

Social Justice and Tax Inequity in Philadelphia:

Recommendations for the Tax Commission

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“Social Justice and Tax Inequity in Philadelphia” was a “Community Action Conference” sponsored by the Center for Ethnicities, Communities, and Social Policy and the Graduate School of Social Work and Social Research, both at Bryn Mawr College in cooperation with Community Legal Services of Philadelphia and Philadelphia Higher Education Network for Neighborhood Development. It was held Friday, February 28, 2003, at the Friends Meeting House, 4th and Arch Streets, in Philadelphia.

The purpose of the conference was to give those who are most negatively affected by current tax policies, and who are underrepresented in the dialogue on tax reform, a chance to add their voice and concerns to the on-going debate on the inequities of the current Philadelphia tax structure.

Invitations to the conference were mailed to a number of community organizations as well as all of the area’s elected officials, and to the members of the newly appointed Philadelphia Tax Reform Commission. The Tax Reform Commission has been charged by the Philadelphia City Council to propose reform of the systems of taxation in the City of Philadelphia. It had three members in attendance, Jonathan Stein, Edward Schwartz, and Brett Mandel. Both Mr. Stein and Mr. Schwartz made formal presentations at the conference. The main body of attendees of the conference, however, represented a cross-section of the community and including in particular representatives from a number of advocacy organizations within Philadelphia. Approximately 75 persons were in attendance. Through breakout sessions, the attendees provided input, which serves as, the basis of the recommendations included in this report. These will be passed on to the Tax Reform Commission.

Tax inequity in Philadelphia is a microcosm of the tax inequity throughout the United States. It is also symptomatic of the inequities associated with policies at higher levels of government. Tax inequity in Philadelphia is closely related to and influenced by the trends of the federal and state government spending, and their financing of local governments. It is critically important to begin any analysis of the tax situation in Philadelphia with the appreciation that the fate of Philadelphia's budget is often inexplicitly tied to the whims of these larger governing bodies. With this mind, it is hopeful that the Philadelphia tax commission will propose policies that take this larger picture into account. The recommendations included in this report reflect consideration of that larger picture. We preface these recommendations with a review of the presentations made at the conference especially in terms of this critical issue of placing tax reform in context of inequity of the overall tax system.

In opening the conference, Jonathan Stein, General Counsel of Community Legal Services of Philadelphia and a Tax Reform Commission member, emphasized the need in public policy deliberations to focus beyond the expenditure side of budgetary discussions that concern the costs of public services, and give detailed attention to how the funds to pay for these services are raised. The issue of tax burdens in the City is not simply a question of the rising costs of services. Instead, the distribution of those burdens is also a critical issue. In addition, Mr. Stein pointed out that the federal and state tax reductions especially in recent years have reduced funds for social programs, while at the same time redistributed substantial tax savings to the wealthy. As a result, lower income families for whom many public services are critical suffer the greatest effects of cutbacks while wealthy individuals reap the greatest gains of recent tax cut plans. Inequality is

compounded and at an increasing rate in recent years. Further, as this pattern of tax cutting continues in serial fashion, it squeezes the federal budget, jeopardizing the extent to which the federal government can help states and localities meet basic needs. Mr. Stein concluded his analysis with the worry **that** choking off federal aid with massive tax cuts will only further reinforce regressive tax systems of local and state governments while shrinking support for needed social services and increasing inequality in the society overall. Local tax reforms that fail to be embedded in this broader context of tax policy change will not succeed in addressing issues of inequity and social injustice. Nor will they in the long run make fiscal sense.

The format of the conference included three panels of presentations. The panelists identified issues of tax inequity in Philadelphia and offered suggestions on corrective measures. The first presentation was by Tim Kearney, aid to city councilman David Cohen. Mr. Kearney addressed the inequity of the Philadelphia wage tax, emphasizing how the current 4.54 percent that city residents pay on their income is unfair to the poor and lower middle class workers who represent the majority of tax payers. The effect of the present wage tax on these workers is seen as an unfair loss of income for them that can be rectified.

Councilman Cohen had introduced bill # 020309 to the Philadelphia City Council for approval. This bill would gradually reduce the city wage tax from 4.54 percent to 1.54 percent over a six-year period. The graduated reduction is to allow city officials time and opportunity to address the loss of revenue as a result of the decrease. Councilman Cohen feels that reducing the wage tax for lower income workers by 3 percent would have the effect of putting more money directly into poor neighborhoods and help to spur economic

growth where it is most needed. Subsequent to the conference, Councilman Cohen's bill passed the City Council but was vetoed by Mayor John Street. Further attempts to revise the wage tax will probably have to await the deliberations of the Tax **Reform** Commission.

