



Proposal to move from Business Privilege & Mercantile Tax to Payroll Preparation Tax

August 26, 2021

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Facts about Business Privilege & Mercantile Tax (BPM)

History

- **The Business Privilege & Mercantile Tax (BPM) was born out of the Pennsylvania Local Tax Enabling Act of 1965.** The Act sought to advance “the underlying policy of allowing for taxation as a quid pro quo for businesses taking advantage of local governmental benefits such as police, fire and other services.”
- **In 1988 the Pennsylvania Local Tax Reform Commission deemed BPM a “nuisance tax”** because of flaws in the drafting of the legislation and lack of definition around the scope of the tax base and situs of services.
- **The Tax Reform Act of 1988 then prohibited local jurisdictions from imposing new business privilege taxes** based on gross receipts, however, it grandfathered in such existing taxes in 272 jurisdictions (including the City of Scranton and the Scranton School District).
- BPM taxes are based on gross receipts of retailers, wholesalers, and some services.
- Businesses that fall under the scope of BPM include retail businesses such as those who have suffered losses as a result of the COVID-19 pandemic.
- Exempt businesses include manufacturers and financial firms.

Facts about Business Privilege & Mercantile Tax (BPM)

Scranton's Experience with BPM

- BPM has proven **difficult to collect and enforce** over the decades in Scranton; tax evasion has been rampant.
- As the Local Tax Reform Commission declared in 1988, **BPM is not an equitable tax system**. BPM singles out some business sectors, like retail and wholesale businesses, and gives a pass to other sectors, like manufacturers and financial firms.
- Efforts in recent years by both the City and School District to collect delinquent BPM have **fallen short of goals and cost our institutions** staff time and substantial commission rates.
- Pennsylvania tax laws give local government **limited tools to raise new revenue streams**.
- The opportunity before Scranton as an Act 47 distressed municipality to abandon the BPM and adopt a different form of business tax is fleeting – and **a choice other cities would like to have**.

Background on the Payroll Preparation (Prep) Tax Option

What is a Payroll Preparation (Prep) Tax?

- A payroll prep tax would tax a percentage of a business's total payroll.

Which businesses fall under the scope of a Payroll Prep Tax?

- An employer conducting business within the city which:
 - Employs 1 or more individuals
 - Owns or leases property for business
 - Maintains a stock of tangible personal property in the city
 - Conducts continuous solicitation within the city related to business
 - Utilizes the streets of a city in connection with business other than transportation
 - Charitable organizations are required to pay on any payroll expense attributable to business activity allowed by section 511 of the IRS code.

Background on the Payroll Prep Tax Option

Why consider a Payroll Prep Tax?

- Represents a more equitable tax than BPM by allowing a sharing of the burden between all business sectors.
- Provides a link with non-resident salaries, employers/employees who benefit from the services provided by the municipality the employer is located in.
- Collections are far more efficient as rates are based on payroll data which is already collected for the purposes of Scranton's local wage tax.
- Paying a set % tax based on a set payroll vs. the unpredictability of paying BPM – small and mid- size business would have better reliance on predicable business expense as opposed to the fluctuating BPM that is based on the regressive sales and service tax.

Requirements

- Payroll amounts are defined as all amounts paid by an employer as salaries, wages, commissions, bonuses.
- Payroll amount will be determined by apportionment.
- ACT 32 – Businesses located outside of city - 90 days grace for work registration.
- Employers are required to file quarterly.
- All taxes and penalties must be used exclusively for general revenue purposes.

Background on the Payroll Prep Tax Option

Requirements Specific to Scranton

- BPM accounts for roughly \$2.5M / (2.4%) of the City of Scranton's annual revenue.
- BPM accounts for roughly \$7.3M / (4.4%) of the Scranton School District's annual revenue.
- Must be revenue-neutral (with previous BPM) in the first year.
- The Rate Set is based on 2019 Taxable base earnings (*see next slide*).
- The legislation allows Scranton to adjust this rate in Year 2 if revenue falls behind past BPM revenue.
- No BPM may be enacted concurrently.
- Current legislation allows the City of Scranton to make this conversion while under Act 47 distressed status (the City is targeted for a January 2022 exit).
- The Scranton School District may enact a Payroll Prep Tax after the City has left Act 47.
- The Scranton School District projects a lag in revenues of \$1.8M during a tax conversion; importantly, this is a *delay* in revenues, not a *loss* of revenues.
- There are ongoing efforts by the City and state legislators to get assistance from the Commonwealth to provide stopgap funding for this projected delay.

