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Local Option Sales Tax Analysis for Hermantown, MN

ESTIMATED CONTRIBUTIONS OF RESIDENTS AND NON-RESIDENTS TO A LOCAL OPTION SALES TAX

Authored by Ryan Pesch and John Bennett



REPORT SPONSOR: CITY OF HERMANTOWN, MINNESOTA

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City of Hermantown

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SUMMARY OF FINDINGS

University of Minnesota Extension conducted a study to estimate the proportion of sales proceeds attributed to both Hermantown residents and non-residents.

Using the most recent sales and use tax data available from the Minnesota Department of Revenue (MN Revenue), Extension estimated that non-residents account for 79.2 percent of taxable sales subject to a local option sales tax (LOST).

In 2020, total taxable sales reported by Hermantown businesses were \$312 million, although \$328 million in taxable sales were subject to the current 1% local option sales tax. The difference relates to some taxable sales unreported such as non-local construction or service firms which conducted businesses in the community or online transactions for pickup or delivery in Hermantown. With 79.2 percent of sales derived from non-resident spending, Extension estimated that Hermantown residents spent \$68.4 million of the total \$328 million in taxable sales subject to a LOST.

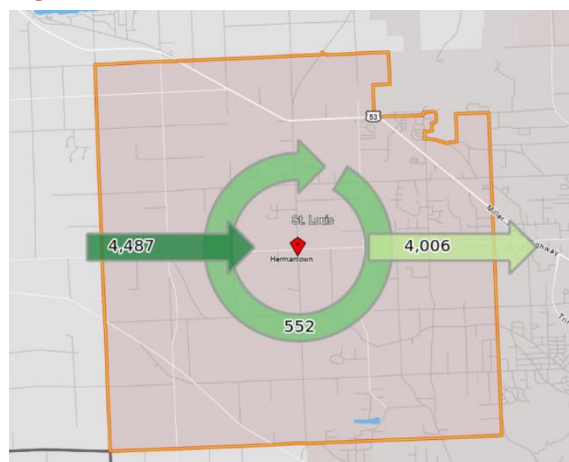
If the tax were in place in 2020, an additional 0.5 percent local option sales tax would have garnered \$1.6 million based on tax proceeds reported by MN Department of Revenue analysts. Hermantown residents would have contributed \$342 thousand in taxes, and non-residents would have contributed \$1.3 million. Based on these estimates, each Hermantown resident would have paid, on average, an additional \$33.44 in sales tax in 2020.

This report is based on a trade area analysis comparing actual taxable sales to potential sales. This is calculated by multiplying the Hermantown population in 2020 (MN Demographic Center) by the Minnesota average per capita sales for each category, and then adjusting for the county's personal income factor. This initial analysis provided an estimate of retail and service purchases made by Hermantown residents. For each merchandise group, the estimates for two types of purchasers—city residents and others—were calculated and adjusted considering the area economy. These adjustments were based on informed estimates and were aimed, in part, at reducing potential overestimates of the sales tax share attributable to non-residents. Assumptions and calculations are included for major retail and service categories so local decision makers can adjust totals if they have more nuanced insight.

Several factors and features of Hermantown's economy helped frame the analysis for the different merchandise categories:

- Hermantown has a large concentration of retail, especially for its population. The community is a major hub for retail goods in the Duluth metro area.
- Hermantown has a large proportion of its residents that leave for work (Figure 1). In this dynamic, commuters often shop for goods and services near where they work and those commuting into the city purchase in the city.

Figure 1: Hermantown worker in-flow and out-flow



Inflow and outflow of wage earners.

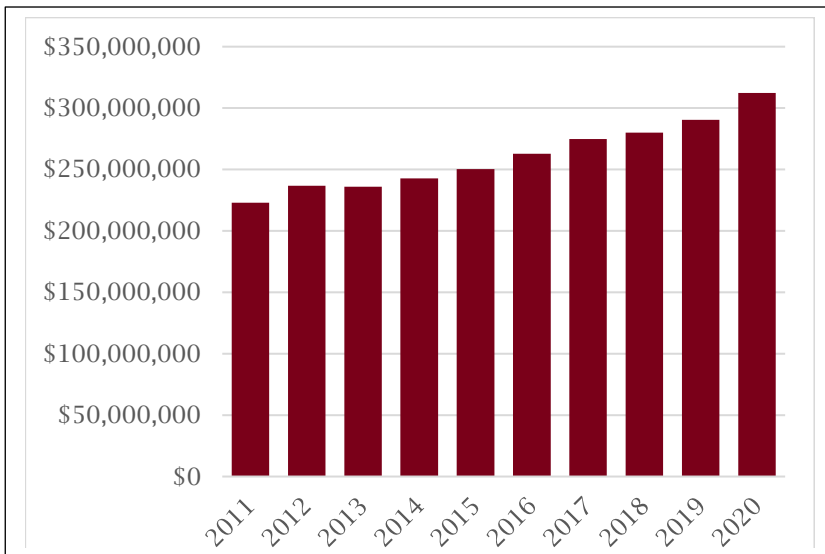
Source: 2019 U.S. Census Bureau On-The-Map

Figure 2 shows the estimated percentage of sales—across all merchandise categories—attributed to both residents and non-residents in 2020. These estimates are based on the adjusted analysis to reflect the city’s economic and consumption circumstances more accurately. Based on these findings, Extension estimates city residents represent 20.8 percent of all taxable retail and service sales subject to the tax (\$68 million), and the remaining 79.2 percent (\$260 million) are attributed to non-residents.

Figure 2: Estimated 2019 Taxable Sales Subject to LOST

	Taxable Sales	Percent of Sales
City residents	\$68,354,411	20.8%
Non-residents	\$259,550,089	79.2%

Figure 3: Taxable sales reported by local firms from 2011-2020



Source: Minnesota Department of Revenue

The total taxable sales in the city rose steadily from 2011 to 2020 (Figure 3). Total taxable sales were \$222 million in 2011 and \$312 million in 2020. This provides some sense of the stability of a LOST going forward. Unlike other communities, the city did not experience any decrease in sales between 2019 and 2020 due to the economic shock of the pandemic.

