

**PHILADELPHIA TAX REFORM COMMISSION
DRAFT REFORM CONSIDERATIONS
August 20, 2003**

Real Estate Tax Reform Considerations

Assessment System Reform

Taxes and Issues Addressed:

Real Estate Taxation, Assessments and Revenue Generation, and Property Tax Relief

Rationale for Policy Recommendation:

Fairness: Because real property assessment levels vary dramatically (certain properties are over assessed while other properties are under assessed) and because the assessment process treats similar properties differently, the City's application of the Real Estate Tax is considered to be unfair. Additionally, property owners widely consider increases in the tax burden that result from increased assessments – rather than from increased tax rates – to be unfair.

Certainty: Dramatic fluctuations in assessed property values result in unreasonable tax increases for property owners and make accurate financial planning difficult.

Transparency and Accountability: The structure of the Board of Revision of Taxes (BRT) makes it unclear which political actors are responsible for increases in Real Estate Tax bills.

Policy Recommendations:

1. Separate the assessment and the appeals functions to improve fairness and accountability.
 - a. Create an Assessment Appeals Board appointed by the Mayor (exact number of members and their qualifications would need to be determined) to hear and decide the outcome of assessment appeals.
 - b. Do not change the governance and assessment duties of the BRT.
2. Increase taxpayer representation in the assessment process to improve fairness.
 - a. Create a Taxpayers' Advocate appointed by the Mayor subject to approval by City Council (qualifications for the position would need to be determined).
 - b. Provide that the Taxpayers' Advocate would represent all property owners in the appeal process; improve public understanding of the assessment and appeal processes; monitor and report on the quality of the assessment process; and review and comment on the BRT's Assessment-Practice Principles.
3. Obligate the Mayor and City Council to set Real Estate Tax and Use & Occupancy Tax rates each year after reviewing assessment estimates.
 - a. This charge would make Philadelphia's Real Estate Tax system budget-based instead of assessment-based.

- b. This charge would require a change, by ordinance, in the date by which the BRT must present assessment data to the City's elected officials as well as a requirement that City Council must restate (and potentially change) Real Estate Tax and Use & Occupancy Tax rates each year.
- 4. Eliminate fractional assessments to improve fairness, certainty, and transparency.
 - a. Require that all assessments reflect 100 percent of property value (essentially the sales price in an open market). This valuation method would eliminate any real or perceived unfairness in the assessment of different types of properties.
 - b. This change would need to be accompanied by implementation of a budget-based system so that taxpayers will not see an unreasonable increase in their real estate bills when their property is assessed at its full market value.
- 5. Require that, in order to improve fairness, transparency and certainty, the BRT officially adopt, and report publicly, a set of Assessment-Practice Principles.
 - a. The BRT should annually promulgate and submit to City Council and the public Assessment-Practice Principles to guide its work. This document could potentially be created with the help of an advisory board with representatives appointed by the BRT, the Mayor, City Council, the Controller's Office, and the newly created Taxpayers' Advocate.
 - b. A series of reforms the Tax Reform Commission would like to see incorporated in this set of assessment-practice principles include:
 - i. Require State certification of all assessors.
 - ii. Reject assessment caps to avoid preserving any unfairness in the system.
 - iii. Collect better quality data about the condition of each property.
 - iv. Reassess all properties annually to reflect changes (up or down) in value.
 - v. Increase reliance on computer modeling and information management systems. Regression techniques, computer calculated neighborhood indexes, GIS mapping, and new CAMA products are among the tools that should be considered.
 - vi. Provide more information about how assessments are performed when notices are sent out. For example, each notice should contain information about the average assessment in that neighborhood for that type of property, and reasons why the assessment deviates from the average.
- 6. Improve the overall fairness of the assessment system with an effort to establish appropriate land and structure values for the entire city.
 - a. As part of efforts to reset assessment values to reflect 100 percent of property value, internally, or with the help of an outside firm, use computerized land mapping to calculate accurate land values for all properties in Philadelphia.
 - b. Utilize funds from the city's Productivity Bank or a one-time surcharge on Real Estate Tax bills to fund the effort to establish accurate base values (the working group has received estimates that such an effort could cost between \$0.4 and 3.2 million).

7. Utilize buffering techniques to enhance overall certainty and guard against large, unexpected tax increases.
 - a. Implement a three-year averaging program in which the Real Estate Tax is levied on the average assessed property value from the past three years.
 - b. If the City adopts Land-Value Taxation, implement a three-year land-averaging program in which the Real Estate Tax is levied on the average assessed land value from the past three years.

