
THE STERLING ACT: A BRIEF HISTORY

INTRODUCTION

As the City of Philadelphia approaches the new millennium, the Mayoral election poses a number of challenges before the electorate. Issues such as education reform, crime, and population trends lie atop candidates' agendas. Another issue of prime importance is the local income tax climate within the Greater Philadelphia region. The City of Philadelphia currently imposes residential and non-residential income tax rates of 4.84 and 4.208 percents, respectively. From its inception in 1939, the wage tax has grown considerably. The levy is now the city's single largest revenue provider.

Despite the wage tax's revenue generation capacity, the levy has inadvertently weakened the region's economic health. In addition to federal transportation and housing policy, technological advance, and a decline in the city's manufacturing base, imposition of the city wage tax has contributed to a steady population decline within Philadelphia's borders. In 1950, the city's population totaled 2,071,605. By 1996, the population had dwindled to 1,478,002.

Although urban population decline has been a national phenomenon, studies have linked wage tax increases to a decline in jobs, and ultimately residents within Philadelphia. For example, a 1992 study by Professor Robert P. Inman of the University of Pennsylvania attributed a loss of 100,000 jobs since 1966, to the city wage tax. He also demonstrated that a 20 percent increase in the city's average wage tax rate would lead to the loss of approximately 80,600 jobs.¹

Meanwhile, as the population has flocked to the suburbs, surrounding municipalities have been forced to increase service provision. Due to limits imposed upon their income taxing authority, local

jurisdictions have turned to property tax increases in order to meet the demands of these growing constituencies. The sum of Greater Philadelphia's various tax inequities is a great deal of intra-regional economic disparity, as well as limited economic growth when compared on an inter-regional basis. In order to understand why Greater Philadelphia's patchwork tax climate exists in its current state, its needlework must first be unwoven.

One of the major blocks upon which the current tax structure rests is the Sterling Act (P.L. 45). The first version of P.L. 45 stated:

From and after the effective date of this act, the council of any city of the first or second class shall have the authority by ordinance, for general revenue purposes, to levy, assess and collect or provide for the levying, assessment and collection of such taxes on persons, transactions, occupations, privileges, subjects and personal property, within the limits of such city of the first or second class.

Passed in 1932, the Sterling Act effectively conferred Philadelphia and Pittsburgh with the authority to impose taxes on a variety of conditions so long as they are not "now or hereafter become subject to a State tax or license fee."² The Sterling Act was also the first local income tax enabling legislation in the Commonwealth's history. The amorphous manner in which the Sterling Act was written has provided opponents and proponents of the legislation with a great deal of interpretive and implementation flexibility over the years. In addition to the Sterling Bill, a number of other forces have helped shape Greater Philadelphia's local income tax structure. In particular, one must examine three formative factors on a time series basis:

- 1) State government actions/legislation
- 2) City government actions/legislation
- 3) Court cases and decisions

This paper seeks to discern the various movements and decisions in these three areas

¹ Inman, Robert P. "Can Philadelphia Escape its Fiscal Crisis with Another Tax Increase?" Business Review: Federal Reserve Bank of Philadelphia Sep./Oct. 1992, pg. 5 - 20.

² P.S. § 15971 et seq.

which have led to the current application as well as the net-effects of local income tax policy within Greater Philadelphia. Legislative action and court decisions will be analyzed by decade in order to understand how the public sentiment towards local taxing authority and its related legislation have changed over time.

THE 1930'S

In 1932, Pennsylvania was mired in the depth of the Great Depression. Government at all levels was facing increasing budget deficits; increasing unemployment and decreasing tax revenues. In the spring of 1932, Representative Sterling of Philadelphia introduced House Bill 214 that served as the initial basis for what would become P.L. 45. According to transcripts of the debate at various points, Councilman Harry J. Trainer of Philadelphia conceived the original idea behind the Sterling Act. Trainer, as well as other supporters of the bill, believed that conferring the power to tax to Philadelphia and Pittsburgh would allow the cities to alleviate many of the problems emanating from the depression. On July 23, 1932, Senator Salus (Philadelphia) stated, "I believe it [the Sterling Act] is the salvation of Philadelphia, and that we will be able to take care of our poor; and the one man to whom we all ought to be thankful is Harry J. Trainer of Philadelphia."³

