Philadelphia Tax Reform Commission

Final Report
November 15, 2003

Volume I

Third Printing

CITY OF PHILADELPHIA

TAX REFORM COMMISSION
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Vice Chairs

November 15, 2003

To the Citizens of Philadelphia:

On behalf of the Philadelphia Tax Reform Commission, we are pleased to submit this report containing our recommendations for fundamental tax reform.

When you proclaimed your dissatisfaction with the local tax system, your elected officials empowered you to change it by creating an independent Tax Reform Commission through a ballot referendum. This opportunity was not lost on the nearly 170,000 Philadelphians who voted in November 2002 to create this Commission to "recommend methods to reduce the taxes of residents, workers, and businesses."

The Commission has worked hard since January to develop its recommendations, which were endorsed by Commissioners Armbrister, Cruz, Forkin, Garrison-Corbin, Jackson, Jones, Mandel, Miller, Newell, Schwartz, Sorgenti, Taubenberger, VandenBrul, and Weintraub. Commissioner Stein dissented.

Our most important recommendations are as follows:

- Restructure, simplify, and improve the real estate assessment process, while creating a Taxpayers' Advocate to represent property owners in assessment appeals;
- Utilize buffering techniques to guard against large, unexpected property tax increases, advocate for state property tax relief, and increase awareness about existing tax relief programs;
- Phase in land-value taxation, reducing taxes for most residents while removing a key impediment to economic development;
- Adopt a budget-based real estate tax system to ensure that the City collects only the taxes it needs to provide valuable and essential services to residents;
- Over the next decade, gradually reduce and finally repeal the Business Privilege Tax, which is levied on both the gross receipts and net income of firms doing business in the city;

- Reform the Business Privilege Tax while this tax still exists, to level the playing field between companies inside and outside the city and between incorporated and unincorporated firms, and to help startup firms manage early operating losses;
- Accelerate the City's program of reductions in the Wage, Earnings, and Net Profits Tax rates, to achieve a goal of equalizing the resident and nonresident tax rates at 3.25 percent by 2014, and further improve the competitiveness of Philadelphia as a residential and business location; and
- Invest at least $1 million in the Greater Philadelphia Urban Affairs Coalition's Campaign for Working Families, to help return up to $150 million in annual federal and state tax credits that currently are not received by eligible low-income Philadelphians.

Our study of Philadelphia's tax system demonstrates that as a city we tax what others do not; our taxes are too high; and our taxes are unfairly imposed. We have also found that Philadelphia compounds the problem of a high overall tax burden by relying too heavily on wage and business taxes, the taxes that are most likely to drive residents, businesses, and jobs from the city. The city's incomparably high wage and business tax rates have damaged Philadelphia's economy over the past three decades, ultimately reducing tax revenue and the ability of the City and School District of Philadelphia to finance citizen services.

Our tax system is broken. It didn't break overnight and it can't be fixed overnight. The recommendations in this report provide the City with a 10-year plan for fundamentally reforming its tax system. To regain its competitive edge, the City needs to abandon its historic piecemeal approach to tax reform, and adopt the ambitious, comprehensive reform program recommended in this report.

We appreciate the opportunity to be of service to our great city and gratefully acknowledge all of those who assisted us in our work. We stand ready to answer any questions and assist in any manner you deem appropriate.

Respectfully submitted,

Edward A. Schwartz	**Raymond Jones**	**Al Taubenberger**
Chair	*Vice Chair*	*Vice Chair*

Acknowledgements

The Tax Reform Commission's study of Philadelphia's tax structure relied heavily on the help of many organizations and individuals. We apologize in advance for anyone we may have overlooked.

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Community and Economic Development; Robert Ebel, The World Bank; Kendall Fullard, African-American Chamber of Commerce; Amy Gill, and C. Daniel Hassell, Pennsylvania Department of Revenue; Philis Goddard, Bob Lane, Paul Levy, and Elise Vider, Center City District/Central Philadelphia Development Corporation; Joe Golden, Philadelphia Gas Works; Ed Goppelt, Hallwatch; Ted Gwartney, Town of Greenwich, Connecticut; Benjamin Howells, City of Allentown, Pennsylvania; Les Hudson and Carol Scheman, University of Pennsylvania; David Hyman, Kleinbard Bell & Brecker LLP; Robert Inman, Wharton School, University of Pennsylvania; Tom Felix and Ken Jarin, Ballard Spahr Andrews & Ingersoll; Jim Jordan, SEPTA; Michael Masch and Carol Moyer, Governor's Office of the Budget; Kim McFadden, Governor's Action Team; Janet Milkman and Ann Marie Walker, 10,000 Friends of Pennsylvania; Uri Monson and Joe Vignola, Pennsylvania Intergovernmental Cooperation Authority; Dianne Reed, KPMG LLP; Greg Rost and Anne Nadol, Temple University; Debbie Sills, Deloitte Consulting; Tim Monahan and Hether Smith, Julien J. Studley, Inc.; Joshua Vincent, Center for the Study of Economics; and Laura Weinbaum, Project HOME.

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Much of what we have done was possible because of the terrific work of legal interns Jim Boyer, Yan Gao, Tim Leska, and research interns Lisa Bolotin, Mike Fabius, Eric Prengel, Amir Shachmurove, and Helen Tam. Director of Communications Robin Leary and Administrative Assistant Megan McCormick have also been indispensable. Finally this report reflects the serious, thoughtful analysis of our research staff, including Jody Bradwell, Steve Landis, and especially Mary Braun, who managed its planning, writing and production from beginning to end. The old adage that we could not have done this without them certainly applies here, and we would be remiss in not acknowledging their enormous contribution.

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About the Philadelphia Tax Reform Commission

Creation of the Commission

In November of 2002, Philadelphia voters were asked the following ballot question:

Shall the Philadelphia Home Rule Charter be amended to provide for the creation, appointment, powers and duties of an independent Philadelphia Tax Reform Commission which would recommend methods to reduce the taxes of Philadelphia residents, workers and businesses in an equitable manner in order to enhance Philadelphia's ability to compete with other jurisdictions in attracting and retaining new residents, businesses and jobs, based upon the Commission's comprehensive analysis of taxation in Philadelphia?

By a four-to-one margin, Philadelphia voters supported the creation of the first independent Tax Reform Commission in Philadelphia's history.

The Commission is composed of 15 members—four members appointed by the Mayor, four members appointed by the City Council President, one member appointed by the City Controller, and one member appointed by each of the following: the African-American Chamber of Commerce, the Greater Philadelphia Chamber of Commerce, Greater Philadelphia First, the Greater Northeast Philadelphia Chamber of Commerce, the Hispanic Chamber of Commerce, and the North Philadelphia Chamber of Commerce. The Commission's Advisory Committee is composed of representatives from 23 different business, community, educational, and research organizations.

The Commission was sworn in on January 15, 2003 and released its final report on November 15, 2003.

Commissioners

- **Edward A. Schwartz**
  Chair
- **Raymond Jones**
  Vice Chair
- **Al Taubenberger**
  Vice Chair
- **Brett H. Mandel**
  Real Estate Tax Chair
- **Stewart M. Weintraub**
  Business Tax Chair
- **William R. Miller, IV**
  Communications Chair
- **Clarence D. Armbrister**
- **Luis Cruz**
- **Thomas P. Forkin**
- **Patricia Garrison-Corbin**
- **Melvin T. Jackson**
- **David Newell**
- **Harold A. Sorgenti**
- **Jonathan M. Stein**
- **Andrew VandenBrul**

Advisory Committee

- Action Alliance of Senior Citizens of Greater Philadelphia
- Asian-Americans United*
- Consumer Education and Protective Association**
- Community Legal Services
- Federal Reserve Bank of Philadelphia
- Fox School of Business and Management of Temple University
- Greater Philadelphia Association of Realtors
- Institute for the Study of Civic Values
- Keystone Research Center
- National Association for the Advancement of Colored People, Philadelphia Chapter
- National Congress of Puerto Rican Rights
- National Organization for Women, Philadelphia Chapter
- Pennsylvania Economy League, Eastern Division
- Pennsylvania Institute of Certified Public Accountants, Greater Philadelphia Chapter
- Philadelphia Bar Association
- Philadelphia Citizens for Children and Youth***
- Philadelphia Unemployment Project
- Philadelphia Building and Construction Trades Council
- Philadelphia Council AFL-CIO
- Tenants' Action Group
- Urban League of Philadelphia
- West Philadelphia Partnership
- Wharton School of the University of Pennsylvania

Working Groups

Business Tax Working Group

Stewart M. Weintraub, *Chair*

Group Members
- **Luis Cruz,** Commissioner
- **Thomas P. Forkin,** Commissioner
- **Louise Francis,** National Organization for Women, Philadelphia Chapter
- **Patricia Garrison-Corbin,** Commissioner
- **Robert G. Graff**, Pennsylvania Economy League, Eastern Division
- **Stephen Herzenberg,** Keystone Research Center
- **Jack E. Hunter, Jr.,** Pennsylvania Institute of Certified Public Accountants, Greater Philadelphia Chapter
- **Raymond Jones**, Commissioner
- **Brett H. Mandel,** Commissioner
- **William R. Miller, IV,** Commissioner

* Declined to participate.

** By January 2003, this organization had ceased to function.

*** Philadelphia Citizens for Children and Youth replaced the Parents' Union for Public Schools, which, by January 2003, had ceased to function.

- **Frederic Murphy,** Fox School of Business and Management of Temple University
- **David Newell,** Commissioner
- **Jonathan M. Stein,** Commissioner
- **Harold A. Sorgenti,** Commissioner
- **Audrey C. Talley,** Philadelphia Bar Association
- **Al Taubenberger,** Commissioner
- **Herb Taylor,** Federal Reserve Bank of Philadelphia
- **David Thornburgh,** Pennsylvania Economy League, Eastern Division
- **Andrew VandenBrul**, Commissioner

Real Estate Tax Working Group

Brett H. Mandel, *Chair*

Group Members

- **Clarence D. Armbrister,** Commissioner
- **Joseph P. Blake,** West Philadelphia Partnership
- **Luis Cruz,** Commissioner
- **Robert G. Graff,** Pennsylvania Economy League, Eastern Division
- **Michael Mikstas,** Greater Philadelphia Association of Realtors
- **Edward A. Schwartz,** Commissioner
- **Jonathan M. Stein,** Commissioner
- **Al Taubenberger,** Commissioner
- **David Thornburgh,** Pennsylvania Economy League, Eastern Division
- **Stewart M. Weintraub,** Commissioner
- **Alan M. White,** Community Legal Services

Wage Tax Working Group

Raymond Jones, *Chair*

Group Members

- **Luis Cruz,** Commissioner
- **John Dodds,** Philadelphia Unemployment Project
- **Patricia Garrison-Corbin,** Commissioner
- **Robert G. Graff,** Pennsylvania Economy League, Eastern Division
- **Stephen Herzenberg,** Keystone Research Center
- **Brett H. Mandel,** Commissioner
- **William R. Miller, IV,** Commissioner
- **Pedro Rodriguez,** Action Alliance of Senior Citizens of Greater Philadelphia
- **Edward A. Schwartz,** Commissioner
- **Harold A. Sorgenti,** Commissioner
- **Jonathan M. Stein,** Commissioner
- **Al Taubenberger,** Commissioner
- **Herb Taylor,** Federal Reserve Bank of Philadelphia
- **David Thornburgh,** Pennsylvania Economy League, Eastern Division
- **Stewart M. Weintraub,** Commissioner

Financing Working Group

Edward A. Schwartz, *Chair*

Group Members

- **Clarence D. Armbrister,** Commissioner
- **Luis Cruz,** Commissioner
- **John Dodds,** Philadelphia Unemployment Project

- **Scott R. Douglass,** Wharton School of the University of Pennsylvania
- **Thomas P. Forkin,** Commissioner
- **Patricia Garrison-Corbin,** Commissioner
- **Robert G. Graff,** Pennsylvania Economy League, Eastern Division
- **Melvin T. Jackson,** Commissioner
- **Brett H. Mandel,** Commissioner
- **William R. Miller, IV,** Commissioner
- **Jonathan M. Stein,** Commissioner
- **William J. Stull,** Fox School of Business and Management of Temple University
- **Herb Taylor,** Federal Reserve Bank of Philadelphia
- **David Thornburgh,** Pennsylvania Economy League, Eastern Division
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- **Andrew VandenBrul,** Commissioner

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Executive Summary

The Philadelphia Tax Reform Commission was created by a vote of nearly 170,000 citizens to "recommend methods to reduce the taxes of Philadelphia residents, workers and businesses." On October 15, 2003, the Commission voted 14-to-1 for a comprehensive overhaul of the city's tax structure.

Our 15 Commissioners and 23 Advisory Committee members, a group from diverse backgrounds and perspectives, spent 10 months and more than 10,000 hours conducting a comprehensive review of the city's tax structure. The thousands of pages of evidence we reviewed and the dozens of experts and citizens to whom we listened persuaded us that Philadelphia's unique tax structure has fundamentally damaged the city's economy. We have concluded that tax reform is a prerequisite to economic recovery and prosperity in Philadelphia and throughout the region. We believe our recommendations meet our charge of reducing Philadelphia's tax burden equitably, in order to improve its competitiveness in attracting and retaining residents and businesses.

Our Vision and Guiding Principles

The Commission agrees with former U.S. Supreme Court Justice John Marshall that, "the power to tax involves the power to destroy." In Philadelphia, high tax rates and an unusual tax mix have contributed to a loss of more than 250,000 jobs and more than 430,000 residents since 1970.

We believe that tax reform will fundamentally transform Philadelphia's economy and increase prosperity throughout the region. We envision a tax structure that is fair and simple, real estate taxes that reflect the true value of property, lower taxes on personal income, and an elimination of onerous business taxes on sales and profits. Above all, we conceive of a tax structure that no longer inhibits and impedes economic prosperity. In crafting our recommendations, the Commission has been guided by five principles of local taxation: *competitiveness, equity, stability, neutrality and simplicity*.

The Need for Tax Reform

Residents and businesses in the United States are able to choose locations based on the attractiveness of the overall package of public services and tax levels offered by a locality. Philadelphia's tax structure and high tax rates have a variety of causes, some of which the City cannot control. However, Philadelphia's policy makers can act to reduce the high overall level of taxation, improve the mix of taxes, and reform inadequate real property assessment practices.

Why Taxes Matter

Although many factors influencing business and resident location decisions remain constant from community to community within a metropolitan area, tax levels can vary dramatically. Businesses and residents can move within a region to avoid paying high local taxes while still enjoying many of the region's benefits. There is general agreement among economists that local taxes have an important impact on economic growth; taxes have a significant impact on where individuals live and work and where businesses locate and invest. Econometric analysis shows that, for this reason, taxes have their strongest impact on local communities.

Philadelphia's High Tax Burden

Because Philadelphia's tax burden is higher than that of competitor jurisdictions, the city has difficulty competing for and retaining residents, businesses, and jobs. Substantial evidence from econometric analysis, surveys and anecdotal evidence, indicates that the city's high tax burden has significantly reduced the size of its economy.

Philadelphia's High Tax Rates Hinder Economic Prosperity

The city's tax rates are substantially higher than those of other major cities and nearby suburban municipalities. Since the 1990s, the City's *Five-Year Financial Plan* has acknowledged that Philadelphia's unusually high rates make it difficult to compete for residents and businesses, and numerous studies confirm the existence of an unusual tax burden in Philadelphia. The District of Columbia's annual report on tax burdens in the largest U.S. cities consistently ranks Philadelphia as one of the highest taxed cities in the nation. Economist Robert Inman of the Wharton School of the University of Pennsylvania calculated Philadelphians' combined state and local tax burden as 14.4 percent of income, compared with a level of only 9.0 percent in the Pennsylvania suburbs. Numerous studies have attempted to measure the impact of local taxes on Philadelphia's employment, resident income, property values and business activity. This econometric research suggests that 61 percent of the decline in Philadelphia's share of national employment (approximately 172,889 jobs) between 1971 and 2001 could be attributed to the rise in Wage Tax rates over that period.

Philadelphia's Tax Mix Dampens Economic Prosperity

Philadelphia's unusually high reliance on business and personal income taxes is far more damaging to the economy than a more traditional revenue structure would be. In 1997, personal income taxes accounted for 33.3 percent of total tax revenue in Philadelphia, as compared to an average of 8.5 percent for the 10 largest U.S. cities. Business income tax revenue contributed 12.4 percent to Philadelphia's tax revenues, versus an average of only 5.3 percent elsewhere. In contrast, in 1997 property taxes made up just 19 percent of Philadelphia's tax revenue, while overall U.S. cities with more than 300,000 residents obtained 40 percent of their financing from this source.

Only eight of the 20 largest U.S. cities levy local income taxes, with Philadelphia's 4.4625 percent rate standing at more than twice the average; the city's nonresident rate is higher than that of any other locality. The gross receipts portion of the Business Privilege Tax is six-to-nine times higher than in the average southeastern Pennsylvania suburb. Only three of the nation's 20 largest cities tax the net income of corporations, and one of those cities is phasing out the tax.

With its heavy reliance on those tax sources that are most likely to drive residents, jobs, and businesses from the city, Philadelphia compounds the problems created by its high overall tax burden. Today's workers, customers and suppliers are highly mobile; as a result, high local business and income taxes directly reduce business profits and encourage flight from the city. Because land is immobile, the effect of property-based taxes on employment levels, income, and business activity is smaller than that of taxes on personal and business income.

The City's *Five-Year Financial Plan* demonstrates that the gap between Philadelphia employment growth and U.S. employment growth dropped significantly after Philadelphia began reducing income taxes incrementally in 1996. Econometric analysis conducted by Econsult Corporation for the Commission indicates that reducing local business and income taxes results in substantial increases in jobs, resident incomes, business activity, and property values.

Philadelphia's low property values, below those in cities such as Baltimore, Hartford, and New Haven, are also a symptom of economic distress that should be improved by a more attractive package of taxes and services. Philadelphia's low property values can be linked at least in part to the city's high overall tax burden and its inefficient mix of tax revenue sources. Economic theory and research indicate that reforming Philadelphia's tax structure will lead to increased property values throughout the city. As property values rise, it will be possible for the city to generate additional Real Estate Tax revenue without increasing the tax rate.

In sum, a broad array of evidence points to the conclusion that reducing Philadelphia's reliance on wage and business taxes could significantly increase the size of its economy while maintaining a tax revenue stream adequate to finance needed public services.

Inadequate Property Tax Assessment

Although the city economy would benefit from a move towards property-based taxes, Philadelphia's inaccurate and regressive property assessments must be improved in order to increase tax system equity and maximize the revenue-generating potential of this approach.

Philadelphia's property assessments miss the industry target for accuracy by more than 50 percent. Other older cities with similar housing stocks do significantly better. The City's assessments are also several times worse than comparable cities in terms of equity, with lower-priced homes typically assessed at higher fractions of their value than higher-priced properties. Households in poorer Philadelphia neighborhoods, like North and West Philadelphia, actually face a higher property tax burden relative to property values than those in more affluent areas such as the Northwest, Northeast, and Center City.

Problems with the property tax system prevent the city from experiencing efficiency gains associated with tax reform. In addition, the city's assessment process is complicated and creates distrust of the tax system.

Demographics and Philadelphia's Service Responsibilities

Taxes in Philadelphia support public education, municipal services, and county level services. Despite the city's high crime and poverty rates, it is responsible for the same range of county level criminal justice and human services expenditures as other Pennsylvania counties. As a result, the tax burden in Philadelphia for county level services is seven times the median of other Pennsylvania counties. The City cannot change its service responsibilities or the Commonwealth's method for supporting county level services, but it can make overall tax reductions, adopt a more efficient tax mix, and improve the system of real property assessment. If these changes promote economic growth and jobs and reduce poverty, they may also reduce the need for poverty-related and crime-related services over time and strengthen the city's tax base.

Tax Reform Recommendations

The Commission's recommendations are firmly grounded in tax and economic theory. Throughout our research process, we also sought input from Philadelphia businesses, community groups, residents, and City agencies to judge whether these ideas resonated with stakeholders. We consider them sound in principle and achievable in practice. Although we believe each of these recommendations will improve tax competitiveness, equity, stability, neutrality, or simplicity, they will be most effective if implemented as a comprehensive tax reform package. Except where noted, each of these recommendations would take effect beginning in fiscal year 2005.

Assessment System Reform Recommendations

Recommendation 1: Separate the Property Assessment and Appeals Process.

To address citizen concerns about the impartiality of appeals, create a seven-member Property Assessment Appeals Board (the "Appeals Board") of qualified individuals appointed by the Mayor, which would be separate from the Board of Revision of Taxes (BRT). The current system, in which judges of the Court of Common Pleas appoint BRT members, would continue.

Recommendation 2: Establish a Taxpayers' Advocate.

Create a Taxpayers' Advocate nominated by the Mayor and approved by City Council to advocate for property owners in appeals, improve public understanding of the assessment and appeals process, monitor the quality of the assessment process, and review both the BRT's Assessment-Practice Principles and the Appeals Board's practices and procedures.

Recommendation 3: Establish Accurate Land and Structure Values for All Property Parcels.

As real estate assessments are integral to an equitable and well-functioning local tax system, the BRT should establish accurate land and structure values for all property parcels in Philadelphia through more comprehensive and accurate data collection. This effort could be funded by the City's Productivity Bank, other savings related to proposed changes in the Real Estate Tax, or a one-time surcharge on Real Estate Tax bills.

Recommendation 4: Adopt a Set of Assessment-Practice Principles.

The BRT should adopt, publicize, and annually update a set of assessment-practice principles that includes:

- a requirement that all assessors be state certified;
- a commitment not to create or preserve inequalities by artificially capping assessments;
- a commitment to annual reassessment of all properties to reflect every increase or decrease in value;
- a commitment to continually improve the quality of the data collected about the condition of each property;
- a commitment to increase reliance on computer modeling and information management systems;
- a commitment to incorporate advanced regression techniques, computer calculated neighborhood indexes, GIS mapping, and Computer Assisted Mass Appraisal (CAMA) products; and
- a commitment to provide more information about how assessments are performed when assessment notices are sent out.

Recommendation 5: Eliminate Fractional Assessments.

The BRT should assess properties at 100 percent of market value instead of the current 70 percent factor; removing an extra layer of complexity from the process and making it easier for property owners to evaluate the accuracy of their assessments. Other proposed changes to the property tax system would guard against unreasonable increases in property tax bills as a result of this step.

Recommendation 6: Implement a Property Tax Buffering Program.

To allow for gradual adjustment to any future changes in a property's assessed value, the Commission rejects all types of phasing, caps, and freezes in favor of recommending a three-year averaging program wherein the Real Estate Tax is levied on the average of the assessed property value from the past three years. If the City adopts a system of land-value taxation, the tax would be levied on the past three years' average land value plus the current year's structural value.

Budget-Based Property Taxation Recommendation

Recommendation 7: Implement a System of Budget-Based Property Taxation.

Beginning in fiscal year 2006, shift from an assessment-driven to a budget-based system of property taxation such as is used by most municipalities. The Commission recommends creating a system of budget-based property taxation by legislatively obligating the Mayor and City Council to determine all annual Real Estate Tax rates *after* setting the budget and reviewing assessments, thereby maintaining a stable revenue stream under the control of local government. This system would end the revenue windfall that currently occurs when property assessments rise and the Real Estate Tax produces more than the originally projected amount of revenue.

Land-Value Taxation Recommendation

Recommendation 8: Phase-in Land Value Taxation.

Land-value taxation should be phased-in over 10 years; until 50 percent of all Real Estate Tax revenues are generated from a tax on the value of land (an increase from the current 22.5 percent) and 50 percent of revenues are generated from a tax on the value of structures (a decrease from the current 77.5 percent). To achieve this target, the tax imposed upon structures would be gradually reduced and the tax on land gradually increased.

The Commission reviewed extensive research and testimony demonstrating that land-value taxation maximized its economic development goals when implemented in conjunction with other types of tax and policy reform. Land-value taxation, complemented by the other recommendations of this Commission, would be consistent with the Commission's mission to improve the City's competitiveness in a fiscally and socially responsible manner. The Commission also confirmed the practicality of accurately assessing land values and determined that the issue of tax-delinquency would not threaten attempts to impose land-value taxation in a revenue-neutral manner. Land-value taxation, which encourages maximizing land's potential, will encourage private investment in the city and help reduce blight and abandonment.

Property Tax Relief Recommendations

Recommendation 9: Expand Efforts to Address Property Tax "Ability to Pay" Issues.

Although the net worth of all property owners increases when values rise, those living on fixed incomes often find the corresponding increase in property taxes difficult to afford. The Commission developed the following recommendations to address this concern.

Implement a Quarterly Payment Plan—Allow homeowners to pay their property tax in four installments through the fiscal year instead of one lump sum. This system would save the City millions of dollars in borrowing costs as a result of tax revenues starting to be collected at the beginning of the fiscal year.

Apply Tax Payments to the Current Year's Tax Liability—Applying any payments received to this year's taxes would help low-income elderly residents qualify for the state's property tax rebate program, even if they have outstanding tax delinquencies from past years.

Consider Developing a Low-Income Property Tax Relief Program—The City could create a program similar to the Water Department's Water Relief Assistance Program, to "freeze" the delinquent Real Estate Tax bills of low-income homeowners and provide a tax credit or incentive to remain current in their bills.

Recommendation 10: Advocate for Increased Property Tax Relief from the Commonwealth of Pennsylvania.

Create a State Circuit-Breaker Property Tax Relief Program—The Commonwealth should join 31 states in providing low-income property owners with an income tax credit calculated as a percentage of the property taxes paid in excess of a certain percentage of household gross income.

Expand State-Funded Low-Income Property Relief Programs—The Commonwealth should raise the maximum income eligibility requirements for participation in these valuable programs.

Recommendation 11: Increase Awareness About Real Estate Tax Relief Programs.

Expand informational property tax outreach programs and provide additional counseling for low-income tax delinquent property owners to increase the number of low-income and elderly individuals taking advantage of the property tax relief programs offered by the City and the Commonwealth.

Commercial and Residential Tax Rates Recommendations

Recommendation 12: Advocate for a Change in the Pennsylvania Constitution to Allow for Variable Real Estate Tax Rates.

The City should advocate for a change in the Pennsylvania Constitution that would allow the City to tax real estate differently based upon its use. Consultant research requested by the Commission indicated that commercial and industrial landowners are less sensitive to increases in the real estate tax rate than to other types of business taxes. Other business taxes could be reduced more quickly if a higher tax on commercial and industrial real estate were levied.

Real Estate Transfer Tax Recommendations

Recommendation 13: Do Not Reduce the Real Estate Transfer Tax Rate.

While the Real Estate Transfer Tax rate is one of the highest in the country, in the current economic climate other taxes should receive priority for the scarce resources available for tax reduction.

Recommendation 14: Recommend Technical Changes to the Real Estate Transfer Tax.

Restrict a taxpayer's ability to structure real estate transactions to avoid being subject to the tax.

Real Estate Non Utilization Tax Recommendations

Recommendation 15: Eliminate the Real Estate Non Utilization Tax.

This tax, designed to penalize the owners of unused, deteriorating property, has never been collected. After its adoption, its constitutionality was quickly challenged, and the court barred the City from collecting the tax. Rather than allowing this uncollectable tax to remain on the City's books, the Commission recommends eliminating it and relying on implementation of land-value taxation and increased enforcement efforts by the Department of Licenses and Inspections to achieve the goal of placing pressure on owners of under-utilized and deteriorating real estate to improve their properties.

Use and Occupancy Tax Recommendations

Recommendation 16: Do Not Reduce the Use and Occupancy Tax Rate.

Use and Occupancy business taxpayers will benefit significantly from the reforms and phase-out of the Business Privilege Tax, therefore other taxes should receive priority for the scarce resources available for tax reduction.

Recommendation 17: Repeal the Use and Occupancy Tax if a Constitutional Amendment Permits Philadelphia to Tax Different Classes of Real Estate at Different Rates.

Repeal the Use and Occupancy Tax if the Pennsylvania Constitution is amended to permit commercial and industrial Real Estate Tax rates to be higher than residential Real Estate Tax rates.

Net Income Portion of the Business Privilege Tax Structural Change Recommendations

Recommendation 18: Adopt Single-Sales Factor Apportionment.

Adopt sales receipts as the only factor for apportioning the net income base of multi-jurisdictional businesses. The current formula for apportioning income in Philadelphia double weights sales and equally weights the contribution of local property and payroll to a business' net income. Businesses that make sales in Philadelphia without locating here benefit from the current formula, while businesses maintaining buildings and employees in the city are penalized. This change would simplify Business Privilege Tax payment and collection while removing the disincentive to locate and grow here.

Recommendation 19: Grant Unincorporated Businesses a Deduction for Payments to Partners, Members, and Sole Proprietors when Calculating Net Income under the Business Privilege Tax

Allow unincorporated businesses to deduct payments made to partners, members, and sole proprietors. The Commission recommends initially allowing 50 percent deductibility and increasing deductibility to 100 percent by 2010. While such businesses may now deduct 60 percent of their Business Privilege Tax liability against the Net Profits Tax that they also pay, their effective tax rate remains higher than that of corporate competitors. This recommendation would level the playing field and help Philadelphia compete with the suburbs in attracting and retaining businesses.

Recommendation 20: Lengthen the Business Privilege Tax Net Operating Loss Carryforward Period.

Extend the net operating loss carryforward from three to 10 years, effective with excess losses reported on 2005 tax returns. Other jurisdictions, including the state and federal governments, allow such losses to be carried forward for 20 years. This reform would make Philadelphia more competitive and business-friendly towards start-up and high-technology companies with life cycles that often begin with many years of losses.

Business Privilege Tax Administrative Reform Recommendations

Recommendation 21: Establish Two Estimated Payment Dates.

Restructure the Business Privilege Tax estimated tax payment schedule by creating two estimated payment dates between April 15th and June 30th. The current structure forces businesses to pay their entire tax liability before they receive that year's gross receipts and net income, compounding the detrimental impact of the Business Privilege Tax on Philadelphia's ability to compete. New businesses must actually pay two years of taxes at once. This change would improve fairness, contribute to the city's ability to compete, and reduce the tax burden on fledgling businesses.

Recommendation 22: Unify Statutory Refund and Assessment Periods.

Set the statutory refund and assessment periods at a uniform three years. Currently, no ordinance limits the period within which the City is authorized to audit a taxpayer and assess additional tax. The City is authorized, by ordinance, to file a lawsuit for collection of unpaid taxes within six years of the date the return was filed or due. Conversely, a taxpayer is limited, by ordinance, to filing a refund claim within three years after the tax is paid. The net result is that the City can audit a five-year-old return and assess additional tax, but the taxpayer will not be able to claim a refund from a four-year-old return that could have offset the additional tax. This disparity creates the perception that Philadelphia has a discriminatory business tax environment, and hampers the City's ability to attract and retain businesses.

Incremental Elimination of the Business Privilege Tax

Recommendation 23: Incrementally Eliminate the Business Privilege Tax.

Eliminate the Business Privilege Tax by fiscal year 2015. This approach would minimize the revenue impact of this recommendation and allow the City to gradually adjust its budget. In addition to attracting new investment and retaining firms considering leaving the city, this measure will ensure that businesses no longer bear more than their fair share of the tax burden. The Department of Revenue will be able to enforce other business taxes more aggressively, and the process of running a business in Philadelphia will be simpler. The Commission's proposed gross receipts rate reductions through fiscal year 2008 are those already in the City's Five-Year Financial Plan. To minimize the financial impact of the Commission's three classes of Business Privilege Tax reform recommendations (structural change to the net income portion of the Business Privilege Tax, Business Privilege Tax administrative change, and Business Privilege Tax elimination), the phase-out of the net income portion of the Business Privilege Tax does not begin until fiscal year 2006.

Wage, Earnings, and Net Profits Tax Recommendations

Recommendation 24: Adjust Wage and Earnings Tax Rates on January 1st.

Adjust the rates of the Wage and Earnings Taxes January 1st of each year instead of July 1st. Fiscal year adjustments have resulted in an undue compliance burden, since firms report earnings on a calendar year basis for state and federal purposes. This recommendation will also make Wage and Earnings Tax rate changes consistent with those of the Net Profits and School Income taxes.

Recommendation 25: Accelerate Local Income-Based Tax Rate Reductions.

Accelerate the City's program of incremental reductions in the Wage, Earnings, and Net Profits Taxes reducing resident and nonresident tax rates to 3.25 percent by 2014. This approach minimizes the revenue impact of rate reductions and allows the City to gradually adjust its budget. By reducing the resident Wage Tax rate more rapidly than the nonresident rate, the resident and nonresident rates would equalize within 10 years. The rationale for this policy is that the City should allocate a greater share of its tax reduction investment to lowering taxes for its residents, in the absence of financial assistance from the Commonwealth to reduce the City's Wage Tax burden.

Recommendation 26: If the City Receives Support from the Commonwealth for Wage Tax Relief, Adopt a More Aggressive Program of Income-Based Tax Rate Reductions.

Assuming the City receives aid to finance Wage Tax cuts in an amount similar to that proposed under Governor Edward G. Rendell's Plan for a New Pennsylvania, the Commission recommends further reducing the Wage Tax rates, until 2014, when resident rates would be lowered to 3.0 percent and nonresident rates to 2.5 percent. This action would maintain the differential between residential and nonresidential payers to reflect the state aid allowing for the reduction.

Income Tax Relief Recommendation

Recommendation 27: Help Low-Income Philadelphians Apply for State and Federal Income Tax Relief.

Last year, 45,000 eligible Philadelphia households did not file for the federal Earned Income Tax Credit (EITC). An estimated $76.5 million in tax credits available under this program were not received by low- and moderate-income Philadelphia households. Pennsylvania Department of Revenue data also suggest that another $75 million in annual Commonwealth tax forgiveness is not received by eligible low-income Philadelphians.
The City should invest at least $1 million in the Greater Philadelphia Urban Affairs Coalition Campaign for Working Families, an initiative to increase participation in the EITC. This funding will help low-income families negotiate the application process necessary to receive federal and Commonwealth tax credits. It will also support additional outreach to low-income households, free and low-cost tax preparation services, and a new focus on expanding participation in the tax forgiveness program under the Pennsylvania Personal Income Tax.

Miscellaneous Tax Recommendations

Recommendation 28: Do Not Reduce the Sales Tax, Parking Tax, Amusement Tax, Vehicle Rental Tax, Hotel Room Rental Tax, Liquor Sales Tax, Mechanical Amusement Device

Tax or Hotel Use or Occupancy Tax Rates.

After conducting a comprehensive analysis of all taxes imposed in Philadelphia, the Commission has concluded that other taxes should receive priority for the scarce resources available for tax reduction.

Fiscal Impact of Tax Reform Commission Recommendations

After working closely with the City Departments of Finance and Revenue, the Commission estimates that its recommendations would result in a net revenue loss of $192.4 million to the City's general fund over the life of the City's fiscal year 2004-2008 Five-Year Financial Plan, and $142.4 million for fiscal year 2009 (assuming the City would otherwise have continued only incremental tax reductions that year). We believe these recommendations are fiscally and socially responsible because their incremental nature allows the City to gradually adjust its budget. These calculations used the most conservative possible assumptions and do not take into account any of the expected benefits from a more competitive tax structure.

Financing Tax Reform

As tax reform improves Philadelphia's economy, the tax base will grow; revenues will increase and there will be no long-term negative net fiscal impact. However, while the economy adjusts, a short-term fiscal gap may affect budgeted priorities. The Commission considered steps to address this critical problem. As a result, we are confident that the City can "finance" tax reform, and that the proposed package is fiscally responsible.

Economic Growth

If lowering certain taxes helps the city attract or retain firms and families, a tax reduction will not reduce tax revenues on a dollar-for-dollar basis; this effect will grow over time. Accordingly, the City can maintain a consistent level of essential service delivery without having to generate dollar-for-dollar replacement revenues. Although there is much debate about the magnitude of economic growth resulting from federal tax reform, there is widespread agreement among economists that reducing local taxes has significant positive effects.

The Commission retained Econsult Corporation to conduct an econometric analysis of tax reform policy options. Econsult's analysis of the Commission's recommendation to phase-out the gross receipts portion of the Business Privilege Tax and significantly reduce the Wage Tax rate suggests that:

- By 2010, an additional 47,604 Philadelphia jobs will be created. By 2017, 175,165 new jobs will be created.
- The median house value, in real terms, will increase in value by $7,617 by 2010, and by $19,325 by 2017.
- Through base expansion, the City will be able to recapture a total of $276 million of lost revenue by 2008.

Due to data constraints, econometric analysis of the proposals to phase-out the net income portion of the Business Privilege Tax, adopt single-sales factor apportionment and level the playing field between corporations and unincorporated firms is not possible. However, economic theory suggests that these reforms should produce a supply-side response similar to that generated by other tax cuts.

Local Implementation

We estimate that $42 million to $75 million in recurring revenues and $45 million to $55 million in one-time revenues could be generated from policy considerations not contingent upon state enabling legislation, state cooperation, or extensive cooperation with suburban jurisdictions.

Improve Tax Collection—According to the Department of Revenue, the City currently collects between 90 and 95 percent, depending on the tax, of the amount due within two years of the due date. This estimate does not include collection of non-reported taxes. Improving tax enforcement and increasing the penalty for non-compliance will reduce the burden faced by residents and businesses.

Initiate a Tax Amnesty Program—In conjunction with an increased effort to improve voluntary taxpayer compliance, a tax amnesty program could be implemented. This would bring new taxpayers onto the tax rolls and give eligible taxpayers a last chance to "come clean" before the implementation of aggressive new tax enforcement policies.

Analyze and Adjust the City's Fine Structure—The amount of a fine can be raised to whatever sum is necessary to discourage future violations, subject to any restriction imposed by the enabling statute or the state Constitution. All fines could be analyzed and selected fines could be increased.

Analyze and Adjust the City's Fee Structure—Many fees do not generate sufficient amounts of revenue to cover the cost of the services they are intended to fund. For example, the Gun Permit Fee generates $30,000 a year, yet the annual operating cost of the Gun Permits Unit is nearly $2.7 million. The City's fee structure could be analyzed and adjusted accordingly, increasing non-tax revenues.

Fees for Rights-of-Way Access—Philadelphia could follow the lead of other cities and increase charges associated with rights-of-way (ROW) access in order to recover costs associated with ROW management and costs, direct and indirect, generated as a result of street degradation and shortened street life.

Increase Code Enforcement—The ultimate goal of increased code enforcement is increased compliance. However, the experience of other cities indicates that increased code enforcement can lead to a temporary spike in non-tax revenues.

Collect Overdue Payments from Veterans Stadium Skyboxes—Efforts could be made to collect the entire amount still owed for City-funded renovations and construction of luxury boxes in Veterans Stadium.

Adjust the Five-Year Plan for Unanticipated Refinancing Projects—Unexpected savings could be used to fund tax reduction. For example, the savings realized by refunding a portion of the Philadelphia Municipal Authority bonds associated with the Criminal Justice Center and the Curran-Fromhold Correctional Facility could be dedicated to funding tax reform.

Increase Entrepreneurially Generated Revenues—The City could seek entrepreneurial ways to increase non-tax revenues, such as leasing rooftop space on City-owned buildings to telecommunication and broadcasting companies and marketing exclusive rights to concessionaires.