Extension forecasted taxable sales proceeds for the an additional 0.5% local tax for 2021, 2022, and 2023 using a simple exponential smoothing forecast model that employs a moving weighted average and a 95% confidence interval to provide an upper and lower bound to the estimate (Figures 5 and 6). This model estimates total tax proceeds in 2023 to be between an upper limit of \$1.9 million and a lower limit of \$1.6 million.

Considering the historic disruption of the pandemic and its uneven effect on business categories, this forecast is an unlikely scenario based only on past trends. National evidence shows that home-focused businesses like food, building materials, and general merchandise did well through the pandemic, whereas dining, accommodations, and amusement saw record sales decreases. The sharp rebound in sales in 2021 further complicates any forecast. Hermantown followed this national pattern of an increase in some retail categories and a decrease in services (Figure 4).

Figure 4: Change in Taxable Sales by Percent, 2019-2020

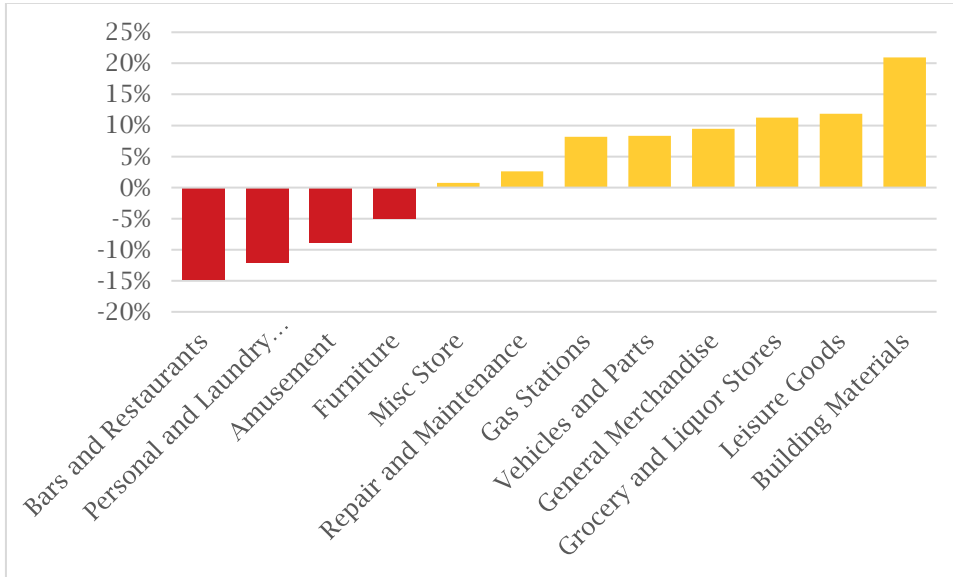


Figure 5: Forecast for Tax Proceeds based on Past Trends 2011 - 2020

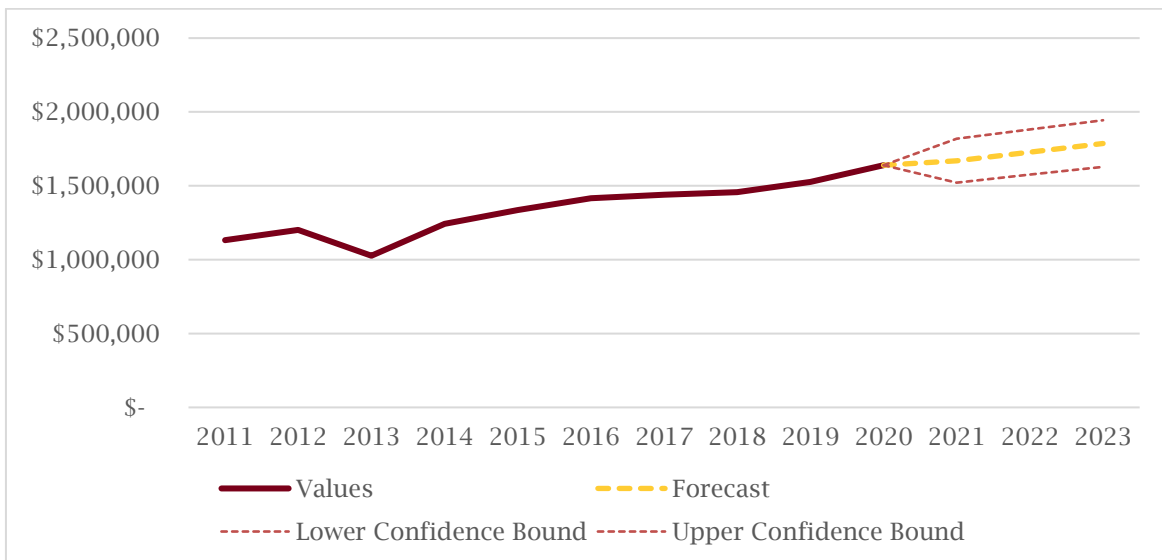


Figure 6: Forecast with Upper and Lower Bound

	Forecast	Lower Bound	Upper Bound
2020	\$1,639,523	\$1,639,523	\$1,639,523
2021	\$1,669,747	\$1,521,455	\$1,818,039
2022	\$1,728,207	\$1,575,315	\$1,881,099
2023	\$1,786,667	\$1,629,274	\$1,944,060

Use taxes also affect the tax proceeds from a local option sales tax. Use taxes derive from city businesses purchasing products from out-of-state sources and in other Minnesota locations. Use taxes are often less consistent and more difficult to estimate accurately than sales taxes. In 2019, the city received \$96,624 from in use tax proceeds from its local option tax at 1%. The 0.5% tax would have garnered an additional \$48,000 if it were in effect.