Work Completed Assessing the Payroll Prep Tax Option

City of Scranton

The City of Scranton successfully petitioned the Court of Common Pleas to enact the Payroll Prep Tax. The rate (see chart below) was certified by the Act 47 Coordinator and approved by the court of common Pleas in November 2020. The Rate Set is based on 2019 Taxable base earnings.

School District		City Revenue BP&M 2019	Total Rate
\$ 7,328,981.00	2019 Revenue	\$ 2,532,875.88	BPM
0.008064	2019 rate	0.002786775	1.085%
0.007930	2018 refer referendum		
0.000134	Change		

The legislation allows Scranton to adjust this rate in Year 2 if revenue falls behind past BPM revenue.

Scranton School District

In 2019 the Scranton School District put a referendum on the ballot for the November municipal general election. [Scranton voters overwhelmingly supported exploring a conversion from BPM to a Payroll Prep Tax, with 72% voting yes.](#)

Examples of Payroll Tax for Scranton Businesses

Examples Specific to Scranton *(based on 2019 data; \$ rounded)*

- Dentist with \$134,000 in payroll = pays \$1450
- Pizzeria with \$149,000 in payroll = pays \$1650
- Retail company with \$160,000 in payroll = pays \$1750
- Healthcare company with \$202,000 in payroll = pays \$2200
- Printing company with \$700,000 in payroll = pays \$7600
- Bank with \$4,200,000 in payroll = pays \$46,000
- Manufacturer with \$6,347,000 in payroll = \$70,000

Next Steps to Enact a Payroll Prep Tax

Timeline

1. School District Referendum (complete November 2019)
2. City of Scranton petition to Court of Common Pleas (complete November 2020)
3. Tax Policy Working Group consideration (complete)
4. Data preparation (in process)
5. Appeals process adoption/implementation (in process)
6. Scranton School Board consideration/adoption (September 2021)
7. Scranton City Council consideration/adoption (September 2021)
8. City of Scranton legislation and 2022 Budget adoption (December 2021)
9. Evaluate options for most efficient means of collections
10. Work jointly to determine best path forward for delinquent BPM collections
11. Solicit RFP for delinquent payroll tax collection services
12. Business and public education/marketing (*see next slide*)
13. Business technical assistance during conversion year(s)

Business and Public Education/Marketing for a Payroll Prep Tax

Business and Public Awareness

- Accessible webinars to learn the process
- Outreach to Chamber of Commerce, Scranton Tomorrow, Rotary Club, other business organizations who can inform their membership
- Detailed information on City and District websites
- Press releases/earned media
- Newspaper and business journal advertisements
- Social media posts and reminders

Business Technical Assistance

- Offer assistance in understanding the new tax and how to calculate
- Provide examples from businesses with similar payrolls
- Provide information on the appeals process

Considerations around a Conversion

- **Alignment with Economic Growth Goals**
 - Legacy issues from the BPM aside, a payroll tax is less onerous for businesses:
 - A payroll tax is a more equitable business tax than BPM
 - A payroll tax is a more predictable business tax than BPM
 - Pittsburgh's experience shows that in the medium-term the payroll tax brings in more revenue while eliminating the inequities of the BPM (*see Pittsburgh section*)
- **Rare and Fleeting Opportunity**
 - Cities across the Commonwealth are hamstrung by a lack of revenue options
 - Scranton has an opportunity to adopt a modern tax with an equitable scope and greater predictability, and open up future growth and more efficient tax collections (saving both the City and District money)
- **Progress toward a Modern, Efficient Tax System**
 - Businesses make location decisions based on a range of factors; it is unlikely businesses will uproot in reaction to this particular change
 - Having **no** business tax is the most desirable outcome for the City in the long-term, but barring the ability to strike the tax altogether, a payroll tax is a step in the right direction

Payroll tax - A very brief history in Pittsburgh

In 2004, the City of Pittsburgh entered Act 47 after many years of stagnant revenue growth, a large debt burden, an unfunded pension, structural deficits, and spiraling employee and maintenance costs. While the plan focused on many cost saving initiatives it also prompted the state to pass Act 222 establishing the Payroll Preparation Tax to attempt to establish a fairer way of levying local taxes in Pittsburgh and other urban centers.

