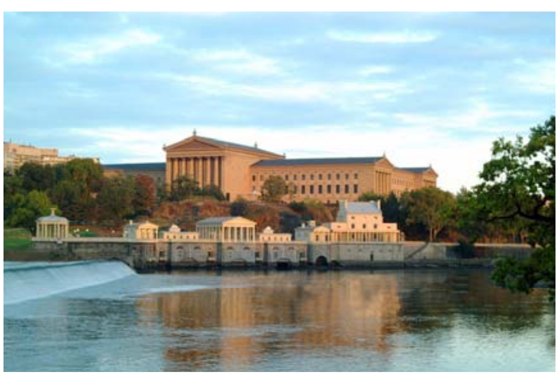
Mayor's Task Force on Tax Policy & Economic Competitiveness in Philadelphia

Thinking Beyond Today: A Path to Prosperity

Presented to
Mayor Michael A. Nutter
and
City Council President Anna C. Verna



October 2009

Mayor's Task Force on Tax Policy & Economic Competitiveness
Task Force Members

Harold T. Epps, (Chair) President and CEO of PRWT Services, Inc.

Joseph Dworetzky, (Vice Chair) Shareholder of Hangley Aronchick Segal & Pudlin

Joe Ashdale, Business Representative for D.C. 21

Thomas Callan, Managing Director for BlackRock's Global Opportunities

Della Clark, President of The Enterprise Center

Pelayo Coll, Partner at Blank Rome

Anthony J. Conti, CPA, Managing Partner, Philadelphia Office, PricewaterhouseCoopers LLP

Wendi Kotzen, Partner at Ballard Spahr Andrews & Ingersoll LLP

Michael Horsey, CPA, Managing Partner of Mitchell & Titus LLP

Randy Hutchinson, Manager of State/Local Taxes, Sunoco (retired)

Robert Inman, PhD, Finance Professor at the Wharton School at the University of Pennsylvania

Paul R. Levy, President and CEO of Center City District (CCD)

Matthew Melinson, CPA, Managing Director at SMART Business Advisory and Consulting, LLC

Kathleen O'Brien, Partner at Montgomery McCracken

Angelo Perryman, President and CEO of Perryman Building and Construction Services

Janet Ryder, Vice President of Labor Participation for the Philadelphia Council AFL-CIO

Wayne W. Williams, Department Chair of Economics and Accounting at the Community College of Philadelphia

WWW.PHILA.GOV/TAXPOLICY

Photo Credits for Cover:
E. Savaria Jr., M. Kennedy, B. Krist, Philadelphia Convention and Visitors Bureau, City of Philadelphia Department of Records.

October 2009

Dear Mayor Nutter and Council President Verna:

In creating the Mayor's Task Force on Tax Policy and Economic Competitiveness, you demonstrated your commitment to the future of Philadelphia and challenged us to help improve the quality of life and financial well-being of Philadelphians today and in the years to come. Thank you for your leadership.

As you know, many of the challenges that Philadelphia's citizens and local elected officials face are not of their own making — operational burdens imposed by the unique situation of being both a city and a county, levels of poverty, illiteracy, and unemployment that stem from decades of economic shifts and damaging policy choices at the state and national levels. However, we cannot simply bemoan the conditions thrust upon us nor wait for assistance from beyond the city's borders. Moreover, not all of our problems are caused by others. As a city, we have made our own share of mistakes.

Philadelphia has an unnecessarily complex and expensive tax structure coupled with a high-cost, unpredictable real estate development environment. This combination has contributed to the city's ongoing job and population loss. At the same time, Philadelphians continue to demand and deserve more from their government - they want to feel safe, have high quality jobs and educational opportunities, and have cleaner streets, parks, and community facilities. However, we cannot fulfill these expectations for quality services and opportunities if we keep losing jobs at the rate we have been doing for the last several decades. It is time that we assert that what we have been doing is not working and that now is the time to do something different.

For the most part, the changes needed are well known – lower taxes, a different mix of taxes, and more efficient government can give Philadelphia the resources it needs to focus on more complex issues like education, poverty, and violence. Recommendations to improve the tax structure have been offered in report after report, but while there have been some improvements, implementation has not been comprehensive due to concerns about the costs and risks of change. These are, of course, valid concerns, but the cost of inaction is even more troubling.

In this report we set a clear and understandable target, and we lay out a plan of action for transforming and re-energizing Philadelphia's economy. If implemented, these recommendations will transform Philadelphia's tax structure from one that reflects a 19th century, manufacturing-based economy to one that will drive growth and innovation in a 21st century, service-based economy. By 2025, this will result in 70,000 more jobs than we would have if we continue our current approach. Not only will we be able to save 47,000 jobs that Philadelphia would otherwise be expected to lose during that time, but the city will have a net gain of 23,000 more jobs than we have today.

As you would expect, a radical shift is needed in order to achieve job gains rather than job loss. Therefore, many of our recommendations are revolutionary – they will change the tax structure, tax mix, tax base and tax level in Philadelphia. Meanwhile, other recommendations can dramatically improve the City's operations and its interactions with citizens through less radical yet necessary improvements. If implemented, these recommendations can transform the tax and development landscape in Philadelphia and put the city on a path to prosperity.

These recommendations were crafted with the knowledge that there is no one single, perfect, guaranteed path to making Philadelphia more competitive and creating opportunities for jobs and wealth. That being said, taking reasonable risks is the only way to achieve the transformational change and alter our current path of continuous decline.

Our fundamental problem is that Philadelphia has a tax structure that was appropriate to an industrial economy when people and firms were tied to the fixed assets of railroads, factories, and ports. By continuing to derive the lion's share of locally-generated revenues by taxing people and jobs that are now highly mobile, we continue to undermine our future. Only by making a wholesale shift by lowering the burden on people and businesses and placing a greater emphasis on land and improvements can we guarantee a future of growth.

Philadelphia can emerge from this economic downturn a stronger, healthier city, but not without the leadership and commitment of our elected, community, and business leaders. The members of this Task Force stand ready to assist you in turning these recommendations into reality and putting Philadelphia on a path to prosperity.

Sincerely,

Harold Epps, Task Force Chair
Joseph Dworetzky, Task Force Vice Chair

TABLE OF CONTENTS

APPENDICES & ADDITIONAL MATERIALS
ARE AVAILABLE ONLINE AT
WWW.PHILA.GOV/TAXPOLICY

EXECUTIVE SUMMARY

In the spring of 2009, Mayor Nutter convened business, academic, and community leaders and charged them with examining the city's tax structure and real estate market in order to create a better Philadelphia: a place with more opportunities for employment and wealth creation for city residents and a city where new businesses can easily form and existing ones can grow. Without action, Philadelphia can expect continuing job and population losses and an increasingly difficult struggle to raise the funds needed to provide essential government services.

From the many insightful reports over the past decade, the general contours of a solution are well known — lower taxes, a different mix of taxes, and more efficient government. The Task Force has leveraged these previous efforts to develop a set of recommendations and plan for action which will transform and revitalize Philadelphia's economy. Today, the most important recommendation is simply this: set a goal of fundamentally changing what we tax and begin making these transformational changes now.

To position itself for growth once the current recession ends, Philadelphia must commence administrative and management improvements and policy shifts immediately. In some cases, administrative and management improvements must be implemented before major policy shifts can occur.

To add 70,000 jobs (47,000 saved plus a net gain of 23,000) to the city's economy by 2025 and to create immediate opportunities for families to build wealth and entrepreneurs to follow their dreams, the Task Force recommends:

THE IMPORTANT POLICY IDEA — SHIFT FROM MOBILE TO IMMOBILE TAX BASES:

- Restart Planned Cuts to the Business Privilege Tax in 2012 & More Aggressively Reduce Wage Tax Rates to lower the cost of living and working in Philadelphia
- Offset a Portion of the Rate Reductions through an Increase in the Real Estate Tax
- Implement a Homestead Exemption to Protect Homeowners
- Communicate Philadelphia's more competitive tax policies through an aggressive business attraction program.

THE PREREQUISITES — ADMINISTRATIVE CHANGES:

REMOVE BARRIERS TO PHILADELPHIA AS A BUSINESS LOCATION

- Adopt Market-Based Sourcing
- Adopt Single Sales Factor Apportionment

IMPROVE PROPERTY ASSESSMENTS

- Adopt a System of Fair and Accurate Property Values
- Use Buffering Mechanisms to Protect and Transition Property Owners
- Separate the Appeals and Assessment Functions

IMPROVE INTERACTIONS WITH GOVERNMENT

- Provide Predictable, Streamlined Procedures
- Make Rules and Regulations in Philadelphia Normal
- Create a Taxpayer Advocate
- Make Tax Incentives Accessible and User Friendly

REDUCE CITY SPENDING

- Invest in Technology to Generate Efficiencies and Enhance Productivity
- Reduce the Cost of Philadelphia's Fastest Growing Expenses: Health Benefits and Pensions

IMPROVE TAX COLLECTION & COMPLIANCE

- Upgrade Tax Administration Technology & Human Resources
- Offer a Tax Amnesty to Fund Tax Administration Improvements
- Encourage Compliance with Competitive Interest & Penalty Rates

USE PUBLICLY-OWNED & TAX DELINQUENT PROPERTY TO SPUR DEVELOPMENT

- Upgrade Technology and Data for Philadelphia Property Information
- Improve the Public Property Acquisition and Disposition Process
- Consider Strategic Acquisition of Tax Delinquent Properties
- Target Investments to Produce Greatest Impacts

INTRODUCTION

"A thorough review of our tax policy and barriers to development is needed in order to best position the City for growth and economic competitiveness*… The Task Force shall provide a report to the Mayor and the President of City Council setting forth its recommendations regarding the City's tax policy and economic competitiveness."*

Excerpt from Mayor Michael Nutter's Executive Order 3-09, signed February 11, 2009.

The Task Force's mission is to evaluate the City's tax policies and structure as well as its real estate development environment, to determine how these compare to neighboring jurisdictions and peer cities, and to recommend changes to the tax structure and development process that will improve Philadelphia's competitiveness. The period during which we conducted these examinations has been an extraordinary time. Philadelphia, the nation, and the world are currently confronting economic turmoil. While the City's elected leadership must address the day-to-day operational challenges the recession has created, this Task Force has been charged to look ahead to the eventual economic recovery and to identify what steps Philadelphia should take now to ensure that the City can participate fully and emerge stronger and more competitive from this recession.

We have realized that our work comes at a perfect moment. The recession allows the City a brief period to get itself ready for the extraordinary undertaking that will be necessary to transform Philadelphia into 21st century city. If we use that time wisely, we will be prepared to not only rebound, but also to grow, once the recovery begins.

The Goal:
70,000 more jobs

THE VISION FOR THE FUTURE

The Task Force's work is driven by a shared vision for Philadelphia's future.

In this vision, Philadelphia is a location of choice for residents and businesses, where opportunities for better jobs and greater wealth are available to all Philadelphians, and where local government has sufficient financial resources to provide high-quality services to the community. To realize this future, Philadelphia must reverse decades of job and population loss.

Rather than witness further decline, we propose taking the steps necessary to generate 70,000 jobs in Philadelphia by 2025 beyond what can be expected if we maintain the status quo, including a net gain of about 25,000 jobs over where employment stands today. In order for Philadelphia to position itself for growth out of the current recession, the City must begin its efforts now.

Philadelphia's declining share of the nation's and region's economic activity has contributed significantly to deficiencies in the real estate market. Lack of demand depresses prices below the cost of construction, discouraging new construction and ongoing investments and upgrades in properties. The major construction cost factors, such as prices for materials, labor, land, and professional services are largely beyond the sphere of influence of local government. Thus, the Task Force believes that government can best enhance the competitiveness of the real estate development market and the economic future of all Philadelphians by creating an environment in which there is more demand for Philadelphia's real estate from people who want to live and work here and from businesses that want to locate and grow here.

We understand that improving Philadelphia requires progress on a number of fronts and we benefitted from many suggestions made at public hearings; but this report is specifically focused on tax policy and real estate development. In particular, the Task Force fully understands that improving levels of educational attainment for the working population of the city and reducing poverty is essential to achieving the goal of a thriving, vibrant Philadelphia. We also know that efforts to address education and poverty cannot be successful if the city fails to offer meaningful job and business creation opportunities for its residents.

The Task Force concludes that Philadelphia must make fundamental, transformational changes in the way government does business and in what we choose to tax in order to make this city competitive and avoid a future of continued job and population loss and the associated increase in poverty and decrease in services. The recommendations laid out in this report will transform Philadelphia's dated tax structure and real estate environment into one that fosters growth and opportunity in a modern, services-based economy.

