CITY OF PHILADELPHIA

CITY COUNCIL

November 22, 2010

Robert Wonderling
Greater Philadelphia Chamber of Commerce
200 S. Broad Street, Suite 700
Philadelphia, PA 19102

Dear Mr. Wonderling:

Further to your letter of October 20, 2010 and as part of our ongoing dialog with the Greater Philadelphia Chamber of Commerce regarding the business privilege tax (BPT) reform proposal (Bill No. 100635) pending before City Council, we are writing to provide additional information and analysis. We have organized our comments under topical subheadings and attempted to consolidate responses to overlapping/duplicative questions.

To provide context for the comments below, we want to reiterate the underlying policy goals for the proposed reform, which would eliminate the net income portion of the BPT and replace the revenue with an increased tax on gross receipts. We are advocating this approach because, after two years of research and analysis, we think it will generate significant economic growth in Philadelphia, help small and locally-based businesses, and create a more equitable and efficient tax system.

1. Sourcing of gross receipts

The legislation does not propose to change the current sourcing rules – in large part this is because the city does not have the data needed to determine the cost of changing the rules. However, as we stated most recently in our October 29, 2010 meeting with Mr. Hankowsky, you, and Mr. Maloney, we are interested in further researching a shift to market-based sourcing, including analyzing whether the foregone revenue from Philadelphia-based service providers under such a change would be replaced by revenue from non-Philadelphia firms providing services in the city. We would like to engage the Chamber's assistance in further researching this issue, with an eye toward future legislative or regulatory action.

2. Concern about "tax pyramiding"

The phenomenon of "tax pyramiding" – whereby taxes are paid at each stage in the chain of production – is largely is addressed by the alternative method/rates authorized for manufacturers, wholesalers, and retailers authorized in the BPT enabling legislation and in place since the inception of the tax. These three sectors of the

economy, which account for the majority of economic activity under which products move through multiple stages of production, have the option of utilizing what is, in essence, a "net receipts" tax method. Under the alternative method, manufacturers are able to deduct their cost of goods from their receipts and, to this significantly smaller receipts base, apply a slightly higher tax rate. Wholesalers and retailers are able to deduct both their cost of goods and their cost of labor from their taxable receipts and apply an alternative rate to this much smaller base.

In preparing our proposal, we investigated the "break even" margin at which companies in these sectors would be better off using the alternative method/rate rather than the default gross receipts rate. As we have shared with the Chamber previously, we found that the alternative rates now in place would be advantageous only to businesses with relatively low margins (<6% for manufacturers, <4.5% for wholesalers, and <16% for retailers). In an effort to enhance the "escape valve" the alternative method provides for these sectors – which often operate a low margins – our proposal increases the alternative rates by a significantly lower percentage that the default gross receipts rate. As a result, utilization of the alternative method/rate would be advantageous, compared to the default gross receipts rate, for businesses with higher margins (<24% for manufacturers, <17% for wholesalers, and <59% for retailers).

In calculating the replacement rates needed to preserve revenue-neutrality, we assumed that more businesses in these sectors would begin to utilize the alternative method/rate under a receipt-only BPT structure. The Administration's analysis assumed that 100% of retailers and manufacturers would utilize the alternative method and concluded that, industry-wide, both sectors would realize tax savings under the proposal: $4.5M/year or 16% in retail and $3.8M/year or 13% in manufacturing.[1]

Your letter pointed to the Washington state Business and Occupation ("B&O") Tax as an example of tax pyramiding. A 2002 study of Washington's tax structure determined that the level of B&O pyramiding "var[ies] considerably from industry to industry," with the tax on services pyramiding approximately 1.5 times while "for some types of manufacturers the rate of pyramiding is over five or six times."[2] The crucial distinction between the B&O Tax and the BPT, of course, is that under the B&O no deductions are allowed for cost of goods and cost of labor[3] in the industries where pyramiding is of most concern – namely, manufacturing, wholesaling, and retailing. As noted above, our proposed rate adjustments under the existing alternative taxing method for these industries – as well as the potential amendment to address this same issue in the construction industry, the structure of which also creates a significant pyramiding effect – mitigates this concern.

