



The Road to Tax Reform

THE PHILADELPHIA TAX REFORM COMMISSION

The Philadelphia Tax Reform Commission was created to recommend methods to reduce 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. Take a look at how the Commission suggests Philadelphia reach that goal.

The Abridged Final Report of the Philadelphia Tax Reform Commission

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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.

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 upon 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 upon local communities.

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.

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.

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.

The Commission’s recommendations are firmly grounded in tax and economic theory. 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.



What Would the Recommendations of the Tax Reform Commission Do?

- Totally eliminate the Business Privilege Tax (which is levied on both sales and profits of firms operating and doing business in the city) over the next ten years;
- Reform the business tax, while it exists, to begin to level the playing field between companies inside and outside the city and between incorporated and unincorporated firms, and to help startup firms manage early operating losses;
- Reduce both the resident and non-resident Wage Tax to an equal rate of 3.25 percent by 2014 to encourage larger companies to locate here and end the tax incentive for residents with city jobs to leave;
- Invest at least \$1 million in Greater Philadelphia Urban Affairs Coalition's campaign to help return an estimated \$150 million in annual unclaimed federal and state tax forgiveness credits to Philadelphia families;
- Phase in land-value taxation so that, at the end of ten years, 50 percent of all Real Estate Tax revenues will be generated from a tax on the value of land and 50 percent on the value of structures;
- Reassess property values to reflect 100 percent of property value instead of fractional assessments that contribute to unequal tax burdens among property owners;
- Adopt a budget-based Real Estate Tax system that would obligate the Mayor and City Council to set real estate rates each year after reviewing assessment estimates;
- Create the position of Taxpayer's Advocate to work with citizens on assessment appeals, improve the public's understanding of the process, and review actions of the Board of Revision of Taxes.

We believe these recommendations are fiscally and socially responsible because their incremental nature allows the City to gradually adjust its budget. 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.

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 was 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 Home Rule Charter directed 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.

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.

MYTHS AND REALITIES ABOUT TAX REFORM

MYTH — *Philadelphia can't afford tax reform.*

REALITY — *The City of Philadelphia can afford meaningful tax reform; it cannot afford continued loss of jobs and residents.*

*We have consistently shown the ability to find room in the city budget to fund new initiatives. We found funding for stadium finance and neighborhood transformation. Now we must make tax reform a priority. It may not be easy to reform the city's tax structure, but it is a necessary step if the city is to enjoy a bright future. Maintaining the status quo is a recipe for continued long-term decline. In its report, *Tax Policy, Job Growth & Neighborhood Transformation*, the Central Philadelphia Development Corporation concluded, "If Philadelphia tries to avoid the daunting challenge of restoring competitiveness we will continue to erode the job base that is the foundation for neighborhood stability and municipal services."*

Philadelphia City Controller Jonathan Saidel declared, "Many wonder if the city can afford tax reform. It is clear we can't afford not to do it . . . I can firmly assert that the Tax Reform Commission's proposals are fiscally responsible." (Council of the City of Philadelphia Public Hearing before the Committee of the Whole, Wednesday, February 25, 2004.)

Joseph Vignola, Executive Director of the Pennsylvania Intergovernmental Cooperation Authority — the city's state-appointed fiscal

oversight board — said, "The strength of the Commission's report is that it makes considered attempts to implement these changes while allowing for the current projected growth in the City's Five-Year Plan . . . the Tax Reform Commission's report offers a program for responding to future revenue shortfalls." (Council of the City of Philadelphia Public Hearing before the Committee of the Whole, Wednesday, February 25, 2004.)

Philadelphia's burdensome tax structure drives employers and residents from the city, forcing those left behind to shoulder the burden for the cost of government. Through implementation of incremental tax cuts and changes, the city can gradually adjust the budget and react to changing economic conditions. The Tax Reform Commission was charged with making fiscally responsible recommendations and worked to make sure that its recommendations will not compromise delivery of city services. The Commission's analysis shows that tax reform will create tens of thousands of jobs and hundreds of millions of dollars of investment in communities across Philadelphia. This growth should make tax reform "pay for itself." Any short-term fiscal gaps could be filled through budgetary discipline or the addition of new revenue streams.

By enacting the recommendations of the Tax Reform Commission to eliminate the Business Privilege Tax, reduce the Wage Tax, and reform the Real Estate Tax, we can create a bright future for Philadelphia — truly, we can't afford *not* to.



MYTH — *Tax reform will force the city to cut critical services.*

REALITY — *Philadelphia can reform its tax structure without jeopardizing the quality of city services — in fact, we are already reducing taxes and improving services. For years now, the city has been slowly reducing its taxes while dramatically expanding services to neighborhoods across the city.*

In arguing for tax cuts, former Chief of Staff to Mayor Rendell David L. Cohen testified before City Council that, “It’s not double-talk. You can stabilize staffing levels *and* even reduce staffing levels and you can deliver a higher quantity and higher quality of service to the public of the City of Philadelphia.” (Council of the City of Philadelphia Public Hearing before the select committee on Fiscal Stability & Intergovernmental Cooperation, Tuesday, January 31, 1995.)