The next presenter, Elizabeth McNichol, a Senior Fellow at the Center on Budget Policies and Priorities, is involved in their State Fiscal Project. She works on state and local budget and tax issues, looking at the impact of local and state tax systems on low and moderate-income people. Ms. McNichol presented what she refers to as "Five Keys to a Quality Tax System," They are: (1) Provide appropriate and timely revenue; (2) Distribute tax burdens equitably; (3) Promote economic efficiency and growth; (4) Ensure easy administration; and (5) Guarantee accountability. Of these five keys Ms. McNichol emphasized (1) and (2), focusing most of her concern on (2) Distribute tax burdens equitably.

In reference to the first key, "Provide appropriate and timely revenue," Ms. McNichol believes that the tax structure should adequately fund city services. She states that the revenue system should be able to grow with the cost of providing basic services. If the cost of providing services is increasing faster than the growth of revenue, then the tax system and structure is inadequate and problematic and needs to be revamped so that it will be able to adjust to the changes in the cost of providing needed services.

Concerning the second key, "Distribute tax burdens equitably," Ms. McNichol advocates for a fair tax structure that should be based on people's ability to pay. She points out that on the state level, Pennsylvania's personal income tax is somewhat progressive, but the overall state tax system is regressive because the poor pay a higher

percentage of their income in property, sales and excise taxes than all other taxpayers. As it stands now in Pennsylvania, as income increases, the percentage of income paid in property taxes, and sales and excise taxes decreases.

In regards to Philadelphia, Ms. McNichol sees the Philadelphia flat 4.54 percent wage tax as inequitable and regressive because it does not tax other sources of income such as interest and dividends of wealthy families, versus individuals and families whose only source of income is from their wages; hence a much larger percentage of low-income wage earners' total income is taxed as compared to wealthier families. She also points out that the cost of the "Business Privilege Tax" and the "Sales Tax" is business expenses that are passed directly on to the consumer at a higher rate than other taxes. Since low-income consumers spend a higher percentage of their income on basic purchases affected by these taxes, these particular business-related taxes place a disproportionately higher tax burden on low-income families.

In response to Councilman David Cohen's bill to relieve the burden on low-income wage earners by reducing the wage tax by 3 percent, Ms. McNichol basically supports such a change and suggests making the wage tax more progressive by adopting the "Poverty Subtraction Tax-Back Provision" of the Pennsylvania income tax code, which would target a tax reduction for low-income tax payers. She believes that targeting this type of tax cut for those who need it most would be more effective and less costly than an overall across-the-board wage tax reduction. An across-the-board wage tax reduction will also reduce the wage tax for those who can afford to pay. To balance the budget, and to stay consistent with her basic principles of sound taxation which she had enumerated at the outset of her presentation, Ms. McNichol stated that you can not have a

major revenue producing tax reduced without raising another tax and/or cutting the services that the city is providing. Tax reductions to reduce inequity in the wage tax in light of its relationship to other taxes, need to be counterbalanced with other changes in either the wage tax or other taxes.

Ms. McNichol concluded that reducing taxes in and of itself would not necessarily have a positive effect on producing economic growth. She pointed to studies that show government spending to ensure the provision of quality services has a positive effect on economic growth and actually positively influences the decisions of businesses on where to locate. The available research suggests that simply reducing taxes to retain and attract business and **to spur economic growth** is a strategy that can backfire.

Jean Hunt, Director, Campaign for Working Families, Center for Research on Religion and Urban Civil Society, University of Pennsylvania, went next. She asked the question: What are the economic and social goals of tax policy? Her presentation spoke to the “core family needs” of low-income working mothers, especially mothers who are going from “welfare to work” under reforms regarding public assistance that have been instituted in recent years. For these mothers, “core family needs” include adequate housing, food, childcare, and health care. Ms. Hunt cited a study that indicated working mothers needed an hourly wage on average of \$18 to meet their family’s needs; if they received a child care subsidy a job earning \$13.50 an hour would meet their needs; if medical assistance were added on, a \$11.50 an hour job would suffice; if a housing subsidy were added to this package, then, but only then, a working mother could get by on \$6.50 an hour. Financing these services or raising wage levels is therefore critical for ensuring the ability of these families to be “self-sufficient.”

Ms. Hunt was therefore concerned about the social justice implications of proposed reforms of the Philadelphia tax system. If the taxes were simply reduced, then it is distinctly possible that the efforts of low-income families to achieve self-sufficiency would be jeopardized, as would the entire welfare reform effort. Ms. Hunt wants to see a tax structure in place that will not penalize those who need help the most, poor working mothers. Her major recommendation was, however, to be realistic about the prospects for reform and to focus on one feasible reform and concentrate on that. She feared that important momentum could be frittered away pursuing a diffuse reform agenda.