Policymakers must also consider the impacts that a LOST may have on consumer purchasing behavior, particularly whether it will result in a loss of consumer purchases to other jurisdictions. Extension examined records of 11 cities that enacted a local option sales tax between 1999 and 2006 (information available on the Minnesota Department of Revenue website). Records do not indicate a major purchasing change due to the additional sales tax, and most of the jurisdictions have shown continued sales growth (see Appendix A). These communities, however, may not be comparable to Hermantown. All communities included in this analysis are located outside the Twin Cities metro area and may retain more shoppers than communities in the metro area where one can easily switch spending from one jurisdiction to another.

BACKGROUND AND METHODOLOGY

Community economics educators at University of Minnesota Extension provide applied research and education to help community and business partners make better informed decisions. In recent years, Minnesota has adopted laws enabling local governments to enact a local option sales tax. Extension has assisted these administrations in estimating their potential tax proceeds and the portion of taxes paid by local residents.

This report estimates the proportion of tax proceeds generated by Hermantown residents compared to non-residents. The most recently available state sales tax data (2019) from the Minnesota Department of Revenue (MN Revenue) was used.

Trade Area Analysis and Calculations

Extension conducted a trade area analysis of retail and service sales in select merchandise categories, estimating the amount of taxable sales subject to sales taxes made by both local residents and non-residents. Use tax is a much smaller portion of the total collection compared to sales tax proceeds. It is also estimated using a different formula.

Extension calculated potential sales for the city in each merchandise category and compared this calculation to actual taxable sales from the Minnesota Department of Revenue sales tax statistics for the same category. Actual sales greater than potential sales indicate the county attracts sales from outside its boundaries, or has sales greater than one would expect from its residents. Extension used the difference between potential and actual sales to set reasonable estimates of spending by residents and non-residents across all categories. These estimates also helped inform adjustments for each category.

Potential sales calculations are based on average statewide spending by merchandise category and the population of the county, then adjusted by the level of income in Hermantown. Specifically, potential sales result from county population, state per capita taxable sales, and the index of income (see sidebar and Appendix B).

The following section details the initial and adjusted trade area calculations for all merchandise categories. The sections labeled “Analysis with Adjustments” lists the final estimate of sales generated by non-residents. A rationale for adjustments and conclusions is also included.

Potential sales estimate the dollar amounts for purchases made by local residents *if* local residents spend as much as the average Minnesota resident.

Potential sales are calculated by the following formula:

$$(T \div PMn) \times PO \times (YWC \div YMn) = \text{potential sales}$$

T = Total Minnesota taxable sales for a merchandise category

PMn = 2020 population of Minnesota (5,706,494)

PO = 2020 population of Hermantown (10,221)

YWC = Per capita income of St. Louis County residents (\$50,986)

YMn = Per capita income of Minnesota residents (\$62,005)

TRADE AREA ANALYSIS BY MERCHANDISE CATEGORY

The following pages provide detailed analysis by merchandise category.

Vehicles and Parts

9.6 percent of total taxable retail and service sales

The **21 businesses** in this retail category include repair parts, snowmobiles, boats, trailers, and recreational vehicles. *Sales of cars and other on-road vehicles are not included in this category since they are subject to a different tax.*

	(\$Millions)
Actual taxable sales	\$28.61
-Potential sales	\$4.95
= \$ variance	\$23.66
= as % of potential	477.8%

Unadjusted Trade Area Analysis

Potential taxable sales to residents	\$4.95
Surplus	\$23.66
Total	\$28.61
Surplus percentage	82.7%

Analysis with Adjustments

Capture rate of Hermantown residents	87%
Residents' \$ share	\$4.29
Non-Residents' \$ share	\$24.32
Total	\$28.61
Non-resident share per group	85.0%

Analysis for Vehicles and Parts

Extension's trade area analysis estimates that Hermantown surpasses potential sales by a great deal. Extension estimates that 85% of total sales are coming from non-residents, with total actual sales at \$29 million.

Furniture Stores

4.1 percent of total taxable retail and service sales

These 4 **businesses** sell furniture, beds, carpeting, window coverings, kitchenware, and wood-burning stoves.

	(\$Millions)
Actual taxable sales	\$12.12
Potential sales	\$2.30
= \$ variance	\$9.81
= as % of potential	426.6%

Unadjusted Trade Area Analysis

Potential sales to residents	\$2.30
Surplus	\$9.81
Total	\$12.12
Non-resident share per group	81.0%

Analysis with Adjustments

Capture rate of Hermantown residents	84%
Residents' \$ share	\$1.94
Non-Residents' \$ share	\$10.18
Total	\$12.12
Non-resident share per group	84.0%

Analysis for Furniture Stores

With only four business reporting, this category still pulls in a significant amount of sales, some \$10 million more in taxable sales than expected for the size of the community. Extension set the non-resident share at 84%, which translates to very conservative 84% capture rate of Hermantown resident spending.

Electronics and Appliances

N/A percent of total taxable retail and service sales*

These N/A **businesses** primarily include household-type appliances, sewing machines, cameras, computers, and other electronic goods.

(\$Millions)

Actual taxable sales
-Potential sales
= \$ variance
= as % of potential

Unadjusted Trade Area Analysis

Potential sales to residents
Surplus
Total
Non-resident share per group

Analysis with Adjustments

Capture rate of Hermantown residents
Residents' \$ share
Non-residents' \$ share
Total
Non-resident share per group

Analysis for Electronics and Appliances

Data for electronics and appliances were unavailable for reporting as the number of establishments was too low. All taxable sales from any electronic businesses in the community were reported in miscellaneous retail.

