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PhillyDeals: Looking at other ways to tax city businesses



By Joseph N. DiStefano

How should the City of Philadelphia tax companies within its borders? Right now, it charges two "business privilege" taxes:

It demands \$6.45 of every \$100 of a company's profits, the so-called net-income tax.

It also takes 14 cents on every \$100 of total sales, the gross-receipts tax.

These business taxes are slapped on top of city property taxes and other local levies.

For a generation, Philadelphia business taxpayers, their lawyers, and the **Greater Philadelphia Chamber of Commerce** have targeted the gross-receipts tax as unfair and discouraging to employers, says city **Finance Director Rob Dubow**. The current city tax ordinance calls for phasing it out over the next 12 years.

But **City Council at-large members Bill Green** and **Maria Quiñones Sánchez** say that is backwards.

"We have concluded lowering the net-income tax will have a better effect on the Philadelphia economy than lowering the gross-receipts tax," Green told me last week.

Their draft bill, which they plan to introduce in the fall, wouldn't just cut the net-income tax. It would boost the gross-receipts tax, to around 54 cents for every \$100 in sales, while eliminating the city business-income tax, both in stages over the next five years.

Until now, Green and Quiñones Sánchez have made mostly logical arguments in favor of the shift. It's relatively easy to verify sales at companies that already pay state sales tax. Out-of-town companies can be made to pay taxes on their sales to Philadelphians. "**Home Depot, Lowes, Target** - their stores are not going to move because their gross-receipts tax goes up a little bit," says Green.

By contrast, profits from Philadelphia sales are tough to trace, let alone tax, at big multistate companies, especially with legal local-income-tax dodges, like the Delaware investment holding company that turns taxable store profits into tax-free franchise or licensing fees.

That's why Texas and Ohio have switched to gross-receipts taxes recently, and a California tax

commission is recommending it do the same, Green says.

But the two Council members are now going beyond intentions and logical arguments. They have built a new weapon: An analysis of city tax data by **Stephen Mullin** of **Econsult** (and also a former city commerce director) that indicates who would pay more and who would pay less if the law is changed.

The idea, says Green, isn't to boost business-tax revenues, which topped \$350 million in 2008-09. "We want this to be revenue-neutral," Green claims. It is to change who pays, and to put as much of the burden as possible on out-of-town companies that suck money out of the city.

Green argues that his bill would exempt small businesses (local or not), ease pressure on the city's surviving manufacturers, and keep new businesses that spawn in Center City, University City, and other neighborhoods from leaving town so quickly.

According to a draft of Mullin's report, construction firms, retail businesses, and hotel operators would together pay up to \$25 million more each year, while law and accounting firms and manufacturers would collectively save up to \$35 million a year.

An estimated 40,000 businesses, or nearly half the number currently paying the taxes, would drop off the business-privilege tax rolls, saving them a total of more than \$10 million a year, because the bill would exempt the first \$100,000 in yearly sales.

Banks and insurers would also pay less because state laws leave them exempt from most taxes on sales, Green told me.

Because revenue at construction companies has lately fallen due to the recession, and the analysis didn't initially take into account the financial-sales exemption, the gross sales tax may have to be increased - perhaps to 60 cents per \$100 to cover lost income-tax revenue.

Tax lawyer **Stewart Weintraub** of **Chamberlain Hrdlicka**, who has served on tax-reform commissions under former **Mayors John F. Street, Ed Rendell, W. Wilson Goode**, and **William J. Green III** (the councilman's father), says he is not surprised law and accounting firms come out as big winners.

"They pay the largest proportion" of the net-income tax, he told me. Banks and utilities "will pay literally zero" if the proposal passes. "They're also winners," said Weintraub.

Weintraub is concerned that higher taxes on hotels and other tourist-focused businesses could hurt one of Philadelphia's few growth industries.

"We need to lower business taxes over time," says Green, whether it's the sales or income tax.

"The proposal inherently picks winners and losers," cautioned **Rob Wonderling**, president of the chamber. He praised Green and Quiñones Sánchez for reaching out, and said he was scheduled to meet with both again in the next few weeks.

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