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Time to Reinstate the Philadelphia Intangible Wealth Tax

By Marc Stier and Eugene Henninger-Voss March 28, 2022

Wealth inequality in America, in Pennsylvania, and in our region has been growing strikingly since the late 1970s. And wealth inequality continues to increase during the pandemic. The dramatic rise in wealth inequality threatens economic growth, reduces the tax revenues needed to fund vital public institutions, and undermines our democracy.

To counter wealth inequality and to raise the revenue needed to fund programs that support the well-being of working people in our city, we call for the reinstitution of a wealth tax of 4 mill or .4% of the value of intangible wealth in Philadelphia. We estimate that this tax would raise more than $200 million per year in revenues for the city, which would provide the funds necessary to create and / or expand programs that would enable us to break down the barriers of class, race, and gender that stand in the way of opportunity for so many of our fellow Philadelphians. Doing that—as well as supplying public amenities that the city cannot now afford—would also make our city a better place for everyone to live.

History of the wealth tax in Pennsylvania and Philadelphia

The Commonwealth of Pennsylvania has taxed intangible wealth (that is, wealth that is not real property–such as the houses and apartments people own) since 1831. From that time until 1913, the state collected the tax and turned over a share of the revenue to counties. Between 1913 and the repeal of the tax throughout the state in the 1990s, the tax was collected by counties who retained all revenue—with the exception of the years from 1935 to 1943 when the state added an additional emergency tax on intangible wealth.[1] The Pennsylvania Supreme Court held the tax unconstitutional under the United States Constitution on the grounds that, because it only taxed the holdings of the stock and bonds of corporations that did no business in Pennsylvania, it violated the Commerce Clause's requirement that states not discriminate against or unduly burden interstate commerce.[2] In 1997, in the aftermath of that decision, then Mayor Ed Rendell and Council President John Street sought to find an alternative that would bring in the roughly $17 million in revenues by enacting a personal property tax on all investments held in Philadelphia accounts, regardless of who owned them or issued them. That poorly designed tax, however led financial firms to flee the city because it put them at a competitive disadvantage in holding assets owned by those who lived outside the city limits, who for some reason were required to pay this tax.[3] The proposal we are putting forward would only

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1. Note, Administration of the Intangible Property Tax in Philadelphia, *University of Pennsylvania Law Review*, vol 103, 1954, 319-432.

2. Annenberg v. Commonwealth, 757 **A.2d** 338 (Pa. 2000). The Pennsylvania Supreme Court's ruling was based on the line of decisions in U.S. Courts that culminated in Fulton Corp. v. Faulkner, 516 U.S. 325, 331 (1996).

3. Joseph N. DiStefano, "Banks Shift Jobs and Account out of Philadelphia," *Philadelphia Inquirer*, July 8, 1997.

tax the wealth of Philadelphia residents and thus would create no incentive for financial firms to leave the city.

The rationale for an intangible wealth tax

Despite this episode, the rationale for an intangible wealth tax that led to its creation in Pennsylvania in 1831 remains strong today. Philadelphia, like all county and municipal governments and school districts in the state, already impose wealth taxes. The problem is that existing wealth taxes are only on the value of real property and not at all on the main sources of wealth held by wealthy families. Real property makes up only 32% of all assets held by American households. Real estate accounts for 51% of the assets held by the families in the lowest-income 60% of families, but makes up only 22% of the assets held by the highest-income 10% of families—and no doubt, a substantially lower percentage among the top 1% of all families. Taxing only the wealth that is bound up in real estate holdings, while not taxing the wealth held in financial instruments and the value of businesses, places a far higher tax burden on low- and moderate-income families and a lower tax burden on high-income families.[4]

The rationale for taxing intangible wealth has only grown stronger in the last 50 years as income and wealth inequality have grown to a level not seen in the United States since the Gilded Age. In 2019, the top 10% of families by income held 70% of all financial and non-financial wealth in the United States, up from 62% in 1989. The bottom 60% only held 8% of wealth, down from 13% in 1989.[5] In 2019, the top 1% held 32% of all wealth up from 24% in 1989.[6]