Building Materials

28.2 percent of total taxable retail and service sales*

These **9 businesses** sell lumber, hardware, paint, wallpaper, tile, hardwood floors, roofing, fencing, ceiling fans, lawn equipment, and garden items.

	(\$Millions)
Actual taxable sales	\$84.17
Potential sales	\$10.32
= \$ variance	\$73.85
= as % of potential	715.6%

Unadjusted Trade Area Analysis

Potential sales to residents	\$10.32
Surplus	\$73.85
Total	\$84.17
Non-resident share per group	87.7%

Analysis with Adjustments

Capture rate of Hermantown residents	82%
Residents' \$ share	\$8.42
Non-residents' \$ share	\$75.75
Total	\$84.17
Non-resident share per group	90.0%

Analysis for Building Materials

Building material is a huge category in Hermantown, accounting for nearly 29% of all taxable sales in 2020. The town brought in \$74 million more than expected from potential sales calculations, so clearly these businesses are pulling in significant traffic from outside of Hermantown. Extension set the non-resident share at 90% to account for such a large surplus.

Food and Groceries

0.8 percent of total taxable retail and service sales

The 4 **businesses** in this merchandise group include grocery stores, delis, bakeries, and butcher shops that sell food to be prepared at home. Liquor stores are also included in this group.

	(\$Millions)
Actual taxable sales	\$2.33
- Potential sales	\$6.93
= \$ variance	(\$4.60)
= as % of potential	-66.3%

Unadjusted Trade Area Analysis

Potential sales to residents	\$6.93
Surplus	(\$4.60)
Total	\$2.33
Non-resident share per group	-197.2%

Analysis with Adjustments

Capture rate of Hermantown residents	32%
Residents' \$ share	\$2.21
Non-residents' \$ share	\$0.12
Total	\$2.33
Non-resident share per group	5.0%

Analysis for Food and Groceries

Extension's trade area analysis estimated a sizeable deficit in the food and liquor category at \$4.6 million less in taxable sales than expected from potential sales calculations. Even in categories with a deficit, it is an unreasonable assumption that zero non-resident spending happens. Therefore, Extension set the non-resident share at a very modest 5% of sales.

Health and Personal Items

N/A percent of total taxable retail and service sales

Stores selling prescription drugs, food supplements, vision supplies, cosmetics, and hearing aids are among the N/A **businesses** included in this merchandise group.

(\$Millions)

Actual taxable sales
Potential sales
= \$ variance
= as % of potential

Unadjusted Trade Area Analysis

Potential sales to residents
Surplus
Total
Non-resident share per group

Analysis with Adjustments

Capture rate of Hermantown residents
Residents' \$ share
Non-residents' \$ share
Total
Non-resident share per group

Analysis for Health and Personal Items

Data for health and personal stores were unavailable for reporting as the number of establishments was too low. All taxable sales from any health stores in the community were reported in miscellaneous retail.

Gas/Convenience Stores

2.4 percent of total taxable retail and service sales

This merchandise group covers **10 businesses** selling convenience items at a store that also sells fuel.

	(\$Millions)
Actual taxable sales	\$7.10
-Potential sales	\$2.21
= \$ variance	\$4.89
= as % of potential	221.0%

Unadjusted Trade Area Analysis

Potential sales to residents	\$2.21
Surplus	\$4.89
Total	\$7.10
Non-resident share per group	68.8%

Analysis with Adjustments

Capture rate of Hermantown residents	80%
Residents' \$ share	\$1.78
Non-residents' \$ share	\$5.33
Total	\$7.10
Non-resident share per group	75.0%

Analysis for Gas/Convenience Stores

Hermantown has a sizeable surplus in the gas and convenience store category, netting \$4.9 million more than potential sales calculations. Extension set the non-resident share at 75% to account for this surplus. This analysis provides a capture rate of 80% for Hermantown residents.

Apparel/Clothing

N/A percent of total taxable retail and service sales

This merchandise group includes N/A **businesses** selling new clothing and accessories, jewelry, shoes, bridal items, clocks, and luggage.

(\$Millions)

Actual taxable sales
Potential sales
= \$ variance
= as % of potential

Unadjusted Trade Area Analysis

Potential sales to residents
Surplus
Total
Non-resident share per group

Analysis with Adjustments

Capture rate of Hermantown residents
Residents' \$ share
Non-residents' \$ share
Total
Non-resident share per group

Analysis for Apparel/Clothing

Data for clothing were unavailable for reporting as the number of establishments was too low. All taxable sales from any clothing businesses in the community were reported in miscellaneous retail.

Leisure Goods

2.4 percent of total taxable retail and service sales

The **6 businesses** in this merchandise group sell sporting goods, books, music, hobby items, fabrics, and toys.

	(\$Millions)
Actual taxable sales	\$7.23
Potential sales	\$1.75
= \$ variance	\$5.47
= as % of potential	312.4%

Unadjusted Trade Area Analysis

Potential sales to residents	\$1.75
Surplus	\$5.47
Total	\$7.23
Non-resident share per group	75.8%

Analysis with Adjustments

Capture rate of Hermantown residents	82%
Residents' \$ share	\$1.45
Non-Residents' \$ share	\$5.78
Total	\$7.23
Non-resident share per group	80.0%

Analysis for Leisure Goods

Even though this is a relatively minor category at 2.4% of taxable sales, Extension's trade area analysis estimates that the city has a major surplus. The community brought in over \$5 million more in taxable sales than expected based on potential sales calculations. In this category which includes niche stores such as specialized sporting goods and hobby stores, it is reasonable that local traffic is pulled out of the city for these specialized needs. In this context, Extension had the local capture rate at a very conservative 82%, which translates to a 80% non-resident share of taxable sales.

General Merchandise Stores

35.9 percent of total taxable retail and service sales*

The **4 businesses** in this category sell general merchandise and are unique because they have the equipment and staff needed to sell a large variety of goods from a single location. This includes department stores, superstores, dollar stores, and variety stores.