Land-Value Taxation

Taxes and Issues Addressed:

Real Estate Tax, Land-Value Tax, Commercial and Residential Tax Rates, and Property Tax Relief, Competitiveness, Economic Development

Rationale for Policy Recommendation:

Fairness: The Real Estate Tax is imposed in a way that increases taxes on (penalizes) those who build and maintain their structures, but decreases taxes on (rewards) those who allow buildings to deteriorate.

Distribution of Tax Burden: In general, this tax would shift the tax burden from residential properties to commercial, industrial, and vacant properties; from inexpensive land to expensive land; and from well-used properties to underused properties.

Competitiveness: Land-Value Taxation would shift some of the tax burden from residential properties onto vacant/commercial/industrial properties. However, because commercial and industrial landowners appear to be less sensitive to increases in the Real Estate Tax than other types of business taxes, this would do little to diminish the supply-side stimulus created by other business tax reductions.

Economic Development/Blight Reduction: Land-Value Taxation could reduce the amount of blight and abandonment in the City and increase the amount of economic development and private investment in Philadelphia.

Policy Recommendations:

The Working Group reviewed extensive research and information concerning the benefits of Land-Value Taxation as well as positive testimonials from officials in other jurisdictions that have adopted Land-Value Taxation. The information has been enlightening and compelling. The research has demonstrated that Land-Value Taxation maximized its economic development goals when implemented in conjunction with other tax reforms. Land-Value Taxation, complemented by other recommendations of the Tax Reform Commission, could foster an economic benefit to the City, and would be consistent with our mission to improve the City's competitiveness in a fiscally and socially responsible manner. We have satisfactorily resolved the issue that it is practical to properly assess land values and we have determined that the issue of tax-delinquency would not threaten attempts to impose Land-Value Taxation in a revenue-neutral manner. We believe that it is most prudent to consider Land-Value Taxation after planned and proposed reassessment reforms establish accurate values for city properties. The following recommendations are designed to create a process pursuant to which formal

consideration and debate about the benefits of Land-Value Taxation could move forward and City Council could vote on legislation to reduce taxes on structures and increase taxes on land.

8. Reflect the fact that we currently tax land and structures by legislatively levying a separate tax rate (at current level) on land and on improvements by expressing tax rates and tax liability separately for land and improvement values on bills sent to all taxpayers.
9. Rely on assessment-system reform to establish assessments that will inform estimations of how a system of Land-Value Taxation would affect tax bills for city properties.
10. Require that, after values for land and improvement have been reestablished, City Council vote on whether to decrease the tax on structures and increase the tax on land.
 - a. Consider establishing a ratio of the tax on structures to the tax on land that would generate an equal amount of revenue from both taxes (a smaller differential could be implemented in the first year to phase in such a system).
 - b. Consider limiting any increases in future taxes on Real Estate Taxes to the tax on land.

Property Tax Relief

Taxes and Issues Addressed:

Real Estate Taxation and Property Tax Relief

Rationale for Policy Recommendation:

Fairness: Because the tax on property can be especially burdensome for some segments of the population (such as asset-rich individuals living on a fixed income), this tax is considered to be unfair. Although taxes on property are linked to wealth, they are not directly linked to an individual's ability to pay.

Certainty: As the real estate market fluctuates, real estate taxes can vary dramatically; this lack of certainty makes real estate taxes burdensome. This tax is especially burdensome for people without mortgages who must pay their property tax bill all at once.

Policy Recommendations:

11. Expand efforts to address issues surrounding "ability to pay" Real Estate Taxes.
 - a. Establish installment payment plans for all Real Estate Taxpayers (research must be performed to determine the cash-flow impact of different installment plans).
 - b. Apply tax payments to the current year's tax rather than to delinquent tax bills so taxpayers are not prohibited from participating in state-rebate programs.
 - c. Consider a low-income property tax relief demonstration project similar to the Water Relief Assistance Program to provide tax-delinquent property owners with a one-time tax credit if they enter into a payment program (research must be performed to determine program effectiveness and its applicability to Real Estate Tax delinquency).