The original version of Sterling's bill intended to allow first class cities, second class cities, and boroughs the taxing powers as stated by the legislation. By the time the bill arrived at the Governor's desk, taxing authority was limited only to first-and second class cities. In 1932, as is the case now, Philadelphia was the state's only first class city; Pittsburgh was the only second class city. Although it is difficult to complete the thoughts and debate that circulated at the time, it is possible to infer, based upon population distributions, that the Harrisburg power structure in the 1930's rested in the hands of Philadelphia and Pittsburgh legislators. As a result, they may have possessed the authority and numbers to restrict the application of the Sterling Act to first and second class cities. The bill received almost

unanimous support as it moved through its various stages. On August 5, 1932, Governor Pinchot signed the Sterling Act into law. The legislation was signed with a three-year sunset provision applicable to second class cities.

The Sterling Act's passage occurred without a great deal of fanfare. The bill was only one aspect of the Governor's 14-point harmony program - an all-encompassing series of legislative acts designed to alleviate budgetary problems that had plagued Philadelphia's government for several years. Nevertheless, alert Philadelphia City Council members immediately recognized the taxing potential. According to the August 6, 1932 *Philadelphia Bulletin*, "Council leaders intend to take advantage of this authority at once, to formulate a program that will produce sufficient revenue to offset the huge and growing deficit in the budget...to obtain money to help the unemployed." At the time, tax proposals ranged from levies on clinical service at city hospitals to taxes on hot-dog stands.⁴

By November of 1932, the first version of a city wage tax was introduced to a great deal of opposition. The initial legislation was crafted by the City's Chamber of Commerce in order to compensate for a foreseeable \$20 million deficit in the 1933 city budget. The proposal, which would have imposed a 0.5 percent payroll tax on "the gross earned income of every person residing or employed or engaged in business...within the territorial limits of Philadelphia", was met by fierce hostility from citizens, particularly labor groups. As a result, the City Council unanimously (by a vote of 17-0) killed the legislation on November 14, 1932. According to Bernard Samuel, Finance Committee Chairman, the bill was "buried so deep, you won't find it in 10,000 years."⁵

The Chairman's warning did not last as long as intended. In 1937, the idea of a city wage tax was reintroduced. The city's budget difficulties were lingering and still growing. Based upon the proposal's initial failure in 1932, legislators rewrote the bill to make it more politically feasible.

³ Pennsylvania Legislative Journal, July 23, 1932, pg. 665.

⁴ Wiegand, Harold. "Tax Plans Made by City and State." *Philadelphia Bulletin* 6 Aug. 1932.

⁵ "Wage Tax Dead; Council Votes 17-0 to Bury it." *Philadelphia Bulletin* 14 Nov. 1932.

This time, the tax was extended to those who earned a living within Philadelphia but lived outside the city borders. This addition, combined with the dire need of financial rescue, made the 1937 legislation a more palatable option for legislators and citizens alike. Councilmember Edward A. Kelley declared, “In principle, such a proposal is a fair and equitable means of raising necessary additional revenue, and about 200,000 non-residents who earn their living here would pay a pro rata share of the cost of Philadelphia government.”

The city’s first wage tax imposition of one and one-half percent was finally approved (17-3 vote) on December 13, 1939 and Philadelphia became the first city in the nation to impose an income tax.⁶ According to newspaper articles, wage tax supporters in academic and legislative circles intended the tax to be a temporary measure.

THE 1940’S

The 1940’s were the beginning of a wave of legal

wage tax. At the same time, the city was profiting immensely from the newly imposed levy. In 1940, the city collected over \$16 million in revenue at a 1.5 percent rate. Chart 1-A demonstrates that revenues actually increased through the 1940’s, despite a rate decrease.

The Philadelphia wage tax was an innovative and highly productive revenue generation mechanism. In the October 6, 1942 edition of *Citizen’s Business*, the Pennsylvania Economy League wrote, “it [wage tax] reaches, as perhaps nothing else could, that large group of persons who earn their living in the city, but live beyond its borders. There is a growing feeling that some way must be found by our large cities to make these non-residents share in meeting the cost of government of the communities in which they earn their living.”⁷ The wage tax had also helped the City of Philadelphia balance its budget.

