POLICY BRIEF

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Are City Tax Revenues Falling Short?

The City of Pittsburgh asked Harrisburg for help with their finances, and they got it. The City asked the business community to back its attempt at reform of business taxes, and they got it. In place of those taxes, the City asked legislators to enact a payroll tax of 0.55 percent on all for-profit businesses in Pittsburgh, and they got it. The City budgeted $41 million in revenue from the payroll tax, and it now appears very unlikely they will collect that much.

The mid-year collection totals on the payroll tax show it has fallen about 10 percent short of delivering half of the budgeted amount, even though two quarterly payments have been collected. Data from the City Controller's office show that the payroll tax has brought in $18.5 million through the end of June, a monthly average of just over $3 million. If collections continue at that rate, the City can expect $36 million for the year, at least $5 million short of the budgeted amount. An increase to about $4 million per month will be needed to reach the 2005 target.

It should come as no surprise that the biggest monthly collection came in March, when $7.2 million was paid. As we noted at the beginning of the year *(Policy Brief Volume 5, Number 2)* the City took the opportunity to make a tax grab by basing the first installment of the tax on the payroll of firms for October, November, and December of 2004. Obviously, the City was engaging in retroactive taxation--levying a new tax on payroll disbursed before the tax went into effect--for the period when seasonal hiring at many firms is at its highest.

Moreover, it is important to consider the likely shortfall in the payroll tax in light of the other tax levies the City collects. According to the data through June, there is a nearly $100 million shortfall in the collection of revenue compared to budget. To be sure, revenues from some of these taxes such as parking, amusement, and earned income are ongoing and a lot of the current shortfall will be made up. Meantime, however, there are several taxes for which payments were due early in the year and making up their shortfall is decidedly problematic. For example, real estate tax collections are running $22.4 million below budget. A year ago, the June real estate shortfall was $19.2 million.

On the other hand some revenues are running ahead of last year. Namely, the real estate transfer tax collection has received boosts from a 33 percent rate increase and the sale of some large downtown properties. Moreover, thanks to one more month of collection in 2005 compared to 2004, parking tax receipts are running ahead of the year ago numbers. The bad news is that the average monthly parking collections in 2005 have dipped below the first six month revenues from a year ago despite a substantial pickup in Pirates attendance.

Then too, the City has captured a small windfall in the form of late mercantile and occupation tax payments from 2004 that were not budgeted since those taxes were eliminated as of December 2004. That bonus will be partially or completely offset because the City will have to set aside money to cover refunds to those workers who are exempt from $42 of the new emergency services tax but who had to pay in January anyway under the City's collection scheme.

By June of 2004, Pittsburgh had collected 72 percent of its budgeted tax revenues. As of June 2005, the City has collected only 68 percent suggesting that Pittsburgh's economy and tax production will need a boost during the second half to prevent revenues falling well short of the budget target.

As far as the payroll tax is concerned, it appears improbable that the City will collect the additional $23 million necessary to reach the $41 million budget target for a number of possible reasons. Perhaps the $7.5 billion taxable payroll estimate was too high, although, to be fair, there was substantial agreement among analysts on the number. In all likelihood, there have been employment cuts in the City and perhaps some movement of jobs out of the City, both of which could have reduced the taxable payrolls. Or it could simply be that some firms are not paying the tax on a timely or complete basis. Whatever the reason, the lesson for the City is clear: new and higher taxes often fail to deliver the anticipated revenues. Where they can, taxpayers will engage in legal avoidance behavior by reducing their tax liability.

The City made a big mistake by failing to hold a harder line on planned spending in the 2005 budget. A City in distress should have had no increase in planned expenditures. Instead, for 2005, budgeted spending rose by $12 million and would have risen by $16 million if the Legislature had not saved the City $4 million by eliminating the previously required transfer of RAD dollars to the school district. That's a rise of four percent in a City that is taxing its way to bankruptcy.

It's very clear. Before the onerous tax burden the City imposes on residents and businesses can be reduced, there must be substantial cuts in expenditures. Belts will have to be tightened further and the authorities with saleable assets must generate funds to help with the City's crushing debt service.

The Act 47 team, the oversight board and the City government need to get down to business and start moving the City in a direction of real year over year spending reductions.

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