	(\$Millions)
Actual taxable sales	\$106.96
potential sales	\$9.28
= \$ variance	\$97.68
= as % of potential	1052.5%

Unadjusted Trade Area Analysis

Potential sales to residents	\$9.28
Surplus	\$97.68
Total	\$106.96
Non-resident share per group	91.3%

Analysis with Adjustments

Capture rate of Hermantown residents	92%
Residents' \$ share	\$8.56
Non-Residents' \$ share	\$98.40
Total	\$106.96
Non-resident share per group	92.0%

Analysis for General Merchandise Stores

The 4 businesses in this category account for an extremely large share of taxable sales (35.9 %) in Hermantown. These large big box general merchandise stores bring in a very large surplus and drive traffic from outside the community. Actual sales were 10 times greater than potential sales calculations in this category for a \$98 million surplus. Extension estimates that Hermantown is capturing 92% of local residents, while 92% of sales are coming from non-residents.

Miscellaneous Retail

2.2 percent of total taxable retail and service sales

20 businesses are part of this group, including florists, used merchandise stores, pet supply stores, and other retailers.

	(\$Millions)
Actual taxable sales	\$6.56
Potential sales	\$5.83
= \$ variance	\$0.73
= as % of potential	12.5%

Unadjusted Trade Area Analysis

Potential sales to residents	\$5.83
Surplus	\$0.73
Total	\$6.56
Non-resident share per group	11.1%

Analysis with Adjustments

Capture rate of Hermantown residents	86%
Residents' \$ share	\$4.99
Non-residents' \$ share	\$1.58
Total	\$6.56
Non-resident share per group	24.0%

Analysis for Miscellaneous Retail

Extension's trade area analysis estimates that Hermantown had a small surplus in the miscellaneous retail category (\$730,000), which was a combination of any sales from electronics, clothing, health stores, and accommodations plus those typically in the miscellaneous retail category. This is due to sales being suppressed in these other categories due to privacy issues. Extension set the non-resident share to 24%.

Amusement and Recreation

0.8 percent of total taxable retail and service sales*

The 7 **businesses** in this group include casinos, bowling lanes, water parks, amusement parks, arcades, bingo halls, golf courses, ski slopes, marinas, dance or fitness centers, recreational clubs, ice rinks, swimming pools, roller rinks, etc.

	(\$Millions)
Actual taxable sales	\$2.32
Potential sales	\$6.77
= \$ variance	(\$4.45)
= as % of potential	-65.7%

Unadjusted Trade Area Analysis

Potential sales to residents	\$6.77
Surplus	(\$4.45)
Total	\$2.32
Non-resident share per group	-191.6%

Analysis with Adjustments

Capture rate of Hermantown residents	33%
Residents' \$ share	\$2.20
Non-residents' \$ share	\$0.12
Total	\$2.32
Non-resident share per group	5.0%

Analysis for Amusement and Recreation

Extension's trade area analysis estimates that the city has a significant deficit in this category, so Extension set the non-resident share at 5% to account for some small portion of outside spending.

Accommodations

N/A percent of total taxable retail and service sales

These N/A **businesses** provide lodging or short-term accommodations for travelers, vacationers, and others. Included are hotels, motels, lodges, bed & breakfasts, campgrounds, fraternities, boarding houses, and dormitories.

(\$Millions)

Actual taxable sales
Potential sales
= \$ variance
= as % of potential

Unadjusted Trade Area Analysis

Potential sales to residents
Surplus
Total
Non-resident share per group

Analysis with Adjustments

Capture rate of Hermantown residents
Residents' \$ share
Non-residents' \$ share
Total
Non-resident share per group

Analysis for Accommodations

Data for accommodations were unavailable for reporting as the number of establishments was too low. All taxable sales from any accommodations businesses in the community were reported in miscellaneous retail.

Eating/Drinking Establishments

5.5 percent of total taxable retail and service sales

These **26 businesses** sell food at full-service or limited-service establishments. The group includes cafeterias, bagel shops, ice cream parlors, snack bars, food service contractors, caterers, lunch wagons, and street vendors. It also includes bars, taverns, and nightclubs.

	(\$Millions)
Actual taxable sales	\$16.27
Potential sales	\$10.86
= \$ variance	\$5.41
= as % of potential	49.8%

Unadjusted Trade Area Analysis

Potential sales to residents	\$10.86
Surplus	\$5.41
Total	\$16.27
Non-resident share per group	33.2%

Analysis with Adjustments

Capture rate of Hermantown residents	78%
Residents' \$ share	\$8.46
Non-residents' \$ share	\$7.81
Total	\$16.27
Non-resident share per group	48.0%

Analysis for Eating/Drinking Establishments

The eating and drinking category—which includes all bars, restaurants, and other food service—is a modest category with \$16 million in taxable sales and has a sizeable surplus. This is not surprising given the level of outside traffic being brought into the community from retail businesses. It stands to reason that these shoppers do some dining when in the community. Extension set the non-resident share at 48%, which translates to a conservative 78% capture rate of Hermantown resident spending, considering the many other dining and drinking options in the Duluth metro area.

Repair and Maintenance

2.7 percent of total taxable retail and service sales

The 23 **businesses** in this group restore machinery, equipment, and other products. The group does not include plumbing or electrical repair services but does encompass auto repair, cameras, televisions, computers, copiers, appliances, lawn mowers, specialized equipment, small engines, furniture, shoes, guns, etc.

