



“IN THE KNOW:” Business Privilege Tax

A major battle is brewing in City Hall over the fate of something called the “Business Privilege Tax.” It’s pretty important to pay attention because, even if you don’t have the “privilege” of paying it, the tax brings in a significant chunk of money to the city: around \$365 million in the last fiscal year.

Everyone seems to agree that the BPT discourages businesses and jobs. Philadelphia ranks among the top of the list for taxes imposed on businesses by major cities (the BPT is just one of several taxes businesses pay). So the dispute is not about *whether* to reform the BPT, but *how and when* in order to achieve the economic growth Philadelphia so desperately needs.

Tomorrow, November 30 at 10 a.m., City Council will hold a public hearing on a proposal from two of its members, Bill Green and Maria Quiñones Sánchez, that they believe will fix the BPT. The Nutter administration has already come out swinging, saying the proposal would cost the city \$23.3 million in annual funds, which it can’t afford in this economy. Controller Alan Butkovitz, the city’s elected fiscal watchdog, goes even further, calling the Green and Sánchez proposal a dangerous “experiment.”

Like most issues in government, the disagreement is about more than just money – it is playing out on the eve of the 2011 municipal elections, when all the City Council seats are up for grabs and Mayor Nutter may face an opponent in the Democratic primary. His most talked-about potential rival? Bill Green. Some say Alan Butkovitz also has his eye on the mayor’s office.

The Committee of Seventy hasn’t taken a position on the BPT. We are using this IN THE KNOW as a basic introduction to help you (and us) better understand the competing issues. You can expect more installments as the BPT debate plays itself out over the next few months. We hope you find this first edition a good start.

- November 29, 2010

What exactly is the Business Privilege Tax?

The BPT has two parts: (1) a .1415% tax on the money you earn if you run a business (also called revenue or total sales) before deducting expenses; that’s called the “Gross Receipts Tax,” and (2) a 6.45% tax on the profit you earn after deducting expenses; that’s called the “Net Income Tax.”



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I'm already confused. Try again.

Let's say you own a small neighborhood appliance store. The total amount of money you bring in at the end of a year represents your revenue (this is what gets taxed at .1415%). But don't run to the bank just yet. Your revenue and what you actually earned (your profit) are two entirely different figures. To figure out what you actually earned, you have to deduct all of your annual expenses from your revenue or total sales – these at least include the cost of the appliances you sold to your customers, your employees' salaries and benefits, your annual rent and utilities, the taxes you owe and even money you spent on advertising. Whatever is left over is your net profit (this is what gets taxed at 6.45%).

Do I have to pay the BPT?

You do if you are engaged in a business, profession or other activity in order to make a profit – and you are doing these activities within the city limits.

What about those big companies that aren't headquartered here?

A big company with stores here but headquartered elsewhere (like Target, whose corporate office is in Minnesota) has the same responsibility to pay the BPT as a self-employed freelance writer who lives on Rittenhouse Square and sells stories to local newspapers. What they have in common is that they both do business here.

I heard even city bloggers have to pay.

That's true. This came to light last summer when some bloggers in the city got letters demanding a \$300 business license fee (which means they would have to pay the BPT too) because they earn some money from selling ads. As you can imagine, that didn't go over very well, especially for bloggers earning less than \$300.

Sounds pretty silly to me too.

Lots of people agreed. The best thing to come out of the bloggers' controversy is that it pointed out that anyone who does business in the city, even a tiny amount, is supposed to pay the BPT.

How much does the city collect from the BPT?

The amount rises and falls depending on whether the economy is good (and people are making money) or bad (and they're making less), and also BPT's tax rate in any given year. (The tax rate on both revenue and profits has fluctuated over the years since the BPT started in 1985.) But in fiscal year 2009 (July 1, 2008 – June 30, 2009) the BPT brought in around \$386 million. In fiscal year 2010 (July 1, 2009 – June 30, 2010), it brought in around \$365 million – about 15.8% of total tax revenues.



Is reforming the BPT a new idea?

No. A 2003 Tax Reform Commission recommended phasing out the entire two-part BPT by 2015 because of its negative effect on business growth. The Commission said the BPT funds could be made up by cost efficiencies in city government and more collections of the city's wage tax because of the projected growth in jobs once the tax was gone. (The wage tax is paid by all employees who work for or provide services to a city-based employer.)

Is this happening?

No. Legislation passed by City Council in 2008 called for gradual reductions in the BPT until 2017, when the tax on revenues would be eliminated and the tax on profits lowered from 6.45% to 6%. Then the economy collapsed and City Council froze the BPT reductions.

Now that the economy is slowly improving, are the BPT reductions back on track?

In 2009, Mayor Nutter convened a Task Force on Tax Policy and Economic Competitiveness to recommend what to do next. The Task Force proposed gradually lowering (1) the .1415% tax on revenues starting in 2012, with a goal to abolish it in 2025, and (2) the 6.45% tax on profits from 6.45% to 6%, also by 2025.

How will this plan affect businesses?

The Nutter administration says this strategy makes sense because, eventually, the tax will fall on larger companies that make higher profits – and will help small businesses struggling to survive. (Sometimes a company can have many sales but wind up with very little or no profits after deducting expenses.)

Will this create more jobs?

