



Philadelphia Tax Reform Commission



**Final Report
November 15, 2003**

Executive Summary

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 Taubenberg**, 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 Taubenberg**, 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 Taubenberg**, 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
 - **Stewart M. Weintraub**, Commissioner
 - **Andrew VandenBrul**, Commissioner
- Staff**
- Christopher Dwyer,
Executive Director
- Joan E. Kreider Bradwell,
Staff Attorney
- Mary L. Braun,
Research Analyst
- Stephen K. Camp-Landis,
Research Analyst
- Robin Leary,
Director of Communications
- Megan McCormick,
Administrative Assistant
- Legal Interns*
James Boyer
Yan Gao
Timothy Leska
- Research Interns*
Lisa Bolotin
Michael Fabius
Eric Prengel
Amir Shachmurove
Helen Tam

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 21st century *can* be a story of rebuilding and growth.

Third Printing