---

[1] Department of Revenue, "Analysis of City Council BPT Proposal: Revenue Neutral Realistic Scenario (5.77 mills on gross receipts)" (aggregated by industry).

[2] Washington State Tax Structure Study Committee, "Tax Alternatives for Washington State: A Report to the Legislature," pg. 24.

[3] *Id.* at pg. 13.

3. Relative effect of net income vs. net income taxes on economic growth

The fundamental question at hand is which tax rate – gross receipts or net income – influences its respective base more. Our economists – like those in Ohio,[4] California,[5] and other jurisdictions – think it is the net income tax and, accordingly, that eliminating the net income tax will have a more positive effect on Philadelphia's economy than the negative effect of concurrently raising the gross receipts tax to maintain revenue-neutrality.

The net income tax – a much higher rate on a smaller base – more typically hits firms that do not have to be located in a particular jurisdiction, are more profitable and growing, and are more likely to be making sales beyond the local market. The strength of these businesses generates local income that increases local demand and therefore supports the firms that are in Philadelphia because they want to sell into the Philadelphia market.

With respect to economic analyses of the relative effects of the two taxes on job growth, Ohio's recent tax reform experience is instructive. In 2005, the governor proposed a package of tax reforms, including eliminating the state's corporate income tax, which generated $758M per year, and implementing a new commercial activity tax (CAT), analogous to a gross receipts tax for most businesses, that would generate over $1.4B in tax revenue per year. The overarching purpose of the reforms was to "provide a competitive edge for businesses located in Ohio"[6] – which is also one of the key goals of the BPT reform proposal.

---

[4] Ohio's recent tax reform included elimination of the state's 8.5% corporate net income tax and implementation of a receipts-based commercial activity tax (CAT). Ohio's economists explained the CAT as follows:

> The CAT is a broad-based, low-rate tax designed to have minimal impact on economic decisions, fall relatively lightly on companies that have significant investment and employment in Ohio, and fall more heavily on companies that make heavy use of the Ohio market. The CAT is based on the benefit principle that a business should pay taxes base on the benefits it receives from state and local government services, whether the business is nominally profitable or not. The CAT essentially assumes that such benefits are proportional to the business's activity, where activity means the use of the state market in making sales.

REMI Consulting, Inc., "The Dynamic Economic and Fiscal Impact of the Ohio Administration's Proposed Changes to the Commercial Activity Tax, Corporate Franchise Tax, Personal Income Tax, Tangible Personal Property Tax, and Sales Tax" ("REMI Report"), April 18, 2005, pg. 35.

[5] In recommending that California eliminate its 8.84% corporate income tax and implement a 4% net receipts tax, among other reforms, the state-chartered Commission on the 21st Century Economy explained: "While all taxes can interfere with economic decisions, higher marginal tax rates disproportionately affect efficient outcomes (relative to the revenue raised) and can impair economic growth." Report of the Commission on the 21st Century Economy, September 2009, pg. 34 (available at http://www.cotce.ca.gov).

[6] REMI Report, pg. 84.

The state engaged REMI Consulting, Inc., a respected economic forecasting and policy analysis firm, to analyze the economic effect of the reforms. Of most relevance is REMI's finding about the relative effect of raising additional revenue from three different business taxes – the existing taxes on corporate income and machinery/inventory and the proposed new tax on commercial activity, largely analogous to the gross receipts tax. The analysis concluded:

> To provide a standard method of comparison amongst the taxes within the context of a controlled environment where isolated business impact changes were made, we modeled the impact of each tax given a $100M increase. When evaluated in this format, the least economically damaging among the three business taxes is the commercial activity tax. Also, the commercial activity tax consistently has the least amount of detractions against the $100M collections.[7]

We expect the same would be the case here. And a key reason REMI identified for the relative advantageousness of the commercial activity tax relates directly to one of the core policy goals behind the proposed BPT reform:

> This result is not unexpected since some of the tax burden falls on firms outside of Ohio who are selling goods into Ohio in competition with Ohio. Therefore, the Ohio firms that sell within Ohio are not placed a competitive disadvantage with the non-Ohio firms selling into Ohio, since both will be taxed the same. The other two business taxes do place the Ohio firm at a competitive disadvantage with non-Ohio firms selling into Ohio since only the local firms are taxed. Also, the current business taxes place a burden on Ohio firms that sell their products outside Ohio, placing them at a competitive disadvantage. This is not the case with the [commercial activity tax], which exempts exported goods.[8]

This may be an appropriate place to note that the studies of the employment-related effects of gradual reductions in Philadelphia's gross receipts tax over the past two decade shed no light on the relative supply-side effectiveness of the gross receipts and net income taxes as there was no variation in the net income tax during the period studied.

Moving away from economic theory and to ground-level results, the Ohio experience is even more telling. The tax reform has been a success, with the state winning *Site Selection* magazine's "Governor's Cup" for the most new and expanded large-scale capital projects two years in a row, and with Ohio business owners reporting that the reform is working as planned.

---

[7] REMI Report, pg. 1.

[8] *Id.*, pg. 2.

From the president/CEO of a manufacturing and distribution company:

> The significant reduction of income taxes with the replacement of the CAT [] is a benefit, because a significant amount of our sales occurs outside Ohio. Realizing these savings gives us additional capital to redeploy and reinvest in our equipment and new inventories. These are exciting opportunities for us to expand our business.[9]

From the State and Local Tax Manager for Goodyear Tire & Rubber Company:

> Eventual elimination of Ohio Corporate Income/Franchise taxes also provides similar incentive for businesses to locate here or state her. Our recent announcement to build a new Akron Corporate Headquarter Campus and, thus, stay in Akron was based in part of the 2005 reform. For Goodyear, our total Ohio tax liability has stayed the same after the 2005 Ohio tax reform, but we now believe that our tax payments will be more stable in the future. Stability and predictability are important to Goodyear, and the Ohio reforms helped solidify the tax burden.
>
> There can be no doubt that the Ohio tax reforms have leveled the playing field on fairness, equity, and simplicity.[10]

From the Associate Director, Economic Development and Tangible Taxes, for Proctor & Gamble:

> Clearly, the tax reform has drastically reduced our company's Ohio tax compliance efforts. We spent almost four months of a full-time tax manager's time in the tax compliance effort to complete our Ohio multi-county property tax return and corporate franchise tax return. The new CAT requires minimal effort each month to extract the data and submit our return, and the work is now being done by administrative resources versus technical tax experts.[11]

These are just the results – increased local investment; an incentive for businesses to locate and stay in Philadelphia; a competitive edge for Philadelphia-based businesses competing regionally, nationally, and globally; a more stable revenue stream; and a

---

[9] Interview with Michael Bass, President & CEO, Hy-Ko Products Company (available at: http://www.ohiomeansbusiness.com/incentives-and-tax-reform/tax-climate/ohio-tax-reform-year-2-in-review/impact-of-ohios-tax-reform.php).

[10] Interview with Vince Magnacca, Manager, State & Local Tax, Goodyear Tire & Rubber Company (available at: http://www.ohiomeansbusiness.com/incentives-and-tax-reform/tax-climate/ohio-tax-reform-year-2-in-review/impact-of-ohios-tax-reform.php).

[11] Interview with Tom Kemen, Associate Director, Economic Development & Tangible Taxes, Tax Division, The Procter & Gamble Company (available at: http://www.ohiomeansbusiness.com/incentives-and-tax-reform/tax-climate/ohio-tax-reform-year-2-in-review/impact-of-ohios-tax-reform.php).

simpler, more efficient, and more equitable tax system – that we expect will follow from the proposed BPT reform.

4. Comparison to former Mercantile License Tax

There are significant differences between the former Mercantile License Tax and the BPT. First, the gross receipts portion of the BPT does not apply to goods sold outside of the city. Under the Mercantile License Tax, by contrast, out-of-city sales were not entirely exempt from taxation. Second, the Mercantile License Tax was applied to a much smaller base of economic activity than the BPT applies to due to the exclusion – first pursuant to state Supreme Court case law and later pursuant to city policy – of over a dozen industries from the tax.