Budgetary Discipline

The Commission is prohibited from recommending specific expenditure reductions, municipal government cost savings, or municipal government service reductions in order to offset any potential revenue reductions. However, discussion with various official agencies, examinations of past efficiency gains, and analyses of initiatives in other municipalities, have convinced us that Philadelphia can achieve significant cost savings through improved government efficiency and effectiveness. The Commission proposes that future efforts include, but not be limited to:

- Routine review of programs to determine the benefits received for the dollars spent.
- Equitable sharing of spending reductions by all elected officials.
- Holding all top-level managers accountable for continuously improving city service and administrative functions.
- Consolidation of information technology operations and investment in newer technologies that would support improved business practices.
- Consolidation and reorganization of City agencies to improve accountability and reduce redundancy.

Commonwealth Cooperation

The City's efforts to achieve tax reform could benefit from active assistance from the Commonwealth of Pennsylvania. The following additional policy considerations are either contingent on state enabling legislation, state cooperation, or extensive cooperation with suburban jurisdictions.

Increase PILOT Payments by Tax-Exempt Institutions—The City could lobby the Commonwealth for the authority to establish formal payments in lieu of taxes (PILOTs) to require large non-profit organizations to pay for those City services that they use. Property owned by tax-exempt institutions accounts for about 25 percent of the city's total assessed value and annually costs $100 million in lost property tax revenues.

Expand the Sales Tax Base—The base of the Pennsylvania and Philadelphia Sales Tax could be expanded. Eliminating unnecessary exemptions would generate substantial revenue for both the Commonwealth and the City. However, the Commission believes that some items, such as groceries and medicine, should continue to be exempt from the Sales Tax. City officials should also consider urging the Commonwealth to join the Streamlined Sales Tax Project, to enable the City and the Commonwealth to collect Sales Tax from e-commerce vendors and other remote sellers.

Adopt a Regional Asset District Sales Tax—A regional sales tax could help fund parks, libraries, professional sports facilities, cultural facilities, historic sites, and civic facilities throughout the region. These promote economic development and enhance the quality of life for residents in southeastern Pennsylvania, and financial support for them should be spread through the region.

Regional Real Estate Tax Reform—A regional tax distribution plan could be established. This type of program redistributes resources based on need.

Adjust for Regional Disparities Though Statewide Funding Reform—The City could advocate for reforms to alter the manner in which local jurisdictions in the Commonwealth of Pennsylvania fund public education and county services. The City should also continue to lobby the Commonwealth to fulfill its constitutional obligation to fund the local court system.

Changing Philadelphia's Tax Mix

The Home Rule Charter directs the Commission to develop recommendations that will "decrease the overall tax burden on Philadelphia residents, individuals who work in Philadelphia, and Philadelphia businesses." After analyzing the fiscal and economic impact of different taxes, the Commission believes that long-term economic benefits would result simply from changing Philadelphia's tax mix.

Although the Commission is not recommending any tax increases, it believes that there would be substantial long-term economic benefits resulting from implementation of its tax reform recommendations, even if selected taxes were marginally increased. If the City cannot alter spending or generate additional revenues to cover short-term budgetary gaps, the City could—as a last resort—increase certain taxes to finance the proposed package of tax reforms and still generate positive results.

Increase Amusement Tax Revenues—The Amusement Tax could be increased from five percent to 10 percent of gross amusement related receipts. Since all forms of traditional drama, comedy, musical comedy, dramatic recitation of recognized works of literary art, and repertoire works are exempt from the Amusement Tax, the Commission feels confident that Philadelphia's cultural institutions would not be adversely affected by this tax increase.

Increase Parking Tax Revenues—The Parking Tax could be increased from 15 percent to 20 percent of gross parking receipts. Because the Commission's tax reform recommendations will mitigate the burden placed upon parking lot owners and operators, an increase in this tax would not overburden Philadelphia residents or businesses.

Increase Property Tax Revenues—If all other revenue generating options fail and there is no other way to fund the package of tax reform, the City could increase property-based tax rates. Evidence suggests that shifting from local business and wage taxes to property-based taxes will result in substantial increases in jobs, resident incomes, business activity, and property values. A budget-based system of property taxation would act as a relief valve that would allow the City to expand its reliance on property-based taxation only if it could find no other way of incorporating the Commission's package of reforms into the budget.

Tax-Related Economic Development Tools

Tax-related economic development tools have been necessary to offset obstacles to development created by Philadelphia's tax structure. As tax reform is realized, the City should reevaluate its mix of economic development tools to see if tax abatements, tax exemptions, tax increment finance districts, and collaborative tax incentive zones are still necessary. The following proposals—which could be implemented immediately—should be considered.

Develop a Comprehensive Economic Development Plan—In conjunction with quasi-public development agencies, the City should create a comprehensive economic development plan.

Add Sunset Review Clauses to Economic Stimulus Programs—Periodically review the usefulness of economic stimulus and economic development programs to evaluate their effectiveness and to determine if the life of these programs should be extended.

Expand Collaborative Economic Development and Tax Incentive Programs—The Commission's recommended package of tax reform reduces the City's net cost of participating in these programs. Therefore, the City should vigorously lobby for Commonwealth designation of additional Keystone Opportunity Zones and other collaborative programs that provide state and local businesses tax incentives.

Complementary Reform Considerations

If tax reform is to be feasible and meaningful, it must be accompanied by other reforms in the way the City manages the business of government. The following proposals will complement and enhance the Commission's package of tax reform recommendations.

Improve Interactions Between Taxpayers and the City's Revenue-Collection Bureaucracy—The City should invest in the technology necessary to make the taxpaying experience more accessible and less antagonistic by using telecommunications technology to make paying taxes more customer-friendly and collections more certain.

Create an Office of Tax Policy—Given the influence that taxes have on the City's long-term economic health, the City should invest in an institutionalized capacity to analyze tax and economic development policy. An Office of Tax Policy, forms of which exist in New York City and Washington D.C., would monitor Philadelphia's tax policy and the City's largely decentralized economic development policy and report on changes necessary to maintain and improve the tax system.

Continue to Research the Feasibility of Implementing a City Income Tax—The Commission considered, but did not recommend, a proposal to replace four income-based taxes—the Wage Tax, the Earnings Tax, the Net Profits Tax, and the School Income Tax—with a single City income tax using the same base as Pennsylvania's Personal Income Tax. A relative dearth of information about the economic impact of this proposal prevented the Commission from recommending a City income tax. However, the Commission believes that this idea deserves further consideration. A Philadelphia Office of Tax Policy would be well suited to continue this research.

Evaluate Tax Expenditures—City officials and the public should be able to apply the same degree of scrutiny to tax incentives as to direct expenditures and determine whether the investment of public resources is justified by the social benefits. The City should annually publish a tax expenditure report containing information about each tax expenditure's source in law, rationale, and an estimate of actual and projected costs by fiscal year. The City should also periodically undertake cost-benefit analyses of its major tax expenditure programs. The Office of Tax Policy could perform these analyses.

Attach Fiscal-Impact Statements to all Proposed Pieces of Legislation—The Administration and City Council currently have no means of assessing whether a bill under consideration represents sound fiscal policy. To remedy this problem and to help promote better tax policy, the Commission believes that a fiscal-impact statement should be attached to all proposed pieces of local legislation.

Amend the Pennsylvania Uniformity Clause—In 1874, the citizens of Pennsylvania amended the state Constitution by adding a series of provisions aimed at limiting the General Assembly's authority to enact economically preferential legislation. One of these provisions was the Uniformity Clause, which states that, "all taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax." This clause has often prevented taxing authorities from reforming the tax system to meet policy goals and could be amended so that elected officials would have more flexibility in crafting tax policy.

Create a Rainy-Day Fund—The City Charter requires that the City's annual operating budget be balanced. Because of this restriction, the City has routinely overestimated some expenditure categories while underestimating revenues, in order to maintain a sufficient cushion in the budget to ensure financial stability. A rainy-day fund designed to hold expenditures down in good times and save for hard times would help Philadelphia meet long-term service demands and continue planned tax reductions during periods of economic contraction. Unlike the current fund balance, a rainy-day fund would have strict legal triggers for fund contributions and formulas to determine the amounts of fund withdrawals.

Create a Non-Tax Revenue Master List—The Commission believes that the City should evaluate its license charges and fees on a regular basis to determine whether the City generates enough revenues to adequately cover administration expenses, whether charges are unreasonably high and should be lowered, or whether charges are nuisances to collect and administer and should be abolished. A comprehensive master list of all non-tax revenue would help facilitate this process.

Reform the City's Regulatory Processes—Outdated and unnecessarily burdensome regulations have been cited as a major deterrent to business growth in Philadelphia. The City could establish a Regulatory Study Commission to evaluate the relevance, necessity, cost, and benefit of any new City regulations, and serve as a filter agency through which proposed regulations are passed on to City Council. Concurrently, a Code Task Force could review and revise the existing Regulatory Code to eliminate or consolidate regulations that are outdated, costly, or counterproductive. Inter-agency databases should be expanded and agency personnel should be cross-trained to improve coordination among the multiple agencies involved in the regulatory process and allow caseworkers to address concerns raised by customers. Payments for licenses and permits should be accepted on-line by credit card and customers should be able to check the status of their applications and access code and payment requirements on-line.

Extract Greater Value From City Assets—Large assets such as Philadelphia International Airport, Philadelphia Gas Works, and Philadelphia Water Department are the types of entities that Philadelphia's competitor cities do not typically own and operate. The City could actively explore ways to extract greater value from its assets. Possible options include increasing annual transfer payments made to the City, transferring operations to a government authority or a private contractor for a substantial upfront fee, and selling smaller city assets.

Market Philadelphia's New Tax Structure and Improved Business Climate—Assuming that the Commission's recommendations are enacted into law, the Commission proposes that the City, in cooperation with private sector leadership organizations, invest in a new program of marketing Philadelphia's business climate, highlighting tax reform and other public initiatives that enhance the City's and the region's competitiveness. The marketing message should focus on the entire package of reforms implemented since the early 1990s, and ongoing initiatives, including fundamental tax reform. The economic benefit of the Commission's recommendations will be leveraged to the extent that business decision makers and investors are aware of the City's tax reform plans, and other progressive steps to improve the City's competitiveness.

Conclusion

Implementing the Commission's recommended package of reforms will not be easy, nor will it happen overnight. Philadelphia's high tax burden and damaging choice of taxes is a problem that developed gradually over more than half a century, and it is a problem that will not be fixed in a year or even five years.

The Commission's plan is ambitious yet feasible. The recommendations are phased in over a 10-year period, so the City can have time to adjust and the economic benefits of tax reduction can be realized. With fiscal discipline and skill in gaining support and resources from all levels of government, the City can adopt the reformed tax structure we recommend without reducing the services that Philadelphia residents want and need.

The Commission is asking Philadelphia's citizens and public officials to have the courage and the foresight to recognize what we ourselves have concluded after 10 months of intensive discussion and research: tax reform is a prerequisite to the sustained economic development that we all hope to achieve. The primary message of this report, and the research on which our recommendations are based, is that in the long run everyone wins from tax reform.

Indeed—if Supreme Court Justice John Marshall is correct that "the power to tax involves the power to destroy"—it is equally true that the power to design a sound tax policy is the power to create. We can create a city where the burdens and benefits of citizenship are fairly divided, and where economic opportunity abounds. Philadelphia's story in the 21^{st} century *can* be a story of rebuilding and growth.

Section 1: The Vision

When we, the members of the Philadelphia Tax Reform Commission, began to review the City's tax structure in January 2003, we brought to the table diverse backgrounds and different perspectives on the city, on public policy, and on taxes. We differed about the importance of the City's tax structure as a public policy problem and a vehicle for change, which taxes posed the greatest problem for the city's economy, and the fiscal feasibility of reducing taxes at all. It is testimony to the power of the evidence we have reviewed and the strength of the case for tax reform that we came to substantial agreement on a broad package of fundamental tax reforms.

The research and survey evidence we have reviewed, the testimony we have received, and our own personal experiences, taken as a whole, point clearly to the same conclusion. Philadelphia's tax structure has had damaging effects on the city's economy. While we cannot predict fully the impact of the changes that we propose, it is quite clear that without a major overhaul of our tax system, sustained, vibrant economic recovery will be difficult to achieve. At the conclusion of a 10 month process of research and deliberation, we believe that fundamental tax reform is a prerequisite to the economic transformation of Philadelphia.

We share a compelling vision of Philadelphia's future, if we embark today on a comprehensive, long-term tax reform plan.

The Vision

The City's Economy is Vibrant

As artificial barriers to the city's development created by the onerous tax structure are lifted, the true potential of the city as a venue for the productive combination of ideas, influences, and exchange might be realized. The increased size and density of the city economy will create a larger market for suppliers, more choices for customers, and faster diffusion of new ideas—all of which will make Philadelphia firms more competitive and successful. The increased productivity of the city economy will bring new jobs and businesses to Philadelphia, providing higher incomes and property values.

The economic development will bring with it new construction, more professional service and technology jobs, and continued growth in the hospitality sector. Many newly employed professionals will choose to live downtown, fueling increased demand for new residential development and an increasingly vibrant nightlife. The current movement of suburban empty nesters back into the city will continue and broaden support for Philadelphia's cultural institutions. Demand for housing in city neighborhoods will increase as well, reversing decades of housing abandonment and declining property values. Those new residents will patronize neighborhood restaurants and stores, leading to more neighborhood jobs and businesses.

Philadelphia Residents Can Work in Their Own City

Economic development will benefit residents of Philadelphia. Instead of enduring long commutes to suburban jobs, there will be new opportunities for employment within the city, closer to their homes, families, and children. Enhanced job opportunities can create the realistic possibility of attaining self-sufficiency for thousands of low-income residents.

City Government Provides Quality Public Services

A larger tax base will enable city residents and businesses to receive the services that they need and demand at a lower tax cost. As economic growth drives up property values throughout the city, the School District will receive increased Real Estate Tax and Use and Occupancy Tax revenue with no increase in the tax rate. Combined with increased Commonwealth support, the District should be able to provide its students with the same educational resources now enjoyed by students throughout the region.

Philadelphia's Tax Structure is Fair and Simple

Of course, the greatest impact will be on the tax system itself. Taxpayers will have to spend less time and money complying with the tax laws, and have greater confidence that they are being treated fairly. The Real Estate Tax paid by property owners will reflect the true market value of their property. No neighborhoods will be systematically over assessed or under assessed. Over time, individuals will be more likely to trust the property tax assessment system, especially since they will have greater access to information on how their assessment is determined and assistance in filing appeals. The Wage Tax rate will be significantly lower, no longer taking such a large bite out of paychecks.

The City of Philadelphia is the Region's Economic Engine

An increasingly productive City economy will benefit the entire region. Suburban firms and residents will obtain higher quality services—ranging from legal, architectural, and accounting services to health care and office supplies—at lower costs. Suburban businesses will benefit from being located in a more competitive metropolitan area and the wages and incomes of their workers should increase. City and suburban property values are likely to rise to a level more comparable to other major cities in the Northeast.

Philadelphia's Tax Rates Are No Longer a Major Obstacle to Economic Prosperity

Businesses and individuals will no longer be forced to balance the prestige, convenience, and productivity of a Philadelphia location against the City's onerous tax burden. The Philadelphia region should move up in the rankings of city business climates published by national magazines. The improved tax structure, coupled with the city's existing strengths, will provide the city, the region, and the Commonwealth with the tools necessary to effectively market Philadelphia.

Today's Reality

Today, Philadelphia's local Wage Tax rate is higher than that of any city in the country. The City's Wage Tax rate is more than four times that in nearly every surrounding suburban community. The City's business tax rates are higher than in any other city except New York City, and Philadelphia is the only city in the country that taxes both business gross receipts and net income. The overall tax burden on residents—taking into account all local taxes—is second only to New York City among the nation's largest cities. Numerous studies have demonstrated what common sense suggests: these high tax rates have driven out of the city hundreds of businesses and thousands of residents that otherwise would have stayed. Since 1969, the City has lost a total of 255,800 jobs and 432,446 residents. An onerous and illogical tax structure appears to have been a major factor contributing to this loss.

The Road Map

The reality of 2003 is a far cry from this vision of Philadelphia. The fundamental message of this Commission, however, is that if we hope to achieve this vision, fundamental tax reform must be part of the process. This report provides a road map to achieve that vision.

The necessary changes will not be easy, nor will they happen overnight. The City's high tax burden and damaging choice of taxes is a problem that developed gradually over more than half a century, and it is a problem that will not be fixed in a year or even five. The magnitude of the required change is great, and the City budget could not withstand the impact of immediate implementation.

Our recommendations are phased in over a 10-year period, to allow the City to make the necessary fiscal adjustments. Further, this time frame will allow the economic benefits of tax reduction to be realized.

The Commission's plan is ambitious yet feasible given the timetable established. With fiscal discipline and skill in gaining support and resources from all levels of government, the City can adopt the reformed tax structure we recommend without reducing the services that Philadelphia residents want and need. Two things, above all else, are required to implement our plan: the will of public officials and the support of the citizens of Philadelphia.

The Commission is asking Philadelphia's citizens to think seriously about tax reform, weigh the evidence, and follow the debate. Citizens should consider our proposals in a public spirited way, and, when taking a position on tax reform, give weight to the interest of the entire city as well as their own interests as residents. Further, citizens should take the long view—consider the effects of tax reform over the next 10 or 20 years, and especially how their children and grandchildren will be affected.

The Commission is asking the City and the Commonwealth's elected leadership to have the courage and the foresight to recognize what we ourselves have concluded after 10 months of intensive discussion and research: tax reform is a prerequisite to the sustained economic development that we all hope to achieve. The primary message of this report, and the research on which our recommendations are based, is that in the long run everyone wins from tax reform: city residents, workers, property owners, and the working poor. Most important, the primary beneficiaries of our recommendations will be our children. They are the ones who will benefit most from a growing economy, with increased employment opportunities, wealth, and the promise of a better future.

Indeed—if Supreme Court Justice John Marshall is correct that, "the power to tax involves the power to destroy"—it is equally true that the power to design a sound tax policy is the power to create. We can create a city where the burdens and benefits of citizenship are fairly divided, and where economic opportunity abounds. Philadelphia's story in the 21^{st} century *can* be a story of rebuilding and growth.

Section 2: Guiding Principles of a Quality Local Tax System

When crafting its recommendations, the Tax Reform Commission was guided by the following principles of a quality local tax system: competitiveness, equity, stability, neutrality, and simplicity. A summary of these principles is provided below.

Competitiveness

A municipality's tax burden is one of the many factors that influence the location decisions of families choosing a home; workers selecting a job; and businesses choosing where to locate and invest. When calculating total tax burden, it is important to consider the tax rate, tax stability, tax administration, and tax structure. When a municipality's tax burden is higher than that of competitor jurisdictions, it is difficult for that municipality to attract and retain residents, businesses, and jobs.

Equity

The principle of horizontal equity suggests that the tax system should impose a similar burden upon similar types of taxpayers. The principle of vertical equity, often referred to as progressivity, suggests that the tax system should recognize the differing abilities of taxpayers to pay. These two principles often conflict. For example, horizontal equity would require all residential property owners to pay at the same property tax rate, while vertical equity would demand that groups of asset-rich and income-poor individuals be given a property tax break.

The Uniformity Clause in Pennsylvania's Constitution makes the central principle of a progressive tax system—that taxes be levied in accordance with people's ability to pay—virtually impossible. Nonetheless, tax reform that imposes a similar burden on similar types of taxpayers, and policy initiatives that address ability to pay issues, increase tax system equity.

Stability

As tax revenues are used to fund essential public services, it is necessary for the tax structure to generate a relatively stable stream of revenue. Stability of revenues is important, since the demand for local services does not decrease, and may even increase, during economic recessions. A balanced tax portfolio ensures that tax revenues will not be unduly sensitive to upward or downward swings in the economy.

Neutrality

Tax neutrality is a core component of the Commission's mission to help Philadelphia attract and retain both businesses and residents. The principle of tax neutrality is based upon a conviction that the economy and the marketplace, rather than the tax structure, should influence location decisions made by residents, workers, and businesses. Typically, municipalities interested in achieving greater tax neutrality reduce the cost of tax compliance and shift the tax structure away from mobile factors of production such as capital and labor.

Simplicity

A clear and easily understood tax structure minimizes both the monetary and non-monetary costs incurred by businesses and residents trying to comply with the tax system.

By promoting tax system simplicity and transparency, it is possible to reduce the tax burden borne by residents, workers, and businesses without affecting tax revenues. Increasing tax system simplicity has the ancillary benefit of reversing the erosion of trust that can occur when taxpayers perceive the system to be overly complex.

Section 3: Historical Overview of Philadelphia's Tax System

The power to tax is, and has always been, vested by the Pennsylvania Constitution solely in the Pennsylvania General Assembly. The General Assembly has the power to delegate that authority to local elected bodies through enabling legislation in which it defines the scope of their authority. Article VIII of the Constitution, entitled "Uniformity of Taxation," restricts the power of the General Assembly to the imposition of taxes that are "uniform, on the same class of subjects…"[1] This uniformity requirement follows the delegation of tax authority, subjecting all local taxation to the same constitutional uniformity standard.

Philadelphia has been delegated the authority to impose City and School District taxes, but only City Council is delegated the power to tax. The School District of Philadelphia is governed by an appointed, not an elected, body. Therefore, the General Assembly cannot delegate to it any direct authority to impose taxes. Rather, the School District's authority is derived from and limited by the City's power to tax and any restrictions imposed upon that power. The General Assembly imposes special requirements upon City Council's exercise of its authority to impose School District taxes and its responsibility to fund the School District's budget.

Since colonial days, Philadelphia has imposed a tax on property. The tax originally extended to personal property, which included parcels but apparently, not residences and structures. Over time, the tax base expanded to include all real property. The modern real estate tax structure was authorized in 1933 when the General County Assessment Act established uniform assessment procedures. This act grants Philadelphia the power to impose a tax upon the real estate located within its territorial limits, subject only to constitutional and state exemptions and the restrictions of the Uniformity Clause of the Pennsylvania Constitution.

Philadelphia's broadest power to tax was authorized by the Sterling Act. Enacted in 1932 in the midst of the Great Depression, the Sterling Act allows Philadelphia to tax any person, transaction, occupation, privilege, subject, or personal property, provided that such items are within the geographic limits of the City and are not subject to a state tax or license fee. The Mercantile License Tax (1953-1984), the Real Estate Transfer Tax, the Wage and Net Profits Tax, and several minor taxes derive their authority from the Sterling Act.

In 1963, the legislature enacted the First Class City Public Education Home Rule Act, commonly referred to as the "Little Sterling Act." This act authorizes City Council to grant the School District the power to impose a tax upon anything the City is permitted to tax, except the wages or net income of nonresidents. The City derives its current authority to impose the Philadelphia School Income Tax and the Business Realty Use and Occupancy Tax from the Little Sterling Act. In the past, the act provided authority for the now-repealed School District's General Business Tax on gross receipts and its Corporate Net Income Tax. In 1971, the General Assembly enacted the First Class School District Liquor Sales Tax Act, which authorized the City to impose a dedicated 10 percent tax on retail sales of liquor to benefit the School District.

With the First Class City Business Tax Reform Act enacted in 1984, the legislature for the first time permitted Philadelphia to impose a privilege tax measured by net income, a subject of tax previously reserved for the State and prohibited to the City pursuant to the Sterling Act. Although the Sterling Act authorized the Mercantile License Tax, also a tax based upon gross receipts, Philadelphia was previously barred from imposing any corporate level business tax measured by net income. Pursuant to the authority granted by this enabling legislation, City Council adopted the Business Privilege Tax, a tax levied upon a taxpayer's net income and a tax levied upon gross receipts.

The Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (the "PICA Act"), enacted in 1991, further expanded the City's tax authority.[2] Enacted to assist the City's efforts to access the debt markets to secure the loans required to resolve a financial crisis, the PICA Act authorized new City taxes. Pursuant to this legislation, the City dedicated a portion of the existing resident Wage, Earnings, and Net Profits Tax to secure the debt repayment. It then imposed the Sales and Use Tax and Hotel Occupancy Tax to replace those revenues in the General Fund.

The History of Philadelphia's Wage Tax

The 1930s–Creation of the Wage Tax

During the Great Depression, to "afford relief for the welfare and unemployment situations in Philadelphia,"[3] the General Assembly enacted the Sterling Act. That act authorized Philadelphia to impose a tax upon any item or transaction within its territorial limits, provided that the item or transaction was not subject to a current or future State tax or license fee.

Due to strong opposition from Wage Tax opponents, the City was slow to act following the enactment of the Sterling Act. Ultimately the City, which was experiencing considerable budgetary problems, decided to temporarily adopt a Wage Tax. The first ordinance, adopted in late 1938 and quickly repealed on January 7, 1939, imposed a 1.5 percent tax upon the wages and net profits of residents and nonresidents working in the City, but exempted certain domestic workers from tax and allowed a credit for Real Estate Tax paid.[4]

After amending the original legislation to satisfy the Uniformity Clause, on December 13, 1939, the City enacted the current Wage, Earnings, and Net Profits Tax (the "Wage Tax"). With that act, Philadelphia gained the dubious distinction of being the first city in the nation to impose a personal income tax. The first year the Wage Tax was collected, 1940, the tax provided 28 percent of all City and School District tax revenues, establishing itself as an important factor in the City budget process.

The 1940s–Growing Reliance on and Opposition to the Wage Tax

The 1940s ushered in a wave of challenges and campaigns to eliminate or reduce the harshness of the unpopular Wage Tax. The tax had been sold to opponents as a temporary measure to help the City weather the fiscal and human services crises caused by the Depression. However, it quickly became a permanent and increasing source of tax revenue. Opponents of the tax continually tried and failed to cap the tax rate and exempt nonresidents. The tax's proponents justified inclusion of nonresidents with the argument that the City provided substantial benefits to nonresident employees through City services and provision of high-income jobs.[5]

By the late 1940s, Real Estate Tax revenues, as a percentage of total tax revenues had declined from a pre-Wage Tax average of more than 90 percent to 57 percent in 1947. Meanwhile, the share of tax revenues from the Wage Tax rose from 28 percent of 1940 tax revenues, to 37 percent of 1947 tax revenues.

Suburban legislators, frustrated in their attempts to exempt nonresidents from the Philadelphia Wage Tax, sought to transfer a portion of Wage Tax revenues to the suburban jurisdictions by granting those jurisdictions the authority to impose their own tax on the earnings of their residents. Heeding their requests, the General Assembly passed Act 481 during the 1947 legislative session. This Act, referred to as the "Tax Anything Act," granted most local jurisdictions the same taxing authority that the Sterling Act granted to Philadelphia. However, to the exasperation of Philadelphia's suburbs, Act 481 required that local jurisdictions allow all nonresident Philadelphia employees to credit the Philadelphia Wage Tax against the income taxes otherwise due. This provision effectively eliminated support for such local legislation.

Residents, nonresidents, and federal and state employees all fought this tax in the courtroom. In *Dole v. Philadelphia*, 11 A.2d 163 (Pa 1940), a Philadelphia resident wage earner lost his challenge when the Pennsylvania Supreme Court upheld the constitutionality of the tax. Federal employees working in Philadelphia launched a series of challenges. In *Kiker v. City of Philadelphia*, 31 A.2d 289, 346 Pa. 624 (1943), *cert. denied*, 64 S. Ct. 41, 320 U.S. 741, 88 L.Ed. 439, a New Jersey resident employed at the Philadelphia Navy Yard unsuccessfully challenged the constitutionality of the tax on the dual grounds that Philadelphia had no authority to tax him as a nonresident and had no authority to tax him as a federal employee working on federal property. A Pennsylvania state employee lost a similar challenge in *Marson v. Philadelphia*, 342 Pa. 369, 21 A. 2d 228 (1941). Challenges to Philadelphia's authority to impose the tax on federal employees continued into the 1970s but were consistently rejected by both state and federal courts.[6]

Finally, in 1947, opponents of the Wage Tax managed to secure limitations upon the spread of the tax through amendments to the "Tax Anything Act." A one percent cap was placed on Wage Tax levies in first class counties, and second, third, and fourth class counties were restricted from imposing a wage tax on nonresidents.

The 1950s–Continued Opposition

Active opposition to the Wage Tax continued unabated into the 1950s, with repeated attempts to repeal the nonresident wage tax provisions. However, throughout the decade the legislature steadily approved higher wage tax caps. By 1957, the tax rate rose to 1.5 percent. With the end of the post-World War II economic boom, efforts to restrain the growth of the Wage Tax were undermined by the decline in Philadelphia's economy.[7] Mayor Richardson K. Dilworth successfully argued that the budget surpluses of prior years would soon end and Wage Tax rate increases would be the only method of balancing the general budget.

The 1960s–Further Expansion of the Wage Tax

Between January 1960 and January 1969 the Wage Tax rate doubled from 1.5 percent to three percent. During this period, the City continued to increase its reliance upon Wage Tax revenues and decrease its reliance upon Real Estate Tax revenues. The decade began with a 44 percent Real Estate and 38 percent Wage Tax share of total City and School District revenues and closed with 29 percent and 55 percent shares, respectively. During the 1963, 1965, and 1967 General Assembly sessions, opponents of the tax introduced legislation that would have exempted nonresidents. These efforts failed each time.

The 1970s–Limited Success for Wage Tax Opponents

Pennsylvania imposed its first state tax on wages with the enactment of the Personal Income Tax in 1971. When the Sterling Act was enacted in 1932, Pennsylvania reserved the authority to bar Philadelphia from imposing a tax upon any item that Pennsylvania chose to tax in the future. Special legislation, a "Savings Clause," was included to preserve Philadelphia's Wage Tax and avoid a major fiscal deficit in the City.

During the early 1970's the Wage Tax rate increased to 3.3125 percent. Triggered by a further Wage Tax increase in 1976 to 4.3124 percent, in 1977, opponents of the Wage Tax upon nonresident income successfully convinced the General Assembly to amend the Savings Clause by imposing limitations on the City's authority to increase the tax rate applicable to nonresidents. Pursuant to that legislation, the nonresident tax rate was capped at the then current rate of 4.3125 percent until the rate imposed upon City residents rose higher than 5.75 percent. If the rate imposed upon residents reached this level, the nonresidents rate could be increased, except that the rate imposed upon nonresidents could never exceed 75 percent of the rate imposed upon residents. The decade closed with no further changes to the Wage Tax rate, which stood at the statutory maximum of 4.3125 percent for both residents and nonresidents.

The 1980s–Adoption of a Split-Rate

In July 1983, Philadelphia created its first differential between the nonresident and resident Wage Tax rates. The resident rate rose to 4.96 percent while the nonresident rate remained frozen at the 4.3125.

Philadelphia residents, asserting that the differential violated the Uniformity Clause, challenged the constitutionality of this split-rate structure.[8] The Pennsylvania Supreme Court upheld the tax on the grounds that the City had a reasonable and non-arbitrary basis for imposing a higher tax rate upon its residents than upon the nonresidents.

The 1990s–Philadelphia's Fiscal Crisis and the Gradual Rate Reductions

During the early 1990s, Philadelphia experienced a serious fiscal crisis. Its budget deficit was inhibiting the City's ability to provide essential services and impeding it from accessing the bond markets. After much debate, the City and the Commonwealth agreed to work together to resolve the City's financial problems. In 1991, the General Assembly created the Pennsylvania Intergovernmental Cooperation Authority ("PICA") to oversee the City's finances.

The General Assembly legislatively obligated the City to submit annual five-year financial plans for PICA's approval. PICA was vested with the power to borrow money, issue bonds, and secure the payment of the bonds with a dedicated source of tax revenue. The City, with the agreement of PICA, was authorized to impose one or more new taxes as a dedicated funding stream to secure debt repayment, or as a replacement source for general fund revenues from established taxes that were dedicated to debt repayment. The menu of new taxes included new authority to impose a City Sales and Use Tax, a Hotel Occupancy Tax, and the option of dedicating a portion the City's Wage Tax revenues to debt service.

PICA was unwilling to rely upon revenues from new taxes for which the City had no revenue history. Consequently, the City chose to dedicate 1.5 percent of the resident Wage and Net Profits Tax to servicing the debt on the PICA bonds.[9] The total wage tax rate structure remained the same. Only the allocation of the revenue changed.[10] The City then enacted a one percent City Sales and Use Tax and a one percent Hotel Occupancy Tax to close the funding gap created by dedicating a portion of the Wage Tax to PICA bond repayment.

In 1994, the City successfully secured State legislation requiring Pennsylvania's suburban employers of Philadelphia residents to withhold the Wage Tax and remit it to the City. This change significantly improved tax collection.

Recognizing that Philadelphia's fiscal crisis was linked to the City's struggling economy, Mayor Edward G. Rendell implemented a gradual Wage Tax reduction program. Fears of creating another fiscal crisis limited the magnitude of these rate cuts. During the first five years of the Wage Tax rate cut, the resident rate declined from a 1983–1995 high of 4.96 percent to 4.5635 percent, and the nonresident rate decreased from a 20-year high of 4.3125 percent to 3.9672 percent, effective July 1, 2000. This program of gradual Wage Tax rate cuts was designed to send the message that the City was serious about changing its tax structure and improving its business climate. Many economists and businesses considered these Wage Tax rate cuts to be long overdue.

The History of Philadelphia's Business Taxes

Philadelphia's First Business Tax

The early history of Philadelphia's business taxes parallels that of the Wage Tax. When the Sterling Act was first adopted, Philadelphia was preempted by the State's Corporate Net Income Tax from imposing a tax upon the net income of corporations doing business in Philadelphia. Unincorporated businesses were not subject to the State's corporate income tax. Consequently Philadelphia was authorized to tax their net income. When the City finally adopted the Wage Tax in 1939 it also implemented a tax upon the net profits of unincorporated businesses. Although it is perceived to be a separate tax, the Net Profits Tax continues to be subject to the same tax rates as those imposed upon resident and nonresident wage earners. The Net Profits Tax remained the sole business tax imposed by the City until 1950.

1950s–New Business Taxes and Rate Increases

In the early 1950s, to relieve fiscal pressure that had been building throughout the 1940s, Philadelphia increased the Net Profits Tax rate to 1.25 percent. At the same time, the City attempted to broaden its business tax base. Although the City unsuccessfully attempted to expand the Net Profits Tax to include corporations,[11] during this decade it imposed both a School District and a City tax upon the gross receipts of local businesses. The City was able to pass these gross receipts-based taxes despite the Sterling Act's prohibition of duplicate Pennsylvania and Philadelphia taxation, because the Commonwealth only taxed business net income.

The School District Gross Receipts Tax was enacted in 1950. In the late 1940s and early 1950s, the School District engaged in a capital campaign to build more schools to accommodate the post-war baby boom. In response to these funding needs, the General Assembly authorized the School District, contingent upon the approval of City Council, to impose a Gross Receipts Tax upon any business operating within the district.[12] When, pursuant to that legislation, City Council authorized the School District General Business Tax effective January 1, 1950, the School District became the beneficiary of the first local tax upon both incorporated and unincorporated businesses. The General Business Tax imposed a one mill[*] tax upon receipts from business transacted within the School District by any resident or nonresident, incorporated or unincorporated business.

Two years later, pursuant to the authority of the Sterling Act, City Council imposed the Mercantile License Tax upon incorporated and unincorporated businesses for the privilege of doing business in the City. The Mercantile License Tax was set at a tax rate of three mills upon the annual gross volume of business transacted in the City. All revenues flowed directly to the City's General Fund.

[*] One mill is 1/1000, or one-tenth of one cent.

This tax spawned a flood of litigation.[13] Citing the Sterling Act's prohibition of City taxation of any item that was the subject of a state license fee, state licensed and regulated businesses asserted that they were exempt.

Although the Pennsylvania Supreme Court upheld the constitutionality of the Mercantile License Tax, it held that state licensing fees and regulations preempted the City from imposing this tax upon the banks, savings and loan associations, securities dealers and a myriad of other industries.

1960s–Philadelphia's Increasing Reliance on Business Taxes

During the 1960s, like individuals subject to the City's Wage Tax, unincorporated businesses liable for the Net Profits Tax experienced a doubling of rates, from 1.5 percent in 1959 to three percent in 1969. In 1968, City Council amended the School District's General Business Tax, doubling the millage rate to two mills, but capping the tax at two percent of net income—which effectively created a tax of the lesser of two mills of gross receipts or two percent of net income.[14] The business tax burden grew two years later when, pursuant to the authority granted by the General Assembly in the First Class City and School District Corporate Net Income Tax Act of 1969, the City enacted the Corporate Net Income Tax to benefit the School District.[15] This tax imposed a rate of three percent upon net income of corporations for the privilege of doing business within the City.

1970s–Creation of the Business Realty Use and Occupancy Tax and Repeal of the School District Net Income Tax

During the 1970s, the City continued to explore other sources for business tax revenues. In 1970, City Council authorized the School District to impose a Business Realty Use and Occupancy Tax upon all incorporated and unincorporated businesses. Two years later, the School District and City Council elected *not* to re-authorize the unpopular Corporate Net Income Tax, the apparent result of the School District's forced choice between the Corporate Net Income Tax and the Business Realty Use and Occupancy Tax. During the years that businesses paid both taxes, the City's revenue from each tax was roughly equal: in 1970, $13.7 million in revenue Corporate Net Income Tax and $11.3 million from the Use and Occupancy Tax, and in 1971, $13.3 million from the Corporate Net Income Tax and $14.0 million from the Use and Occupancy Tax. [16]

1980s–Sweeping Business Tax Reform

To raise the revenues necessary to stave off an impending fiscal crisis, Mayor William J. Green embarked upon a major overhaul of City business taxes:

- Initially Mayor Green increased the Mercantile License Tax rate from three mills to four mills; a year later he increased the rate from four mills to five mills. During this time, the tax was also amended to provide that taxpayers could only deduct 50 percent of their receipts from out-of-City deliveries (prior to this change such deliveries were 100 percent exempt).

- In 1980, the Business Realty Use and Occupancy Tax rate doubled, increasing from 1.25 percent to 2.5 percent. This tax rate was increased again in 1982 to 3.25 percent.
- The Real Estate Transfer Tax (a tax that affects both businesses and individuals) underwent a series of rate increases: doubling from one percent to two percent in 1981 and increasing to 2.5 percent in 1983.
- In 1982, the business Net Profits Tax rate increased to 4.96 percent.
- In 1983, the Mechanical Amusement Device Tax, imposed upon all coin operated entertainment machines or devices except jukeboxes, quadrupled from $25 to $100 per machine.
- Only the School District's General Business Tax remained untouched.

Business Tax Committee

Mayor Green's actions alarmed the business community—the Philadelphia Chamber of Commerce demanded that Mayor Green revoke these tax increases before further damaging the City's economy and business climate. The Mayor contended that he was forced to adopt such severe increases as a result of the fiscal crisis he inherited upon taking office. His predecessor, Mayor Frank L. Rizzo, had granted generous wage concessions to the City's labor unions that were straining the City's finances. Nevertheless, he invited the Chamber of Commerce to provide a better, more equitable business tax structure that addressed the City's fiscal needs. The Chamber of Commerce, in conjunction with the Greater Philadelphia First Corporation, formed the Business Tax Committee to evaluate a business privilege tax as an alternative to the Mercantile License Tax and General Business Tax.

