



Philadelphia Business Taxes: Incentives and Exemptions

Like many cities, Philadelphia does not regularly evaluate whether tax breaks achieve their goals

About this report

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Overview

Philadelphia business tax rates are among the highest of any large city in the nation, and the tax structure is frequently cited as one reason for the city's relatively weak job-creation record over the past several decades. A key element of that structure is the business income and receipts tax (BIRT), which taxes profits and revenue of businesses located in the city. Only 11 of the nation's 30 largest cities impose levies on corporate profits or revenue, and only Philadelphia does so on both.

To make these business taxes less onerous, Philadelphia's leaders have created a large and varied group of tax incentives and exemptions. Known as tax expenditures, they constitute an integral but little-understood aspect of the city's business tax policy. Supporters view the expenditures—which do not appear in the city's budget or financial statements—as investments in growing, maintaining, and attracting businesses, thereby enhancing the tax base. Critics see them as drains on public resources that have little accountability, haphazard goals, and scant proof that they pay off in business growth or future tax revenue.

To help policymakers and the public better understand the role that these measures play in Philadelphia's overall tax policy, The Pew Charitable Trusts sought to quantify the city's tax expenditures and compare them with those of other major cities. In Philadelphia, the analysis looked at two types of tax expenditures: incentives to spur companies to take specific actions, such as hiring more workers or investing in neighborhoods; and industrywide exemptions to support particular business sectors deemed by policymakers to merit special treatment. The study covered two periods, 2001-03 and 2010-12, in order to show change over time; the 2010-12 data were the most recent for which information was complete.¹

The research found that Philadelphia has 21 city-approved business tax reduction programs or provisions, the most among the nation's 30 largest cities. Eight of those reductions took effect after 2012, too late for their impact to be included in this analysis.

The research also found that from 2010 to 2012, the tax incentive programs resulted in an average of \$109.6 million per year in forgone revenue for the city and the school district—a 634 percent increase from 2001-03, when the average annual inflation-adjusted amount was \$14.9 million. This report describes revenue as “forgone” rather than “lost,” in part because repealing the tax incentives would not necessarily restore an equivalent amount of money to local coffers; businesses probably would alter their operations to reduce their tax liabilities.

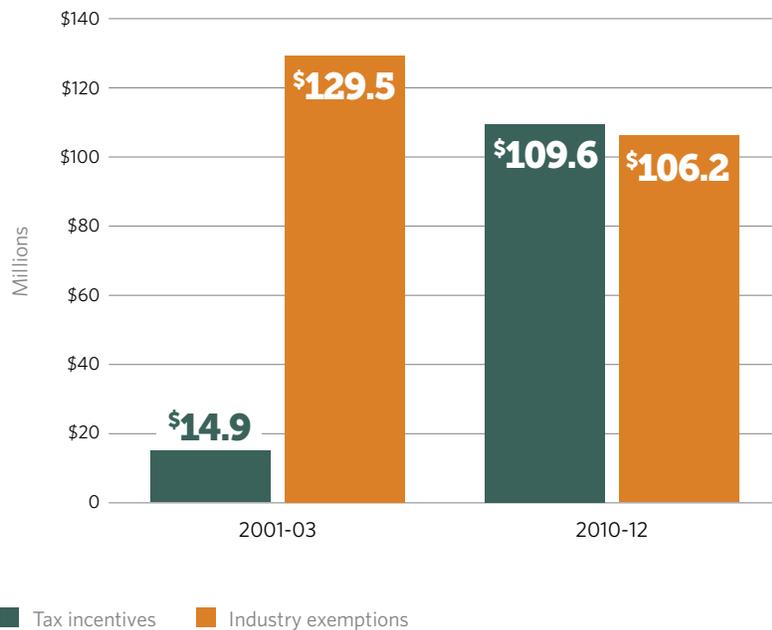
The vast majority of the \$109.6 million stemmed from two programs: the 10-year property tax abatement on new construction and building improvements for commercial and industrial property, and the Keystone Opportunity Zone initiative, which exempts businesses within designated areas from state and local business taxation. Like all tax incentives, both of these programs require companies to commit to making new investments in the city and are in effect for limited periods of time.

The other main source of tax expenditures—industrywide exemptions primarily for finance, insurance, utilities, and port-related firms—produced at least \$106.2 million in forgone revenue annually from 2010 to 2012. The amount was 18 percent less than in 2001-03, adjusted for inflation. Unlike tax incentives, exceptions are granted to individual companies without any time limits. Companies determine their eligibility in tax filings, which city auditors can challenge. (See Figure 1.)

Figure 1

Forgone Business Tax Revenue in Philadelphia

Annual average, in millions



From 2001-03 to 2010-12, Philadelphia's forgone business taxes grew primarily as the result of expanded use of tax incentives meant to retain and attract businesses and to spur real estate development, hiring, community reinvestment, and other commercial activity. The average annual amount of forgone revenue from tax incentives increased by 634 percent. Industry-specific exemptions declined 18 percent. All figures are inflation-adjusted to 2012 dollars.

Note: See Appendix D for list of credits, abatements, and exceptions.

Source: Pew analysis of Philadelphia Department of Revenue and Office of Property Assessment records

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Whether these tax expenditures have paid off for Philadelphia is hard to say. There is no question that there have been benefits, in terms of jobs created and buildings constructed. The issue is whether those benefits outweigh the costs.

Philadelphia reports on some of its smallest tax-expenditure programs but does not conduct comprehensive analyses of how much all the tax expenditures cost or whether they achieve their purposes—and is not required by law to do so. Only a few cities, including New York and Washington, require that kind of reporting. For those reasons, this report does not compare forgone revenue for the city of Philadelphia and the school district with other jurisdictions.

In 2012, the staff of the Pennsylvania Intergovernmental Cooperation Authority (PICA), a state agency that oversees Philadelphia's finances, called on the city to clarify and evaluate specific tax expenditures, concluding: "A lack of detailed accounting prevents a systematic process of evaluating whether the costs of these policies are justified in relation to their benefits."

This study does not attempt to determine whether Philadelphia business tax expenditures have met their goals, but it does look at ways that cities can design programs to include evaluations. According to public finance and policy analysts, measuring the impact of tax benefits and setting clear rules for receiving them are key steps toward an effective and equitable tax system that fosters economic development and generates needed revenue.

Philadelphia business taxes

Among the 30 largest U.S. cities, only Philadelphia taxes both local business income and gross receipts as part of its business income and receipts tax (BIRT).

Five other cities—Columbus, Ohio; Detroit; New York; Portland, Oregon; and Washington—tax business net income or profits but not receipts. Among these cities, Philadelphia’s 2015 tax rate of 6.41 percent was third-highest behind New York and Washington, where some tax rates are higher because the District of Columbia performs certain functions of a state government. When combined with state corporate income taxes (9.99 percent in Pennsylvania), business profits in Philadelphia were taxed at the highest rate among the 30 cities.²

Another five cities—Los Angeles; Memphis, Tennessee; Nashville, Tennessee; San Francisco; and Seattle—tax only gross receipts, meaning all of the money that comes in the door, regardless of whether the company makes a profit. In 2015, companies paid 0.1415 percent of their gross receipts in Philadelphia, a lower rate than in those five cities. (See Table 1.)

All of the 30 cities tax commercial real estate, and some (but not Philadelphia) also tax other forms of business property, such as office equipment and machinery.

Philadelphia’s unique status in taxing both business income and gross receipts began in 1984, when the state Legislature, in response to the business community’s concern over the city’s high gross receipts tax, added an income portion so that the gross receipt rate could be reduced. Since then, business leaders and economists have argued repeatedly that the BIRT has given businesses reason to flee the city or set up operations elsewhere.

To reduce the tax burden—and encourage companies to stay, expand, and hire—the city has created credits, property tax abatements, and other exceptions to the business tax code. Most of the 21 expenditures discussed in this study are linked to the BIRT.

Table 1

Business Taxes in Philadelphia and Other Major Cities

Taxes and rates for fiscal year 2015

City	Tax on business net income (profits)	Tax on business gross receipts (sales)	Tax on profits of partnerships or sole proprietors	Tax on commercial real estate*	Tax on commercial use of property	Tax on unsecured business property, such as equipment or machinery*
Columbus	2.5%		2.5%	\$80.76		
Detroit	2.0%			\$86.79		\$86.79
Los Angeles		0.101 to 0.507% [†]		2.8096%	\$5.92	2.8096%
Memphis [‡]		0.3%		3.4%		3.4%
Nashville [‡]		0.3%		1.8064%		1.3548%
New York City [§]	8.85%		4%	10.684%	3.9% of base rent	
Philadelphia	6.41%	0.1451%	3.92%	1.34%	1.13%	
Portland	3.65% [#]		3.65%	\$4.58		\$4.58
San Francisco		0.1625%		1.1826%		1.1826%
Seattle		0.150 to 0.415% [†]		\$0.59 and \$1.78 ^{**}	\$1.56/sq foot	2.6235%
Washington	9.4%		9.4%	\$16.50 or \$18.50 ^{††}		\$3.40 per \$100

Of the 30 biggest U.S. cities examined for this study, 11 had taxes on corporate income or receipts as of mid-2015. The 11 cities also had other taxes on partnerships or sole proprietors, commercial real estate, and other business property.

Notes:

* Levied as percentage of assessed value or amount per \$1,000 of assessed value, unless otherwise noted.

† Different rates by industry classification.

‡ Tennessee collects business tax and remits it to cities.

§ New York's corporate income tax rate of 8.85 percent applies to most businesses; its effective tax rate on commercial use of property is lower for nonowners.

Includes county income tax.

** Higher rate for business floor space, lower for stairwells, kitchens, and other auxiliary space. Repealed in 2016.

†† Rate is \$16.50 for values below \$3 million, \$18.50 for values above.

Sources: City officials, tax codes, financial documents

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About the Study

To tally forgone taxes in Philadelphia, Pew analyzed business tax filings maintained by the Philadelphia Department of Revenue. No individual payers are named in this report, because tax records are confidential. Pew also examined data on commercial and industrial property from the Office of Property Assessment, focusing on accommodations and expenditures from four city taxes: the business income receipts tax (BIRT), which applies to net and gross business income; the net profits tax (NPT) on the profits of unincorporated proprietorships and partnerships; the real property tax on the assessed value of commercial real estate; and the use and occupancy tax (U&O) on the assessed value of the portion of property used by commercial occupants who do not own the whole parcel, such as renters.