To create new opportunities for residents and businesses, Philadelphia must have:

Accurate, Easy, and Transparent Government Interactions— Today, Philadelphia's tax structure and real estate development environment appears to be complex and unpredictable, allowing those in-the-know to gain an advantage, driving others to leave, and scaring off potential residents, investors, and entrepreneurs.

A Tax Structure and Development Environment That Encourages Growth Opportunities — Philadelphia now heavily taxes things that can pick up and leave, such as residents, employees, and businesses, with its Wage and Business Privilege Taxes. As technology and globalization have made it possible for people to work and businesses to locate almost anywhere, these taxes chase residents, companies, and jobs out of Philadelphia into the suburbs and to other regions.

A Lower Overall Tax Burden— Changing Philadelphia's mix of taxes and making interactions with government easier and more predictable can create opportunities for job seekers, businesspeople, entrepreneurs, and homeowners. Yet Philadelphia has no chance of reaching its potential if it continues to place one of the largest tax burdens in the nation on its firms and families. In order to be competitive with our neighboring suburbs, the City needs to reduce the overall tax burden on residents and businesses through reductions in spending, growth in non-tax revenues, and, where possible, additional and better targeted support from the state and federal government.

WHY NOW? THE CASE FOR REFORM

No one likes to pay taxes. Yet local taxes are how we raise the money needed for important community services – public safety, a clean environment, and quality public schools. The challenge for Philadelphia is to find ways to raise the money it needs without imposing a burden that chases businesses and families away, deters others from moving in, and leaves the remaining taxpayers with an ever larger tax bill for the same or reduced level of services.

Nearly three-quarters of the financial support for municipal government is generated locally by taxing people, jobs, real estate, and business activity that occurs within the city's borders. While the City must continue to seek more financial support from higher levels of government for providing mandated county services, Philadelphia must also work to foster an environment conducive to job and population growth.

Philadelphia's history of population and job loss is, in large part, driven by the historical transition from an industrial to a service economy. A century ago more than half our working population was employed in manufacturing establishments that were dependent on our fixed rail lines and on the port. Today, less than 5% of our workforce is engaged in manufacturing. In the digital age, when people and businesses are highly mobile, Philadelphia's tax structure and development environment is exacerbating and accelerating the city's decline. Designed for a manufacturing economy, Philadelphia's tax burden on its residents and businesses is now far heavier than elsewhere in the region or in the country, but we do not offer a commensurate increase in the quantity and quality of municipal services.

Despite the global recession which presents immediate challenges to all cities' budgets today, trends are tilting in Philadelphia's favor. Across the United States, there is growing demand for walkable, transit-oriented communities rich with cultural amenities, well-maintained public parks and attractive waterfronts. Philadelphia has many inherent advantages that should allow it to capitalize on these favorable trends, and municipal government has a significant opportunity to reposition the city for renewed growth once recovery takes hold. To participate fully in recovery, we must first address our own shortcomings.

Philadelphia is older, poorer, and less educated than other cities.

While Philadelphia must be mindful of how the city compares to its peers across the nation and around the world, in terms of taxes we must also look closer to home and focus on our competitiveness within the region. Firms deciding whether to locate in Philadelphia or Phoenix will consider many factors including availability and quality of labor, proximity to suppliers and clients, and transportation infrastructure, before exploring the tax implications of each location. However, once firms are focused on the region and are deciding between Philadelphia and Conshohocken, local taxes become a more prominent factor in the decision making process. A Philadelphia that is more competitive with its suburbs and other East Coast centers as a business location can expand economic opportunities for all citizens and restore the city's role as a leader of regional growth.

How Did We Get Here

Philadelphia's current trajectory of job loss, declining population and rising poverty rate has its roots in external forces and in policy decisions at the local level. Understanding how the city came to reach its present condition has helped the Task Force craft a meaningful and appropriate strategy to do better.

Population and Employment

During the nineteenth century, Philadelphia became this country's largest manufacturing city and was home to a wide variety of industries ranging from textiles to sugar refining to ship-building to railroads. Like many industrial cities across the United States, Philadelphia's population peaked in the 1950's and has been steadily declining ever since. In 1950, Philadelphia had 2.07 million residents and was the third largest city in the United States, behind only New York and Chicago.

Over the next six decades, Philadelphia lost more than 620,000 residents, or 30% of its 1950 population, according to U.S. Census data. Philadelphia's greatest population loss occurred during the 1970's when the city lost more than 260,000 people in a single decade. Today, Philadelphia has 1.45 million residents and is the sixth most populous city, behind New York, Los Angeles, Chicago, Houston, and Phoenix.

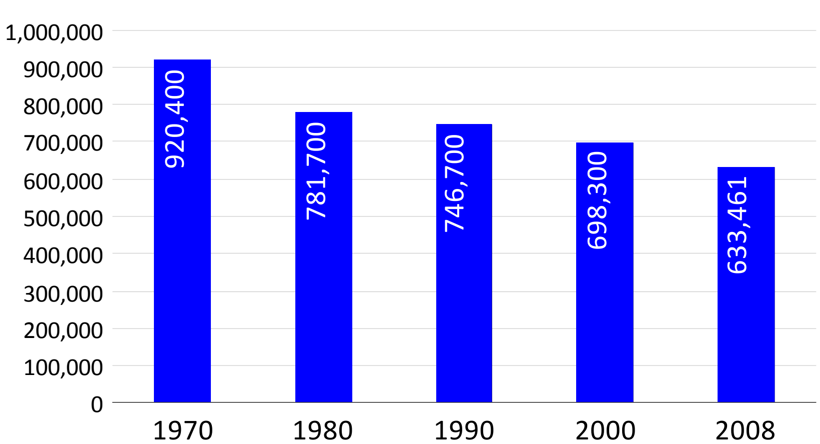
Concurrent with dramatic population loss, Philadelphia has lost jobs at an alarming rate. In 1950, Philadelphia's share of total employment in the United States was over 1%. Today, Philadelphia's share of national employment is just 0.4%, a decline of more than half.

Not only has Philadelphia lost jobs relative to the nation Philadelphia has lost market share within the Greater Philadelphia region, according to the Center City District. In 1993, 41% of the region's private jobs were located in Philadelphia. Today, Philadelphia has just 26% of the total private employment in the region.

Poverty

Philadelphia's population declined as working and middle class residents left and its poverty problem grew. Philadelphia currently has the highest poverty rate among the ten largest cities in the U.S. According to the American Community Survey, as of 2007, nearly one-quarter of all individuals, one out of every five families and more than one-third of children in the city, are living at or below the poverty level. The negative impact of these statistics on City government is twofold. First, poor citizens require greater municipal assistance. Secondly, they are unable to contribute to the tax base as fully as others.

Philadelphia Employment 1970-2008



Educational Attainment

Philadelphia residents have a low level of educational attainment. According to the 2005 - 2007 American Community Survey, only 21% of Philadelphia residents had earned a bachelor's degree or higher, while an equal number of Philadelphia's residents have not even graduated from high school. The link between education and employment is critical. A 2007 study, A Tale of Two Cities, noted that the earning capacity of Philadelphia residents without college degrees was significantly lower and the unemployment rate was dramatically higher (between 19% and 25%) than for those with a college degree (3.5%). The lack of an educated city workforce is a significant barrier to attracting new businesses and investment to Philadelphia.

Aging Population

While an aging population will affect many of the nation's cities in the coming years, Philadelphia's senior population is particularly large and vulnerable. The Philadelphia Corporation on Aging reports that nearly half (46%) of Philadelphia's seniors have incomes of less than 200% of the poverty level, compared with only 18% of seniors in the four surrounding suburban counties. This growing, relatively poor senior population will require significant governmental and social services that will put a further strain on the City's budget.

Combined City /County Service Burden

Philadelphia has a significant financial burden which comes from being a city and county. Most American cities are located within larger counties. The cities are responsible for providing basic services like trash collection and police and fire protection. The larger counties – made up of the central city and the often wealthier surrounding suburbs – raise revenue for other government functions like social services and the courts.

Since 1854, the City of Philadelphia has shared the same boundaries as the County of Philadelphia. When the city held the lion's share

Expenditures per Capita on City Functions

Rank	City	Population	Police	Fire	Highways	Parks & Recreation	Housing & Community Development	Total
1	New York City	8,363,710	$562	$202	$77	$75	$421	$1,336
2	San Francisco	808,976	$491	$320	$76	$303	$145	$1,336
3	Baltimore	636,919	$653	$251	$186	$102	$83	$1,275
4	Detroit	912,062	$564	$249	$143	$88	$122	$1,166
5	Milwaukee	604,477	$433	$197	$263	$8	$244	$1,144
6	Boston	609,023	$547	$320	$84	$30	$150	$1,130
7	Chicago	2,853,114	$494	$164	$191	$32	$108	$989
8	**Philadelphia**	**1,447,395**	**$419**	**$142**	**$44**	**$57**	**$194**	**$855**
9	Phoenix	1,567,924	$281	$143	$97	$67	$77	$665

Source: U.S. Census Bureau Survey of Government Finance, 2005-2006 Fiscal Year; Population data from US Census. Note: Washington, D.C. is not included in the analysis due to a lack of comparable data. While the US Census of Governments data allows us to compare expenditures along similar functions in different cities and counties, the data does not quantify to what extent different places provide different levels of services. The degree to which any place provides a higher level of service than its peers cannot be identified in the data and may alter conclusions.

Expenditures per Capita on County Functions

Rank	City	Welfare	Health & Hospitals	Judicial and Legal	Total	State Operation of Welfare?
1	San Francisco	$757	$1,942	$120	$2,819	No
2	New York City	$1,242	$1,227	$76	$2,545	No
3	**Philadelphia**	**$456**	**$1,069**	**$192**	**$1,717**	**No**
4	Boston	$300	$349	$29	$679	No
5	Baltimore	$5	$233	$102	$339	Yes
8	Detroit	$12	$87	$89	$189	Yes
9	Chicago	$52	$75	$14	$141	Yes
10	Milwaukee	$0	$65	$29	$94	No
11	Phoenix	$0	$0	$38	$38	No

Source: U.S. Census Bureau Survey of Government Finance, 2005-2006 Fiscal Year; Population data from US Census. Notes: Washington, D.C. is not included in the analysis due to a lack of comparable data. While the US Census of Governments data allows us to compare expenditures along similar functions in different cities and counties, the data does not quantify to what extent different places provide different levels of services. The degree to which any place provides a higher level of service than its peers cannot be identified in the data and may alter conclusions.

of the region's employment, this was not a major problem. Today, residents of the city pay for both city services and county functions while residents of our competitors in the region and around the nation typically do not. Further, other cities that have a coterminous city and county, such as Denver and San Francisco, also have lower levels of poverty than Philadelphia and thus a lower service burden.

The burden of providing county services has squeezed other areas of the budget. Between 1952 and 2008, the number of Philadelphia government employees engaged in the provision of city services has grown by just 4%, while the number of employees needed to support the county functions has grown by 63% over the same time period. Today, Philadelphia spends more per capita on county services than many of its peers, but less for city services. Thus, Philadelphians are paying more in taxes than their peers in other cities but are seeing less spent on the services which directly impact their neighborhoods.

The Task Force is keenly aware of the need for wider sharing of the cost of county services. Unfortunately, the feasibility of securing additional support from other governments in the short term is highly uncertain. The Task Force has focused its recommendations on proposals that can be implemented with limited assistance from other levels of government. This approach is not only the most practical but it represents the best response to those who criticize Philadelphia for seeking help without getting its own house in order.

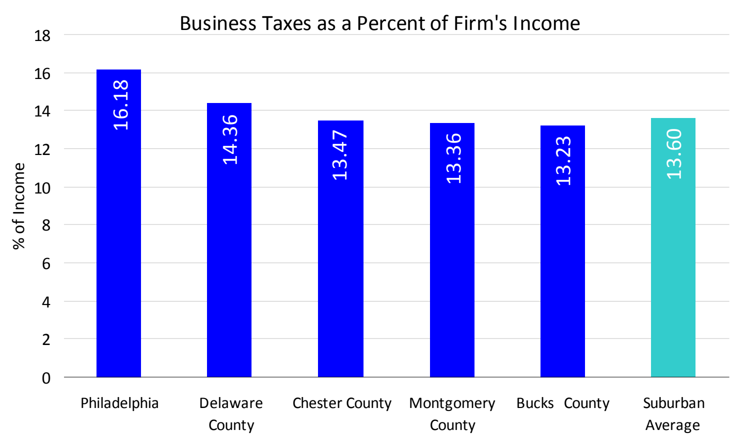
Competitive Position in the Region

Philadelphia residents and companies are the most heavily taxed in the region. Philadelphia currently taxes its residents 3.93% on gross wages, whether earned inside or outside the city. The City taxes non-residents 3.5% on all wages earned in Philadelphia. Approximately 70% of Philadelphia suburban municipalities in Pennsylvania have an income tax, but the tax rate for most other jurisdictions is no higher than 1%. According to The Wharton School's Robert Inman, a typical Philadelphia-based corporation pays more than 16% of total income in local taxes, while the average suburban firm pays only 13.5% of its income in local taxes. The difference is even larger for non-corporate small businesses.