The Business Tax Committee decided that two structural changes were necessary:

- The tax base had to be broadened to include the financial and other regulated industries protected from taxation by the Sterling Act and by the implied preemption doctrine applied by the courts to exempt certain industries from the Mercantile License Tax.
- To make the business tax structure more equitable, the tax should be imposed upon net income, not gross receipts, thereby basing the tax upon a business's ability to pay.

Under the Sterling Act, the State's Corporate Net Income Tax preempted such a City net income tax on corporations. Thus, the Business Tax Committee realized that the structural changes it sought could only be accomplished with the cooperation of the General Assembly, and it set to work enlisting support for the necessary enabling legislation.

Initially the Committee wanted to replace the Mercantile License and School District General Business Taxes with one tax upon business net income. However, the City's continuing fiscal problems led newly elected Mayor Wilson W. Goode to limit his support to revenue neutral reforms proposed by the Business Tax Committee. The Committee reluctantly agreed to develop a revenue plan that generated $210 million during its first two years. With the assistance of the Department of Revenue, the City's Business Tax Committee estimated that, with a tax based upon business net income, the rate would have to be set at 10 percent or higher. Realizing that—coupled with the State Corporate Net Income Tax rate of 10.5 percent—the total net income tax would drive businesses from the City, the Committee abandoned its goal of only taxing business income.

The Business Tax Committee eventually adopted a minimum gross receipts tax as one component of a comprehensive business tax. However, before finalizing the tax structure, the Committee knew that it had to gain the support of the industries previously exempt from City taxation. These industries possessed enormous political power, and the Committee feared that they would block the State enabling legislation required to impose the net income tax portion of the Business Privilege Tax. The Committee's solution was to provide special provisions that applied only to these industries.

Following the Committee's recommendation, the City's Business Privilege Tax was adopted by ordinance on May 30, 1984. After some debate, the initial rates of the Business Privilege Tax were set at 3.05 mills of gross receipts and 3.7 percent of net income. The revenue produced in 1985 from this initial rate structure did not meet the $210 million revenue neutral target. As a result, the rates were increased in 1986 to 3.9 mills of gross receipts and 4.35 percent of net income.

In 1989, City Council reduced the tax on gross receipts to 3.25 mills and increased the net income tax rate to the current 6.5 percent. Its decision was influenced by two facts:

- Pennsylvania's Corporate Net Income Tax rate had been reduced from 10.5 to 8.5 percent; and
- Philadelphia now had sufficient experience with the net income portion of the Business Privilege Tax to reliably predict the amount of revenue that would be generated at different rates of tax.

The Business Tax Committee expected that this type of reduction in the gross receipts portion of the Business Privilege Tax would continue until only the net income portion of the Business Privilege Tax remained.

1990s–Tax Reform Efforts

During the 1990s, the City adopted several programs designed to spur job growth and revitalize business development through targeted tax relief.

- In 1990, the General Assembly enacted the Pennsylvania Tax Increment Financing Act, which authorized the City and the School District to create special economic development districts in which the increased tax revenue generated by development could be used to finance improvements.[17]
- In 1998, the General Assembly and City Council approved the creation of Enterprise Zones, Keystone Opportunity Zones, and Keystone Opportunity Expansion Zones. Virtually all State and City taxes are abated for the first ten years after a business moves into one of these zones. However, to qualify for these abatements each business must either increase its employment by at least 20 percent during the first year of operation, or make a capital investment in property in the zone equivalent to 10 percent of its gross revenues for the preceding year.

These tax incentive programs encouraged business growth in those select geographic locations most in need of economic revitalization. However, these reforms did not relieve any of the tax burden on the majority of Philadelphia businesses.

The Select Committee on Businesses Taxes

In response to complaints from the business community, City Council in 1992 created the Select Committee on Business Taxes. This Select Committee was charged with recommending changes to improve Philadelphia's anti-competitive business tax structure.

The City made a number of small changes based on the Select Committee's recommendations:

- Effective with fiscal year 1996, the gross receipts portion of the Business Privilege Tax was lowered from 3.25 mills to 3.0 mills.
- In 1998, the City expanded the base of the gross receipts portion of the Business Privilege Tax to include all businesses that have an active presence in the City.[18]
- The City repealed four taxes which collectively generated less than $25,000 in annual revenues: the Auction Tax, the Bowling Alley Tax, the Alarm Signal Tax, and the Sound Reproduction Tax.
- The City made structural changes to the calculation of the Amusement Tax and expanded the tax base to include movie theaters.

However, many of the Select Committee's most significant recommendations were considered too costly to implement.

- The Committee recommended granting unincorporated business a 100 percent credit of the net income portion of the Business Privilege Tax to offset the tax due under the Net Profits Tax. This change was rejected even though it would have been a step in the direction of achieving tax parity between incorporated businesses that pay only the Business Privilege Tax and unincorporated businesses that pay both the Business Privilege Tax and the Net Profits Tax.
- The Committee recommended that the Business Privilege Tax new start provisions be changed. This change was rejected, even though it would have helped new businesses by no longer requiring them to pay essentially a double tax on their gross receipts, even if they operated at a loss.
- The Committee recommended that the Real Estate Transfer Tax rate be reduced to 2.5 percent. This change was rejected despite the fact that it would have helped both businesses and individuals

Business Taxes at the Dawn of the New Millennium

The 1990s closed on a decade of marginal job growth and continued population loss. The tax structure remained unchanged and the City's marketability as a business location continued to decline. Office expansion outside of the City exploded during the 1980s and 1990s, while new construction in the City was minimal. Center City office and commercial property vacancies were so high that in 1997 City Council approved special real estate tax abatements for conversions of such property from commercial business or industrial use to commercial residential use.[19] The gross receipts portion of the Business Privilege Tax continued to slowly decline. However this occurred too slowly to help many businesses. By 2000, the City's piecemeal approach to tax relief-driven economic development had little impact outside of the targeted areas and businesses.

The History of Philadelphia's Real Property Taxes

Overview

During Philadelphia's early history, the City imposed a tax upon tangible real and personal property. A general tax upon the personal estate, goods, and implements of residents dated back to the pre-Revolutionary era. The first codified distinctions between real and personal property appear to have been made during the mid-nineteenth century, when the General Assembly passed several laws establishing assessment standards and authorizing taxation of intangible personal property.[20] Tangible personal property continued to be taxed under the old law. State law did not define the specific items of property subject to property tax. However, in 1887, the General Assembly prohibited taxation of watches, household furniture, and pleasure carriages.[21] Current real property tax law is derived from the General County Assessment Act of 1933.[22]

The General Assembly of Pennsylvania authorizes, and Philadelphia imposes, both a City and a School District Real Estate Tax. The combined City and School District tax is referred to as the total Real Estate Tax. Since 1952, the School District tax rate has increased from 1.325 percent to 4.79 percent. During this same period, the City tax rate has increased from 1.7 percent to 3.474 percent. Although the City Real Estate Tax rate decreased once in 1974 and again in 2003, the total Real Estate Tax rate has risen steadily.

More recently, the Real Estate Tax share of combined City and School District revenue has remained relatively stable. In 1952, Real Estate Tax revenue constituted a 28 percent share of the City and School District's combined revenue and in 2000 constituted a 29 percent share. However, during this same time period, Real Estate Tax revenue as a share of general fund tax revenue declined from 40 percent in 1952 to 19 percent in 2000.

Property Assessments

A system for valuing property subject to tax also predates the Constitution. Property assessors were appointed until 1799, when the legislature established that one assessor and two assistant assessors should be elected in each ward in Philadelphia. Also in 1799, assessment procedures were codified for the first time. From 1834 to 1841, assessors were required to hold meetings where they would set standard property values. In 1841, the General Assembly made several important reforms by:

- Transferring valuation duties from the assessors to the County Commissioners. For the first time, standards for valuing property were separated from standards for assessing property, creating the precursor to the modern structure where a board sets the standards and the assessors perform the assessments.
- Creating an Office of Assessor and requiring the assessor and all assistant assessors to take an oath of office to diligently and accurately value all real estate and

tangible and intangible personal property subject to tax.

- Creating the State Board of Revision of Taxes charged with establishing a uniform system for the valuation of real and personal property and any other "objects" subject to tax.
- Authorizing taxpayer appeals and creating the first assessment appeals process.

The following year, the General Assembly established satellite State Board of Revision of Taxes offices in every county.[23] Each board was authorized to examine and determine whether the assessment returns of the County assessors conformed to the laws of the Commonwealth. These offices were also charged with equalizing the valuation of similar real and personal properties if those assessments did not conform.

In 1854, the City-County Consolidation Act mandated that Philadelphia's Board of Revision of Taxes be composed of elected officials, including the County Commissioners, the City Treasurer, and the Receiver of Taxes. It also mandated that the Board continue the practice of electing assessors.[24]

During the years following city-county consolidation, the General Assembly changed the Philadelphia Board of Revision of Taxes from a state office to a separate municipal office organized specifically to assess and value property for taxation and changed the method of selection of board members from election to appointment.[25] The Court of Common Pleas was vested with the authority to appoint the members of the Board and with the authority to hear appeals of its decisions. In 1873, the General Assembly vested the Board of Revision of Taxes with the power to appoint assessors.[26]

With its enactment of the General County Assessment Law in 1933, the General Assembly provided standards with which each county assessment office must comply.[27] This law designates the subjects of taxation for local purposes; regulates the assessment and valuation of persons, property, and subjects of taxation for county purposes; and exempts certain items from taxation. In addition, it delineates the procedures that each assessor must follow when valuing property. For example, the law requires each assessor to value property according to its actual value. The assessor may consider the price at which the property was sold, but this price cannot be controlling.

In 1937, the Board of Revision of Taxes' authority expanded to include hearing condemnation cases resulting from the City's exercise of its right of eminent domain.[28] The Board of View, which had been authorized to hear such cases, was abolished. In 1964, the Board of View was re-established, but the majority of its members are the members of the Board of Revision of Taxes.

The Board of Revision of Taxes' current structure, powers, and duties, were established by the legislature in 1939.[29] It is composed of seven members who are appointed for six-year terms through secret election by a majority of the Court of Common Pleas of Philadelphia. By law, members must be competent and qualified citizens. The members of the Board of Revision of Taxes appoint a Chief Property Assessor, regular assessors, and assistant assessors. The Board is required to divide the county into assessment districts, establish records of assessments, update records, allow the public to examine such records, and give notice of an increase or decrease in assessment value.

Abatement Programs

To encourage construction within the City, Philadelphia has created several abatement programs for its real estate tax.

- In 1974, City Council provided an abatement for improvements constructed to certain residential properties in order to "repair and rehabilitate" the deteriorating neighborhoods of the City.
- For similar reasons in 1978, tax abatements were approved for improvements to deteriorating commercial and industrial property.
- Again, in 1983, to encourage the construction of residential units within the City, any improvements or construction of residential buildings were granted abatement of the Real Estate Tax.
- Finally, in 1997, in order to fill vacancies arising from tenants leaving commercial buildings, City Council authorized abatements for the conversion of commercial buildings to commercial residential buildings.

In the decades following the adoption of these programs, the City made multiple changes, expanding the programs and, in some instances, extending the abatement periods.

Charitable Exemptions

According to Pennsylvania's Constitution, Purely Public Charities may be exempt from Commonwealth taxes. As such, local governments may not levy a Real Estate Tax on any property used by a charity to further their charitable mission. Until the *Hospital Utilization Program v. Commonwealth* (hereinafter "HUP") decision, many organizations were secure in their status as Public Charities. In *HUP*, the Pennsylvania Supreme Court articulated a subjective five-part test that organizations were required to meet to qualify as a Purely Public Charity. This ruling effectively called into question the exemption that many non-profit organizations, including hospitals and educational institutions, had historically been granted. The ruling also introduced serious doubts into the minds of the principals of charitable organizations about their tax liability, as local tax boards throughout Pennsylvania began to tax non-profit property.

In 1994, Mayor Edward G. Rendell issued an Executive Order to create a Voluntary Contribution Program, in which non-profit properties that had previously been exempt were asked to make a voluntary payment in lieu of taxes in order to retain their previous exemption. These voluntary contributions equaled 40 percent of their Real Estate Tax and Use and Occupancy Tax bills (33 percent if they agreed by an earlier deadline). Contributions were divided between the City (45.3 percent) and the School District (54.7 percent), reflecting the general division of Real Estate Tax revenues. These institutions also were given the option to provide services to the City to pay for up to one-third of the negotiated monetary contribution. At the City's request, services were focused on those disadvantaged Philadelphians with the greatest need.

By March 1995, 50 organizations had signed five-year contracts to make voluntary contributions. Each contract was negotiated individually, and some smaller non-profits contributed at a "hardship" level of $10,000 per year. During this five-year period, the City and School District collected an average of $4.8 million annually. A major factor contributing to non-profit willingness to negotiate payments was the *HUP* ruling. Non-profits saw the Voluntary Contribution Program as a way to avoid expensive litigation that might result in the loss of their tax exemption.

This program effectively ended in 1997 with the General Assembly's enactment of the Institutions of Purely Public Charity Act. This act defined the requirements of an institution of purely public charity by codifying and providing objective applications of the *HUP* opinion.

Consequently, when the term of each organization's voluntary contribution expired, many Philadelphia charities refused to renew the agreement. By 2000, after the original five-year voluntary contribution program contracts expired, only 20 percent of the original 50 non-profits agreed to continue their contributions.

State Public Utility Realty Tax

The Public Utility Realty Tax Act (PURTA) imposes taxes upon incorporated Pennsylvania utilities in lieu of local real estate taxes. PURTA was first imposed by the Public Utility Realty Tax Act of 1970 and was reenacted by the Tax Reform Code of 1971. PURTA is a Commonwealth tax imposed upon select real estate owned by utilities. The tax revenues from PURTA flow into the Pennsylvania General Fund; a substantial portion of these revenues are then redistributed to local school districts. As a result of the deregulation of the electric, gas, and telecommunication industries, major changes were made to the PURTA legislation and the revenues flowing to the City and the School District declined substantially. Virtually all municipalities and school districts throughout the state experienced similar declines. An isolated few reaped increased revenues.

Philadelphia School District Dedicated Non-Real Estate Taxes

Overview

The School Reform Commission is responsible for the School District's budget. Because this body is appointed rather than elected, it does not have the authority to directly levy taxes. City Council, on behalf of the School District, has the authority to impose taxes dedicated to the School District and to reauthorize, amend, or repeal the taxes annually. As with all City taxing authority, City Council's authority to approve School District tax legislation is founded in state enabling legislation.

Historically, the City dedicated a portion of its Real Estate Tax revenues and equal amounts of its Personal Property Tax revenues to the School District. However, with the 1963 enactment of the Little Sterling Act, the School District's potential sources of dedicated tax revenues expanded. [30]

In 1998, the General Assembly enacted legislation providing the criteria necessary for the legislature to declare a school district distressed and the requirements imposed upon the school district, including appointment of a School Reform Commission and restrictions upon any changes in its revenue. PA LEGIS 1998-46, §1 ("Act

46”). In 2002, the legislature declared the Philadelphia School District distressed. Pursuant to Act 46, the City must ensure that the District is funded at a level equal to the highest amount of revenue it received in the previous three fiscal years. The City is further required to continue to authorize and impose each tax that was imposed prior to the date of distress.[31]

School District General Business Tax

During the late 1940s, the School District’s student enrollment growth exceeded the capacity of the District’s facilities and resources. Unfortunately, it also outstripped the City’s ability to fund that growth. In 1949, the General Assembly recognized the advantage of dedicated school taxes and authorized the School District General Business Tax—a tax on the gross receipts of incorporated and unincorporated businesses operating within the School District boundaries.[32] From 1950 until 1983, revenues from this School District General Business Tax increased from $5.6 million to $14.7 million.[33] However, the School District budget required more revenue than the tax could produce.

In 1984, at the urging of City businesses and with the support of the General Assembly, the City reformed its business tax system. To compensate the School District for the loss of its dedicated revenue stream caused by elimination of the General Business Tax, the City decreased its reliance on the Real Estate Tax and allowed the School District to increase its reliance thereon. In 1983, the School District received $14.7 million in General Business Tax revenues and $181.3 million in Real Estate Tax revenues. A year after the General Business Tax was repealed, the School District received $231.7 million in Real Estate Tax revenue.

In 1984, the City imposed a Real Estate Tax rate of 3.9 percent and the School District imposed a tax rate of 3.575 percent. In 1984, the combined taxpayer rate was 7.475 percent. In 1985, the City rate decreased to 3.505 percent and the School District rate increased to 3.970 percent, where they remained until 1989.

Personal Property Taxation

Historically, Philadelphia dedicated 50 percent of its Personal Property Tax collections to the School District budget. The tax was repealed, as it applied to the School District, effective in 1968, with the imposition of the newly enacted School District Investment Net Income Tax.[34]

School District Investment Net Income Tax

After the Little Sterling Act was created in 1963, the City was able to tax, on behalf of the School District, anything, including individuals, that the City was authorized to tax under the Sterling Act, with the exception of nonresident wages or net income.[35] The City and School District first acted upon this authority in 1967, when they adopted the School District Investment Net Income Tax (commonly known as the School Income Tax). The School Income Tax today is imposed at a rate equal to the rate imposed upon wages and net profits, but upon limited, unearned income sources.

School District Corporate Net Income Tax

In 1968, in response to a looming budget crisis and a campaign promise not to raise taxes, Mayor James H.J. Tate balanced the City's budget by changing the City's accounting system from a calendar year to a fiscal year. This maneuver allowed the City to credit revenue from the eighteen-month transition year against the twelve-month budget. The following year, with the City's fiscal crisis exacerbated, and Mayor Tate's campaign promise fulfilled, the General Assembly authorized special enabling legislation for a new School District tax. The City adopted the short-lived School District Corporate Net Income Tax.[36] In its first year, this tax provided the School District with an additional $17.3 in revenue. During the following two years, revenues declined to $13.7 and $13.3 million. After only three years, the School District abandoned the tax in favor of the more reliable Business Realty Use and Occupancy Tax.

Business Realty Use and Occupancy Tax

In 1970, City Council overrode Mayor Tate's veto and adopted the Business Realty Use and Occupancy Tax.[37] Authorized by the Little Sterling Act, this tax is imposed by the School District upon the actual user or occupier of real estate used or occupied for the purpose of carrying on any business, trade, occupation, profession, vocation, or any other commercial or industrial activity.[38] As a tax imposed for the privilege of doing business, the taxpayer is the person exercising the privilege, whether that person owns the property, rents it, or merely occupies it rent-free.[39] Each person's tax base is a proportionate share of the assessed value of the real estate, determined by the ratio of the square footage of the property used or occupied to the total square footage available for use or occupancy.

During its first fiscal year, July 1, 1970 through June 30, 1971, the tax contributed $11.3 million to the School District's revenues. The Use and Occupancy Tax rate increased several times during the 1980s, gradually rising from 1.25 percent to the current rate of 4.62 percent.

Less than two weeks after the tax was adopted, the owners of the John Wanamaker Department Store invoked the Uniformity Clause to challenge the constitutionality of the Use and Occupancy Tax.[40] The taxpayer relied upon the long line of Supreme Court decisions prohibiting classification of real property for tax purposes based upon its use.[41] Although they prevailed in the lower court, the taxpayers lost in the Pennsylvania Supreme Court. That court distinguished between the real property tax imposed on ownership of property at issue in such decisions, and the privilege tax, such as a use and occupancy tax, imposed upon the business use of property.[42]

The Business Realty Use and Occupancy Tax provides limited exemptions from tax liability. The School District is not authorized to levy this tax upon public utilities subject to tax by the Commonwealth of Pennsylvania under the Tax Act of 1963 for Education,[43] or persons engaged in Philadelphia Port-related activity.[44]

Persons and organizations exempt from the Real Estate Tax are exempt from the Business Realty Use and Occupancy Tax based upon the rationale that they do not use the property for a business purpose.[45] In general, businesses that use and occupy real property for which the City grants real property tax abatements do not receive a comparable abatement of the Use and Occupancy Tax. [46] However, qualified users are exempted from the Use and Occupancy Tax when their property is located within a Keystone Opportunity Zone or a Keystone Opportunity Expansion Zone.[47]

Liquor Sales Tax

The School District experienced serious financial shortfalls during the 1990s. In an effort to secure additional tax revenue, the School District and City turned to State enabling legislation passed in 1971 granting the District the authority to impose a 10 percent tax on liquor served in retail establishments.[48] The District imposed the tax, which the City authorized, effective January 1, 1995.[49] The public reaction was swift and vocal. City Council passed the ordinance by a bare majority of nine to eight, after contentious public hearings and Council debate.

Tavern and bar owners united in an effort to defeat the tax in court. The Licensed Beverage Association of Philadelphia and individual tavern and bar owners immediately filed for an injunction against enforcement.[50] They alleged that the enabling legislation either had expired, had been implicitly repealed by subsequent enabling legislation, or was pre-empted by state taxes and fees imposed upon the liquor industry. The court rejected those arguments. Their subsequent action to restrain the collection of the tax after June 30, 1995 was similarly rejected. [51] In that second action, the industry argued that the School District and City Council were required to submit the tax to Council's vote each year. Having failed to re-authorize the tax for the District's 1996 fiscal year, the City was barred from collecting the tax. This argument was dismissed by the Court as based upon faulty logic and not grounded in the enabling legislation or the ordinance.[52]

Miscellaneous City Taxes

Personal Property Tax

Philadelphia's tax on tangible and intangible personal property predates the Pennsylvania Constitution. Over time, the tax gradually became a tax solely upon intangibles.[53] The most recent reform and codification of the state tax enabling legislation occurred in 1919, when the stock of any corporation subject to the State's tax on capital stock was excluded from the Personal Property Tax. This provision proved to be the undoing of the tax. In the 1998 decision in *Annenberg v. Commonwealth*, [54] the Pennsylvania Supreme Court declared that the portion of the statute that imposed tax upon securities not subject to the State Capital Stock Tax violated the Constitution. Although the Court declared the provision severable, the City suspended collection of the tax in 1997.

Public Parking Facility Tax

The Parking Facility Tax was originally approved in 1937 as a "Parking Lot Tax" imposed upon all transactions in which a fee was paid to park any type of motor vehicle in an open parking lot. The scope of the tax was broadened in 1956 to include all public parking lots, and again in 1980 to include any public parking facility.

The initial rate of 10 percent set in 1937 was not increased until 1985, when it was raised to 20 percent. In response to public pressure from business owners, the rate was reduced to 17.5 percent in 1986, and to 15 percent in 1987.[55]

Amusement Tax

Philadelphia imposed a consumer tax on the privilege of attending or engaging in amusements as early as 1937. The ordinance excludes from the definition of "amusement" television broadcasts and any entertainment the proceeds of which benefit religious, educational, or charitable organizations, military organizations or personnel, and police or fire departments. In 1993, the tax was amended to repeal a special 2.5 percent gross receipts tax upon establishments that raised liquor prices when entertainment was provided and to add movie theaters to the tax base.[56] The tax is currently levied at a rate of 5.0 percent.

Mechanical Amusement Device Tax

Adopted in 1945, the Mechanical Amusement Device Tax is imposed at the annual rate of $100 on each coin-operated amusement device, except those operated pursuant to a sound recording license (i.e. jukeboxes).[57]

Real Estate Transfer Tax

Based upon the authority granted by the Sterling Act, City Council approved the Real Estate Transfer Tax (enacted as the Realty Transfer Tax) in 1952, to be effective for all real property transfers completed on or after January 1, 1953. The Sterling Act prohibits the City from imposing a tax on the same property and transactions as the state, whether the state imposition predates or postdates the City tax. When Pennsylvania adopted a state-level transfer tax in 1953, the General Assembly avoided the Sterling Act preemption by specifically authorizing Philadelphia to impose its Real Estate Transfer Tax. By convention, both parties to the transaction, the owner and the purchaser, generally pay equal shares of the tax.

In 1988, the City adopted an ordinance raising the Real Estate Transfer Tax rate from 2.5 percent to 4.07 percent. In response to a court decree, the City agreed to reduce the rate to 3.0 percent by 1994. In its 1993 report, the Select Committee on Business Taxes recommended further reduction to 2.5 percent. That recommendation was not adopted and the rate remains at three percent. The Committee also proposed that the City adopt the state Real Estate Transfer Tax definition of a taxable lease to simplify administration of the tax upon long-term leases. The City acted upon this proposal.

Philadelphia real estate transactions are subject to one of the highest tax rates in the nation. This high rate encourages investors to seek legal methods of avoiding the tax on transfers. A common tax-avoidance plan involves transferring, over a three-year period, up to 89 percent of the ownership interests in the company owning the real estate (instead of transferring the property itself). Transactions are structured to provide that the owner retains an 11 percent interest. However, the transactions often lack economic substance: i.e., the retained interest often is committed in the original transfer transaction, to occur three years and one day after the 89 percent transfer.

Similarly, if ownership of land and the improvements therein are held by different ownership entities, property lawyers have argued that transactions involving sales of leased property subject to 30-year leases are subject to the tax on the land, not the leased structures. The new property owner purchases the land and pays the tax thereon, then terminates the leasehold after the transaction is recorded, thereby allowing the parties to avoid the tax upon the structure. The City vigorously litigates transactions such as these that are structured to avoid the tax through technicalities that have no economic substance.

Real Estate Non-Utilization Tax

In 1982, Philadelphia enacted a Real Estate Non-Utilization Tax for purposes of penalizing property owners for allowing property to lie fallow and deteriorate.[58] The constitutionality of this tax, however, was quickly challenged and the Court granted declaratory relief barring the City from collecting it.

Hotel Room Rental Tax

In 1982, Philadelphia adopted a dedicated Hotel Room Rental tax to fund the Pennsylvania Convention Center.[59] The tax rate was phased-in from three percent upon enactment to six percent upon completion of the Convention Center. The proceeds from this tax are dedicated to payment of the debt and operations of the Convention Center. If construction of the Center had not commenced by 1988, the balance of the dedicated fund would have been used for tourism promotion.[60]

Sales and Use Tax and Hotel Occupancy Tax

In 1991, pursuant to the authority conferred in the Pennsylvania Intergovernmental Cooperation Authority legislation, Philadelphia enacted a one percent Sales and Use tax upon the retail purchase price of tangible personal property or services sold or used within the City.[61] Because this tax is not dedicated to fund the PICA debt, it contains no sunset provisions.

The City of Philadelphia also enacted a Hotel Occupancy Tax in 1991 pursuant to the authority granted by the PICA legislation.[62] The Hotel Occupancy Tax is imposed at the rate of one percent of the rent of every hotel room within the City.

Tourism and Marketing Tax

A 1999 City ordinance imposes a one percent Tourism and Marketing Tax upon the cost of hotel room rental.[63] This tax is in addition to the existing six percent Hotel Room Rental Tax. Together they are collected as seven percent tax. Revenue from this tax is dedicated to funding the marketing of regional attractions.[64]

Vehicle Rental Tax

On March 28, 2000, City Council enacted a two percent tax on the gross price paid for all vehicle rentals.[65] Revenues from this tax are used to fund the debt service for stadiums built to host the City's professional baseball and football teams.

Repealed Taxes

- Auctioneer Tax—An annual tax of $500 was imposed on auctioneers between 1945 and 1993.[66]
- Petroleum Processing Tax—Petroleum processors were subject to a $5 per barrel tax imposed from July 1, 1976 to June 30, 1977.[67]
- Gasoline Distributors Tax—Gasoline distributors paid a two percent gross receipts tax on certain gasoline deliveries within the City. [68] In 1981, shortly after its creation, this tax was superseded by a state tax on such deliveries.
- Pari-Mutual Tax—Harness and flat racing wagers were taxed at rates between two percent and four percent from 1963 to 1982.[69] This tax is not collected and no longer appears in the Philadelphia Code of Ordinances.
- Vending Machine Tax—Between July 1, 1988 and December 31, 1989, an annual tax of $100 was imposed on all vending machines, except those dispensing newspapers.[70]
- Sound Reproduction Tax—Businesses engaged in sound reproduction were subject to a five percent gross receipts tax until its repeal in 1992.[71]
- Bowling Alley Tax—Enacted in 1945 at an annual rate of $25 per alley, this tax was imposed at a rate of $100 per alley when it was repealed in 1992.
- Condominium Conversion Privilege Tax—Enacted in 1982, this tax was held unconstitutional on the grounds that it lacked uniformity. It was repealed in 1993 and preempted by the Uniform Condominium Act.[72]
- Emergency Sales Tax—From March 1,1938, until December 31, 1938 the City imposed an emergency two percent Sales Tax.[73] Although it generated $6.8 million in revenue in its 10-month lifespan, the emergency tax was not re-enacted as a permanent tax. The tax was a permissible City levy because the state Sales Tax had not yet been enacted.

The Impetus behind Tax Reform in the 2000s

In November 2001, the City Controller's Office released its *Tax Structure Analysis Report*, the result of an 18-month study of the City's economic health and tax system. Well-received by the business community, the report called for significant and more rapid reductions in Wage and business taxes and adoption of land-value real estate taxation. At a public hearing on the Controller's Report held by City Council in February 2002, more than 50 expert witnesses appeared, most of whom supported the conclusions reached in the report.

However, in his January 2002 budget proposal for fiscal year 2003, Mayor John F. Street proposed freezing the Wage Tax rates at the 2003 level and dedicating approximately one-half of the revenue saved from the freeze to accelerating the gradual reduction of the gross receipts portion of the Business Privilege Tax. The balance of the savings was intended to offset the financial effects of a national recession and poor pension fund investment performance.

Response to the Mayor's proposal by City Council and the general public was immediate and intense. City Council quickly resolved, at a minimum, to preserve the gradual tax cuts planned through 2007. A march on City Hall demonstrating support for continuation of the Wage Tax rate reduction policy was held on April 12, 2002. By April 15, 2002, a unanimous City Council authorized the continuation of the scheduled Wage Tax rate reductions and accelerated reduction if the City's Wage Tax revenues increased.

During this fight for the Wage Tax rate reduction, City Council moved forward a resolution to convene an independent commission to study the City's entire tax structure and recommend comprehensive reform. In April 2002, Council approved a referendum for the November 2002 ballot that would amend the City Charter by creating an independent Tax Reform Commission, with fifteen Commission members and twenty-three Advisory Board Members.

In the late summer of 2002, the citizen tax revolt was re-ignited by newly released property assessments which dramatically increased many taxpayers' liability.

After a difficult year filled with campaigns against Wage Tax rate freezes and against unprecedented increases in real estate assessments, support for tax reform was overwhelming. By a four-to-one margin, City voters approved the referendum on November 5, 2002, creating the first independent Tax Reform Commission in Philadelphia history.

Even after the Tax Reform Commission was created, City Council continued to pursue Wage Tax reform. On April 25, 2003, City Council adopted legislation that requires further Wage Tax rate reductions if Wage and Real Estate Tax revenues increase above specified levels.[74]

Section 4: The Need for Tax Reform

Many basic economic and social forces have worked to Philadelphia's disadvantage in recent decades. The loss of the city's comparative advantage as a manufacturing location, improved suburban transportation networks, and an increasing supply of low-density suburban housing all make it harder for the city to compete. While these trends are beyond the control of local government, local public policy in Philadelphia has in some ways contributed to the city's economic decline.

The American federal system is structured to allow local governments to make their own decisions about education, law enforcement, taxation and other public policies. Residents and businesses are free to choose a location based in part on the attractiveness of the overall package of public services and tax levels within a local jurisdiction. Localities, therefore, effectively compete with each other for residents and businesses. Locations that provide an attractive package of services and tax rates will succeed in this competition; localities that do not provide an attractive tax and service package will suffer decline.

Evidence suggests that, while Philadelphia's tax and service package has not been the only factor contributing to the city's long-term loss of population and jobs, it has certainly contributed to that loss. High taxes, inadequate public schools, and low levels of public safety all appear to have discouraged residential and business growth. The Tax Reform Commission was created to make recommendations designed to improve the tax elements of the package of taxes and services Philadelphia offers citizens and businesses.

This chapter contains an analysis of the major problems of Philadelphia's tax system. The city's high tax rates are partially the result of high service needs, a weak tax base, the city's service responsibilities as a city-county, and a low level of fiscal equalization in the state's methods of funding county services. To achieve more significant tax reductions over the long term, therefore, the state should be an active partner in reforming the state-level policies that contribute to the city's high tax burden. However, local public officials can make tangible changes by addressing three issues: Philadelphia's high overall level of taxation; an inefficient mix of taxation; and inadequate real property assessment practices. Unilateral City-initiated tax reforms may not be sufficient in and of themselves to entirely restore the city's competitiveness as a place to live, work, and do business, but they are vital elements of a package of state, regional, and local public policy changes that together could set the city on a path to economic recovery. Increasing tax structure competitiveness, equity, stability, neutrality, and simplicity will set the stage for a new Philadelphia.

Why Taxes Matter

The dominant view among economists regarding the effect of inter-jurisdictional differences in taxes and services is that businesses and individuals will "vote with their feet" when confronted with a tax structure that is not competitive with nearby jurisdictions. Although many factors influence business location, many of these factors (such as cost and quality of the labor force, housing quality and cost, and energy and transportation costs) are constant within any given region. In contrast, tax levels can vary dramatically from community to community. Thus, businesses can move within a region to avoid paying high local taxes while retaining many of the benefits of operating in that region. By influencing location decisions in this way, local taxes affect economic growth.

While there is considerable disagreement about the magnitude of the impact of federal taxes on national economic growth, there is more general agreement among economists about the important impact that local taxes have upon the level of economic growth within a local jurisdiction. The theory behind tax cuts at the federal level is that individuals will work, save, invest, or consume more in response to lower income tax rates. There is, however, substantial disagreement about the magnitude of these responses to lower federal taxes.

The primary behavioral effect of local tax cuts is that they influence *location decisions* of households and firms. Local tax reductions, holding constant all other factors that influence location decisions, make a location more attractive to individuals and businesses, thereby inducing more residents and businesses to locate within the jurisdiction. While local tax reductions may affect the quantity of labor supply, consumption, saving, or investment by individual households and businesses, the effect of tax cuts within a local jurisdiction upon the economy of that jurisdiction is expected to result primarily from changes in *where* individual households choose to work, save, consume, and invest. There is a solid basis, therefore, to expect that the impact of taxes upon economic growth at the local level is likely to be significantly greater than the impact of tax cuts at the federal level. There is little serious disagreement among economists that overall local tax levels do have a significant effect on economic growth within a local jurisdiction.

A review of the literature addressing the effect of state and local taxes on economic growth by economist Michael Wasylenko concludes that, "taxes have a small, statistically significant effect on interregional location behavior. The suggested estimate of interregional elasticity is -0.2."[1] This implies that a 10 percent increase in tax levels leads to a decrease in overall economic activity within a state or region of 2.0 percent. However, econometric analysis reveals that taxes have a much stronger impact upon economic growth within local communities. Studies of the effect of local taxes on intraregional economic growth find elasticities ranging from -0.79 to -1.95.[2] This implies that a 10 percent increase in tax levels leads to a decrease in overall economic activity of 7.9 to 19.5 percent.

Philadelphia's High Tax Burden

Because Philadelphia's tax burden is higher than that of competitor jurisdictions, it is difficult for the city to compete for and retain residents, businesses, and jobs. There is substantial evidence—from econometric analysis, surveys, as well as anecdotal evidence—that the city's high tax burden has significantly reduced the size of its economy.

Anecdotal Evidence

In 2002, the Central Philadelphia Development Corporation met with executives from large Philadelphia companies. These business leaders expressed serious concern about Philadelphia's tax structure. [3]

- A national accounting and consulting firm reported that their Philadelphia office pays the second highest rate of business taxes among all of the company's offices, with only the New York City office paying higher taxes.
- An information technology firm reported that it has lost many high-salary employees to a competitor in the suburbs whose employees are not subject to the Wage Tax.
- A chemical manufacturer reported that its employees are paid higher salaries as compensation for the Wage Tax, but that employees still view the tax as taking money from their pockets. Both employee and employer feel they are "paying extra" for little benefit since most workers live in the suburbs.

Survey Evidence

Survey evidence from a variety of sources suggests that Philadelphia's total tax burden is an important factor when businesses and residents choose where to locate. 62 percent of respondents to the Commission's survey of Philadelphia's business community on taxes classified the gross receipts portion of the Business Privilege Tax as a large burden on their business. 58 percent of respondents found the Wage Tax to be a large burden, and 56 percent indicated that the net income portion of the Business Privilege Tax places a large burden on their business. One respondent wrote, "The City Wage Tax is possibly the greatest single reason this city is and will continue to be passed by, by other cities, counties, and states." Another respondent wrote, "Doing business in Philadelphia with the current wage tax structure makes it difficult to recruit individuals who have other choices where they are not impacted by the tax."[4]

Surveys conducted by various organizations also suggest that high taxes have contributed to the city's loss of population and business activity in recent decades.

- A 2002 survey of registered voters in Philadelphia sponsored by the Pennsylvania Economy League found that 49 percent of voters had considered moving out of the city and, among those, 18 percent reported that the high City Wage Tax was among the reasons they considered leaving the city. This was the third most often cited reason for leaving, behind only "wanting a better environment for their family," and, "crime, drugs and violence." Further, 54 percent of respondents indicated that they believe the City's taxes have "a great deal" of influence on the decisions of people to leave the city.[5]

- In a 2001 survey of city business owners and managers by the City Department of Commerce, taxation was the most frequently mentioned disadvantage of operating in Philadelphia, cited by 51 percent of respondents. Over 60 percent of representatives of manufacturers and professional service firms mentioned taxes as a disadvantage of a city location.[6]
- In a 2000 survey conducted by the Central Philadelphia Development Corporation, 63 percent of Center City office workers identified the Wage Tax as one of the things they like least about working in Center City. Respondents cited the Wage Tax at a higher rate than any other factor, including safety, the cost and availability of parking, and the difficulty of commuting.[7]
- In 1998, the City Planning Commission surveyed Philadelphia households who were selling their homes. Among families with children, the primary reasons behind their decision to sell were a desire for: a safer neighborhood (76 percent), lower car insurance (71 percent), a more attractive neighborhood (68 percent), better schools (57 percent), a larger home or yard (52 percent), and the City Wage Tax (51 percent).[8] While these results clearly point to the importance of city services, they also indicate that taxes are an important consideration among families who choose to leave the city.

Philadelphia's High Tax Rates

Philadelphia's tax rates are substantially higher than those of other major cities and nearby suburban municipalities. Since the mid-1990s, the City's *Five-Year Financial Plan* has acknowledged that Philadelphia's unusually high tax rates make it difficult for the city to compete with other jurisdictions in attracting and retaining businesses and residents. In 1996, the City began a program of annual, incremental cuts in the Wage Tax, Earnings Tax, Net Profits Tax, School Income Tax, and gross receipts portion of the Business Privilege Tax. In the past seven years, income-based tax rates have been reduced by over 10 percent and the rate of the gross receipts portion of the Business Privilege Tax has been reduced by over 35 percent. However, the city's taxes remain among the highest in the country.

Numerous credible studies have concluded that Philadelphia businesses, residents, and workers shoulder an unusually large tax burden.