While Philadelphia was enjoying the fruits of the newly imposed levy, outside interests were mounting campaigns to reduce or eliminate the city’s wage taxing power. The Camden County

Chart 1-A - City of Philadelphia General Fund Revenues, Expenditures; General Property Tax & Wage Tax Revenues (1940 - 1995)

Fiscal Year	General Fund Revenues (\$1,000)	General Fund Expenditures (\$1,000)	General Property Tax Revenue (\$1,000)	Wage, Earnings & Net Profits Tax Revenue (\$1,000)	Wage, Earnings & Net Profit Tax Rate (%)
1940	NA	NA	NA	16,283	1.5
1945	NA	NA	42,600	22,430	1.0
1950	NA	NA	50,305	37,542	1.25
1955	165,544	161,099	63,272	50,189	1.25
1960	216,408	219,594	84,538	70,934	1.5
1965	271,918	278,880	99,593	90,869	1.625
1970	462,481	459,165	112,372	212,067	3.0
1975	698,665	725,453	107,985	302,295	3.3125
1980	1,123,674	1,085,652	202,171	557,933	4.3125
1985	1,586,048	1,477,040	228,336	745,500	4.96 *
1990	1,925,118	1,833,960	314,051	927,554	4.96
1995	2,143,048	2,039,329	339,534	847,527	4.96

and legislative challenges against Philadelphia’s

Board of Freeholders, Camden County Mayors

⁶ “Tax on Earnings Passes 17 to 3.” *Philadelphia Bulletin* 13 Dec. 1939.

⁷ “To the Credit of the City’s Earned Income Tax.” *Citizen’s Business* 6 Oct. 1942: No. 1585.

Association, and the Wage Tax Protest League all began drives in the early 1940's to repeal Philadelphia's wage tax application to residents of other states.

Philadelphia's Mayor Samuel refused to concede to the argument that implied "taxation without representation." and the New Jersey drive faced defeats on a number of ends. In 1943, Howard Kiker, a New Jersey resident who worked at the Philadelphia Naval Yard, filed suit against the City of Philadelphia on the basis of the constitutionality of the tax. The Pennsylvania Supreme Court ruled that "the income tax ordinance of the City of Philadelphia as applied to New Jersey resident employed by federal government at Philadelphia Navy Yard on League Island is not unconstitutional as depriving him of property without 'due process of law' on theory that he received no benefit or protection from city where all benefits of facilities of Philadelphia were legally available to him."⁸ The U.S. Supreme Court would later refuse to hear appeals filed by the Wage Tax Protest League on two occasions.⁹ The embattled New Jersey residents were rendered to a state legislature resolution, which called for Congress to enact legislation to prevent Philadelphia from levying the wage tax upon New Jersey residents.

A number of internal movements within Pennsylvania also waged a losing war against the Philadelphia wage tax in the 1940's. Philadelphia Councilman Eugene J. Hagerty introduced a bill to reduce the wage tax rate to 1 percent. The bill failed to reach the Council floor by a vote of 16 to 3.¹⁰ In 1942, the Pennsylvania Superior Court upheld a ruling by Municipal Court Judge Joseph G. Tumolillo in Schaller-vs. -City of Philadelphia, which affirmed the City's authority to impose the wage tax on federal employees. The Pennsylvania Supreme Court upheld the ruling as well.¹¹ In March of 1943, the Pennsylvania House of Representatives debated House Bill 16 - "an act

prohibiting any political subdivision from imposing any wage income or occupation tax on non-residents." On March 15, the bill failed by a vote of 108 - 73.

Opponents of the bill asserted that Philadelphia was providing a favor to non-residents through provision of high-income jobs and payment of the wage tax was one, small method of retribution. For example, Representative Salus (Philadelphia) stated, "They [Main Line residents who work in Philadelphia] are by far in the majority the ordinary worker. They can well afford to pay this tax if they want to receive the high pay they get in Philadelphia, and the conditions we have in Philadelphia... The proportion of taxes paid by the surrounding counties to the city of Philadelphia is so small that they ought to be happy and contented to make their small contributions to make this arsenal of American a successful, financial city and save it from going into the red."¹² Despite failed attempts to change aspects of the Sterling Act, legislators circumvented Philadelphia's income tax authority by passing another formative income tax bill.

In order to fully understand local income tax policy with respect to the Southeastern Pennsylvania region, the 1947 "Tax Anything Act" must be taken into consideration. On June 25, 1947, Governor Duff signed Act No. 481 into law. Act 481 empowered "cities of the second class, cities of the second class A, cities of the third class, boroughs, towns, townships of the first class, school districts of the second class, school districts of the third class and school districts of the fourth class to levy, assess, and collect or to provide for the levying, assessment and collection of certain additional taxes subject to maximum limitations for general revenue purposes."