Two periods were chosen to view changes over time: 2001-03 and 2010-12, the most recent period for which tax data are substantially complete. For each period, an annual average was computed to preserve confidentiality and reduce the impact of a major increase or decrease in revenue or profits in any given year.

For comparison, researchers looked at the nation's 30 most populous cities, of which 11 imposed local taxes on business income or receipts as of 2015: Columbus, Ohio; Detroit; Los Angeles; Memphis, Tennessee; Nashville, Tennessee; New York; Philadelphia; Portland, Oregon; San Francisco; Seattle; and Washington. Researchers also looked at the counties in which these cities are located, because Philadelphia functions both as a city and a county. Information about tax expenditures in those places was gathered from municipal websites and a survey of local officials.

The study did not look at quasi-governmental or nonprofit sectors that are exempt from federal and state tax and that Philadelphia and most other cities also do not tax. In Philadelphia, quasi-governmental agencies include the Southeastern Pennsylvania Transportation Authority (SEPTA), Philadelphia Gas Works, and the Philadelphia Industrial Development Corp. Universities, hospitals, religious institutions, and other nonprofit organizations also do not pay city business taxes. Those with business activity that is unrelated to their nonprofit missions, such as operation of a commercial parking lot, are required to pay on that income. (See Appendix A for full methodology.)

Also not included in the study are a variety of state tax incentives that do not result in forgone revenue at the local level, as well as instances of tax increment financing.

Key Terms

Abatement: A reduction in tax liability for a specific period of time, usually applied to property taxes and generally created to encourage investment.

BIRT: The business income and receipts tax, Philadelphia's primary tax on businesses.

Credit: A discount applied to total taxes due that typically requires a separate application or approval process.

Exemption: Removal of an entity from some or all taxation.

Forgone revenue: The amount of money that taxes are reduced because of incentives, exemptions, or other tax expenditures.

Gross receipts: A firm's total revenue before expenses and other charges.

Keystone Opportunity Zones: A state-authorized program, designed to encourage business expansion and job creation on vacant and underutilized parcels, that exempts businesses in specific locations from many state and local taxes.

Net income: A firm's profit or income after expenses and other charges.

Tax expenditures: The cost incurred when a taxing jurisdiction provides exceptions to its tax code or regulations for specific purposes or organizations.

Tax incentives: Credits, exemptions, or other exceptions to tax rules designed to encourage a business or other taxpayer to take a specific action, such as hiring more employees or moving to a blighted neighborhood.

Use and occupancy tax: A tax on real estate used for commercial purposes, with revenue going to the School District of Philadelphia.

Types of incentives and their effect on city revenue

Our analysis estimates that forgone tax revenue from business tax incentives in Philadelphia amounted to \$109.6 million per year on average from 2010 to 2012 for the city and the school district. That was equivalent to nearly 7 percent of total city property and business tax revenue. A decade earlier, in the 2001-03 period, forgone taxes from these programs totaled an inflation-adjusted \$14.9 million per year, equivalent to just under 1 percent of city property and business tax revenue.³

There are three types of incentives:

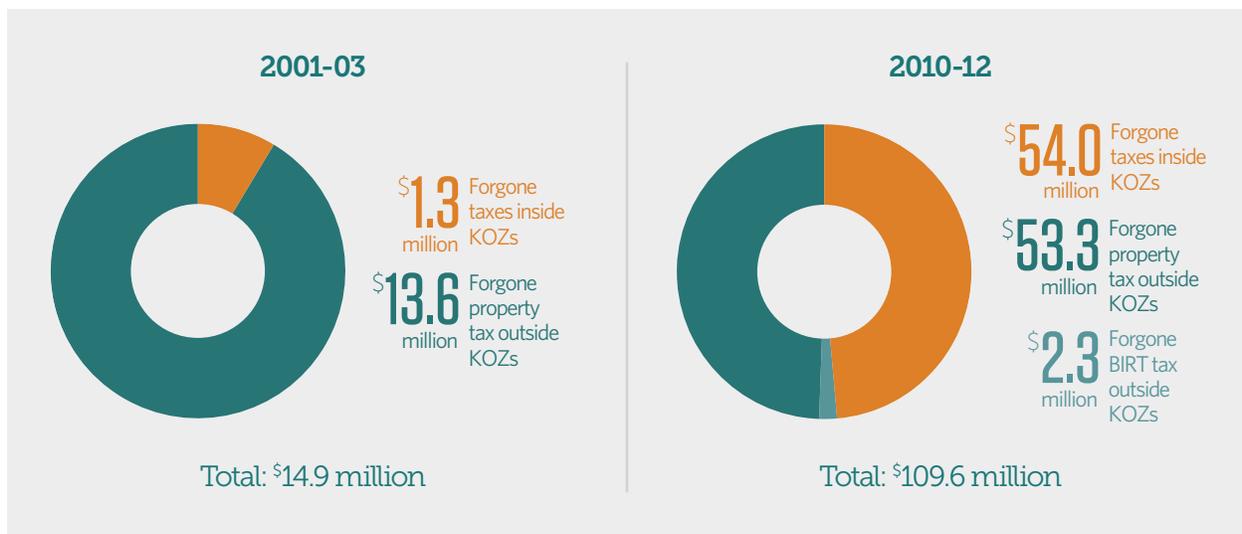
- **Geography-specific exemptions:** Companies located in Keystone Opportunity Zones (KOZs) are exempt from state and local business taxation and receive property tax abatements. The largest source of tax incentives in 2010-12, these exemptions and abatements produced an average of \$54 million a year in forgone revenue. KOZs are designed to spur business creation and expansion in vacant or underutilized parcels in the city.

- **Commercial and industrial property tax abatements:** Such abatements averaged \$53.3 million in 2010-12. They are available citywide and are designed to encourage commercial and industrial development and revitalize communities. Different from KOZ abatements, they are the only citywide abatement program for nonresidential property.
- **Tax credits for specific purposes:** These programs averaged \$2.3 million in annual BIRT credits in 2010-12. Most of the credits went to neighborhood-based development organizations.

In 2010-12, Philadelphia’s BIRT revenue averaged \$392 million a year, while property tax revenue—commercial and residential, for the city and the schools—averaged nearly \$1.1 billion a year. The largest source of tax revenue was the wage tax, which brought in \$1.53 billion on average during that period. Economists say part of the tax can fall on employers if they are forced to pay higher wages than they might otherwise to counter the impact of the wage tax on take-home salaries. For this report, Pew did not consider the tax, which is withheld by employers but paid by workers, to be a business tax.

In the years between the two periods studied, the city’s property tax abatement and BIRT tax credit programs grew. In addition, new credits were created, and only one, for internships, was ended. Adjusted for inflation, the total forgone revenue rose 634 percent over the period—driven largely by commercial property tax abatements and BIRT tax credits—while total revenue from property, use and occupancy, and BIRT taxes rose 6.4 percent. (See Figure 2.)

Figure 2
 Philadelphia’s Forgone Revenue From Tax Incentives
 Annual average



From 2001-03 to 2010-12, the value of corporate tax incentives in Philadelphia grew substantially, driven largely by commercial property tax abatements and income tax credits within Keystone Opportunity Zones. All figures are inflation-adjusted to 2012 dollars.

Sources: Pew analysis of Philadelphia Department of Revenue and Office of Property Assessment records

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In the view of Philadelphia Finance Director Rob Dubow, the tax incentives should be seen in this context: A weak tax base and high demand for services increase tax rates on businesses (as well as on residents), causing some companies to leave the city, others to stay away, and startups to launch elsewhere. To counter all of that, the city has created numerous tax exceptions, and the resulting forgone revenue results in a higher burden on all taxpayers, keeping rates high. “To attract business, we have to compensate,” Dubow said.⁴

Public finance and governance experts say exceptions to tax codes should explicitly state their public policy goals, such as providing incentives for the private sector to create jobs. The programs, they say, should also have several other components: clear criteria for determining whether businesses receive and maintain the tax benefit; penalties or loss of benefits if the criteria are not met; cost controls such as caps on the amount of forgone revenue; expiration or reauthorization dates to ensure reviews of the programs; reporting on the value of the tax benefits; and evaluation to determine whether the tax programs achieve their goals and provide social benefits that are adequate to justify their costs. In reviewing specific tax exceptions in this report, Pew notes whether programs include these features.

And, like other types of expenditures, experts say, business tax incentives should be taken into account during the city’s budgeting process. “Nobody thinks of this as spending. But it is, and it is a lot of money,” said James Edward Maule, a tax professor at Villanova University’s law school.⁵

Here is a listing of Philadelphia’s tax incentive programs, associated forgone taxes, and major requirements, as well as some comparable programs in other cities.

Geography-specific exemptions

The state created the Keystone Opportunity Zone program in 1998.⁶ In addition to exemption from state and local business taxes and the city’s property tax, firms in KOZs do not pay sales tax on items they use or consume on the KOZ site. City Council and the state Department of Community and Economic Development must approve each KOZ.

From 2001 to 2003, KOZ credits and abatements totaled an annual average of \$13.6 million in inflation-adjusted dollars. From 2010 to 2012, the city gave KOZ credits and abatements worth \$54 million on average each year to 293 companies: \$35.2 million in forgone BIRT revenue, \$11.4 million in property tax abatements, \$3.7 million against the net profits tax on individuals and partners, and \$3.7 million in use and occupancy tax revenue.

The first KOZs were located in North Philadelphia, along the Delaware River waterfront, and in industrial parks in the Northeast section of the city. More recently, zones have been created for office development in University City and the Navy Yard in South Philadelphia. In 2001-03, retail and wholesale firms were the largest category of KOZ recipients. In 2010-12, finance and insurance businesses received the most KOZ credits, 56 percent of the total.⁷

Most of the zones are designated for 10 years, some longer. A business must increase employment or investment during its first year in a zone but subsequently is not required to maintain those levels of employment or investment to continue receiving the benefits.⁸ There is no cap on the dollar value of benefits a company can receive while in a zone, although penalties are imposed on businesses that close down or move out of the zone in the first five years. The Philadelphia Department of Commerce receives self-reported annual filings from KOZ companies but does not publish reports on them. The Pennsylvania Department of Community and Economic Development reports on KOZs every five years.

Of the 10 other comparison cities with business taxes, most offer some form of relief, typically from property taxes, to firms located in specified geographic zones. Three of the cities—Columbus, New York, and Detroit—offer location-based programs that also reduce local corporate income taxes, as does the KOZ.