- In the District of Columbia's annual report on tax burdens in the large U.S. cities, Philadelphia is consistently ranked as one of the highest taxed cities in the nation. The overall 2002 state and local tax burden on a Philadelphia family earning $25,000 per year is calculated to be the third highest out of 51 cities included in the report. For families at higher income levels, up to $150,000 per year, Philadelphia's rank never falls below fifth out of 51 cities.[9]
- A 1998 study by Vertex, Inc., a state and local tax research and software firm, found that Philadelphia's business tax burden was the highest among 27 major U. S. cities.[10] The study estimated the combined federal, state, and local tax liability of a representative service company with $15 million in gross revenue

and $1.5 million profits. In terms of local business taxes, Philadelphia's tax burden ranked fourth out of 27 cities, behind only New York City, Chicago, and Cleveland. While the overall business tax burden in Philadelphia in 1998 declined by 2.15 percent from the 1993 estimate published in a previous Vertex report—more than any other city—the overall tax burden in Philadelphia in 1998 remained the highest among the 27 comparison cities.

- A 2000 report by the New York City Independent Budget Office concluded that Philadelphia's local tax effort in 1997 was $6.84 per $100 in taxable resources. Only New York City had a higher local tax effort by this measure.[11]
- The city's tax burden is extremely high compared to its own suburbs. A 2002 study by economist Robert Inman of the Wharton School of the University of Pennsylvania found that the combined state and local tax burden of a typical Philadelphia resident in fiscal year 2000 was 14.4 percent of income. The combined tax burden in the city's Pennsylvania suburbs was only 9.0 percent of income.[12]
- The City's Wage Tax and Business Privilege Tax rates are well above typical rates in other cities and local suburbs, as shown in Figure 4.1. The City's resident Wage Tax of 4.4625 percent exceeds the average local resident income-based tax rate in other cities by 462 percent and the average local earned income tax rate in the 240 municipalities in the western suburbs by 499 percent. Philadelphia's 6.5 percent tax on business net income exceeds the average rate in other cities by 907 percent. The City's tax on business gross receipts of 2.1 mills exceeds the average of other cities by 348 percent and the suburban average by between 500 and 775 percent, depending upon the industry.

Figure 4.1: *Philadelphia Local Tax Rates Compared to Other Cities and Suburban Jurisdictions, 2003*

Tax	*Philadelphia*	*Average Rate in 20 Largest Cities*	*Average Rate in PA Suburbs*	*% by which Philadelphia Exceeds Other Cities*	*% by which Philadelphia Exceeds Suburbs*
Resident Personal Income Tax	**4.4625%**	**0.79%**	**0.745%**	**462**	**499**
Business Net Income Tax	**6.5%**	**0.65%**	**0**	**907**	**N.A.**
Business Gross Receipts Tax (Retail)	**2.1 mills**	**0.47 mills**	**0.35 mills**	**348**	**500**
Business Gross Receipts Tax (Wholesale)	**2.1 mills**	**0.47 mills**	**0.24 mills**	**348**	**775**
Business Gross Receipts Tax (Other)	**2.1 mills**	**0.47 mills**	**0.28 mills**	**348**	**650**

Source: Commonwealth of Pennsylvania, Department of Community and Economic Development, 2003; Commerce Clearing House, 2003.

High Tax Rates Hinder Economic Prosperity

Economic research suggests that Philadelphia's high tax rates have a detrimental influence on the city's economic prosperity. Since the 1980s numerous studies have attempted to measure the impact of local taxes on Philadelphia's economy.[13] These studies generally conclude that local taxes have a substantial effect upon Philadelphia's employment, resident income, property values, and business activity.

Econometric analysis indicates that the city's high relative tax burden has been a primary cause of the city's economic decline in recent decades. Between 1971 and 2001, Philadelphia's share of national employment declined from 1.24 percent to 0.52 percent. A forthcoming study by Andrew Haughwout, Robert Inman, Steven Craig, and Thomas Luce, found that 61 percent of this decline (approximately 172,889 jobs) could be attributed to the rise in the City's Wage Tax rates over that period.[14] This research suggests that the City's high tax rates have been a major factor contributing to the city's economic decline in recent decades.

Research also suggests that Philadelphia has exhausted its long-term capacity to increase local government revenues through increases in local tax rates. This research is based on the idea that government collects no revenue if the tax rate is 0 percent and if the tax rate is 100 percent. In between these two points there is a graphical "inverted-U" relationship between tax rates and total tax collections. Government revenue is maximized at a tax rate that lies somewhere between 0 percent and 100 percent. Accordingly, if the economy is operating to the right of the peak of the inverted-U curve, then decreasing the tax rate can increase government revenue as it attracts more tax-paying businesses and individuals than would otherwise remain. In a 2001 study, Robert Inman and Andrew Haughwout found that the rates of the gross receipts portion of the Business Privilege Tax, nonresident Wage Tax, and Real Estate Tax were beyond their revenue-maximizing level. In other words, raising their rates would generate even less revenue and lowering them would generate greater revenue. Their study concludes that, "Philadelphia is at, or very close to, the peak of its long-run revenue hill."[15]

Philadelphia's Peculiar Tax Mix

Compared to other large cities, Philadelphia has an unusually high reliance on business and personal income tax revenue, and an unusually low reliance on property and sales tax revenue.

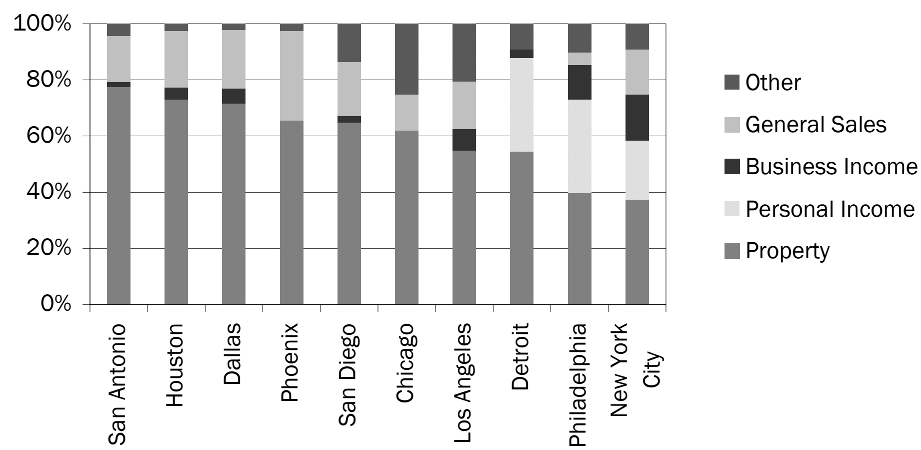
As shown in Figure 4.2, in 1997 personal income tax revenue in Philadelphia—-revenue from the resident Wage Tax, Earnings Tax, Net Profits Tax and School Income Tax—was 33.3 percent of total tax revenue, compared to an average of 8.5 percent among the 10 largest U.S. cities. Business income tax revenue made up 12.4 percent of Philadelphia tax revenue compared to an average of 5.3 percent in other cities.

When compared to other large city governments, Philadelphia's percentage of School District and City revenue from the Real Estate Tax is unusually low. Real Estate Tax revenue made up only 39.7 percent of City and School District tax revenue in Philadelphia, compared to a big-city average of 59.7 percent.[16] In fiscal year 1997, property tax revenue made up 19 percent of Philadelphia's tax revenue. For all cities in the U.S. with at least 300,000 residents, the average percentage of local municipal tax revenue derived from the property tax in 1997 was 40 percent.[17]

When comparing Philadelphia's tax structure to the tax structure of other cities around the country, it is obvious that Philadelphia has an unusually high dependence upon business and wage taxes.

- Among the nation's 20 largest cities, only three tax the net income of corporations—New York City, Philadelphia, and Detroit. Detroit's 1.2 percent Corporation Income Tax is being phased out, with complete elimination scheduled for 2009. Philadelphia is the only major U.S. city to levy a tax on both business net income and gross receipts.[18]
- The gross receipts portion of Philadelphia's Business Privilege Tax is between six and nine times the average rate levied in suburban communities in southeastern Pennsylvania, depending on the industry.[19]

Figure 4.2: *Distribution of Tax Revenues in the Ten Largest U.S. Cities, 1997*



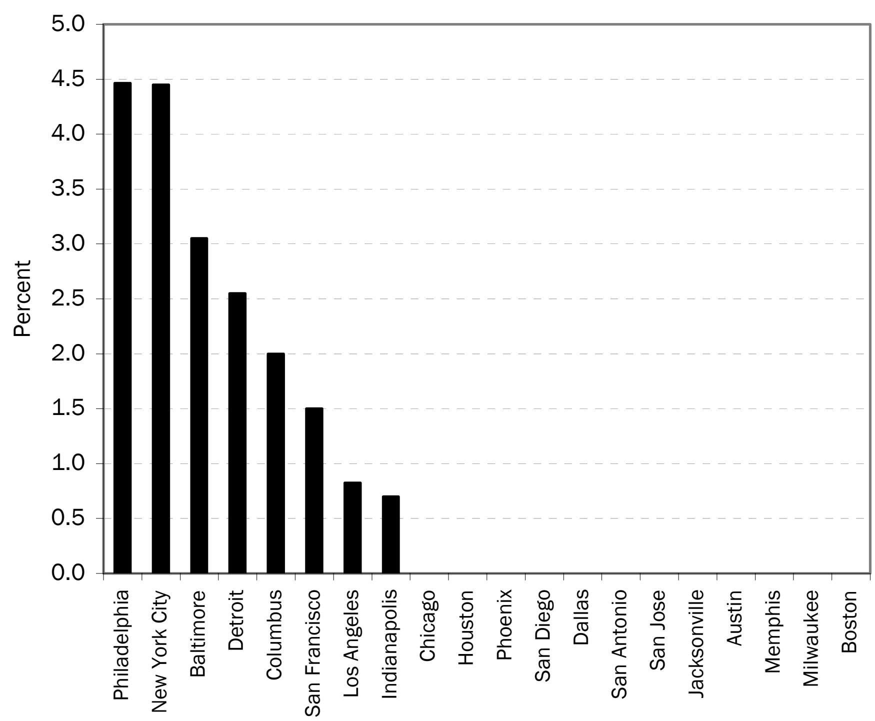
Source: New York City Independent Budget Office, 2000.

- The local earned income tax rate levied on residents exceeds 1.5 percent in only three of 240 municipal jurisdictions in the city's Pennsylvania suburbs.[20] Local governments in Philadelphia's New Jersey suburbs levy no local income taxes at all.
- Among the 20 largest cities in the country, only eight levy local income taxes, as shown in Figure 4.3. Philadelphia's local income tax rate for residents, currently 4.4625 percent, is the highest in the nation. Among other major cities with local income taxes, the median rate is 2.0 percent, less than half of Philadelphia's current rate.
- Philadelphia's tax rate on nonresident income, currently 3.88 percent, is higher than that of any other city in the United States. The next highest local commuter tax is 2.25 percent, the rate imposed in Dayton, Toledo, and Youngstown, Ohio.[21]

A Bad Tax Mix Dampens Economic Prosperity

Economic theory and econometric research strongly suggest that Philadelphia's peculiar combination of taxes is far more damaging to the economy than an alternative revenue structure would be. With its heavy reliance on those tax sources that are most likely to drive residents, jobs, and businesses from the city, Philadelphia compounds the problems created by its high overall tax burden.

Figure 4.3: *Current Local Income Tax Rates in the Twenty Largest U.S. Cities (Maximum Rate in Cities With Progressive Income Taxes)*



Source: Commerce Clearing House, 2003.

Economic Theory

In the 21st century, most workers, customers, and suppliers are highly mobile. As such, most businesses cannot pass on the cost of local business taxes to their employees (by lowering wages), to their customers (by raising prices), or to their suppliers (by reducing the purchase price of goods and services). Thus, high local business taxes in Philadelphia directly reduce profits and encourage businesses to leave the city. The impact of business taxes upon profit margins is especially pronounced for businesses whose workers are willing to work in the suburbs, whose customers are not concentrated in the city, and who are not highly dependent upon city suppliers. Further, because there are costs associated with commuting, to the extent that high business taxes result in fewer jobs located within the city, the city will become less attractive as a residential location.

Although the City's Wage Tax is levied upon individuals, economic theory suggests that a significant portion of the burden created by the tax falls upon city businesses. Businesses employing workers who have the option of working either in the city or the suburbs will have to pay a premium (equal to the value of the Wage Tax) in order to attract employees. Although this premium may take many forms (such as higher wages, better benefits, or fewer work hours per day), this premium is an extra burden that must be paid by businesses. This cost reduces the profitability of city firms and provides an additional incentive for businesses to locate offices and factories in the suburbs.

Compared to taxes on income and business activity, property-based taxes have a relatively small economic impact. Unlike workers and businesses, land is immobile and cannot relocate to escape high taxes. For this reason, economic theory predicts that the overall effect of property-based taxes on the city's economy—employment levels, income, and business activity—is smaller than the effect created by the Wage Tax or the Business Privilege Tax. Most economists agree that property-based taxes are capitalized into the market value of real estate and as a result property values typically decrease when property taxes increase. No tax comes without an economic cost. Wage and business taxes drive out jobs and residents. Property-based taxes lower property values. The task for policy-makers is to select that mix of taxation which does the least overall damage to the local economy.

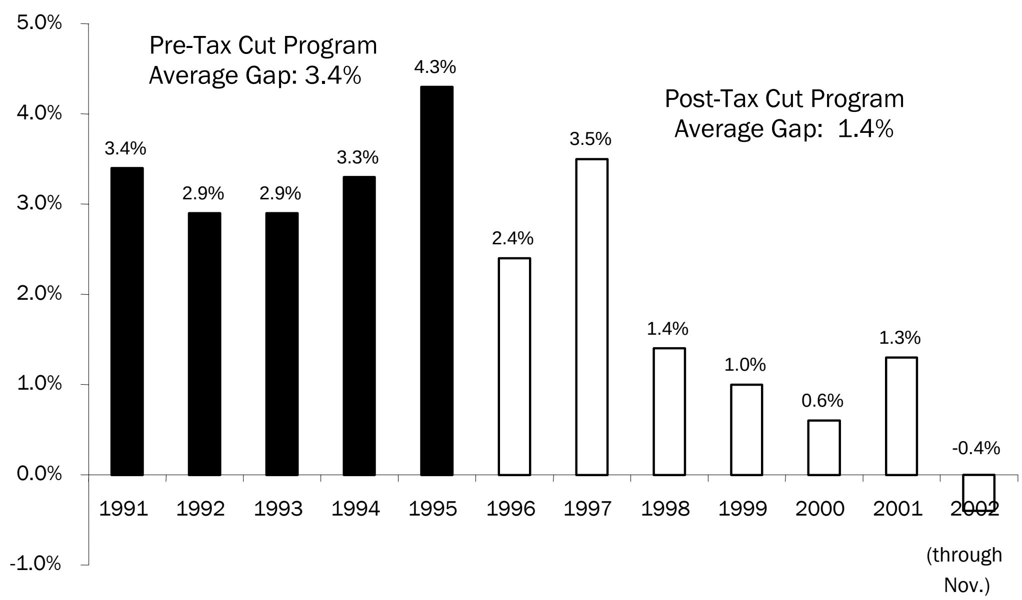
Evidence

Results from two different Philadelphia business surveys indicate that some taxes are more harmful than others. City business owners who responded to the Commission's 2003 survey reported that the Wage and business taxes were most burdensome to their companies. The City Department of Commerce surveyed Philadelphia businesses in 2001 concerning the city's business climate.[22] Wage, Earnings and Net Profits Taxes and the gross receipts portion of the Business Privilege Tax were the taxes most often cited as those that should receive top priority for tax reduction. Approximately 77 percent of respondents indicated that the Wage, Earnings and Net Profits Taxes were among the top three taxes in terms of priority for tax reduction, and 69 percent of respondents indicated that the gross receipts portion of the Business Privilege Tax was among the top three taxes in terms of priority for tax reduction.

Econometric analysis of the impact of taxes upon the Philadelphia economy is consistent with economic theory and survey findings. Econsult (2003) directly compared the economic impact of an immediate $125 million cut in the Wage Tax to equal dollar value cuts in the gross receipts portion of the Business Privilege Tax and the Real Estate Tax. Econsult found that, in terms of the increase in resident income and property values, Wage and business tax cuts result in a substantially larger impact than property tax cuts. Further, although the Econsult study found that Wage and business tax cuts would substantially increase city employment, it did not find that property tax cuts would have a statistically significant impact upon employment. Econsult also found that shifting the city's tax burden away from business and Wage taxes and onto property-based taxes results in substantial increases in jobs, resident incomes, business activity, and property values. This finding suggests that local tax policy in Philadelphia is not a zero sum game. Dollar-for-dollar replacement of business and Wage Tax revenue with property tax revenue leads to net increases in city tax bases, City tax revenues, and private economic wealth.

Evidence of this positive impact can be found in the City's *Five-Year Financial Plan* (Figure 4.4), which shows how the gap between Philadelphia employment growth and U.S. employment growth dropped substantially after the City began its program of incremental tax reductions in 1996.

Figure 4.4 *Gap Between Philadelphia Employment and U.S. Employment Growth*



Source: U.S. Bureau of Labor Statistics.

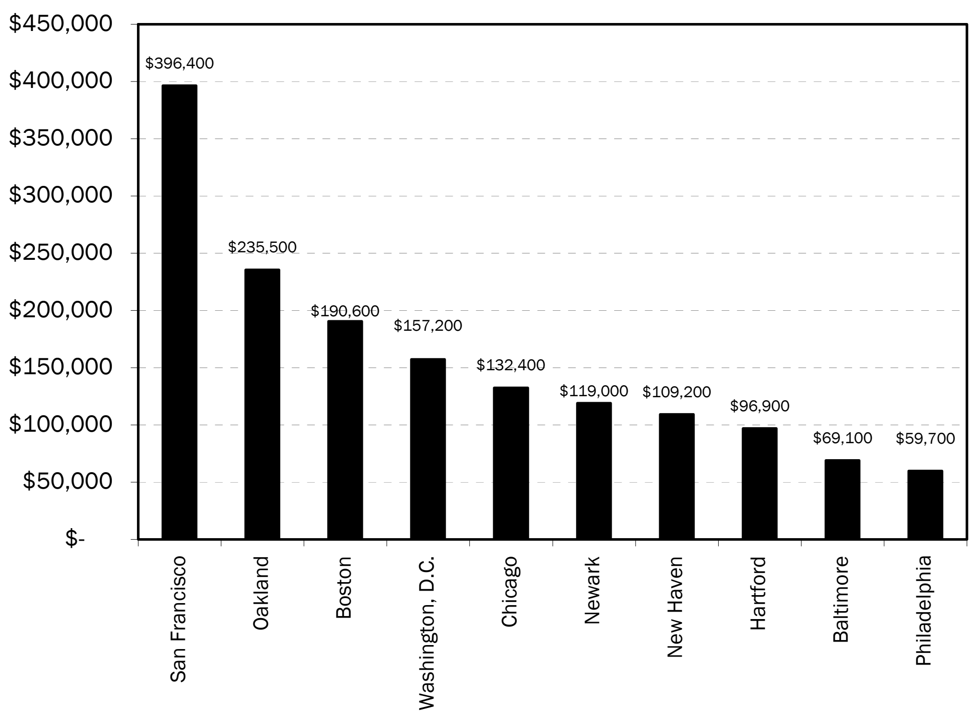
The Impact of City Tax Policy on Property Values

Property values reflect market expectations about the future value of location as a place to live and do business in the long run. As shown in Figure 4.5, residential property values in the city of Philadelphia are low compared to other major northeastern cities. While Philadelphia's large stock of single-family homes has made home ownership far more accessible than in many other cities, the fact that property values are so far below values in comparable regional cities is a symptom of Philadelphia's economic distress. Philadelphia's low property values can be linked at least in part to the city's high overall tax burden and its inefficient mix of tax revenue sources.

Economic theory suggests that, to the extent that tax reform makes Philadelphia a more attractive place to live and work, tax reform will increase the demand for city property and lead to both higher market values of existing property, as well as new construction. Assuming that property-based tax rates remain constant, increasing property values will generate additional tax revenue. Econsult (2003) supports this theoretical assumption. Econsult's study finds that lower City Wage and business taxes would lead to increased property values in the city.[23]

Historical trends suggest that city property values are closely linked to market expectations of the City's future tax rates and fiscal condition. While city residential property values

Figure 4.5: *Comparison of Property Values in Selected Cities, 2000*

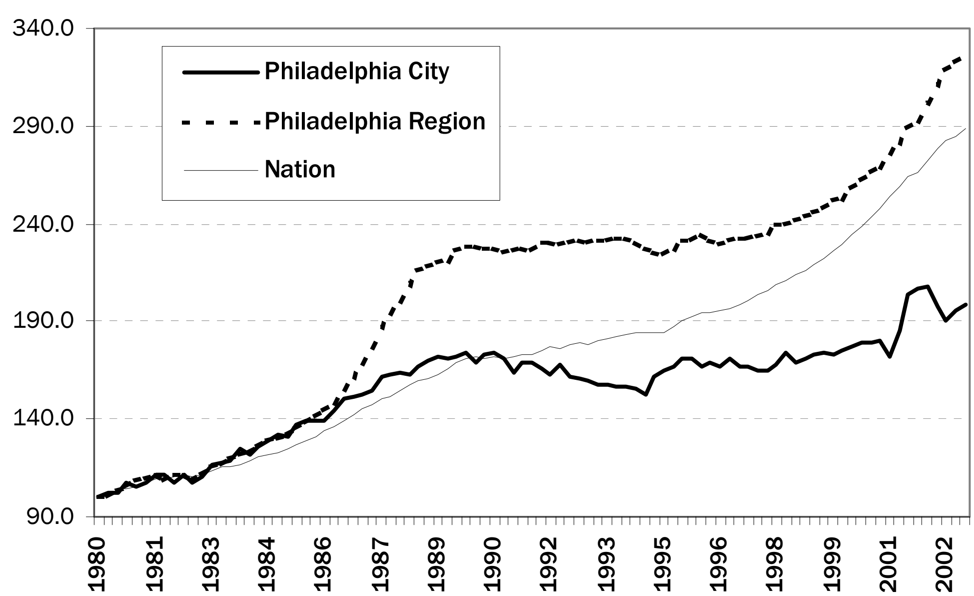


Source: U. S. Census Bureau.

kept pace with the nation in the 1980s, housing prices fell significantly shortly after the City's financial crisis of 1990-1991. After it was revealed in August 1990 that the city faced a FY91 budget deficit of $153.5 million, with the prospect of future deficits as high as $450 million, the real estate market quickly responded to the possibility of future tax increases or service cuts. City home values fell by over eight percent in a six-month period. Property values continued to decline through 1994. In 1995, following three consecutive years of balanced budgets and the announcement of the first cuts in 20 years in the City Wage Tax and the gross receipts portion of the Business Privilege Tax, property values began to increase. Since then, while the City's fiscal stability has been maintained and tax rates have continued to decrease, Philadelphia's property values have increased. See Figure 4.6.

In considering the appropriate local tax mix for Philadelphia, City officials should take a cue from the trend in other major cities. Other cities are reducing their reliance on business and personal income-based taxation. The City of Detroit is reducing its income taxes for residents and nonresidents by one third over a ten-year period from 1999 to 2009. The income tax rate for residents, which was 2.95 percent in 1999, is scheduled to be two percent by 2009, and the nonresident rate will be reduced from 1.475 percent to one percent over the same period. Detroit also plans to eliminate its corporate income tax by 2009. In 1999, New York City repealed its nonresident earnings tax, which had been levied at a rate of 0.45 percent on commuter wages and 0.65 percent on nonresident earnings from self-employment.[24]

Figure 4.6: *House Price Indices, Philadelphia City, Philadelphia Region, and U. S. Average, 1980-2003 (1980 = 100)*



Source: Gillen, 2003.

In sum, a broad array of evidence points to the conclusion that Philadelphia's high reliance on Wage and business taxes leads to fewer jobs, reduced resident income, less business activity, and lower property values in the city. Thus, it is necessary to reduce the proportion of overall tax revenues that derive from Wage and business taxes. With such a change in the City's tax mix, Philadelphia can significantly increase the size of its economy while maintaining a tax revenue stream adequate to finance needed public services.

Inadequate Property Tax Assessment

Philadelphia's economy would benefit if taxes were shifted away from mobile factors of production onto land and property. However, problems with Philadelphia's property assessments diminish the revenue generating potential of such a shift.

Accuracy and Equity

Philadelphia's property assessments do not meet industry standards for accuracy; all across the city, assessed values diverge widely from market values. Philadelphia's property assessments do not meet industry standards for equity; properties in poorer neighborhoods are, on average, assessed at a higher percentage of market value than properties in more affluent neighborhoods. The inaccuracy and regressive nature of Philadelphia's assessments violate standards of vertical and horizontal equity. Inaccurate and regressive assessments effectively make policy makers less likely to support any efforts to increase reliance upon property-based taxes.

Philadelphia's coefficient of dispersion (COD), a measure of assessment inaccuracy, is very high compared to the standard recommended by the International Association of Assessing Officers (IAAO). Figure 4.7 presents the average COD by type of property in Philadelphia, based upon 2003 assessment data. For each class of property, Philadelphia's COD is significantly above the IAAO standard for large urban jurisdictions.

Philadelphia's COD is also much higher than that of suburban jurisdictions in southeastern Pennsylvania and other major cities across the country. Although cities

Figure 4.7: *Average Assessment Error by Property Type*

Property Type	*Philadelphia Mean COD*	*Target COD According to IAAO Standards*	*% Within Target*
Single-Family Residential	34.4%	≤15%	51.4%
Hotels, Condos and Apartments	32.2%	≤15%	50.5%
Retail	48.6%	≤15%	34.6%
Commercial	46.7%	≤15%	37.3%
Industrial	58.9%	≤15%	31.4%
Vacant Land	77.4%	≤20%	26.0%

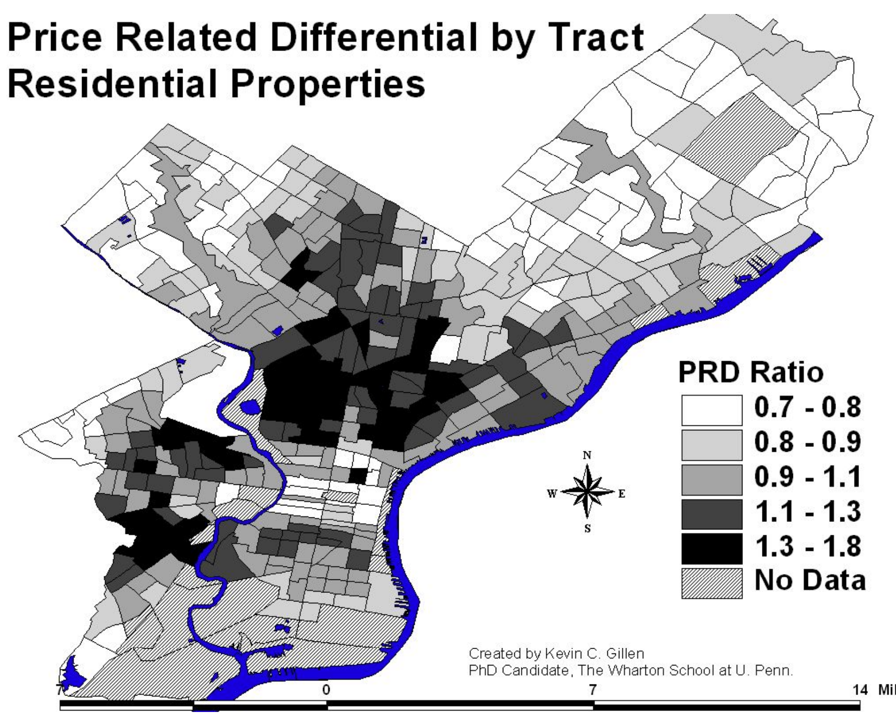
Source: Gillen, 2003.

like Boston, Baltimore and Chicago have older, heterogeneous housing stocks similar to Philadelphia's, they have a significantly lower level of general assessment error. Compared to other major cities in the U.S. for which comparable information is available, only Buffalo has a higher level of assessment error than Philadelphia.[25]

Another serious concern is that the city's assessments are regressive. The Price-Related Differential (PRD) is a quantitative measure of the degree of assessment regressively. For single-family homes, Philadelphia's PRD is six times larger than what is prescribed by the IAAO's national standards for assessment uniformity. Lower-priced properties are typically assessed at higher fractions of their value than higher-priced properties. Thus, the assessment system results in a higher tax burden (in percentage terms) upon poorer households than upon more affluent households. Although many older cities have regressive assessments, Philadelphia has the highest degree of assessment regressivity among any major U.S. city for which equivalent data is available, surpassing such comparable cities as Baltimore, Chicago, Pittsburgh, and Washington, D.C. by several orders of magnitude.[26]

The extent of the problem can be clearly seen in Figure 4.8. The map indicates the average assessment ratio (the ratio between assessed and market value) for residential property in each city neighborhood as a proportion of the citywide assessment ratio. Darker tracts are overassessed relative to lighter tracts. Taken as a

Figure 4.8



Source: Gillen, 2003.

whole, neighborhoods with higher property values in the northwestern and northeastern sections of the city, as well as in Center City, are under assessed relative to less affluent neighborhoods in North Philadelphia and West Philadelphia.

Land Valuation

Problems with the property tax system also prevent another tax policy change that can be expected to increase the efficiency of the city tax system: the gradual shift toward land-value taxation. The efficiency benefits of land-value taxation require that taxes place a higher burden upon property owners that own relatively highly valued land and a lower burden upon property owners with relatively highly valued improvements. This cannot be achieved without an assessment system that accurately determines the value of both land and improvements. Without major improvements in the overall assessment system, it will not be possible to value land and improvements separately with a sufficient degree of accuracy to insure that land-value taxation results in an accurate targeting of the tax burden toward property owners with higher land values. The expected economic stimulus effects of land-value taxation will for that reason be unlikely to occur unless the current problems with the assessment system are addressed.

Assessment System Simplicity

Philadelphia's assessment process is overly complicated and convoluted. This violates the principle of tax system simplicity. The convoluted assessment process makes it difficult for average citizens to understand the process and to make an informed judgment about whether their assessment is accurate; furthermore, it erodes trust in the tax system. If citizens do not trust the fairness of the assessment process, and if they cannot determine whether their own assessments are fair, they will be less likely to support a shift to increased reliance on property taxation, as opposed to Wage and business taxes.

Demographics and Philadelphia's Service Responsibilities

Philadelphia tax revenues can be divided into three parts—those taxes levied to support public education and dedicated to the School District of Philadelphia, those taxes levied to provide traditional municipal services that are provided by the City, and those taxes levied to provide county-level services that are also provided by the City.

Figure 4.9 presents a comparison of the tax burden associated with municipal, school district, and county services in Philadelphia and in the average Pennsylvania municipality, school district, or county, respectively.

Figure 4.9: *Philadelphia's Tax Burden Compared to Other Jurisdictions in Pennsylvania, Fiscal Year 2001 (Total Taxes Collected as a Percent of Market Value of Real Estate)*

Expenditure Type	*Philadelphia*	*State Average (Excluding Philadelphia)*
Municipal Services	4.3%	0.4%
Public Education	1.8%	2.1%
County Services	2.8%	0.5%
Total	8.9%	3.0%

Source: Commonwealth of Pennsylvania, Department of Community and Economic Development, 2003; City of Philadelphia, 2001; Commonwealth of Pennsylvania, State Tax Equalization Board, 2003.

Philadelphia's tax burden for county and municipal services—measured as total taxes collected as a percentage of the market value of real estate—are extremely high compared to the statewide average. The city's tax burden to support public education is comparable to, and in fact somewhat below, the state average. This suggests that the city's high municipal and county tax burden are the primary contributors to the city's overall high tax burden.

Total Philadelphia taxes collected to support public education are 1.8 percent of market value, somewhat below the tax burden in the average Pennsylvania school district. At the same time, School District of Philadelphia spending per student in 2001- 2002 ($8,748) was only 3.9 percent below the state average of $9,099. This result might not be expected, given the city's relatively weak tax base of $152,718 per student, compared to a state average of $233,582 per student. The city's ability to maintain a near-average spending per student despite its relatively low school district tax burden and limited tax base reflects the fact that state and federal funding of local school districts in the Commonwealth do promote fiscal equalization to some extent. State and federal funding for public education is targeted to districts with low fiscal capacity and high poverty among the student population.

The Commonwealth's method of providing aid to support the cost of county services does not serve to equalize tax burdens. This works to the disadvantage of Philadelphia more than any other county in the state. With the exception of Philadelphia, counties in Pennsylvania generally include a mixture of urban, suburban, and/or rural areas. As a result, outside Philadelphia, higher income and lower income areas share the cost of providing county services, which are closely related to crime and poverty. Philadelphia is the only city-county in the Commonwealth, and this unique status has a significant impact on the City's spending and tax burden. In terms of spending per capita, tax burden, market value per capita, and indicators of need for service such as crime and poverty rates, Philadelphia is dramatically different from every other county in the Commonwealth, as illustrated in Figure 4.10.

Despite the city's demographic and economic dissimilarity from other counties, it is responsible for providing the same range of county level services as every other Pennsylvania county: maintaining the local judicial and corrections systems, and providing children and youth, homeless, mental health, mental retardation, drug and alcohol, and public health services. The city's high crime and poverty rates insure a significantly higher degree of need for these services than in other counties, and this is reflected in the city's high spending per capita for county services. At the same time, for some of these services (judicial and corrections) state funding is minimal, and for others, state funding, while substantial, is not targeted to counties with high service needs or low fiscal capacity. Generally, state funding for county programs is provided through a matching grant with a single matching rate for all counties. The result is that counties such as Philadelphia with high needs for service and low fiscal capacity will necessarily be forced to levy high tax rates to support county human service programs. This result is reflected in Philadelphia's extremely high tax burden for county level services, a burden that is *seven* times the median among Pennsylvania counties.

The city's high overall tax burden is also driven by a high tax burden to support municipal services. The city's municipal tax burden is more than ten times the average tax burden of other municipal governments in Pennsylvania. Clearly, this high tax burden is driven in part by the city's high crime rate compared to the typical local jurisdiction in Pennsylvania. It is also the product of the city's relatively weak tax base per capita compared to other municipalities, and the city's broad array of public services, including regional public amenities such as funding of sports stadiums, museums, and the Philadelphia Zoo.

In sum, Philadelphia's high overall tax burden reflects four structural problems: high need for county level services; low fiscal capacity; Philadelphia's service responsibilities as a city-county; and the fact that the

Figure 4.10: *Philadelphia Versus Other Pennsylvania Counties, Key Demographic and Fiscal Variables*

	Poverty Rate (1999)	*Crime Per 1,000 Population (2001)*	*County Spending Per Capita (FY01)*	*County Taxes as a Percent of Market Value (FY01)*	*Market Value Per Capita (2001)*
Philadelphia	22.9%	62.5	$2,232	2.8%	$20,794
Pennsylvania Counties (Excluding Philadelphia)					
Minimum	4.4%	4.6	$212	0.2%	$17,388
Median	10.3%	16.9	$520	0.4%	$28,044
Maximum	18.0%	33.7	$971	1.0%	$84,415

Source: Commonwealth of Pennsylvania, Pennsylvania State Police, 2001; Commonwealth of Pennsylvania, Department of Community and Economic Development, 2003; Commonwealth of Pennsylvania, State Tax Equalization Board, 2003; City of Philadelphia, 2001; and U. S. Census Bureau, 2003.

state's method of supporting the cost of county services does not explicitly target funding to counties with high service needs and low fiscal capacity. The City cannot unilaterally change its service responsibilities as a city-county or the Commonwealth's method of providing financial support for county-level services. Local Philadelphia officials, however, can make overall reductions in tax levels, adopt a more efficient mix of taxation, and improve the City's system of real property assessment. To the extent that these policy changes promote economic growth and jobs, and reduce poverty in the city, they may also reduce the need for county and municipal services over time–-many of which are directly related to poverty and crime—and strengthen the city's tax base. It is clear, however, that addressing the structural problems that drive high city taxes will require strong collaboration between the City and State.

Section 5: Tax Reform Recommendations

The Philadelphia Tax Reform Commission's recommendations are firmly grounded in tax and economic theory. However, throughout its research process, the Commission has sought input from Philadelphia businesses, community groups, residents, and City agencies to judge whether its recommendations resonated with stakeholders. Consequently, the Commission considers these recommendations to be sound in principle and achievable in practice.

Although the Commission believes that each of its recommendations will improve tax system competitiveness, equity, stability, neutrality, or simplicity, these recommendations will be most effective if implemented as a comprehensive tax reform package. Except where explicitly noted, each of these recommendations would be effective beginning in fiscal year 2005.

Assessment System Reform Recommendations

Recommendation 1: Separate the Property Assessment and Appeals Process.

To increase assessment accuracy and ensure that the appeals process is unbiased, the Commission recommends creating a Property Assessment Appeals Board (the "Appeals Board") independent of the Board of Revision of Taxes (BRT).

Currently, a seven-member Board of Revision of Taxes, appointed by the judges of the Philadelphia Court of Common Pleas, assesses all Philadelphia property and hears all assessment appeals. This arrangement has been sharply criticized by taxpayers who are displeased with the quality of property assessments and who believe that the appeals process is neither fair nor impartial. The proposed Appeals Board would be a seven-member board of qualified individuals appointed by the Mayor to hear and decide the outcome of assessment appeals. Because the duties of the Board of Revision of Taxes will decrease with the creation of the Appeals Board, the Commission recommends that further analysis be conducted to determine whether it might be appropriate to appoint fewer members to the Board of Revision of Taxes.

Although some advocacy groups have argued that the Court of Common Pleas should not appoint members of the Board of Revision of Taxes, the Commission believes that it is important for the assessing body to retain a degree of independence from the Mayor and City Council. As such, the Commission does not recommend changing the Board of Revision of Taxes appointment process.

Recommendation 2: Establish a Taxpayers' Advocate.

To increase taxpayer representation in the assessment process and to improve tax system fairness, the Commission recommends creating a position of Taxpayers' Advocate. The Taxpayers' Advocate should:

- provide advice, council, and education to property owners in the assessment and appeals process;
- represent low income residential property owners before the Board of Revision of Taxes and the Appeals Board;
- improve public understanding of the assessment and appeal processes;
- monitor and report on the quality of the assessment process; and
- review and comment upon the Board of Revision of Taxes Assessment-Practice Principles and the Appeals Board practices and procedures.

The Commission recommends that the Mayor nominate and the City Council approve candidates for the position of Taxpayers' Advocate.

Recommendation 3: Establish Accurate Land and Structure Values for All Property Parcels.

As real estate assessments are an integral part of an equitable and well functioning local tax system, the Commission recommends establishing accurate land and structure values for all property parcels in Philadelphia. Although investment in automated appraisal technologies and statistical methodologies may yield some gains in assessment uniformity, the highest gain is likely to be realized by more comprehensive and accurate data collection. As such, the Commission explicitly recommends expanding the scope of data collection for Philadelphia land and structural property characteristics. Funds from the City's productivity bank, other savings related to proposed changes in the Real Estate Tax (discussed in Recommendation 9) or a one-time surcharge on Real Estate Tax bills should be used to fund efforts to improve data collection and to establish accurate land and structure values.