Henry Nicholas, President of AFSCME District Council 1199C, spoke next. He stressed that a reduction in the wage tax or any other tax at this time of massive deficits in government budgets will only result in a reduction of city services and the jobs associated with those services. Mr. Nicholas' analysis is that a wage tax cut will not have a positive net impact on those poor people who do not have a job. He therefore opposed Councilman Cohen's bill # 020309 on the grounds that it would not likely increase employment for those who need it most—the unemployed.

Mr. Nicholas emphasized that we can best serve social justice **and expand the tax base** at this time by creating jobs for the unemployed. Redirections in public spending could help by channeling **additional** funding into effective job-creation programs and services as a way to **generate** more jobs. For instance, the state and the city **could** reduce the emphasis **on** building prisons and maintaining prisoners at a cost of \$40,000 a year for each prisoner, and instead **place an emphasis on** economic development via public service provision.

Stephen Herzenberg, Director of the Keystone Research Center, spoke next. His research has led him to conclude that Pennsylvania has one of the most inequitable state and local tax structures in the United States. Mr. Herzenberg emphasized that the primary way to redress Philadelphia's position in this inequitable tax system is by increasing state aid to the City. In turn, the only feasible way for Philadelphia to receive more state funding is for Pennsylvania to raise more revenue. To raise more revenue, the state must: (1) close corporate tax loopholes, (2) broaden the sales tax base, and (3) raise the income tax base.

In a February 25, 2003 report, the Keystone Research Center (KRC) revealed that 82 percent of the corporations doing business in Pennsylvania pay nothing under the state's Corporate Net Income Tax (CNI). The report also revealed that 63 percent of corporations doing business in Pennsylvania pay \$300 or less under the CNI and the Capital Stock and Franchise Tax (CSF) combined. Corporate taxes are projected to contribute 18 percent of the state's General Fund in 2002-03, while consumption and personal income taxes contribute 39 percent and 34 percent respectively. Yet, if the CNI and CSF were fully enforced, the proportion of state revenues coming from business taxes would be considerably higher. Over a ten-year period, there has been a steady decline in the contributions of corporations to Pennsylvania's General Fund from 26 percent to 18 percent, while there has been an increase in the amount of contributions by individuals from 67 percent to 73 percent. The decline in corporate taxes is due in no small part to growing laxity in enforcement in the face of corporations increasingly using creative accounting techniques to avoid the taxes that they are required to pay. While tax inequity among citizens has increased, corporations are becoming less responsible for

paying their legislated share. To add insult to injury, the General Assembly has in recent years lowered the CNI rate, and has begun to phase out the CSF.

Mr. Herzenberg did not specify exactly how the sales tax base should be broadened, but this is an area where additional revenue could be garnered. Attention needs to be given to ensure that this is done in ways that also builds in more equity as well. Simply increasing revenues is not going to be productive if it also increases inequity, especially given the growth in inequity in the overall tax system in recent years.

Mr. Herzenberg provided detailed evidence indicating that Pennsylvania's personal income tax is the lowest in the country and given its place in the overall tax system, it should be increased. Mr. Herzenberg suggested that with a lower CNI Tax and the gradual phasing-out of the CSF Tax by 2010, the State must find alternative tax sources and when it does, these sources should promote greater equity in the tax system overall. One logical place for building greater equity while replacing lost revenue is the income tax. Building in progressive tax rates to the income tax could be a good beginning to both replacing lost revenue and increasing equity in the system overall.

Edward Schwartz, President of the Institute for the Study of Civic Values, and a Tax Reform Commission member, went next. He agreed with Henry Nicholas that spending priorities are a legitimate issue, for instance, the expenditure of 36 percent of the city's budget for the criminal justice system. He also emphasized that a good case could be made that the city wage tax is too high to be competitive with the suburbs for businesses and jobs. He expressed concern however about then relying on real estate taxes to substitute in part because of inequities in that tax and how it is administered in the City.

Mr. Schwartz identified real estate taxes as regressive and that this inequity was compounded by a highly problematic system for assessments. He suggested that any city wage tax reduction be accompanied by real estate tax reform. Mr. Schwartz addressed the issue of a "land tax" as a substitute for the real estate tax. Whereas a real estate tax assesses property in terms of its developed value (especially in terms of the structure built on the property), the land tax taxes the value of land according to its location and market value. A major effect of a shift to a land tax would be to discourage land speculation in marketable parts of the city. This would reduce the incentive for speculators to sit on undeveloped properties paying almost no taxes while they wait for a buyer to purchase a plot in a prime location.