12. Advocate for efforts to provide property tax relief at the state level to improve fairness.
 - a. Recommend “circuit-breaker” legislation at the state level so that individuals who earn less than a certain income level pay a reduced percentage of Real Estate Tax.
 - b. Recommend state legislation to expand income eligibility for participation in low-income and senior-citizen payment plans and tax credits/freezes.
13. Increase awareness about Real Estate Tax relief programs to improve fairness.
 - a. Increase outreach programs to inform residents about tax-relief programs – especially the state-funded program for low-income elderly property owners.
 - b. Provide counseling for low-income tax delinquent property owners (such programs are already available through the Office of Housing and Community Development).
14. Rely on buffering techniques, if adopted as recommended in the *Assessment System Reform* section, to decrease uncertainty and act as a form of general property tax relief.
15. Rely on Land-Value Taxation, if adopted as recommended in the *Land Value Taxation* section, to provide tax relief for owners of property in low-income neighborhoods.

Commercial and Residential Tax Rates

Taxes and Issues Addressed:

Commercial and Residential Tax Rates, and Land Value Tax

Rationale for Policy Recommendation:

Competitiveness: Commercial and industrial landowners may be less sensitive to increases in the Real Estate Tax than other types of business taxes. Thus, the City may be able to minimize revenue losses from business tax reductions by increasing taxes on industrial/commercial real estate.

Distribution of Tax Burden: Taxing different classes of property at different rates would shift the tax burden from residential properties to commercial and industrial properties.

Policy Recommendations:

16. In the short term, rely on a potential implementation of Land-Value Taxation to shift tax burdens from the residential base to other bases.
17. In the future, advocate for a change in the Pennsylvania Constitution to allow for variable real estate tax rates so that the City can tax different classes of real estate at different rates.

Real Estate Transfer Tax

Taxes and Issues Addressed:

The Real Estate Transfer Tax

Rationale for Policy Recommendation:

Competitiveness: Philadelphia's Real Estate Transfer Tax is significantly higher than similar taxes in competitor jurisdictions.

Fairness: Because many businesses successfully avoid paying the Real Estate Transfer Tax, the burden of this tax falls most heavily on purchasers of residential property.

Policy Recommendations:

18. The Tax Reform Commission recognize 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. Research will continue on ways to close loopholes that unfairly place the burden of this tax on certain groups.

Real Estate Non-Utilization Tax

Taxes and Issues Addressed:

Real Estate Non-Utilization Tax

Rationale for Policy Recommendation:

Simplicity: This tax has never been collected.

Policy Recommendations:

19. Eliminate this tax and rely on increased enforcement efforts by the Department of Licenses and Inspections and fine and fee collection to achieve the goal of placing pressure on owners of under-utilized real estate to improve their properties.
20. If the City enacts Land-Value Taxation, the increased reliance on the tax on land would also increase pressure on owners of under-utilized real estate to improve their properties.

Use and Occupancy Tax

Taxes and Issues Addressed:

Use and Occupancy Tax

Rationale for Policy Recommendation:

Competitiveness: The tax is higher than equivalent taxes in competitor jurisdictions.

Policy Recommendations:

21. Do not reduce the Use and Occupancy Tax at this time, as other taxes should receive priority for the scarce resources needed for tax reduction.