Even as Americans have been suffering as a result of the pandemic, the wealth of the richest Americans has been growing ever faster. U.S. billionaires' collective wealth went up by $1.7 trillion, or 57%, since the pandemic emergency was proclaimed in mid-March 2020. Their total wealth reached $4.6 trillion by March 2022, up from $2.95 trillion on March 18, 2020, according to the latest report from Americans for Tax Fairness (ATF) based on Forbes data.[7] The 16 billionaires in Pennsylvania saw their wealth grow by over $27 billion, or 97.9%, in 24 months.[8]

Taxing some forms of wealth but not others—and excluding the wealth held by those with the greatest wealth, not just in our country at this moment but at any place and time in human history—is deeply unfair. But that unfairness may not be the worst aspect of a tax system that taxes real property wealth but not financial or business wealth. What is worse is that it leaves American governments at all levels—federal, state, and local—with insufficient resources for providing common goods. Without those revenues our communities suffer from dirty air and water and other environmental hazards; a lack of public parks and recreation centers; a dilapidated physical infrastructure that undermines

4. Calculations by PBPC based on the Federal Reserve System, Survey of Consumer Finances, 2019, https://www.federalreserve.gov/econres/scfindex.htm.

5. Calculations by PBPC based on the Federal Reserve System, Survey of Consumer Finances, 2019, https://www.federalreserve.gov/econres/scfindex.htm.

6. From Statista.com, based on Federal Reserve Bank of St. Louis, data https://www.statista.com/chart/19635/wealth-distribution-percentiles-in-the-us/.

7. Americans for Tax Fairness, Billionaires Data, 3-10-22, https://docs.google.com/spreadsheets/d/1szqeDvXCYCrOpisNBZiVfYHv1VM3p5y1Hk0ULFDS1YQ/edit#gid=1259834744

8. Americans For Tax Fairness, Billionaires Data, March 18, 2020, https://docs.google.com/spreadsheets/d/1szqeDvXCYCrOpisNBZiVfYHv1VM3p5y1Hk0ULFDS1YQ/edit#gid=1602730034.

commerce; workers that lack the education and training they need to do the jobs of the future—positions that businesses need filled if they are to grow more productive; and the human services and health care we need so that young people and middle-aged people, wherever they live and whatever they look like, can secure the opportunities due them as Americans, and our seniors can stop working for a living and enjoy the retirement they paid into free of worry.

Philadelphia, despite its riches, remains one of the poorest cities in America and desperately needs new sources of revenue to close the deep chasm between the dynamic economy of one part of the city and the poverty of another—poverty made worse by racial, ethnic, and gender discrimination.

A Philadelphia intangible wealth tax

We propose that the City of Philadelphia institute an intangible wealth tax set at a rate of 4 mill or .004 of the value of all financial and business assets. (In technical terms, these assets include all stocks or shares of incorporated or unincorporated companies, business trusts, mutual funds, notes, bonds, and other obligations for the payment of money, and all comparable financial instruments, whether or not publicly traded.) We would exclude from taxation all transaction accounts such as bank or credit union checking and savings accounts and the stocks, bonds, mutual funds and other financial instruments including in traditional IRAs.

In an ideal world, we would propose a graduated intangible wealth tax with tax rates that rose as the wealth of families increased and that excluded the vast majority of families who have little or no intangible wealth.[9] That is impossible because of the Pennsylvania Constitution's uniformity clause. However, excluding retirement accounts, as well as transaction holdings in bank savings and checking accounts, would ensure that the majority of Philadelphians would not have to file an intangible wealth tax return.

These exclusions are defensible under the uniformity clause on two grounds. First, the distinction between bank accounts and brokerage accounts is a common, everyday distinction in the financial world as is the distinction between retirement accounts and other accounts. Under uniformity clause case law, governments in PA are allowed to tax different categories of wealth and income if those categories are usual and customary.