The business privilege tax (BP) had become rot with exemptions through state changes and court precedent limiting the sectors that actually pay the tax. The Payroll Tax was perceived to be a more equitable tax by allowing a sharing of the burden between all sectors. It also provided a link with non-resident salaries benefitting from services provided by a host municipality.

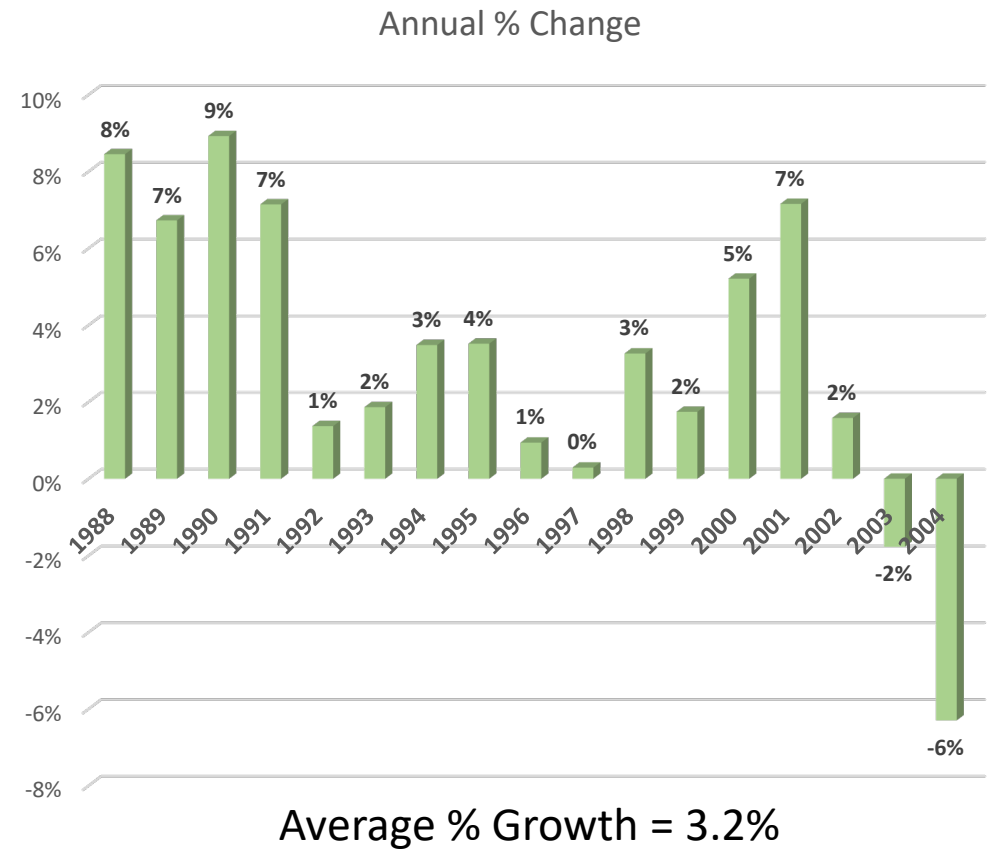