Furthermore, our local and regional economic climate is dramatically different than it was in the early 1980s. Increasingly, Philadelphia is competing within the region to attract and retain profitable firms, which can avoid the "profitability penalty" imposed by the net income tax while still enjoying the city's amenities simply by locating across City Line Avenue, along the Route 202 corridor, in Conshohocken, and so on.

As the 2003 tax Reform Commission reported, "businesses and residents can move within a region to avoid paying high local taxes while still enjoying many of the region's benefits."[12] The 2009 Task Force on Tax Policy and Economic Competitiveness agreed, concluding that "[t]ax savings from moving to a lower cost community in the same region no longer means losing one's labor force, customers, or suppliers."[13]

There can be no question that the high-rate net income tax significantly hampers Philadelphia's ability to compete for businesses. And with the change of administration in Harrisburg, we can no longer depend on significant state support for business attraction efforts. Given this reality, it is essential that we take action now to reform the BPT in a way that makes Philadelphia a more attractive location for profitable businesses.

5. Opinion from Finance Director on revenue impact

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 – including with respect to the proposal being revenue-neutral – and for the discussion to focus on the underlying policy questions. Last week, we received the Administration's analysis of the proposal and were pleased to learn how close our numbers and the Administration's numbers are: we proposed that a top gross receipts rate of 0.0053 would maintain revenue-neutrality; the Administration's analysis suggests a 0.00577 rate is needed.

[12] Philadelphia Tax Reform Commission, "Final Report November 15, 2003 – Executive Summary," pg. 2.

[13] Mayor's Task Force on Tax Policy & Economic Competitiveness in Philadelphia, "Thinking Beyond Today: A Path to Prosperity," pg. 16.

While the numbers are close, we are committed to not raising the gross receipts rate any more than is necessary to achieve revenue-neutrality, and so have asked the Administration for some additional analysis on this point. Specifically, we think the analysis should take into account the BPT base growth assumptions the Administration included in the city's FY11-15 Five-Year Plan.[14]

6. Effect on hotel[15] and hospitality sectors

As for many sectors, there is great variability within the hotel sector in terms of how the legislation would impact businesses. In 2008, the most recent tax year for which we have data, there were approximately 140 hotels that paid the BPT. Of these 140 hotels, 100 – or over 70% – had annual sales of under $10M per year. These 100 filers would, as a group, have a tax reduction under the proposal.

The remaining 40 filers with annual sales over $10M per year would, as a group, have a tax increase under this proposal. The reason for this is that these taxpayers are paying negligible, if any, net income tax currently: their annual sales in Philadelphia are over $800M per year and they are paying net income tax at a level that suggests their profit margin in Philadelphia is approximately one half of 1%. We were not able to look at the tax returns of individual companies due to taxpayer confidentiality rules, but expect that most of these filers are multi-state or multi-national companies that are able to take advantage of tax loopholes, like the Delaware holding company, or other tax planning strategies to show almost $0 taxable income in Philadelphia. In other words, while smaller hotels and Philadelphia-based hotels are paying the net income tax, their large, non-Philadelphia-based competitors are not.

To put the effect of the reform in context, even if the large hoteliers pass on 100% of the tax increase from 1.4 mills to 5.3 mills, we are talking about a $0.60 increase on an average room stay rate of $150. The effect is negligible, consistent with the fact that we are proposing to apply a very, very low rate – one half of one percent – across a broad base.

Perhaps more importantly when considering this sector, the marginal increase in costs to the large hotels would quickly be more than paid for by an increase in occupancy rates, which will result from the increased economic activity in Philadelphia that the reform will generate.

With respect to the effect of the Convention Center expansion, we noted the report in last week's *Philadelphia Business Journal* that hotel developers and proprietors are "anticipating a greater demand for rooms" due to the expansion, and the projection that "[i]t will be the combination of smaller to medium-sized hotels planning to come into

---

[14] 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.