Act 481 provided most municipalities within the Commonwealth the same taxing powers that were conferred upon Philadelphia via the Sterling Act. The purpose of this bill was to provide local governments with greater tax collection equity. At the time of passage, the Governor stated, "Real estate in most local communities of

⁸ Kiker v. City of Philadelphia. 31 A.2d 289, 346 Pa. 624 (1943).

⁹ "Wage Tax Fight Expanded." Philadelphia Bulletin 31 Dec. 1943.

¹⁰ "U.S. Test of City Wage Tax Sought." Philadelphia Bulletin 17 Apr. 1942.

¹¹ "Wage Tax Ruling Appealed." Philadelphia Bulletin 6 Apr. 1942.

¹² Pennsylvania Legislative Journal, March 15, 1943, pg. 846.

Pennsylvania has borne almost the entire cost of government. In many communities, real estate represents only a portion of the value of the property in the community.”¹³ The legislation also explicitly provided municipal governments with the power to tax non-residents.

One portion of Act 481 would later come to play the most significant role in shaping tax disparities between Philadelphia and its surrounding suburbs. It stated the following:

Payment of any tax to any political subdivision pursuant to an ordinance or resolution passed or adopted prior to the effective date of this act shall be credited to and allowed as a deduction from the liability of taxpayers for any like tax respectively on salaries, wages, commissions, other compensation or on net profits of business, professions or other activities and for any income tax imposed by any other political subdivision of this Commonwealth under the authority of this act.

At the time of Act 481, Philadelphia was the only city with the authority to impose a local income tax. Act 481 exempted non-residents of Philadelphia who paid the Philadelphia wage tax from paying the wage tax respective to their area of residence. This essentially neutralized the revenue generation potential of Philadelphia’s surrounding communities since most employees were still subject to the Philadelphia wage tax. It is conceivable that inclusion of Philadelphia’s pre-emption within the “Tax Anything Act” became the basis for some of the suburban-urban antagonism that has existed in the Greater Philadelphia region. Until major employers began transplanting in Suburban counties, Philadelphia’s neighbors had relatively insignificant income tax bases.

Thanks to a rising tide of new taxes, opposition to the “Tax Anything Act” began to mount in the late 1940’s. Senator G. Robert Watkins (R - Delaware County) introduced an amendment to exempt non-residents from the wage levies of any

state municipalities except Philadelphia.¹⁴ Although Watkins proposal initially failed, a number of amendments to the “Tax Anything Act” were passed in 1949. The most important amendments were:

- 1) A one- percent cap on wage tax levies
- 2) A ban on non-resident wage taxes applicable to second, third, and fourth class school districts

The one- percent cap would later lead policy experts and civic leaders to call for Philadelphia to reimburse surrounding counties one percent of wage taxes collected from non-residents. The cap has also imposed difficulties upon suburban municipalities with expanding populations. At a time when greater funds are required to pay for increasing service demands, property tax rate hikes are the only conceivable revenue generation mechanism for many municipalities.

Despite the opposition and limitations imposed upon the bill, the popularity of wage taxes spread throughout the state. By 1951, 250 political subdivisions were levying a municipal income tax.¹⁵ Opponents of the Philadelphia wage tax gained a victory in 1949 as Common Pleas Court No. 1 ruled that Philadelphia could not extend the wage tax to investment profits. The basis for Judge Kun’s ruling was that the wage tax is “not a general income tax” and is limited to wages and net earned profits from the operation of business.¹⁶

THE 1950’S

The 1950’s continued to be a time of turmoil for Pennsylvania taxing municipalities. Although no major legislative changes were implemented, the Pennsylvania House of Representatives again attempted to repeal the non-residential wage tax provisions authorized by the Sterling Act and Act 481. This repeal attempt stalled and died in Senate committee as did a suburban-sponsored

¹⁴ “Local Tax Bill Facing Fight.” Philadelphia Bulletin 23 Apr. 1949.

¹⁵ “250 Political Subdivisions in State Levy Income Tax.” Philadelphia Bulletin 25 Sep. 1951.

¹⁶ “Court Rules Out City Tax on Investments.” Philadelphia Bulletin 9 May 1949.