Commercial and industrial property tax abatements

Philadelphia provides 10-year property tax abatements on all parcels—commercial, industrial, or residential—that undergo development or substantial renovation. By forgoing short-term tax revenue, the city hopes to encourage development that produces higher taxes on the abated properties and surrounding sites once the abatements expire.

From 2010 to 2012, forgone revenue from commercial properties averaged \$53.3 million annually, which is 4.8 percent of total average property tax revenue in those years. That compares with an inflation-adjusted annual average of \$1.3 million, or 0.13 percent of average property tax revenue, in the 2001-03 period, which was soon after the abatement program was expanded to include all types of construction and renovation.

In Philadelphia, property tax revenue is divided between the city and the school district. During the years of our study, the percentage of revenue allocated to the school district ranged from 54.6 to 60 percent. Property taxes are the district's largest source of local revenue. For the city, it is the second-largest source, behind the wage tax.

When taxes are abated, the assessment of a property is reduced for 10 years to reflect the value of new construction and improvements; the assessment of the land itself or untouched structures is not affected. Ten-year abatements on residential development accounted for \$67.5 million per year, on average, from 2010 to 2012. This figure is not part of Pew's estimate of forgone business tax revenue.⁹

History of the BIRT

In 1932, the Pennsylvania Legislature empowered Philadelphia to levy taxes beyond those on real estate. Seven years later, the city began to tax wages and the net profits of unincorporated businesses.

Facing budget problems in 1953, Philadelphia added the mercantile license tax (MLT) on business revenue. The Legislature exempted banks, insurers, and utilities because they were regulated at the state level and paying state taxes on their revenue.

In 1983, the city hiked the MLT by 25 percent to \$5 for every \$1,000 in receipts. Business leaders balked and persuaded city leaders, with state approval, to add a local business income tax at 3.7 percent and reduce the MLT from \$5 to \$3.05. As part of that deal, banks and insurers agreed to pay a tax on their net income or gross receipts taxes, whichever was lower. This arrangement was later extended to securities dealers.

The two-part levy, initially known as the business privilege tax, took effect in 1985. By 1989, the city had raised the net business income rate to 6.5 percent and the gross receipts rate to \$3.25 per \$1,000. Today the rates stand at 6.41 percent and \$1.415 per \$1,000.

In 2011, city officials changed the name of the tax to the business income and receipts tax, its current title, to diminish scorn for the term "privilege." As then-Mayor Michael Nutter said at the time: "It is not necessarily a privilege to pay taxes."¹⁰

The abatement is available to any commercial property owner who fills out an application and is not in arrears on any city taxes. The city is not required to monitor or report on the program's impact. The program also does not cap the total amount of abatements that can be granted or have a reauthorization date.

None of the other cities in this study offers a citywide property tax reduction for all types of commercial development. Most offer construction incentives with limitations, such as those related to location, type of business, and the length and size of the abatement. In Detroit, the state's Commercial Rehabilitation Act freezes the taxable value of a building in the city and exempts the new investment amount from taxes for up to 10 years, with the length of the exemption determined by city government. Washington offers business property tax relief through special programs for supermarkets, art galleries, and technology companies. Memphis provides property tax incentives to individual companies after a cost-benefit analysis, with scoring based on a set of eight criteria determining the length and extent of the abatement.

This study did not examine a variety of other fiscal tools, such as grants and government loans, designed to spur development in Philadelphia and other cities. Nor does the report include state and federal tax incentives for local real estate development.

Tax credits for specific purposes

A number of Philadelphia's tax credits were created with targeted goals in mind, such as community revitalization, job creation, environmental sustainability, and employee health care coverage. Many of these programs provide tax incentives to mitigate the BIRT.

Community revitalization

In addition to the KOZs, Philadelphia has three tax programs available to businesses located anywhere in the city that aim to stimulate economic and community development.

By far the biggest program for which data were available is the community development corporation (CDC) tax credit program. Every dollar that businesses give to qualified community development corporations—nonprofit organizations typically working in low-income areas—reduces their BIRT tax bills by a dollar, up to \$100,000 per year for 10 years. Eighty businesses, many of them legal and professional service firms, received an average total of \$2.3 million per year in CDC tax credits in 2010-12. The legislation has clear criteria for participation, penalties for failing to make the promised donations, a citywide cap of \$4.2 million a year, and reporting requirements but no expiration date on the program itself.

In addition, the city has a credit to assist companies whose business is interrupted because of public works construction, created in 2015 in reaction to complaints about building projects, including the lengthy reconstruction of SEPTA's elevated Market Street line in West Philadelphia. The authorizing ordinance has clear criteria and a \$1 million-per-year aggregate cap but no expiration date or reporting requirements.

Jobs

Philadelphia has several programs intended to generate employment opportunities, but none of them has been widely used.

One of them is the job creation tax credit, established in 2002. For each job a company created, the credit was initially worth \$1,000 or 2 percent of annual wages paid—whichever was higher—for one year. Few companies applied. In 2010, the credit was increased to \$3,000, then in 2012 to the current \$5,000. From 2010 to 2012, six

companies received credits totaling \$14,818. In 2015, the period of eligibility was increased from one year to five but returned to one year in 2016.

Another credit, added in 2006, gives employers a \$5,000 tax credit for every ex-offender they hire. The Revenue Department has no record of any company taking advantage of the credit during the study period. In 2010, City Council wanted to encourage participation and increased the benefit to \$10,000 and dropped some requirements, such as requiring employers to help pay tuition for employees and having the workers return 5 percent of their earnings to the city as reimbursement for the credit. As of mid-2015, three firms had claimed this credit.

In 2012, Philadelphia added a one-time \$2,000 credit for each qualified veteran whom a company hires, but the Revenue Department did not issue any credits that year, the latest examined. The credit is now \$5,000 per veteran employed full time and \$2,500 part time. The credit, which expires in 2020, has eligibility requirements and caps the entire benefit at 500 individuals over three years.¹¹

In 2012 and 2013, the city also had a credit for paid internships. But no claims were filed, and the program was not renewed.

Job-Related Tax Credits in Other Cities

Of the comparison cities that tax business revenue and profits directly, Columbus, New York, and Washington offer specific hiring credits like Philadelphia's.

In 2015, Columbus awarded 18 projects with cash incentives or tax credits of up to \$1.6 million per year for job creation, including seven specifically for office jobs. Six projects received property tax abatements, also totaling \$1.6 million a year.¹²

New York offers employment credits to firms that set up businesses in upper and lower Manhattan and in some neighborhoods in the other boroughs. In 2014, 210 firms received \$27 million in credits.¹³

In Washington, a job growth credit has gone unused because the city has not appropriated funds for it. The city also offers a package of five credits for high-technology companies, including three for hiring. Washington's tax expenditure report shows \$15.9 million credited to businesses in 2014, with the bulk of the money going to programs that do not involve hiring.¹⁴

Portland offered private employers an income tax credit for hiring youth but discontinued the program after a two-year pilot. "There were not enough takers to justify the costs to administer the program," said Scott Karter, manager of Portland's Revenue Audit and Accounting Division.¹⁵

Environmental protection

Philadelphia offers two tax credits focused on environmental protection. One is the sustainable business tax credit, created in 2012, that benefits businesses certified by the mayor's office as "sustainable" for such practices as relying on renewable energy and offering employees incentives to use public transportation.¹⁶ Each qualifying firm can earn an annual credit of up to \$4,000. In 2012, 13 companies reduced their taxes by a total of \$14,536 through this credit. The program has eligibility criteria, caps, penalties, and reporting requirements and expires in 2017.

The city also has a green roof tax credit, issued for installation of a qualifying roof of living vegetation on a commercial structure. The credit, created in 2007, covers half the cost of the roof up to \$100,000 beginning in the year the roof is certified. From 2010-12, three companies constructed green roofs and earned an average of \$563 in credits. This credit has the same requirements as the sustainable business credit but no expiration date. Among the other cities in this study, only New York offers any incentive for green roofs.

Health care coverage

Starting in 2013, Philadelphia companies that added health care coverage for life partners and transgender care, including prescription drugs, counseling, and surgery, became eligible for a tax credit worth \$4,000 or 25 percent of the amount the business spent on added premiums to provide those benefits, whichever is less. The city's authorizing legislation has eligibility criteria, penalties, expenditure caps, and reporting requirements but no expiration date.

Although none of the other comparison cities has a similar program, Washington gives companies a credit for providing paid leaves to workers so they can become organ or bone marrow donors. For a list of tax incentives in other cities, see Appendix B.

Industry-specific exemptions

Philadelphia's other tax expenditures consist of exemptions for industries and types of businesses. Over the period studied, these exemptions produced a relatively stable amount of forgone revenue. In 2010-12, the annual average of these tax expenditures was at least \$106.2 million, down from \$129.5 million a decade earlier, adjusted for inflation.

The exemptions fit into two categories. One concerns various state-taxed and -regulated sectors, namely banking, insurance, energy distribution, telecommunications, railroads, and trucking. These types of industry are exempt from city taxes because of provisions in the 1984 state legislation that gave Philadelphia the authority to tax business net income on top of gross receipts. Companies seeking this exemption are not required to fill out applications and are not subject to any additional requirements like those in place for the tax incentive programs.

Representatives of these industries and some city officials do not consider these exemptions to be tax expenditures like tax credits or property abatements, because state law prohibits municipalities from taxing the income of the industries. City leaders codified these exceptions to Philadelphia's local taxes, which is why Pew counts them in this report.

The other category of exemption is city-granted and covers different types of businesses. This includes income generated by companies through business activity at the Port of Philadelphia; by investment firms, including hedge funds and private equity groups; from some technology-based firms; by manufacturers, retailers and wholesalers, textile dyers, and bookbinders; and from new and small businesses. Port-related and investment firms are fully exempt, the others only partially so, as explained below. None of these exceptions has monitoring or reporting requirements or expiration dates. (See Figure 3.)