Real Estate Tax Reform Considerations –Draft August 19, 2003

<i>Proposal</i>	<i>Effective Date</i>	<i>Revenue Impact</i>
Assessment System Reform		
1. Create an Assessment Appeals Board to hear assessment appeals.	FY 2005	Funding for the Appeals Board and Advocate (= \$1M per year) will be generated through BRT cost savings.
2. Create a Taxpayers' Advocate to represent property owners in appeal process; improve understanding of assessment process; report on assessment process; and comment on Assessment-Practice Principles	FY 2005	
3. Obligate the Mayor and City Council to set Real Estate Tax and Use & Occupancy Tax rates each year after reviewing assessment data	FY 2005	
4. Require that assessments reflect 100 percent of property value	FY 2006	
5. Require the BRT to officially adopt, and report publicly, a set of Assessment-Practice Principles	FY 2005	
6. Improve the overall fairness of the assessment system with an effort to establish appropriate land and structure values for the entire city	FY 2005	
7. Utilize buffering techniques to guard against large, unexpected, tax increases and enhance overall certainty	FY 2005	
Land-Value Taxation		
8. Reflect the fact that we currently tax land and structures by legislatively levying a separate tax rate (at current level) on land and on improvements	FY 2005	-
9. Rely on assessment-system reform to inform estimations of how Land-Value Taxation would actually affect the tax bills for city properties	FY 2006	
10. Require that after land values have been reestablished, City Council vote on whether to decrease the tax on structures and increase the tax on land	FY 2006	
Property Tax Relief		
11. Expand local "ability to pay" programs	FY 2005	Potential cost from expanding tax-relief programs
a. Provide installment payment plan options for all Real Estate Taxpayers		
b. Apply tax payments to current year's tax rather than delinquent tax bills so taxpayers are not prohibited from participating in state-rebate programs		
c. Consider a low-income tax relief project similar to the Water Relief Assistance Program to provide tax-delinquent property owners with a one-time tax credit upon entering a payment program		
12. Advocate for increased property tax relief at the state level	FY 2005	
a. Recommend "circuit-breaker" legislation so low-income individuals pay a reduced percentage of Real Estate Tax		Minimal cost to expand public awareness of tax-relief programs
b. Expand income eligibility for participation in low-income and senior-citizen payment plans and tax credits/freezes		
13. Increase awareness about Real Estate Tax relief programs	FY 2005	
a. Increase outreach programs to inform residents about tax-relief programs		
b. Provide counseling for low-income tax delinquent property owners		
14. Rely on buffering techniques to decrease uncertainty and provide general property tax relief.	FY 2005 FY 2006	
15. Rely on Land-Value Taxation to provide tax relief to low-income neighborhoods.		
Commercial and Residential Tax Rates		
16. Rely on Land-Value Taxation to shift tax burden from residential to other types of real estate.	FY 2006 FY 2005	-
17. Advocate for a change in the Pennsylvania Constitution to allow the city to tax different classes of real estate at different rates.		
Real Estate Transfer Tax		
18. Do not reduce the Real Estate Transfer Tax at this time, as other taxes should receive priority for the scarce resources needed for tax reduction.	FY 2005	-
Real Estate Non-Utilization Tax		
19. Eliminate this tax and use increased enforcement/fine and fee collection to pressure owners of under-utilized real estate to improve their properties.	FY 2005	-
20. Rely on Land-Value Taxation to pressure owners of under-utilized real estate to improve their properties.	FY 2006	
Use and Occupancy Tax		
21. Do not reduce the Use and Occupancy Tax at this time, as other taxes should receive priority for the scarce resources needed for tax reduction	FY 2005	-

Business Tax Reform Considerations

I. Considerations to become Effective FY 2005

Single Sales Factor Apportionment of Multi-Jurisdictional Businesses' Net Income

Taxes and Issues Addressed:

Business Privilege Tax – Net Income Component: Address Impact of Technology and Mobility Driven Changes on Business Net Income, Simplify Structure, Promote Certainty, Encourage Economic Development, Encourage Investment in Facilities, Property and Jobs.

Rationale for Policy Recommendation:

Fairness: The Business Privilege Tax (“BPT”) imposes a tax on the value of a business’s exercise of the privilege of doing business in Philadelphia. That value is based on a business’s net income and gross receipts from sales in Philadelphia. A business which operates in more than one jurisdiction (“multi-jurisdictional business”) must apportion its tax base to determine the value of the Philadelphia business privilege. The traditional three-factor formula for apportioning income of multi-jurisdictional businesses equally weights the contribution of local property, payroll and sales to a business’s net income. While property and payroll undeniably contribute to net income, without sales, a business has no revenues and therefore no net income. When that formula was originally conceived, local property and payroll investments by a multi-jurisdictional business were required for it to achieve the essential measure of its value – its sales. With the increased mobility of sales forces and technological advances in the manner in which sales are solicited, approved, and executed, business has entered an era in which the geographic location of capital and payroll are no longer reliable measures of a business’s exercise of its business privilege. Sales, in contrast, are a readily determined, reliable, fair measure of the extent to which a business avails itself of a jurisdiction’s market.

Philadelphia’s market provides all businesses, regardless of location, with a rich source of sales. Multi-jurisdictional businesses that take advantage of this market through improved mobility and the use of technology, without investing in property and payroll here, are unfairly benefited by an archaic formula more appropriate to an industrial, pre-technology era. Businesses that take advantage of this market and increase their local investment in property or payroll are unfairly penalized with higher taxes. Philadelphia already moved to remedy this inequity by adopting a double-weighted sales factor. Thirty-seven states, including Pennsylvania, have acknowledged the diminishing significance of property and payroll and essential reliability of sales and adopted either single sales factor apportionment or sales factors weighted more heavily than the property and payroll factors.

Distribution of Tax Burden: The tax burden would be equitably imposed on businesses in proportion to their sales from exploiting the Philadelphia market, regardless of their investment in Philadelphia. This change may shift the burden from multi-jurisdictional businesses with Philadelphia investments to those without such investment; however such a shift will not necessarily occur. The change will not affect the tax burden of businesses operating solely in Philadelphia.