¹³ Roberts, A. H. “Home Tax Powers Won’t Make a Hit with Local Officials Seeking Re-Election.” Philadelphia Bulletin 29 Jun. 1947.

attempt to allow Philadelphia suburban municipalities to lay claim to the first one percent of the Philadelphia wage tax.

The most significant court ruling of the 1950's was *Lefferts-vs. -City of Philadelphia*. The decision stated that Section 15971 "does not empower the City of Philadelphia to levy a tax on that portion of the gross income of persons engaged in a profession in Philadelphia received for services rendered outside Philadelphia."¹⁷ The implication meant that work hours within and outside city limits would be recorded separately in order to determine the proper taxable income amount.

The 1950's also heralded the first signs of Philadelphia's economic decline. The boom years of World War II were now long gone, and the city began to fail to meet projected wage tax revenue estimates. In 1956, Mayor Dilworth proposed a .5 percent wage tax increase. The *Philadelphia Bulletin* cited the city "using huge operating surpluses in recent years to expand its services" as the need to increase the wage tax rate.¹⁸ With the potential of surpluses diminishing each year, the city sought rate increases as a method of maintaining the general budget. In 1957, the wage tax increased from 1 1/4 percent to 1 1/2 percent.

THE 1960'S

In the 1960's, the Philadelphia wage tax grew in leaps and bounds, as tax supporters continued to score legislative and legal victories. In 1960, Mayor Tate called for further increases in the wage tax rate. The Mayor, who originally sought another .5 percent increase, was able to negotiate a .2 percent add-on in 1961. At the same time, the city also began to vigorously pursue delinquent wage tax collections from non-residents. The city expected to recoup over \$1 million in lost revenue through strict enforcement.¹⁹ The city continued

to defend the wage tax from the point of view that it was the only equitable means of properly funding a rapidly growing city bureaucracy. In 1965, in defense of wage tax increases, Mayor Tate stated,

*"The growth and redevelopment of our cities to keep pace with modern demands and to serve all the citizens requires fiscal programming of the most far-seeing kind. In Philadelphia's comprehensive fiscal planning, the success of the wage and earning tax is a vital factor."*²⁰

The state continued to be active as well. In 1961, the legislature passed an amended version of the Sterling Act. Although application of the act to second class cities was already moot due to the sunset clause, Governor Lawrence signed a version that omitted any reference to second class cities. The Governor further eased Philadelphia's collection concerns by signing a bill permitting state agencies to directly withhold wage taxes from employees within city limits. The tax revenue would then be remitted to the city. In the past, Philadelphia attempted to collect taxes directly from individuals. The state also passed an amended version of Act 481 in 1965. Act 511, the "Local Tax Enabling Act", reconferred the taxing authority granted through the "Tax Anything Act" while mandating that employers automatically deduct wage taxes from the payrolls, and remit the money to the taxing authority.

There appears to have been very little concern at the state or local level about the economic distortions caused by the wage tax. On September 29, 1961, the *Philadelphia Bulletin* wrote, "There is always the danger of pegging the wage tax at so high a rate that it would drive small businessmen and professional people out of the city. But no one expects it to go that high."²¹

State legislators opposed to the wage tax, continued to seek limits on Philadelphia's taxing authority. By the 1960's, the Pennsylvania House had institutionalized a perennial tradition of

¹⁷ *Lefferts v. City of Philadelphia*, 88 D. & C. 345, (1954).

¹⁸ "Mayor's Plan for Tax Boost Hits Opposition." *Philadelphia Bulletin* 20 Jul. 1956.

¹⁹ "City Expects Suburban Campaign to Raise Wage Tax Yield a Million." *Philadelphia Bulletin* 7 May 1961.

²⁰ "Philadelphia Tax Sets U.S. Pattern." *Philadelphia Bulletin* 7 Mar. 1965.

²¹ "The Wage Tax: Its Revenue Financed City's Rebirth." *Philadelphia Bulletin* 29 Sep. 1961.

introducing legislation to exempt non-residents from wage taxes. During the decade, a bill of this type appeared on numerous occasions including the 1963, 1965 and 1967 legislative sessions - all attempts were to no avail.