Competitive Position with Peer Cities

Philadelphia has more and higher business and individual taxes compared to its peer cities. Philadelphia has 20 different taxes, significantly more than Boston (7 taxes) or even New York (15 taxes). When combined, Philadelphia has the highest overall tax burden for households at all income levels among the largest city in each of the 50 states and Washington, D.C according to an annual study prepared by the Washington D.C. Chief Financial Officer.

A 2008 report by Econsult analyzing tax abatements in Philadelphia found that absent a subsidy, such as the 10 Year Tax Abatement, the average newly built home in Philadelphia would sell at just 25% of the cost of construction (although this figure is downwardly biased as existing homes were included in the calculation of average home price). Report author Kevin Gillen also found that approximately two-thirds of homes in Philadelphia are valued below replacement cost.



Source: "Local Taxes and the Economic Future of Philadelphia: 2009 Report." Professor Robert Inman, The Wharton School, August 2009.

Leading developers of commercial properties also indicate that construction costs in Philadelphia are significantly higher than in other U.S. markets, and that commercial rents are not high enough to justify new construction in this market. Jerry Sweeney of Brandywine Realty Trust advised the Task Force that buildings in Philadelphia sell at rates that are $245 to $500 per square foot cheaper than other East Coast cities such as New York, Washington DC and Boston and that these prices are far below what it costs to produce these buildings. So absent tax incentives, it makes little sense for developers to build major office buildings that can only be sold at a loss. RS Means, a provider of construction cost data, reports that Philadelphia's housing construction costs are 18% above the U.S. average. These findings illustrate the urgency of the problem.

WHAT WE DO RIGHT

Despite the many challenges that the city faces in terms of population, employment and demographic shifts, Philadelphia has many strong assets that can position the city for population growth and economic recovery if some of the current barriers to living, working and investing in the city are removed. We need a transformational change to our tax and regulatory environment to put Philadelphia on par with its suburban neighbors and peer cities, so that the city can take advantage of the opportunities generated by what we already do right.

At the Center of a Strong Region

Philadelphia is located right at the center of a large and dynamic regional and super-regional market. There are 46.1 million people and $1.3 trillion in annual income within a 200 mile radius of Greater Philadelphia. The population of the Greater Philadelphia region is 6.1 million and the region's gross product was $354 billion in 2008. Greater Philadelphia is the second largest market on the East Coast in terms of population, employment and average family income. Philadelphia is strategically located in between the financial and political capitals of the nation, and is immediately accessible via a short drive, train ride or flight to New York and Washington, DC.

Transportation Infrastructure

Philadelphia is highly accessible to both domestic and global markets with an integrated, multi-modal transportation infrastructure. Thirty-two million passengers travel through Philadelphia International Airport annually and there are 600 daily flights to 126 destinations. The Philadelphia Regional Port Authority is the number one perishables port on the East Coast. Philadelphia's extensive regional public transit network includes bus, subway, trolley and regional rail, and is used by one-third of the region's population. Seventy percent of downtown office workers arrive at work each day by taking public transit.

Access to the Regional Workforce

There are approximately 3 million workers in Greater Philadelphia, and our region ranks second in Bachelor's degrees per capita and third in advanced degrees per capita among the top 25 regions in the country. Ninety-two colleges and universities fuel the talent pipeline for Philadelphia based companies who seek to hire recent graduates.

Stable and Balanced Economy

Philadelphia's economy is diverse, with a stable core of life sciences, healthcare, and higher education, a strong concentration of professional and business services, an expanding hospitality and tourism sector, and industry leading companies in fields ranging from petroleum refining (SUNOCO) to apparel (Urban Outfitters) to telecommunications (Comcast).

Philadelphia's leading educational institutions spend nearly $1 billion per year in research and development, and the University of Pennsylvania was the third largest recipient of National Institutes of Health funding in the nation in 2008.
In 2008, Philadelphia had nearly 30 million visitors and was the fastest growing destination for international travelers among the top 20 markets in the country. Philadelphia's unique and authentic historic tourism attractions, such as Independence Hall and the Liberty Bell, draw millions of visitors each year.

Excellent Quality of Life

Philadelphia offers an extraordinary qualify of life with an affordable cost of living. Local residents and visitors have access to incredible arts and culture offerings in Philadelphia, including the Philadelphia Museum of Art, the Kimmel Center for the Performing Arts, the Philadelphia Orchestra, and soon, the Barnes Foundation. All four major professional sports teams play in a centralized sporting complex that draws eight million attendees per year.

Center City Philadelphia has the third largest downtown residential population in the country, behind only New York and Chicago. More than half of those downtown residents walk or bike to work, more than in any other major American city. This relative convenience and walkability is a significant advantage that the city holds over the suburban areas for residents and employees. The downtown offers more than 2,300 retailers, 266 fine dining establishments, and 215 sidewalk cafes.

Affordable Cost of Living

Even with all of these amenities, Philadelphia offers an affordable cost of living relative to its peer cities. In order to enjoy the same quality of life, the average professional services employee living in Philadelphia would have to earn 9% more in Boston, 11% more in Washington, DC and 73% more in New York City.

Many of the members of the Task Force have come to Philadelphia after living and working in other places. Throughout our work, as we discussed the large problems the City faces, our discussions were punctuated by the ongoing realization that Philadelphia has great things to offer businesses and residents and should be competitive with any city in the United States.

Where Are We Going

Despite Philadelphia's assets and amenities and the strength of the region's workforce and economy, the city's future is far from rosy. Regardless of the eventual rebound of the global, national, and regional economies in the next few years, Philadelphia will not grow or even hold steady if we do not address our current barriers to growth. If our taxes remain high, if our people continue to live in poverty due to a lack of educational and employment opportunities, and if our government cannot afford to provide the high-quality services to residents then Philadelphia will continue on its path of decline.

In 1999, Philadelphia's City Controller's Office presented a similarly discouraging vision for Philadelphia's future of job and population loss. It envisioned that Philadelphia's share of the nation's employment would shrink and the total employment in the City would be 780,100 by 2015, 13.5% lower than the 1970 level. Those projections now appear optimistic. According to the Bureau of Labor Statistics, Philadelphia had just 637,600 jobs at the end of 2008.

Philadelphia's Expected Future:

- **Job loss**
- **Population decline**
- **Inadequate resources for city services**

To understand where Philadelphia is headed absent transformational changes, the Task Force sought assistance from economists at Temple University and Moody's Economy.com. Both groups of economists projected continued employment and population losses for Philadelphia; their only disagreement had to do with rate and severity of decline. Charles Swanson of Temple University's Department of Economics expects Philadelphia to lose one-fifth of its jobs between 2008 and 2030. The Moody's Economy.com estimate of a 5% drop in employment seems rosy in comparison, but is still nothing to celebrate. Accompanying this projected employment loss is continuing population loss.

Philadelphia is not in a position to shrink gracefully – our citizens do not require less or lower quality services just because there are fewer of us remaining. The government is locked into long-term fixed costs from agreements made and funds borrowed in years past, and we struggle to maintain infrastructure and facilities built for a city of 2 million people. Just because Philadelphia's population has declined by about 30% since the middle of the last century does not mean that we can simply stop repaving 30% of the streets.

Employment growth is the only option to prevent further deterioration to the quality of life for Philadelphians. Many Philadelphians have worked with ingenuity and passion to create a better future and have achieved successes, but more needs to be done. Progress in areas such as literacy, education, and re-entry for ex-offenders is essential but none of those efforts will ultimately be successful if there are no jobs for Philadelphians. There is one bright spot in this realization. While many factors affect job opportunities in Philadelphia, the tax structure is not only highly influential on the decisions of businesses and residents in the region, but it can be changed quickly. It can take years or decades to see the economic benefits from improvements to our educational system, but improvements to our tax structure can bear fruit almost immediately. It is for this reason that addressing Philadelphia's economic competitiveness is an imperative and is a precursor to solving the city's more intractable challenges. The Task Force urges a major transformation in how Philadelphia raises revenue and does government's business in order to realign Philadelphia's expected trajectory to a more favorable path.

About the Task Force's Work

The Task Force was formed by Executive Order in February 2009 and began meeting in April 2009. Since its formation, the Task Force has met as a full group or in subcommittees every other week for a total of 18 meetings. Over the course of its work, the Task Force has heard from over thirty organizations and individuals in their respective areas of expertise. All meetings, as per the executive order, were open to the public.

In addition, the Task Force has held two public hearings – May 21, 2009 and August 13, 2009 – to receive public feedback. Community residents, business representatives, and other interested individuals attended these meetings and provided testimony regarding their thoughts on the current status and future vision of tax policy and real estate development in Philadelphia. Task Force members also sought input from City Council and their staff in order to better appreciate constituent concerns.

The Task Force began their work by reviewing the work and analysis conducted from previous task force commissions, study groups and independent organizations who have reviewed Philadelphia's tax policy and real estate environment in the past. In addition, the Task Force gleaned lessons from numerous empirical analyses on the effects of previous government policies. The Task Force also reviewed the tax and development structure in other comparable cities and jurisdictions in order to build a richer understanding of how Philadelphia compares within the region and the nation.

In building its final recommendations, the Task Force relied on job and population baseline projections provided by economists at Temple University and Moody's Economy.com. From these baselines, the Task Force modeled different combinations of policies to reach a goal of 70,000 more jobs than the status quo. The Task Force examined these scenarios from individual homeowner and business perspectives and the City's revenue and expenditure perspectives. Importantly, not all Task Force recommendations could be modeled in this manner.

Ultimately, the Task Force selected the combination of policies that 1) could be implemented within a reasonable time period; 2) were supported by empirical evidence or had been tested successfully in other locations; 3) had the greatest positive impact on jobs and economic growth relative to any negative impact on City revenues; and 4) protected vulnerable populations.

One of the strengths of this Task Force is its diverse membership, including tax and legal professionals, business and community leaders, academics, labor representatives, and Philadelphia residents. That being said, while these recommendations represent the strong consensus of the Task Force, not all of the recommendations were unanimously agreed upon. While there is no single, perfect set of recommendations the Task Force has formally adopted this report as expressing its collective opinion on how to best move Philadelphia towards a path to prosperity.

More information on the Task Force's modeling of tax changes can be found in Appendix D, which is available on the Task Force's website. Meeting minutes, videos of public meetings and other supplemental information is also available on the website, accessible at www.phila.gov/TaxPolicy.

The Important Policy Idea

Shift from Mobile to Immobile Tax Bases

When Philadelphia's current tax system took shape, it made sense to tax jobs and businesses. When the Wage Tax was first imposed in 1938, the Philadelphia economy was still dominated by manufacturers and the region's transportation infrastructure was built around rail-lines and the port, not interstates and airports. The manufacturers operated factories with large, difficult to move equipment and needed to be close to their workforce and transportation networks to bring in materials and send out finished products. Most employees did not own autos or have means to commute long distances to work; rowhouses were built by the thousands and people lived close to the factories where they worked. The importance of these factors made taxes a secondary concern – the value of being in the center of a dense labor pool and close to road, rail, and waterway systems gave Philadelphia its value as a business and residential location.

Today's business equipment is not a lathe, it is a laptop. With changes in the technology, transportation, regional residential patterns, and the nature of Philadelphia's economy, firms and their employees are no longer tethered to their location in the central city. Fewer products are shipped by rail, more services are transmitted digitally. Tax savings from moving to a lower cost community in the same region no longer means losing one's labor force, customers, or suppliers. Given the increasing mobility of jobs and businesses within the region, Philadelphia can no longer afford to rely on mobile tax bases for financial support. In addition to taxing too much, Philadelphia is also taxing the wrong things.

If you tax things that can move away at a minimal cost, they will.

