

Testimony before City Council Hearings on Bill #020436

November 13, 2002

Good afternoon, Madam President and Members of City Council.

I am Robert Hornick, CPA. I am chairman of the Pennsylvania Institute of Certified Public Accountants (PICPA) Greater Philadelphia Chapter Committee on Local Legislation and Taxes. With me today are my colleagues Michael Toklish, CPA, and Matthew Melinson, CPA; both of whom are members of our committee and have a wide range of experience with what we are discussing here today: Philadelphia's Business Privilege Tax.

Let me first state that our committee can be relied on to support legislation that is good for our clients, good for our profession, and good for our community. I want to underscore that it is the policy of the Pennsylvania Institute of Certified Public Accountants and the American Institute of Certified Public Accountants – the national organization to which many of our members belong – to strive for tax simplification, wherever possible.

I would like to compliment City Council on the recent support that they have given to continuing City Wage Tax reductions and supporting business-friendly legislation in general. As Philadelphia continues with its tax restructuring accomplishments, the city will be recognized as more and more business-friendly. That is a big step forward.

With regard to the issue being discussed here today, our committee strongly supports changing the present Business Privilege Tax (BPT) income apportionment formula, which is based on the location of property, payroll and sales, to a single factor formula based on sales only. In fact, we have been meeting with various public officials and supporting this change for almost two years now. This change would be in

accordance with a nationwide trend among states and cities.

Today, I would like to:

- (A) Restate and describe the problem
- (B) Provide a suggested solution
- (C) And explain why the suggested solution will work and be most effective.

(A) The problem

The current tax climate in the City of Philadelphia is unattractive for companies that are considering where to locate their operations. While taxes may not be the sole factor considered in businesses' decisions regarding location, they clearly play an important role. The BPT is widely perceived by businesses to be among the most onerous of Philadelphia's taxes. Modifying the current BPT apportionment formula in the manner we suggest would be an important step in changing the perceived and actual tax disadvantages of locating within Philadelphia.

Let me give you an example to help everyone understand. Let us look at two identical businesses, one located within Philadelphia and the other located outside the city. Each business is exactly the same in the three factors--property, wages, and sales-- that are considered for the BPT income allocations. Under the present apportionment formula, the business located in Philadelphia will pay a greater amount of BPT tax than the identical business outside the city. That fact is illustrated on the attached page (Schedule I).

The disadvantage caused by this inequity encourages Philadelphia businesses to move out of the city. It discourages businesses from considering locating in Philadelphia. In instances of firms with offices both inside and outside of Philadelphia, it promotes a policy of keeping work associated with new business outside of the Philadelphia office and actually moving work to the suburban office.

The BPT formula, as it stands today, is a relic of our city's proud industrial past. But that formula is now ill-suited for our service-based economy of today, and it is impelling businesses to exit the city as a result.

(B) The suggested solution

The solution to this problem is to level the playing field, so businesses inside and outside the city with identical business factors will pay the same amount of tax. This can be accomplished by changing the current BPT apportionment formula to a single-factor formula. Again, let me refer to the illustration attached, which shows how the two almost identical businesses fair under the proposed single-factor formula. You will note that with the single-factor formula, each business

pays the same tax, as you would expect if a level playing field is created for all businesses, whether they are in or out of the city.

(C) Why the suggested solution will work and be most effective

The change to a single-factor formula provides a strong incentive for existing businesses to remain here and an incentive for businesses to locate here. Putting the single-factor formula into effect means that in-city businesses will pay less tax and out-of-city businesses will pay more tax relative to what they are currently paying. That raises the question of whether the city would net more or less tax as a result of these offsetting increases and decreases. According to the Philadelphia Department of Revenue, which has worked with us in studying this issue, the net tax change is projected to be an annual net loss of about \$11 million dollars in taxes. This projected loss is a result of about \$19 million dollars less in tax revenue from Philadelphia-based businesses and about \$8 million dollars more from outside-Philadelphia businesses.

What has not been put into the mix is a projection of how many businesses will be kept in the city and how many new businesses will be attracted into the city. Those potential gains and losses are more difficult to project with any certainty.

More certain, however, is that if Philadelphia keeps and attracts businesses, those businesses not only will pay BPT, but also City Wage Tax, real estate tax, sales tax, and Use and Occupancy Tax, as well as spend money locally on the needs of the business and employees.

The proposed single-factor formula change will also simplify the BPT. It will reduce the amount of time and effort that is expended by a business and its professionals to prepare a BPT tax return. In addition, upon audit by the city, there would be easier documentation and verification.

Philadelphia businesses regularly consider the costs they incur in doing business within the city limits. The way the BPT is currently structured throws the equation out of kilter. Businesses run the numbers and clearly see that they will have significant tax savings by relocating outside Philadelphia. That fact is made crystal clear by the example we have presented. Businesses vote with their feet. And because they see that they can save by moving, they leave the city. Michael Toklish was recently involved with just such a consideration for a substantial company presently located in the city. Quite a number of other large businesses in Philadelphia are currently doing the same type of study, as many major 30-year leases in Center City will expire within the next two to five years.

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Often we CPAs are consulted to identify new business locations. Matthew Melinson, for instance, gets calls on a regular basis inquiring about the tax costs of doing business in Philadelphia. For businesses that have a choice, right now we generally cannot recommend Philadelphia as a site for a new business location. We certainly would prefer the City of Philadelphia to be a prime candidate for new business locations. If we can attract and maintain businesses because Philadelphia adopts business-friendly tax laws, of course the result will be a positive flow of tax revenue, jobs, and everything else that cascades from those.

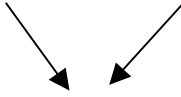
However, it is important to understand that, while we strongly support the change to a single factor apportionment formula, we cannot support Bill 020436 in its present wording. The current wording can create a “tax elite” by allowing large multi-location business taxpayers to easily manipulate the interpretation of the present wording and avoid paying thousands or even millions of dollars in BPT taxes. It could also allow the City to incorrectly tax certain other taxpayers more than it otherwise should. Specifically, the “cost of performance” language should be removed in order to avoid this problem. We could then support this Bill.

In conclusion, I wish to state that we believe that changing from the current apportionment formula to a single factor formula based on sales will significantly help the City of Philadelphia retain and attract business. This change is a vote of confidence for business development in Philadelphia, and it holds forth the potential of a more business-friendly tax environment. We urge you to make this change.

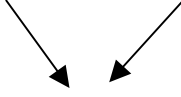
Thank you.

Robert Hornick, Chairman
PICPA
Greater Philadelphia Chapter Committee on Local Legislation and Taxation

Three Factor Apportionment

	In-City Business	Out-Of-City Business
Sales In City	70%	70%
Payroll In City	100%	5%
Property In City	100%	0%
Average % (Weighting Sales Twice)	85%	36%
Net Income	\$1 Million	\$1 Million
Taxable Net Income	\$850,000	\$360,000
Tax @ 6.5%	\$55,250	\$23,400
Total Taxes Paid To City	 \$78,760	

One Factor Apportionment

	In-City Business	Out-Of-City Business
Sales In City	70%	70%
Net Income	\$1 Million	\$1 Million
Taxable Net Income	\$700,000	\$700,000
Tax @ 6.5%	\$45,500	\$45,500
Total Taxes Paid To City	 \$91,000	

Schedule I