[15] We have repeatedly asked to meet with the Greater Philadelphia Hotel Association to discuss the BPT reform proposal. To date, the Association has not been available to meet with us.

the market" that will account for the new rooms coming online.[16] We think the reform proposal will only amplify this increased demand – and nicely compliment the Convention Center expansion – by making Philadelphia a more attractive location for businesses to headquarter and expand.

It is our understanding that business guests provide greater per room fees than convention guests and drive rates for everyone else. We believe the economic expansion that will result from this measure will increase both occupancy percentages and room rates.

7. Experience with similar changes in other cities

Philadelphia is unique in its business tax structure, and not in a good way. We are the only city that has both a receipts-based business tax and an income-based one.

New York, Washington, D.C., Detroit have local business income taxes, ranging from 9.98% in D.C. (which is analogous to a combined local/state-level tax) to 8.85% in New York to 1% in Detroit.

Los Angeles is the only other large city with a receipts-based tax, although its version of the tax has different rates – ranging from 1 mill to 5.28 mills – for different categories of businesses, something we are largely prevented from doing in Philadelphia due to the Uniformity Clause in the state constitution.

As we have said, in an ideal world, we would advocate for eliminating the BPT entirely, as having it in place makes the city a less attractive business location. But here in the real world – where we are dealing with ongoing fiscal challenges – the question is how should we reform our business tax structure in a way that does not take needed revenue off the table and also encourages economic growth?

We are confident that the answer to this question is to implement the proposed BPT reform. Renowned economist Mark Zandi agrees and concluded in his recent op-ed that the proposed BPT reform would be a "big positive step" toward "solv[ing] the city's economic problems."[17]

8. Collection rates for Ohio's receipts-based tax

The contention in your letter that collection rates for Ohio's receipts-based commercial activity tax (CAT) have "have fallen short, substantially short" is inaccurate.

---

[16] Peter Van Allen, "Room boom for hotels?", *Philadelphia Business Journal*, Nov. 19-25, 2010, pg. 1, 34.

[17] Mark Zandi, "Phila. business-tax code needs an overhaul," *Philadelphia Inquirer*, Oct. 24, 2010, pg. C1. (available at: http://www.philly.com/inquirer/opinion/20101024_Philadelphia_business-tax_code_needs_change.html).

Ohio implemented the CAT through a five-year phase-in process starting in 2005. Revenues were 6.5% above projections for the first two years of implementation, FY06 and FY07; modestly below projections (3.1%) in FY08; 7.7% below projections in FY09, at the height of the recession, which had a particularly negative impact on Ohio; 4% below projections in FY10; and, in the first quarter of FY11, have been 6% above projections. [18] Over this period, the CAT has been a significantly more stable revenue source than Ohio's corporate income tax. That is, the income tax would have had much greater swings and led to less predictability for government.

9. Impact on construction industry

Based on our ongoing dialog with the construction industry, we are considering amending the bill to address the tax pyramiding impact of the current BPT on construction projects. 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, 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).

More broadly, we think the proposal will result in increased economic activity and create demand for construction, without which the fiscal picture for these firms would be bleak whatever the city's tax policy.

---

[18] Ohio Dept. of Taxation, Commercial Activity Tax Division, "Overview of the Commercial Activity Tax (CAT)," pg. 30 (presentation on November 14, 2009 reviewing first two years of CAT) (available at: http://www.hudsonlibrary.org/hudson%20website/Entrepreneurship/Hudson%20Presentation.ppt); Ohio Office of Budget Management, "Monthly Financial Report," July 10, 2008, pg. 15 (reporting on State Fiscal Year 2008) (available at: http://obm.ohio.gov/MiscPages/MonthlyFinancialReports); Ohio Office of Budget Management, "Monthly Financial Report," July 10, 2009, pg. 13 (reporting on State Fiscal Year 2009) (available at: http://obm.ohio.gov/MiscPages/MonthlyFinancialReports); Ohio Office of Budget Management, "Monthly Financial Report," July 10, 2010, pg. 13 (reporting on State Fiscal Year 2010) (available at: http://obm.ohio.gov/MiscPages/MonthlyFinancialReports); Ohio Office of Budget Management, "Monthly Financial Report," October 12, 2010, pg. 12 (reporting on first quarter of State Fiscal Year 2011) (available at: http://obm.ohio.gov/MiscPages/MonthlyFinancialReports).