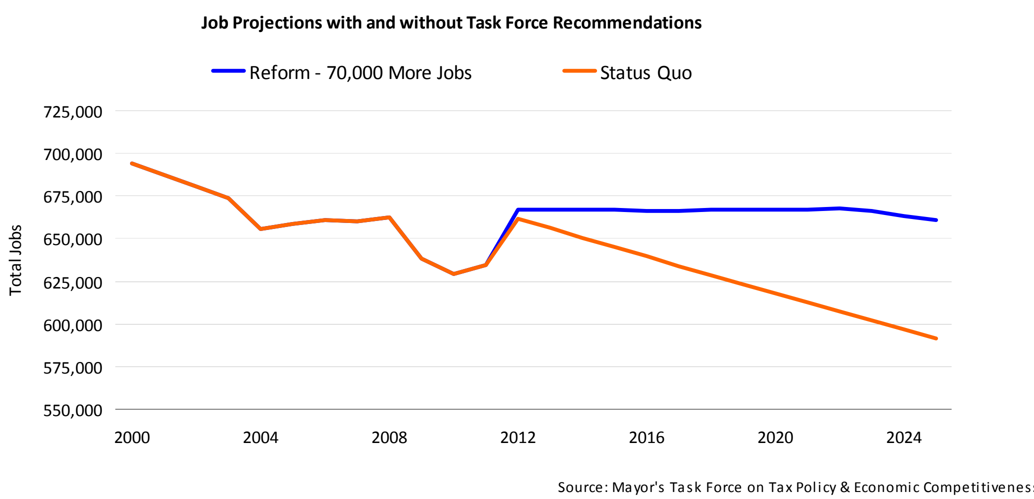
A better mix of taxes for Philadelphia is one that relies less on mobile tax bases like jobs and businesses, and relies more on revenues from the City's assets that cannot be moved: its land and buildings, provided that there are accurate and equitable property assessments upon which to base the tax. Reducing Philadelphia's tax burden and altering the mix of taxes that support local government will help retain existing taxpayers and residents, expand opportunities and wealth, increase small and minority business formation, and attract new people and investment to the City. The Task Force's recommendations seek to increase employment in Philadelphia by 70,000 jobs by 2025 over current projections.

Restart Planned Cuts to the Wage & Business Privilege Tax in 2012 and More Aggressively Reduce Wage Tax Rates

Reducing reliance on mobile tax bases means that the City must continue its planned reductions to the Wage and Business Privilege Taxes. Incremental rate reductions since the 1990's have helped the city retain jobs that it would have otherwise lost. Pausing planned reductions in rates cuts during the current downturn was prudent, but cannot continue past 2012. As the economy begins to rebound Philadelphia cannot expect to participate in a recovery without restarting its efforts to reduce the tax burden. Resuming a rate reduction schedule in 2012 is imperative or the opportunity to leverage the expected upswing will be lost.

The research tells us that without the Wage Tax reductions begun in 1996, Philadelphia would have 25,000 fewer jobs than it has today. Reductions must continue to lighten the burden on Philadelphia residents and commuting employees and to encourage business retention and attraction. Highly mobile service sector jobs, a growing share of the national economy, are more sensitive to changes in the Wage Tax rate than the average Philadelphia job. For this reason, it is imperative that rate reductions continue in order to provide opportunities for Philadelphians in this growing, relatively high wage sector.

The Task Force's recommendations call for an incremental reduction by 2025 of the Wage Tax, combined with Business Privilege rate reductions, until the wage rate for Philadelphia residents drops to 2.7%, the lowest it has been since 1969. The Non-resident Wage Tax rate is particularly discouraging for firm and job location in the city, and therefore we recommend the rate be reduced to 2.4 percent over the same period. The net income portion of the Business Privilege rate would be reduced to 6% and the gross receipts portion would be eliminated by 2025. Our analysis (see Appendix D) anticipates that this set of rate reductions will add 70,000 jobs to Philadelphia by 2025 above current projections for the future. Although the rate reductions leave Philadelphia with tax rates on earned income still higher than surrounding communities, the gap between the Wage Tax rate and earned income tax rates in neighboring jurisdictions will be significantly narrowed such that it is less of a deciding factor in business and residential location choices.



The Task Force has also considered numerous combinations of business tax reductions and shifts to achieve the goal of job creation. Philadelphia has too many taxes and taxing businesses on both gross receipts and net income cannot continue. This unusual practice of taxing both gross receipts and net income means that firms pay even when they do not turn a profit. The Task Force found, based on historical experience, that reductions to the gross receipts portion of the Business Privilege Tax produce significant increases in business activity, and as a result jobs. Additionally, the gross receipts tax requires businesses to pay even when they are losing money and represents a real barrier to entrepreneurs starting a new business here. For this reason, the Task Force favors the elimination of the gross receipts portion of the BPT. This will have the effect of eliminating gross receipts payments not only for Philadelphia firms but also companies outside the city that sell products or

How does Philadelphia create 70,000 jobs by 2025?

Incrementally:

- Reduce the Resident Wage Tax rate to 2.7%
- Reduce the Non-resident Wage Tax rate to 2.4%
- Reduce the Net Income portion of the BPT to 6%
- Eliminate the gross receipts portion of the BPT

What else needs to happen?

- Reduce City spending by up to $200 million a year
- Modestly increase the share of revenue from Real Estate Tax
- Increase share of Real Estate Tax revenue from commercial and industrial properties

services here but do not have to pay the net income portion of the tax. Although losing revenue from those distantly located firms is not optimal, it is a worthwhile tradeoff in order to increase job opportunities and make it easier for Philadelphia to foster new and growing businesses. Changes to the apportionment of net income portion of the tax would ensure that service providers located outside the city with Philadelphia clients would continue to pay.

Although exact predictions are not possible, economic theory suggests that reducing the net income portion of the Business Privilege Tax would have a positive impact on job opportunities in the city. For this reason, the Task Force recommends proceeding with planned reductions to the net income portion from its current level of 6.45% to 6% by 2025.

By reducing both its Wage and business taxes, Philadelphia will create more demand by businesses for commercial and industrial properties within the City and therefore, in the long-term, growth in real estate taxes paid by commercial and industrial properties.

Offset a Portion of the Rate Reductions through an Increase in Real Estate Tax Revenue.

Expenditure reductions and expansion in the commercial and industrial tax base will likely not absorb the entire cost of cuts to the Wage and Business Privilege Taxes, necessitating a rate increase to the Real Estate Tax. Since working Philadelphians will benefit from the Wage Tax rate reductions it is appropriate that they bear some of the burden associated with a property tax increase. The Task Force recognizes that while many property owners are working, those who are not will also face increased property tax burdens under this proposal. Fortunately, there are state and local programs available to assist low- and fixed-income homeowners from property tax increases to ease or remove any increased burden. Additionally, Real Estate Taxes will be offset in part by the ability to deduct them from federal taxes. The amount of the increase when implemented will be dependent on the amount of revenue needed.

The uniformity requirement in the Pennsylvania Constitution creates a tax regime that is unlike those found in other cities, including New York City and Boston, where commercial and residential property can be taxed at different rates. In Philadelphia the requirement for uniform rates contributes to the relatively low share of Real Estate Taxes that come from commercial and industrial real estate. The Use & Occupancy Tax, a tax on the business, trade or other commercial use and occupancy of real estate located in Philadelphia, represents an additional burden for commercial and industrial properties. This burden should also be considered in discussions of shifting to a greater reliance on property-based taxes from these types of properties, but does not reduce the viability of this recommendation. When the Use and Occupancy Tax is included in estimates of the share of property-based taxes derived from commercial and industrial real estate, the share, at 34%, remains well below the percentage in other large Northeast cities.

Revenues By Tax Type as a Percent of General Fund Revenue (in $millions) FY 08 or 09

	Baltimore	Boston	Chicago	Detroit	Milwaukee	NYC	Philadelphia	Phoenix	San Francisco	Washington, D.C.
Property Tax	$681	$1,392	$829	$245	$125	$14,357	$403	$110	$940	$1,885
% of revenue	51%	59%	26%	17%	21%	62%	11%	11%	34%	33%
Earnings Tax	$262	$0	$362	$275	$0	$6,944	$1,206*	$221	$0	$1,308
% of revenue	19%	0%	15%	19%	0%	12%	32%	22%	0%	23%
Business Tax	$0	$0	$94	not avail.	$0	$4,619	$400	$0	$394	$433
% of revenue	0%	0%	3%	not avail.	0%	20%	11%	0%	14%	7%

Source: Dean Kaplan, Public Financial Management with additional cities added by Mayor's Task Force on Tax Policy & Economic Competitiveness. *Total City Wage, Earnings, and Net Profits Tax.

Implement a Homestead Exemption to Protect Homeowners

The Task Force recommends implementing any required Real Estate tax rate increase in a manner that will minimize the burden on homeowners through the introduction of a homestead exemption, which would have the effect of increasing the share of Real Estate Tax revenue collected from commercial and industrial properties. A homestead exemption reduces the amount of an owner-occupied home's taxable value. For example, if Philadelphia offered a $5,000 homestead exemption, a homeowner whose house is worth $100,000 would pay taxes on $95,000 while a commercial property worth $100,000 would continue to pay taxes on the entire $100,000. Adopting a homestead exemption will require authorization from the state legislature. However, enabling legislation for a homestead exemption is already state law and more than half of the Commonwealth's counties have already been granted state approval to offer such exemptions.

Comparison of Real Estate Taxes
Residential vs. Commercial

City	% of Real Estate Taxes Residential	% of Real Estate Taxes Commercial
Baltimore	70%	25%
Boston	36%	56%
DC	43%	56%
Milwaukee	61%	23%
NYC	50%	43%
Philadelphia	55%	27%

Source: Assessment agencies in respective cities and counties.
Note: Data not readily available for Chicago, Detroit, Phoenix and San Francisco. Due to differences in categorization, percentages may not total to 100%.

Low-income non-working seniors will see no difference in their tax burdens because they do not currently pay the Wage Tax and the City already has a program to freeze their tax bills in the event that their assessment or Real Estate Tax rate goes up. Working renters may face higher rents as landlords pass along the increase in Real Estate Tax, but they will also benefit from the lower Wage Tax. All Philadelphians seeking employment will benefit as more job opportunities will be available.

The Task Force considered the impact of tax rate changes on property values in its analysis. While Real Estate Tax increases may decrease property values, it was of the utmost importance to protect homeowners' investments. This was accomplished by limiting the magnitude of the increase on homeowners with a homestead exemption and recommendations to reduce city expenditures. At the same time Wage and Business Privilege Tax rate reductions will also increase the value of commercial and industrial property. Today Philadelphia often boasts of the affordability of rents for office space compared to its peers, like Washington DC, Chicago, New York and Boston. Although a nice selling point, the low rents are a function of insufficient demand. Given business and wage taxes, many firms that want to be in the region, choose to locate outside of the city. As a consequence there is limited competition for space which depresses rents and discourages new construction despite low vacancy rates compared to neighboring jurisdictions. For example, while nationally, 33% of commercial office space is located in central business districts, only 28% of this region's office space is located downtown. This is a number far closer to sprawling auto-dependent regions than to other cities that have as strong a transit infrastructure as Philadelphia.

Cost of Wage & BPT reductions – Expenditure Reductions
=
Amount of additional revenue needed from Real Estate Taxes

By reducing the Wage and Business Privilege Taxes, Philadelphia becomes a more desirable location. More firms will demand space, increasing the rents that landlords can charge and the amount businesses will pay for real estate. This increase in commercial and industrial property values will translate into higher property assessments which lead to higher tax bills for commercial and industrial properties even without a rate increase.

The increase in property tax bills will not negate the benefits of lower Wage and Business Privilege Tax burdens. According to the Center City District, for the downtown commercial office sector, real estate taxes have constituted about 10.5% of occupancy costs - $3.10 per square foot out of an average rent of $29.23 per square foot, a much lower percentage than in other cities. Although not necessarily true in all instances, since this number is a component of rent, commercial officer brokers and developers believe that from a tenant retention and attraction perspective, there is a huge upside in reducing the Business Privilege and Wage Taxes. The Wage Tax, which while technically paid by the employee, often puts a burden on the employer located in the city because of the need to pay their employees (who could take a job in the suburbs instead) higher salaries or compensation to off-set that tax.

SHIFT FROM MOBILE TO IMMOBILE TAX BASES

Action Steps:

- City Council must authorize and the Administration must implement reductions to the Wage and Business Privilege Taxes beginning in 2012.
- City Council must authorize and the Administration must implement more aggressive rate reductions to the Wage Tax.
- The Administration must work with Philadelphia's delegation in Harrisburg to gain legislative approval for a homestead exemption for homeowners.
- The City Council must approve changes to the city-portion of the Real Estate Tax to close the gap between the cost of Wage and Business Tax cuts and the amount of expenditure reductions that can be achieved.

Benefits:

- More job opportunities for Philadelphians.
- Lower cost of doing business for firms.
- Improved environment for entrepreneurs.