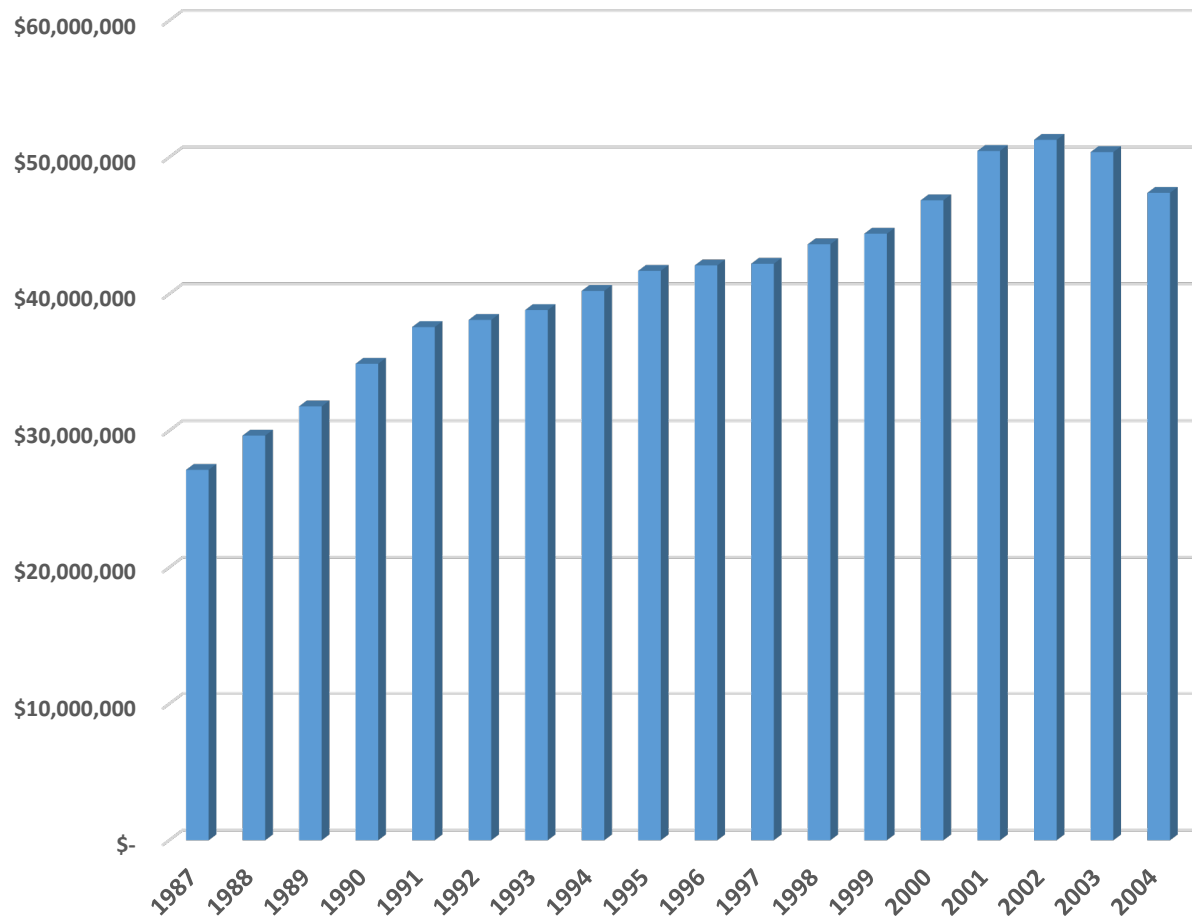
Once an agreed upon Payroll rate was set (0.0055), it was determine that the mercantile tax would be eliminated in 2005 and the BP would be phased out over 5 years (2005-09), after a payroll tax had first been implemented. This allowed time to set up the payroll tax and confront any collection and compliance issues during a transition period.