Legislators also began to pursue innovative means of limiting the city's taxing authority. In 1967, state legislators introduced two bills to limit the power to tax non-residents. One bill sought a rate cap of one-half the rate imposed upon residents, while the other bill would have repealed provisions of Act 481, which allowed Philadelphia's, wage tax to supersede taxes imposed by surrounding municipalities. The city would instead be required to reimburse the municipality for an amount equal to the imposed tax. The primary supporter of the rate cap bill, Rep. Benjamin H. Wilson (R - Warminster) stated, "The Sterling Act imposes no maximum statutory limit on its wage tax and City Council could conceivably raise it to any limit. On the other hand, the Local Tax Enabling Act, which applies to other municipalities, has a maximum statutory limit and I believe it may be prudent for the General Assembly to enact a maximum for Philadelphia."²² The bill never managed to escape committee, and died as a result of the end of the legislative session. Although the idea was reintroduced by Rep. John Stauffer (R - Chester), a vote to move the bill from the Urban Affairs Committee to the House floor failed by a vote of 104 - 70. The bill, calling for reimbursements to surrounding municipalities, also failed to muster the necessary support.

In the 1960's legislative opposition to the wage tax moved to the federal realm for the first time. With the knowledge of dim prospects, Senator Clifford P. Case (R-NJ) introduced a resolution in the U.S. Senate, calling for a constitutional amendment that would forbid states and cities from levying taxes upon non-residents. At the time, each of the 34 states with income taxes imposed the tax upon non-residents, thus making support difficult to garner. In 1968, Representative John Hunt (R., Pitman), whose district included parts of Gloucester and Camden counties, introduced a bill prohibiting taxation of

non-residents. Hunt's bill suffered a similar fate as Case's legislation.

In 1960, the Philadelphia wage tax rate stood at 1 1/2 percent. By the close of the decade, the rate had increased to 3 percent.

THE 1970'S

In 1975, the *Philadelphia Bulletin* referred to the wage tax as "the most contested local tax in the country."²³ The 1970's became a time of virtual war between the City of Philadelphia and non-resident opponents of the wage tax. - particularly those in New Jersey. In November 1970, Camden Assemblyman Jim Florio (D - Camden) introduced a bill to authorize the state attorney general to challenge the constitutionality of the wage tax. Although prior court rulings had declared the tax constitutional, Florio sought to pursue the case from a different angle. The Assemblyman raised the question of whether it is fair for the city to impose a tax of equal rate upon non-residents even though non-residents do not receive municipal benefits in the same proportion. In March 1971 Governor Cahill ordered the state attorney general to "commence action" against the Philadelphia levy.²⁴ In December, U.S. District Court Judge Mitchel H. Cohen dismissed the suit. In his opinion, Judge Cohen wrote, "Just as industry and business select sites providing favorable tax consequences, so too, should an individual in his selection of his place of employment."²⁵ The suit was not appealed to the U.S. Supreme Court.

The wage tax was embattled on other sides as well. Representative Richard McClatchy (R - 149th Dist.) sponsored the recurring Pennsylvania state legislature proposal to limit the non-resident wage tax in 1971. Like its predecessors, the bill suffered a similar fate. Nevertheless, it was one among several failed bills that shifted the focus from the unsuccessful

²² "Wilson Wants Wage Tax Limit for 2 Cities." *Philadelphia Bulletin* 21 Jul. 1968.

²³ "Bunting Expands on Idea for Five-County Taxation." *Philadelphia Bulletin* 11 Dec. 1975.

²⁴ "State to Join Non-Resident Taxpayer Suit." *Philadelphia Bulletin* 19 Mar. 1971.

²⁵ "Court Rejects Suit on Taxing Nonresidents." *Philadelphia Bulletin* 30 Dec. 1971.

strategy of eliminating the non-resident wage tax, to imposing a rate cap.

In 1973, the state House of Representatives scored a small victory against the wage tax. By a vote of 135 to 54, the House voted to eliminate Philadelphia's power of pre-emption by requiring the city to reimburse surrounding municipalities at a rate equivalent to that which would have been collected from residents of their respective areas.²⁶ Strong opposition in the State Senate nullified any chances of the bill's success though. In the October 17, 1973 *Philadelphia Bulletin*, the State Senate Majority Leader Thomas Lamb stated, "There's no way a bill like that is going to get anywhere here."²⁷