According to the Task Force, the changes they propose for the BPT (along with some reductions in the wage tax) would yield 70,000 new jobs by 2025. (They also say the city has to lower its spending by \$200 million a year and increase revenue from the real estate tax. But these are topics for another IN THE KNOW.)

What's the dispute then?

Bill Green and Maria Quiñones Sánchez think the administration has it completely backwards. Their legislation proposes to do the exact opposite of the strategy we just described: **raising** the tax on revenues and **lowering** the tax on profits. By 2015, after a series of gradual changes, the tax on revenues will be .53% and the tax on profits will go away.

Why do they think this is a better idea?

Green and Sánchez say it's the tax on profits (not revenues) that really hurts businesses and drives those that can afford it to move their headquarters – and jobs – outside the city. One



economist who supports their proposal, Mark Zandi from Moody's Analytics Inc., adds that companies can avoid paying the tax on profits by recording their profits in places with lower business taxes. He also points out that revenues are more predictable and easier to keep track of than profits.

How will this plan affect businesses?

Green and Sánchez believe that lowering, and ultimately getting rid of, the tax on profits will take away a reason for businesses to move outside of Philadelphia – and attract new businesses too.

What about those jobs?

There are no absolute estimates, but Green and Sánchez are confident their proposal will generate tens of thousands of new jobs. The Nutter administration seems to believe otherwise.

Would Philadelphia gain or lose money under the Green and Sánchez proposal?

According to Green and Sánchez, neither. They say their proposal will be “revenue neutral,” which means that the total amount of BPT payments collected won't change. They believe taxing revenues (instead of profits) will keep businesses from leaving (and create new businesses). Therefore, a larger number of businesses will be paying that tax. This will offset the loss of revenues from the tax on profits. (The city disagrees, as you will see in a minute.)

Let's go back to that small neighborhood appliance store. Would the Green and Sánchez proposal help or hurt them?

It depends on how high their revenues are. Under the Green and Sánchez proposal, businesses will pay no taxes on the first \$100,000 they earn. They say this will help about 50,000 small businesses and companies just getting off the ground.

What about a company like Target?

With the exception of the first \$100,000 earned, Target would still have to pay a tax on their revenue, or total sales, within the city.

How does the Nutter administration feel about the Green and Sánchez proposal?

The Nutter administration has a problem with their *calculations* and their *timing*.

Start with the calculations.

The city's Finance Director Rob Dubow says the Green and Sánchez proposal will lower the BPT receipts by \$23.3 million annually. He argues that the only way it could be “revenue neutral” is by raising taxes on revenues even higher .



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What's the problem with their timing?

The administration says these issues are very complicated and should be considered along with the entire budget. The budget for the next fiscal year will be discussed in the spring of 2011.

That's only a few months away. What's the big rush?

Green and Sánchez are frustrated by what they see as the city's inability to compete with other cities and its own suburbs for businesses and jobs. They also believe that a full and open debate is more likely to happen when the city is not all tied up in budget talks.

Do the two sides agree on anything?

Yes. Just to give one example: Green and Sánchez agree that the construction industry would be hit hard under their proposal. That's because general contractors who put up the buildings and subcontractors who work on other parts of the construction would both have to pay the tax on revenues. Green and Sánchez agree that the "double taxation" isn't fair and plan to amend their proposal.

Who else would be hit hard, or would benefit, under the proposal?

According to the Nutter administration, the biggest losers are primarily comprised of trade, construction, insurance (primarily HMOs), leisure and hospitality services, and health and social services industries. The biggest winners are primarily professional and technical services, chemical, pharmaceutical and petroleum manufacturing, and retail (food and non-food) industries.

How do we figure out which side is right?

It's going to be tough. Even the Greater Philadelphia Chamber of Commerce – which represents about 5,000 large and small companies in 11 counties in the Greater Philadelphia region – hasn't taken a formal position on the Green and Sánchez proposal. The Chamber wants tomorrow's hearing to be delayed so that the two sides can at least agree on the basic financial data.

So what's going to happen at the hearing?

At the very least, Green and Sánchez will explain their plan and the Nutter administration will challenge it. The hearing should be telecast on Channel 64 on the Comcast cable system in Philadelphia and online at Council's website: <http://www.phila.gov/channel64/>.

And, if you miss it, you can always read the hearing transcript afterward:

http://legislation.phila.gov/council-transcriptroom/transroom_committee.aspx



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How can I find out more about the BPT?

The City's Revenue Department has lots of information about the tax (including helping you figure out if you should be paying it): <http://www.phila.gov/revenue/TaxRevenue.html>.

How can I find out more about the Nutter administration's position?

It is available here:

<http://media.philly.com/documents/Comparing+BPT+Proposal+Winners+and+Losers.pdf>.

How can I find out more about the Green and Sánchez proposal?

Green and Sánchez's reform plan, including the detailed PowerPoint presentation they have been showing to groups around town, is available at:

<http://www.forwardphiladelphia.com/>.

Their response to the Finance Director's November 13 letter is available at:

<http://media.philly.com/documents/11-18-10+letter+to+Dubow+re+BPT.pdf>

Now you've made my head hurt.

Sorry about that. It makes our heads hurt too. Tax stuff is complicated, we know, and remember that this Q&A talks about only one of several taxes the city imposes on businesses. Why don't you let us know how we did in explaining it? Email us about this or any "In the Know" at Info@seventy.org.