Supporting the call for tax cuts, then-Council-President-now-Mayor John F. Street declared, “I think that we can have that kind of discussion that we will be able to get more comfortable with the idea that services are at a level where we can now begin to turn the clock back on some of these taxes. It almost goes without saying that nothing would be better for us, assuming the service level questions get answered, than to be able to say it’s going to cost less to be a resident — either a resident or a business resident of the City and County of Philadelphia.” (Council of the City of Philadelphia Public Hearing before the select committee on Fiscal Stability & Intergovernmental Cooperation, Tuesday, January 31, 1995.)

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MYTH — *Tax reform will not help create jobs and stop the city’s population loss.*

REALITY — *It is possible to pile reports up from the ground to the top of William Penn’s hat to demonstrate that city taxes chase jobs and residents out of the city; reducing taxes will help attract and retain jobs.*

Tax reform is about jobs. If Philadelphia becomes a less expensive place to operate a business, existing jobs will be saved and new jobs will be created. The Tax Reform Commission estimates that its recommendations will create more than 47,000 new jobs in Philadelphia by 2010. By increasing job opportunities in the city, we can encourage people to relocate to and remain in neighborhoods across the city. Like most localities, Philadelphia’s economic fortunes generally depend on the health of the national economy. In the past, however, other places did better than Philadelphia when times were good and less bad when times were not so good. According to the City of Philadelphia’s Five-Year Plan, the gap between Philadelphia employment growth and U.S. employment growth has been cut by nearly 60 percent since the city began to slowly reduce its burdensome taxes.

Wharton School Professor and member of the Mayor’s Council of Economic Advisors, Robert P. Inman has demonstrated how damaging taxes have been for the city. Inman concluded that Philadelphia’s high Wage Tax was responsible for the loss of nearly 100,000 city jobs in recent decades.

When the city has raised taxes to try to meet growing needs in the past, it chased jobs and residents out of the city. But cutting taxes does not have to threaten city services. In its 2001 *Tax Structure Analysis Report*, the City Controller’s Office showed that after the city began to cut its taxes in 1996, Philadelphia finally experienced some job growth and actually increased its tax revenues substantially. It may not be easy to reform the city’s tax structure, but it is a necessary step if the city is to enjoy a bright future. Maintaining the status quo is simply a recipe for continued long-term decline.

By enacting the recommendations of the Tax Reform Commission to eliminate the Business Privilege Tax, reduce the Wage Tax, and reform the Real Estate Tax, we can create jobs in Philadelphia and attract and retain neighbors in communities across Philadelphia.

MYTH — *The best strategy to attract and retain employers is to give targeted tax breaks.*

REALITY — *Tax reform should not be all for some and none for all. We should not try to pick winners. Instead, we should extend the benefit of reduced taxes for all residents and employers.*

In recent years, the city has fostered specific economic activity by directly subsidizing certain firms or by creating targeted assistance programs for certain businesses. But Philadelphia is a large marketplace with thousands of employers and hundreds of thousands of jobs. Bringing a single firm with 1,000 new jobs into the city is just a drop in the bucket when compared to the tens of thousands of jobs that could be created if all Philadelphia employers add one or two new employees.

Instead of trying to pick winners, the city should avoid allegations of favoritism, stay away from the embarrassment of projects that receive government assistance and then fail, and steer clear of programs that reduce taxes for certain taxpayers at the expense of maintaining high taxes for all remaining taxpayers. If targeted tax reform is good for individual employers, then overall tax reform for all should be good for all residents and employers.

By enacting the recommendations of the Tax Reform Commission to eliminate the Business Privilege Tax, reduce the Wage Tax, and reform the Real Estate Tax, we can attract and retain jobs and neighbors and create a sustainable future for Philadelphia.

MYTH — *Tax reform will only help Center City and will do nothing for neighborhoods.*

REALITY — *Tax reform will create jobs and encourage investment in all communities across Philadelphia. Tax reform will benefit all Philadelphians.*

When jobs and neighbors leave Philadelphia, city neighborhoods decline. In its report, *Tax Policy, Job Growth & Neighborhood Transformation*, the Central Philadelphia Development Corporation declared, "Tax reduction and neighborhood revitalization are not polar opposites, but rather two sides of the same coin. Increased business competitiveness is a prerequisite for neighborhood transformation."

Tax reform will increase property values for city homeowners and generate assets that can be used to improve homes and neighborhoods. For most middle-class families, a home is their most significant investment and their most significant asset. Philadelphia residential property values actually rank below lackluster cities like Newark, New Haven, and Hartford. Tax reform will substantially increase property value in Philadelphia.

Every year, the city population drops by thousands of people. This loss leaves neighborhoods across the city diminished and leaves scars of abandonment across the city. Tax reform will create job opportunities that will help attract and retain neighbors. The Central Philadelphia Development Corporation estimates that 44 percent of Center City office workers live in Philadelphia neighborhoods.

By enacting the recommendations of the Tax Reform Commission to eliminate the Business Privilege Tax, reduce the Wage Tax, and reform the Real Estate Tax, we can create jobs and generate investment in city neighborhoods and spread neighborhood transformation throughout the city.

Philadelphia Forward is an organization formed to educate about measures to transform Philadelphia into a vibrant city that is a preferred place to live, work and visit. Its primary focus is to educate and inform citizens and businesses about tax reform in Philadelphia. For more information about Philadelphia Forward or to contribute, please visit www.philadelphiaforward.org.

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