Assessments in heterogeneous cities tend be less accurate and more regressive than assessments in homogeneous suburbs. However, of the other major cities in the U.S. for which comparable information is available, only Buffalo has a higher level of assessment error than Philadelphia. Similarly, among major U.S. cities for which equivalent data is available, Philadelphia has the highest degree of assessment regressivity, surpassing cities such as Baltimore, Chicago, Pittsburgh, and Washington D.C. by several orders of magnitude.

Research performed at the request of the Commission indicated that barely half of Philadelphia's stock of single and multi-family housing, a third of retail and industrial properties, and a quarter of vacant land meet industry standards of appraisal accuracy set by the International Association of Assessing Officers (IAAO). This same research reveals that properties in the most economically disadvantaged neighborhoods are generally over assessed and properties in the most affluent neighborhoods are generally under assessed. As a result, those who are least able to pay Real Estate Taxes are forced to pay more than their fair share and those who are most able to pay Real Estate Taxes are allowed to pay less than their fair share. Since basic public services (trash, fire, police, etc.) are provided to all households, implementation of this recommendation would end the current pattern of redistributing wealth from low-income households to high-income households.

In addition to improving tax system equity, establishing accurate land and structure assessments helps to ensure that the City will effectively capture the benefits of tax reform. If the Commission's proposed package of tax reform induces households and businesses to relocate to Philadelphia, many of the fiscal benefits forecasted to accrue to the city would be in the form of rising property values and increased Real Estate Tax revenues. The City will not be able to recognize these gains unless property assessments adjust as property values change.

Recommendation 4: <u>Adopt a Set of Assessment-Practice Principles.</u>

To improve tax system equity and transparency, the Commission recommends that the Board of Revision of Taxes be required to officially adopt and publicly promulgate a set of assessment-practice principles.

The Commission recommends that formal assessment-practice principles be created with the help of an advisory board comprised of representatives appointed by the Board of Revision of Taxes, the Mayor, City Council, the City Controller, and the newly created Taxpayers' Advocate. Each year, the Board of Revision of Taxes should be required to submit to City Council and make available to the public, a report on any changes that have been made to these assessment-practice principles.

The Commission recommends that the following reforms be incorporated into the Board of Revision of Taxes's set of Assessment-Practice Principles:

- a requirement that all assessors be state certified;
- a commitment not to create or preserve inequalities by artificially capping assessments;
- an annual reassessing of all properties to reflect any increase or decrease in value;
- a commitment to continually improve the quality of the data collected about the condition of each property;
- an increased reliance on computer modeling and information management systems;
- the incorporation of advanced regression techniques, computer calculated neighborhood indexes, GIS mapping, and Computer Assisted Mass Appraisal (CAMA) products; and
- a commitment to provide more information about how assessments are performed when assessment notices are sent out. For example, each notice could contain information about the average assessment in that neighborhood for that type of property, and reasons why the assessment deviates from the average.

Recommendation 5: <u>Eliminate Fractional Assessments.</u>

In order to promote greater equity and simplicity within the tax structure, the Commission recommends eliminating fractional property assessments.

Currently, the actual selling price for most pieces of property is higher than the market price assigned to that property by the Board of Revision of Taxes. Assessing all properties at 100 percent of market value, instead of the current 70 percent, would remove an additional layer of complexity from the process, and contribute to making the administration of the property tax more transparent.

An analysis of Philadelphia assessments reveals that, even with the Board of Revision of Taxes' attempts to assess all properties at 70 percent of their value, assessments across the city exhibit a great deal of variance. Some properties are assessed at more than 100 percent of their market value while other properties are assessed at below 30 percent of their market value. This variance decreases tax system equity. Because it will be easier for property owners to evaluate the accuracy of their assessment if all properties are assessed at 100 percent of market value, this recommendation will decrease assessment error and promote greater tax system equity.

To prevent unreasonable increases in property tax bills when the practice of fractional assessing is abolished, this recommendation must be accompanied by the implementation of rate reduction, property tax buffering, and a budget-based system of real estate taxation.

Recommendation 6: Implement a Property Tax Buffering Program.

The Commission, in an effort to increase tax system stability, recommends implementation of a property tax buffering program.

Typically, large increases in real estate assessments occur when real estate values rapidly increase and when efforts are made to reassess previously under-assessed properties. Tax system stability and relief to property owners who unexpectedly face large tax increases can be achieved when property tax buffering programs are implemented.

- After careful analysis of different buffering programs, the Commission rejects all types of phasing, caps, and freezes, in favor of recommending a three-year averaging program wherein the Real Estate Tax is levied on the average of the assessed property value from the past three years. If the City adopts a system of land-value taxation, the Commission recommends implementing a three-year land-averaging program wherein the Real Estate Tax is levied on the current year's structural value plus the average assessed land value from the prior three years.
- By allowing for gradual adjustment to any future changes in a property's assessed value, tax averaging increases tax-system stability and mitigates the impact of market fluctuations and property reassessments. Unlike other buffering programs, tax-averaging does not distort the relationship between a property's market value and its assessed value, build inequalities into the tax system, rely upon complicated formulas, or expose taxpayers to future assessment spikes. Nor does it lead to dramatically increased property tax liabilities when the program is eliminated or when it expires.

Budget-Based Property Taxation Recommendation

Recommendation 7: Implement a System of Budget-Based Property Taxation.

To promote greater tax system equity, stability, neutrality, simplicity, and competitiveness, the Commission recommends shifting from an assessment-driven to a budget-based system of property taxation.

Compared to real estate tax rates in municipalities around the country, Philadelphia's Real Estate Tax rates change infrequently. As a result, any increase in property values leads to increases in property taxes and property tax revenues. This creates an assessment-driven rather than a budget-based property tax system. In contrast, most municipalities have a budget-based real estate tax system that results in a rate-driven property tax levy. These jurisdictions impartially assess property and then adjust property tax rates to meet explicit budgetary targets. In doing so, they create a stable revenue stream and take advantage of the fact that property-based taxes are uniquely under the control of the local government, which has the power to value the base and to set the rate at which this base is taxed.

All cities have a difficult task providing services, budgeting for those services, and constructing a revenue structure to fund those services. By taking control of Real Estate Taxes as part of a budget-based property tax system, the City's ability to perform this essential government function will improve. After taking into consideration projections of revenues from other tax and non-tax sources, and setting aside a portion of that revenue for delinquencies and court settlements, Real Estate Tax revenues should be the budget-closing item.

As such, the Commission recommends creating a system of budget-based property taxation by legislatively obligating the Mayor and City Council to determine all annual Real Estate Tax rates *after* setting the budget and reviewing assessments.

Implementation of a budget-based system would reduce the political need for inequitable assessment stabilizing policies such as caps on assessment increases. When property values are artificially stabilized, significant tax-system inequities inevitably develop.

In Philadelphia, property tax certainty and revenue stability decrease when assessment error is minimized and assessments closely track property values. This instability is the by-product of Philadelphia's assessment-driven system and systemic property market volatility. If a budget-based property tax system were implemented, assessment uniformity, property tax bill stability, and property tax revenue certainty would cease to be incompatible policy objectives.

Because it allows property tax revenues to be the City's budget-closing item, this recommendation could lead to an increase in the City's reliance on Real Estate Taxes. If projected tax and non-tax revenues are lower than expected, and if efficiency cannot be improved, the City will have to increase its reliance on property tax revenues. This would shift the tax burden from mobile taxpayers, i.e., businesses and wage earners, to real estate. By minimizing the distorting effect of Philadelphia's existing tax structure, this shift would increase tax system neutrality.

The complexity of the current property tax system typically leads taxpayers to blame the Board of Revision of Taxes when rising property assessments lead to increased property taxes. If the system were sufficiently transparent, elected officials could be held accountable for rising property taxes and the Board of Revision of Taxes would be able to focus on establishing accurate assessments. Shifting to a budget-based system would create a more understandable system wherein elected officials are truly responsible for levying taxes.

Currently, a revenue windfall occurs when property assessments rise and real estate taxes produce more than the projected amount of revenue. However, if a budget-based real estate tax system were implemented, windfalls of this type would be less likely to occur because elected officials would have a disincentive to raise more revenue than is absolutely necessary. The process of annually analyzing the property tax burden and the City's budgetary needs would make Philadelphia's tax structure more competitive. This recommendation would be effective beginning in fiscal year 2006.

Land-Value Taxation Recommendation

Recommendation 8: Phase-in Land Value Taxation.

The Commission recommends phasing-in land-value taxation until 50 percent of all real estate tax revenues are generated from a tax on the value of land and 50 percent are generated from a tax on the value of structures.

Even though land values and structure values are currently taxed at a flat rate, Philadelphia's tax on land only generates 22.5 percent of total real estate tax revenues. To promote greater tax system competitiveness, equity, and neutrality, the Commission recommends that the fraction of real estate tax revenues generated from a tax on land values gradually increase.

Because the need for City revenue and the assessed value of property will change over the next 10 years, the Commission has refrained from recommending specific land and structure millage rates. Rather, the Commission recommends the following revenue schedule. See Figure 5.1.

Figure 5.1: *Land-Value Tax Phase-In Schedule.*

Fiscal Year	*Percent of Real Estate Tax Revenues From Tax on the Value of Land*	*Percent of Real Estate Tax Revenues From Tax on the Value of Structures*
2004	22.50%	77.50%
2005	25.25%	74.75%
2006	28.00%	72.00%
2007	30.75%	69.25%
2008	33.50%	66.50%
2009	36.25%	63.75%
2010	39.00%	61.00%
2011	41.75%	58.25%
2012	44.50%	55.50%
2013	47.25%	52.75%
2014	50.00%	50.00%

The Commission reviewed extensive research and information concerning the impact of land-value taxation, as well as testimonials from officials in other jurisdictions that have adopted land-value taxation. The information was both enlightening and compelling. The research demonstrated that land-value taxation maximized its economic development goals when implemented in conjunction with other types of tax and policy reform. Land-value taxation, complemented by the other recommendations of this Commission, would be consistent with the Commission's mission to improve the City's competitiveness in a fiscally and socially responsible manner. During the course of its research, the Commission satisfactorily resolved the issues surrounding the practicality of properly assessing land values and, backed by data from the City's Department of Revenue, determined that the issue of tax-delinquency would not threaten attempts to impose land-value taxation in a revenue-neutral manner.

Because land prices are a reflection of the aggregated value created by the surrounding community, land taxation is more equitable than most other types of taxation. Unlike structure values, land values are not created by the actions of individual property owners, but by the community, acting in the following capacities. First, society provides the legal institutions of land ownership from which the concept of land value springs. Land would be of little value without the legal framework, which assures landowners that their investments will not be taken away from them without due process and compensation. Second, the local government is the provider of infrastructure and amenities such as good schools, roads, and police protection that give land much of its value. Third, land values rise when population growth or increased community economic activity results in an increased demand for land.

Land is unique because, no matter how much it is taxed, the quantity will never change. This makes it possible to levy a tax on land without distorting people's production decisions and stifling economic progress. This ability to generate tax revenue without distorting economic decisions is the very essence of tax-system neutrality.

Municipalities use land tax revenues either to reduce other taxes while keeping service levels constant, or to increase levels of local service provision without raising other types of taxes. Reducing fiscal dependency on other taxes and increasing fiscal dependency on an economically neutral form of taxation promotes economic development. For this reason, the economic impact of land-value taxation is best measured in terms of its revenue alternatives.

By discouraging speculative land holding, this tax policy encourages property owners to maximize the revenue generating potential of their land. Although this may violate the technical definition of tax neutrality, it increases societal economic prosperity. After reviewing the canon of tax literature, the Commission concludes that, even if it has the potential to "distort" the economic decisions of landowners, land-value taxation remains the most economically efficient and economically neutral method of local taxation.

The Commission's recommendation of a gradual increase in the tax on land and decrease in the tax on structures will encourage greater private investment in Philadelphia. This investment will reduce the amount of blight and abandonment in the city, promote economic development, and increase tax system competitiveness.

Because land is fixed in its location and quantity, and because it is relatively unresponsive to business cycle fluctuations, land values are an ideal tax base. Taxing this base produces a relatively constant revenue stream to fund public services.

Critics of land-value taxation have argued that Philadelphia's patterns of property tax-delinquency would reduce the land-tax revenues and decrease tax system stability. To evaluate the merits of this concern, the Commission undertook an analysis of property assessments and delinquencies. This research allowed the Commission to confidently reject the hypothesis that patterns of property tax delinquency would reduce the stability of land-tax revenues.

The Commission recognizes that the Pennsylvania Constitution's Uniformity Clause could present a potential barrier to land value tax-driven policy initiatives. If the courts decide that the Uniformity Clause precludes the division of land and improvement for tax purposes, a land value tax will only see fruition if the legislature amends the Constitution. The Commission is not predicting the outcome of a legal or constitutional challenge. However, land-value taxation has existed in Pennsylvania since 1901 and is currently in place in a number of major Pennsylvania cities. Although land-value assessments and rate differentials have been challenged where the taxing municipality further classified the property based upon its use or location (commercial vs. residential, urban vs. rural), the constitutionality of separate land and structure classes of property has never been challenged.

Property Tax Relief Recommendations

Recommendation 9: Expand Efforts to Address Property Tax "Ability to Pay" Issues.

The Commission developed a tripartite series of recommendations to help homeowners pay their property tax bills. The Commission recommends: 1) establishing quarterly installment payment plans for all real estate taxpayers; 2) applying tax payments to the current year's tax rather than delinquent tax bills; and 3) considering development of a low-income property tax relief program similar to the Water Department's Water Relief Assistance Program (WRAP).

Changing patterns of American investment and income have created a situation wherein the property tax is more burdensome for some groups than others. The most common critique of property taxation involves elderly homeowners who are asset rich, but income poor. Although the net worth of all property owners increases when property values rise, elderly individuals and others living on fixed incomes often find it difficult to afford the corresponding increase in property taxes. This creates an "ability to pay" problem. Another common critique of property taxation is that this tax is a regressive wealth tax. The property tax is progressive to the extent that, as people accumulate more wealth, they typically chose to live in larger homes on larger lots. However, equity issues arise because the poorest segment of the population has a greater portion of its wealth in real estate, which is subject to the property tax, while the wealthiest has a greater portion in financial investments, which are not. The Commission's recommendations to expand efforts to address property tax "ability to pay" issues were developed to help counter these two critiques of the property tax.

Implement a Quarterly Payment Plan

The Commission recommends that the City establish quarterly installment payment plans for all Real Estate Tax payers. In most parts of the state, school district and municipal real estate taxes are levied separately. Typically municipal real estate tax bills are levied in January and school district real estate tax bills are levied in July. In New Jersey and in Harrisburg, elected officials have diffused the property tax burden even further by requiring property owners to pay one quarter of their bill every three months. This type of property tax relief is not currently available to most Philadelphians.

In Philadelphia, City and School District Real Estate Tax rates are set when the City's fiscal year begins on July 1st; assessments are completed in the fall of that same year; appeals are made from October to November; real estate tax bills are mailed in January; and the bulk of all Real Estate Tax payments are collected from February to March. This collection schedule makes property tax payment more burdensome for individuals who do not escrow their property tax into their mortgage.

In an attempt to correct this problem, the City has developed two installment programs. Under these programs, households meeting annual income eligibility requirements may pay their property taxes in up to eight installment payments and seniors meeting annual income eligibility requirements may pay property taxes in up to 20 installment payments. Although the Commission applauds the success of these programs, it believes that the property tax payment system should be restructured so that this type of relief is available to all taxpayers.

Because the City and the School District currently receive Real Estate Tax revenues nearly three-quarters of the way through the fiscal year, both entities are required to issue Tax Revenue Anticipation Notes (TRANs) and pay associated costs for issuance and interest. Thus, in addition to providing tax relief to all property owners, this recommendation would save the City and the School District millions of dollars each year in interest and issuance costs. These savings could be used to help fund necessary changes to the assessment system.

Apply Tax Payments to the Current Year's Tax Liability

In order to participate in the state's property tax rebate program, funded by the Pennsylvania Lottery, elderly homeowners must meet certain income eligibility requirements and they must prove that they have paid that year's Real Estate Taxes. Currently, Philadelphia's property tax payment system prevents low-income seniors with outstanding tax delinquencies from participating in this state program even if they have paid enough property tax to satisfy the current year's liability. To help low-income seniors qualify for Pennsylvania's property tax rebate programs, the Commission recommends changing the property tax payment system so that tax payments are applied to the current year's property tax liability.

Consider Developing a Low-Income Property Tax Relief Program

The Commission recommends that the City consider developing a low-income property tax relief program similar to the Water Department's Water Relief Assistance Program. This type of program would "freeze" delinquent real estate tax bills and provide a tax credit or incentive for qualified low-income homeowners to remain current in their real estate tax bills. As in the Water Department's program and in Philadelphia's low-income senior property tax freeze program, the Commission recommends that when the tax liability is "frozen," a lien be placed on the property to ensure that back taxes can be collected when the property is sold.

Recommendation 10: Advocate for Increased Property Tax Relief from the Commonwealth of Pennsylvania.

The Commission recommends that the City advocate for increased property tax relief from the Commonwealth of Pennsylvania. Specifically, the Commission recommends that the state: 1) pass "circuit-breaker" legislation so that individuals who meet income eligibility requirements can pay a reduced percentage of Real Estate Tax; and 2) increase funding for low-income property tax rebate programs.

Create a State Circuit-Breaker Property Tax Relief Program

The Commission recommends that the Commonwealth create a property tax circuit-breaker program. Although every circuit-breaker program is slightly different, these programs typically provide individuals with an income tax credit that is equal to a percentage of the property taxes paid in excess of a certain percentage of household gross income. Because this type of program is widely considered to be the most effective way of reducing property tax regressivity, 31 states have a circuit-breaker program to provide tax relief to people who are asset rich and income poor. However, any circuit-breaker program must be designed to disallow reductions for those whose incomes were reduced by large capital losses or tax sheltered investments.

Expand State-Funded Low-Income Property Relief Programs

The Commission applauds Pennsylvania's efforts to provide tax relief to low-income elderly property owners, and it recommends raising the maximum income eligibility requirements for participation in these programs.

Recommendation 11: Increase Awareness About Real Estate Tax Relief Programs.

The Commission recommends increasing awareness about existing property tax-relief programs. During the course of the Commission's research, it became clear that many low-income and elderly individuals do not take advantage of the property tax relief programs offered by the City and the state. To correct this problem and promote greater tax system equity, the Commission recommends expanding informational property tax outreach programs and providing counseling for low-income tax delinquent property owners (such programs are already available through the City Office of Housing and Community Development).

Commercial and Residential Tax Rates Recommendations

Recommendation 12: Advocate for a Change in the Pennsylvania Constitution to Allow Adoption of Variable Real Estate Tax Rates.

To promote greater tax system competitiveness, the Commission recommends that the City advocate for a change in the Pennsylvania Constitution that would allow the City to classify real estate based upon its use and to tax it differently based upon that status.

Research indicated that commercial and industrial landowners are less sensitive to increases in the Real Estate Tax rather than to other types of business taxes. However, the Commonwealth's Constitution prevents any municipality from levying different tax rates upon different types of real estate. Implementation of a land-value tax, as proposed by the Commission, would shift some of the tax burden from residential properties onto vacant, commercial, and industrial properties. However, the Commission believes that other types of business taxes could be more quickly reduced if the City were allowed to generate additional revenues by formally levying a higher tax on commercial and industrial real estate.

Real Estate Transfer Tax Recommendations

Recommendation 13: Do Not Reduce the Real Estate Transfer Tax Rate.

The Commission recognizes that Philadelphia's Real Estate Transfer Tax is one of the highest transfer taxes in the country. However, when examining Philadelphia's economic climate, it is apparent that other taxes should receive priority for the scarce resources available for tax reduction.

Recommendation 14: Recommend Technical Changes to the Real Estate Transfer Tax.

Because many businesses successfully avoid paying the Real Estate Transfer Tax, the burden of this tax falls most heavily on purchasers of residential property. To increase tax system equity, the Commission recommends that the following three technical changes be implemented immediately.

Deed in Lieu of Foreclosure

The Real Estate Transfer Tax must always be calculated using the formula method when a property is sold at a sheriff's sale. However, when a deed is transferred in lieu of foreclosure, the formula method need not be used. The Commission recommends formally mandating that the formula method be used to calculate the amount of real estate transfer tax due for a transfer by deed in lieu of foreclosure.

Economic Reality Test

Although the Real Estate Transfer Tax is levied upon the sale or transfer of real estate located in Philadelphia, special rules govern transfers of less than 100 percent of the interest in a real estate company. A transfer of 90 percent or more of an interest in a real estate company, or a binding commitment to transfer 90 percent or more of an interest in a real estate company within a three-year period, is subject to the tax. If no more than 89 percent of the interest in the real estate company is transferred within a three-year period, tax is not due. Thus, to avoid paying the Real Estate Transfer Tax, buyers and sellers of expensive commercial property may enter into 89/11 deals. In these transactions, the parties enter into a binding commitment to transfer 89 percent of the interests in the real estate company during a three-year period, and the remaining 11 percent of the interests in the real estate company three years and a day later. In order to discourage the use of improper 89/11 deals, the Commission recommends creating an economic reality test to ensure that an 11 percent partner retains a real "economic" ownership interest.

Termination of a Thirty-Year Lease

Under current law, a buyer can structure a transaction to acquire land, but not the building on the land, and then obtain ownership of the building by paying the lessee to terminate the ground lease of the building. Currently, the parties pay the Real Estate Transfer Tax on the value of the land, however, upon termination of the ground lease, tax is not paid on the value of the building. The Commission recommends that the Real Estate Transfer Tax be imposed on the value of the consideration paid to the lessee for termination of a lease of 30 years or more.

Real Estate Non Utilization Tax Recommendation

Recommendation 15: Eliminate the Real Estate Non Utilization Tax.

To promote greater tax system simplicity, the Commission recommends eliminating the Real Estate Non Utilization Tax. This tax was created for the purposes of penalizing property owners for allowing property to lie fallow and deteriorate. The constitutionality of this tax was quickly challenged. The court granted declaratory relief barring the City from collecting the tax. To date, no action has been taken to remove the injunction against collection of this tax.

Rather than allowing this un-collectable tax to remain on the City's books, the Commission recommends eliminating this tax and relying on implementation of land-value taxation and increased enforcement efforts by the Department of Licenses and Inspections to achieve the goal of placing pressure on owners of under-utilized real estate to improve their properties.

Use and Occupancy Tax Recommendations

Recommendation 16: Do Not Reduce the Use and Occupancy Tax Rate.

The Commission recommends that the Use and Occupancy Tax rate not be reduced at this time. Use and Occupancy taxpayers will benefit significantly from the reforms and phase-out of the Business Privilege Tax. Other taxes should receive priority for the scarce resources available for tax reduction.

Recommendation 17: Repeal the Use and Occupancy Tax if a Constitutional Amendment Permits Philadelphia to Tax Different Classes of Real Estate at Different Rates.

In the interest of promoting greater tax system simplicity, the Commission recommends repeal of the Use and Occupancy Tax if the Pennsylvania Constitution is amended to permit commercial and industrial Real Estate Tax rates to be higher than residential Real Estate Tax rates.

Net Income Portion of the Business Privilege Tax Structural Change Recommendations

Recommendation 18: Adopt Single-Sales Factor Apportionment.

The Commission recommends that the Philadelphia Department of Revenue formally adopt sales receipts as the only factor for apportioning the net income base of multi-jurisdictional businesses. This recommendation would simplify compliance with, and enforcement of, the Business Privilege Tax; increase the City's ability to attract and retain business investment in jobs and facilities; and reform the apportionment formula to more equitably value a multi-jurisdictional business's exercise of its Philadelphia business privilege based on its receipts from its sales activity in the Philadelphia market.

The Business Privilege Tax imposes a tax upon the value of a business's exercise of the privilege of doing business in Philadelphia. This value is based upon a business's net income and gross receipts from sales in the city. A business that operates in more than one jurisdiction ("multi-jurisdictional business") must apportion its net income to determine the amount of income generated as a result its Philadelphia business activity. The current formula for apportioning income of multi-jurisdictional businesses double weights sales and equally weights the contribution of local property and payroll to a business's net income.

While property and payroll undeniably contribute to net income, without sales, a business has no revenues and no net income. When that formula was originally conceived, local property and payroll investments by a multi-jurisdictional business were required in order to achieve the essential measure of its value—its sales. However, the geographic location of capital and payroll are no longer reliable measures of a business's exercise of its business privilege. Technological advances in the manner in which sales are solicited, approved, and executed have allowed multi-jurisdictional businesses to operate in the Philadelphia marketplace without investing in property and payroll. Despite the adoption of a double-weighted sales factor, Philadelphia's apportionment formula continues to discourage local business investment and gives preferential tax treatment to multi-jurisdictional businesses that do not invest locally in property and payroll.

Philadelphia's first step toward encouraging business growth and job creation is to reform the Business Privilege Tax apportionment method. Under the three-factor, double-weighted sales formula apportionment formula, location or expansion of business operations in Philadelphia will increase a multi-jurisdictional business's apportionment, even absent any concomitant increase in local sales. A change to single-sales factor apportionment would simplify Business Privilege Tax payment and collection while removing the disincentive for multi-jurisdictional businesses to locally invest in property and payroll.

Recommendation 19: Grant Unincorporated Businesses a Deduction of the Net Income Portion of the Business Privilege Tax for Payments to Partners, Members, and Sole Proprietors.

The Commission recommends reforming the Business Privilege Tax to increase tax system equity and competitiveness. The recommendation has two distinct parts. First, the definition of "net income" should be amended to allow unincorporated businesses, such as partnerships, limited liability companies, and sole proprietors, to deduct payments made to partners, members, and sole proprietors. Second, after an initial shift to allow deductions of 50 percent of the payments to partners, members, and sole proprietors, the deduction should be increased by 10 percentage points for each of the succeeding five years so that 100 percent deductibility is achieved by 2010.

Unlike their incorporated counterparts, and in spite of the fact that they must also pay the Net Profits Tax on these distributions, unincorporated businesses are not permitted to deduct payments to partners, members, owners, etc. from Business Privilege Tax. Unincorporated businesses currently receive a credit of 60 percent of the net income tax portion of the Business Privilege Tax liability, which is applied against their Net Profits Tax liability. However, even after application of the credit, unincorporated businesses pay a higher effective tax rate than their corporate competitors. The Commission's recommendation to grant unincorporated businesses a deduction against the net income portion of the Business Privilege Tax for payments to partners, members, and sole proprietors, would help level the playing field between incorporated and unincorporated businesses.

In addition to increasing tax system equity, this recommendation would help Philadelphia compete with the suburbs when attempting to attract and retain businesses. In contrast to suburban jurisdictions that, at most, impose a gross receipts tax, Philadelphia unincorporated businesses are subject to an array of taxes. This taxation of unincorporated businesses intensifies the disparity between the cost of doing business in the city and in the suburbs and has been blamed for driving many businesses across the city line. Permitting the deduction of these payments would encourage business expansion in the City, increase retention of such businesses, and encourage other unincorporated businesses to locate in the city.

Recommendation 20: Lengthen the Business Privilege Tax Net Operating Loss Carryforward Period.

To improve Philadelphia's ability to compete with other jurisdictions when attracting and retaining businesses, the Commission recommends reforming the Business Privilege Tax by extending the net operating loss carryforward to 10 years, effective with excess losses that are incurred in 2004, reported on the 2004 return filed in 2005. This proposed 10-year period coincides with the period of the proposed phase-out of the Business Privilege Tax.

Philadelphia currently has a three-year net operating loss carryforward period. In contrast, other jurisdictions, including the state and federal governments, allow net operating losses to be carried forward for 20 years. Philadelphia's relatively short carryforward period perpetuates the perception that the City's business environment is unfriendly, especially towards start-ups and high-technology businesses that have life cycles that often begin with many years of losses before becoming profitable. Lengthening the net operating loss carryforward period, so that it more-closely resembles that of other jurisdictions, would improve tax system competitiveness and make the city more attractive to new businesses.

Business Privilege Tax Administrative Reform Recommendations

Recommendation 21: Establish Two Estimated Payment Dates.

The Commission recommends restructuring the Business Privilege Tax estimated tax payment schedule by creating two estimated payment dates between April 15th and June 30th.

The Business Privilege Tax estimated payment structure forces businesses to pay their entire tax liability before they receive the gross receipts and earn the income on which this tax is based. This structure decouples tax liability from the realization of the tax base and it magnifies the detrimental impact that the Business Privilege Tax has upon Philadelphia's ability to compete with other jurisdictions in attracting and retaining businesses. This estimated payment structure also forces new businesses to pay two years of taxes at once during their first year of operation.

If the estimated tax system is to be fair, it must be reformed so that the timing of the imposition of the Business Privilege Tax more directly corresponds with the benefit the taxpayer receives from the exercise of the taxed privilege. By better reconciling tax liability with the benefits received, this Commission recommendation would improve tax system neutrality, improve the City's competitiveness, and reduce the tax burden on fledgling businesses.

Recommendation 22: Unify Statutory Refund and Assessment Periods.

The Commission recommends setting the statutory refund and assessment periods at a uniform three years.

Currently, no ordinance limits the period within which the City is authorized to audit a taxpayer and assess additional tax. The City is authorized, by ordinance, to file a lawsuit for collection of unpaid taxes within six years of the date the return was filed or due. Conversely, a taxpayer is limited, by ordinance, to filing a refund claim within three years after the tax is paid. The net result is that the City can audit a five-year old return and assess additional tax, but the taxpayer will not be able to claim a refund from a four-year old return that could have offset the additional tax. This disparity creates an uneven playing field between taxpayers and the Department of Revenue, and adds unnecessary complexity to the tax system. Setting the statutory assessment and refund periods at a uniform three years, while retaining the current six-year collection period, would promote greater tax system equity and simplicity.

Moreover, most jurisdictions have uniform statutory assessment and refund periods of three years for collector and payer. Philadelphia's non-uniform periods create the perception that Philadelphia has a discriminatory business tax environment, and hamper the City's ability to attract and retain businesses. With this recommendation, the Commission hopes to reverse this perception and improve Philadelphia's ability to compete with other jurisdictions in attracting and retaining businesses. These goals would be accomplished without sacrificing the City's current power to sue for collection, or to audit and assess tax against taxpayers who substantially understate their income or tax due, or fail to file returns.

Incremental Elimination of the Business Privilege Tax

Recommendation 23: Incrementally Eliminate the Business Privilege Tax.

To promote greater tax system competitiveness, equity, and simplicity, the Commission recommends incrementally eliminating the Business Privilege Tax by fiscal year 2015. This incremental approach would minimize the revenue impact of this recommendation and allow the City to gradually adjust its budget. A gradual phase-out also leaves the City with the option of adjusting the timing if the revenue impact is too great or if the revenue produced exceeds expectations.

Elimination of the Business Privilege Tax promotes tax system competitiveness by attracting new business investment, retaining those businesses that are considering leaving, fostering business expansion, and creating more jobs. Simply put, other local jurisdictions do not tax businesses the way Philadelphia does.

Currently, the three main city business taxes are the Business Privilege Tax, the Net Profits Tax, and the Use and Occupancy Tax. Elimination of the Business Privilege Tax promotes tax system equity by ensuring that businesses are no longer forced to bear more than their fair share of the tax burden.

Elimination of the Business Privilege Tax promotes greater tax system simplicity. Not only will this reform decrease the Department of Revenue's workload, enabling the department to enforce other taxes more aggressively, but it will also simplify the process of running a business in Philadelphia.

The following table provides a detailed schedule for the elimination of the Business Privilege Tax. It is worth noting that rate reductions for the gross receipts portion of the Business Privilege Tax are already incorporated into the City's current fiscal year 2004 to 2008 *Five-Year Financial Plan*. It is also worth noting that, in order to minimize the financial impact of the Commission's three classes of Business Privilege Tax reform recommendations (structural change to the net income portion of the Business Privilege Tax, Business Privilege Tax administrative change, and Business Privilege Tax elimination), the phase-out of the net income portion of the Business Privilege Tax does not begin until fiscal year 2006.

Figure 5.2: *Business Privilege Tax Phase-Out Schedule*

Year	*Gross Receipts* Tax Rate	*Net Income* Tax Rate
2004	0.21	6.50
2005	0.19	6.50
2006	0.175	5.85
2007	0.1625	5.20
2008	0.15	4.55
2009	0.13	3.90
2010	0.11	3.25
2011	0.09	2.60
2012	0.07	1.95
2013	0.05	1.30
2014	0.03	0.65
2015	0	0

Note: Reductions in the rate of the gross receipts portion of the Business Privilege Tax through 2008 are already incorporated into the City of Philadelphia's fiscal year 2004 to 2008 *Five-Year Financial Plan*.

Wage, Earnings, and Net Profits Tax Recommendations

Recommendation 24: Adjust Wage and Earnings Tax Rates on January 1st.

To promote greater tax system simplicity, the Commission recommends that the City adjust the rates of the Wage and Earnings Taxes effective on January 1st of each year.

Currently, annual reductions in the rates of the Wage and Earnings Taxes are effective on the first day of the City's fiscal year, July 1st. This timing has resulted in an undue compliance burden for businesses that are required to file annual Wage Tax reconciliation forms with the Department of Revenue, and for individuals who are required to file annual Earnings Tax reconciliation forms. In particular, employers and taxpayers have been required to determine the portion of employee compensation or earnings associated with first six months of the calendar year, which are subject to one tax rate, and the portion of earnings associated with the final six months, which are subject to another tax rate. This calculation would not be necessary if the City were to make annual adjustments in the Wage and Earnings Tax rates effective on January 1 of each year. Businesses already report earnings for individual employees on a calendar year basis for state and federal purposes. This change in the effective date of the rate reductions will ensure that the requirement to file Wage Tax and Earnings Tax forms imposes no significant additional reporting burden on individuals and businesses.

Moreover, this recommendation will make the tax treatment of employee compensation and earnings income consistent with the City's treatment of net profits and income taxable under the School Income Tax. Both the Net Profits Tax and the School Income Tax are levied on income received in a calendar year, with one tax rate applied to all income associated with that calendar year.

Recommendation 25: Accelerate Local Income-Based Tax Rate Reductions.

The Commission recommends that the City accelerate its program of incremental reductions in the local income-based taxes—the Wage, Earnings, and Net Profits Tax—to more rapidly improve the competitiveness of the city's tax structure. The Commission recommends that, by 2014, the rate be reduced to 3.25 percent for residents and nonresidents.

Three decades of research by economists have consistently shown that high income-based tax rates harm

Philadelphia's economy. Philadelphia's local income-based tax rate is higher than that of all other jurisdictions in the United States. Most other large cities levy no local income tax. With the exception of New York City, jurisdictions that do impose a local income-based tax have rates that are significantly lower than Philadelphia's rates.

The City Wage Tax provides an incentive for companies to relocate jobs outside the city, for workers to seek employment outside the city, and for Philadelphia residents to move and seek work outside the city. Statistical analysis conducted by Econsult suggests that a reduction in the Wage Tax rate is likely to result in a substantial increase in the number of jobs located in the city, the income of city residents and workers, and property values in the city. Reducing the Wage, Earnings, Net Profits, and School Income Taxes paid by residents and nonresidents would significantly increase the city's ability to compete with other jurisdictions for businesses and residents.

The Commission recommends gradually reducing income-based taxes so that resident and nonresident tax rates would be reduced to 3.25 percent by 2014. This incremental approach minimizes the revenue impact of rate reductions and allows the City to adjust its budget gradually.

This recommendation would reduce the resident Wage Tax rate more rapidly than the nonresident rate to achieve the goal of equal resident and nonresident rates within ten years. The rationale for a more rapid reduction in the resident tax rate is linked to the conviction that, in the absence of any financial assistance from the Commonwealth to reduce the City's Wage Tax burden, the City should allocate a greater share of its tax reduction investment to lowering taxes for city residents.

Figure 5.3 presents the Commission's recommended schedule of rate reductions, assuming the City receives no additional Commonwealth aid to finance Wage Tax cuts.

Figure 5.3: *Schedule of Income-Based Tax Rate Reductions (Without State Aid)*

Calendar Year	*Resident Tax Rate*	*Non-Resident Tax Rate*
2004	4.4625	3.8801
2005	4.350	3.835
2006	4.300	3.770
2007	4.200	3.705
2008	4.100	3.640
2009	4.000	3.575
2010	3.845	3.510
2011	3.690	3.445
2012	3.535	3.380
2013	3.380	3.315
2014	3.250	3.250

Recommendation 26: If the City Receives Support from the Commonwealth for Wage Tax Relief, Adopt a More Aggressive Program of Income-Based Tax Rate Reductions.

Assuming the City receives Commonwealth aid to finance local-income tax cuts in an amount similar to that proposed under Governor Edward G. Rendell's Plan for a New Pennsylvania, the Commission recommends adopting a more aggressive program of income-based tax rate reductions. By 2014, the Commission recommends that the Wage, Earnings, and Net Profits rates, be lowered to 3.0 percent for residents and 2.5 percent for nonresidents. The differential between the resident and nonresident tax rates should be maintained to reflect the state aid that allows the City to maintain lower tax rates.

Figure 5.4 presents the Commission's recommended schedule of rate reductions assuming the City receives additional state aid in an amount similar to that proposed under the Plan for a New Pennsylvania.

Figure 5.4: *Schedule of Income-Based Tax Rate Reductions (With State Aid)*

Calendar Year	*Resident Tax Rate*	*Nonresident Tax Rate*
2004	4.00	3.50
2005	3.90	3.40
2006	3.80	3.30
2007	3.70	3.20
2008	3.60	3.10
2009	3.50	3.00
2010	3.40	2.90
2011	3.30	2.80
2012	3.20	2.70
2013	3.10	2.60
2014	3.00	2.50

Income Tax Relief Recommendation

Recommendation 27: Help Low-Income Philadelphians Apply for State and Federal Income Tax Relief.

The Commission recommends that the City support expanded efforts to promote participation by low-income Philadelphians in federal and state programs designed to reduce the tax burden on low-income households, including the federal Earned Income Tax Credit (EITC) and the tax forgiveness program under the Pennsylvania Personal Income Tax.

The EITC is a refundable federal income tax credit designed to benefit working people who earn low or moderate incomes. This program annually generates more than $252 million in additional income for low-income Philadelphians. Despite the tremendous impact this program has on the local economy and on the ability of low-income families to pay their bills and save for the future, last year 45,000 eligible Philadelphia households did not file for the EITC and an estimated $76.5 million went unclaimed.

The Philadelphia Campaign for Working Families is an initiative to increase participation in the EITC and other public benefits programs targeted at the working poor. In its inaugural year in 2002, the program helped Philadelphia residents qualify for more than $10 million in new federal tax credits. For every $1 that the Campaign spent increasing awareness and operating 26 free tax-filing sites, it generated $14 for low-income families. With additional funding, this program could be expanded to reach more families. Additional support would also allow the Campaign to begin helping families apply for Pennsylvania's tax forgiveness program under the Personal Income Tax. State Department of Revenue data suggest that each year as much as $75 million in tax forgiveness is not received by eligible low-income Philadelphians.

The Commission recommends that the City invest at least $1 million in the Campaign for Working Families to support additional outreach to low-income households, free and low-cost tax preparation services, and a new focus on expanding participation in the tax forgiveness program under the Pennsylvania Personal Income Tax.