A land tax would encourage development and spread the tax burden more equitably across all parcels in the City. It would also encourage the rehabilitation of existing structures or the replacement of dilapidated buildings. It would tie the tax rate to the market value of the property. Parcels in prime locations would pay higher rates than in less desirable neighborhoods. Most plans for a shift to a land tax suggest it would lower property taxes for homeowners who have already developed their land and it would raise taxes for speculators and those who are not developing their properties. Yet, the major advantage of the land tax is its simplicity of administration. Gone would be subjective assessments regarding the value of development on a property. Given that the system of assessments in Philadelphia has been plagued by continued problems especially regarding multiple forms of inequity, this would be a major improvement.

Additional reasons to consider reform of the property tax system along with cuts in the wage tax came from Joe Savage Jr., Interim Director for Blueprint to End

Homelessness. He is concerned with the impact of raising property taxes on those individuals and families who are barely able to meet all of their financial obligations. A rise in property tax will affect homeowners with mortgages, and renters for whom any tax increase will be reflected in their monthly rent bill. Mr. Savage emphasized that many families are close to losing their housing and that tax increases are a contributing factor.

Donna Cooper, Chief of Policy for Governor Ed Rendell and former Executive Director of Good Schools Pennsylvania, spoke after lunch at the conference. She is concerned with equitable and just funding for all school districts in Pennsylvania. She stressed that in our federal system it is the state's responsibility to ensure that each child has access to the opportunity to receive a quality education. She also noted that the State's share of the City's school budget has dropped precipitously over the last two decades. She reminded the conference attendees that most school districts are mainly funded through local property taxes, increasingly so. This is an ominous trend. Affluent communities are able to have a property tax base that can raise funds to ensure quality education, whereas poorer communities are unable to shoulder the tax burden that would be necessary to have schools that are on par with affluent communities.

Ms. Cooper believes there should be a shifting in taxes to support schools throughout the state with more revenues redistributed based on the needs of the individual school districts. Districts like Philadelphia, with higher levels of poverty, have not only a lower tax base but also greater student needs. Therefore, funding needs to compensate for the resulting revenue/expenditure mismatch if we are to ever achieve equity in school financing. Ms. Cooper feels that additional school revenues for districts like Philadelphia can be raised by increasing the Pennsylvania's personal income tax,

which, as was emphasized several times by several speakers at the conference, is one of the lowest in the country.

Shelly Yanoff, Executive Director of Philadelphia Citizens for Children and Youth, underscored the importance of Donna Cooper's comments. Simply cutting taxes will not improve the economic condition of the City if it results in reduced funding for the schools. Ms. Yanoff feels that many taxpayers leave Philadelphia because of the low quality of our schools, and that families will not move to Philadelphia if the schools continue to fail to provide good quality education. Business is likely to relocate elsewhere as well if the City's schools remain underfunded.

The attendees of the conference were given an opportunity to discuss the presentations in breakout sessions and were instructed to make recommendations for tax reforms, which would be forwarded, to the Tax Reform Commission. The following are their major recommendations:

?Institute uniform, accurate, and fair assessments on all real property, especially commercial and business properties.

?Require more accountability by the Board of Revision of Taxes to make sure that businesses in Philadelphia pay their fair share of the taxes they are currently required to pay.

?Rescind selected property tax exemptions for businesses.

?Revise wage and property taxes to better reflect people's ability to pay.

?Require certain non-profit organizations such as hospitals and universities to pay real estate taxes.

?Institute a land tax in the City.

?Use a statewide land tax system for redistributing revenue across schools districts.

?Lobby the State Assembly to make income, sales, excise and property taxes more progressive and equitable for all state taxpayers.

?Lobby the State Assembly to close the corporate tax loopholes, assess the corporate net income tax uniformly, and rescind the phase-out of the capital stock and franchise taxes.

?Educate the citizens of Philadelphia about the tax system and the disbursement of city funds.

The issue of tax inequity in Philadelphia is longstanding but it is also timely. The City is poised to reform its tax system. Concerns about loss of business, jobs and taxpayers are at the forefront. Pressure has been building to cut taxes to attract and retain employers and the middle class. Yet, as the foregoing suggests simply cutting taxes may increase inequities and in the long run also undermine efforts to improve the economic vitality of the City. The win-win strategy is to increase tax equity and improve the attractability of the City at the same time. Thinking all the lines recommended by the conference attendees is a good place to start. In the end, Philadelphia can have more social justice even as it promotes economic growth.