10. Request to "cap" the gross receipts rate

The proposal, which is designed to be revenue-neutral, caps the gross receipts tax rate at 5.3 mills. For reasons discussed above (related to basing calculations on the 2008 base instead of the projected 2015 base, as is appropriate), the replacement rate may not need to reach 5.3 mills to maintain revenue-neutrality and we have requested information from the Administration to confirm the necessary rate. Furthermore, as noted repeatedly, gross receipts tax revenues are more stable than net income tax revenues and, hence, even in an economic downturn, the city's BPT revenues should be fairly consistent, obviating the need to raise rates to meet revenue projections.

11. Approaches to "leveling the playing field" for Philadelphia-based businesses

Your letter queries whether "increased BPT enforcement" against out-of-state taxpayers would be a preferable way to "level the playing field" for Philadelphia-based businesses. Our response is, emphatically, no.

The question highlights one of the key problems with our current direction: we are on course to eliminate the low-rate tax paid by all business, wherever based, on their sales in Philadelphia, while maintaining the high-rate tax paid almost entirely by in-city taxpayers. As has been confirmed by top tax law and accounting practitioners, most out-of-city companies either are not subject to the net income tax or have tax planning opportunities to effectively eliminate their net income tax liability. As a result, the net income portion of the BPT is borne primarily by Philadelphia-based businesses.

These out-of-city businesses will not have any BPT liability by 2022 if the scheduled elimination of the gross receipts tax proceeds, while their Philadelphia-based competitors will continue to be subject to the 6% net income tax. In other words, the city's current course with respect to the BPT, by definition, exacerbates the competitive disadvantage faced by Philadelphia-based businesses.

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.

We hope we can agree that leaving $120M more in the local economy will have a significant positive multiplier effect in the local economy, even without regard to the other pro-growth benefits described above.

12. Effect on real estate industry

The reform will have a significant, and multifaceted, positive effect on the real estate sector. First, the real estate sector – a group of 27,505 BPT filers that includes lessors, agents, brokers, real estate investment trusts (REITs), and other real estate-related

activities – includes approximately 15,000 small businesses that will see their BPT liability fall to $0 pursuant to the across-the-board exclusion of tax liability on the first $100K in receipts for all businesses included in the bill.

Second, pursuant to the reform, the return on investment (ROI) for construction projects – especially those in which the developer plans to sell the units – will be increased significantly due to the elimination of the net income tax, which is drawn directly from profits. The same holds true for building owners who plan, at some point, to sell their properties. To take a simple example, if a property owner buys a $100K property, which she rents out for $900 per month, and on which she currently pays $0 in net income tax due to mortgage interest costs and depreciation, her gross receipts cost would increase by $36/year due to the increase in the gross receipts tax from 1.415 mills to 5.3 mills. If the owner decides to sell the building ten years later, over which time the property's basis would have depreciated from $100K to $50K, the owner would realize a profit of $50K and owe net income tax of $3,250 on the sale. By contrast, the modest increase in gross receipts tax over this period would total $360. Under the proposal, the building owner would save $2,890 – a 90% reduction in BPT liability over ten years.

Third, the reform will generate increased demand for commercial space in the city, while also reducing BPT costs for most tenants in Class A space, generating significant incremental savings that could be split between the tenants and their landlords.