Competitiveness: Philadelphia's first step toward encouraging business growth and job creation is to reform its apportionment method. Although the BPT's impact on Philadelphia's ability to compete for jobs and facilities cannot be absolutely measured, its very existence sets Philadelphia apart from its neighbors. Philadelphia is the only jurisdiction in the region imposing a business privilege tax, other than the minimal gross receipts taxes imposed by some local jurisdictions. At the national level, Philadelphia's business taxes, when combined with those of Pennsylvania, are among the highest.

Businesses will always exploit Philadelphia's market; they will not always invest in its people and property. Under three-factor apportionment, location or expansion of business operations in Philadelphia will increase a multi-jurisdictional business's tax burden, even absent any concomitant increase in local sales. Thus, Philadelphia's competitive disadvantage is exacerbated by employee mobility and technology used to exploit the Philadelphia market without a commensurate level of property and payroll investment here. Philadelphia's competitive disadvantage becomes the competitive disadvantage of multi-jurisdictional businesses that invest in Philadelphia property and jobs. Eliminating the influence of investments in Philadelphia jobs and facilities on a business's Philadelphia taxes will remove the specter of increasing tax burden from business location and expansion decisions.

While the economic analyses of the efficacy of single sales factor apportionment on a state's ability to compete for jobs and facilities are mixed, they are not applicable here. At the state level, 46 states impose some type of corporate income tax. Critics of single sales factor apportionment point to the many variables present in any locational or expansion decision. They minimize or refute any positive impact of the apportionment method on these decisions because virtually all states impose business taxes. However, the rarity of local business taxes sets Philadelphia apart from its counterpart jurisdictions and distinguishes these criticisms of single sales factor apportionment.

Certainty: Businesses will calculate their liability based on their sales and will be able to estimate with relative certainty their potential liability for Philadelphia taxes should they consider locating or expanding in the City.

Simplicity: The current three-factor apportionment formula subjects taxpayers to an unduly complicated system. Property values for apportionment purposes are measured by complex formulas and rules that differ from jurisdiction-to-jurisdiction. Single sales factor apportionment simplifies tax apportionment by limiting a business's calculations to one aspect of its operations.

Efficiency: Adoption of a single sales factor tax structure will introduce the same simplicity and ease of enforcement and collection at the administrative level as it will compliance at the individual taxpayer level.

Policy Recommendations:

8. Revise the apportionment formula to more equitably value a multi-jurisdictional business's exercise of its Philadelphia business privilege based on its exploitation of the market, increase the City's ability to attract and retain business investment in jobs and facilities, and simplify compliance with and enforcement of the BPT.
 - a. Require the Department of Revenue to adopt single sales factor apportionment as the primary method for apportioning the net income base of multi-jurisdictional businesses.

Permit Unincorporated Businesses to Deduct Payments to Partners, Members, Owners

Taxes and Issues Addressed:

Business Privilege Tax: Net Income Base of Unincorporated Businesses, Fairness, Competitiveness

Rationale for Policy Recommendation:

Fairness: Unlike their incorporated counterparts, unincorporated businesses are not permitted to deduct payments to partners, members, owners, etc. In addition, unincorporated businesses also pay net profits tax on these distributions.

Unincorporated businesses receive a credit of sixty percent (60%) of the Net Income Tax portion of the BPT liability, which is applied against their Net Profits Tax liability. Even after application of the credit, unincorporated businesses pay a higher effective tax rate than their corporate competitors. Permitting such deductions would level the playing field.

Competitiveness/Economic Development: Philadelphia's taxation of unincorporated businesses intensifies the disparity between the cost to do business in the City and in suburbs already created by the BPT. Unincorporated businesses are subject to multiple taxation in the City, in stark contrast to suburban jurisdictions that, at most, impose a gross receipts tax. Unincorporated businesses traditionally centered in Philadelphia are increasing their presence outside of the City. Permitting the deduction of these payments would encourage expansion in the City, increase retention of such businesses, and encourage other unincorporated businesses to locate in the City.

Certainty: Unincorporated businesses will benefit from knowing that their tax treatment will parallel that of similar incorporated businesses.

Simplicity/Efficiency: The deductible amount can be specified to provide readily determinable amounts that can be easily administered by the taxpaying business and the Department of Revenue.

Policy Recommendations:

9. Reform the BPT to increase fairness between incorporated and unincorporated businesses and to encourage economic development among this group.

