CITY OF PHILADELPHIA
CITY COUNCIL

November 18, 2010

Rob Dubow, Director of Finance
City of Philadelphia
1401 John F. Kennedy Blvd.
Room 1330, Municipal Services Building
Philadelphia, PA 19102

Dear Mr. Dubow:

Further to our meeting yesterday morning, at which you shared the Administration's analysis of the pending business privilege tax (BPT) reform proposal (Bill No. 100635) we are writing to follow-up on several points. We appreciate the time and energy that your staff put into analyzing the proposal. We do, however, want to raise several concerns with the analysis presented, which we have asked the Administration to address prior to the November 30, 2010 public hearing on the bill.

1. Revenue-Neutral Replacement Rate

In the two years we have spent researching and developing this proposal, we repeatedly emphasized how important it is that everyone agree on the numbers and for the discussion to focus on underlying tax policy. Accordingly, we were pleased to learn yesterday how close our numbers and the Administration's numbers are (our proposal was for a top gross receipts rate of 0.0053; your analysis suggests a 0.00577 rate). However, we think the gross receipts replacement rate will not need to be increased above .0053 – and may, in fact, be able to be reduced – if the analysis takes into account the Administration's BPT base growth assumptions included in the FY11-15 Five-Year Plan.[1] We have asked you to calculate the needed replacement rate taking into account the Administration's growth assumptions.

2. Employment Effect

We have some serious concerns about the employment analysis provided. First, the analysis presupposes that 100% of all jobs of all businesses that file a BPT return are Philadelphia-based jobs – no matter where the BPT filer is located – and, thus, that 100% of all employment change related to the proposal would be in Philadelphia-based jobs. This is a completely unfounded assumption and highlights the importance of differentiating the in-city and outside-city effect of the proposed reform, an issue discussed further below. A business located outside of the city – with zero Philadelphia-based jobs – whose taxes would increase

[1] The FY11-15 Five-Year Plan approved by PICA in August includes the following base growth assumptions for the BPT: 0.15% in FY11, 5.5% in FY12, 1.4% in FY13, 1.5% in FY15, and 1.5% in FY15.

under this proposal could not have an effect on Philadelphia-based jobs. We request that the Administration redo the analysis accounting for the number of BPT filers in each sector that are located outside of the city and do not have Philadelphia-based jobs. Based on the structure of the BPT, whereby the net income portion is borne disproportionately by firms located in the city, we expect the analysis will show net job growth in Philadelphia due to the elimination of the net income tax and distribution of the tax burden across a broader base.

Second, as we raised with you yesterday, the Philadelphia jobs data utilized by the Administration in its analysis[2] includes non-profit employers who do not pay the BPT and would not be impacted by the proposal. For example, the 133,848 employees listed in the "health and social services" sector includes the over 10,000 employees who work for the non-profit University of Pennsylvania Health System, the over 20,000 employees who work for the non-profit Jefferson Health System, the over 9,000 employees who work for the non-profit Children's Hospital of Philadelphia, and so on and so forth.

We have asked the Administration to report on how many of the current filers in the "Health and Social Services" and "Educational Services" sectors do not pay BPT due to their non-profit status and how many employees these filers account for. If non-profits in those categories are not required to file a BPT return at all due to their non-profit status, we have asked for information about how many of the 133,848 health/social services sector employees and 57,477 educational services sector employees, respectively, these non-profits account for.

In addition to "over-counting" employees of non-profits not subject to the BPT, the analysis under-counts some of the potential "winners" under the proposal – namely, self-employed people, sole proprietors, and partners who are not included in the BLS data. As set forth in the recent Center City District report "Philadelphia's Mayor Employment Nodes: Where City Residents Work," there are 7,000 individuals compensated as partners in Philadelphia in the accounting, finance, hospitality, law, real estate, and retail fields – most of which sectors will realize tax savings under the proposal. The analysis underestimates the proportion of the local workforce constituted by these employment sectors. Again, we request that the analysis be corrected to take these employees into account.