	(\$Millions)
Actual taxable sales	\$7.91
Potential sales	\$2.30
= \$ variance	\$5.61
= as % of potential	243.7%

Unadjusted Trade Area Analysis

Potential sales to residents	\$2.30
Surplus	\$5.61
Total	\$7.91
Non-resident share per group	70.9%

Analysis with Adjustments

Capture rate of Hermantown residents	86%
Residents' \$ share	\$1.98
Non-residents' \$ share	\$5.93
Total	\$7.91
Non-resident share per group	75.0%

Analysis for Repair and Maintenance

At 2.7 percent of total taxable sales, repair and maintenance is a relatively small category in Hermantown at \$8 million in actual sales. Even though not a large category, the surplus is significant at nearly \$6 million more than expected based on potential sales calculations. Extension set the non-resident share at 75% to account for this surplus.

Personal Services/Laundry

0.2 percent of total taxable retail and service sales

The **17 businesses** in this merchandise group include barber shops and beauty parlors, death care services, laundry and dry-cleaning services, and a wide range of other personal services, such as pet care (except veterinary), photofinishing, temporary parking, and dating services.

	(\$Millions)
Actual taxable sales	\$0.45
Potential Sales	\$1.05
= \$ variance	(\$0.60)
= as % of potential	-57.3%

Unadjusted Trade Area Analysis

Potential sales to residents	\$1.05
Surplus	(\$0.60)
Total	\$0.45
Non-resident share per group	-134.2%

Analysis with Adjustments

Capture rate of Hermantown residents	41%
Residents' \$ share	\$0.43
Non-residents' \$ share	\$0.02
Total	\$0.45
Non-resident share per group	5.0%

Analysis for Personal Services/Laundry

This category includes businesses that typically serve a local market, such as barbers, hair salons, and dry-cleaning operations. Extension's trade area analysis estimates that the city falls significantly short of potential sales. Yet, even in a category with a deficit, Extension attributes some portion of sales to non-residents. In this case, Extension set the non-resident share at a modest 5 percent. The assumption is that it is unrealistic to think that there would be no non-residents that shopped in the community for goods in this category.



Retail (Non-Store) and Other Services

This section includes taxable sales attributed to North American Industrial Classification System categories 511-813 released by MN Revenue.

	(\$Millions)
Actual taxable sales	\$16.01
% of total taxable retail and service sales In Hermantown	5.4%

Analysis with Adjustments

	(\$Millions)
Residents' \$ share	\$9.76
Non-residents' \$ share	\$6.24
Total	\$16.01
Non-resident share per group	39%

Analysis for Retail and Other Services

This group includes non-store retailers (such as direct selling operations), healthcare, waste management, rental/lease services, administrative support, and the performing arts. Some of these categories serve primarily a local market, whereas categories like 541 (professional and technical services) often serve a non-local market. This mix of business types is too diverse to run a trade area analysis for, but Extension estimated an aggregate 39 percent of these sales are to non-resident customers. The categories of sales are shown below:

Category	Taxable Sales	% non-local	\$ non-local
454 RETL -NONSTORE RETAILERS	\$910,375	70%	\$637,263
532 RENTAL, LEASING SERVICES	\$5,136,797	30%	\$1,541,039
541 PROF,SCIENTIFIC,TECH SERV	\$5,040,402	60%	\$3,024,241
561 ADMIN, SUPPORT SERVICES	\$4,089,188	20%	\$817,838
621 HEALTH -AMBULATORY CARE	\$769,154	30%	\$230,746
623 HEALTH -NURSING,HOME CARE	\$7,940	10%	\$794
711 PERF ART, SPECTATOR SPRTS	\$7,617	30%	\$2,285
813 RELIGIOUS,CIVIC,PROF ORGS	\$44,173	10%	\$4,417
TOTAL	\$16,005,646	0.391025954	\$6,258,623

Construction, Manufacturing, Utilities, Wholesale Operations, Transportation, and Sales Suppressed for Business Confidentiality

A diverse mix of businesses fall into these non-retail categories, and a portion of sales are within a suppressed or non-disclosed subcategory. These industries and services generate \$14.2 million in taxable sales, or 4.8 percent of total taxable sales in Hermantown. Some portion of this amount would be subject to any new sales taxes, including a local option sales tax.

This category includes utilities that primarily serve a local market and are subject to a local option sales tax. The diversity of firm types included in this category makes it difficult to understand the customer mix of these businesses; however, Extension broke out each known subcategory with an assumption of whether customers paying the taxable sales were non-local:

Category	Taxable Sales	% non-local	\$ non-local
CONSTRUCTION	\$839,789	50%	\$419,895
MANUFACTURING	\$903,367	80%	\$722,694
WHOLESALE	\$4,342,413	40%	\$1,736,965
UNDESIGNATED/SUPPRESSED	\$8,076,446	30%	\$2,422,934
Total	\$14,162,015	37%	\$5,302,487

Extension estimated that, overall, 37 percent of sales are to non-residents. This analysis assumes that some subcategories, such as manufacturing sell primarily (80 percent) to non-resident customers, whereas subcategories like construction split sales between resident and non-resident customers.

Analysis with Adjustments

	(\$Millions)
Residents' \$ share	\$9.76
Non-residents \$ share	\$5.30
Total	\$14.16
Non-resident share	37%

APPENDIX A: RESEARCH ON THE EFFECTS OF A LOCAL OPTION SALES TAX

Policymakers are often concerned that enacting a local sales tax will result in a loss of consumer purchases to neighboring communities that have not adopted the tax.

The Minnesota Department of Revenue records the tax collected from a set of Minnesota jurisdictions that have had a local sales or use tax in effect for at least eight years. Most of these cities show continued sales growth. A comparison that includes 11 Minnesota cities adopting a 0.5 percent local option sales tax is offered below (refer to Figures 4, 5, 6, and 7).

Policymakers must determine the best allowable method to raise revenue from a variety of options. One option is raising property taxes, which is not directly related to a household’s current income and raises the financial burden of low-income or retired homeowners. Sales taxes raise revenues based on household expenditures, which, in Minnesota, excludes the basic necessities of food and clothing. However, since sales tax raises revenues from non-residents who shop in Hermantown, resident contributions to tax revenues are significantly lower than a tax generated exclusively by local residents, such as a property tax. Policymakers must carefully consider these and other factors before making a decision about enacting a local sales tax.