> "The test of uniformity is whether there is a reasonable distinction and difference between the classes of taxpayers sufficient to justify different tax treatment. *So long as the classification imposed is based upon some standard capable of reasonable comprehension*, be that standard based upon ability to produce revenue or some other legitimate distinction, [*the Uniformity Clause is satisfied*].[10]

Second, there are defensible policy rationales for the distinctions we are proposing. Household checking and savings accounts are used by families to manage their funds over time, e.g., to save for a rainy day or major purchases. And retirement accounts receive special treatment under tax law, in

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[9] We don't want to rule out entirely the possibility of excluding, say, the first $500,000 of wealth held by Philadelphia families from the tax. We could try to include that in the legislation with a severability clause that allowed the tax to survive even if the exemption is rule unconstitutional. It's also unclear who would have the economic incentive to bring suit against such an exemption. A similar exemption in the gross receipts tax has never been challenged. We could also include in the legislation a slightly higher tax rate that would take effect if the exemption is ruled unconstitutional, which would dissuade any taxpayer from filing suit against it.

10. *Appeal of Borough of Aliquippa*, 175 A.2d 856, 862-63 (Pa. 1961).

part because they have come to replace traditional pensions and in part to encourage families to save for retirement.

We don't have precise estimates of the share of Philadelphia families that would have to pay an intangible wealth tax. But given the concentration of wealth nationally—which, of course, is found in Philadelphia as well—we think it very unlikely that individuals or families below the top 20% in income (that is with an income of less than $112,000 a year) are likely to pay any tax at all. (The only exception would be people with low incomes who have substantial inherited wealth.) And given that the top 10% of households hold 70% of all wealth in the U.S. and the top 1% holds 32%, most of the tax would be paid by the richest Pennsylvanians. Our rough guess—based on our analysis of who would pay a tax on income from wealth—is that the top 5% of families by income, with incomes of $251,000 or more in Pennsylvania, would account for about 70% of the revenues raised by the tax. And about 50% of new revenues would come from the top 1% of households. The threshold for being in the top 1% of families by income is $592,000 and the average income of the top 1% of families in Pennsylvania is more than $1.5 million.

How much would a wealth tax raise?

To estimate the revenue that would be raised by a wealth tax we have borrowed the analytical techniques of Emmanuel Saez and Gabriel Zucman.[11] Saez and Zucman use estimates of the economic returns to business activity and various kinds of financial investments to generate estimates of wealth based on Internal Revenue Service data that separately report income from difference sources of wealth. We used their estimates of the capitalization factors for different kinds of income from wealth and two different sources of tax data, from the IRS and Pennsylvania's Department of Revenue, to generate our estimates of the wealth held by Philadelphians.

The two sources of tax data give us similar estimates. While we are still at an early stage of doing this analysis and warn that we expect to refine our approach substantially in the coming months, our preliminary estimate is that, excluding retirements accounts, Philadelphians hold about $60 to $70 billion in financial and business wealth. Thus, we estimate that a Philadelphia intangible wealth tax could raise between $240 and $280 million a year.

That total, of course, is far higher than the $17 million that a similar tax brought when it was phased out in 1997. Three things account for the difference. First, the richest Americans have become far wealthier. Second, we expect that it will be far easier for the city to enforce payment of the tax today, compared to 1997. The intangible property tax was often called a "voluntary tax" in the past because the city did not have the capacity to ensure that Philadelphians who owed the tax paid it. However, almost all financial assets are now held in brokerage accounts that report holdings and income to the IRS. The IRS shares them with state and local governments. Thus, with a small investment in additional staff, the city would be able to take advantage of tax information that would make