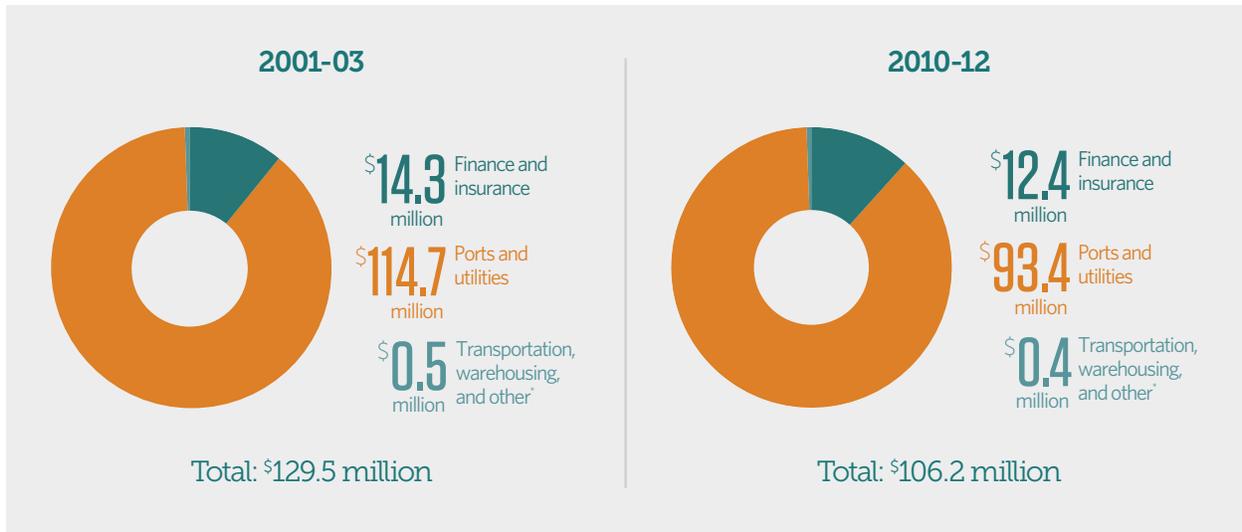
Philadelphia, Memphis, and Nashville exempt banking, insurance, and utilities from local taxes. Other cities exempt one or two of those sectors as well as others.¹⁷

Because of Philadelphia Department of Revenue confidentiality agreements and inconsistencies in data provided by business filers, we were able to break down the amount of the city's forgone taxes only for some industry groupings.

Figure 3

Philadelphia Forgone Revenue From Industry Exemptions

Annual average



From 2001-03 to 2010-12, the value of tax exemptions for specific industries or certain business activities fell by 18 percent, driven mostly by declines in the exemptions claimed by utilities and port-related businesses. All figures are inflation-adjusted to 2012 dollars.

* "Other" includes the information, arts, entertainment, and recreation sectors.

Sources: Pew analysis of Philadelphia Department of Revenue and Office of Property Assessment records

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Forgone taxes from ports and regulated utilities

From 2010 to 2012, the average annual forgone revenue reported for port-related businesses and regulated utilities was \$93.4 million from exemptions for 59 companies, according to Revenue Department records. The value of these exemptions declined during the period studied; in 2001-03, 133 companies received exemptions averaging \$114.7 million per year. These figures are conservative, because they include taxes forgone only by firms that were partially exempt from city business taxes. Port-related companies and utilities that were fully exempt did not have to provide the city with any information about their income, which is essential to making a calculation. The city data also do not allow for accurate analysis of port businesses and utilities separately.

The port exemption was enacted by Philadelphia in 1986 to protect jobs and to help it compete against other East Coast ports, including Baltimore and Norfolk, Virginia, which had no business income taxes.¹⁸ Other cities in this study with major seaports do not give port-related activity special tax treatment. Seattle is bound by a U.S. Supreme Court decision requiring port businesses to pay the local tax. In Los Angeles, stevedoring firms pay the local business tax, although firms with 100 workers or more pay more than those with 99 workers or fewer. New York City port businesses pay city corporate income tax.¹⁹

Utilities and other industries regulated and specially taxed by Pennsylvania are exempt from the BIRT as a result of the 1984 legislation.²⁰ They include telecommunications and transportation carriers, which did not have to pay at least \$486,938 per year in the first study period and \$428,273 in the second. Energy utilities are allowed to exempt the portion of their income that comes from distributing energy, as opposed to generating energy, which has been deregulated and is now taxable. State-regulated utilities are also exempt from city real estate taxes. The city recoups some of that forgone property tax revenue through the state's tax on utility gross receipts, as required under the Public Utility Realty Tax Act. The state distributes the money to local governments.

Among the other cities in this study, only Nashville and Memphis exempt privately owned utilities from local corporate income taxes.

Forgone taxes from finance and insurance

Unlike most for-profit businesses in Philadelphia, banks, insurers, and certain other financial firms pay the lesser of the BIRT net income or gross receipts tax rather than both. From 2010 to 2012, this allowed an annual average of 103 finance and insurance companies to pay \$12.4 million less than they would have if they had been required to pay both parts of the tax.²¹ In 2001-03, the annual average savings for companies in this category was \$14.3 million, adjusted for inflation. These industries also started from a lower tax base than other businesses in Philadelphia, depending on whether the business activity occurs in the city. But city authorities do not break out the impact of that calculation.²²

J. Duncan Campbell III, chief executive officer of the Pennsylvania Bankers Association, said state taxes on banking are substantially higher than taxes imposed on other Pennsylvania industries.²³ In his view, banks and the other regulated industries are not obligated to pay local business taxes in Philadelphia but agreed to pay some as a "special accommodation" when the BIRT was created. "It is not a tax expenditure but instead a special taxing privilege provided uniquely [by the Legislature] to Philadelphia," Campbell said.²⁴

Four of the comparison cities—Detroit, Los Angeles, Memphis, and Nashville—exclude banking from city business taxes. Six cities require banks to pay the local corporate tax. In all 11 cities with business taxes, banks also pay a state tax, except in Washington, where there is no separate state government.

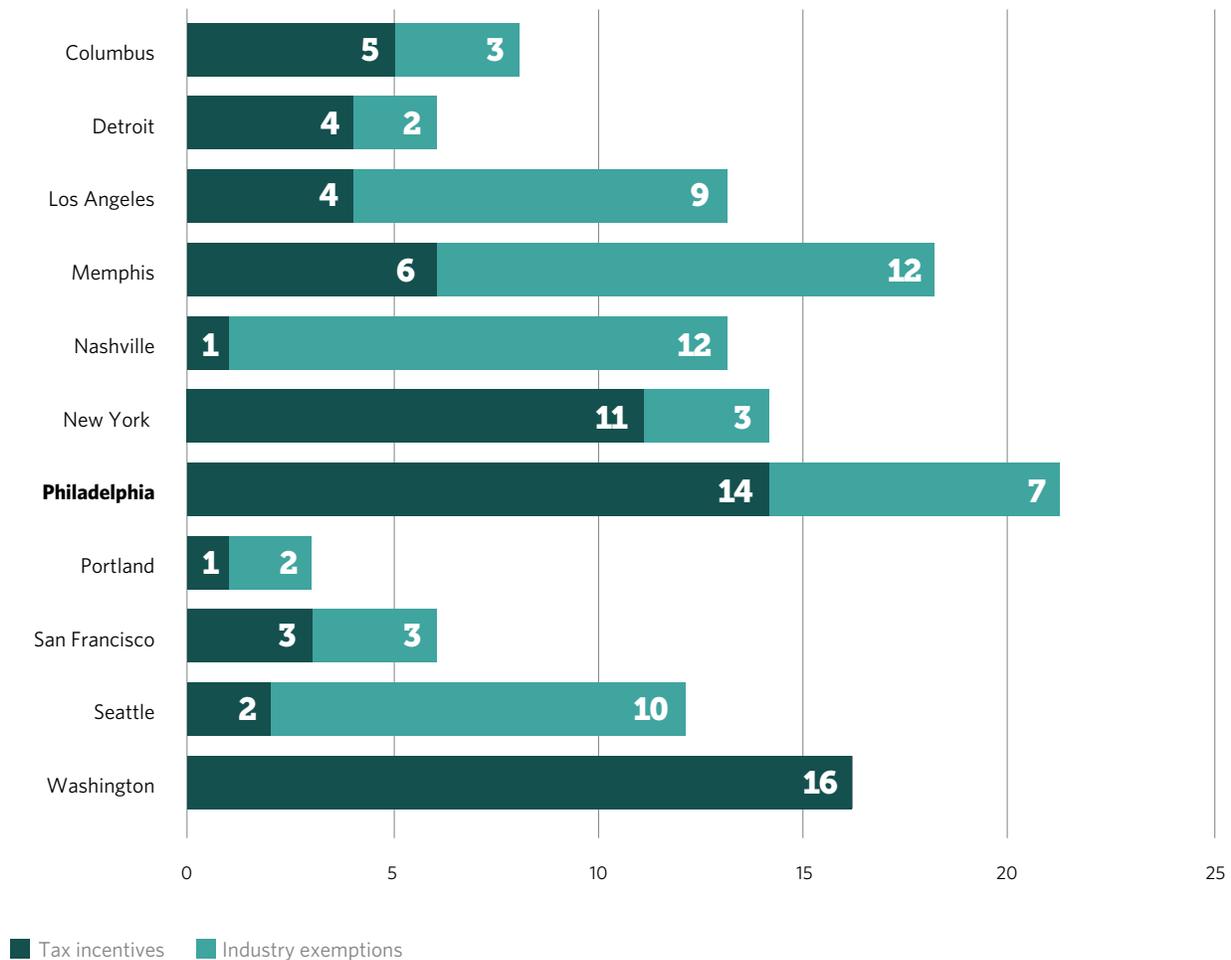
Only Columbus and Portland impose city taxes on insurance companies. In 2011, the most recent year available, New York's largest individual business tax expenditure, \$437 million, was for nontaxation of insurance companies.²⁵ The insurance industry is taxed by all of the states in this study. For a list of industry exemptions in the comparison cities, see Appendix C.

In 2012, Philadelphia fully exempted earnings by private equity firms, hedge funds, and other investment companies—and their partner/owners—from the BIRT and the net profits tax. Local economic development officials argued to City Council that encouraging these firms to stay or locate in the city would generate other tax revenue from sales, wage, and earning taxes. Because there were only a few such firms in Philadelphia, the change would not greatly diminish tax revenue, they said.

In New York City, investment companies are allowed to use a special formula to allocate management fees for publicly traded mutual funds. Portland gives investment firms a credit of 70 percent of the total business tax that otherwise would be due.

Among the nation's 30 largest cities, Philadelphia's 21 local business tax exceptions or industry exemptions are more than any of the 10 other cities that impose taxes on business income or receipts. Memphis had the second-highest number, 18. (See Figure 4.)

Figure 4
Number of Tax Incentives and Exemptions in Cities With Local Business Taxes



As of 2015, Philadelphia had 21 incentive programs or exemptions, the most of any of the 11 major cities with business net income or gross receipts taxes.