Figure 4: Taxable retail and service sales by communities that began collecting a local option sales tax from 1999 to 2006

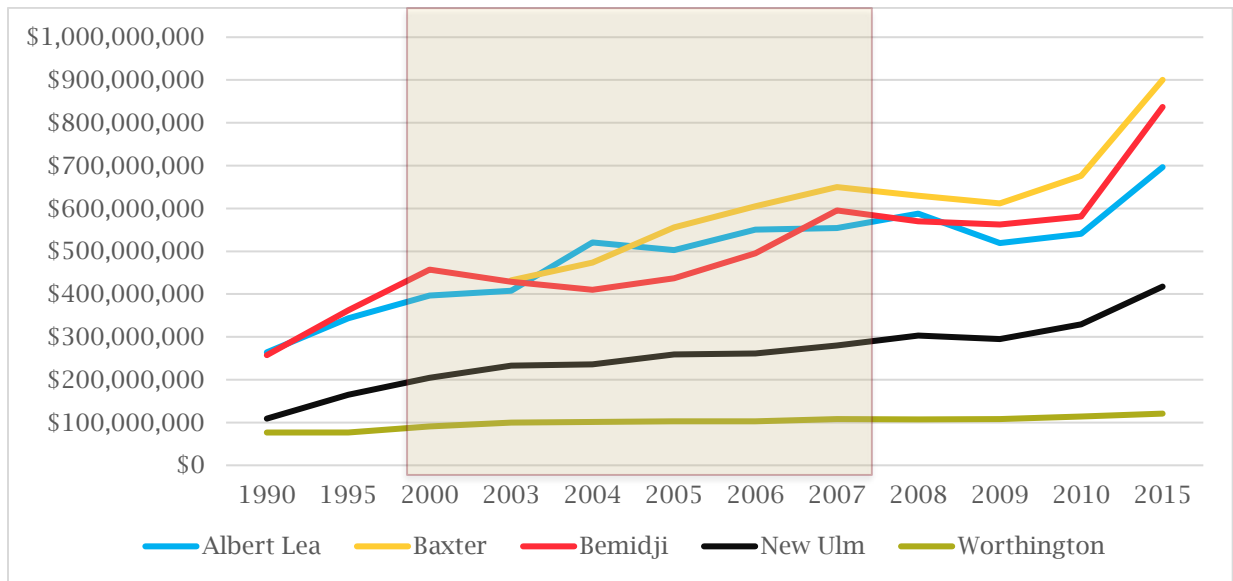


Figure 5: Data table for example communities, taxable retail and service sales (in millions)

Town Name	2015 Population	Year LOST	90	95	00	03	04	05	06	07	08	09	10	15
Albert Lea	18,356	2006	\$264	\$344	\$397	\$407	\$521	\$502	\$551	\$555	\$588	\$519	\$541	\$696
Baxter	8,065	2006				\$432	\$473	\$556	\$605	\$650	\$630	\$612	\$676	\$900
Bemidji	11,917	2005	\$257	\$362	\$457	\$428	\$410	\$437	\$495	\$596	\$570	\$563	\$581	\$837
New Ulm	13,594	1999	\$109	\$165	\$204	\$233	\$236	\$259	\$261	\$280	\$303	\$295	\$329	\$417
Worthington	11,283	2005	\$77	\$77	\$91	\$99	\$102	\$103	\$103	\$108	\$107	\$108	\$114	\$121

Figure 6: Taxable retail and service sales by communities that began collecting a local option sales tax between 2011- 2012

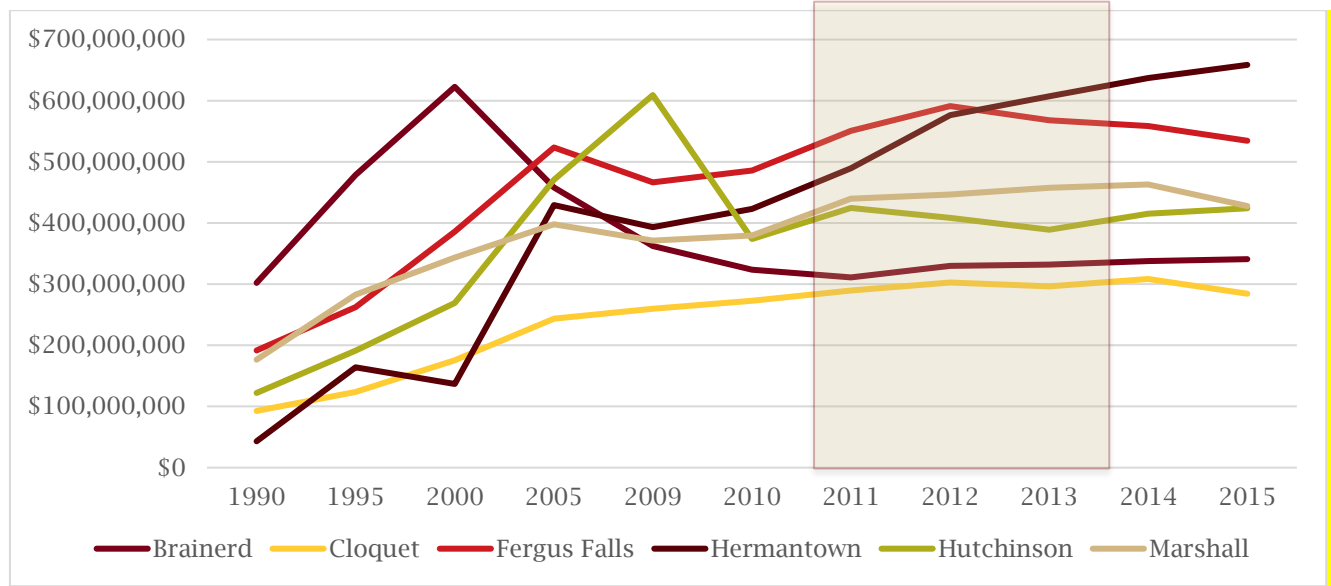


Figure 7: Data table for example communities, taxable retail and service sales (in millions)

