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Overhaul Philly's business-tax code

Philadelphia should change its tax code.

The city's taxes are so out of line with those in the rest of the region — and, for that matter, with the nation and the world — that they form a major barrier to economic success. The city's economy has enormous potential, but it will never be realized without an overhaul of the tax system.

Consider: Under current law, a successful business located in the city could pay more than half its profits in taxes, including payments to the Internal Revenue Service, the Commonwealth of Pennsylvania, and the city. This is well above what businesses pay almost anywhere else. There are many reasons firms might want to locate in Philadelphia, but they have to be really good ones to overcome this tax hurdle.

A recent proposal by Philadelphia City Council members Bill Green and Maria Quinones-Sanchez offers a chance to meaningfully lower this hurdle. They want to shift the Business Privilege Tax from a tax on profits to a tax on sales.

The BPT currently covers both profits and sales, although current law will phase out the tax on sales over the next decade while the tax on profits is reduced only modestly. Reducing the BPT makes perfect sense, but putting the tax burden on businesses' profits is a mistake. It makes much more sense to do just the opposite — eliminate taxes on profits and tax only sales. The Green-Sanchez proposal also does this in a way that avoids worsening the city's budget problems.

There are compelling reasons to support this change in the BPT. Taxing businesses' sales instead of their profits broadens the tax base. The burden would be shouldered by more companies, thus lightening the load for a narrow group of successful firms. The financial pain of paying taxes would be distributed more widely, making it easier for all businesses to bear.

The profitable companies currently paying the bulk of the taxes are precisely the ones most likely to leave the city as their burden increases. Such firms have the resources to go wherever they like, as recent history has proven. Start-ups incubated in the city's Science Center, for example, typically move out to the Route 202 corridor or elsewhere in the country as soon as they start earning some money. Had they remained in the city, these companies would be vital creators of local jobs, wealth, and tax revenue.

It is much easier for companies to avoid paying taxes on profits than on sales. Some businesses set up shop in Delaware, where taxes are low, booking profits there while selling their products and services in the city. Moreover, profits are harder to accurately measure and

easier to manipulate than are sales. Anything that simplifies the tax code is likely, therefore, to produce greater compliance and more tax revenue.

Profits are extraordinarily volatile, swinging wildly with changes in the economy. Business profits crashed during the recent Great Recession, for example, and have grown with the current recovery. Sales also move up and down with the business cycle, but much less so. A more stable source of tax revenue helps city planners budget more accurately and avoid having to borrow money during tough times, when it is generally more costly to do so.

One rap against taxing sales instead of profits is that it would hurt small firms that have yet to earn a profit. To address this issue, the Green-Sanchez proposal would not tax the first \$100,000 of annual sales; about 50,000 small Philadelphia businesses would thus pay no tax. Another worry is that the proposed tax change penalizes weaker, less profitable firms. While this is a reasonable concern, it probably is overdone, as such firms also likely have weak sales.

All tax-code changes, even very good ones, produce winners and losers. Shifting the BPT to a tax on sales and not profits would benefit professional-services firms such as accountants, lawyers, and management consultants, along with some manufacturers, information-service companies, and the publishing and broadcasting industries. These industries generally employ educated workers, who bring lots of income and wealth to the city. Hotels, retailers, and construction firms would be hurt by the proposed tax change. But these industries are less likely to leave the city even

if they face higher taxes, and at the end of the day they too would benefit from a flourishing city economy.

Changing the BPT as the Council members have proposed won't solve the city's economic problems — there is much more work to be done on both taxes and the city's spending priorities — but it would be a big positive step.

Philadelphia's economy has so much going for it: a massive health-care industry that is sure to grow with the aging population, world-class universities, a highly skilled workforce, good transportation and telecommunications infrastructure, and the good fortune to be located between New York City and Washington, D.C. But the benefit of all these advantages will only be realized with a more rational tax code.

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