- a. Amend the BPT definition of “net income” to allow unincorporated businesses to take the same deductions as incorporated businesses for payments to partners, members, and sole proprietors.
- b. Phase-in deduction: FY 2005 allow 50% deduction; incremental 10% deduction for each of the next 5 years, with 100% deductibility by 2010.

Phase-In of Quarterly Estimated Payment System

Taxes and Issues Addressed: Business Privilege Tax Fairness, Competitiveness, Distribution of Tax Burden:

Rationale for Policy Recommendation:

Fairness: Under the current tax structure, businesses pay their entire BPT liability before they receive the gross receipts and earn the income on which it is based. Tax liability is not tied to the realization of the tax base. If the estimated tax system is to be fair, it must be reformed to time imposition of the taxpayer’s burden to coincide with the benefit the taxpayer receives from the exercise of the taxed privilege.

Competitiveness: The negative impact of the BPT on Philadelphia’s ability to compete for businesses is magnified by an estimated tax system that imposes tax based on anticipated revenues and income. Timing the estimated payments to coincide with the taxpayer’s financial benefit from the exercise of the privilege to do business in Philadelphia may not directly improve Philadelphia’s competitiveness. However, such reform will definitely remove an especially onerous aspect of the anti-competitive BPT.

Simplicity: The state and federal government estimated tax systems operate on a quarterly basis. Adoption of a similar system for payment of BPT estimated tax would simplify taxpayer compliance.

Policy Recommendations:

10. Restructure the BPT estimated tax system to make the payment schedule fair to taxpayers and simplify compliance.
 - a. Initially, provide for two estimated payments occurring in April and June.
 - b. Thereafter, phase-in a quarterly estimated tax system.

Extension of Period for Net Operating Loss Carryforward

Taxes and Issues Addressed: Business Privilege Tax: Promotion of Philadelphia as a Desirable Business Location

Rationale for Policy Recommendation:

Competitiveness: Other jurisdictions, including Pennsylvania and the federal government, allow net operating loss (“NOL”) carryforward periods in excess of ten (10) years. Due to this fact, Philadelphia’s current allowance of a three-year carryforward causes Philadelphia to be considered as an unfriendly business environment for start-ups and high-tech businesses. For these businesses, the length of the available NOL carryforward period often is a critical factor in their location decisions. Reforming the BPT to increase the NOL carryforward period to more

closely resemble that of other jurisdictions would remove this disincentive and make the City more attractive to new businesses.

Policy Recommendation:

4. Reform the BPT to extend the NOL carryforward period to be competitive with other jurisdictions.
 - a. Amend the BPT to permit 10-year NOL carryforwards.
 - b. Amendment to apply to losses incurred in 2005, with the result that no fiscal impact will occur until 2009.

Reduction of Statutory Period for City BPT Assessment

Taxes and Issues Addressed:

Business Privilege Tax: Parity between Taxpayer and Tax Collector

Rationale for Policy Recommendation:

Fairness/Equity: Currently, the City is authorized to assess the tax liability of taxpayers for a period up to six (6) years after their initial due date. Yet, taxpayers may only appeal their tax assessments for three (3) years after their return is filed. Accordingly, the current system is unfair, and should thus be amended to level the playing field between the taxpayer and the tax collector.

Competitiveness: Most jurisdictions surveyed have uniform statutory periods of three (3) years for collector and payer. Philadelphia's non-uniform periods attach yet another unfavorable characteristic to its tax structure, adding to the perception that Philadelphia is an undesirable business location.

Policy Recommendation:

5. Reform the BPT so that its statutory refund and audit periods are uniform.
 - a. Amend the BPT so that the statutory period for the City to assess a taxpayer's liability is only three years.
 - b. Provide that the shortened period will not apply in cases of substantial underreporting and underpayment or fraud.

II. Considerations to become Effective FY 2006

Phase-Out of Business Privilege Tax

Taxes and Issues Addressed:

Business Privilege Tax: Attraction/Retention of Business, Simplification of Tax Computation, and Promotion of Fairness/Equity

Rationale for Policy Recommendation:

Fairness/Equity: Heavy burdens are currently imposed on the businesses of Philadelphia

in the form of additional taxes (e.g. the Use and Occupancy Tax), the impact of the City Wage Tax on their salary structures, and high tax rates (e.g. Net Income Tax rate = 6.5%). Thus, elimination of the most anti-competitive tax would create an environment where businesses are not forced to bear more than their fair share of the tax burden.

