed, how the funds can be used, and the procedures required to approve a tax-sharing agreement.

It is also a good idea for city officials to address how the school district will
use the funds. One local official noted that sharing city revenues for a new school facility appears to be a win-win situation, but that using city funds to address the financial operating problems of a school district should be avoided. In the latter scenario, he noted, the school district might not make many changes during the period in which city funds are received, in essence putting off the changes that will ultimately be needed to balance the budget. This is not always the case, however; in the case of the East Peoria high school district, the superintendent noted that the district made changes to its operating budget during the tax-sharing period, leading to a balanced budget after the original agreement expired.

City officials should think about how the proposed sharing of tax revenue would affect the city’s ability to finance competing needs. As illustrated in Mt. Vernon’s original agreement with the school district and the City of Carbondale’s agreement with the university, one option is to increase the local sales tax rate and designate one portion of the increase for financing the city’s needs and the other portion for school needs.

The city and the school district need to educate the public and determine whether the public supports the use of the sales tax to help the school district. Even if a city is not required to obtain voter approval, it is still prudent to hold public hearings and provide a means for alternative views to be presented and discussed.

If it does decide to raise the sales tax rate in order to help the school district, the city will need to prepare a resolution authorizing the increase. It is also helpful to develop a written intergovernmental agreement describing the structure and nature of the arrangement. The participating entities need to address the terms of the agreement (e.g., how much the sales tax will increase, how much the school district will receive, the length of the agreement). They may also want to address other issues such as how funds can be used, what type of reporting or approval process will be used, and what happens if sales tax revenues are less than what was anticipated. East Peoria, for example, included a provision stating that the city’s sharing of tax revenue would be decreased if projections indicated that actual sales tax revenues would be less than the amounts the city received in either 2003 or 2004.

After the agreement is implemented, it is useful for the parties involved to assess what went well and what could be improved. This information will be important if a similar situation arises in the future or if other jurisdictions request advice or information on sales tax sharing. (Exhibit 2 summarizes the steps in the review and approval process.)

**OTHER COMMUNITIES PURSUE OPTIONS**

A law passed by the Illinois Legislature in late 2007 gave voters in Illinois counties the authority to establish a local option sales tax for school facility purposes (e.g., construction, rehabilitation, financing). With voter approval, a county school facility sales tax can be imposed in quarter percentage-point increments up to a maximum of 1 percent. The sales tax proposal can be placed on the ballot through a resolution by the county board or a resolution by school district boards that constitute at least 51 percent of the student enrollment within the county. The funds are distributed among the county’s school districts on the basis of student enrollment. As of early 2008, the voters in one county had approved an increase, and other school boards were discussing this option.

Other municipalities in Illinois also are planning to share city tax revenues with school districts or are doing so. For example, in 2007, the voters in the non-home-rule Village of Forsyth, Illinois (estimated population 3,500), approved
a referendum to increase the village sales tax for public infrastructure. The village will transfer the revenues from a sales tax increase of half a percentage point to the school district, which will use the funds to pay debt service on bonds that were issued to finance a new school facility. The plan is for the school district to repay the village annually over a specified time period. The village and school district are discussing joint uses of the new facility. In the Chicago metropolitan area, the Village of Lincolnwood (population 12,400) agreed to share specified sales tax revenues with the school district in exchange for the district’s support of Village TIF districts and efforts to become a home-rule community.

CONCLUSION

Is it reasonable to expect a city government to share tax revenues when a local school district requests financial assistance? One local official’s answer to that question was that it is the taxpayers’ money — let them decide. This would entail educating the public and then having a voter referendum, or using some other means to determine if there is sufficient public support. In about a dozen states, voters have the authority to approve a local option sales tax to be used for school purposes. As one local official noted, each community is different. The city and school district need to work together to discuss options and determine if there is sufficient support for some type of joint effort.

Notes
6. In the case of Forsyth, the state legislature revised the definition of public infrastructure to include public schools.
8. Gary Kelly, Utilization of a Local Sales Tax to Provide a Source of Revenue for Three Selected Illinois School Districts, a dissertation prepared at Southern Illinois University at Carbondale, December 2006. This dissertation is a good source of additional information on the initial tax-sharing agreements developed in the three cities addressed in this article.

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