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Taxed to the Max

Despite cuts, Philadelphia remains, by many measures, America's most-taxed large city.

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In each of the last 11 years, Philadelphia has cut its wage and business tax rates, something that's happened nowhere else in America.

Over that time, the effort, aimed at making the city more competitive, has saved taxpayers more than \$1 billion.

Yet, with the possible exception of New York, Philadelphia remains the highest-taxed major city in the land.

In 2006, the city still has:

The nation's highest wage-tax rate.

One of the heaviest overall state and local tax loads for residents.

The steepest combination of state and local business taxes.

And Pennsylvania suburbanites who work in Philadelphia face the highest overall tax burden for commuters in the country, largely because of the city's nonresident wage tax.

Many economists and business leaders say it is no surprise that the city has continued to lose people and jobs - although at a slower pace than in past decades.

They argue that wage and business taxes haven't been cut enough to help reverse a half-century of economic bleeding.

And they note that Philadelphia's greatest current success story - the residential construction boom - is the result largely of the most dramatic tax cut of all, the 10-year real-estate tax abatement.

But city officials say the rise in property values and vibrancy show that Mayor Street has struck the appropriate balance between taxes and quality of life.

"If the only thing that mattered to people was taxes, they'd all move to North Dakota," said Lance Haver, the city's director of consumer affairs. "The market has spoken. It's saying the city's got it right. People want to live in Philadelphia."

Accelerating the pace

There is a chance that the city may creep down the national tax rankings in the years to come.

Street's proposed budget calls for enacting small, scheduled cuts in the wage tax while making deeper business tax reductions.

Some of his would-be successors at City Hall want to accelerate the pace of tax reduction. Then there's the state gaming money, some of which will start flowing to the city once the slots parlors are up and running.

The state legislature is all but certain to earmark that money - headed for property-tax relief elsewhere in Pennsylvania - for cutting the wage tax in Philadelphia. In a few years, the wage-tax rate, currently 4.301 percent for residents, could be pushed below 4 percent.

"I think we have a heck of a success-equation building here," said Mark S. Schweiker, president of the Greater Philadelphia Chamber of Commerce, referring to the prospects for tax relief and the general condition of the city.

"But left as they are now, [business] taxes are a deterrent to expanding the job base," he said. "It's hard to conduct a business marketing campaign and have to try to keep that deficiency stowed away."

Taxes are hardly the sole determinant of a city's economic well-being. Businesses and people consider a lot of factors in determining whether to come, stay or go.

Relocation factors

In appraising a prospective locale, CEOs weigh the cost and availability of office space, access to markets and resources, the nature of the labor force, and the price of utilities. Families look at crime, schools, housing prices, job opportunities and quality of life.

Much of what both groups see when they look at Philadelphia is positive. In the last few years, Center City and other neighborhoods have blossomed as places to live.

But recent Census Bureau estimates show Philadelphia's population continuing to decline. As for jobs, the city has lost a net of about 16,000 since 1995, reports the federal Bureau of Labor Statistics.

"It feels frustrating," said Cary Borish, whose family owns the six Marathon Grill restaurants. "You have a wonderful residential and retail rejuvenation in Center City, but our business depends on office jobs. It seems so clear that we need to compete on taxes to help jobs come."

Like Street, some economists, including Robert G. Lynch of Washington College in Chestertown, Md., assert that services often have more impact on business-location decisions than do tax rates.

But other experts who have looked at Philadelphia say that tax rates remain a drag on the city's future.

"The city's tax system has improved," said Richard Voith, an economist with Econsult, a consulting firm in West Philadelphia. "But if you want to preserve services in the long run, you need a tax system that's less destructive."

The numbers tell the story. Philadelphia remains the land of high taxes.

Taxes on city residents

The resident wage tax, at 4.301 percent (down from a peak of 4.96 percent in the mid-1990s), is the highest in the country.

Among major cities, New York comes in second, taxing income at an average of about 3.6 percent. Most cities don't tax residents' income at all.

In terms of combined state, local and school taxes, Philadelphians bear among the heaviest burdens in the country, according to an annual report prepared by the Finance Office of the District of Columbia.

The study looks at families of four in the largest city in every state - across five income categories.