Sources: Tax codes and city officials

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Other industry exceptions

There are other industry tax exemptions in Philadelphia, some of which Pew was unable to quantify because they were put in place after the study period or would require calculations based on individual confidential tax returns.

Since 2013, the city has exempted certain technology-based service firms from taxes on work done in Philadelphia for customers outside the city. Other service firms must pay taxes on any work performed in the city, even if it is done for an out-of-town customer. The law applies specifically to computer systems design, software publishing, data processing, and other technology service businesses and carries no reporting or other requirements.

Manufacturers, wholesalers, and retailers with large receipts but low profit margins are allowed to use alternative formulas to compute their tax bills. They are permitted special deductions for the cost of operations, including labor, that go beyond what is allowed for other types of companies. The purpose is to make up for what would otherwise be a high tax obligation under the gross-receipts section of the two-part BIRT.

The city also gives textile dyers and bookbinders the right to exempt their sales from the gross receipts part of the BIRT. These exceptions, approved in 1996 for dyers and 2006 for bookbinders, came in response to pleas from the two groups that they should be treated less like service providers and more like manufacturers, who do not pay BIRT on sales outside the city.²⁶ Firms can also exempt from their tax obligation the interest and fees that they receive on loans made to development projects in low-income communities through the federal new markets tax credit.

Hoping to aid business creation and expansion, Philadelphia has enacted programs to benefit new and small businesses.

Startups and businesses relocating to Philadelphia now get a two-year exemption from all BIRT tax obligations if they hire at least six employees. The city also eliminated a one-time \$300 business licensing fee and allowed all companies—new and old, large and small—to exempt the first \$100,000 in sales, as of 2016, from both the gross receipts and net income taxes. This exception was designed to help smaller firms with lower sales. The city has estimated that these tax changes would result in \$185 million in BIRT forgone revenue from 2016 to 2020, or an average of \$37 million a year.²⁷ These benefits, which are granted automatically to all who qualify, do not have detailed eligibility criteria, penalties, caps, expiration dates, or reporting rules.

Other cities have a wide variety of tax-related programs to spur business formation and growth. Washington, for instance, has a tax credit for high-tech companies that allows them to pay a lower business income tax rate than nontechnology companies. In Los Angeles, creative artists can exclude the first \$300,000 of receipts from taxation. San Francisco excludes the first \$1 million of receipts from taxation for all businesses.

Using Accounting Rules to Cut Taxes

Accountants say several major accounting rules that are available to all companies may be more significant in determining a company's local tax liability than city tax credits or other tax reduction programs. Among these rules are:

Separate reporting: Philadelphia businesses are required by state law to file separate forms for affiliated businesses, rather than a single consolidated report. This allows businesses to shift income to affiliated holding companies in low- or no-tax jurisdictions, such as nearby Delaware, by purchasing intangibles, such as intellectual property, from the holding company. The business then has less taxable income in Philadelphia. It is not possible to break out the amount of forgone revenue resulting from this policy. Of the six cities that tax net income, Philadelphia is the only one where separate reporting is required.

Net operating loss: Philadelphia lets companies that lose money in one year use those losses to reduce taxable income for three succeeding years. Five of the six cities that tax net income have similar provisions. The state has a 20-year net operating loss provision that is independent of the city's.

Single sales factor: In 2015, Philadelphia adopted a new BIRT policy called "single sales factor apportionment," long advocated by the business community as a way to reduce the tax bills of city-based companies that pay net income taxes. Previously, businesses had to compute their taxable profits based on the value of their property, payroll, and sales in the city. Under the new policy, their profits are calculated based only on sales in Philadelphia. This is intended to put them on an even tax footing with competitors based outside the city. The new policy is expected to reduce BIRT taxes by \$48 million a year.²⁸ Of the six cities that tax net income, only New York and Philadelphia use this form of apportionment.

Tax expenditure rules and practices

Making a tax expenditure an effective public policy tool requires a well-designed program codified in law, ongoing evaluation of its effectiveness in reaching its goals, and transparency in its application, experts say. Various jurisdictions have adopted some of these rules and practices; Pew has highlighted others in its studies of state tax incentives.²⁹

Design

Successful tax expenditures begin with program design. Key features include a clearly stated purpose, explicit eligibility criteria to meet that purpose, limits on government's overall expenditures, and credible penalties or consequences for noncompliance. Regular reporting requirements are also essential for ongoing evaluation.

In Philadelphia, the design of tax expenditures also must take into consideration the uniformity clause of the Pennsylvania Constitution, which limits the ability of local governments to direct any tax advantage to individual companies. As a result, Philadelphia tends to offer tax expenditures to an entire industry or type of business, or for a designated section of the city, rather than negotiated benefits for specific companies. The city's newer credits and exemptions are designed to create jobs, for instance, by offering the benefits to all companies that meet the set criteria. "When uniformity ties the hands of local governments, they come up with ingenious ways to work around it," said Drexel University economics professor Matthew Freedman.³⁰

Tax Increment Financing

In Philadelphia, there is one type of tax-related economic development program that can benefit individual companies without running afoul of the state's uniformity clause. That is tax increment financing (TIF). These programs are not considered tax expenditures; the developer pays property taxes, but much of that revenue is used to help finance the project.

The state gave localities the authority to establish TIF districts in 1990. In Philadelphia, a TIF starts with an agreement between the Philadelphia Authority for Industrial Development (PAID) and a developer on the value of increased tax revenue the new project will generate. During the life of the loan (up to 20 years), the city continues to collect all of the taxes produced by the property but keeps only the amount that would have been due in absence of the development. The difference is forwarded by PAID to the developer's lender. The city does not guarantee payment of the loan if the developer defaults.

Philadelphia's first TIF, in 1995, helped PNC Bank to finance office space. In all, 16 TIF projects have been approved for a total of \$207.8 million in financing, including \$55 million to renovate the Gallery at Market East and \$33 million for a new combined W and Element Hotel at 15th and Chestnut streets.

By law, TIFs require more oversight than other city tax-incentive programs. Each one must have a credible business plan showing that the development will generate the amount of increased tax revenue projected and that it would not take place without a TIF. The city finance director, City Council, and the school district must approve the plan.

Most of the city's newer incentives have expenditure limits, or caps, on the number or value of credits each year so that any resulting decline in city tax revenue is limited. (See Appendix D.)

Freedman said offering tax benefits to businesses has potential drawbacks, regardless of the structure of the program. A uniform, broad-based program, such as the property tax abatement, can create concerns that benefits are going to projects that might not need them, he said. On the other hand, a system based on tax incentives directed to individual firms can result in decisions based on political influence and favoritism.

In some comparison cities, economic development officials have the ability to tailor property or business tax reductions specifically for individual firms. In New York, the Industrial Development Agency can negotiate property tax abatements for eligible manufacturing, industrial, and commercial businesses undergoing large-scale expansion or modernization.³¹ Columbus offers a downtown office tax incentive for individual projects that can be negotiated up to a maximum of eight years. In Nashville, property tax freezes or reductions are considered on a case-by-case basis depending on varied factors, including job creation, economic impact, capital investment, and wage rates. In Philadelphia, economic development officials use grants, loans, and other tools in individual negotiations but are not permitted to tailor tax incentives to specific firms.

In designing business tax expenditure programs, officials also must balance the intricacy of compliance rules against the amount of benefit. Philadelphia Revenue Department figures indicate that many businesses applied for some tax credits and then did not take them. Robert Hornick, chair of the legislative and local tax committee of the Greater Philadelphia Chapter of the Pennsylvania Institute of Certified Public Accountants, said the value of the benefits offered by many programs is less than the accounting and other expenses that companies incur

in the process.³² This perception has led city officials over time to increase the job creation tax credit and loosen some eligibility rules, although the effect is not certain.

“The complexity of laws and regulations can, in and of itself, create disincentives,” Glenn Shinnars, a Bucks County certified public accountant, testified before City Council in 2013.³³

Evaluation

In Philadelphia, the smaller and newer tax credit programs have extensive reporting requirements. But analysis or reporting is not required from the major programs, such as the KOZs and the commercial property tax abatement. Nor are the officials who run the major programs required to try to determine whether the tax expenditures are having the desired economic and/or social impact, although various ad hoc and independent reports have been produced.

Of all the tax expenditures in Philadelphia, the 10-year property tax abatement has undergone the most evaluation. In 2014, the city commissioned a report that found that 65 percent of the construction in the city from 2003 to 2013 would not have occurred without tax abatements.³⁴ Another report, funded by the building industry, indicated that the abatements generate enough new revenue from other taxes—even during the years in which the abatement is in effect—to more than offset the loss in property tax revenue.³⁵ On the other hand, a coalition of public school advocates published a report in 2013 saying that the program reduced tax revenue available to the city schools and suggesting that the prime beneficiaries were high-end housing developers; this report presumed that all of the construction would have happened regardless of whether the abatements were available.³⁶

A 2014 report on the KOZs by the city controller’s office concluded that forgone KOZ revenue produced little payback in terms of added wage tax revenue and that such programs “tend to subsidize firms in sectors that are already doing well under local economic conditions.”³⁷ Economic development officials criticized that analysis, saying it did not adequately take into account the fact that the properties involved were largely vacant before the KOZ and contributed little or no tax revenue or other economic benefits to the city. They also said the controller’s report did not evaluate how many jobs would have left the city had it not been for the KOZ program.

City Council President Darrell L. Clarke said such contradictory findings often leave council members uncertain about the city’s ability to gauge the effectiveness of tax expenditures. “We just have to cross our fingers,” he said.³⁸

Evaluating tax expenditure programs is not easy, because it is difficult to estimate how many jobs would have been created or structures built had the programs not been in place. But timely and detailed data can help. Previous Pew research on state-level tax expenditures points to three steps.³⁹

The first is to establish a plan for regular evaluation of each program in coordination with other program evaluations and to assign evaluation responsibility to specific departments or offices. Academic and private sector economists can also serve as evaluators.

Second, evaluators should look at the impact of individual tax expenditures on the community as a whole and do so over an appropriate length of time in order to give the program time to work. They also should calculate the positive impacts on target firms and the potential negative effects on others, measuring them against alternative strategies designed to produce the same outcomes.

The third step is to build effective evaluations into overall tax policy. Tax expenditures should be considered in the broader context of the city's economy, overall tax structure, and budget.

Transparency

In addition to the question of whether tax expenditures are evaluated in a meaningful way, there is the question of whether the amounts of forgone revenue are publicly reported.