How Do We Get There: Administrative Improvements

While shifting the share of revenue that the City derives from mobile to immobile taxes is an essential part of the Task Force's recommendations, Philadelphia is not yet ready to implement this change. The shift to a greater reliance on property taxes requires a reliable system for levying and collecting that tax. A major impediment is the widespread perception that the City's property assessment system is flawed. Property owners cannot be expected to accept possibly larger tax bills if the system of determining who pays what is thought to be unreliable, inequitable, opaque, and inaccurate. Philadelphia also needs to ensure other barriers to businesses and development are addressed and that the City has the appropriate tools to administer an efficient and fair tax system. So, municipal government should use this severe downturn in the economy to get its house in order and be prepared for the eventual rebound.

The Task Force identified the following changes as prerequisites to shifting from mobile to immobile taxes which, if implemented now, can quickly alter the way businesses are taxed and begin to remove disincentives for locating in Philadelphia. Work on these initiatives should commence immediately so the City is prepared to aggressively reduce Wage and Business Privilege Tax rates starting in 2012.

Recommendation 1: Remove Barriers to Philadelphia as a Business Location

Philadelphia needs to immediately reduce the burden on mobile tax bases to keep jobs and people in the city. The rules that the City currently uses to determine the share of a business's income that is subject to the Business Privilege Tax and Net Profits Tax are stem from the Uniform Division of Income for Tax Purposes Act (UDITPA), created in 1957 at a time when the economy was more dominated by manufacturing and when local property and payroll investments were necessary to generate revenue. Philadelphia has nearly completed the shift from a manufacturing to service economy, but its tax structure has not kept up. As the global and local economies evolve, Philadelphia's tax code must also evolve if the city is to maintain or expand its share of the nation's employment and economic activity.

Services account for virtually every new job created in America since the 1970s. To have any chance of reaching its potential, Philadelphia cannot maintain a tax structure that is unfriendly to service companies. As other jurisdictions take steps to modernize their tax structure, Philadelphia must not let itself be left behind. With technological advancements and the overall shift to a services-based economy, physical proximity to one's suppliers and clients no longer drives business location decisions. With a laptop, cell phone, and wireless internet connection, most businesses and employees can conduct their affairs from anywhere on the planet, no matter where their customers are located. For these businesses that can choose to locate anywhere, we can no longer afford to give them a reason to avoid Philadelphia.

To determine how much of a firm's profits to tax, the City currently considers whether it has chosen to have property or employees in the city and where the client is located. For two firms with the same profits in Philadelphia, the one that has employees and/or property here pays a higher Business Privilege Tax. This system favors regional businesses that do not locate in the city and creates a disincentive for companies to invest in Philadelphia. For service firms, profits are allocated based on where the firm performs the work, while for manufacturing firms the location of buyer of the product is a determining factor, discouraging service firms with clients outside Philadelphia from locating here. Changes to the Business Privilege and Net Profits Tax regulations can persuade locally-based firms to continue to grow within the city and encourage regional and national companies, particularly service firms, to locate facilities and expand their workforces in Philadelphia.

The Task Force recommends two changes to the city's apportionment formula that can be adopted by administrative action by the Department of Revenue to modernize the City's business taxes – Market-Based Sourcing and Single Sales Factor Apportionment.

Adopt Market-Based Sourcing

UDIPTA created two rules for apportioning sales of businesses that operate in multiple taxing jurisdictions, one for manufacturers, and one for services companies. Under UDIPTA Section 16, sales of manufacturers are apportioned based on the location of the customer, which is known as "market-based" sourcing. Under UDIPTA Section 17, sales of services companies are apportioned based on where the income-producing activity takes place, which is known as "cost of performance" sourcing (COP). However, a growing number of states and local governments have adopted market-based sourcing for services companies, abandoning COP sourcing altogether and treating all companies equally.

While market-based sourcing provides a better measure of the economic profit a company derives from a given marketplace, the principal driver of this shift to market-based sourcing has been for economic development purposes. The second most often cited reason is that it is quite a bit easier to monitor and enforce compliance under market-based sourcing than it is under COP sourcing. Market-based sourcing levies taxes based on the location of the customer, whereas COP sourcing levies taxes based on where the income-producing activity takes place.

Philadelphia currently employs COP sourcing for services companies. Under COP sourcing, Philadelphia-based services businesses are liable for BPT and NPT for any income generated by their employees while working in Philadelphia, regardless of where the customer is located. Under market-based sourcing, Philadelphia-based companies would only be subject to BPT and NPT on income they generate from Philadelphia-based customers. Under market-based sourcing, all companies domiciled outside Philadelphia that sell services to businesses or residents of the City would be subject to BPT and NPT, as long as those business meet minimum nexus standards which would allow Philadelphia to impose the tax.

The Impact of Market-Based Sourcing on Tax Receipts Immediately Following Implementation

The Department of Revenue does not have readily available data to model the potential impact of implementing market-based sourcing. So, the Task Force undertook a study to assess the impact that implementation of market-based sourcing had on state tax receipts in states that have adopted market-based sourcing. The study examined post-implementation revenue trends of five of the eleven states that have adopted market-based sourcing for services. The other states either don't have a history to analyze because of recent adoption, or they had other concurrent, substantive changes to their tax regulations that rendered any observations meaningless. The goal of the study was only to determine whether there were any meaningful, adverse impacts on tax receipts post implementation. The Task Force found none. While this evaluation did not isolate for the impact of implementing market-based sourcing from the effects of general economic activity, revenue trends ranged from -5.6% to +23.8% in the first or second years post implementation. To put this in perspective, -5.6% is the equivalent of $20 million in 2007 BPT revenues. Two of the five states had 4 and 5 years of very strong growth in corporate income taxes following adoption, with no down years. The State of Pennsylvania's Tax Reform Commission 2004 studied the impact of implementing market-based sourcing at the state level, and estimated that the impact would be revenue neutral. This is consistent with the expectations and experience cited by virtually all revenue officials the Task Force consulted with in its study.

What the Task Force Learned from Revenue Officials that Implemented Market-Based Sourcing for Services

In the Task Force's discussions with state revenue officials, two themes emerged. First, economic development was the most commonly cited reason for implementing market-based services. Jim McNulty, Program Manager, Taxpayer Services and Policy Division for Iowa, an early adopter (1992), stated: "(market-based sourcing) enables Iowa-based companies to take better advantage of the Iowa single sales factor and is used by the Iowa Department of Economic Development in recruiting businesses to locate or expand in Iowa. (It) resulted in a tax reduction for many Iowa-based service companies who performed services in more than one state; it resulted in additional tax due for many non-Iowa based service companies who performed services in (Iowa)."Second, compliance monitoring and enforcement is easier under market-based sourcing than COP sourcing. Keith Akers, Chief Auditor for the Maryland Department of Revenue, stated: "COP sourcing is really labor intensive. You have to trace where an activity is performed, salaries of the people that do the work, etc. (Market-based sourcing) is substantially better and easier to enforce." The Task Force wants to stress that while compliance under market-based sourcing may be easier, it is not without its own unique challenges.

Market-based sourcing is the way Philadelphia and municipal governments currently apportion sales for manufacturers. Eleven states have adopted market-based sourcing for services

How Different Types of Companies are Affected by Changes in Apportionment Rules

Company Profile	% of Total Sales to Customers Domiciled in Philadelphia (MBS)	% of Total Sales Where Income Producing Activity Takes Place in Philadelphia (COP)	% Payroll in Phila	% Property in Phila	Revenue	Pre-Tax Income	COP & MFA	COP & SSF	MBS & MF	MBS & SSF	COP & MFA	COP & SSF	MBS & MF	MBS & SSF
Service Companies							Business Privilege Tax Liability				Effective net income rate			
Hotels, Restaurants and Healthcare Providers that have all their payroll and property in Philadelphia, and derive all their sales from the Philadelphia marketplace.	100%	100%	100%	100%	$ 100,000,000	$ 15,000,000	$ 967,500	$ 967,500	$ 967,500	$ 967,500	6.45%	6.45%	6.45%	6.45%
Legal, Investment, Consulting, Accounting, and Software firms that have large employment base in Philadelphia relative to sales.	10%	40%	40%	40%	$ 100,000,000	$ 15,000,000	$ 387,000	$ 387,000	$ 241,875	$ 96,750	2.58%	2.58%	1.61%	0.65%
Legal, Investment, Consulting, Accounting, and Software firms that have no employees or property in Philadelphia but generates sales from the Philadelphia marketplace and have nexus.	10%	0%	0%	0%	$ 100,000,000	$ 15,000,000			$ 48,375	$ 96,750	0.0%	0.0%	0.32%	0.65%
Manufacturing Companies														
Manufacturers where proximity to clients is important; all property, payroll and sales are in the City of Philadelphia (this would be highly unusual in today's global economy).	100%	100%	100%	100%	$ 100,000,000	$ 15,000,000			$ 967,500	$ 967,500			6.45%	6.45%
Manufacturers that have a large employment base in Philadelphia relative to local sales.	10%	40%	40%	40%	$ 100,000,000	$ 15,000,000			$ 241,875	$ 96,750			1.61%	0.65%
Manufacturers that have no presence in Philadelphia, but sell into our marketplace, such as computer hardware manufacturers.	10%	0%	0%	0%	$ 100,000,000	$ 15,000,000			$ 48,375	$ 96,750			0.32%	0.65%

Note: COP is "cost of performance" sourcing; MBS is "market-based" sourcing; MFA is "multi-factor" apportionment (50% sales, 25% payroll, 25% property); and SSF is "single sales factor" apportionment. Source: Mayor's Task Force on Tax Policy & Economic Competitiveness

companies as well, six in just the last three years.

The recent rapid shift to market-based sourcing for services companies can be explained by its attractiveness as an economic development tool. Market-based sourcing essentially lowers the tax burden for local companies, and shifts the tax burden to businesses located elsewhere who derive economic profit from selling into the local marketplace. For services companies already domiciled in Philadelphia and who provide services to clients in the region, nationally or internationally, such as software, accounting, legal, consulting and financial services, they would experience a significant drop in their BPT or NPT liability. Market-based sourcing would also help the city attract multi-state/multi-national services companies, as only a small portion of their sales would be subject to BPT. Market-based sourcing has the added attraction of being a broad-based economic development tool as it would benefit all Philadelphia-based service providers that sell beyond our borders.

Adopt Single Sales Factor Apportionment

Today, Philadelphia regulations specify that businesses use an apportionment formula based on a weighted average of sales, property and payroll in Philadelphia, where the weights are currently 50 percent, 25 percent, 25 percent. The Task Force recommends adopting increasing the weight on sales from 50% to 100%, which will reduce the disincentive for businesses to invest in Philadelphia property and to grow employment here.

Generally speaking, multi-jurisdictional firms that have a higher percentage of sales in Philadelphia than they do property and payroll would pay more. Of the businesses already in Philadelphia, under single factor apportionment, firms who have a larger relative share of their property and payroll in the City compared to

Impact of Single Sales Factor Apportionment on Philadelphia

Type of Firm	% of Payroll in Philadelphia	% of Property in Philadelphia	% of Receipts from Philadelphia (Double Weighted)	Average Apportionment
Philadelphia Firm	100%	100%	100%	100%
Suburban Competitor	0%	0%	100%	50%

Source: Mayor's Task Force on Tax Policy & Economic Competitiveness their percentage of Philadelphia sales would pay less. Firms with a higher percentage of sales in Philadelphia than their property and payroll in the city would pay more. This change would not affect a majority of Philadelphia businesses directly, as they have all their payroll, property, and sales in the city already.

The Department of Revenue estimates that this change will lower the tax bills on 6.6% of the City's firms, raise bills on 8.3%, and 85.1% will remain unchanged. The Department of Revenue estimates that based on 2007 data the cost to implement SSF would be $20 to $28 million in reduced revenue collections. The Task Force feels that this tax expenditure is justified, because without removing this and other disincentives to invest in property and payroll, the City of Philadelphia will fail in its efforts to grow its tax base.

REMOVE BARRIERS TO PHILADELPHIA AS A BUSINESS LOCATION

Action Steps:

- Introduce and adopt regulation amendment for market-based sourcing.
- Introduce and adopt regulation amendment for single sales factor apportionment.
- Allocate adequate resources for tax enforcement activities targeting firms outside the city and region.

Benefits:

- Encourages regional and national firms to locate offices in Philadelphia.
- Ensures tax obligations are met regardless of a firm's physical location.