Efforts to limit the non-resident wage tax would eventually prove to be successful. In 1976, Senator Craig Lewis (D - Bucks County) proposed a temporary 3 percent wage tax limit for non-residents. At no time in the future could the rate exceed 75 percent of the rate imposed on city residents. Lewis intended to capitalize on an opportune time, for Mayor Rizzo was pushing for passage of a large tax package that required state approval. Although Lewis' original draft faced strong opposition, a milder version was eventually passed. On December 21, 1977, Savings Clause and Limitations 7359 was passed. The non-resident tax rate could no longer exceed 4.3125 percent until the residential rate reached higher than 5.75 percent. At that point, the non-residential rate could be increased but could not exceed 75 percent of the residential rate. The clause stated,

...the provisions of such ordinance imposing a tax rate in excess of four and five-sixteenths per cent with respect to persons who are not legal residents of such city shall be deemed suspended and without any validity to the extent that such tax rate exceeds the tax rate of four and five-sixteenths per cent on income of such nonresidents. And such excess tax rate provisions shall remain suspended and without validity until such date as the city of the first class, by ordinance, imposes a rate of tax on income of both legal residents and nonresidents

of such city in excess of the tax rate imposition of five and three-fourths per cent per year...such suspension is removed and the rate deemed valid only to the extent the tax rate imposed on income of such nonresidents does not exceed seventy-five per cent of the tax rate imposed by ordinance per year on the income of legal residents...

Congressman John Hunt continued to attack the wage tax at the federal level as well. Hunt's latest attempt sought a 50 percent reduction in non-resident tax rates in Federal areas and a 33.3 percent reduction for non-residents who lived in non-federal areas. The legislation would also credit the non-resident the amount paid in wage taxes to the area of residence income tax. In 1971, the New Jersey Senate adopted a resolution calling for prompt action on Hunt's bill, but once again, the legislation would eventually die.

Despite strong and somewhat successful opposition during the 1970's the Philadelphia wage tax continued to grow. In 1971, Mayor Tate passed a .3 percent increase which brought the effective rate to 3.3125. At the end of the decade, the residential rate was 4.315 percent.

THE 1980's & 1990's

By the 1980's, the majority of formative policy and legislation regarding local taxing authority had been passed. Under the Thornburgh and Casey administrations, statewide "tax reform" became a popular buzzword, and a number of attempts were made to pass comprehensive reform packages.

Governor Thornburgh appointed a task force to examine statewide tax reform. With regard to the wage tax, the task force wrote, "it should be noted that equalizing the extent of nonresident taxation in Philadelphia and other municipalities is not necessarily desirable. Philadelphia may indeed have special attributes and circumstances that would make such equalization undesirable as judged by either the benefit principle or equity criteria."²⁸

²⁶ "House Votes Tax Break for Suburban Towns." *Philadelphia Bulletin* 17 Oct. 1973.

²⁷ Ibid.

²⁸ "Local Non-Property Taxation." *Pennsylvania Tax Commission* Mar. 1981.

The Casey tax reform proposal would have limited the residential and non-residential wage tax rates to 4.5 percent and 3.95 percent respectively. It would have also required the city to reimburse municipalities of residence for employees paying the non-residential wage tax. The reimbursement would have equaled .25 percent of an employee's quarterly income earned within the city.²⁹ The Casey tax reform proposal went down to a crushing defeat in a statewide referendum.

On several occasions, bills were passed by the House or Senate which would have placed caps on non-residential and residential wage tax rates, but these attempts never failed to garner the necessary support of both chambers. For example, in 1982, a measure failed in the Senate that would have reduced the non-resident wage tax rate to 2.9 percent. Senator Vince Fumo (D., Phila.) stated that such a bill would be "devastating" to the local economy.³⁰ The wage tax rate hit its peak in 1983 when it climbed to 4.96 percent for residents of Philadelphia. The non-resident rate remained at 4.3125 percent. This was the first time that a differential would exist between residential and non-residential wage tax rates.

Despite a lack of meaningful legislation, the 1980's were a time of important court actions. In 1981, a Federal Judge dismissed a suit filed by a New Jersey resident that claimed the city discriminated by not applying the wage tax to visiting athletes and entertainers. Judge James T. Giles wrote that the suit failed to demonstrate, "intentional, invidious discrimination."³¹ The City of Philadelphia would later attempt to collect back taxes from a number of visiting athletes. In 1983, Thomas A. Leonard, an independent candidate for Mayor challenged the constitutionality of the new two-tiered wage tax system in Commonwealth Court. Leonard's claim was based on the state uniformity clause which states, "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the

authority levying the tax, and shall be levied and collected under general laws." Judge Crumlish Jr. ruled that the two-tiered tax was unconstitutional. In his decision, Judge Crumlish wrote,

We are of the opinion that the non-resident distinction is without a difference, an artificial one which splits in two the class of wage taxpayers in the City of Philadelphia. In our view, the legislature and City Council have arbitrarily created an unjust burden and have discriminated against those members of a class who, because of an invisible boundary line, live by command or choice within the city's limits.