Many states, including Pennsylvania, regularly quantify the amount of revenue forgone through state-level tax expenditures and issue formal public reports on their websites. But few cities report their tax expenditures. Of the 11 cities in this study that tax corporate sales or profits, only Washington and New York release comprehensive tax-expenditure reports on a regular basis, because it is required by local law. The Washington report includes explanatory comments on the purpose and impact of the expenditures. In 2003, the Philadelphia Tax Reform Commission recommended that the city evaluate tax expenditures and produce an annual report.

Philadelphia's record is mixed. Officials at the Revenue Department said they submit annual reports to the mayor and City Council on the aggregate amount of forgone revenue for the six tax-credit programs for which reporting is required. These one- to four-page documents include a synopsis of the tax credit program, the number of applicants, and the value of credits issued since the credit was enacted. The reports are not required to include information on whether the credits are having the desired impact.

No city-level reporting is required for the Keystone Opportunity Zones, the largest credit program. Early in 2016, the state issued a required report on all of the zones across Pennsylvania for 2011-14. For Philadelphia, the report shows what types of businesses have been receiving the local tax credits and highlights the fact that property tax assessments for expired KOZs in the city have increased by 300 percent since the program began. The report does not attempt to assess the amount of revenue forgone by the city, nor does it seek to discuss the jobs and economic activity attributable to the KOZs.⁴⁰ City Council member Helen Gym has introduced legislation that would require public reporting and evaluation of city business subsidies, including KOZ benefits.

The least transparent Philadelphia business tax benefits are the industry exemptions; they have no legal requirements for public reporting. Dubow, Philadelphia's finance director, said the city has not attempted to quantify the value of these exemptions—or determine their efficacy—because the emphasis of the past three mayoral administrations has been to reduce the business tax burden.⁴¹ Since 2001, the gross receipts rate has declined from 0.2525 percent to 0.1415 percent while the net income rate has fallen from 6.5 to 6.41 percent.

City officials are not required to calculate the projected effect on overall revenue when new tax expenditures are introduced.⁴² However, when they project that a new tax expenditure will have a significant impact on revenue, they take that into account in the city's operating budget and five-year financial plan. Detailed projections of the revenue impacts are included in documents provided to the Pennsylvania Intergovernmental Cooperation Authority, which oversees Philadelphia's finances, but these documents are generally not made public.

The Government Accounting Standards Board (GASB), which oversees state and local accounting practices, passed new rules in 2015 requiring reporting of tax expenditures for individual taxpayers or firms. The rules will require governments to disclose requirements for tax abatement programs, the aggregate forgone revenue, and revenue lost because of tax expenditures.

Conclusion

To make up for imposing one of the nation's highest business tax burdens, Philadelphia has enacted a number of tax incentive programs in the past decade in addition to many existing business tax reduction measures. As a result, forgone tax revenue increased seven times faster than underlying tax collections from 2001 to 2012. The city already had a number of long-standing exemptions for select industries.

Many leaders in the business community say the tax incentives and exemptions are the price Philadelphia must pay to keep or attract businesses—and to compete with other jurisdictions offering tax deals. Tax expenditures have now become an integral part of Philadelphia's tax structure.

The effectiveness of these expenditures is difficult to determine. One reason is that city officials are not required by law to ascertain whether some of the programs have produced the desired or promised results. Another is that it is difficult to determine what would have happened without those tax breaks.

In a February 2016 statement, Mayor Jim Kenney said his administration will evaluate the costs of each tax expenditure program and determine whether it is meeting its goal.

"We will be taking a look at all of the various abatements, tax credits, and exemptions that are currently on the books," Kenney said. "These tax relief measures are necessary, because we have created such an antiquated tax system that we need to put in place workarounds to try to offset the expense of doing business here."

Recently enacted programs, such as the job creation tax credit, include requirements that would allow city officials to figure out what the programs cost and whether they are producing the intended results. But the biggest and oldest programs, including the property tax abatement and Keystone Opportunity Zone, lack many of those provisions. Because of the uniformity clause of Pennsylvania's constitution, Philadelphia is less able than other cities to target its tax expenditures where they might be needed the most.

Philadelphia is far from alone in its limited ability to assess its tax expenditures. Of 11 cities with local corporate taxes, only two—New York and Washington—routinely monitor and report on their tax expenditures in a comprehensive way. The nation's standard-setting accounting organization and local public-finance experts have called on cities to do a better job documenting their expenditures.

For several decades, business leaders and tax experts have called for transformation of the city's entire tax structure in order to improve Philadelphia's competitiveness with its suburbs and other large cities. The recent overhaul of the city's property tax system, the Actual Value Initiative, was viewed as an important first step in laying the groundwork for comprehensive change.

Given the increase in forgone taxes over the past decade, tax expenditures merit a place in Philadelphia's tax policy discussion. Knowing how much these tax exceptions cost, and whether they are meeting their goals, is a key component of a coherent and equitable city tax policy.

Appendix A: Methodology

For this report, The Pew Charitable Trusts defined business tax expenditures as programs or provisions written into the local tax code and meant to incentivize or support private business activities or to influence private commercial behavior. By this definition, tax expenditures include business tax credits, commercial property tax abatements, and targeted industry exemptions but not direct city grants or loans for businesses. Because this study focuses on local tax policy, it does not cover federal and state tax exemptions for charitable, educational, religious, and other nonprofit private activities. It also does not include the actions of quasi-governmental or nongovernmental public agencies such as transportation, housing, or economic development authorities.

Our data collection had two main components. One focused on tax laws in major cities and was based on legislative and fiscal documents, a survey of tax officials, and follow-up interviews with those officials. The second involved a detailed tally of Philadelphia tax expenditures based on Pew's examination of official tax records under strict confidentiality agreements with the city of Philadelphia.

Selecting the comparison cities

To place Philadelphia in a national context, we compared it with the 30 most populous U.S. cities. Because Philadelphia functions as both a city and county, we looked at tax policies in the counties encompassing these cities as well. Using official websites, we identified the cities and counties that taxed corporate income for the tax year 2014. Although local governments impose a variety of business taxes and fees, we looked only for corporate income taxes so as to keep our comparisons directly relevant to Philadelphia. Of the 30 cities and their counties, these 11 were found to levy local taxes on corporate income:

- Columbus, Ohio, in Franklin County, with small extensions into Delaware and Fairfield counties.
- Detroit, in Wayne County.
- Los Angeles, in Los Angeles County.
- Memphis, Tennessee, in Shelby County.
- Nashville, Tennessee, in Davidson County (consolidated with city).
- New York City, in New York, Kings, Queens, Richmond, and Bronx counties.
- Philadelphia, in Philadelphia County (consolidated with city).
- Portland, Oregon, in Multnomah County.
- San Francisco, in San Francisco County (consolidated with city).
- Seattle, in King County.
- Washington (functions as county and state).

For these 11 cities and their counties, we compiled an inventory of the major local taxes on business or commercial activity, plus any tax credits, exclusions, exemptions, or abatements that the city or county offered to its business taxpayers. We did not include business fees or niche taxes, such as parking taxes and commercial trash fees. We followed up with surveys of and interviews with local officials for more detail about the taxes, the underlying laws, and any official monitoring or reporting on the tax expenditures. In most cases, we were able to categorize each tax expenditure as a credit against income tax, an abatement of property tax, or an exemption/exclusion from taxation—the three mechanisms most often used in the tax expenditures we were studying.

Computing Philadelphia's tax expenditures

For Philadelphia, we set out to estimate the dollar amount of tax expenditures from all programs and provisions fitting our definition. Two periods were chosen to view changes in expenditures over time: 2001 to 2003, and 2010 to 2012, the most recent year for which tax data were substantially complete at the time this research began. For each three-year period, we computed an annual average to preserve confidentiality and reduce the impact of outliers in any given year.

We focused on tax expenditures against the following major business taxes:

1. Business income receipts tax (BIRT) on business net and gross income.
2. Net profits tax (NPT) on the profits of unincorporated proprietorships and partnerships.
3. Real property tax on the assessed value of commercial real estate.
4. Use and occupancy tax on the assessed value of the portion of property used by commercial occupants who do not own the whole parcel, such as renters.

Using Philadelphia's tax code and the city's official website, we identified the following tax expenditures and categorized them by their mechanism, such as credit, abatement, or exemption:

1. Keystone Opportunity Zone, a combination of credits and abatements.
2. Community development corporation (CDC) tax credit.
3. Job creation tax credit (JCTC).
4. Philadelphia Reentry Employment Program (PREP) tax credit.
5. Sustainable business tax credit.
6. Green roof tax credit.
7. Real property tax abatement.
8. Port-related firms exemption.
9. City tax exemption on state-regulated industries, including banking, insurance, telecommunications, transportation carriers, and energy distribution companies.
10. Bookbinders exemption.
11. Textile dryers exemption.

Several other credits, such as the life partner health benefits tax credit and investment firm exemption, are mentioned in the report but are not included in our fiscal tally because they took effect after 2012.

Company-level data on the credits and exemptions listed above is held by the Philadelphia Department of Revenue, while property owner data on property tax abatements is held by the Office of Property Assessment. We used a different process to obtain and analyze each data set.

Tax credits and tax exemptions

Under a special arrangement with the Department of Revenue, and working on its premises, Pew directly examined the business tax return data for each time period, tax, and tax expenditure. Under terms of the arrangement, Pew did not retain any data containing names of individual firms or taxpayers and agreed not to print any names in connection with the data or any details that could make any individual firm identifiable. This is in keeping with the strict confidentiality of city tax records.

Tax credits:

- For each year and each taxpayer, using the Revenue Department's record of payments received or credited, known as the payment file, Pew totaled the amounts listed as "credit" for each payer or group of payers under each tax expenditure program. These are forgone taxes.
- Pew then adjusted for inflation each year's dollar figures to make them comparable with 2012, the final year of data in this study. Pew used the U.S. Bureau of Labor Statistics consumer price index inflation calculator, found at http://www.bls.gov/data/inflation_calculator.htm.
- Finally, Pew summed the three years of inflation-adjusted figures in each of the two periods and then divided each figure by three to arrive at an annual average figure for each period.

Exemptions for Public Utility Commission and port-related firms (these are grouped together in city records and could not be disaggregated accurately):

- For each year, Pew eliminated individual-level errors in the data, in consultation with Revenue Department staff. This included exempt income data that were sometimes recorded on the wrong line of the city's tax return.
- Pew then summed the net-income figures found on Line 2 and Line 3 of BIRT Schedule A and on Line 2b and Line 2c of BIRT Schedule B.
- Pew applied Philadelphia's BIRT to the income figures at the rates in effect each year. This determined the forgone tax each year.
- Finally, Pew inflation-adjusted the figures and computed the annual averages, using the process described above.

