POLICY BRIEF

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Eliminating Exemptions? -Not So Fast

Based on what has been reported to date, the panel appointed by the Governor to review the City of Pittsburgh's finances apparently will float a proposal to reform the Business Privilege Tax (BPT) by closing some of the exemptions now extended to certain industries. Presumably, eliminating the BPT exemption would produce tens of millions in additional revenues for the City. Unfortunately, this proposal may be a cure worse than the disease and set the City on far worse financial footing in the long run.

The BPT is one of two business taxes termed gross receipt taxes (the mercantile tax is the other) levied by the City. The BPT violates the "ability to pay" principle of taxation because it is levied on the gross, rather than net, revenues of a business and severely harms enterprises with small profit margins. The City has the highest rate (6 mills) of any municipality in Allegheny County that levies the tax.

A major source of controversy arises from the fact that industries such as manufacturing, insurance, banks and financial institutions, and non-profits are excluded from paying the BPT. Because they are exempt, many of these enterprises have made substantial investments in the City.

The pertinent question: Is it reasonable to expect that the BPT exclusions can or will be removed? It is certainly easier said than done. There are four primary reasons this proposal is not likely to succeed.

First, the elimination of current exemptions would have to be approved by the General Assembly. Since there has yet to be any favorable reception of the City's other tax proposals, it is doubtful that any serious consideration would be given to the exemption plan. Moreover, since the exemptions have been in effect for a long time and were instituted for what must have been seen as good reasons, it will be necessary to hold extensive hearings before a vote to eliminate exemptions can be taken.

Second, closing the BPT exemptions would be harmful to local companies that are accustomed to being exempt and have made business decisions based on that exemption. Imagine the impact on manufacturers such as PPG, Alcoa, Heinz, and U.S. Steel. For one thing, how would gross revenue be defined in view of the fact that almost all of the production and sales occur at sites outside the City? The banking and financial community--Mellon, PNC, Federated Investors, etc. have been exempt because of their special status as state regulated industries. Recall that Federated retained their BPT exemption through special legislation back in 1996. Legislation extending the BPT to these firms could result in decisions to move their headquarters address out of the City to such sites as Robinson or Marshall Township or maybe even out of the County.

Third, it is questionable whether the state could pass legislation to allow Pittsburgh to treat subjects of the BPT differently than they are treated in the remainder of the state. It is one thing to have different rates for classes of business in one jurisdiction; it is another matter to have certain businesses excluded from the tax in every jurisdiction except one. If somehow it does pass, there would certainly be drawn out legal challenges.

Lastly, if the BPT exclusions were lifted, it is probable that some type of offset would have to be offered to at least partially alleviate the burden on companies who would now be subject to the BPT. The problem here is that the only other sizeable revenue source that could provide significant relief is the real estate tax. Obviously, a reduction in the property tax rate could not be limited to the firms losing their BPT exclusion. A reduction in the millage rate would extend to all taxable real estate and result in significant declines in revenue for the City, substantially offsetting the revenue gain from additional business privilege taxes.

Clearly, exempting some industries from certain taxes is usually a very bad idea and always leads to complaints about unfair treatment. Such exemptions should not be enacted without careful consideration of the impact on other non-exempt industries. However, the fact is that once exemptions have been in place for decades, eliminating them would be a breach of faith with firms who have made large investments under the assumption they would have the exemption in perpetuity.

As the prospects for major tax increases for the City dwindle, it is incumbent upon the City, or the financial panel that may eventually oversee its budgets, to implement cost-saving measures. Across-the-board spending cuts, asset sales, and outsourcing services are the most business-friendly actions the City can undertake in the short run.

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