Competitiveness: Philadelphia imposes one of the most costly business privilege taxes in the country and the most costly in the region and state. With the lack of fairness and complexity problems inherent in the tax, the BPT's anti-competitive impact clearly contributes to the perception that the City is an undesirable business location and acts as a disincentive to business expansion. Accordingly, elimination of this tax would change this unfavorable perception, attract new business investment, retain those businesses who are considering leaving, foster expansion, and undoubtedly create more jobs. The elimination of the BPT would guarantee that Philadelphia would become more competitive with other jurisdictions.

Simplicity: The imposition of the BPT causes complexity in two ways. First, it forces the taxpayer to compute a complex tax that other jurisdictions do not impose. Second, and related, it forces businesses to consider a major factor that does not exist in other jurisdictions when making business location and expansion decisions. Therefore, elimination of the BPT would aid tax compliance and would simplify the business-location decision.

Certainty/Efficiency: With elimination of the BPT, the liability of the taxpayer would be more certain as he/she would have one less tax to compute. Furthermore, the BPT is the most complex tax administered by the Revenue Department. Upon final phase-out, the Revenue Department could devote the resources committed to the BPT to the more effective and efficient enforcement of the other city taxes.

Policy Recommendation:

6. Eliminate the BPT to make Philadelphia a more desirable business location and to simplify tax liability computations. The adoption of a phase-out would ease the revenue impact and allow the City gradually to adapt its budget. Finally, the adoption of a phase-out would leave the City with the option of adjusting the timing if the revenue impact is too great or if the revenue produced exceeds expectations.
 - a. Enact a 10-year phase-out of the BPT.
 - b. Accelerate the phase-out if a City-Wide Income Tax is adopted, or if revenue production exceeds estimates.
 - c. Freeze the phase-out if revenue production estimates are not met.

Business Tax Reform Considerations –Draft August 19, 2003

<i>Consideration</i>	<i>Effective Date</i>	<i>Revenue Impact</i>
1. Adopt Single-Sales Factor Apportionment	FY 2005	\$11 M
2. Grant Unincorporated Businesses a Deduction for Payments to Partners, Members, and Sole Proprietors <ul style="list-style-type: none"> a. Deduction limited to 50% b. Deduction increase 10% annually c. 100% deduction 	FY 2005 FY 2006 FY 2010	TBD
3. Phase-In Quarterly Estimated Payments <ul style="list-style-type: none"> a. Two payments between April 15 and June 30 b. Consider phase-in to four payments between January 1 and December 31 	FY 2005 No Target Set	2 Payments = \$ 0 4 Payments = \$ 30 M \$1 M lag for 5 years
4. Extend NOL Carry-Forward to 10 Years <ul style="list-style-type: none"> a. Effective for losses incurred in 2005 and thereafter 	FY 2005	No impact until 2008; amount TBD
5. Reduce Statute of Limitations for Tax Assessments From 6 Years to 3 years; 6 year limitations period to apply to: <ul style="list-style-type: none"> a. Collections b. Substantial underpayment, fraud 	FY 2005	TBD
6. 10 Year Phase-Out of the Business Privilege Tax <ul style="list-style-type: none"> a. Reduce rates annually b. Accelerate phase-out if revenues permit c. Provide circuit-breaker in event revenues so require 	FY 2006	Per year (approximate): NIT Reduction =\$ 18M GRT Reduction =\$ 15M

Wage, Earnings, and Net Profits Tax Rate Reduction

Taxes and Issues Addressed:

Wage Tax, Earnings Tax, Net Profits Tax, Competitiveness, Economic Development

Rationale for Policy Recommendation:

Competitiveness: Most other large cities in the United States levy no local income tax.

Of the cities that do, the rates are almost always substantially lower than the rate in Philadelphia. While local income taxation is common in Pennsylvania, Philadelphia's local income tax rate is substantially higher than all other jurisdictions in southeastern Pennsylvania.

Economic Development: Three decades of research by economists have consistently shown that the wage tax has resulted in a substantial reduction in the number of jobs located in the City. The 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 outside the City and seek work outside the City. Statistical analysis conducted by Econsult demonstrates that a reduction in the wage tax rate could be expected 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.

Policy Recommendation:

1. Adopt a program of deep cuts in the resident and non-resident wage, earnings, and net profits taxes. The cuts would be phased in incrementally through fiscal year 2014. The program is presented in the table below.

