

Testimony Concerning House Bill 1871, Printer's No. 2959  
Submitted by Darrell L. Clarke, President of Philadelphia City Council  
to the  
Pennsylvania House of Representatives Finance Committee

June 2, 2016

Good Morning Chairman O'Neill, Democratic Chairman Wheatley and members of the House Finance Committee.

I am Darrell Clarke, President of Philadelphia's City Council, and I am here to provide testimony on House Bill 1871.

Let me begin by simply saying, thank you. I am delighted to have this conversation about one of my highest priorities. I strongly support a Constitutional Amendment that would grant broad authority to General Assembly to create more than one class of property for real estate tax purposes, subject to restrictions that the General Assembly – and I emphasize General Assembly -- may impose.

But I do not and I cannot support the language that is in House Bill 1871. I believe that this language could tie the City's hands in harmful and counterproductive ways. It is inflexible. It is unfair to homeowners. And if it becomes the law, I seriously doubt whether Philadelphia would ever implement the authority granted to it, given the restrictions in the current language.

As many of you know, the key elements of HB 1871 are:

1. Authorization to impose one City real estate tax rate on property that is "used for business purposes" and a different rate on all other real property – mostly homeowners;
2. The difference between the two rates would be capped at 15%.
3. A requirement that Council reduce other unrelated business and/or wage taxes by the amount attributable to the difference in the two real estate tax rates.

My opposition to this particular proposal is based on a thorough analysis from both a Constitutional perspective and a tax policy perspective. I have brought with me copies of that analysis for members of this Finance Committee

Here is what we learned:

**First:** no other state constitution or statute that authorizes different classes of real property for taxing purposes demands reductions in other unrelated taxes as a condition for having different real estate tax rates. And for good reason. Placing this kind of restriction in the Constitution enshrines unproven tax policy in the Constitution. Worse, it denies both the local government

and the General Assembly the flexibility to create or change tax policy as local economic circumstances dictate.

**Second.** This proposal would HANDCUFF local tax policy by effectively creating a business tax freeze once the City decided to raise the tax rate on properties used for business purposes. As long as the 15 percent variance were in place, if the City ever needed to raise additional revenue it could not increase a single business tax unless it first raised the real estate taxes on homeowners. So you see why I said earlier that this proposal is harmful to homeowners.

**Third.** Philadelphia does not need a Constitutional Amendment to force it to reduce business and wage taxes. We have been reducing business and wage taxes for the last twenty years, beginning in 1995. Additional cuts are coming in the immediate future, as reflected both in our local legislation and the most recent proposed Five Year Plan. Here's what we've been doing:

During the period from 1995 to 2015:

- The resident wage tax was reduced by 21% and the non-resident wage tax by 19%, and
- The resident net profits tax was reduced by 21% and the non-resident net profits tax by 19%, and
- The business net income tax was reduced by 1.4% and the gross receipts tax was reduced by 56%.

It is estimated that collectively these tax reductions, over the past twenty years, have reduced wage and business taxes by as much as \$5.8 billion over that period.

And there's more: In addition to these cuts, City Council has enacted other measures to stimulate the growth of new businesses and provide relief to small businesses. In 2016, businesses will be able to exclude the first \$100,000 in revenue from the Business Income and Receipts Tax. This exclusion alone reduces business taxes by \$30 million per year.

Further reductions of wage and business taxes are planned:

- Wage taxes, both resident and non-resident, will be reduced by 4.67% over the next five years; and
- Net Profits taxes both resident and non-resident will be reduced by 4.67% over the next five years, and
- Net Income taxes will be reduced by 6.1% over the next five years.

Total planned reductions in wage and business taxes, plus the Single Sales Factor and BIRT Exclusion will, over the next five years, yield an estimated tax savings for businesses and wage earners of \$485 million for an average reduction of \$98 million per year.

**Fourth.** The 15% cap is not just a little bit lower than the cap permitted in other jurisdictions – it’s extraordinarily lower. Consider these jurisdictions: Washington DC 200%, Chicago 250%, New York nearly 500% and Boston 244%. Why does this matter? Because the goal in having different rates is to spread the tax as fairly as possible and have the resources to reduce other business and wage taxes in a meaningful way. A cap of merely 15% would thwart that goal, judging from the experience elsewhere.

**Fifth.** The amendment as drafted would almost certainly require that residential property that is rented be considered to be property used for business purposes; to be taxed at the higher of the two authorized rates. I believe, however, that any real property which is someone’s home, whether it is owned or rented, should be taxed at the same lower rate. Otherwise, once the increased property tax rate is applied to rental properties, landlords will simply pass the cost on to their tenants, increasing the burden on our residents even further. Major cities like Boston, Chicago and Washington DC recognize this fact and tax all residential properties at the same rate whether owned or rented.

**Sixth.** Not all properties used for business purposes operate on the same economic model. High volume, low margin businesses such as supermarkets and car dealers which occupy large spaces are affected differently, by increased property taxes, than an office tower leased to a law firm. A one size fits all classification of real property denies the differential impact that property taxes have on different business models, even when you offset the increase with wage or business tax reductions. That’s why we support more than a simple two-tiered property tax model. We need to be as fair as we possibly can to all classes of property owners.

The document that I distributed to you earlier today points out additional flaws in the Coalition’s proposal, flaws which are also reflected in HB1871. For example, the proposed constitutional language would only apply to City real estate taxes, and would not permit bifurcated rates with respect to the School District of Philadelphia. By increasing City real estate tax by 15% only increases the combined City and School District rate by 6.8%.

What Philadelphia needs is a Constitutional Amendment that provides the General Assembly with the authority to create classes of property and leave it up to City to set the tax rates that insure growth in all its business sectors and does not penalize homeowners and those who choose or must rent their homes. What we do not need is a Constitutional Amendment that puts handcuffs on our local tax policies and one that constrains our ability to implement creative solutions that will help our City grow, prosper and contribute to the economic well being of the Commonwealth.

This past Thursday City Council adopted a Resolution affirming the position I have articulated today. A copy of the Resolution is attached to my written testimony.

I truly appreciate this opportunity to appear before this Committee on this most important subject matter. I look forward to working with you and would be happy to answer any questions you might have at this time.