Town Name	2015 Pop	Year LOST	90	95	00	05	09	10	11	12	13	14	15
<i>Brainerd</i>	13,178	2011	\$302	\$479	\$623	\$458	\$362	\$324	\$311	\$330	\$332	\$338	\$341
<i>Cloquet</i>	11,201	2011	\$93	\$124	\$175	\$244	\$260	\$273	\$290	\$303	\$296	\$308	\$284
<i>Fergus Falls</i>	13,471	2011	\$192	\$263	\$386	\$523	\$467	\$486	\$551	\$591	\$568	\$558	\$534
<i>Hermantown</i>	7,448	1996 - increase 2012	\$43	\$164	\$137	\$430	\$393	\$423	\$489	\$576	\$607	\$637	\$659
<i>Hutchinson</i>	13,080	2011	\$122	\$191	\$269	\$471	\$609	\$374	\$425	\$409	\$389	\$415	\$424
<i>Marshall</i>	12,735	2011	\$176	\$283	\$343	\$398	\$371	\$380	\$440	\$447	\$457	\$463	\$428

APPENDIX B: DEFINITIONS OF TERMS

Gross sales

Gross sales include taxable sales and exempt businesses with sales and use tax permits. This is the most inclusive indicator of business activity for reporting jurisdictions, but it can be misleading when used in comparisons. At times, non-taxable commodity items (e.g., gasoline) can have large price variations, creating huge swings in gross sales.

Taxable sales

Taxable sales are sales subject to sales tax. Taxable sales exclude exempt items, items sold for resale, items sold for exempt purposes, and items sold to exempt organizations. For the purpose of this study, taxable sales were the focus of the analysis. For more information on what is taxed in Minnesota, see the "Minnesota Sales and Use Tax Instruction Booklet" available at <https://www.revenue.state.mn.us/minnesota-tax-handbooks>

Taxable retail and service sales

In this study and other retail trade analyses conducted by University of Minnesota Extension, the term "taxable retail and service sales" refers to the North American Industry Classification System (NAICS) numbers of 441 to 454 (retail) and 511 to 812 (most service industries) released by the Minnesota Department of Revenue for a geographic area.

Current and constant dollar sales

Current dollar (or "nominal dollar") sales are those reported by the state. No adjustment has been made for price inflation. In general, this measure of sales is not satisfactory for comparisons over long periods of time since it does not account for changes in population, inflation, or the state's economy. Constant dollar (or "real dollar") sales reflect changes in price inflation by adjusting current dollar sales according to the Consumer Price Index (CPI). Constant dollar sales indicate the real sales level with respect to a base year. This is a more realistic method of evaluating sales over time than current dollar comparisons, but it still does not take into consideration changes in population or the state's economy.

Number of businesses

The number of sales and use tax permit holders who filed one or more tax returns for the year.

Index of income

This index provides a relative measure of income, calculated by dividing local per capita income by state per capita income. The base is 1.00. For example, a 1.20 index of income indicates that per capita income in the area is 20 percent above the state average.

Potential sales

Potential sales are an estimate of the amount of money spent on retail goods and services by residents of a county or county. It is the product of county population, state per capita sales, and the index of income (based on the county personal per capita income).

Actual sales

For this study, the Minnesota Department of Revenue's 2019 sales data for Hermantown provides the actual sales numbers used.



Variance between actual and potential sales

The variance between actual and expected sales is the difference in sales from the “norm” (i.e., the amount above or below the standard established by the expected sales formula). When actual sales exceed expected sales, the county has a “surplus” of retail sales. When actual sales fall short of expected sales, the county has a retail sales “leakage.” Discrepancies between expected and actual sales occur for a variety of reasons. For this study, we use potential sales per merchandise group to create a first-cut estimate of residents’ purchase activities.

Cautions

Gross sales

Gross sales are a comprehensive measure of business activity, but it should be noted the numbers in this report are self-reported. Furthermore, gross sales are not audited by the state of Minnesota. It is believed that gross sales figures are generally reliable, but there is the possibility of distortions, especially in smaller cities where misreporting may have occurred.

Misclassification

Holders of sales and use tax permits select the North American Industry Classification System (NAICS) category that best fits their business. All sales reported by a business is attributed to that selected NAICS category. Regardless of who makes this classification, errors are occasionally made. Also, sometimes a business will start out as one type but evolve over time to a considerably different type. Misclassifications can distort sales among business categories, especially in smaller cities. For example, a furniture store that is classified as a general merchandise store will underreport sales in the furniture store category and over-report sales in the general merchandise category.

Suppressed data

The sales data for merchandise categories that have less than four reporting firms are not reported. This is a measure taken by most states to protect the confidentiality of sales tax permit holders. Sales for suppressed retail categories are placed into the miscellaneous retail category (NAICS 999) and included in total sales but not total sales of a typical retail trade analysis. For this report, however, all taxable sales—including NAICS 999—are part of calculating the amount of special taxes collected.

Consolidated reporting

Vendors with more than one location in Minnesota have the option of filing a separate return for each location or filing one consolidated return for all locations. The consolidated return shows sales made, tax due, and location by county, and county for each business. Data for consolidated filers are combined with data for single-location filers to produce the figures in this report. Occasionally, consolidated reports may not be properly deconstructed, and all sales for a company may be reported for one town or county. Whenever misreporting is discovered, the Minnesota Department of Revenue is contacted to clarify the situation.