Bill Urbanic, Budget Director

City Council of Pittsburgh

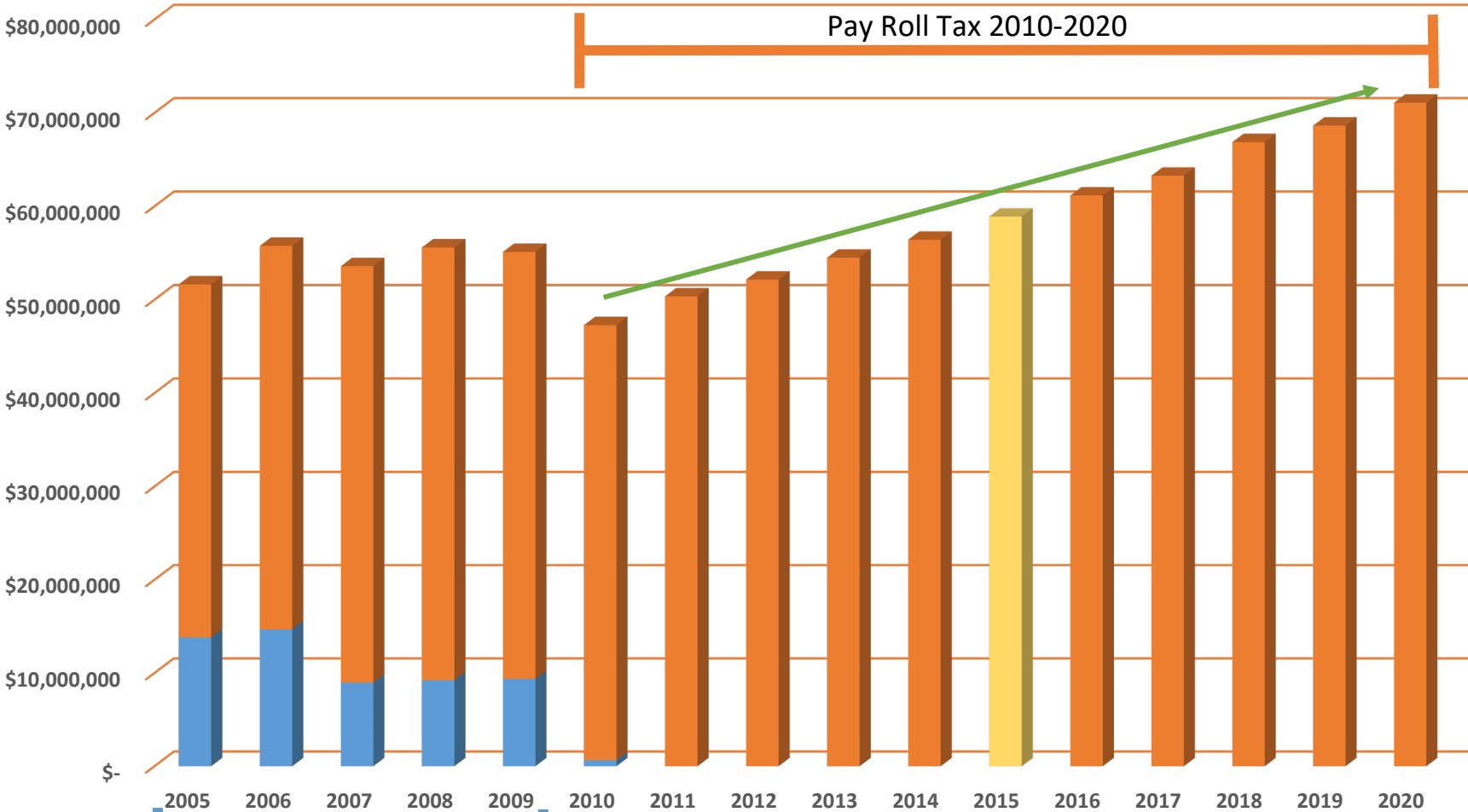
October 2019

Business Privilege and Mercantile Taxes 1987-2004



BP showed strength over the years because many professional firms (i.e. legal, investment) had seen growth. However, that growth was market dependent and a little harder to predict, as you can see by the annual percentage changes.