Exemptions for financial service firms (these include banks and insurance companies, which are allowed to pay the lesser of the tax due on their net income or the tax due on their gross receipts):

- For each year and each taxpayer, Pew summed the tax-due figures found on Line 1 and Line 4 of BIRT Schedule J. This would have been the amount of taxes due in the absence of exemptions.
- Pew summed the tax-due figures found on Line 5 of BIRT Schedule J, representing the amounts that these firms actually paid.
- Then Pew deducted the amount paid from the amount owed. This determined the forgone tax from this group.
- Finally, Pew inflation-adjusted the figures and computed the annual averages, using the process described above.

Tax abatements

Information on the owner and tax-exempt status of each real estate parcel in the city is publicly available from the Philadelphia Office of Property Assessment. Pew purchased a full data set covering each tax year in this study and performed the following analysis:

- For each year, out of approximately 500,000 property records, Pew isolated those records flagged with tax exemption code 8, which is the city's designation for commercial properties that qualify for its 10-year property tax abatement.
- Pew summed those properties' market values and then multiplied this aggregate market value by 32 percent to derive the aggregate assessed value. This percentage was the city's fractional assessment model in use at the time.
- Pew multiplied the aggregate assessed value by the property tax rate in effect each year to derive the aggregate property tax on the properties. Pew performed the same exercise on the building portion of the aggregate tax, because this is the part of the tax that is abated.
- The building portion would not have been paid and represents the forgone tax.
- Finally, Pew inflation-adjusted each year's figures and computed the annual averages, using the process described above.

Inflation adjustment

In many places in this report, dollar figures were inflation-adjusted to 2012, the final year of data collection used for this research. To do this, Pew used the U.S. Bureau of Labor Statistics inflation calculator. Below are the multipliers applied to the nominal-dollar figures from each year:

2001	2002	2003	2010	2011	2012
1.296407	1.2762308	1.247792	1.052911	1.020694	1.000000

Appendix B: Incentives in Major Cities With Local Business Taxes

Columbus	3 from income tax: jobs growth; downtown office; job creation
	2 from property tax: enterprise zone tax abatement, community reinvestment area tax abatement (pre- and post-1994)
Detroit	1 from income tax: renaissance zone
	3 from property tax: commercial rehabilitation, obsolete property rehabilitation, renaissance zone
Los Angeles	4 from gross receipts tax: retail motor vehicle sales, creative artist up to \$300,000, new businesses up to 3 years old, small businesses with less than \$100,000 gross receipts
Memphis	6 from property tax: community development, retail, business expansion, job creation, downtown Memphis, affordable housing
Nashville	1 from property tax: commercial property tax abatement
New York City	4 from income tax: biotech corporation, industrial business zone, real property tax escalation, relocation and employment
	7 from property tax: commercial revitalization, commercial expansion, industrial and commercial abatement, Madison Square Garden, Chrysler Building, green roof, solar generating system
Philadelphia	13 from income tax: Keystone Opportunity Zone credit,* community development tax credit, job creation tax credit, military veteran employment tax credit, ex-offender employment tax credit, green roof tax credit, sustainable business tax credit, domestic partner health care tax credit, transgender health care tax credit, distressed business tax credit, new businesses up to two years old, exemption of first \$100,000 in sales, exemption of interest and fees earned by companies that arrange federal new markets tax credits
	1 from property tax: rehabilitation and new construction for commercial and industrial properties
Portland	Small-business exemption of \$50,000 in gross receipts

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San Francisco	3 from gross receipts tax: job creation tax credit, tax-exempt zone, small-business exemptions of \$1 million in gross receipts
Seattle	2 from gross receipts: multi-activity tax credit for businesses with combined activities such as manufacturing and retail, small businesses with sales of less than \$100,000
Washington	<p>11 from income tax: qualified high-technology tax exemption and reduction, employee relocation, employment, hiring disadvantaged workers, retraining disadvantaged workers, qualified social electronic commerce companies, job growth, paid leave for organ or bone marrow donors, employer-assisted home purchases, economic development zones, brownfield revitalization and cleanup (also property tax)*</p> <p>5 from property tax: new or improved buildings used by high-technology companies; development of a qualified supermarket, restaurant, or retail store; high-technology commercial real estate database and service providers; qualified social electronic commerce</p>

The number and type of tax incentive programs vary widely across cities with local business taxes. Most cities offer some type of incentive against tax levied on commercial property.

Note:

* Philadelphia Keystone Opportunity Zone and Washington brownfield revitalization and cleanup include property tax abatement.

Sources: Local officials, tax codes, and financial documents

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Appendix C: Industry Exemptions in Major Cities With Local Business Taxes

Columbus	Banking, insurance, trucking
Detroit	Banking, insurance
Los Angeles	Banking, insurance, airlines, trucking, transportation, court reporters, bail bonds, residential rental (fewer than three units), day care (fewer than eight children)
Memphis	Accounting; architecture; banks, building and loan associations, mortgage bankers, and similar organizations; camps and trailer parks; engineering, insurance, and insurance holding companies; law firms; lessors of agricultural, forestry, mining, oil, public utility, and airport properties; medical, dental, and allied health service firms; operators of residential and nonresidential buildings; public utilities; veterinary services
Nashville	Accounting; architecture; banks, building and loan associations, mortgage bankers, and similar organizations; camps and trailer parks; engineering, insurance, and insurance holding companies; law firms; lessors of agricultural, forestry, mining, oil, public utility, and airport properties; medical, dental, and allied health service firms; operators of residential and nonresidential buildings; public utilities; veterinary services
New York City	Insurance, investment firms, media/publishing
Philadelphia	Insurance, banking, utilities, investment firms, port-related firms, bookbinders, textile dyers
Portland	Insurance, real estate brokers
San Francisco	Insurance, utilities, investment firms
Seattle	Accommodations, boxing and wrestling, commuter ride-sharing and carpool funds, farming, horse racing, insurance, international banking facilities, liquor, real estate commissions, trust funds for other taxes
Washington	None

Most major cities with local business taxes offer exemptions for certain industry sectors. Finance is the most common one. Others range from trucking firms to dental practices to bookbinders.

Note: For-profit sectors only.

Sources: Local officials, tax codes, and financial documents

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Appendix D: Rules and Conditions on Philadelphia Tax Expenditures

Program name or type	Eligibility criteria	Tax benefit for companies	Penalties imposed or refunds sought if companies fail to fulfill commitments	City government reporting required, and by which department	Limits on city's overall expenditures	Expiration or reauthorization date
Keystone Opportunity Zone	Companies with operations and employment within specified geographic zone	Exemption from city and state business and property taxes	Percentage due back depends on length of time operating in the zone	Initial filing with Department of Commerce and subsequent annual renewal	No	Varies
Commercial or industrial property tax abatement	New construction or substantial renovation of existing structure	Taxable assessment is reduced by the value of the construction or improvement	No	No	No	No
Community development corporation tax credit (CDC)	Companies donating to certified CDC	Up to \$100,000 in credits off BIRT per year for 10 years	Loss of benefit but no penalty imposed or refund sought	Department of Revenue annual report due each July to mayor/ City Council	Up to 84 businesses for a combined \$4.2 million per year	No
Distressed business tax credit	Companies experiencing loss of business because of public works projects	20% of lost sales up to \$20,000 or after-tax net income loss	No	No	\$1 million per year; no number of companies specified	No
Job creation tax credit	Companies located in Philadelphia hiring new employees	\$5,000 credit off BIRT per new employee for one year	Full refund if job is eliminated within five years	Department of Revenue annual report due each July to mayor/ City Council	Not to exceed 2% of total BIRT revenue in prior year	No
Philadelphia Reentry Employment Program tax credit	Companies employing, or donating to qualified nonprofits that hire, certified formerly incarcerated Philadelphians	\$10,000 credit off BIRT per full-time employee for three years	Full refund if company leaves city within five years of receiving credit	No	1,000 individuals	No
Employment of returning veterans of the armed forces tax credit	Companies employing U.S. military veterans	\$5,000 per full-time, \$2,500 per part-time worker per year for 3 years	Company receives credit only after veteran is employed six months	No	500 individuals	2020

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Program name or type	Eligibility criteria	Tax benefit for companies	Penalties imposed or refunds sought if companies fail to fulfill commitments	City government reporting required, and by which department	Limits on city's overall expenditures	Expiration or reauthorization date
Sustainable business tax credit	Companies certified by Mayor's Office of Sustainability or other office designated by the mayor	Up to \$4,000 credit off BIRT per year	Company receives credit only after tax year is completed	Office of Sustainability files annual report to mayor and City Council	25 companies	2017
Green roof tax credit	Companies installing certified green roof on commercial structure	Credit is up to 50% off cost of the green roof up to \$100,000	Full refund if company does not comply with eligibility criteria	Department of Revenue annual report due each December to mayor/City Council	\$1 million per year; no company number specified	No
Life partner health benefits tax credit	Companies providing health benefits for LGBT couples signing affidavit of domestic partnership	The lesser of \$4,000 or 25% of benefit cost off BIRT per full-time employee for two years	Full refund if company rescinds benefit within three years	Department of Revenue annual report due each December to mayor/City Council	\$2 million, no limit on number of companies	No
Transgender care health benefits tax credit	Companies providing health benefits for transgender care	The lesser of \$4,000 or 25% of benefit cost off BIRT per full-time employee for two years	Full refund if company rescinds benefit within three years	Department of Revenue annual report due each December to mayor/City Council	\$2 million, no limit on number of companies	No
Port-related business tax exemption	Any firm operating at Port of Philadelphia and serving port-related functions	All business income and gross receipts excluded from BIRT	No	No	No	No
State-regulated utilities exemption*	Privately owned power distribution, telecommunications, transport carriers	All or partial net income and/or gross receipts excluded from BIRT	No	No	No	No
Banks and financial services exemption*	Banks, financial trusts	All or partial net income and/or gross receipts excluded from BIRT	No	No	No	No
Insurance companies exemption*	Insurance companies	All or partial net income and/or gross receipts excluded from BIRT	No	No	No	No

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Program name or type	Eligibility criteria	Tax benefit for companies	Penalties imposed or refunds sought if companies fail to fulfill commitments	City government reporting required, and by which department	Limits on city's overall expenditures	Expiration or reauthorization date
Investment firm owners tax exemption	Investment firms operating in city	No tax on income or receipts	No	No	No	No
Textile dyers exemption	Textile dyers	Sales exempt from gross receipts tax	No	No	No	No
Bookbinders exemption	Bookbinders	Sales exempt from gross receipts tax	No	No	No	No
New markets tax credit exemption	Firms that receive interest and fees on loans to new market projects	Exempts interest and fees on loans to new market projects	No	No	No	No
New business exemption	New businesses that meet hiring requirements	Full BIRT and NPT exemption for two years	No	No	No	No
\$100,000 exemption	Available to all BIRT filers, exemption on first \$100,000 in gross receipts and net income from those sales	Full BIRT exemption	No	No	No	No

Most of the city's newer incentives have expenditure limits or caps on the number or value of credits each year so that any resulting decline in city tax revenue is limited. The exemptions for sectors do not have such features.