Despite his ruling, Crumlish refused to order an injunction against collection of the tax. "With regret", Crumlish wrote, "If this court enjoins the collection of the current wage tax, a \$60 million deficit would result, causing an unbalanced budget, and propel the city into a state of fiscal paralysis."³² The case would later be appealed to the Pennsylvania Supreme Court, where Judge Crumlish's decision was overturned. In a 7-0 ruling, the Court claimed that the two-tier tax was constitutional. Justice John P. Flaherty wrote,

The tax scheme in question meets constitutional requirements for there exists the requisite basis for treating residents and non-residents of Philadelphia as separate classes of wage earners subject to different tax rates. The legitimate distinction between those classes rests not upon the superficial fact that one class resides in Philadelphia while the other resides elsewhere, but rather, at a deeper level of analysis, upon significant differences between the two classes of wage earners that provide reasonable and concrete justifications for their being taxed at different rates.³³

In 1994, Councilman Wallace H. Nunn (Delaware County Council) proposed that the County Solicitor examine the possibility of suing the Commonwealth on the grounds that the County cannot tax its citizens in a "fair and modern"

²⁹ "Understanding Local Tax Reform." Local Government Commission Jan. 1989.

³⁰ Roche, Walter F. "Senate Again Defeats Bill on Wage Tax." Philadelphia Inquirer 23 Nov. 1982.

³¹ Cooper, Dick. "Judge Dismisses City Wage Tax Suit." Philadelphia Inquirer 14 Mar. 1981.

³² Eisner, Jane. "Wage Tax is Ruled Illegal - Order doesn't Halt City's 2-level Levy." Philadelphia Inquirer 20 Jul. 1983.

³³ Wilson, George. "Wage-tax Case: Two Opposite Unanimities." Philadelphia Inquirer 12 Apr. 1985.

manner, as prescribed by the 14th amendment.³⁴ The suit would have directly pursued the Sterling Act itself, and the tax preemption that allows non-residents paying the Philadelphia wage tax to obtain a credit against the income tax imposed within the area of residence. The lawsuit was never pursued.

CONCLUSION

In 1940, Mayor Lambertson stated, “We are not wedded to this form of tax [wage]. It is an experiment which gives us a year to survey the field and see if there is some better way to raise the necessary money.”³⁵ 58 years later, the experiment continues. Although the wage tax has undergone a number of legislative and court challenges over the years, it retains an extremely strong presence and constitutes a great portion of the City of Philadelphia’s revenue base. It also continues to force business and jobs to leave Philadelphia’s boundaries, while deterring any meaningful regional answers to economic development issues. Through a historical analysis of the state and local legislative actions as well as court challenges, a number of trends have become apparent:

1) Most court challenges were never filed directly against the Sterling Act or Act 511. Until Councilmember Nunn’s idea of testing the constitutionality of the Sterling Act on the basis of the 14th amendment, lawsuits directly attacked the City Council ordinance that created the residential and non-residential wage tax.

2) The failure of state legislation to impose restrictions upon the Philadelphia wage tax became a regular rite of passage, but opposition seemed to lessen as time proceeded. With an impending loss of representatives due to population loss, the state may revisit this strategy with greater success in coming years.

3) The federal government had very little success in regulating local taxing power and the

Supreme Court appeared to have little interest in involvement with this issue. After the 1970’s, efforts at the federal level to limit local taxing authority were virtually non-existent.

4) Wage taxes and their enabling legislation have been extremely impervious to legal challenges. The best chances for limiting legislation appears to lie within state and local legislatures.

³⁴ Frishling, Bill. “DELCO Mulling Court Challenge to Tax Restriction.” Philadelphia Inquirer 12 Oct. 1994.

³⁵ Binzen, Peter. “The Wage Tax: Past, Present - and Future.” Philadelphia Inquirer 16 Nov. 1987.