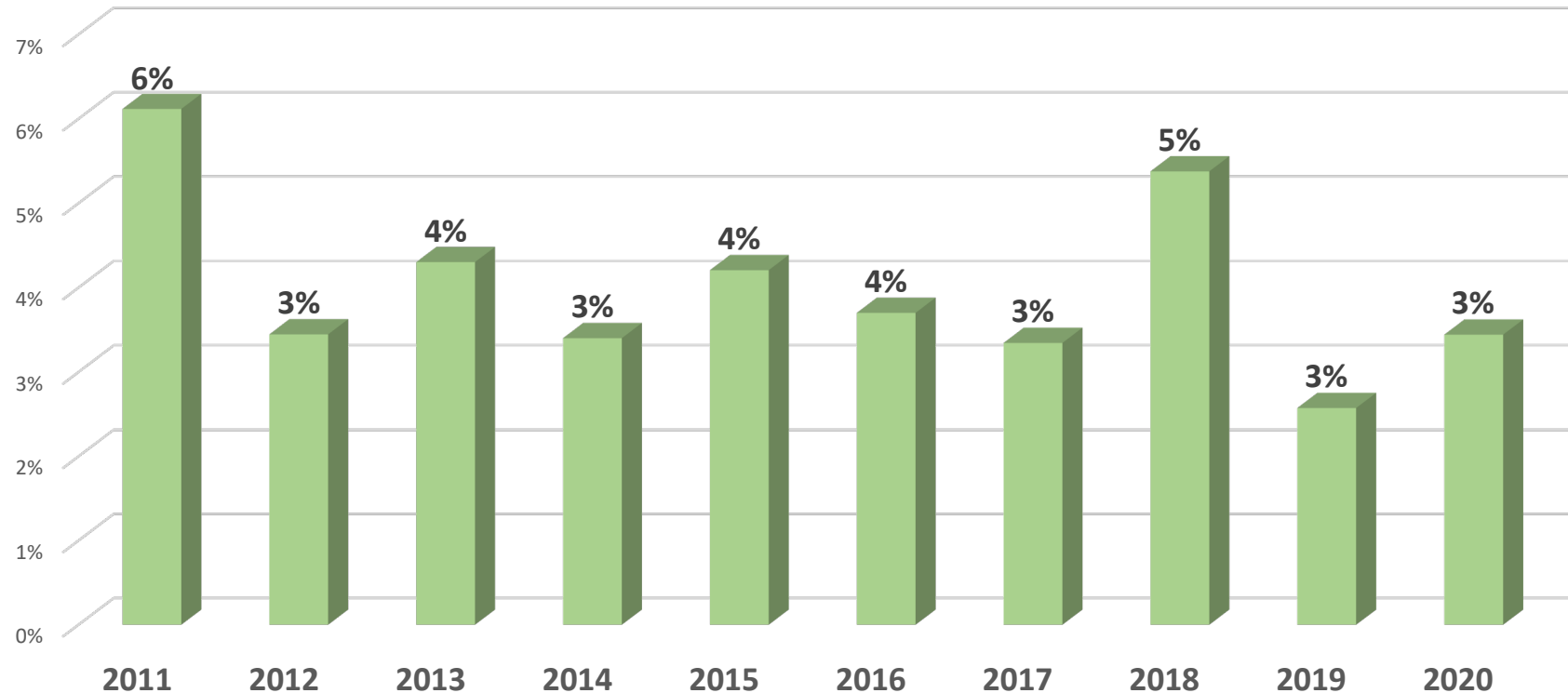
Payroll Tax Implementation and Phase Out of BP Tax 2005-2020



The Business Privilege Tax was originally levied at the rate of 6 mills. It was lowered to 2 mills in 2005 and 2006. In 2007 through 2009, the rate is lowered to 1 mill and was eliminated for 2010. The Payroll Tax rate was set at .0055

2015 City received an extra quarter payment due to ordinance change to align calendar year actual booked was \$73,930,205. This amount was smoothed to \$58M for presentation purposes

Payroll Tax Annual Percentage Change 2011-2020



Average Annual % Growth = 4%

Percentage change for past 10 years has been a consistent source of steady growth in Pittsburgh since it is based on wages. The wages are spread among all private sector businesses, so it is not dependent on just a few sectors having a good or bad year, unlike Business Privilege Tax. This also makes Payroll tax easier to forecast and track. The growth is still dependent on economic conditions in terms of wages, compliance, and collections.

Summary

For Pittsburgh, the Payroll Tax has supplied a stable source of tax revenue that is fairly applied against all for-profit businesses that operate within the City's limits. By better distributing the burden and basing the tax on salaries of those for-profit businesses it has proven to be more dependable and easier to forecast tax.

While there have been some problems with application of the tax on transient businesses such as delivery services (i.e. UPS, Fedex...) In the scheme of things these are small details that we continue to work through.

All in all the Payroll tax has worked in the Burgh.