Miscellaneous Tax Recommendations

Recommendation 28: Do Not Reduce the Sales Tax, Parking Tax, Amusement Tax, Vehicle Rental Tax, Hotel Room Rental Tax, Liquor Sales Tax, Mechanical Amusement Device Tax, or Hotel Use and Occupancy Tax Rates.

The Commission recommends that the Sales Tax, Parking Tax, Amusement Tax, Vehicle Rental Tax, Hotel Room Rental Tax, Liquor Sales Tax, Mechanical Amusement Device Tax, and Hotel Use and Occupancy Tax rates not be reduced at this time. After conducting a comprehensive analysis of all taxes imposed in Philadelphia, the Commission has concluded that other taxes should receive priority for the scarce resources available for tax reduction.

Fiscal Impact of Tax Reform Commission Recommendations

The City Charter requires the Commission to evaluate the fiscal impact of its recommendations for changes to the tax structure. Working closely with the City Departments of Finance and Revenue, the Commission used the most recent available data to estimate how its reforms would reduce tax collections below the forecasts in the City's *Five-Year Financial Plan, Fiscal Year 2004 – Fiscal Year 2008* (the "*Five-Year Financial Plan*").

As shown in Figure 5.5, the Commission's proposals result in a cumulative revenue loss of $192.4 million to the City's general fund over the life the City's *Five-Year Financial Plan.*

Figure 5.5: *City General Fund Fiscal Impact of Tax Reform Commission Recommendations (Millions of Dollars)*

Fiscal Year	*Annual Impact*	*Cumulative Impact*
2005	17.1	-
2006	34.9	52.0
2007	56.4	108.4
2008	84.0	192.4
2009	142.4	334.8

Although the Commission had nothing with which to compare its proposed tax structure for fiscal year 2009 and beyond, it estimated the revenue loss to the City's general fund for that year by assuming that the City would continue the current pace of tax reductions and that current growth projections would also extend into the future, resulting in a one-year shortfall of $142.4 million.

The Commission believes that its recommendations are fiscally and socially responsible because of their incremental nature. Moreover, it is important to note that these calculations do not take into account any of the expected benefits from a more competitive tax structure and use the most conservative possible assumptions. For example, when calculating the fiscal impact, the Commission assumed that each business that pays the Net Profits Tax and the net income portion of the Business Privilege Tax would be able to take advantage of the Commission's recommendation to allow unincorporated businesses to deduct payments to partners, members and sole proprietors. However, certain payments on passive investments will not be deductible. Thus, the actual fiscal impact of that particular recommendation will be substantially reduced. Refer to Appendix K for more information about the underlying assumptions behind the Commission's fiscal impact estimates.

Part 6: Financing Tax Reform

The Philadelphia Home Rule Charter specifically states that the Tax Reform Commission's "recommendations" are to be "solely related to proposed changes to the Philadelphia tax structure." Therefore, the Commission has refrained from recommending any specific dollar-for-dollar replacement revenues to fund the proposed package of tax reforms. However, because the Charter obliges the Commission to consider tax reform in a manner that is "fiscally responsible," the Commission has conducted extensive research to determine whether its tax reform recommendations meet that requirement.

The Commission's long-term answer is that lowering tax rates on businesses and wages will reduce tax revenues less than a static analysis might otherwise indicate. Econometric research and economic theory suggest that the Commission's tax reform recommendations will generate substantial economic growth. The Commission is confident that economic growth over the long run will increase tax revenues sufficiently to offset the temporary impact of reduced tax rates. Furthermore, based upon its research, the Commission believes that as Philadelphia's economy improves, the tax base will grow and gradually replace revenues so that there will be no negative net fiscal impact.

However, the Commission recognizes that until the economy fully adjusts, the City may experience a short-term fiscal gap. Concerned that this short-term gap might affect budgeted priorities, the Commission gave consideration to a number of steps that the City can take to address this critical problem. As a result of this research, the Commission is confident that the City can finance tax reform and that the Commission's proposed tax reform package is fiscally and socially responsible.

If only modest economic growth occurs, and if the identified supplemental sources of revenue and budgetary discipline cannot be used to fill the fiscal gap, the Commission believes that the City could—as a last resort—increase certain taxes in order to finance the proposed package of tax reforms. Through its research, the Commission has come to believe that long-term economic benefits would result simply from changing Philadelphia's tax mix. The Commission is not explicitly recommending any specific tax increases. However, it believes that there would be substantial long-term economic benefits from its tax reform package even if selected taxes were marginally increased.

Economic Growth

Although the benefits attributable to economic growth can be difficult to measure, the Commission believes that, if lowering certain taxes helps the city attract or retain firms and families, a tax reduction will not reduce tax revenues on a dollar-for-dollar basis; this effect will grow over time.

Accordingly, the City will be able to maintain a consistent level of essential service delivery without having to generate dollar-for-dollar replacement revenues.

The dominant view among economists regarding the effect of inter-jurisdictional differences in taxes and services is that businesses and individuals will "vote with their feet" when confronted with a tax structure that is not competitive. As a result, the relationship between local tax rates and local tax revenue cannot be represented by a simple formula where one multiplies the new tax rate times the old tax base. For example, a decrease in the Wage and Net Profits Tax rates is expected to result in more jobs and more wages and salaries. Thus, when a tax rate falls by 10 percent, tax revenues are likely to fall by less than 10 percent.

Economists refer to this phenomenon as a "supply side-effect." The underlying sources of supply-side growth are very different at the national and local levels. Supply-side growth at the national level is largely related to increased investment and labor effort. At the local level, the shifting of activity from one jurisdiction to another generates supply side growth. Although there is much debate among economists about the magnitude of the supply side effects resulting from federal tax reform, there is widespread agreement among economists that local taxes do have significant supply side effects.

While economic theory clearly establishes the beneficial impact of lower local tax rates on local tax bases, it does not establish the size of the effect. The Commission retained Econsult Corporation to evaluate this issue by conducting an econometric analysis of various tax reform policy options. They performed a statistical analysis of historical data to estimate the size of the supply side effects, if any, relating to changes in the rates of Philadelphia's Wage Tax, Real Estate Tax and Business Privilege Tax (gross receipts portion). Econsult found consistent empirical evidence that:

- Reductions in the Wage and the gross receipts portion of the Business Privilege Tax significantly increase employment in the City of Philadelphia.
- Reductions in tax rates expand the base of the particular tax being reduced.
- Changes in the rates of the Wage, Real Estate, and the gross receipts portion of the Business Privilege Tax have cross-base effects (a cut in one tax increases the revenues collected from other taxes).

Initial losses in tax revenues are partially offset by growth in the tax base resulting from tax reductions. Econsult's econometric analysis of the Commission's recommendation to phase out the gross receipts portion of the Business Privilege Tax and significantly reduce the Wage Tax rate suggests that:

- By 2010, an additional 47,604 Philadelphia jobs will be created. By 2017, 175,165 new jobs will be created.
- The median house value, in real terms, would increase in value by $7,617 by 2010, and by $19,325 by 2017 (this calculation assumes that the number of households is constant over the horizon).
- Through base expansion, the City will be able to recapture a total of $276 million of lost revenue by 2008.

Due to data constraints, it was not possible to econometrically analyze the Commission's proposals to phase out the net income portion of the Business Privilege Tax and adoption of single-sales factor apportionment. However, economic theory suggests that these reforms should produce a supply-side response similar to that generated by other tax cuts.

Capture the Benefits of Wage and Business Tax Base Expansion

The Commission believes that tax revenue losses resulting from a reduction in tax rates will be partially offset by significant Wage and Real Estate Tax base growth. Thus, the Commission expects that the City will be able to maintain a consistent level of essential service-delivery while cutting taxes, without having to generate dollar-for-dollar replacement revenues. Econsult research indicates that, in 2010, the Wage Tax base will be $2.7 billion larger (this translates into 8.7 percent growth in wages and salaries). By 2017, the Wage Tax base is expected to be $10.1 billion larger than it would have been without the tax cut. Similarly, by 2010 the base of the Business Privilege Tax (gross receipts portion) will have grown by $4.8 billion. However, by 2015 the gross receipts portion of the Business Privilege Tax would be completely phased out so that additional growth in the tax base does not produce additional revenue.

Capture Benefits of Property Tax Base Expansion

To the extent that tax reform makes Philadelphia a more attractive place to live and work, property values will rise. This occurs because property values reflect market expectations about the value of a location as a place to live and do business. These expectations are influenced by the City's long-run economic prospects.

When calculating the revenue impacts of the Commission's tax reform recommendations, the largest unknown variable is whether or not the City will be able to increase property-based tax revenues in proportion to the predicted rise in property values. It remains to be seen whether the City can resist the political pressure to slow the growth of assessments or lower the effective property tax rate as property values rise. Assuming that Real Estate Tax revenues rise in proportion to property values, the city will be able to maintain a consistent level of essential service-delivery while cutting taxes, without having to generate dollar-for-dollar replacement revenues.

Econsult research indicates that the phased-in tax reductions proposed by the Commission will cause the property tax base to be $4.9 billion larger by the year 2010. This represents an 11.4 percent increase in property values. By 2017, the property tax base will be $16.3 billion greater than would have been the case without the Wage and Business Privilege Tax (gross receipts portion) cuts. The growth in the property tax base will also result in an increase in revenues from the Business Realty Use and Occupancy Tax.

Local Implementation

Based upon a review of economic literature and econometric research, the Commission believes that the recommended package of tax reform will generate significant economic growth. In the short-term, while the economy adjusts, the Commission recognizes that its tax reform recommendations could have a fiscal impact. This section of the report contains a detailed list of policy options that could be immediately implemented to successfully fill this short-term gap. The Commission estimates that $42 million to $75 million in recurring revenues and $45 million to $55 million in one-time revenues could be generated from policy considerations that are not contingent upon state enabling legislation, state cooperation, or extensive cooperation with suburban jurisdictions. Consistent with its charter, the Commission has refrained from analyzing specific cost-reduction programs. However, the Commission believes that Philadelphia can achieve significant cost savings though improved government efficiency and increased budgetary discipline.

Improve Tax Collection

Philadelphia must do more to collect revenues from individuals and businesses that are either ignorant of their tax obligations or consciously choose not to pay what they owe the City. Improving enforcement and increasing the penalty for non-compliance will allow the City to finance tax reform and lower the burden faced by all Philadelphia residents and businesses.

The Commission proposes that tax collection and compliance be increased. According to the Department of Revenue, the City currently collects between 90 and 95 percent, depending on the tax, of the amount due within two years of the due date. This estimate does not include collection of non-reported taxes. There will be costs associated with increased tax collection, and an initial adjustment period will be necessary before payoffs from new collection initiatives can be fully realized. However, based upon discussions with the Revenue and Law Departments, the Commission believes that the benefits of improved tax collection far outweigh the costs.

Initiate a Tax Amnesty Program

The Commission considered that, in conjunction with an increased effort to improve voluntary taxpayer compliance, a tax amnesty program could be implemented. This type of program would bring new taxpayers onto the tax rolls and give eligible taxpayers a last chance to "come clean" before the implementation of aggressive new tax enforcement policies. The Commission believes anyone who participated in prior amnesty programs should be barred from participating in this amnesty program. Such an amnesty program should provide attractive terms, such as penalty abatements and reduced interest. In addition to the one-time revenues generated by this program, increased taxpayer compliance will result in a broader tax base.

Analyze and Adjust the City's Fine Structure

The primary purpose of fines is to punish and deter inappropriate and illegal behavior. Since a fine serves not only as a punishment but also a deterrent, the amount of a fine can be raised to whatever sum is necessary to discourage future or continued violations, subject to any restriction imposed on the dollar amount by the enabling statute or the state Constitution. Thus, the Commission considered that all fines could be analyzed and that selected fines could be increased. This would have the dual benefit of generating additional non-tax revenue and helping to curb illegal or inappropriate behavior.

Analyze and Adjust the City's Fee Structure

A fee is a voluntary payment made by members of the public who elect to exercise certain privileges. Although revenue raised through fees may only be used for the administration and supervision of the exercised privilege, many fees do not generate sufficient amounts of revenue to cover these costs. For example, the Gun Permit Fee generates $30,000 a year, yet the annual operating cost of the Gun Permits Unit is nearly $2.7 million. The Commission does not believe that the provision of these types of services should be subsidized by tax dollars, and it considered that the City's fee structure could be analyzed and adjusted accordingly. Increasing any artificially low fees would increase non-tax revenues.

Fees for Rights-of-Way Access

The Commission considered that the City could follow the lead of other cities and increase charges associated with rights-of-way (ROW) access in order to recover costs associated with ROW management, and to recover costs generated as a result of street degradation and shortened street life. Currently, costs associated with rights-of-way management are not fully recovered by telecommunications license fees and rights-of-way fees. These costs, borne primarily by the Streets Department and the Law Department, include direct salaries, benefits, overhead, computer systems, vehicles, and consultant studies. In addition to recommending that a new nexus of fees be introduced to cover these costs, the Commission believes that street-opening charges should be sufficiently large to cover the indirect costs associated with street degradation and shortened street life.

Increase Code Enforcement

The ultimate goal of increased code enforcement is increased compliance. However, the experience of other cities indicates that increased code enforcement can lead to a temporary spike in non-tax revenues. Increased code enforcement should have one of two results: either non-tax revenue goes up from fining violators or violators come into compliance. Regardless of which result occurs, the City is a winner. Since there are also non-monetary benefits associated with increased code enforcement, this strongly complements the Commission's mission of developing socially and fiscally responsible reform. The Commission believes that the City could generate additional revenues by actively improving its code enforcement.

Collect Overdue Payments from Veterans Stadium Skyboxes

The Commission considered that efforts could be made to collect the money still owed to the City for City-funded renovations and construction of luxury boxes in Veterans Stadium. If the City is going to seriously pursue tax reform, it is imperative that it is vigilant in its efforts to collect these types of revenue.

Adjust the Five-Year Plan for Unanticipated Refinancing Projects

The Commission considered that all unexpected savings (savings not built into the current Five-Year Plan) could be used to fund tax reduction. For example, the savings realized by refunding a portion of the Philadelphia Municipal Authority bonds associated with the Criminal Justice Center and the Curran-Fromhold Correctional Facility could be dedicated to funding tax reform. Although this type of unexpected savings has traditionally been used to fund a variety of special projects, there is no reason why this money could not be set aside and used to fund tax reform.

Increase Entrepreneurially Generated Revenues

The Commission considered that the City could seek entrepreneurial ways to increase non-tax revenues. These revenues would give the City greater budgetary flexibility and allow it to finance tax reform. After analyzing programs in cities across the country, the Commission is convinced that it is possible to increase non-tax revenues without increasing the cost of living and doing business in Philadelphia.

The Commission considered that the City could aggressively pursue entrepreneurial activities including, but not limited to:

- leasing rooftop space on city-owned buildings to telecommunication and broadcasting companies;
- developing and trademarking an official logo in order to sell novelty items and souvenirs;
- marketing exclusive rights to concessionaires; and
- creating either a boutique or an online marketplace to sell used city property, such as old street signs, parking meters, demo voting machines, and expendable library books.

Budgetary Discipline

Consistent with its charter, the Commission has refrained from analyzing specific cost-reducing programs. The Commission is prohibited from recommending specific expenditure reductions, municipal government cost savings, or municipal government service reductions in order to offset any potential revenue reductions. However, discussion with various official agencies, examinations of past efficiency gains, and analyses of initiatives in other municipalities have convinced the Commission that Philadelphia can achieve significant cost savings through improved government efficiency and effectiveness. The Commission believes that it would be fiscally and socially irresponsible to ignore the potential benefits associated with programs that increase government efficiency and effectiveness. After careful deliberation, the Commission has reconciled this apparent conflict in the Charter by foregoing the evaluation of specific proposals in favor of stating that it believes the City can achieve significant cost savings though improved government efficiency.

Steps Towards Budgetary Discipline

The Commission strongly endorses the City's ongoing efforts to examine its operations, to improve the delivery of services, and to address the serious problems of public society that require high levels of City spending.

Within this framework, the Commission proposes that future efforts include, but not be limited to:

- routine review of City programs to determine the benefits received for the dollars spent;
- equitable sharing by all elected officials of spending reductions;

- holding all top-level city managers accountable for continuously improving city service and administrative functions;
- consolidation of information technology operations and investing in newer technologies that would support improved business practices; and
- consolidation and reorganization of city agencies to improve accountability and reduce redundancy.

Commonwealth Cooperation

The Commission believes that the City's efforts to achieve tax reform could benefit from active assistance from the Commonwealth of Pennsylvania. Within this framework, the Commission unanimously endorsed Governor Edward G. Rendell's proposal to use funds from the Commonwealth of Pennsylvania to help the City of Philadelphia reduce its resident Wage Tax to 3.7415 percent by fiscal year 2008 and to increase Commonwealth funding of the School District of Philadelphia by $282 million by fiscal year 2006.

The following policies, considered by the Commission, are either contingent on state enabling legislation, state cooperation, or extensive cooperation with suburban jurisdictions. The Commission did not calculate a precise fiscal impact of these initiatives. However, it believes that the potential fiscal impact of this category would be substantial.

Increase PILOT Payments by Tax-Exempt Institutions

The Commission considered that the City could lobby the Commonwealth for the authority to establish formal payments in lieu of taxes (PILOTs) so that large non-profit organizations may pay for those City services that they use. Philadelphia, like many other major municipalities across the country, is home to numerous tax-exempt institutions. Government facilities, publicly-owned utilities, educational institutions, many healthcare providers, athletic and convention centers, religious institutions, cultural and performing arts venues, and other non-profit organizations are exempt from paying Real Estate Taxes.

Property owned by these tax-exempt institutions accounts for about 25 percent of the City's total assessed property value and annually costs the city $100 million in lost property tax revenues. This exemption reduces the property tax base and increases the tax burden on non-exempt property. PILOT payments are made by tax-exempt organizations in order to partially compensate the City for its lost tax revenue and to help pay for the services used by these institutions.

Expand the Sales Tax Base

The Commission considered that the base of both the Philadelphia and the Pennsylvania Sales Tax could be expanded. Eliminating unnecessary exemptions would generate substantial revenue for both the Commonwealth and the City. However, the Commission believes that some items, such as groceries and medicine, should continue to be exempt from the Sales Tax. City officials should also consider urging the Commonwealth to join the Streamlined Sales Tax Project, which would enable the City and the Commonwealth to collect Sales Tax from e-commerce vendors and other remote sellers.

Adopt a Regional Asset District Sales Tax

The Commission considered that a Regional Asset District Sales Tax could be developed to fund regional assets. Regional parks, libraries, professional sports facilities, cultural facilities, historic sites, and civic facilities promote economic development and enhance the quality of life for residents throughout southeastern Pennsylvania. Therefore, financial support for them should also be spread through the region. Creating a regional asset district would insure that cultural institutions and other important regional assets are no longer supported directly by the City's general fund. This type of regional financing was first recommended more than two decades ago, in a report to the Pennsylvania Tax Commission.[1] The mechanism for dividing these revenues could be modeled after the Allegheny Regional Asset District or Denver's Scientific and Cultural Facilities District.

Regional Real Estate Tax Reform

The Commission considered that a regional tax distribution plan could be established. This type of program would redistribute resources based on need. It would discourage inter-jurisdictional competition, since any regional growth would benefit the entire region instead of just one community.

Philadelphia could model its program after the Minneapolis-St. Paul metropolitan area property tax sharing system (which has been in existence since 1975). Municipalities within the Minneapolis-St. Paul region annually compare their commercial and industrial property values with the 1971 total assessment for those classes of properties. Forty percent of the increase over the 1971 assessment is put into a metropolitan pool, which is then redistributed according to each community's population and tax base. When the program began, Minneapolis and St. Paul were the major beneficiaries. However, as a result of successful downtown redevelopment, Minneapolis is now a net contributor and St. Paul receives significantly less money than it previously received. Small communities are now the major beneficiaries of the regional tax-sharing program.

Adjust for Regional Disparities Though Statewide Funding Reform

The Commission recognizes that, on its own, Philadelphia cannot fully resolve issues of tax fairness and regional tax disparities. Thus, the Commission considered that the City could advocate for reforms that would alter the manner in which local jurisdictions in the Commonwealth of Pennsylvania fund public education and county services.

The Commission examined whether the Commonwealth should meet its constitutional mandate to "provide for the maintenance and support of a thorough and efficient system of public education" by increasing state funding. The Commission supports Governor Rendell's proposal to significantly increase the state share of public school funding statewide.

The Commission reviewed whether the Commonwealth should increase its funding for county-level programs in Philadelphia. An underlying factor behind Philadelphia's high tax burden is its dual status as both a city and a county. Thus, unlike all other cities in

Pennsylvania, it is unable to spread the financial burden for county services to suburban residents. If the Commonwealth increases its support for the cost of poverty-related county level services in Philadelphia, it would be possible for Philadelphia to embark on a more ambitious tax reform program that, among other things, would dramatically reduce or eliminate the nonresident Wage Tax.

The Commission believes that the City should continue to lobby the Commonwealth to fulfill its constitutional obligation to fund the court system. In 1987, the Pennsylvania Supreme Court invalidated county funding of local courts. Subsequent legal activity and Supreme Court action established guidelines for the Commonwealth to implement a unified court-funding scheme. However, full Commonwealth assumption of these funding obligations has not yet occurred. If the Commonwealth assumes these obligations, the City would be able to more aggressively pursue tax reform.

Changing Philadelphia's Tax Mix

Philadelphia's Home Rule Charter directs the Commission to develop recommendations that will "decrease the overall tax burden on Philadelphia residents, individuals who work in Philadelphia, and Philadelphia businesses." After analyzing the fiscal and econometric impact of different taxes, the Commission has come to believe that long-term economic benefits would result simply from changing Philadelphia's tax mix.

The Commission is not explicitly recommending any specific tax increases. However, it believes that there would be substantial long-term economic benefits, even if selected taxes were marginally increased. Thus, if only modest economic growth occurs and if the City cannot alter spending or generate additional revenues to cover any short-term budgetary gaps, the Commission believes that the City could—as a last resort—increase certain taxes in order to finance the proposed package of tax reform.

Increase Amusement Tax Revenues

The Commission considered that the Amusement Tax could be increased from five percent of gross amusement related receipts to 10 percent of gross amusement related receipts. Historically, the Amusement Tax has been as high as 10 percent; currently it is only five percent. When compared to other Philadelphia taxes, the economic burden created by the Amusement Tax is relatively small. Revenues generated from an increase in the Amusement Tax would enable the City to reduce more onerous taxes. Since all forms of traditional drama, comedy, musical comedy, dramatic recitation of recognized works of literary art, and repertoire works are exempt from the Amusement Tax, the Commission feels confident that Philadelphia's cultural institutions would not be adversely affected by this tax increase.

Increase Parking Tax Revenues

The Commission considered that the Parking Tax could be increased from 15 percent of gross parking receipts to 20 percent of gross parking receipts. Historically, the Parking Tax has been as high as 20 percent, and Pittsburgh currently has a parking tax rate of 31 percent. Because the Commission's tax reform recommendations will mitigate the burden placed upon parking lot owners and operators, the Commission believes that an increase in this tax would not overburden Philadelphia residents and businesses. When compared to other Philadelphia taxes, the economic burden created by the Parking Tax is relatively small.

Increase Property Tax Revenues

The Commission considered that, if all other revenue generating options failed and there were no other way to fund the Commission's recommended package of tax reform, the City could increase property-based tax rates. Economic theory and econometric evidence suggest that shifting from local businesses and wage taxes and onto property-based taxes will result in substantial increases in jobs, resident incomes, business activity, and property values. Thus, it is possible for the City to decrease its total tax burden by reducing its reliance on business and income-based taxation and increasing its reliance on property-based taxes. The Commission considered that a budget-based system of property taxation could act as a relief valve that would allow the City to expand its reliance on property-based taxation if the City could find no other way of incorporating the Commission's package of tax reforms into the budget.

Section 7: Tax-Related Economic Development Tools

The Philadelphia Home Rule Charter explicitly charges the Tax Reform Commission with "conducting a comprehensive analysis of and making recommendations regarding reforms to…real estate tax abatements, tax increment finance districts, Empowerment Zones, Keystone Opportunity Zones, and any other programs that use tax abatements or exemptions as economic development tools."

After examining Philadelphia's tax structure and numerous tax-related economic development tools—used in Philadelphia during the past several decades—the Commission believes that tax-related economic development tools have been necessary to offset obstacles to development created by Philadelphia's tax structure. However, as tax reform is realized, the Commission believes that the City should reevaluate its mix of economic development tools to see if tax abatements, tax exemptions, tax increment finance districts, and collaborative tax incentive zones are still necessary. In the interim, the Commission believes that the following proposals—which could be implemented immediately—should be considered.

Develop a Comprehensive Economic Development Plan

The Tax Reform Commission proposes that, in conjunction with related quasi-public development agencies (e.g., Philadelphia Industrial Development Corporation, Philadelphia Commercial Development Corporation, and Redevelopment Authority), the City should create a comprehensive economic development plan.

Mechanisms to be considered should include tax increment financing, grants, low-interest loans, and tax abatements to target industries that exhibit a competitive advantage, have significant prospects for growth, and will stimulate local economic growth. The City should then utilize clawback mechanisms, which would ensure that recipients of City funding either meet or exceed expected targets or refund government money.

Add Sunset Review Clauses to Economic Stimulus Programs

Because the City's economic climate is always changing, it is important to periodically review the usefulness of economic stimulus and economic development programs in order to evaluate their effectiveness and to determine if the life of these programs should be extended. As such, the Commission proposes that sunset review clauses be added to all existing and future economic development programs.

Expand Collaborative Economic Development and Tax Incentive Programs

The Commission believes that the locally derived economic benefits will exceed the locally borne costs of participating in these programs. For example, the Commission's proposal to phase-out the Business Privilege Tax and reduce the Net Profits Tax rate, combined with the City's existing 10-year Real Estate Tax Abatement programs, would minimize the local cost impact of designating additional Keystone Opportunity Zones, while providing significant Commonwealth tax benefits. Therefore, the Commission proposes that the City vigorously lobby for Commonwealth approval of the designation of additional Keystone Opportunity Zones and other types of collaborative economic development zones.

Part 8: Complementary Reform Considerations

The Tax Reform Commission believes that if tax reform is to be feasible and meaningful it must be accompanied by other reforms in the way the City manages the business of government. The following is a list of reform proposals that will complement and enhance the Commission's package of tax reform recommendations.

Improve Interactions Between Taxpayers and the City's Revenue-Collection Bureaucracy

The Commission considered that the City could utilize technology to facilitate improved interactions between taxpayers and the City's revenue-collection bureaucracy. The Commission believes that the City should invest telecommunications technology to make paying taxes more customer-friendly and collections more certain. The Commission recognizes that the Department of Revenue has made some strides in improving interactions between taxpayers and the City's revenue-collection bureaucracy. However, the Commission believes that the City should also consider:

- making all tax-related activities, from finding forms to filing tax returns, available on-line;
- allowing individuals and businesses to pay taxes with credit cards;
- allowing taxpayers to file tax returns by phone; and
- developing an information data exchange system to allow businesses to use Electronic Data Interchange and Electronic Funds Transfers to pay taxes.

Create an Office of Tax Policy

Given the influence that taxes have on the City's long run economic health, the Commission believes that the City should invest in an institutionalized capacity to analyze tax and economic development policy. The Commission considered that an Office of Tax Policy could be created to regularly monitor Philadelphia's tax policy and report on tax changes necessary to maintain and improve the City's tax system.

There is no central office for tax policy in Philadelphia, such as those in New York City, Washington D.C., several states, and the U.S. Treasury Department. In addition, economic development policy is detached from the City's financial administration and administered largely through quasi-governmental agencies. If the city is to become competitive in the face of global economic shifts, continuing changes in the marketplace, and increased competition from other jurisdictions, tax reform should be institutionalized through a continuous review of taxes (both local and state), local and regional economic development tools, and the City's overall competitive position. This ongoing review could result in new City policies, regulations, and ordinances, as well as the proposal of Philadelphia Home Rule Charter amendments, state legislation, and amendments to the Pennsylvania Constitution, if necessary, to continuously improve Philadelphia's tax structure.

Continue to Research the Feasibility of Implementing a City Income Tax

The Commission considered, but did not recommend, a proposal to replace the City's four existing income-based taxes—the Wage Tax, the Earnings Tax, the Net Profits Tax, and the School Income Tax—with a single City income tax piggybacked on Pennsylvania's Personal Income Tax.

A relative dearth of information about the economic impact of this proposal ultimately prevented the Commission from recommending a City income tax. However, the Commission believes that this idea deserves further consideration and it suggests that the City continue to research:

- the likely effects of a City income on city employment, resident income, and property values;
- the amount of additional revenue that could be generated from broadening the tax base (this estimate should take into account the cost of administration and potential differences in enforcement difficulty under the current system and under the proposed system); and
- the distributional shift in tax burdens created by the proposal—specifically the impact of increasing tax burdens on high-income households (who would be more heavily taxed) and decreasing tax burdens on low-income households (who could be eligible for tax forgiveness).

If created as proposed by this Commission, a Philadelphia Office of Tax Policy would be well suited to continue this research.

Evaluate Tax Expenditures

The City has increasingly used tax incentives as a tool of economic development policy. Granting a tax abatement or exemption to certain taxpayers entails a cost equivalent to City expenditures. City officials and the public should be able to apply the same degree of scrutiny to tax expenditures as they do to direct expenditures. They should be able to determine whether the investment of public resources in any particular tax expenditure program is justified by the social benefits the investment generates.

To this end, the Commission believes that the City should annually publish a tax expenditure report. This report could be similar in structure to the tax expenditure reports published by the federal government and by the Commonwealth of Pennsylvania. The report should contain information about tax credits, deductions, exemptions, and abatements provided in law that result in a significant reduction in revenues that would otherwise be received. For each tax expenditure program, the report should include a description of the nature of the tax expenditure, its source in law, its rationale, and an estimate of its actual and projected costs by fiscal year.

In addition, the City should periodically undertake cost-benefit analyses of its major tax expenditure programs. The estimated costs for specific tax expenditures should be compared to the estimated benefits (such as the number of jobs created, the value of new construction, and new taxes generated). These analyses could be preformed by the Office of Tax Policy, and used to assess which tax expenditure programs are producing the largest return on the city's investment. This would allow policy makers to better target the City's investment toward the most productive tax expenditure programs.

Attach Fiscal-Impact Statements to all Proposed Pieces of Legislation

The administration and City Council currently have no means of assessing whether a bill under consideration represents sound fiscal policy. To remedy this situation and to help promote better tax policy, the Commission believes that a fiscal-impact statement should be attached to all proposed pieces of local legislation.

Amend the Pennsylvania Uniformity Clause

In 1874, the citizens of Pennsylvania amended the state Constitution by adding a series of provisions aimed at limiting the General Assembly's authority to enact economically preferential legislation. One of these provisions was the Uniformity Clause, which states that "all taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax." This clause does not destroy the government's ability to distinguish between, and tax differently, classes of taxpayers. However, it has been interpreted to require a substantial equality of the tax burden upon each member of the same class. Pennsylvania's Uniformity Clause has often prevented taxing authorities from reforming the tax system to meet policy goals.

The Commission considered that the Uniformity Clause could be amended so that elected officials would have more flexibility in crafting tax policy. Some of the possible reforms that would be possible if the Uniformity Clause were amended include:

- increasing tax system progressivity by allowing for a graduated income tax;
- promoting economic growth by providing tax relief to small businesses and start-up companies that are creating jobs; and
- improving tax system competitiveness by allowing real estate to be classified based upon its use and taxed differently based upon that classification.

Create a Rainy-Day Fund

The City Charter requires that the City's annual operating budget be balanced. This provision has been interpreted to preclude the City from budgeting an excess of revenues over expenditures. Because of this restriction, the City has routinely overestimated some expenditure categories while underestimating revenues, in order to maintain a sufficient cushion in the budget to insure financial stability in the event of an economic downturn or major unanticipated expenditure. As a result, the budget has become a less realistic representation of the City's actual available resources and spending targets.

To successfully reduce taxes over the next decade, the City will need to exercise a high degree of budgetary control. To enhance the City's ability to commit to tax cuts the City should create a rainy-day fund. Rainy-day funds are one type of mechanism, used at the state level and by other large cities, which can help stabilize spending during cyclical periods of revenue contraction and expansion. A rainy-day fund designed to hold expenditures down in good times and save for hard times, would help Philadelphia meet long-term service demands and continue planned tax reductions during periods of economic contraction.

To adopt the rainy-day fund, the City may need to amend the Charter to explicitly authorize the City to budget a surplus. Unlike the current fund balance, a rainy-day fund would have strict legal triggers for fund contributions and formulas to determine the amounts of fund withdrawals.

Create a Non-Tax Revenue Master List

The Commission believes that the City should evaluate its license charges and fees on a regular basis to determine whether the City generates enough revenues to adequately cover administration expenses, whether charges are unreasonably high and should be lowered, or whether charges are nuisances to collect and administer and should be abolished. A comprehensive master list of all non-tax revenue would help facilitate this process.

Reform the City's Regulatory Processes

Outdated and unnecessarily burdensome regulations have been cited as a major deterrent to business growth in Philadelphia. Efforts to make the City's tax structure more resident and business friendly should be complemented by reforms to the City's regulatory processes.

The Commission considered that the City could establish a Regulatory Study Commission to evaluate the relevance, necessity, cost, and benefit of any new City regulations, and serve as a filter agency through which proposed regulations are passed on to City Council. Concurrently, a Code Task Force could review and revise the existing Regulatory Code to eliminate or consolidate regulations that are outdated, costly, or counterproductive. Inter-agency databases should be expanded and agency personnel should be cross-trained to improve coordination among the multiple agencies involved in the regulatory process and allow caseworkers to address concerns raised by customers. Payments for licenses and permits should be accepted on-line by credit card and customers should be able to check the status of their applications and access code and payment requirements on-line.

Extract Greater Value From City Assets

Large assets such as Philadelphia International Airport, Philadelphia Gas Works, and Philadelphia Water Department are the types of entities that Philadelphia's competitor cities do not typically own and operate. The Commission does not believe that the sale of these assets will provide sufficient revenues to fully finance tax reform any time in the near future.

However, it considered that the City could actively explore ways to extract greater value from its assets. Possible options include sale of smaller assets, contracting operations with a substantial upfront one-time payment to the City, transferring operations to an authority with a substantial upfront one-time fee, and increasing annual transfer payments made to the City. Extracting greater value from its assets would give the City budgetary flexibility and allow it to pursue tax reform more aggressively.

Market Philadelphia's New Tax Structure and Improved Business Climate

Assuming that the Commission's recommendations are enacted into law, the Commission proposes that the City, in cooperation with private sector leadership organizations, should invest in a new program of marketing Philadelphia's business climate, highlighting tax reform and other public initiatives that enhance the City's and the region's competitiveness.

The marketing message should focus on the entire package of reforms implemented since the early 1990s, and ongoing initiatives, including fundamental tax reform. The economic benefit of the Commission's recommendations will be leveraged to the extent that business decision makers and investors are aware of the City's tax reform plans and other progressive steps to improve the City's competitiveness.

The City, in conjunction with private sector leadership organizations, must develop a vision for the City's economic growth. This vision should focus on those sectors in which the City is well positioned to compete from both a tax and non-tax perspective. A coordinated marketing effort with a focus on industry clusters will help to pave the road for increased economic development.

Appendices

Appendix A: Philadelphia Tax Reform Resolution

Council of the City of Philadelphia
Office of the Chief Clerk
Room 402, City Hall
Philadelphia

(Resolution No. 020264)

RESOLUTION

Proposing an amendment to the Philadelphia Home Rule Charter to provide for the creation, appointment, powers and duties of a Philadelphia Tax Reform Commission, and providing for the submission of the amendment to the electors of Philadelphia.

WHEREAS, Under Section 6 of the First Class City Home Rule Act (53 P.S. §13106), an amendment to the Philadelphia Home Rule Charter may be proposed by a resolution of the Council of the City of Philadelphia adopted with the concurrence of two-thirds of its elected members; now therefore

RESOLVED, BY THE COUNCIL OF THE CITY OF PHILADELPHIA,

That the following amendment to the Philadelphia Home Rule Charter is hereby proposed and shall be submitted to the electors of the City on an election date designated by ordinance:

ARTICLE III – EXECUTIVE AND ADMINISTRATIVE BRANCH –

ORGANIZATION

CHAPTER 1
OFFICERS, DEPARTMENTS, BOARDS,
COMMISSIONS AND OTHER AGENCIES

Section 3-100. Executive and Administrative Officers, Departments, Boards, Commissions and Agencies Designated. The executive and administrative work of the City shall be performed by:

* * *

(e) The following independent boards and commissions, which, except for the Board of Trustees of the Free Library of Philadelphia, are hereby created:

City Planning Commission;

Commission on Human Relations;

Board of Trustees of the Free Library of Philadelphia;

Board of Pensions and Retirement;

Civil Service Commission*;*

Philadelphia Tax Reform Commission and its Advisory Committee.

* * *

CHAPTER 8
INDEPENDENT BOARDS
AND COMMISSIONS

* * *

SECTION 3-805. Philadelphia Tax Reform Commission and Advisory Committee. The Philadelphia Tax Reform Commission shall be composed of fifteen members, appointed as follows:

(a) Four members shall be appointed by the Mayor;

(b) Four members shall be appointed by the Council President;

(c) One member shall be appointed by the City Controller;

(d) One member shall be appointed by each of the following: the President of the African-American Chamber of Commerce, the President of the Greater Philadelphia Chamber of Commerce, the Chief Executive Officer of Greater Philadelphia First, the President of the Greater Northeast Chamber of Commerce, the President of the Hispanic Chamber of Commerce, and the Executive Director of the North Philadelphia Chamber of Commerce.

(e) The Commission's Advisory Committee shall consist of twenty-three members. One member of the Advisory Committee shall be appointed by each of the following: the Director of Action Alliance of Senior Citizens of Greater Philadelphia, the Director of Asian-Americans United, the Director of Community Legal Services, the President of the Board of the Consumer Education & Protective Association, the Director of the Keystone Research Center, the President of the National Congress of Puerto Rican Rights, the Director of the Parents' Union, the Director of Philadelphia NOW (National Organization for Women), the Director of the Philadelphia Unemployment Project, the Director of the Tenant Action Group, the President of the Federal Reserve Bank of Philadelphia, the Dean of the Fox School of Business and Management of Temple University, the President of the Greater Philadelphia Association of Realtors, the President of the Institute for the Study of Civic Values, the President of the NAACP Philadelphia Chapter, the Executive Director of the Pennsylvania Economy League Eastern Division, the President of the Pennsylvania Institute of Certified Public Accountants Greater Philadelphia Chapter, the President of the Philadelphia Bar Association, the Business Manager of the Philadelphia Building and Construction Trades Council, the President of the Philadelphia Council AFL-CIO, the President of the Urban League of Philadelphia, the Executive Director of the West Philadelphia Partnership, and the Dean of the Wharton School of the University of Pennsylvania. If any of those

organizations ceases to exist or refuses to make an appointment, the members of the Commission shall by a majority vote designate an organization of a similar nature to make an appointment.