Note:

* This exemption granted as part of state law

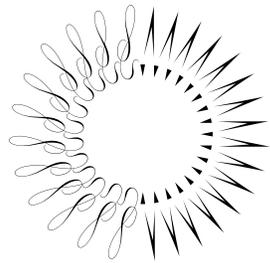
Sources: City officials, ordinances, and regulations

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Endnotes

- 1 We chose the 2010-12 study period because it was the most recent for which tax data were sufficiently complete. We preferred to use 2000-02 as the comparison point, but data issues in 2000 required us to use 2001-03 instead. For each period, we computed an annual average to preserve confidentiality and reduce the impact of particularly large or small filings in any given year.
- 2 The Tax Foundation, "State Corporate Income Tax Rates and Brackets for 2015," <http://taxfoundation.org/article/state-corporate-income-tax-rates-and-brackets-2015>.
- 3 Based on revenue calculations in the city's and school district's Comprehensive Annual Financial Reports.
- 4 Pew interview with Rob Dubow, Philadelphia finance director, July 1, 2015.
- 5 Pew interview with James Edward Maule, law professor, Villanova University, Jan. 28, 2014.
- 6 Keystone Opportunity Zone, Keystone Opportunity Expansion Zone and Keystone Opportunity Improvement Zone Act of Oct. 6, 1998, P.L. 705, No. 92.
- 7 Pew analysis of Revenue Department records.
- 8 Any Pennsylvania business relocating into a KOZ must demonstrate a significant economic impact, such as a 20 percent increase in employment in the first year or an investment equivalent to 10 percent of the previous year's gross revenue in capital improvements to the KOZ property. Or it must enter into a lease agreement for property located within the KOZ for a term at least equivalent to the duration of the KOZ and with the aggregate payment under the lease agreement at least equivalent to 5 percent of the gross revenue of that business in the preceding calendar or fiscal year. Philadelphia Department of Commerce and tax code, [http://library.amlegal.com/nxt/gateway.dll/Pennsylvania/philadelphia_pa/thephiladelphiacode?f=templates\\$fn=default.htm\\$3.0\\$vid=amlegal:philadelphia_pa](http://library.amlegal.com/nxt/gateway.dll/Pennsylvania/philadelphia_pa/thephiladelphiacode?f=templates$fn=default.htm$3.0$vid=amlegal:philadelphia_pa).
- 9 Abatement amounts from the Philadelphia Office of Property Assessment for years 2012, 2011, 2010, 2003, 2002, and 2001. The figures do not include property tax exemptions for firms located in KOZs; those are counted in the KOZ tallies.
- 10 Mike Dunn, "Nutter: No Privilege in Paying Biz Tax," CBSPhilly, Oct. 30, 2011, <http://philadelphia.cbslocal.com/2011/10/30/nutter-no-privelege-in-paying-biz-tax/>.
- 11 City of Philadelphia, *Business Income and Receipts Tax Regulations*, last modified Feb. 15, 2016, <http://www.phila.gov/Revenue/Regulations/BIRT%20Regulations%20Compilation.pdf>.
- 12 Email from Robert S. Jones, enterprise zone manager, Columbus, Ohio, Jan. 20, 2016.
- 13 City of New York Department of Finance, Office of Tax Policy, *Annual Report on Tax Expenditures: Fiscal Year 2014* (February 2014), http://www1.nyc.gov/assets/finance/downloads/pdf/reports/reports-tax-expenditure/ter_2014_final.pdf.
- 14 District of Columbia Office of Revenue Analysis, *District of Columbia Tax Expenditure Report* (May 2014), http://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/2014%20Tax%20Expenditure%20Report_0.pdf.
- 15 Email from Scott Karter, Jan. 1, 2016.
- 16 Certification as a sustainability business is based on five criteria: the product or services provided; business model; how the company interacts with its employees and community; environmental impact; and transparency of corporate governance structures and processes.
- 17 In Tennessee, the state levies the business tax and returns a portion to the cities. Washington has a local tax on banks. Detroit and San Francisco have utility taxes that are levied directly on users, not on the utility firms.
- 18 Pew interview with Gregory Iannarelli, chief counsel of the Philadelphia Regional Port Authority, June 20, 2015. City law also exempts port-related firms from paying the School District of Philadelphia's use and occupancy tax. Hotels are the only other industry that the city exempts from the tax.
- 19 Pew interview with Bob Evans, former manager of leasing and property development at the Port Authority of New York and New Jersey, July 8, 2015.
- 20 The Pennsylvania state gross receipts tax is imposed on the following companies conducting business in Pennsylvania: pipeline, conduit, steamboat, canal, slack water navigation, and transportation companies; freight or oil transporters; telephone and telegraph companies; express service, palace car, and sleeping car companies; electric light, water power, and hydroelectric energy companies; and managed health care organizations. Pennsylvania tax code, <http://www.revenue.pa.gov/GeneralTaxInformation/Tax%20Types%20and%20Information/Pages/Corporation%20Taxes/Gross%20Receipts%20Tax.aspx#.V07Y6KPD-70>.

- 21 One taxpayer used inconsistent filing methods in reporting 2010 net income. This analysis substituted an average of that taxpayer's 2011 and 2012 income in place of that number.
- 22 The law excludes interest earned from deposits or loans from any person or business living or based outside the city limits. Other service businesses are taxed on work performed in the city regardless of where the customer is based. In addition, other businesses are taxed on net income based on a formula that takes into account sales, as well as their payroll and property in the city. Finance companies apportion net income based only on their already-reduced sales. Insurance companies, similarly, are taxed only on net income derived from sales based on risk underwritten in the city, without regard to the size of their city payroll or property.
- 23 Banks pay a state tax of 0.89 percent on their assets. Insurers pay a 2 percent gross premiums tax. Credit unions are tax-exempt at the federal, state, and local level and are not counted in this study.
- 24 Pew interview with J. Duncan Campbell III, president, Pennsylvania Bankers Association, Sept. 10, 2015.
- 25 City of New York Department of Finance, Office of Tax Policy, "Annual Report on Tax Expenditures, Fiscal Year 2015" (February 2015), http://www1.nyc.gov/assets/finance/downloads/pdf/reports/reports-tax-expenditure/ter_2015_final.pdf.
- 26 Philadelphia City Council testimony (February 2006), <http://legislation.phila.gov/transcripts/Public%20Hearings/whole/2006/wh022706.pdf>.
- 27 Rob Dubow interview, July 1, 2015.
- 28 City Council testimony by Finance Director Rob Dubow (October 2011), <http://legislation.phila.gov/transcripts/Public%20Hearings/finance/2011/fi102411.pdf>.
- 29 The Pew Charitable Trusts, *Reducing Budget Risks: Using Data and Design to Make State Tax Incentives More Predictable* (December 2015), http://www.pewtrusts.org/en/research-and-analysis/reports/2015/12/reducing-budget-risks?hd&utm_campaign=2015-12-02%20PNN&utm_medium=email&utm_source=Eloqua.
- 30 Pew interview with Matthew Freedman, economics professor, Drexel University, Dec. 2, 2015.
- 31 New York Economic Development Corp., "Commercial Tax Incentives," <http://www.nycedc.com/program/commercial-tax-incentives>.
- 32 Pew interview with Robert Hornick, legislative and local tax committee chair, Greater Philadelphia Chapter of the Pennsylvania Institute of Certified Public Accountants, Nov. 18, 2014.
- 33 Philadelphia City Council testimony (December 2013), <http://legislation.phila.gov/transcripts/Public%20Hearings/finance/2013/fi121113.pdf>.
- 34 Jones Lang LaSalle, "Economic Impact Analysis of Proposed 10 Year Tax Abatement Adjustments" (2014), http://phillytaxabatement.com/pdf/TaxAbatementAnalysis_20140514T222535Z.pdf.
- 35 Kevin D. Gillen and John A. Westrum, "What is the Net Fiscal Impact of the Abatement?" (March 6, 2014) http://www.designadvocacy.org/sites/designadvocacy.org/files/gpar_presentation_03_06_14.pdf.
- 36 Philadelphia Coalition Advocating for Public Schools, "Short Changing Students: How the Ten Year Tax Abatement Underwrites Luxury Developments and Starves Schools" (Oct. 29, 2013), <http://wearepcaps.org/2013/10/29/short-changing-students-how-the-ten-year-tax-abatement-underwrites-luxury-developments-and-starves-schools>.
- 37 City of Philadelphia Office of the Controller, "An Analysis of the Keystone Opportunity Zone Program, 1999-2012: The Costs and Benefits to Philadelphia" (March 19, 2014), http://www.philadelphiacontroller.org/publications/KOZ-Report_March2014.pdf.
- 38 Pew interview with Darrell Clarke, president, Philadelphia City Council, Aug. 19, 2015.
- 39 The Pew Charitable Trusts, *Tax Incentive Programs: Evaluate Today, Improve Tomorrow* (January 2015), <http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2015/01/tax-incentive-programs>.
- 40 Pennsylvania Department of Community and Economic Development, "Keystone Opportunity Zone Program: Revitalizing the Blight and Creating Opportunities in Your Community" (Jan. 7, 2016), <http://www.newpa.com/download/koz-report-2011-2014-f/?wpdmdl=58423>.
- 41 Rob Dubow interview.
- 42 In 2013, City Council passed an ordinance requiring the finance director or controller to issue a fiscal impact statement on the revenue effects of proposed legislation if the main sponsor or no fewer than three council members requested one. Dubow said it has been done once, to evaluate the impact of property tax abatements on school revenue.



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