In the table, Scenario 1 is the schedule of tax cuts contained in the City's current Five Year Plan. Scenario 2 shows the impact of the current Five Year Plan cuts combined with additional reductions that would result if the City received state funds to cut the wage tax under Governor Rendell's Plan for a New Pennsylvania. Scenario 3 presents a potential Tax Reform Commission recommended schedule of deep wage tax cuts, assuming that the City receives state aid for wage tax reduction under some state tax reform plan similar to the Plan for a New Pennsylvania. Scenario 4 presents a potential TRC recommended schedule of deep wage tax cuts, assuming no state tax reform plan is adopted.

2. Repeal Bill 92 and Bill 73 and instead implement more significant and certain wage tax cuts according to the above schedule. The program of deep wage tax cuts described above removes the rationale for Bill 92 and 73, which were designed to commit the City to large wage tax reductions.

			Scenario 2: Current Five Year Plan Cuts Plus State Tax Reform		Scenario 3: Deep City Cuts Plus State Tax Reform		Scenario 4: Deep City Cuts Without State Tax Reform	
			<i>Incorporates Bill 92 and Bill 73 and Rendell Plan for a New Pennsylvania</i>				<i>Incorporates Bill 9 and Bill 73, Plus Enhanced Wage Tax Reduction, but NO Rendell Plan</i>	
	<i>Resident</i>	<i>Non- Resident</i>	<i>Resident</i>	<i>Non- Resident</i>	<i>Resident</i>	<i>Non- Resident</i>	<i>Resident</i>	<i>Non- Resident</i>
2004	4.4625	3.8801	3.8921	3.3841	4.000	3.500	4.4625	3.8801
2005	4.3700	3.8475	3.7996	3.3515	3.900	3.400	4.3500	3.8500
2006	4.3325	3.8149	3.7621	3.3189	3.800	3.300	4.3000	3.8000
2007	4.2950	3.7823	3.7246	3.2863	3.700	3.200	4.2000	3.7000
2008	4.2575	3.7497	3.6871	3.2537	3.600	3.100	4.1000	3.6000
2009	4.2575	3.7497	3.6871	3.2537	3.500	3.000	4.0000	3.5000
2010	4.2575	3.7497	3.6871	3.2537	3.400	2.900	3.9000	3.4000
2011	4.2575	3.7497	3.6871	3.2537	3.300	2.800	3.8000	3.3000
2012	4.2575	3.7497	3.6871	3.2537	3.200	2.700	3.7000	3.2000
2013	4.2575	3.7497	3.6871	3.2537	3.100	2.600	3.6000	3.1000
2014	4.2575	3.7497	3.6871	3.2537	3.000	2.500	3.5000	3.0000
<p>?? In 2002, Council passed Bill 92, which implements wage tax cuts of 0.0375/0.0326 through 2008.</p> <p>?? In 2003, Council passed Bill 73, which implements proportional cuts in the resident Wage Tax rate when real estate tax growth exceeds projections</p> <p>?? The Five-Year Plan estimates the impact of Bill 73 will represent a single cut of .0550% in FY 2005</p>								

Shift the Burden of Taxation from the Wage Tax to the Real Estate Tax

Taxes and Issues Addressed

Wage Tax, Earnings Tax, Net Profits Tax, Real Estate Tax, Economic Development, Fiscal Responsibility

Rationale for Policy Recommendation:

Economic Development: Philadelphia's high wage tax is the result of two factors: a high overall level of taxation; and an unusually high dependence on local income taxes. Among the ten largest cities in the U. S., Philadelphia's overall tax burden is ranked second. Further, Philadelphia has the highest percentage of local taxes that derive from personal income taxes. Economic theory consistently suggests that local income taxes are far more damaging to the local economy than taxes on real estate. Philadelphia's high wage tax is so unusual that Nobel laureate Joseph Stiglitz presents it as a case study in his popular public economics textbook. All of these considerations suggest that reductions in the wage tax would substantially improve the City's economy, even if they were partially financed by increases in real estate tax revenue.

Fiscal Responsibility: The wage tax cuts required to achieve competitiveness will result in substantial reductions in city revenues. Some of these costs could be

offset through productivity improvements, revenue enhancements, or the increase in economic growth that should result from the tax cuts. However, additional tax revenues from other sources may be necessary to maintain the City's fiscal stability.

Policy Recommendation:

3. The financial cost of wage tax cuts should be paid for, to the greatest extent possible, through productivity improvements and other cost saving or revenue enhancing actions. To the extent this is not possible, the cost should be absorbed through increased real estate tax revenues. The extent of the necessary increase in real estate tax revenue should be determined each year by the Mayor and City Council when they reset real estate tax rates as part of a budget-driven real estate tax system.