(f) All appointments to the Commission and its Advisory Committee shall be made within thirty days after the Commission is first created.

(g) No member of the Commission, while serving as a member, shall seek or hold a position as an elected public official within the Commonwealth, or as an officer of a political party.

(h) Vacancies on the Commission and its Advisory Committee shall be filled by the appointing authority who originally appointed the member whose seat has become vacant.

* * *

ARTICLE IV
EXECUTIVE AND ADMINISTRATIVE
BRANCH POWERS AND DUTIES

The Mayor, The City Representative and
Departments, Boards and Commissions under the Mayor

* * *

CHAPTER 9
PHILADELPHIA TAX REFORM COMMISSION

SECTION 4-900. Powers and Duties.

(a) Within sixty days after its creation, the Philadelphia Tax Reform Commission shall convene its first meeting in the City Council chambers and thereafter the Commission shall meet at least monthly at such times and at such places as determined by the Commission. Members of the Advisory Committee shall be provided notice of all meetings of the Commission in the same manner as notice is provided to members of the Commission, and shall be permitted to attend all such meetings. The purpose of the Commission is to conduct a comprehensive analysis of and make recommendations regarding reforms to the tax structure and all taxes imposed in Philadelphia and the tax structure of the Commonwealth of Pennsylvania which affects Philadelphia and all counties

in Pennsylvania, including but not limited to the wage tax, the business privilege tax, the net profits tax, the gross receipts tax, the amusement tax, the use and occupancy tax, the real property tax, the school income tax, the real estate transfer tax, the liquor-by-the-drink tax, the parking tax, the Philadelphia sales tax, the hotel bed tax and any other taxes imposed by the City and by the School District, as well as real estate tax abatements, tax increment finance districts, Empowerment Zones, Keystone Opportunity Zones, and any other programs that use tax abatements or exemptions as economic development tools. The Commission shall also examine all laws of the Commonwealth of Pennsylvania that authorize or limit the ability of the City to impose taxes. The Commission shall analyze each tax to determine why it is imposed, how much revenue the tax generates, the impact of the tax on businesses or residents and the Philadelphia economy, whether it may be eliminated or consolidated with another tax or otherwise simplified, and whether and to what extent the rate of the tax may be decreased in a fiscally and socially responsible manner. The Commission shall also compare and contrast the tax structure in Philadelphia to the tax structures in jurisdictions that have experienced growth in residents and businesses, using accepted models of economic analysis. The Commission's work shall be guided by the principle that Philadelphia's tax structure should enhance and improve Philadelphia's ability to compete with other jurisdictions in the region and throughout the nation in attracting new residents, businesses and jobs and retaining current residents, businesses and jobs. The Commission's work shall also be guided by the principle of tax fairness and tax equity in apportioning tax burdens. The Commission shall, subject to the availability of appropriations, appoint and fix the compensation of an executive director and such other staff as may be required for the proper conduct of its work (provided that the appointment of an executive director shall require a vote of two-thirds of all the members of the Commission), and it shall invite the participation of any staff or Board members of each of the organizations that appoint members to either the Commission or the Advisory Committee as set forth in subsections 3-805(d) and (e), as *well as utilize any available resources, studies or reports of any such organization. The Commission may also, subject to the availability of appropriations, retain as consultants any other organization or individual with regionally or nationally recognized expertise in local tax policy or municipal finance. The Commission's Advisory Committee shall provide technical, economic and public policy advice to the Commission. All departments, boards, commissions and other City agencies shall cooperate fully with the Commission in the performance of its duties and responsibilities and shall provide any and all documents, data, analyses or other information related to revenues, taxes, or tax policy requested by the Commission, except documents the nondisclosure of which is legally privileged or which have been prepared for or by the Law Department for use in actions or proceedings to which the City is or may be a party, and provided that the Commission shall maintain the confidentiality of any documents, data, analyses or other related information upon the written request by any City agency that the material being provided to the Commission be treated as confidential. The Commission shall hold at least two public hearings in the Council chambers to receive testimony from the public concerning tax reform.*

(b) On November 15, 2003, the Commission shall by a vote of two-thirds of all members of the Commission adopt a written report containing specific recommendations solely related to proposed changes to the Philadelphia tax structure in order to decrease the overall tax burden of Philadelphia residents, individuals who work in Philadelphia, and Philadelphia businesses. The Commission shall also consider recommendations made by the Advisory Committee in the development of its report. The Commission shall also make recommendations related to state-wide tax reform, including public education funding, that will enhance and improve the overall tax structures in Philadelphia and all other counties in the Commonwealth of Pennsylvania. The Commission shall not make any recommendations related to any expenditure reductions, municipal government cost savings, or municipal government service reductions to offset any potential revenue

reductions which may result from the implementation of any recommendations set forth in the Commission's report. The Commission shall provide copies of its report to the Mayor, each member of Council and the Clerk of Council, to each of the Commission's appointing authorities, and to each member of the Advisory Committee, and the Commission shall see to it that copies are provided to all public libraries in the City and that a copy is posted on the City's official Internet site. The Commission shall also provide copies of its report to the Governor, the President Pro Tempore of the Senate, the Majority Leader of the Senate, the Minority Leader of the Senate, the Speaker of the House of Representatives, the Majority Leader of the House of Representatives, and the Minority Leader of the House of Representatives. For each recommendation that requires action by the Council or the General Assembly, the report shall include a proposed ordinance or bill implementing the recommendation with a fiscal impact statement and an econometric analysis of the projected revenue change, if any, resulting from such recommendation. The Commission shall also publish and distribute with its report any minority report adopted by three or more members of the Commission.

(c) After issuing its report, the Commission shall thereafter be reconvened only as directed by a resolution of the Council adopted by a two-thirds vote of all the members of the Council, provided that the Commission shall not be reconvened until at least five years have elapsed since the date the Commission adopted its last report. Within sixty days after adoption of such a resolution, new members of the Commission and its Advisory Committee shall be appointed in accordance with the appointment process set forth in Section 3-805, provided that any former member of the Commission or the Advisory Committee may be reappointed as a member of the Commission or Advisory Committee.

(d) Nothing in this Section shall be construed to prevent any member of Council or the Mayor from proposing, enacting, or approving at any time any bill relating to taxes or tax reform.

* * *

Explanation:

Italics indicate new matter added.

CERTIFICATION: This is a true and correct copy of the original Resolution, Adopted by the Council of the City of Philadelphia on the sixteenth of May, 2002.

Anna C. Verna
PRESIDENT OF THE COUNCIL

Marie B. Hauser
CHIEF CLERK OF THE COUNCIL

Introduced by: Councilmembers Nutter, Mariano, DiCicco, Goode, Kenney, Rizzo, Tasco, Ortiz, Council President Verna, Councilmembers Blackwell, Clarke, Krajewski, O'Neill, Reynolds Brown, Miller and Cohen

Sponsored by:

Appendix B: Philadelphia Tax Reform Ordinance

City of Philadelphia

(Bill No. 020255)
AN ORDINANCE

Providing for the submission to the qualified electors of the City of Philadelphia of an amendment to the Philadelphia Home Rule Charter relating to the creation, appointment, powers and duties of an independent Philadelphia Tax Reform Commission, as approved by Resolution of the City Council; fixing the date of a special election for such purpose; prescribing the form of ballot questions to be voted on; and authorizing the appropriate officers to publish notice and to make arrangements for the special election.

THE COUNCIL OF THE CITY OF PHILADELPHIA HEREBY ORDAINS:

SECTION 1. There shall be submitted for the approval or disapproval of the qualified electors of the City of Philadelphia at the election to be held November 5, 2002, an amendment to the Philadelphia Home Rule Charter relating to the creation, appointment, powers and duties of a Philadelphia Tax Reform Commission.

SECTION 2. There shall be placed on the ballot the following question to be answered "Yes" or "No" by the qualified electors participating in the election:

> Shall the Philadelphia Home Rule Charter be amended to provide for the creation, appointment, powers and duties of an independent Philadelphia Tax Reform Commission which would recommend methods to reduce the taxes of Philadelphia residents, workers and businesses in an equitable manner in order to enhance Philadelphia's ability to compete with other jurisdictions in attracting and retaining new residents, businesses and jobs, based upon the Commission's comprehensive analysis of taxation in Philadelphia?

The proposed amendment is contained in Resolution No. 020264 approved by

Council on May 16, 2002, and filed in the Office of the Clerk of Council.

SECTION 3. The Clerk of Council is hereby directed to have printed in pamphlet form, in sufficient number for general distribution, the proposed amendment to the Philadelphia Home Rule Charter as set forth in Resolution No. 020264, together with the ballot question set forth in Section 2 of this Ordinance.

SECTION 4. The Clerk of Council is hereby directed to cause to be published in three (3) newspapers of general circulation in the City and in the Legal Intelligencer the proposed amendment to the Philadelphia Home Rule Charter, together with the ballot question set forth in Section 2 of this Ordinance, once a week during the three (3) weeks preceding the election on November 5, 2002; and further, at such other time and in such other manner as she may consider desirable.

SECTION 5. The Mayor is hereby authorized and directed to issue a proclamation giving at least thirty (30) days' notice of such election. The Clerk of Council shall cause a copy of the proclamation to be published, together with the notice provided for in Section 4 of this Ordinance.

SECTION 6. The appropriate officers are authorized and directed to take such action as may be required for the holding of an election on the ballot question set forth in Section 2 of this Ordinance as provided for by the laws of the Commonwealth of Pennsylvania.

Appendix C: Outreach Efforts

Public Meetings

The Tax Reform Commission commenced its work on January 15, 2003 when commissioners and advisory committee members were sworn into their positions. The Commission continued to hold public meetings at least once a month until November 2003. During this time the Commission held 14 public meetings. Audio recordings were made at each of these public meetings.

Town Meetings

During the course of its work, the Commission organized town meetings in the northeastern, northwestern, western, and southern sections of the city. These four meetings allowed neighborhood residents a chance to voice their concerns about Philadelphia's tax structure. Audio recordings were made at each of these public meetings.

Public Hearings

On May 15, 2003 and on October 7, 2003 the Commission held public hearings in City Council chambers. This was done pursuant to a City Charter requirement that the Commission "hold at least two public hearings in the Council chambers to receive testimony from the public concerning tax reform."

At these hearings, the Commission listened to testimony from elected officials, interest group representatives, experts, and citizens. Each hearing lasted approximately eight hours. The views of more than 100 citizens and organizations were expressed to the Commission through direct testimony and written statements at these hearings. The testimony before the Commission was videotaped and broadcast over the local public access channel. It was also transcribed.

Availability of Information

Public hearing transcripts, written testimony, and videotapes, as well as public meeting and town meeting audiotapes are on file as records of the Commission and open for public review.

Additional information about the Commission's work and research materials may also be obtained from the Commission website: www.philadelphiataxreform.org.

Appendix D: Total Tax Collections

Figure D.1: *Total Tax Revenue, City and School District of Philadelphia and PICA, Fiscal Year 2002 Actual and Fiscal Year 2003 Preliminary, Dollars in Millions*

Tax	*FY02 Actual*	*FY03 Preliminary*
Amusement Tax	13.8	14.1
Business Privilege Tax	295.8	286.1
Hotel Room Rental Tax	29.6	29.3
Liquor Sales Tax	28.3	29.1
Net Profits Tax		
City Portion	13.4	11.7
PICA Portion	9.9	10.7
Total	23.3	22.4
Parking Lot Tax	37.9	38.7
Real Estate Tax		
City Portion	373.6	361.1
School District Portion	441.2	490.2
Total	814.8	851.3
Real Property Transfer Tax	96.7	103.4
Sales Tax	108.1	108.0
School Income Tax	16.9	16.9
Use and Occupancy Tax	93.4	101.6
Vehicle Rental Tax	3.9	3.9
Wage and Earnings Taxes		
City Portion	1,006.0	1,013.4
PICA Portion	268.1	273.4
Total	1,274.1	1,286.8
Total Taxes	**2,836.6**	**2,891.6**

Note: All Fiscal Year 2002 figures are actual. Fiscal Year 2003 figures for School District and PICA taxes, Hotel Room Rental Tax and Vehicle Rental Tax are preliminary. All other Fiscal Year 2003 figures are actual.
Source: City of Philadelphia, Department of Revenue, 2003; City of Philadelphia, 2003; School District of Philadelphia, 2003.

Appendix E: Philadelphia Tax Reform Commission Resolution

Philadelphia Tax Reform Commission
Municipal Services Building, Room 1440
Philadelphia

(Resolution No. 001)

RESOLUTION

WHEREAS, the Philadelphia Home Rule Charter amendment establishing the Philadelphia Tax Reform Commission mandates that the Commission "make recommendations related to state-wide tax reform, including public education funding, that will enhance and improve the overall tax structures in Philadelphia and all other counties in the Commonwealth of Pennsylvania;" and

WHEREAS, the Charter amendment stipulates that "the Commission's work shall be guided by the principle that Philadelphia's tax structure should enhance and improve Philadelphia's ability to compete with other jurisdictions in the region and throughout the nation in attracting new residents, businesses and jobs and retaining current residents, businesses and jobs;" and

WHEREAS, the Rendell Administration has proposed a program of statewide tax reform that will provide funds from the Commonwealth of Pennsylvania permitting the City of Philadelphia to reduce Philadelphia's resident wage tax to 3.7415 percent by Fiscal Year 2008 and to increase Commonwealth funding of the School District of Philadelphia by $282 million by Fiscal Year 2006; to raise $282 million for the School District of Philadelphia locally would require a 37 percent property tax increase; and

WHEREAS, an Econsult Corporation analysis of the Governor's statewide tax reform plan commissioned by the Philadelphia Tax Reform Commission has concluded that, "the Rendell tax reform proposal is likely to increase the size of the Philadelphia economy and increase the city's property values" and "increase City revenues so that wage taxes plus the state aid to the city will significantly exceed baseline revenue forecasts;" and

WHEREAS, the Econsult analysis concludes further that "increases in property values would allow the city to generate additional funds for both the City and School District without increasing tax rates;" now therefore

RESOLVED, that the Philadelphia Tax Reform Commission supports the Rendell Administration's proposal to use funds from the Commonwealth of Pennsylvania to help the City of Philadelphia reduce its resident wage tax to 3.7415 percent by Fiscal Year 2008 and to increase Commonwealth funding of the School District of Philadelphia by $282 million by Fiscal Year 2006.

The Philadelphia Tax Reform Commission further urges the Pennsylvania General Assembly to give serious consideration to the Econsult analysis of these proposed statewide tax reforms in making its final decision.

*   *   *

CERTIFICATION: This is a true and correct copy of the original Resolution, Adopted by the Philadelphia Tax Reform Commission on the fifth of June, 2003.

Edward A. Schwartz
COMMISSION CHAIRMAN

Christopher Dwyer
COMMISSION EXECUTIVE DIRECTOR

Introduced by: Chairman Schwartz

Appendix F: Survey of Philadelphia's Business Community

In August 2003, the Commission surveyed a sample of Philadelphia businesses to determine their views on Philadelphia's tax system. The Commission felt it was important to have results from an up-to-date survey that sampled the views of all Philadelphia firms, including businesses from across all city neighborhoods and industries.

With the assistance of the Department of Revenue, Commission staff developed a random sample of firms that pay the Business Privilege Tax. The sample was stratified into three groups by the amount of the Business Privilege Tax payment, to insure adequate representation of small, medium, and large-sized businesses. A total of 1,000 surveys were mailed, and 206 responses were received. A 20.6 percent response rate such as this survey achieved is considered excellent for a mail-only survey with no follow-up telephone call or mail reminder.

The cover letter to the survey requested that the survey be completed by the "owner or other top executive of your business, a person who has the ability to make decisions about the location of your business." The surveys asked questions about firm characteristics, views on Philadelphia taxes, and expectations for future business growth. The results of the survey are reported below.

Characteristics of Businesses That Responded to the Survey

A number of survey questions asked respondents about the characteristics of their businesses, including industry, location, number of workers, percentage of workers that live in the city, and the race and the ethnicity of the business owners. The diversity of responses suggests that the 206 respondents well represented the city's entire business community.

The respondents were distributed across a wide range of industry sectors, with the largest concentration in business and professional services (24 percent), retail services (18 percent), health care (11 percent), and manufacturing (10 percent). The remaining 37 percent of respondents represented a wide range of other industries, including: manufacturing, construction, distributor/wholesaling, retail, finance, insurance, real estate, transportation, education, social services, hotels, restaurants, and bars.

Firms were asked to indicate their primary place of business. The largest percentage of respondents were from Center City (38 percent), Northeast Philadelphia (20 percent), and South Philadelphia (9 percent). 10 percent of firms responding to the survey reported that they did business in multiple locations in the city. The remaining 23 percent of respondents were widely distributed across all other areas of the city.

Firms that responded to the survey represent a range of business sizes. 55 percent of respondents had fewer than 20 employees, another 24 percent had between 20 and 99 workers, while the remaining 21 percent of firms had 100 or more employees.

A high percentage of the employees at the responding firms live in the city. Yet, there were a substantial number of respondents whose workers generally live outside the city. For 37 percent of the respondents, between 80 and 100 percent of workers live in the city. For 15 percent of the respondents, between 0 and 20 percent of workers live in the city.

Survey respondents were asked about the race and ethnicity of the majority of the owners or shareholders of their businesses. Eighty-three percent of businesses that responded were majority white-owned, while 7 percent of businesses responding were majority African American-owned, and 5 percent were majority Asian-owned. Four percent of respondents were majority Hispanic owned, and 94 percent were majority non-Hispanic owned firms. A small percentage of survey respondents reported they were not sure about the race or ethnicity of the majority of their firm's owners.

There is a correlation between race and ethnicity and firm size among the respondents. While 55 percent of all survey respondents employed fewer than 20 workers, 78 percent of Asian-owned firms and 83 percent of African-American-owned firms employed fewer than 20 workers. All of the Hispanic-owned respondents fell into this firm size category.

Views on City Taxes

Survey Comments

When asked if they had any comments or concerns about Philadelphia taxes at the end of the survey form, many respondents had notable responses. One firm wrote, "All business and wage taxes should be phased-out over a five-year period, during which time real estate taxes should be increased to make up for the phase out of all other taxes." Another wrote, "The City Wage Tax is possibly the greatest single reason this City is and will continue to be passed by, by other cities, counties and states."

With respect to the fairness of the Business Privilege Tax, one respondent wrote, "The Business Privilege Tax and gross receipts tax are an unfair tax for businesses that may lose money each year or make small profits. It is a large burden for our company that has a large amount of gross receipts and small profit or loss. Cash flow is a problem and this is a double tax for our business that has a small profit margin. The net income portion is high enough at 6.5 percent."

A number of survey respondents cited taxes as having an important bearing on their decisions about whether to stay in the city or remain in business. One respondent wrote, "I am seriously considering moving both of my companies outside the city to avoid the city wage tax and gross receipts tax." Another wrote, "The high amount and number of taxes are contributing to my decision of whether to stay in business."

A business and professional services company with between 250 and 499 employees wrote that, "Doing business in Philadelphia with the current wage tax structure makes it difficult to recruit individuals who have other choices where they are not impacted by this tax."

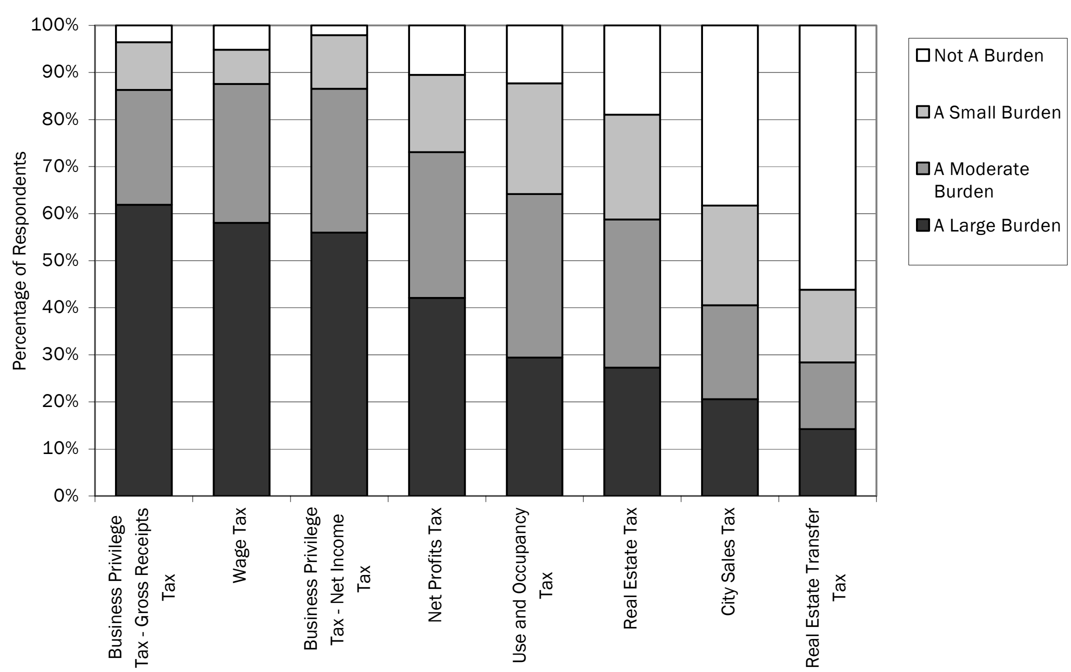
Survey Results

In the survey, respondents were presented with a list of major Philadelphia taxes and asked to indicate the level of economic burden the tax imposes on their business. Respondents were allowed to indicate that the tax imposed a "large," "moderate," or "small" burden, or to indicate that the tax was "not a burden." When respondents left answers blank in this section of the Survey, it was assumed that they felt that the corresponding tax created no appreciable burden on that business.

The distribution of the responses is presented in Figure F.1. The responses suggest that the gross receipts portion of the Business Privilege Tax, the Wage Tax, and the net income portion of the Business Privilege Tax impose the greatest economic burden on Philadelphia businesses.

- 62 percent of respondents indicated that the gross receipts portion of the Business Privilege Tax imposed a large burden on their companies;
- 58 percent of respondents indicated that the Wage Tax imposed a large burden on their companies; and
- 56 percent of respondents indicated that the net income portion of the Business Privilege Tax imposed a large burden.

Figure F.1: *Burden of Philadelphia Taxes on Respondents*



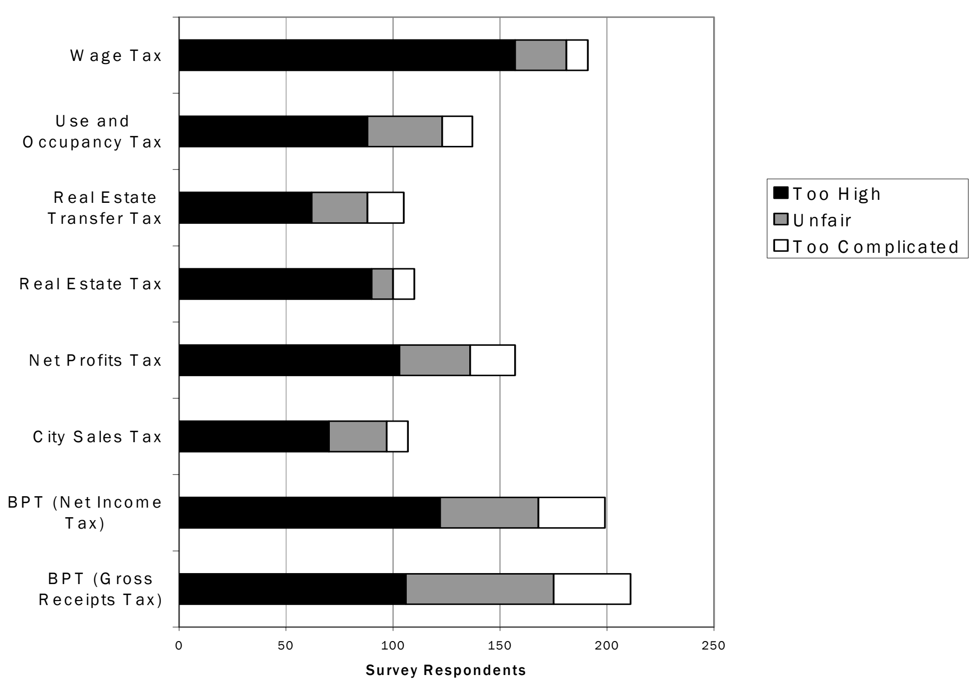
Respondents were next presented with a list of major Philadelphia taxes and asked to indicate for each whether they believed the tax was "too high," "unfair," or "too complicated." The responses to this question are presented in Figure F.2.

Overall, the gross receipts and net income portions of the Business Privilege Tax, and the Wage Tax, had the largest number of responses indicating the tax was too high, unfair, or too complicated. More respondents indicated the Wage Tax was too high than any other tax. The most unfair taxes, according to the respondents, were the gross receipts and net income portions of the Business Privilege Tax, the Use and Occupancy Tax, and the Net Profits Tax. The gross receipts and net income portions of the Business Privilege Tax were the taxes most often cited as too complicated.

The survey next asked, "Are you currently considering increasing, decreasing, or eliminating your business activity (investment or employment) in the City of Philadelphia?" Respondents were allowed to indicate "increasing," "decreasing," "eliminating," or "no change" in their business activity. Fifty percent of respondents indicated no change in business activity, 23 percent indicated they were decreasing business, 15 percent indicated they were eliminating business, and 12 percent indicated they were increasing business.

Respondents were next asked to indicate whether they believed this statement: "The Wage Tax requires you to pay your employees higher salaries or compensation in order to attract workers who have the option of working in the suburbs." Respondents were allowed to indicate

Figure F.2: *Problems of Philadelphia Taxes*



"yes," "no," or "not sure." 76 percent of respondents indicated yes, 14 percent indicated no, and 10 percent indicated they were not sure.

Of the respondents who indicate that they were not forced to provide additional compensation due to the Wage Tax, 40 percent are in the healthcare industry, a considerably higher proportion than the 11 percent of total survey respondents that are in the health care sector. This may reflect the high degree of concentration of the health care sector in the city, which may mean that the labor market for health care workers is effectively a city market, rather than a regional market. The manufacturing sector seems to be strongly affected by the Wage Tax: 90 percent of manufacturing employers responded that the wage tax does force them to pay more to compete with the suburbs.

The survey results suggest a correlation between firm size and the degree to which firms are forced to pay higher salaries to compensate for the Wage Tax. Fifty-seven percent of companies with one-to-four employees responded that the Wage Tax forces them to pay higher salaries. Nine out of ten of the largest companies responding to the survey indicated they did believe they were forced to pay their workers more to compensate for the Wage Tax. One possible explanation for this pattern of responses is that larger companies are hiring workers from a regional labor market, while smaller companies are hiring workers from a more localized, city labor market.

Appendix G: Legal Barriers to Tax Reform

The Uniformity Clause of the Pennsylvania Constitution is the keystone around which the Pennsylvania courts have built an impressive body of law impeding local tax reform efforts. Originally conceived and adopted as a necessary guardian against discriminatory taxes that favored selected corporations, today the Uniformity Clause hinders, and often prevents, local government response to modern economic realities.

Background

Economic discrimination in the mid-19th century provided the catalyst for adoption of the Uniformity Clause. Public debt increased rapidly to fund large-scale construction projects and development of Pennsylvania's infrastructure amid an era of substantial, often publicly financed, private development of the railroad industry. [1] While state and local taxes were rising to pay the municipal debt, the state granted railroad companies and "improvement" companies that performed public and private construction generous exemptions from tax.[2] The railroad and improvement companies were incorporated under charters that were individually approved through separate acts of the General Assembly. Each "specially" legislated corporate charter included tax provisions that effectively exempted the chartered company from tax.[3]

In 1825, Pennsylvania's debt was $6.3 million, and by 1837 it had grown to $24.3 million. By 1853, Philadelphia alone carried a debt burden of $7.5 million, an amount greater than that of the entire state only 25 years earlier.[4] To pay for this development, the General Assembly authorized extensive real and personal property taxes. The favorable tax treatment granted large corporations sparked controversy and taxpayer lawsuits. Pennsylvania's citizens were frustrated: inequitable taxation and economic legislation created a system that increasingly burdened the majority while benefiting a wealthy minority dominated by the railroad companies. Taxpayers challenged the Commonwealth's right to enact special legislation and enter into special contracts relieving railroad and improvement companies of taxes imposed on other corporations, its authority and that of local jurisdictions to incur debt, and the general unfairness of the tax system.[5]

Prior to the Civil War, the General Assembly addressed, in part, these tax inequities with legislation effectively repealing the tax exemptions granted in these legislated charters. In 1859, it enacted the "Act to Equalize Taxation Upon Corporations," which the state tax collector interpreted as superseding the tax exemptions in the corporate charters. The affected railroads and improvement companies filed lawsuits in which they unsuccessfully alleged state legislative interference in contracts in violation of Article I, §10 of the U.S. Constitution.[6] During and after the Civil War, the state grew and developed more rapidly, renewing and increasing the problem of special legislation.[7] Although the General Assembly again enacted a law taxing all corporations, and the resulting lawsuits were once again unsuccessful, the issue of inequitable local property taxation was not yet resolved. Meanwhile, railroads were confiscating private land, receiving preferential judicial treatment, and causing uncompensated economic and, at times, physical injury to ordinary citizens.[8]

Constitutional Convention of 1873–1874

Against this backdrop of distrust of the General Assembly and growing fear of the power wielded by the large railroads, Pennsylvania citizens approved a referendum calling for a constitutional convention. In 1873, the state's fourth Constitution Convention set about the task of drafting reforms that would limit public debt, prohibit special contracts, and require a fair tax system.

In 1874, the citizens of Pennsylvania ratified a new Constitution containing extensive state and local tax and finance provisions designed to eliminate current, and prevent any future, special legislation.[9] With a broad stroke of the pen, the convention delegates opened the new article on tax and finance with the clear mandate that, in Pennsylvania, taxes were to be fair, providing that "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax."[10] Without further elaboration of the substance of the uniformity clause, the delegates addressed the primary issue that led to the call for a convention—economic discrimination through special tax, lending, and investment legislation. Indeed, the issue of special charters approved by the legislature was of such magnitude that several provisions limit state and local financing of, or investment in, private businesses,[11] and two identical provisions, one entitled "Power to tax corporations not to be surrendered," and a later one entitled "Taxation of corporations," prohibit the state from entering into any contract or making any grant by which it would suspend or surrender its authority to tax any business.[12] With the ratification of the Constitution of 1874, Pennsylvania's appalling history of discriminatory taxation ended and the small businesses and ordinary citizens of Pennsylvania finally received protection from tax laws that only benefited the powerful.

Judicial Interpretation of the Uniformity Clause

Judicial interpretation of the Uniformity Clause provided the intended protection in the decades after its adoption. However, since early in the 20th century, it has impeded government policies to provide economic assistance, through personal and business income and property tax relief. The Uniformity Clause contains the seemingly simple mandate that "taxes shall be uniform, upon the same class of subjects..." in order to pass constitutional muster.[13] Yet, those 10 words have prevented Pennsylvania and its local jurisdictions, like Philadelphia, from adopting tax measures that their elected representatives believed were grounded in sound social and economic policy. The courts define the boundaries of each "class" so broadly that the poor are not a class, the elderly are not a class, areas of economic blight are not a class. Consequently, tax legislation favoring these groups could not be enacted until the constitution was amended to authorize the General Assembly to exempt them from tax.[14] The most recent example is Pennsylvania's policy decision to provide state personal income tax relief for its poorest citizens. After the Supreme Court found the provision unconstitutional, the Uniformity Clause had to be amended through a lengthy ratification process that took several years, followed by new state legislation to amend the tax code to provide the intended relief.[15]

At the local level, a township's exemption of residents earning less than $600 from a $10 occupation tax resulted in the court's striking down the entire tax as a violation of the Uniformity Clause because those residents earning more than $600 were victims of economic discrimination.[16] The very disease that the Uniformity Clause was intended to cure was invoked against those it was intended to protect.

The courts may declare that the legislature has the authority to distinguish between classes of taxpayers if such distinction rests upon well-grounded considerations of public policy,[17] yet, no case has found that a tax is uniform based upon the government's social, economic or tax policy. The judicial interpretation of the Uniformity Clause created an impassable barrier to state and local policy-based tax laws designed to help the weakest segments of society, the poor, elderly, and infirm, and the most economically distressed areas in the state. As the Pennsylvania Supreme Court emphasized when deciding the third, and final, constitutional challenge to tax legislation designed to help the poor: "whether or not these tax preferences serve some useful social policy, the fact remains that unequal burdens are being imposed on similar privileges in violation of the Uniformity Clause."[18]

Consequently, constitutional amendments were necessary before the State was authorized to enact new laws, to allow local jurisdictions to provide property tax relief for veterans, the elderly, disabled, infirm or poor, or to offer property tax abatements to encourage development of deteriorating property.[19]

The Uniformity Clause as a Deterrent to Tax Reform

The Tax Reform Commission was challenged by City Council to propose a creative solution to the problems endemic to Philadelphia's tax structure. The Commission has proposed a solid, well-researched plan. However beneficial those reforms may be, at least one recommendation, the land value-tax proposal, carries the threat of constitutional litigation. Although land-value taxation has existed in certain areas in Pennsylvania since 1913 and continues to be used in to this day in several major Pennsylvania cities, its constitutionality under the Uniformity Clause has never been litigated. Given the body of law holding that real estate cannot be divided into classes for purposes of taxation, its constitutionality remains in question.[20] Consequently, the Uniformity Clause could present a potential barrier to the Commission's policy-driven tax initiative.[21]

The recommendation to amend the Uniformity Clause to permit imposition of different tax rates on residential and commercial real estate and phase-out the Use and Occupancy Tax remained a secondary recommendation because it is specifically precluded by existing judicial decisions interpreting the Uniformity Clause.[22] Constitutional amendment procedures will take at least two to three years to secure the necessary amendment.

A third reform, researched but never proposed, would have exempted either businesses operating at a loss or all businesses from a threshold level of the gross receipts portion of the Business Privilege Tax. This potential reform was clearly unconstitutional. Multiple judicial decisions hold that a tax that sets a threshold level of income or revenue as the standard for the tax's applicability, or one that, in effect, creates any type of graduated tax structure, violates the Uniformity Clause.[23] A threshold level exclusion from gross receipts tax would have created a class of unprofitable businesses that, merely due to their profitability, would have been exempt from tax. It also would have created a graduated tax system based upon the ratio of gross receipts tax paid to gross receipts.

Balanced Economic Discrimination as Policy Tool

The Uniformity Clause grew out of rampant abuse of power by the General Assembly, local elected officials, and the powerful railroad and improvement companies that dominated the Pennsylvania economy during the 19th century. Modern laws better protect citizens and businesses from secret deals benefiting large corporations. Communication and technological advances expose the actions of public officials to more scrutiny than was possible in the 19th century. Community leaders and organizations provide oversight that adds another level of protection. The abuse of power that created preferential, economic discrimination that benefited the railroads and improvement companies is held in check more in the 21st century than was possible even in the 20th century. The economic protectionism advanced by the judiciary's strict construction of the Uniformity Clause is not needed in this modern era.

Other contrasts between the 21st and 19th centuries present even more compelling arguments for the removal of this barrier to change. In this new century, the competition for businesses and demands of a growing elderly and impoverished population require creative solutions to funding the necessary services without driving businesses and working citizens away. Pennsylvania and its local jurisdictions must be nimble. Philadelphia must be nimble. It cannot wait several years to enact a change that, in the wisdom of its elected representatives, is required for the survival and progress of its business and individual constituents. Interstate and intrastate competition to attract businesses and the best and the brightest young people will not wait while Philadelphia asks Harrisburg, and Harrisburg asks the rest of the state, for permission to act.

In the past six years, legislation to amend the Uniformity Clause to eliminate the uniformity requirement entirely has been introduced twice in Harrisburg. Whether total elimination or an amendment adopting a more workable provision is the best solution cannot be resolved in the interest of local tax reform alone. But the discussion, and call for change, most certainly must start there. The debate on amendment must engage government, business and community leaders, members of the judiciary, and Pennsylvania's citizens. The Uniformity Clause has not been revisited, except to add specific exemptions, since 1874. The time is ripe for a call to change, and no city is better positioned to lead those efforts than Philadelphia.

Appendix H: City Income Tax

The Tax Reform Commission considered, but ultimately did not recommend, a proposal to replace the four existing personal income-based taxes—the Wage Tax, the Earnings Tax, the Net Profits Tax, and the School Income Tax—with a single City income tax (CIT).

The Commission considered different types of local income taxes (both of which would require changes in local and state laws):

- **Proposal 1:** A local income tax could be administered by Pennsylvania's Department of Revenue. This tax would be levied on the same base as the state Personal Income Tax (PIT).
- **Proposal 2:** A local income tax could be administered City Department of Revenue. This tax would be levied on the same base as the PIT, with one exception—the definition of taxable compensation would be the same as the definition now used under Philadelphia's Wage and Earnings Taxes.

Arguments For and Against a City Income Tax

Arguments For a CIT

There are three major arguments for creating a City income tax.

First, a City income tax could potentially lower the costs of tax administration for the City and the burden of compliance for taxpayers.

Second, because the tax would be levied upon a base that includes a broader range of income categories than the four existing income-based taxes, adopting a City income tax may potentially allow the City to generate the same level of revenue as currently at a lower tax rate.

Third, adopting a City income tax could make Philadelphia's tax structure more progressive. By expanding the tax base to include categories of unearned income that are not currently taxable in Philadelphia, this change would shift more of the tax burden toward high-income households that generally receive a higher proportion of their income from these currently untaxed income categories. Furthermore, state administration of a City income tax would increase the feasibility of implementing a low-income tax forgiveness program. It would reduce the cost of administering this type of program and insure that the City adopts the state's definition of the poverty class, thereby avoiding the possibility of a Constitutional challenge.

Arguments Against a CIT

There are three major arguments against creating a City income tax.

First, broadening the income tax base could have a negative economic impact on Philadelphia's economy. By increasing the tax burden on households with types of income that are not taxed under any of the existing income-based taxes, some households may be encouraged to leave the city.

Second, the shift to a City income tax could decrease the stability of the

City's tax revenue stream. Because unearned income tends to be more sensitive to cyclical economic trends than earned income, the tax revenues would be more sensitive to the business cycle.

Third, many economists believe that local governments should avoid substantial income redistribution though progressive local taxation. Over the long term, local redistributive policies may encourage middle-class and wealthy households to leave the city, leading to a substantial decline in the tax base. Because of Philadelphia's high poverty rate and the degree of City responsibility for poverty-related public services, the City's current tax and spending regime is already substantially redistributive—adopting a City income tax may exacerbate the problem.

Legal Issues

State Enabling Legislation and City Ordinance

Adoption of a City income tax would require state enabling legislation that authorized the City to levy this tax upon residents and upon the income of nonresidents earned in the city or resulting from the operation of a business or sale of property located in the city. The enabling legislation and the implementing city ordinance would have to be carefully drafted to avoid any constitutional challenges by nonresidents under the federal Commerce Clause, the federal Privileges and Immunities Clause, or the state Uniformity Clause.