In one of those categories, income of \$50,000, Philadelphia had the biggest tax load in the most recent report, which covered 2004. In the four other categories, it was third.

Philadelphia ranks at or near the top despite having relatively low real-estate taxes - and a sales tax, at 7 percent, the lowest among the nation's 10 largest cities.

What Philadelphia does have is a combination of state income tax (3.07 percent) and city wage tax (4.301) that amounts to 7.371 percent - the highest rate in the country, except for a few places, such as New York, where graduated taxes make the wealthy pay more.

Business taxes

On the business front, the picture is similarly daunting.

According to the California-based Kosmont-Rose Institute Cost of Doing Business Survey, which looks at 368 cities, Philadelphia is the most expensive place in America for a business to operate - in terms of taxes and fees.

Why? Only a few of the nation's largest cities, Los Angeles and Memphis among them, tax a company's local gross receipts, as Philadelphia does (at 0.19 percent last year, down from a peak of 0.325) through its business privilege tax.

Only a few others, including Washington and New York, tax net profits as Philadelphia does (at 6.5 percent, a rate that has not fallen). The wage tax also is a business cost, to the degree that companies must increase salaries to offset it.

The Pennsylvania suburbs have lower taxes on gross receipts and none on corporate profits, and the wage tax (called the earned-income tax is capped by the state at 1.0 percent for those municipalities that choose to levy it.

Commuter taxes

The region also ranks as the nation's highest-tax location for suburban commuters.

Runzheimer International, a Wisconsin consulting firm, crunched 2005 data on average taxes - including real estate, state income and sales - paid by families with wages earned in the central city and a home in the suburbs. It looked at the largest metropolitan area in each state.

Here again, Philadelphia was number one, beating out New York and Chicago.

The main reason the region ranks so high in this category is the commuter wage tax - 3.7716 percent. Pennsylvanians bear its full brunt; New Jersey residents get a credit against their state income tax.

Of the nation's 20 largest cities, only three others - Columbus, Ohio (2.0 percent), Detroit (1.25) and Indianapolis (0.175) - have commuter taxes. New York's commuter tax was repealed in 1999.

Philadelphia's rate is the largest in any city, large or small, by a considerable margin.

That the city and region are in this situation demonstrates just how high taxes were when the tax-cutting began 11 years ago.

Mayor Rendell got it started, after resolving the city's financial crisis of the early 1990s, and Street continued it, sometimes grudgingly. With the passage of time, some of the current mayor's allies have grown tired of the business community's focus on the issue.

Said Councilman Darrell L. Clarke, "We keep cutting taxes, and businesses still can't create jobs. If they could tell me, 'If you cut the net-profits tax, we'd create 10,000 jobs over a specific period,' I'm on board. But so long as I don't see it, you can't expect me to keep reducing the numbers of city jobs."

To those who question the value of cutting taxes, advocates point to the city's borders, where businesses are plentiful on the lower-tax, suburban side - and to the long-term numbers: 265,000 jobs and 450,000 residents gone since 1970.

It may not be easy to prove that lower taxes create jobs. But Philadelphia's experience demonstrates that being seen as a high-tax city doesn't help.

"We've undersold what we've done," said David B. Thornburgh, executive director of the Pennsylvania Economy League, speaking of the recent tax cuts. "We should be saying: 'We have high taxes. We know it. We've cut them by a billion dollars, and we're going to continue to cut them.'"

"But until you see the private-sector-jobs numbers start trending positive - not just [jobs] in education and health care and local government - then we're losing ground."

Glossary of Tax Terms

Resident Wage Tax: A flat tax of 4.301 percent on all wages earned by city residents, regardless of where the work is done.

Commuter Wage Tax: A flat tax of 3.7716 percent on all wages earned in Philadelphia by all nonresidents.

Business Privilege Tax: A tax on business activity that has two elements: the gross-receipts tax and the net-profits tax.

Gross Receipts Tax: A tax of 0.19 percent on all city-based revenues generated by all companies regardless of location. A company owes the tax even if it doesn't make any money. For every \$1,000 that comes in the door, the company owes the city \$19.

Net Profits Tax: A tax of 6.5 percent on a company's net income. How much of a company's net income is subject to the tax depends on what percentage of its business - in terms of facilities, personnel and sales - is located inside Philadelphia.

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