RECOMMENDATION 2: IMPROVE PROPERTY ASSESSMENTS

Before Philadelphia can seek to raise a greater share of its revenues from Real Estate Taxes, the system for determining how much property owners will pay must be equitable, accurate, transparent, credible, and reliable. Philadelphia is required under state law 72 P.S. § 5341.13(a) to assess properties for taxation purposes based on how much they are worth. At present, due to significant historic problems at the City's Board of Revision of Taxes (BRT) - the City agency responsible for determining the value of real property and hearing all appeals of property valuations – the BRT's assessments do not reflect actual property values in Philadelphia. A recent series by the *Philadelphia Inquirer* has also raised many questions about the BRT's inconsistent treatment of individuals and properties across the city, further reducing public confidence in the agency.

At present, experts drawn from the executive and legislative branches of City government are working together to address the current challenges with the property assessment system and to chart a course for improvement. The Task Force recommends that the adopted strategy include overhauling the current property assessment system to create fair and accurate assessments that reflect market values, creating programs to protect and transition property owners to the new system and separating the assessment and appeals functions to remove potential conflicts of interest. Without significant improvements to the property assessment system Philadelphia will be unable to implement a more competitive tax structure and will continue to struggle economically.

Adopt a System of Fair and Accurate Property Values

Similarly situated taxpayers should be taxed similarly. For example, two neighbors with similar homes with similar levels of improvements should expect to be taxed similarly. As it now stands, two neighbors with similar homes may be paying very different property tax bills and two people with very different size or quality homes may be paying the same amount. Even worse, Philadelphians who own properties of lower values tend to pay more taxes in relation to the value of their homes than do owners of higher value properties. The lack of equity and fairness demands reform.

Fortunately, the City can look at what other counties and states are doing to inform the changes that need to be made. Following the norm of assessment practices in major counties and states, Philadelphia's Real Estate Taxes should reflect the actual market value of property. Once properties are assessed at their actual market value, City Council can legislate new tax rates so property taxes can be equally and fairly applied. Although it is outside of the scope of the Task Force to evaluate improvement efforts already underway, the Task Force recommends the City implement in calendar year 2011 a system of actual value assessments that conforms with the standards of the International Association of Assessing Officers (IAAO). More accurate assessments will benefit property owners whose real estate values are at the lower ends of the spectrum and have remained relatively stable in value, but that have been assessed at a much higher percent of their market value than properties in appreciating neighborhoods.

Frequency of Property Assessments Across Cities

City, County or State	Frequency of All Property Assessments
Boston	Triennially
Cook County (includes Chicago)	Triennially
Detroit	Annually
Maricopa County (includes Phoenix)	Annually
Maryland (includes Baltimore)	Triennially
Milwaukee	At least once every five years
New York City	Annually
Philadelphia County	Theoretically annually but in practice there is not a regular, consistent practice
San Francisco	Annually*
Washington, D.C.	Annually

* As a result of CA Proposition 13, only properties that change ownership, new construction (complete or partial) and decline-in-value properties are assessed annually in California. Source: BRT Governance Working Group, City of Philadelphia with additional cities added by Mayor's Task Force on Tax Policy & Economic Competitiveness.

Having fair and accurate property assessments however, is not a one time event and to assure that the assessed values keep up with the market, the Task Force recommends that assessments should be updated routinely through city-wide computer analyses and spot-checked by individualized, professional appraisals. Complete revaluation of Philadelphia properties should be mandated at set intervals and consistent with peer counties. For most major cities (and their respective counties), assessments of all properties are conducted between once every year and once every three years. In Philadelphia there is not a regular, consistent practice.

Use Buffering Mechanisms to Protect and Transition Property Owners

Philadelphia's property assessments have not kept pace with actual sales prices. Moving to up-to-date assessments will create a large net increase in assessed values when revaluation is complete. To avoid taxpayers being hit with whopping tax increases, City Council must approve a new, reduced tax millage rate to take into account the increase in real estate assessed values. Even with this rate reduction, property owners who have been historically "under-assessed" will see higher tax bills. The Task Force recommends that at the same time a new millage rate is implemented, (1) the City create programs to protect those on fixed and limited incomes, if existing state and local programs are found to be insufficient; (2) assist homeowners who would otherwise experience a sudden and dramatic increase in tax bills with temporary buffering programs (described below) to smooth the transition; and (3) provide a permanent homestead exemption for all homeowners. The Task Force recommends implementing a homestead exemption for owner-occupied homes. Any potential temporary buffering program should be evaluated when the new, actual assessment values are calculated and should balance the desire to provide relief to property owners whose tax bills will increase significantly with the need to generate sufficient revenues from Real Estate Taxes to offset the impact of reductions in the Wage and Business Privilege Taxes.

Separate the Appeals and Assessment Functions

As part of the BRT overhaul, the Task Force recommends separating the real estate assessment process from the real estate value appeals functions. Property assessments and appeals of those assessments should be separate in order to ensure independence and avoid any potential conflict. Separating these functions will also increase property owners' confidence in the integrity of the process. By separating these functions Philadelphia will be consistent with the practices of all major cities (and their respective counties). The City should also determine whether a first level of administrative appeal would prove more efficient than passing all appeals directly to a separate and independent appeals board.

Protections Already in Place for Seniors, Low-Income Residents and Others

- Philadelphia Installment Program: Low-income Philadelphians can apply for an installment payment program to make real estate tax payments for their primary residence more manageable.
- Philadelphia Low-Income Senior Citizen Tax Freeze: Low-income seniors who receive notice of a property assessment or rate increase and meet the program's eligibility criteria can have their property tax frozen unless there is an increase in income making them ineligible or if the property is sold.
- Philadelphia Real Estate Tax Credit for National Guard or Reserve members called to active duty Outside of Pennsylvania: The City of Philadelphia offers a credit against the City-portion of the real estate tax for their primary residence for members of the National Guard or Reserve called to active duty outside Pennsylvania.
- The Commonwealth of Pennsylvania's Property Tax Rebate: The Commonwealth of Pennsylvania provides property tax rebates to residents throughout the state age 65 and older; widows and widowers age 50 and older; and people with disabilities age 18 and older with incomes under $35,000.

Potential Temporary Buffering Programs

- Rolling Average of Property Values: Property owners are taxed based on the average of their assessments over some time period (e.g. five years).
- Phase-In of Property Tax Increases: Phase-in a percentage of any tax increase over some period of time.
- Deferral of Property Tax Payments: Defers (or postpones) tax payments over some period of time.

Improve Property Assessments

Action Steps:

- Immediately implement a fair and accurate system of property assessments that conforms with the standards of the International Association of Assessing Officers (IAAO).
- Regularly update assessments through city-wide computer analyses and individualized, professional appraisals.
- Use buffering mechanisms to protect and transition property owners:
  - Promote existing programs for seniors, low-income homeowners and others.
  - Expand or add assistance programs if existing programs are insufficient to protect homeowners.

o Create temporary buffering programs for property owners who will face a sudden and dramatic increase in their property tax bills.

  - Institute a homestead exemption on the taxable value of owner-occupied homes.
- Separate the property assessment and assessment appeal functions from the BRT to improve the integrity of the assessment process.

Benefits:

- Treats all taxpayers consistently and fairly.

Recommendation 3: Improve Interactions with Government

Today, Philadelphia's tax structure and real estate development environment can be complex and unpredictable, allowing those in-the-know to gain an advantage, driving others to leave, and scaring off potential residents, investors, and entrepreneurs. In addition to recommendations to improve the property assessment process described above, there are other improvements to transparency that can encourage development and investment. Predictable and streamlined procedures are needed to eliminate real and perceived barriers to doing business in Philadelphia. Philadelphia residents and business owners should be able to have direct and clear communications with all City government agencies and departments and should see a timely and efficient response from those entities to problems or issues. All branches of City government should have high standards for customer service and all customer-facing employees should be held accountable for meeting or exceeding those standards. The Task Force recommends several steps to achieve accurate, easy and transparent government interactions.

Philadelphia's zoning code was written in 1962 and has more than 30 different categories of residential zones alone. These cities have modernized their zoning codes:

- Boston
- Chicago
- Pittsburgh
- Seattle
- Portland
- Baltimore
- Milwaukee
- San Diego

Source: Building Industry Associate & Task Force research

Provide Predictable, Streamlined Procedures

The Task Force believes that the City must continue to make citizens' and businesses' interactions with government easier and more predictable. There are many immediate opportunities for improvement to existing procedures which can be accomplished through the elimination of duplicate or unnecessary steps in a process, simplification of required paperwork, increased use of technology, and improved customer service.

Several groups inside and outside City government, including the Building Industry Association of Philadelphia, the Zoning Code Commission, and Reform Teams, have been evaluating current operations and making thoughtful and detailed recommendations to improve policies and procedures. For example, it currently takes a seven-step process involving three different parties to pay a single invoice for a Street Closure Permit. This is the type of inefficiency that the City's Development Process Reform Team is working to eliminate. While the specifics of these issues are beyond the scope and expertise of the Task Force, the Task Force believes that the City should make it a high priority to complete and implement reforms that are underway in the areas of customer service, real estate development and small business formation, including:

- Continue to implement the reforms outlined in the Building Industry Association of Philadelphia's comprehensive 2004 report on the development review process and zoning code;
- Develop a new zoning code which should minimize the need for variances for real estate development projects;
- Create a simple, efficient, and cost effective process for issuing development permits;
- Launch a new website targeted toward small and start-up businesses to help them navigate the various requirements of starting or growing a business; and
- Dedicate case workers within the City Commerce Department assigned to businesses of all sizes that need assistance of any kind from the City;

- Continue improvement and promotion of the 311 customer service and issue tracking system for all non-emergency questions and concerns from citizens and businesses;
- Clearly articulate and publish the parameters of authority for the Art Commission and Historical Commission and consolidate their project review functions, or at least have both Commissions meet jointly in reviewing major projects so that developers don't get conflicting messages from these two Commissions;
- Offer more electronic applications, forms, and payment options for residents and businesses;
- Utilize technology to provide detailed and up-to-date information to citizens and businesses;
- Improve customer service training for all front-line employees;
- Reduce paperwork requirements.

Looking for more information about improvements to the development process in Philadelphia?
Visit www.fixitphilly.org.

Making Rules and Regulations in Philadelphia Conform to National Norms

Philadelphia not only has a high tax burden compared to its peers, but also sets itself apart in some instances by taking administrative positions and promulgating regulations that are different from practices and procedures in other communities. This adds complexity for firms operating in multiple jurisdictions and makes Philadelphia a more difficult place to do business. The City should avoid taking these unique positions in the future and reform existing regulations and positions to improve conformity. This applies to the area of taxes, as well as real estate development. For example, Philadelphia's definition of unearned income differs from that of the Commonwealth of Pennsylvania.

Adopting new standards for development in Philadelphia

Cost of a 10-foot, 2-inch copper pipe:	$103
Cost of same size cast iron pipe:	$90
Cost of same size PVC pipe:	$6.45
Philadelphia getting in line with its peers:	Priceless

Source: Building Industry Association, "If We Fix It, They Will Come."

One of the most glaring examples of Philadelphia taking a position that differentiates it from other places is the use of polyvinyl chloride (PVC) piping as the standard plumbing material. Philadelphia's Plumbing Code strictly limits the use of this material, which has become the modern standard as part of the International Plumbing Code. In fact, the Commonwealth of Pennsylvania adopted the Uniform Construction Code, which includes the International Plumbing Code, as the statewide code in 1999 and asked all municipalities to adopt the same standards. To date, Philadelphia has not done so. In addition to making Philadelphia different from the rest of the state and most of the country, studies have found that there are substantial cost savings for development projects that can be achieved under a modernized Plumbing Code.

Create a Taxpayer Advocate

It is inevitable that some tax-related transaction will not go smoothly. The Task Force believes that the City should offer accessible and impartial assistance to taxpayers who have issues that remain unresolved after taking the normal steps to address the problem.

For example, the Internal Revenue Service (IRS) created the Office of the Taxpayer Ombudsman (now called the Office of the Taxpayer

Advocate) in 1979 to act as the primary advocate for taxpayers within the IRS. The Taxpayer Advocate monitors the quality of taxpayer services provided by the IRS and has the authority to determine whether a taxpayer is suffering, or will suffer, a significant hardship as a result of the manner in which tax laws are being administered.

The City Taxpayer Advocate should be independent from the Department of Revenue and would:

- Assist individual and business taxpayers in resolving issues with the Department of Revenue that are not satisfactorily addressed through normal channels;
- Identify specific areas where citizens and businesses tend to have problems and concerns with City taxes; and
- Propose appropriate administrative and legislative changes to mitigate those problems.