3. Differentiation of In-City and Outside-City Impact

One of the significant issues we are addressing with this legislation is the competitive disadvantage imposed on Philadelphia-based businesses under the current BPT structure. There can be no question that the net income portion of the BPT is borne primarily by Philadelphia-based businesses, whereas the gross receipts portion is paid by all businesses – whether based in the city or not – that make sales in Philadelphia's market.

[2] The data was drawn from the Bureau of Labor Statistic (BLS) Quarterly Census of Employment and Wages (QCEW). The QCEW is based on self-reporting by employers of all employees covered by unemployment insurance. Under Pennsylvania law, non-profits are required to pay into the unemployment compensation system on behalf of their employees and, thus, are included in the BLS numbers. We spoke today with a BLS economist for the Philadelphia region who confirmed that the QCEW data includes employees of non-profits.

Our analysis indicates that the city's current course – eliminating the gross receipts tax, while only modestly decreasing the net income tax – would take off the table over $40M per year of BPT revenue paid by businesses that are not based in Philadelphia. Our proposal, by contrast, would shift $120M of the BPT tax burden off of Philadelphia-based businesses and onto these non-city firms.

Accordingly, we have asked the Administration to analyze the number and business sector of BPT filers located inside and outside Philadelphia, and how the tax liability of these respective groups would change under the proposal. We have also asked for an analysis of the "biggest winners" and "biggest losers" – broken down by industry sector and business location – under the current course of eliminating the gross receipts tax and marginally reducing the net income tax.

4. Amendment re Tax Pyramiding in Construction Industry

As we noted yesterday, we are considering amending the bill to address the tax pyramiding impact of the current BPT on the construction industry. The amendment would allow contractors to deduct from their taxable receipts the amounts paid to subcontractors, provided that the subcontractors are subject to the business privilege license and BPT requirements, are in compliance with the same, and pay BPT on the receipts received from the contractor.

We think this amendment not only addresses an existing unfairness in the BPT with respect to this industry (essentially, double taxation of the same receipts), but also will result in significant tax savings for the industry. The construction industry paid $24.5M in BPT in 2008 ($14.9M net income and $9.4M in gross receipts) and would pay approximately $35M ($0 net income and all gross receipts) under the legislation as introduced. Our preliminary analysis suggests that, with the amendment, the industry would pay approximately $17M in BPT (again, all gross receipts) by full phase-in – an industry-wide savings of over $7M compared to current BPT liability. Based on the average salary figure used in the Administration's analysis, this $7M in tax savings should result in 103 new construction industry jobs.

We have asked the Administration to do a fiscal analysis of such a deduction (both in terms of savings to the industry and any additional increase in the replacement rate on account of the same) and to re-run the employment analysis taking these new numbers into account.

5. Positive Supply-Side Effect

The largest assumption made in your analysis is that there will not be a positive supply-side effect on the local economy – the economic growth in the local economy that will create jobs,[3] increase rents in commercial space, and increase hotel stays and room rates because local businesses will have far more to spend. As renowned economist Mark Zandi indicated in his recent op-ed, this proposal is a "big positive step" toward "solv[ing] the city's economic

[3] We note that even without assuming a positive supply-side effect and even with the analytical issues noted above, the Administration's analysis indicates that the proposal will have zero net effect on employment (a net change of 218 jobs out of 518,304 or .0004).

problems." Even without accounting for resultant economic growth, we are confident that after correcting for the issues raised above the Administration's own analysis will show that this proposal will have a positive impact on Philadelphia's economy.

We understand that the Administration has widely circulated its analysis of our reform proposal. For an informed discussion going forward, we would appreciate it if you would share this response with those to whom you sent your analysis (or provide us with their contact information so we can send it directly).

We look forward to receiving responses to these questions and to our continuing dialog about this proposal, which we think will reduce the onerous tax burden for the majority of Philadelphia businesses and make our great city more economically competitive for years to come.

Sincerely,

Bill

Bill Green
Councilman At-Large

Maria Quiñones Sánchez
Seventh District Councilwoman

Cc: Council President Anna C. Verna and all members of City Council
Mayor Michael A. Nutter