No Magic Bullet

Cutting the Business Privilege Tax Fails To Relieve Unfair Burden on City's Poor

In tax policy matters, the larger public interest is often the first casualty. The second casualty is the equitable issue of tax progressivity, as those benefiting from progressivity and tax fairness often have little voice in the debates and policy formulation.

Sometimes the obvious needs restatement: Taxes are the source of critical services needed by both individuals and businesses, but they also play an important role in either enhancing or worsening fairness across all segments of our society. Advocacy tides for tax cutting or tax subsidies often reflect the self-interests of vocal groups whose relentless pursuit of their goals lends an almost ideological coloration where critical analysis or competing public interest alternatives fall by the wayside.

At the national level, we have seen a country weakened by the sharp rise of income inequalities and the starving of needed services, research, education and infrastructure as tax cutting and subsidies have further enriched already well-off individuals and businesses. At our local level, some have taken aim at Philadelphia's Business Privilege Tax (BPT), an albeit imperfect tax but one providing more than $400 million in revenues, the second-largest source of revenue for a strapped city that has the highest percentage of people living in poverty of the ten largest cities in the U.S. It has become an unanalyzed mantra among some that cutting or even eliminating the tax would provide the silver bullet to prosperity and job growth for the city.

Yes, a business-dominated Tax Reform Commission, of which I was a dissenting member, did recommend these cuts, but this was almost preordained from a body that had virtually no representation from labor, consumers, academia, homeowners or renters, elderly, and a host of other significant segments of our society. A tax cut is a reverse government expenditure, and the Tax Commission refused to evaluate the efficacy of tax cutting as a prime tool of business growth in comparison to other government initiatives, especially those that businesses themselves put at the top of their list for growth, such as a skilled and educated workforce, transportation and infrastructure, and quality-of-life issues.

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Tax-cutting advocates like the Tax Commission risk their legitimacy when their cuts cause major gaps in a city budget. It is an illegitimate defense of these revenue shortfalls either to embrace supply-side mythology — which holds that tax cutting leads to increased tax revenues — or play the tax-shifting game of having other taxes, like real estate taxes, often paid by others, fill the revenue gap. The Tax Commission did in fact cite real estate tax revenue increases and other "revenue alternatives" to fill the major gaps resulting from proposed across-the-board wage tax and Business Privilege Tax cuts, even though this would burden others less able to pay and increase housing costs.

The Tax Reform Commission, despite my request, refused to obtain new research such as that done by the District of Columbia Tax Reform Commission to assess all variables affecting population and business growth. The D.C. Commission found no empirical support for cutting taxes as an inducement for economic growth and found labor force availability and quality — often the result of government investments in education — more important.

State and local governments have reduced billions in business taxes upon wishful thinking (or effective business lobbying). These reductions have produced little or no economic growth but, rather, real evidence of weakening infrastructure and government services, which all businesses and residents need (see Prof. Robert Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development* (2004)).

Professor Lynch reported that firms' locating decisions were made largely around the provision of a variety of public services, not primarily because of state or local taxes. Tax incentives do not work because they are not a significant business cost and do not substantially affect profits. "In short, state and local tax cuts and incentives are not effective for stimulating economic activity or creating jobs in a cost-effective manner. On the contrary, by forcing reductions in public services, tax cuts and incentives may retard economic and employment growth."

Philadelphia Inquirer readers may have read the lead op-ed last April on reviving the metropolitan economies of areas like Philadelphia. The article was written by the directors of the Brookings Institution's Metropolitan Policy Program and the director of the Economy League of Greater Philadelphia. They found the keys to driving prosperity and ensuring sustainable growth were the assets of "innovation, modern infrastructure, strong human capital, and quality places." There was not one word about tax cuts and subsidies. (Bruce Katz, Amy Liu, and Steve Wray, "Pa. economic revival lies in its metro assets," April 14, 2008).