Make Tax Incentives Accessible and User Friendly

In the long term, improvements to the City of Philadelphia tax structure and governance should eliminate the need to use tax incentives to encourage real estate development and job creation, but reality requires that incentives continue for the time being. Currently available tax incentive programs should be more widely promoted by the City so that all businesses have an equal opportunity to receive the assistance they need to grow. Program requirements should be designed so that the eligibility criteria are easy to understand and inclusive rather than targeted to specific firms, industries, or locations. Incentives should be easy to administer for both the City and recipients.

Philadelphia does not have to look far to find a best practice in the area of tax incentives. The City's own 10 year real estate tax abatement program for new construction and substantial renovations is a terrific example of an incentive that is widely known and promoted within the real estate development community, available as of right, and easy to access with a simple application. This tax abatement is widely credited with helping to revitalize Philadelphia's real estate market and has been used across all neighborhoods of the city. Future tax incentive programs, and modifications to existing programs, should be modeled on the 10 year abatement in terms of accessibility and simplicity.

Other programs are not as easy to access and administer and have significant room for improvement. For example, the City's existing Job Creation Tax Credit (JCTC) program is not widely promoted and can be difficult to access once companies do become aware of it. In order to receive credits, a company must apply in advance for the program and commit to a specific number of jobs it will create over a five year period. If the company misses the target by even one job (i.e. only 49 jobs are created versus a commitment of 50 jobs), the program guidelines require that the company pay back all of the credits received to date. The Department of Revenue has some discretion to waive that requirement in extenuating circumstances, but often a business would not want to take that risk. Additionally, if the company were to create more jobs than it originally committed to (i.e. 60 jobs are created instead of 50), the firm receives no additional credits for those additional jobs created.

IMPROVE INTERACTIONS WITH GOVERNMENT

Action Steps:

- Complete and implement ongoing reform efforts to streamline development and business processes.
- Leverage technology and training to improve information sharing, customer service and outcomes
- Identify areas where Philadelphia falls outside of the norm and take steps to get in line with best practices of peers.
- Create a Taxpayer Advocate.
- Promote and simplify existing tax incentives.
- Offer tax incentives that are available of right and easy to access.

Benefits:

- More equitable access to assistance programs.
- Enhanced business activity and job creation.
- Improved customer service and more efficient interactions with City government for citizens and businesses.

Recommendation 4: Reduce City Spending

Taxes are high in Philadelphia both in comparison to neighboring jurisdictions and peer cities. Changing Philadelphia's mix of taxes and making interactions with government easier and more predictable can create opportunities for job seekers, businesspeople, entrepreneurs, and homeowners. But until Philadelphia lowers its taxes so that the amount people and businesses pay are competitive regionally and nationally, the city will not reach its potential. While fully recognizing that municipal leaders have been through an arduous and draining process in securing support from the Commonwealth for temporary increases to the sales tax and extensions of time on pension funding, the Task Force still recommends that the City immediately and continuously analyze and implement strategies to reduce its spending by up to $200 million dollars annually between through 2025 and thereafter. This spending reduction will enable the needed reductions of taxes on mobile tax bases without necessitating a dollar for dollar replacement from increases in other tax sources. The $200 million spending reduction represents an approximate decline of no more than 5% in City spending. In this environment where firms and families are reducing their spending by 5%, 10%, or more, the City of Philadelphia must also implement reductions.

At the same time, the Task Force recognizes that the City is required to supply greater services than some neighboring jurisdictions because of the higher poverty rates in Philadelphia and the City's obligation to fund county functions such as human services and courts. While the City must continue to press for the Commonwealth of Pennsylvania to assume more of its share of Philadelphia's county-related costs (particularly with regards to the First Judicial District), economic and political conditions at the state and federal levels makes the outcome of these efforts highly uncertain. Therefore, to cut the cost of City government without affecting service levels, the Task Force believes that the City must focus on efficiencies, productivity, and expenditures that are out of line with peer and comparable cities and the private sector.

The Philadelphia Sales Tax

As the work of the Task Force drew to a close, the state legislature gave approval to the City of Philadelphia to raise its Sales Tax from 1% to 2%, which is in addition to the 6% state Sales Tax.

The Task Force understands the immediate and temporary financial pressures the City faces and notes that the increase is set to expire in 5 years. Although temporary, the increase in the Sales Tax is, however, in conflict with the Task Force's recommendation that the City of Philadelphia reduce the overall level of taxation in Philadelphia and to reduce reliance on taxes of mobile bases, of which the Sales Tax is one.

Additionally, given the increased share of city revenues from this source, the City should work in partnership with the Commonwealth to audit Sales Tax payers.

Invest in Technology to Generate Efficiencies and Enhance Productivity

The Task Force believes that the City should invest in technology to improve its administrative capacity, its ability to research and analyze trends and to improve business processes and interactions with residents. City investment in technological improvements has not kept pace with the private sector. As a result, the City operates old systems and technologies that are costly to maintain, inefficient to operate and may produce lower levels of tax collection. Although technology upgrades will create a cost for the City in the short-term, the Task Force maintains that long-term savings in efficiencies and productivity warrant the expense.

While it is beyond the scope of the Task Force to recommend specific technological improvements, the Task Force recommends that the Division of Technology receive sufficient resources to invest in ongoing upgrades and new technologies. It is the responsibility of the City's Chief Technology Officer to identify, prioritize and implement technology improvements for all City departments. Project prioritization should take into account expected expenditure savings.

Best Practice: Statewide Consolidation of Servers, State of Arizona

The Arizona Department of Administration (ADOA) Information Services Division is consolidating agency computer servers into the ADOA data center in order to maximize efficiencies gained from the use of common resources. Over the course of fiscal year 2008, 14 agencies consolidated their servers into the ADOA data center saving more than $1 million annually. In fiscal year 2009, another 8 agencies are expected to participate in server consolidation with an estimated savings of $800,000. In addition to the savings generated through consolidation, additional savings are generated through the cost avoidance of audit requirements.

See http://www.governor.state.az.us and http://isd.azdoa.gov/ for more information.

Reduce the Cost of Philadelphia's Fastest Growing Expenses: Health Benefits and Pensions

The Task Force recommends that the City, together with the major employee bargaining units, reform the City's health benefits and pensions to bring costs in line with peer cities and the private sector. The City's FY2010-FY2014 Five Year Plan shows that between fiscal years 2000 and 2008, City health benefits and pension costs grew 144% and 96%, respectively, significantly faster than the budget overall. Not only are benefit costs a rapidly growing portion of the City's budget, but benefits and total compensation appear to outpace those of peer cities and the regional private sector. According to a January 2008 study conducted by the Pew Charitable Trusts and Economy League of Greater Philadelphia, "[Philadelphia] workers appear to be compensated more generously than regional private sector employees and higher than workers employed by comparable cities." There are, of course, two sides, or many sides, to the question. Nevertheless, the reality is that the City can no longer afford to fund these costs.

In particular, the study found that contributions made by employees to their pensions were lower compared to peer cities and Philadelphia municipal worker health benefits are 44% higher than state and local government averages and three times the typical private sector cost in the region. With a current City workforce of 29,215 employees and more than 36,600 retirees and other claimants benefiting from the pension system according to a July 2008 actuarial valuation of the City's retirement system, Philadelphia simply cannot sustain the current imbalance between contributions and benefits paid. The Pew study noted that Philadelphia could save $114 million per year if City health benefits were simply comparable to the state and local averages and over $140 million annually if they were comparable to regional private sector benefits.

REDUCE CITY SPENDING

Action Steps:

- Incrementally reduce government spending by $200 annually million by 2025.
    - Invest in technology efficiencies and productivity.
    - Reduce the cost of employee pension and health benefits.

Benefits:

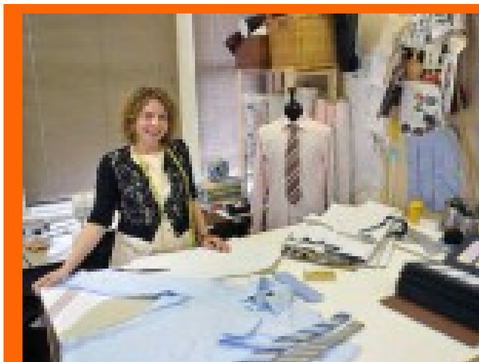
- Reduces total tax burden on Philadelphia firms and families.
- Makes Philadelphia competitive regionally and nationally.

Recommendation 5: Improve Tax Collection & Compliance

While there is no single perfect tax structure, taxpayer compliance and the desire to locate a business within the city improves if the taxpayers and decision makers believe that taxes are levied and collected in a rational, fair, transparent, and equitable manner. To accomplish this, the Task Force recommends generating additional revenue without raising tax rates by equipping the Department of Revenue and other agencies with better tools to collect money currently due to the City and making it easier for taxpayers to remit payments in the future.

Upgrade Tax Administration Technology & Human Resources

The Task Force believes that the City should have state-of-the-art, networked property information and tax databases with adequate professional staffing to make collection of all tax types more efficient, to monitor trends and to measure, over time, the impact of the entire Philadelphia tax structure and development policies on job creation and income growth. Investments also should be made in the professional development of Department of Revenue staff to maintain and expand expertise and institutional knowledge and to provide adequate staffing to assist taxpayers.



At its second public hearing, the Task Force heard from small businesswoman Sarah Van Aken, owner of SVA Holdings. She had been trying to pay her taxes but hadn't been able to reach anyone at the City willing to take her money and each time she called she had to tell her story all over again. Sarah would be able to spend time on her business rather than on the phone with the Department of Revenue if there were enough people to answer the phones with the right information and technology to resolve her questions and accept payment.

The ability to perform more quantitative analyses of tax collection data can assist the City in adjusting its operations to improve efficiency and effectiveness. For example, enhancing the capability to quantify the effectiveness of certain collection techniques (how and when the delinquent is contacted) based on the type of delinquency (tax type, age, amount owed, etc.) can enable the Revenue and Law Departments to tailor their strategies for pursuing compliance for specific situations. Additional resources can also be directed to expanded auditing activity, enabling reviews of taxes not currently overseen by the City of Philadelphia, like the Sales Tax, and permitting more in-depth auditing of taxpayers headquartered outside of the region.

These investments in information systems and resources for tax administration in the Departments of Revenue, Licenses and Inspections, and Law, as well as the Tax Review Board, will not only improve revenue collection and compliance efforts, but can provide data and analysis to more easily understand how various groups of taxpayers are affected by the current structure, provide guidance for future tax policy decisions, and inform community and economic development strategies. For example, by dedicating staff to maintain business location information, the City can monitor the impact of commercial corridor investments in a reliable, uniform manner. This requires computer systems that can easily aggregate and provide information about tax payments and adequate staff to ensure the quality of the data and interpret the results. While nearly everyone agrees that Philadelphia's tax structure is a problem, insufficient data frustrates efforts to identify and gain consensus around solutions to make Philadelphia more competitive. Taxpayers, elected officials, and tax administrators would all benefit from more information.

Offer a Tax Amnesty to Fund Tax Administration Improvements

To pay for necessary technology and human resource upgrades, the Task Force recommends that the City of Philadelphia offer a one time tax amnesty program and invest a portion of the proceeds into tax administration. While tax amnesties may encourage delinquency in later years and merely shift forward collections that would have been received in the future without having to waive interest or penalties, the Task Force believes that an amnesty at this time is appropriate, as the last amnesty program was in 1986. The current budgetary position does not seem to allow for new investments in areas such as technology and staff training at this time without an immediate infusion of funds from an amnesty. An amnesty would also improve Philadelphia's competitiveness by demonstrating a willingness to partner with individuals and businesses wanting to come into compliance at a reduced cost in these tough economic times. This investment will also improve collections in the future by adding currently unregistered enterprises to the tax rolls. Additionally, the amnesty would improve the City's cash position in this period of fiscal distress.

Sample of 2009 Tax Amnesty Programs

City	Amount Collected thru August 2009
City of Phoenix	$2 million
City of Los Angeles	$14 million
State of New Jersey	$700 million

Source: City and State government websites

Encourage Compliance with Competitive Interest & Penalty Rates

Following an amnesty, the Task Force recommends reducing the interest and penalty it applies to delinquent payments (excluding those with delinquencies pre-dating the amnesty). Philadelphia has unusually high and uncapped interest (12% annually) and penalties (30% in the first 12 months and 15% each year thereafter) on tax underpayments. In peer jurisdictions, interest on underpayments is at a rate somewhat over the prime rate and typical penalties are capped at 25-50% in non-fraud situations. For example, after one year Atlanta matches Philadelphia's interest rate of 12% but the penalty rate is one third the amount of Philadelphia's at 10%. Philadelphia's combined interest and penalties often overwhelm and frighten struggling taxpayers, and create circumstances where taxpayers who otherwise might step forward to work out underpaid or unpaid taxes do not pay at all.