As we highlighted during our September 10, 2010 presentation to the Chamber's State and Local Tax committee, due to Philadelphia-based taxes the cost for tenants to locate in Class A office space in Center City are $3.89/sf higher than for comparable space in the suburbs.[19] The BPT accounts for $3.67 (>93%) of this premium and, of that, the majority is due to the net income tax.[20] For larger partnerships (including law, accounting, consulting, and financial advisory firms) with high profit margins and thus high net income tax liability, the BPT-related premium to locate in Center City is $7.75/sf to $12.42/sf – a 30% to 40% premium.[21]

With the elimination of the net income tax, the "economic rent" for many Center City tenants – particularly the professional services firms that occupy the majority of Class A office space – will be reduced significantly. The BPT-component of the economic rent for typical Class A office space tenants should drop by over $3/sf and by over $7/sf for large partnerships. These savings could be allocated between landlords and tenants.

Furthermore, the proposed reform should increase demand for Class A office space based on the projected positive supply-side impact. By making the city a more attractive location for profitable businesses – and no longer penalizing them for their

---

[19] Paul Levy, "Can Tax Reform Get Traction in 2010? Overview of Task Force Recommendations on Tax Reform," pg. 17 (available at: http://www.centercityphila.org/docs/LevyCPDCTax120909.pdf).

[20] *Id.*

[21] *Id.*

profitability – more of these firms should locate, grow, and remain in the city, driving up demand for office space. This higher demand (and, ultimately, higher rents as landlords and tenants split the tax savings) will help begin to address to current "cost barrier" to new construction in Philadelphia.

We have been pleased to hear vocal support for the reform from property owners whose tax bills would increase in the short-term under proposal, but who recognize that the medium- to long-term effects of the reform – in terms of increased economic activity in Philadelphia – are positive.

13. Continued BPT liability of banks and insurance companies

Banks, insurance, companies, utilities, and other "regulated industries" would not have any BPT liability as of 2015 on receipts from their state-regulated activity.

The continued BPT revenue from these sectors reflected in the analysis is a function of several factors, including: (1) the ongoing tax liability on the non-regulated activity of these businesses; and (2) the inclusion in the "banking and related services" and "insurance" NAICS categories of tax filers who do not meet the definition of "regulated industries" and, hence, will continue to have BPT liability. For example, traditional insurance companies are regulated by the state, one requirement of which is that they pay an insurance premium tax to the state. Health maintenance organizations (HMOs), by contrast, do not pay the insurance premium tax and do not qualify as a "regulated industry" for purposes of the BPT.

14. Complete elimination of BPT as better proposal

We have stated – repeatedly – our agreement with the long-term goal of eliminating the BPT entirely, and we have built into the proposal the BPT revenue reductions for FY14 and FY15 already included in the FY11-15 Five-Year Plan. In the current economic climate, where resources are scarce, we are pursuing a proposal that is revenue-neutral vis-à-vis the FY11-15 Five-Year Plan and that we think will have a significantly more positive impact on the local economy than eliminating the gross receipts tax. We are open, however, to amendments that would extend the BPT reductions into 2016 and beyond.

In recent *New York Times* commentary, outgoing Senator Evan Bayh offered some suggestions for how the Democratic Party could regain its footing, advice that applies equally well to policy-making at the local level. He wrote:

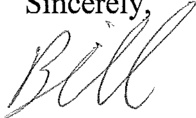
> In the near term, every policy must be viewed through a single prism: does it help the economy grow? A good place to start would be tax reform. Get rates down to make American businesses globally competitive. . . .

Simplify the code to reduce compliance costs and broaden the base. In 1986, this approach attracted bipartisan support and fostered growth.[22]

The proposed BPT reform would accomplish these same pro-growth policy goals at the local level – making Philadelphia-based businesses more competitive regionally, nationally, and globally; simplifying the tax code; and broadening the tax base.

We know the Chamber shares our interest in reducing Philadelphia's onerous tax burden and making the city more welcoming to business. Accordingly, we hope the Chamber will support this proposal, which reduces the tax burden for the majority of Philadelphia businesses and will make our great city more economically competitive for years to come. We look forward to our continuing dialogue with the Chamber on this matter.

Sincerely,



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

[22] Evan Bayh, "Where Do Democrats Go Next?", *The New York Times*, Nov. 3, 2010, pg. A27 (available at: http://www.nytimes.com/2010/11/03/opinion/03bayh.html).