Pennsylvania Intergovernmental Cooperation Authority (PICA) Bonds

Until the PICA bonds are satisfied, the City is legally required to transfer to PICA the dedicated revenue from the first 1.5 percent of the Wage, Earnings, and Net Profits Tax rates. Eliminating these taxes and replacing them with a City income tax will require bondholder approval or, more likely, approval by the insurance companies that guaranteed the bonds. The PICA statute would have to be amended to permit dedication of a portion of the proposed City income tax to servicing the PICA debt.

Net Profits Tax

The Net Profits Tax currently is imposed at the entity level to guarantee that nonresidents pay the tax upon the appropriate tax base, to minimize disputes regarding the proper allocation of the net profits between resident and nonresident tax rates, and for efficient compliance and administration.

If the City adopted a City income tax, state legislation would be required either to enable it as a separate tax, or to incorporate the Net Profits Tax into a City income tax. Before a determination can be made of the best framework for the Net Profits Tax, a careful, thorough analysis of the impact of each structure would be required—with particular attention paid to the level at which this tax is imposed.

School Income Tax

Under state Act 46, the City has an obligation to authorize and levy the School Income Tax. In order for the City to replace the School Income Tax with a City income tax, Act 46 requires the City to obtain state enabling legislation and to adopt a City ordinance specifically providing for the allocation to the School District of all revenue attributable to items of income currently subject to the School Income Tax.

City Income Tax Revenue Impact

The Commission estimated the net revenue impact of a City income tax if it had been levied at a rate of 4.5885 percent in calendar year 2000 (this rate is the average of the fiscal year 2000 and 2001 resident Wage Tax rate). The results of this analysis are presented in Figure G.1. It is important to note that these estimates are based upon the following assumptions:

- These revenue estimates do not take into consideration the potential economic impact of this proposal. Although much research has been conducted on the benefits of a tax rate reduction, there is no quantitative research analyzing the impact of the type of base expansion that would occur if a City income tax were adopted.
- Because no reliable data exists on nonresident rental income and capital gains associated with selling property located in or doing business in Philadelphia, the nonresident revenues are assumed to remain constant and the following scenarios only calculate the impact of an increase in the resident tax base.
- When calculating the revenue impact, both scenarios were reduced by $25.5 million, the estimated increase in revenue resulting from the full taxation of net profits. This was done to avoid "double counting" the increased Net Profits Tax revenue that will result from the Commission's Business Privilege Tax recommendations.
- These revenue estimates assume that Philadelphia would not have a low-income tax forgiveness program modeled after the state's program. This type of program, in the year 2000, would have reduced City income tax revenues by approximately $38 million.
- These revenue estimates assume that there will be no change in tax compliance and enforcement.
- These revenue estimates do not take into account the fact that there may be a significant administrative cost to the City associated with collecting a City income tax. However, the Commission notes that New York State retains two percent of the revenues generated by the New York City's Income Tax as a collection fee. The commission assumes that this arrangement reflects the true cost of tax collection and that costs of administering a Philadelphia income tax could be similar.

The Commission's analysis suggests that if a locally-administered City income tax had been levied on city residents at a rate of 4.14 percent in fiscal year 2003, it could have generated approximately the same level of revenue as was actually collected that year from city residents under the Wage, Earnings, Net Profits, and School Income Taxes.

Figure G.1: Estimated Net Revenue Impact of City Income Tax (without cost of administration)

Proposal	*Revenue Impact*
1—State Administration	$6.2 million
2—City Administration	$70.3 million

Source: Tax Reform Commission Staff estimate, based on data from the Pennsylvania Department of Revenue and City Department of Revenue.

The actual fiscal year 2003 resident tax rate for these taxes was 4.5 percent. This suggests that one of the potential benefits of a locally-administered City income tax is a rate reduction of approximately 0.36 percentage points for city residents (assuming that the costs of administration are nominal).

The difference in the revenue impact of the two proposals shown in Figure G.1 is due to the fact that the Pennsylvania Personal Income Tax's definition of taxable compensation is narrower than the current definition of taxable compensation under the City Wage and Earnings Taxes. The PIT excludes certain forms of income from its definition of compensation that are taxable under the current City Wage and Earnings Taxes, including certain employer and employee contributions for health and other benefits. If the state administered the City income tax, the City would be forced to adopt the state's definition of taxable income.

Need for Further Research

Ultimately the Commission considered, but did not recommend, the proposal to replace the City's four existing income-based taxes with a single City income tax.

However, the Commission believes that this idea deserves further consideration and suggests that the City continue to research:

- The amount of additional revenue that could be generated from broadening the tax base—this estimate should take into account the cost of administration and potential differences in enforcement difficulty under the current system and under the proposed system;
- The distributional shift in tax burdens created by the proposal—specifically the impact of increasing tax burdens on high-income households (who would be more heavily taxed) and decreasing tax burdens on low-income households (who could be eligible for tax forgiveness); and
- The likely effect of a City income tax upon the economy—including total city employment, resident income, and property values.

Appendix I: Tax Exemptions for Low-Income Philadelphians

The Tax Reform Commission considered several proposals to exempt low-income workers from local income-based taxes.

While considering these proposals, the Commission remained cognizant of its obligations under the Philadelphia Home Rule Charter. The Charter mandates that the Commission "analyze each [City] tax to determine…whether and to what extent that rate of the tax may be decreased in a fiscally and socially responsible manner… The Commission's work shall be guided by the principle that Philadelphia's tax structure should enhance and improve Philadelphia's ability to compete with other jurisdictions…and the principle of tax fairness and tax equity…"[1]

The issue of tax exemptions for low-income workers was particularly complicated for the Commission because this issue presented a direct conflict between the primary goals the Commission was obligated to consider—competitiveness and equity.

Given the City's limited capacity to increase operational efficiency and generate new revenues, the Commission believes that the revenues available to finance tax reform are limited. Every additional dollar spent on tax reductions targeted to low-income workers means one less dollar available for "across-the-board" tax rate cuts for all taxpayers. Hence, the Commission faced a choice between tax cuts targeted at low-income workers and across-the-board tax cuts for all workers.

Economic Growth

Those arguing in favor of low-income wage tax exemptions claimed that each dollar of wage tax reductions targeted at low-income households has a larger economic impact upon the city than one dollar of across-the-board wage tax cuts.[2] This argument is supported by the following assumptions:

- Because the poor, on average, spend a higher percentage of their overall income, they are more likely to quickly spend the money they save through the tax exemption.
- Because poor people are more likely to spend their money within the city, their spending habits do more to stimulate the local economy and increase tax revenues.
- A higher portion of targeted Wage Tax cut dollars will benefit city residents and therefore stimulate the city economy.
- Because wealthy households are more likely to use local Wage Tax payments as itemized deductions on their federal income tax returns, a larger percentage of across-the-board wage tax cuts will "leak" out of the city though higher federal income tax payments.

Those arguing against low-income wage tax exemptions believe that tax policy affects the local economy by influencing the location decisions of businesses and residents. They argue that the effect of tax cuts on location decisions is economically more significant than the effect of tax cuts on consumption. They also argue that, because low-income households are less mobile than higher income households, across-the-board tax cuts will have a greater effect upon location decisions than low-income tax cuts. Finally they argue that the research supporting the exemptions was flawed and incomplete because it failed to even consider that any new jobs would be created thereby.

The Commission is not aware of any empirical research that estimates the local economic impact of tax cuts targeted at low-income families, for Philadelphia or for other local jurisdictions. However, the Commission is aware of a substantial body of empirical research suggesting that local tax rates have an effect upon location decisions and local economic growth. Thus, the Commission concludes that across-the-board wage tax cuts are more likely to result in substantial impacts on city economic growth than are tax cuts targeted at low-income workers.

The Commission therefore believes that the choice between low-income tax cuts and across-the-board tax cuts is a choice between economic growth and vertical equity. Based on its review of empirical research, the Commission believes that cuts in the Wage Tax rate for all residents and nonresidents are far more likely to result in substantial long-term economic growth in Philadelphia than an equal dollar amount Wage Tax cut targeted to low-income workers.

The Commission believes that the long-term interests of poor Philadelphians are better served by tax changes designed to promote economic growth than by tax changes designed to directly reduce the tax burden on poor households. In the long-term, the economic growth that will result from the Commission's proposed package of broad based tax reform will benefit all city residents, including low-income city residents. Assuming low-income residents are provided with the skills that the city's future employers demand, they will benefit substantially from the new job opportunities created by tax reform.

The Commission's Overall Package of Recommendations is a Better Way to Promote Equity

The Commission believes its overall package of tax reform recommendations promotes tax equity in a way that makes sense for Philadelphia. Several of the Commission's recommendations simultaneously ease the tax burden on low-income households, while promoting competitiveness, neutrality, and economic growth.

- The Commission's recommendation to reduce Wage Tax rates will benefit everyone who works or lives in Philadelphia—including low-income families.
- The recommended reduction and eventual elimination of Philadelphia's Business Privilege Tax will promote economic growth in the city, thereby increasing job opportunities for low-income families and enhancing the City's financial capacity to provide services to residents, including low-income families.

- The Commission's recommendation to improve property assessments will increase tax system progressivity and correct current assessment patterns—which assess lower value properties, and properties in low-income neighborhoods, at higher rates, on average, than higher value properties and properties in high-income neighborhoods.
- The recommendations to implement a quarterly Real Estate Tax payment system, tax buffering, and expanded "ability to pay" programs are all designed to decrease the burden on taxpayers.

State and Federal Income Tax Relief

The Commission believes that the primary responsibility for promoting an equitable distribution of income and welfare in society falls to federal and state government, not local government. This belief is supported by a body of economic theory and evidence.[3] Because of household and business mobility, localities that attempt to shift tax burdens from poorer households to wealthier households in a significant way are likely to, over the long term, see their high-income populations dwindle. The reality of local government competition suggests that local governments should aim to align tax burdens with public service benefits received by households, rather than their ability to pay.

The Commission recognizes that at the federal and state level there are well-established programs to redistribute income though income tax credits. The federal Earned Income Tax Credit (EITC) and the tax forgiveness program under the state Personal Income Tax provide millions of dollars of tax credits to low-income households each year. However, approximately $150 million in annual state and federal tax credits are unclaimed by low-income Philadelphians. Because it believes in the importance of these programs, the Commission has recommended that the City make a significant investment in increasing participation in these programs, thereby assisting low-income families to receive the federal EITC and state tax forgiveness benefits to which they are entitled.

Appendix J: Economic Growth Acceleration Bonds

In considering how to manage near-term revenue shortfalls expected to result from new tax reductions upon businesses and individuals, the Tax Reform Commission studied the possibility of borrowing to compensate for lost tax collections. In addition to hearing testimony and reviewing written materials on the subject, we retained Public Financial Management (PFM)—a government financial advisor, investment manager, investment consultant and strategic consultant—to evaluate the feasibility of issuing debt to finance municipal tax cuts.

The Commission requested this research starting from a skeptical perspective on issuing bonds to finance planned deficits caused by tax reduction. Our members cited the recent poor economic climate, which has made it difficult for many local governments to balance budgets; concern about Philadelphia's general obligation credit rating; and uncertainty about whether the supply-side response to tax reduction would be able to fund *both* the revenue losses and the new debt service attributable to such bonds.

Commission consultants found no exact precedent for this type of credit, noting that "[O]ur research…has not found any prior cases where bonds were issued at a time of budget balance to finance an expected temporary period of deficits caused by planned tax revenue reductions." Such "Economic Growth Acceleration Bonds" would be a new hybrid instrument resembling, to varying degrees, three existing models: traditional deficit bonds, economic development financing, and bonds issued to fund certain operating initiatives.

The Commission learned that while rating agencies have repeatedly expressed reservations about each of these non-traditional forms of financing, a substantial market of buyers exists. The rating agencies therefore have singled out areas of concern for buyers of these securities.

- Unlike securities to fund lasting capital projects, deficit and operating bonds fund one or a few fiscal years' activity, so their repayment schedules are mismatched to the useful life of the project.
- Deficit financing is often interpreted as a potential sign of underlying, long-term fiscal distress.
- Economic development initiatives may not yield sufficient growth to justify issuing the securities, while crowding out basic services.

In looking specifically into the possibility of Philadelphia issuing debt for new tax cuts, the Commission asked PFM to model three financing scenarios: $100 million, $200 million, and $300 million in eight annual 10-year revenue bond issues that would exactly fill a particular year's budget shortfall. The credits would be secured by existing over collections of

PICA's portion of the City Wage Tax, the 1.0 percent City Sales Tax, or both, and would become more manageable to repay after fiscal year 2008, when the amount of debt service on the PICA bonds is expected to fall. The costliest of the three scenarios would provide deficit reduction of between $17.2 million and $68.8 million per year from fiscal year 2005 to 2012, with annual debt service payments beginning in fiscal year 2006 that rose to $44.8 million by fiscal year 2013 and declined thereafter.

Although it appears that such tax-exempt bonds to finance tax cuts could be issued at a reasonable cost and would likely receive high ratings because of their strong security features, the Commission was unable to resolve the likely impact upon the city's general obligation credit rating. On the one hand, Philadelphia's ratings, at investment grade only since the early 1990s, are the lowest among the six largest U.S. cities, while its outstanding debt ratio is the highest among the 10 largest cities. Balancing out these concerns are the city's reputation for strong budget management and state financial oversight.

While reassured by its consultants that such securities would be purchased and rated highly, the Commission decided that the incremental, phased nature of its program should guarantee modest enough revenue losses that they can be managed without resorting to the public debt markets. The Commission also found that the credit community shared its concerns about deficit borrowing in general (particularly with regard to Philadelphia's general obligation rating), and about supply-side gains from tax reduction possibly not materializing, resulting in a need to raise taxes or cut services. The Commission therefore decided not to recommend for consideration the option of financing any portion of its recommended tax cuts by issuing additional municipal debt.

Appendix K: Assumptions Behind Fiscal Impact Estimates

When estimating the fiscal impact of the Commission's recommendations, the, relevant comparison is between (1) the tax revenue projected to result from the Commission's recommendations, and (2) the tax revenue projected in the City's *Five-Year Financial Plan, Fiscal Year 2004 – Fiscal Year 2008* (the "*Five-Year Financial Plan*"). The revenue projections relied upon by the City in the *Five-Year Financial Plan* are based on actual revenue collected on a fiscal year basis, projected forward.

Determining the Taxable Base for the Net Income Portion of the Business Privilege Tax

Several of the Commission's recommendations make structural changes to the formula used to compute taxable net income. Before calculation of the impact of these structural changes could be made, and before calculating the impact of eliminating the Business Privilege Tax, it was necessary to determine the base of the net income portion of the Business Privilege Tax.

Business Privilege Tax returns are filed on a calendar year tax basis. The returns for a particular tax year are stored in one file in the City's master data bank, regardless of the year in which they are filed. However, the City books its revenue on a fiscal year basis. The *Five-Year Financial Plan* revenue projections are based on these fiscal year revenue receipts.

In order to create a base from which to project the impact of the recommendations on the Five-Year Plan, the fiscal revenue receipts were converted into the return data format. Relying on the fiscal year 2002 Business Privilege Tax revenue data received from the City Office of Budget and Program Evaluation (the "Office of Budget"), and the April 15, 2002 Business Privilege Tax return data obtained from the City Departments of Finance and Revenue Research Office (the "Research Office"), a base tax year was created from which all revenue projections were calculated. The method used to create this base tax year was presented in detail to, and approved by, the Office of Budget.

Single Sales Factor Apportionment (Recommendation 18)

The fiscal year 2002 Business Privilege Tax return data was provided by the Research Office and reported the Net Income Tax and Gross Receipts Tax portions of the Business Privilege Tax, broken down by industry classification. The raw data is contained in a flat file of 2002 return information created by that office and the Mayor's Office of Information Services. The Research Office identified the taxpayers that apportioned their net income between Philadelphia and other jurisdictions and adjusted the taxable net income on the return to take into account single factor apportionment. This endeavor required a substantial commitment by the Research Office staff to the development of the flat file and of the methodology used to project the impact single sales factor apportionment would have had the Net Income Tax reported on 2002 Business Privilege Tax returns. As described above, this information was used in conjunction with the projected growth factors employed by the City in the *Five-Year Financial Plan,* to determine the impact of single-sales factor apportionment on projected revenue for fiscal years 2004 through 2009.

Unincorporated Business Deduction of Partner, Member and Sole Proprietor Payments (Recommendation 19)

In order to calculate the impact of Recommendation 19, the Research Office designed search criteria that reported, and aggregated by industry classification, taxpayers that filed both Business Privilege Tax and Net Profits Tax returns due on April 15, 2002. The report isolated the portion of the Net Income Tax base that would be affected by this recommendation. The report included the Net Income Tax both as reported on the return and as adjusted for single-sales factor apportionment.

The report also showed the value of the 60 percent Net Income Tax credit deducted from the amount of Net Profits Tax that otherwise would have been due. This information was used to ascertain whether the actual credit claimed by taxpayers on their 2002 Net Profits Tax returns equaled 60 percent of the Net Income Tax reported on the 2002 Business Privilege Tax returns filed by unincorporated firms that also filed Net Profits Tax returns. A comparison of the Net Income Tax paid by unincorporated businesses that also filed Net Profits Tax returns indicated that the full 60 percent credit was utilized to offset Net Profits Tax liability. This information formed the basis for calculation of the reduced Net Income Tax credit, which results in the increased Net Profits Tax revenue that offsets the costs of the package of business tax recommendations.

Lengthen the Business Privilege Tax Net Operating Loss Carryforward Period (Recommendation 20)

The Commission recommends extending the net operating loss carryforward period from the current three years to 10 years. This recommendation has no impact on the *Five-Year Financial Plan* because the first year impact will be in fiscal year 2009. In that year, taxpayers will be allowed to deduct net operating losses from the prior four years. The City Department of Revenue and the Research Office could not obtain the raw data on losses that were carried forward for three years and then expired before being utilized because the data bank storing the return data does not track net operating loss history.

The Commission requested net operating loss historical data from the Pennsylvania Department of Revenue, Bureau of Research (the "Bureau of Research"). This information is captured at the state level on the state Corporate Net Income Tax return. The Bureau of Research could not provide the raw data requested. The data reported would not necessarily be that of Philadelphia taxpayers because many businesses file their returns from addresses other than their operating locations. In addition, calculation of state and City taxable net income, while similar, is not identical. Therefore, the net operating losses reported would not be useful in any projections.

The Research Office, working with the Commission staff, designed a method for determining the annual fiscal impact of the current three-year loss carryforward period. That method requires creation of a flat file of all return data for each year, and further substantial programming and database searching to produce a report of the net operating loss carryforwards actually used to reduce tax liability that year.

Incremental Elimination of the Business Privilege Tax (Recommendation 23)

The revenue impact of the incremental elimination of the Business Privilege Tax did not require any calculations or assumptions beyond the assumed tax base growth rates and baseline tax rates set forth above.

Estimating the Fiscal Impact of the Business Tax Recommendations on Business Privilege Tax and Net Profits Tax Revenues

Once the Business Privilege Tax base was determined, the Commission estimated the fiscal impact of its proposed Business Privilege Tax reform through the end of fiscal year 2009. The Commission's fiscal impact estimates were based on the following assumptions:

- The net income base and gross receipts base of the Business Privilege Tax will grow 2.0 percent in fiscal year 2003, 3.5 percent in fiscal year 2004, 4.0 percent in fiscal years 2005 and 2006, and 4.5 percent in fiscal years 2007, 2008, and 2009. Tax Revenue projections in the City's *Five-Year Financial Plan* are based on the same assumptions for the period from fiscal year 2003 through fiscal year 2008.
- The revenue impact was measured relative to a baseline scenario wherein the City implements the cuts in the gross receipts portion of the Business Privilege Tax (hereafter the "Gross Receipts Tax") projected in the *Five-Year Financial Plan* through fiscal year 2008. City Council has adopted an ordinance setting these rate cuts through fiscal year 2008.
- The baseline scenario assumes that the Gross Receipts Tax rate in fiscal year 2009 will remain at the 2008 rate of 0.15 percent.

The Commission also estimated the fiscal impact of its Business Privilege Tax Recommendations on Net Profit Tax revenues, through fiscal year 2009. This estimate was based on the following assumption:

- An unincorporated taxpayer that is also subject to Net Profits Tax currently deducts 60 percent of the tax paid under the Net Income Tax from its Net Profits Tax liability. Consequently, any reduction in the Net Income Tax liability of an unincorporated taxpayer that is also subject to Net Profits Tax will reduce the value of the 60 percent Net Income Tax credit. Because the credit is a reduction in tax liability, not a deduction from the taxable base, every $100 decrease in Net Income Tax liability will result in a $60 increase in Net Profits Tax liability. As a result, the increase in Net Profits Tax revenue attributable to recommended decreases in the Net Income Tax are deducted from the impact of the Business Privilege Tax cuts to produce the net impact of the Commission's business tax proposals on the City's Five-Year Plan.

The Commission estimated the fiscal impact of the recommendation to allow unincorporated businesses to deduct payments to partners, members and sole proprietors through fiscal year 2009. This estimate was based on the following assumption:

- The Commission chose a conservative approach that maximized the negative revenue impact. Not every unincorporated business will be permitted to claim the deduction. The deduction will be available only to unincorporated taxpayers that actively engage in performing personal services, other than services required to monitor passive investments. Payments will not be deductible if made to passive investors in unincorporated businesses that receive a return on their financial investments, such as owners of interests in unincorporated real estate companies. The Commission's estimate of the impact of this recommendation, however, is conservative insofar as it assumes that all distributions to partners, members, or sole proprietors will be deductible. In reality, the Commission estimates that a minimum of 20 percent of these distributions will not qualify for deduction. By not taking this factor into account in its revenue impact estimates, the Commission insures that its estimates err on the side of overstating the projected fiscal costs rather than understating them.

Wage and Earnings Tax

The Commission estimated the fiscal impact of its recommendations to reduce income-based tax rates (Commission Recommendations 25 and 26). Behind these estimates are the following underlying assumptions:

- It is assumed that the base of the Wage and Earnings Taxes will grow 3.5 percent annually from fiscal year 2004 through fiscal year 2006, and at 3.75 percent annually from fiscal year 2007 through fiscal year 2009. Tax Revenue projections in the *Five-Year Financial Plan* are based on the same assumptions for the period from fiscal year 2004 through fiscal year 2008.
- It is assumed that the resident and non-resident portion of the tax base will grow at the same rate throughout the forecast period.
- The revenue impact was measured relative to a baseline scenario wherein the City implements the minimum Wage Tax and Earnings Tax rate cuts adopted by City Council. These rate cuts were also used as the basis for projecting revenues in the City's *Five-Year Financial Plan* through fiscal year 2008.

- The baseline scenario assumes that the same Wage and Earnings Tax rate cut will be implemented in fiscal year 2009 as is scheduled to be implemented in fiscal year 2008.

Appendix L: Endnotes

Section 3: A Historical Overview of Philadelphia's Tax System

1 Constitution Of The Commonwealth of Pennsylvania 1968, Art. VIII, 1.

2 Act of June 5, 1991, P.L. 9, No. 6.

3 Taken from remarks of Senator Salus, July 27, 1932, in the Senate of Pennsylvania. Senator Salus believed that the Sterling Act would be the "salvation of Philadelphia," as it would provide the City the ability to take care of the unemployed, which the "Legislature of Pennsylvania ha[d] not [then]tofore been able to do." The Sterling Act passed in the Senate with 47 ayes, and 0 nays on July 27, 1932. The act passed in the House with 195 yeas, and 0 nays on July 18, 1932.

4 *Butcher V. City Of Philadelphia*, 6 A.2d 298, 333 Pa. 497 (1939) Challenge to constitutionality on grounds exemption and credit created lack of uniformity denied as such provisions were severable.

5 Gupta, 1999. The Commission acknowledges the valuable contribution of the research performed by Anuj Gupta and the Pennsylvania Economy League on the history of Philadelphia's Wage, Earnings, and Net Profits Taxes.

6 *City of Philadelphia v. Schaller*, 148 Pa. Super. 276, 25 A.2d 406 (1942); *City of Philadelphia v. Samuels*, (1940); *Application of Thompson,* 157 F. Supp. 93 (E.D. Pa. 1957), aff'd, 258 F.2d 320, cert. denied, 79 S.Ct. 317, 358 U.S. 931 (1958); *City of Philadelphia v. Kenny,* 28 Pa. Cmwlth. 531 (1977), *cert. denied*, 434 U.S. 923 (1977) rejecting yet another New Jersey federal employee challenge and citing the long history of challenges rejected the state and federal Supreme Courts; *Philadelphia v. Cline*, 58 Pa.Super. 179, 44 A.2d 610 (1945), *cert. denied; Barnes v. Philadelphia,* 328 U.S. 848 (1946) (further challenges by New Jersey federal employees working in Philadelphia rejected).

7 *Id.*

8 *See Leonard v. Thornburgh*, 489 A.2d 1349 (Pa. 1985).

9 Phila. Code §19-2803(1); §19-2804, City Pledge; Duration of Taxes added, 1991 Ordinances, p. 403, effective July 1, 1991.

10 In the City Code, the chart of Wage Tax Rates reports only the portion dedicated to General Fund. Phila. Code §19-1502. The PICA Tax 1.5 percent rate is imposed under Section 19-2803(1) of the Code. For purposes of discussion of rate decreases and resident and nonresident rate differentials, both the Wage Tax and the PICA Tax rates are collectively referred to as the Wage Tax rate. However, the proposed legislation contains only the City Wage Tax figure.

11 *Murray v. City of Philadelphia*, 71 A.2d 280, 364 Pa. 157 (1950).

12 Act of May 23, 1949, P.L. 1669, as amended, 24 P.S. 584.1.

13 *See, e.g., Davidson Transfer and Storage Co. v. City of Philadelphia*, 3 Pa. D.&C.2d 58 (1955) (ruling on applicability of the Mercantile License Tax to mutual and stock insurance companies, Bell Telephone Company, trucking companies, and taxicab owners doing business within Philadelphia); *Abbott's Dairies, Inc. v. City of Philadelphia*, 87 Pa. D.&C.2d 197 (1953) (ruling on applicability of the Mercantile License Tax to the wineries and ice-cream manufacturers doing business within the City).

14 Act of November 16, 1967 (P.L. 504).

15 Bill No. 1175, approved June 12, 1969.

[16] See discussion of Use and Occupancy Tax under School District Taxes, *infra.*

[17] The Pennsylvania Tax Increment Financing Act, Act of July 11, 1990, P.L. 465, no.113, as amended by the Act of December 16, 1992, P.L. 1240, No. 164.

[18] Phila. Code §19-2603, added, Bill No. 980005 (approved April 2, 1998); Business Privilege Tax Regulation 103, effective July 1, 1998.

[19] Phila. Code §19-1303(5); added, Bill No. 970274 (approved July 1, 1997).

[120] Act of 1844, April 29, P.L. 486, providing for taxation of intangibles; *infra. at n.26 - 28*.

[21] Act of 1887, May 13, P.L. 114 §1; 72 P.S. §4782.

[22] Act of 1933, May 22, P.L. 853; 72 P.S. § § 5020-101 *et seq.* (West 1994 and Supp. 2002).

[23] Act of 1842, July 27, P.L. 441.

[24] *Richie,* 37 Pa. Super. 190, 1908 WL 3788, p.2 (Pa. Super. 1908), *citing* Act of 1854.

[25] Act of 1865, March 14, P.L. 320; Act of 1867, February 2, P.L. 137.

[26] Act of 1873, April 12, P.L. 715.

[27] Act of 1933, May 22, P.L. 853; 72 P.S. § § 5020-101 *et seq.* (West 1994 and Supp. 2002).

[28] Act of 1937, April 28, P.L. 473.

[29] Act of 1939, June 27, P.L. 1199.

[30] Phila. Code § 19-1801.

[31] Whether the City is authorized to reduce the rate of School taxes, provided it ensure that the District receive the requisite amount of funding, is not clear. However, the City clearly must refrain from violating the requirements of Act 46 when deciding whether to amend taxes dedicated to the School District.

[32] Act of May 23, 1949, P.L. 1669, as amended, 24 P.S. 584.1.

[33] Philadelphia Bulletin Almanac, 1950, 1969; City of Philadelphia Annual Reports 1983-1985.

[34] *Supra.*

[35] 53 P.S. § 16101, Act of August 9, 1963, P.L. 640 Sec. 1, amended 1967, Nov. 16, P.L. 500, Sec. 1, imd. effective. "The council of any city of the first class may, by ordinance, authorize the board of education of such school district to impose taxes for the purposes of such school district on any persons, transactions, occupations, privileges, subjects and real and personal property, which may now or hereafter be taxable by such city for general revenue purposes, except that no such ordinance shall authorize the imposition of a tax on the wages, salary or net income of any person not a resident of such school district."

[36] The First Class City and School District Corporate Net Income Tax Act of 1969; Enabling Act of May 29, 1969; City Ordinance approved June 12, 1969.

[37] Phila. Code § 19-1806; Ordinance June 4, 1970.

[38] Phila. Code § 19-1806(2)(a) (CCH 2002).

[39] Philadelphia Use and Occupancy Tax Regulations, § 1201, Definitions.

[40] *John Wanamaker, Philadelphia v. School District,* 274 A.2d 524, 526-527 (Pa. 1970).

[41] *Id.* at 525. See also *Lower Merion Township v. Madway*, 233 A.2d 273 (Pa. 1967); *Deitch Co. v. Board of Property Assessment*, 209 A.2d 297 (Pa. 1967); *Delaware, Lackawanna & Western Railroad Co.'s Tax Assessment*, 73 A. 429 (Pa. 1909).

[42] *Wanamaker, 274 A.2d at 527. See*, *e.g.*, *Madway*, 233 A.2d at 278 (stating the uniformity clause forbids the taxing of one man's land at a lower rate than another's simply because of the type of business conducted thereon).

[43] *Id.*

[44] *Id.* at § 19-1806(3)(c). *See also Id.* at § 19-1806(1)(d) (defining port-related activities as loading or discharging cargo to or from vessels conducted on piers, wharves, or marine terminal facilities in the port of Philadelphia and activities related thereto such as furnishing dockage, wharfage, truck and/or railroad car loading and unloading and storage of cargo which is to be loaded or has been discharged from vessels at a pier, wharf or marine terminal facility in the Port of Philadelphia).

[45] Phila. Code. 19-1806(3)(b).

[46] Philadelphia Use and Occupancy Tax Regulations § 201.

[47] *See* Phila. Code § 19-3203(2) (stating that, subject to the conditions set forth in §§19 - 3204 and –3206, a person or business subject to the realty use and occupancy tax authorized under § 19-1806, with respect to local property located in the zone, may claim a 100 percent exemption from such tax).

[48] 1971, June 10, P.L. 154, No. 7, § 4. 53 P.S. § 16134.

[49] Bill No. 447 adding Section 19-1805 to Chapter 19-1800 of the Philadelphia Code, effective January 1, 1995, repealed a district tax on the retail sale of liquor products. That tax, enacted in 1970, was stricken by the PA Supreme Court in *United Tavern Owners of Philadelphia v. Philadelphia School District*, 272 A.2d 868 (PA. 1971), on the basis that the tax was preempted by state taxation of liquor. Added, June 27, 1994 Ordinances, p. 791. Section 4 of the Ordinance provides that it is to take effect January 1, 1995.

[50] *Licensed Beverage Association Of Philadelphia V. Board of Education of The School District Of Philadelphia,* 669 A.2d 447 (1995).

[51] *Id.*

[52] *Id.* at 1202.

[53] See the summary of the history of the Philadelphia Personal Property Tax in *Report of the Board of Revision of Taxes, Philadelphia County (1940) at page 19.*

[54] 757 A.2d 333 (Pa. 1998).

[55] 1937 Ordinances, p. 391; Amended, 1985 Ordinances, p. 570; amended, 1986 Ordinances, p. 304; amended, 1989 Ordinances, p. 769.

[56] Bill No. 000612 (December 15, 1993), eff. July 1, 1994; Bill No. 000405 (March 19 1993), eff. July 1, 1993.

[57] 1945 Ordinances, p. 16; 1951 Ordinances, p. 331; 1953 Ordinances, p. 244; Amended, 1982 Ordinances, p. 865

[58] Added, Enrolled Bill No. 1250, enacted June 10, 1982; 1982 Ordinances, p. 1303.

[59] Phila. Code §19-2400. Former Chapter 19-2400 repealed and this Chapter added, 1986 Ordinances, p. 962.

[60] Phila. Code §19-2403.

[61] Phila. Code § 19-2701(1).

[62] Phila. Code § 19-2701(1).

[63] Phila. Code §19-2402.1; Added, Bill No. 990116 (approved May 6, 1999), effective July 1, 1999.

[64] Added, Bill No. 990116 (approved May 6, 1999), effective July 1, 1999. Enrolled bill read "regional attractions, marketing agency".

[65] Bill No. 000083 (approved March 28, 2000).

[66] 1945 Ordinances, p. 20, as amended; 1949 Ordinances, p. 1051; 1953 Ordinances, p. 242; repealed, 1993 Ordinances, p. 109.

[67] Phila. Code § 19-2102; 1976 Ordinances, p. 543.

[68] Added, 1981 Ordinances, p. 881 (Chapter 19-2200 was superseded by the Act of June 23, 1981, P.L. 98, Act No. 35, 75 Pa. C.S.A. § 9501 et seq.)

[69] *Id.*

[70] *Id.*

71 *Summary Schedule of Tax Rates Since 1952 (rev'd June 23, 2003).*

72 68 Pa.C.S. §3100, et seq. Added, 1982 Ordinances, p. 838. Amended and definitions added, 1986 Ordinances, p. 290. Tax held to be invalid by *Multi-Family Counselor v. City of Philadelphia*, 2 D&C 4th 1 (Philadelphia Common Pleas, April 13, 1989)). Repealed, 1993 Ordinances, p. 110.

73 *Kohn v. City of Philadelphia,* 51 Pa. Super. 635, 30 A.2d 673 (1943).

74 §19-1502(3); Bill No. 030073 (became law April 25, 2003).

Section 4: The Need For Tax Reform

1 Wasylenko, 1997, p. 49.

2 Wasylenko, 1997. Another literature review, Bartik, 1991, concluded that the intra-regional elasticity is about -1.5.

3 Central Philadelphia Development Corporation, 2003.

4 See Appendix F.

5 Pennsylvania Economy League, 2002.

6 City of Philadelphia, Department of Commerce, 2001.

7 Center City District, 2001.

8 City of Philadelphia, City Planning Commission, 1998.

9 Government of the District of Columbia, 2003.

10 Vertex, Inc., 1998.

11 New York City Independent Budget Office, 2000.

12 Inman, 2002.

13 Grieson, 1980; Gruenstein, 1980; Inman, 1992; Luce, 1994; Inman, 1995.

14 Haughwout et al., forthcoming.

15 Haughwout and Inman, 2001.

16 New York City, Independent Budget Office, 2000. This study actually understates Philadelphia's dependence on the personal income tax, because it excludes the portion of the City Wage, Earnings and Net Profits Taxes paid by commuters, in an effort to measure the tax burden on city residents only.

17 U.S. Census Bureau, 1997. Note that Philadelphia's figure excludes taxes raised by the School District of Philadelphia and includes taxes dedicated to the Pennsylvania Intergovernmental Cooperation Authority, to insure comparability with the Census data.

18 Some cities levy business taxes based on the number of employees. Chicago and Denver, for instance, levy a business tax of $4 per employee per month. These taxes are likely to be far less onerous than taxes based on income and gross receipts.

19 Commonwealth of Pennsylvania, Department of Community and Economic Development, 2003.

20 Commonwealth of Pennsylvania, Department of Community and Economic Development, 2003.

21 Commerce Clearing House, Inc., 2003.

22 City of Philadelphia, Department of Commerce, 2001.

23 The findings in Haughwout and Inman, 2001 are consistent with Econsult's findings in this regard.

24 There has been some consideration of reinstating a commuter tax in New York City in response to the City's budget deficit.

25 Gillen 2003. While officials at the Philadelphia Board of Revision of Taxes agree with the general conclusions of Kevin Gillen's research, they dispute the magnitude of the problems he identifies.

26 Gillen 2003.

Section 6: Financing Tax Reform

1 Sorrell and Inman, 1981.

Appendix G: Legal Barriers to Tax Reform

1 *See* Wade J. Newhouse, *Constitutional Uniformity and Equality in State Taxation* 1731-32 (2nd ed. 1984).

2 *Commonwealth v. Fayette County Railroad*, 55 Pa. 452, 1867 WL 7562 (1867); *Union Improvement Company v. Commonwealth*, 28 Leg. Int. 309, 1871 WL 10880 (Pa. 1871).

3 *Fayette County Railroad*, 55 Pa. 452, 1867 WL 7562 (1867).

4 Kristin E. Hickman, *The More Things Change, The More They Stay the Same: Interpreting the Pennsylvania Uniformity Clause*, 62 ALB. L. REV. 1695 (1999).

5 *Id.*

6 *See id. at n.2.*

7 Commonwealth of Pennsylvania. General Assembly. *Pennsylvania History: The Era of Industrial Ascendancy: 1861-1945.* From <http://legis.state.pa.us/WU01/VC/visitor_info/pa_history/pa_history.htm.> Accessed October 2003.

8 See railroad industry background in *Appeal of State Line and Juniata Railroad Company,* 77 Pa. 429 (1875).

9 Pa. Constitution 1874.

10 Pa. Constitution 1874 Art. IX, §1.

11 Pa. Constitution 1874 Art. IX, §§4 – 14. Note, the original constitution contained two sections identified as Section 6.

12 Pa. Constitution 1874 Art. IX, §§3, 6

13 Pa. Constitution Art. VIII, §1.

14 Pa. Constitution Art. VIII, §2(b), amendments adopted between 1958 and 1985.

15 *Amidon v. Kane*, 279 A.2d 53, 63 (Pa.1971).

16 *Saulsbury v. Bethlehem Steel Co.*, 196 A.2d 664 (Pa. 1964).

17 *Equitable Life Assurance Society v. Murphy*, 621 A.2d 1078, 1087. (Pa. Commw. Ct. 1993).

18 *Amidon v. Kane*, 279 A.2d 53, 63 (Pa.1971).

19 Pa. Constitution Art. VIII, §2(b) – (c), Purdon's Pennsylvania Statutes Annotated, and Historical Notes thereto.

20 See *Kenney v. Keebler,* 419 A.2d 210, 53 Pa. Commw. Ct. 507 (1980); *also, see:* Anthony Coughlan, *Land Value Taxation and Constitutional Uniformity*, 7 GEO. MASON. L. REV. 261, 262 (Winter, 1999).

21 See Report, Chapter Five, Recommendation 8: *Phase-in Land Value Taxation.*

22 *Kenney v. Keebler,* 419 A.2d 210, 53 Pa. Commw. Ct. 507 (1980).

23 *American Stores v. Boardman*, 6 A.2d 826 (Pa. 1939), *Saulsbury v. Bethlehem Steel Co.*, 196 A.2d 664 (Pa. 1964), *Equitable Life Assurance. Society v. Murphy*, 621 A.2d 1078 (Pa. Commw. Ct. 1993).

Appendix I: Tax Exemptions for Low-Income Philadelphians

1 Phila. Home Rule Charter, Art. IV, Chapter 9, §4-900, approved by voters November 5, 2002.

2 Herzenberg, 2003.

3 Ladd and Doolittle, 1982; McGuire, 1997.

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