If the interest and penalties were more in line with peers, both the abnormally high interest and penalty rates as well as the systematic unfairness that arises because more sophisticated taxpayers often are able to negotiate settlements that minimize the high interest and penalties and less sophisticated taxpayers with fewer resources wind up paying more, would be addressed. A reduction in the overall interest and penalty burden would also help mitigate the perception of Philadelphia as a hostile tax environment.

IMPROVE TAX COLLECTION & COMPLIANCE

Action Steps:

- Invest in tax administration technologies and resources.
- Offer tax amnesty.
- Lower interest and penalties.

Benefits:

- Additional revenue collection without rate increases.
- Improved taxpayer compliance and satisfaction.
- Makes Philadelphia more competitive with its peers.

RECOMMENDATION 6: USE PUBLICLY-OWNED & TAX DELINQUENT PROPERTY TO SPUR DEVELOPMENT

In addition to subsidies and tax incentives, the City and other agencies should use publicly-owned property as a tool for reducing Philadelphia's high cost of development and to focus activity in areas that have significant development potential. The Task Force recommends several steps to better leverage the significant amount of Philadelphia's publicly-owned property to spur development throughout the city.

Upgrade Technology and Data for Philadelphia Property Information

There are approximately 15,000 properties owned by the City and other public or quasi-public agencies in Philadelphia, including the Redevelopment Authority (RDA), the Philadelphia Housing Development Corporation, the Philadelphia Housing Authority, and the Philadelphia Authority for Industrial Development (PAID). However, there is currently no centralized database that allows public officials to access property information. The Task Force believes that the City should have a state-of-the-art property database under the direct control of the City or the RDA that can be shared across multiple agencies and with adequate professional staffing to ensure that information is accurate and kept up to date.

Best Practice: Genesee County (Michigan) Land Bank Authority

After finding that its current tax foreclosure process was too slow and prevented properties from getting back into productive use in a timely fashion, Michigan implemented a streamlined process for tax foreclosures in 1999. This new process puts tax delinquent properties into local county ownership after two and a half years. The new law also offered hardship postponements, to protect struggling homeowners.

After passage of this new state law, Genesee County (which includes the city of Flint) created the Genesee County Land Bank Authority to use the new tax law as a community and economic development tool by acquiring abandoned, tax delinquent property, assembling land for new development or transfer to adjacent homeowners, and creating new green spaces.

The Genesee County Land Bank is recognized as a national model for the utilization of tax delinquent properties for community and economic development, and was recently awarded a $1 Million grant by the Ford Foundation to continue its work.

Additionally, there is no single tool that citizens can use to find out information about publicly owned properties in their neighborhoods or that allow real estate developers to discover investment opportunities. The Task Force believes that the City should maintain a centralized website that would provide up-to-date information on property owned by the City and related agencies. This website could also be used as a communications tool to market these properties for sale to the private sector to generate additional revenue for the City. The Task Force has been informed that the RDA and City Department of Public Property are currently working on some of these initiatives, and supports those efforts.

In addition, there are significant data gaps with respect to both publicly and privately owned real estate in Philadelphia that the Task Force believes the City should address. For example, Philadelphia does not have a single source of information on new construction in the city and would also benefit from improved data collection for properties up for Sheriff's sale and the subsidized rental stock. The City and related agencies that own property should invest in technology and training in areas such as geographic information systems (GIS) that would allow City agencies and the private sector to better analyze real estate trends, identify priority areas of investment and monitor the impact of development policies and programs.

Improve the Public Property Acquisition and Disposition Process

In addition to the 15,000 properties in public ownership, there are some 40,000 vacant and abandoned properties that remain in private ownership. Many of these parcels are seriously tax delinquent and frequently the amount of the delinquent taxes exceeds the value of the particular parcel. These properties do not serve a productive purpose: The Wharton School's Susan Wachter has shown that derelict vacant properties undermine the tax base by decreasing the value of neighboring homes by as much as 20%. In order for these properties to be made available for redevelopment or other productive use, the delinquent taxes must addressed through sheriff's sale or similar process.

Unfortunately, the current mechanisms the City and related agencies use to acquire and sell property are complicated, inefficient, and overly political. The Task Force supports ongoing efforts by the City Department of Public Property, the RDA, and the Office of Housing and Community Development (OHCD) to replace the existing Vacant Property Review Committee process with a better and more efficient system that:

- Implements a transparent, widely advertised, open bid process for potential buyers to acquire public property;
- Starts with accurate, accessible and up-to-date information about publicly-owned properties;
- Uses all available communications tools (email, website, media), appropriate intermediaries (real estate brokers, attorneys), and procedures (auctions, requests for proposals) to actively market properties for sale to the private sector;
- Reaches out to regional and national development companies, as well as local real estate developers, to attract private investment;
- Ensures adequate professional staffing to identify acquisition opportunities and review and respond promptly to proposals from the private sector;
- Rebalances the role of elected officials toward approving policies and procedures for fair and efficient transfers of property and away from involvement in individual transactions.

Strategic Acquisition of Tax Delinquent Properties

There are approximately 80,000 to 100,000 tax delinquent properties in Philadelphia, an astonishing 15% of the total taxable properties. Allowing owners to fail to pay their taxes is unfair to all homeowners and businesses that do and it encourages others to neglect their obligations.

Under the current system, many of these properties will not be subject to Sheriff's Sale as the costs and time for the legal and other work required to implement the foreclosure process is not commensurate with the value of the properties. However, this leaves tens of thousands of properties in the hands of owners who have little or no interest or incentive to maintain or invest in their properties. The City should explore opportunities to more aggressively address delinquent properties to return them to the market for productive re-use and thus protect and expand the tax base. Specific methods that the City should explore include bulk sales for lower value properties and simplified tax lien sales. At the same time, programs to assist homeowners facing financial hardship should be developed and uniformly applied.

Target Investment for Greatest Impact

The Task Force believes that the City must also target its investment of time and resources where that investment can have the largest impact. Philadelphia should use existing data, and build on the improvements described above, to identify neighborhoods with the highest potential for revitalization and target its acquisition strategy accordingly. In particular, the City should focus on areas where there are multiple adjacent parcels and assemble larger sites for redevelopment.

Use Publicly-Owned & Delinquent Property to Spur Development

Action Steps:

- Create a centralized database to share property information across agencies.
- Launch a public website to provide information and market acquisition opportunities for all publicly owned property in the city.
- Implement a more streamlined process to dispose of publicly-owned property.
- Develop streamlined procedures to take control of vacant and delinquent properties and assemble land for redevelopment.

Benefits:

- Improved communities and growth in tax base through reuse of vacant land and properties.
- Encourage private investment in targeted areas.
- Additional revenues from sales of publicly-owned property and returning delinquent properties to the City's tax rolls.

CONCLUSION

Philadelphia's tax policy and real estate environment demand true reform rather than continuing to work around the margins and tinker with the City's policies. Indeed, during the last decade we have tried the tinkering approach and while it has slowed decline it hasn't lead to growth. During the first part of this decade, many other comparable cities have experienced real growth in jobs and population, while all Philadelphia can say is that we lost less jobs and people than in the past. That simply isn't good enough.

Even without the Task Force's proposed changes, as the recession draws to a close Philadelphia will probably see a short-term net gain in jobs, but as employers restore their payrolls after the cuts of the last two years, as with each business cycle in the last thirty years, we will not achieve in recovery the levels of employment we enjoyed prior to the recession. Instead, we will continue down a path of steady decline and diminishing opportunities.

Fortunately the situation is not as hopeless as it seems. Philadelphians have the ability to choose the future of our city. There is broad consensus among many groups that despite local challenges, Philadelphia has the physical, economic, intellectual, and cultural assets to be a thriving city in the 21st century and we have many of the tools required to make needed changes.

The residents of Philadelphia deserve a better future than the one the city can currently offer. We have to look beyond the challenges and obstacles we face today and make fundamental, transformational changes to create a better future. Improving the tax structure alone will not cure all the city's ills, but it is an essential part of any solution. We offer the recommendations in this report with the hope of, and a shared commitment to, creating a Philadelphia that provides expanding opportunities for all its residents.

Acknowledgements

We begin by thanking Mayor Michael A. Nutter for creating the Task Force and giving us the opportunity to address long standing concerns regarding Philadelphia's tax policy and economic competitiveness. We hope this report and our recommendations provide the necessary guidelines for the Mayor and City Council to take action to improve our city.

We are also grateful to the many people who provided their time and expertise to the Task Force over the course of its work. We apologize in advance for any omissions. The presentations and insight from the following individuals have proved invaluable: Tilahun Afessa, Philadelphia Department of Revenue; Stephen Agostini, Philadelphia Budget Office; Andrew Altman, Philadelphia Commerce Department; Camille Barnett, Philadelphia Managing Director's Office; Joe Bright, Cozen O'Connor; Duane Bumb, Philadelphia Commerce Department; Michael DiSanto, Citizens Bank; Rob Dubow, Philadelphia Finance Department; Brian Flanagan, Philadelphia Commerce Department; Kevin Gillen, Wharton and Econsult; Terry Gillen, Philadelphia Redevelopment Authority ; David Glancey, University of Pennsylvania and former chairman of the Board of Revision of Taxes (BRT); Ira Goldstein, The Reinvestment Fund; Joseph Gyourko, Zell/Lurie Real Estate Center at Wharton; Stephen Herzenberg, The Keystone Research Center; John Herzins, Philadelphia Department of Public Property; Bill Hirschfeld, Cushman & Wakefield; Dean Kaplan, Public Financial Management; Peter Kelsen, Blank Rome; Philip Korb, Ballard Spahr; Trip Lukens, Reaves C. Lukens Company; Uri Monson, Pennsylvania Intergovernmental Cooperation Authority; Steve Pollock, Philadelphia Bar Association; Sam Rhoads, Philadelphia Industrial Development Corporation; Michael Sklaroff, Ballard Spahr; Jerry Sweeney, Brandywine Realty Trust; Stewart Weintraub, Schnader, Harrison, Segal & Lewis LLP; Jim Zwolak, Philadelphia Law Department.

We appreciate the time, expertise, and insights that City Council members Frank DiCicco, W. Wilson Goode, Jr., Bill Green, William Greenlee, James Kenney, Donna Reed Miller, Maria Quinones-Sanchez and their staffs shared with the Task Force. The report and its recommendations are stronger as a result of your input.

We also want to acknowledge and thank the many individuals and organizations that took the time to present testimony at the two public hearings of the Task Force, which were held in May and August, 2009, and those who shared their thoughts and ideas via email and through the Task Force website.

We also appreciate the work of the Economy League of Greater Philadelphia who conducted a roundtable of business leaders to discuss issues of tax policy and competitiveness in the City of Philadelphia and specifically Alison Gold and Steven T. Wray who provided invaluable insights into the management of the Task Force. The report can be found on the Task Force's website at:
http://www.phila.gov/taxpolicy/PDFs/Roundtable_Summary_July_2009.pdf

The Task Force also appreciates the financial support of the Wharton Social Impact Initiative of the Wharton School, University of Pennsylvania, for financial support for support staff for the Task Force's analysis of tax policy in U.S. cities and the likely impacts of alternative reform proposals on the Philadelphia economy.

We are especially appreciative of the economic and demographic forecasting and insights provided by Joseph McLaughlin, Simon Hakim, and Charles Swanson of Temple University and Ryan Sweet of Moody's Economy.com. While your vision of the direction Philadelphia is heading was sobering, understanding the challenge is essential to improving our city's future.

The Pennsylvania Institute of CPAs and its CEO Bert Trexler were wonderful to volunteer their offices to host two meetings of the Task Force. The Task Force members and their companies and staffs that hosted the group's working sessions were essential to the success of the group; we thank them mightily.

The efforts of interns Christopher Chomiak and Michael Bruckner were vital to the work of the Task Force. Their time and dedication is greatly appreciated.

We would also like to thank the technological and creative support that has been provided to the Task Force. The Task Force website, www.phila.gov/taxPolicy, is accessible and user-friendly thanks to the following Philadelphia Division of Technology staff: Venia Hill, Clinton Johnson, and Scott Liffman. Our public hearings were taped and aired on Channel 64 with the assistance of Gere Cannon, Mark McLaughlin, John McNally, and Cliff Weldon. The report cover design would not have been possible without Susan Lowry of the Philadelphia Industrial Development Corporation.

Finally, we express our particular gratitude to, and respect for, Marisa Waxman, Maia Jachimowicz, and Anne Bovaird Nevins who have provided smart, funny, and extraordinarily capable support for every aspect of the Task Force's work. A Philadelphia that attracts young people like them to public service must have a bright future.