Our presidential campaign, amidst a mortgage foreclosure crisis, rising child poverty, more than 45 million uninsured, and Food Stamp enrollments at a high, has helped make us more aware that the divisions in our society pose a real threat to the lives of all. The greatest tax policy need is to restore the often forgotten principle of tax progressivity back into tax policy. Both in Pennsylvania and Philadelphia, when one compares the impact of state and local taxes on various income strata, as the Pennsylvania Budget and Policy Center in Harrisburg has done, one finds that the tax burden as a percentage of income is more than three times greater for the lowest 20 percent strata of people earning less than $18,000 compared with the top 5 percent earning over $167,000 a year

At the state and local levels, tax progressivity means adopting equivalents of the successful federal Earned Income Tax Credit (EITC), the most successful anti-poverty initiative of the last thirty years. When Senator John Edwards came to a North Philadelphia church in May with ACORN, the National Leadership Conference for Civil Rights and Mayor Nutter to kick off a new national campaign to cut poverty in half over ten years, a leading prong of the effort was EITC expansion.

Philadelphia, notwithstanding its Tax Reform Commission, has created a local EITC via passage of the late Councilman David Cohen's wage tax credit ordinance, which allows wage taxpayers who earn less than about $32,000 in annual income to receive a wage tax credit to ameliorate this long-standing regressive tax that has unfairly impacted those least able to pay it. This local rebate, more than any other local tax policy initiative, would move toward economic self-sufficiency the high proportion of Philadelphia families with children who currently have incomes too small to pay for a basic-needs budget.

This rebate would be spent by lower-income families within the city as a local economic stimulus, as opposed to other wage and BPT cuts, which are also directed at more out of city and better-off individuals and businesses.

The new Nutter Administration initially sought to repeal the Cohen tax credit ordinance, but has since obtained an ordinance that cuts the already small tax credit in half with an even more delayed implementation to begin in 2014.

If business tax cuts are on the table, let's note that small businesses or start-ups have always been the rationale and "poster children" of BPT cutting or elimination. But the undifferentiated BPT cuts or repeal would also lessen tax loads on the Wal-Marts, Targets, Sunocos and those many out-of-city businesses, national and international, who pay the BPT even though they choose not to set up their businesses here.

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Some thoughtful policy-makers like Councilwoman Maria Quinones-Sanchez are thinking about targeting BPT cuts to smaller businesses or those more likely to be located in the city. For example, in 2006, if the first $500,000 of total business sales had been exempted from the BPT — a way of supporting smaller or newer businesses — then about 64,000 of 77,000 businesses would have been totally relieved of the tax, yet 84 percent of the total $382 million in BPT collected that year would have been preserved for needed city services.

Another proposal would establish a credit — equivalent to the net income portion of the BPT less the gross receipts portion of the tax. That would provide gross receipts tax relief for Philadelphia based businesses who are paying their fair share of taxes. Businesses not based in Philadelphia and those that have managed to avoid business income tax would not be given any additional breaks. This alternative would keep more than 50 percent of gross receipts revenue in the city coffers while still providing targeted tax relief to Philadelphia businesses.

The plan to eliminate the gross receipts portion of the BPT is made even more questionable by the fact that two-thirds of Philadelphia's largest businesses (those earning $10 million a year or more) pay nothing or next to nothing on the net income side of the tax. In effect, gross receipts is the only tax paid by the vast majority of Philadelphia's largest businesses.

Unfortunately, confidentiality rules have made this non-payment of taxes one of Philadelphia's best kept secrets and have prevented open and honest discussions of who benefits from tax policy.

Councilwoman Sanchez's newly introduced disclosure bill would go a long way to creating that transparency.

Tax equity among BPT payers should mean that tax evaders and exempt or favored businesses like insurance companies, financial institutions and utilities would pay their fair share of BPT like other businesses.

For too long, oft repeated fictions and rhetoric rather than facts have steered our debates on taxation. It's high time that tax progressivity and the public interest become the foundation for Philadelphia and Pennsylvania tax policy. ■

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