11. Emmanuel Saez and Gabriel Zucman, "Wealth Inequality in the United Since, 1913: Evidence from Capitalized Income Tax Data," Working Paper 20625, National Bureau of Economic Research, http://www.nber.org/papers/w20625. The capitalization factors we use to move from income tax data to our estimates can be found here: https://gabriel-zucman.eu/files/PSZ2022AppendixTablesI(Aggreg).xlsx.

enforcements of the tax relatively straightforward. It may be more difficult to secure accurate valuations value of privately held businesses. But we estimate that the value of publicly held stocks and bonds is roughly $50 billion, and a minimally aggressive effort on the part of the city to collect the intangible wealth tax on these assets should bring in about $200 million per year alone. The intangible property tax we propose would not be "voluntary." Third, the tax repealed in 1997 excluded stocks and bonds issued by corporations that had an economic nexus in Philadelphia, which excluded a great deal of wealth. By including this wealth, we avoid the constitutional problems that led to a constitutional challenge to the old tax and we raise far more revenue.

Will the wealthy flee Philadelphia if an intangible wealth tax is adopted?

For 20 years, tax "reformers"— who ritualistically call for deep cuts in business and wage taxes—have taken center stage in discussions about economic growth and job creation in Philadelphia. In a forthcoming paper, we will return to that debate, not just with evidence that refutes the claims that tax cuts are either necessary or sufficient to spur job creation, but also with reasons to think that business and wage tax cuts, together with the spending reductions they require would actually make the chasm between much of our population and the dynamic parts of economy even greater. Here, however, we want to turn to the specific question about whether wealthy Philadelphians who will pay the intangible wealth tax are likely to flee our city to escape.

Stop and think for a moment about the tax rate we propose and you'll realize that this scenario is fanciful. A 4-mill tax on $500,000 in wealth is only $2,000. Would a family with that level of wealth—beyond retirement accounts—that lives in Center City and is able to walk to art and cultural institutions and events, extraordinary restaurants, and our parks and waterfronts move to the suburbs such as Cherry Hill or Malvern that are a long car or train ride away (and that's even worse during rush hour) to save $2,000? Would such a family that lives in Chestnut Hill or Mt. Airy, and that is not only a short car or train ride to Center City but within walking distance of the extraordinary beauty of the Wissahickon Park make such a choice? To ask that question is to answer it.

And would a family that has sunk roots into our city—with friends and neighbors and whose children have friends and connections to area schools—abandon those connections to save this small amount of money?

While at higher levels of wealth a 4-mill tax would cost families much more, their ability to pay the tax grows commensurately with their wealth. A $40,000 tax is a lot of money for most of us, but for a family that has $10 million in wealth it's not burdensome, nor is a $400,000 tax for a family with $100 million in wealth.[12]

It is conceivable that, at much higher tax rates, a wealth tax might be considered when people think of leaving the communities to which they're attached. That is why it makes sense to envision a nationwide wealth tax of 2% or 3% for the richest Americans, or even a wealth tax of 1% for a state.

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[12] One way to ensure that the temptation to leave Philadelphia is minimized by the institution of a wealth tax is for collar counties surrounding the city–Bucks, Chester, Delaware and Montgomery Counties–to institute the tax as well. A region wide wealth tax dedicated to SEPTA which be an ideal way to generate funds necessary to support current operations as well as to expand the system. (SEPTA could borrow capital funds on the substantial revenue such a region-wide wealth tax would generate.) Investing in public transit is, as we will point out in future work, an important way to generate additional economic growth while also overcoming the barriers standing in the way of Philadelphians working in the suburbs (and vice versa). The existing contributions that Philadelphia and the collar counties make to SEPTA could then be reprogrammed for local purposes.

But a tax set at a fraction of these rates would not so unduly burdensome as to overcome the deep connections people have to the communities in which they have made their lives.

So far, we've just been talking about lost opportunities to enjoy the arts, food, and recreational events more easily if wealthy people leave Philadelphia to escape a wealth tax. A great deal of recent research also underscores the strong economic ties that link very wealthy people to the communities in which they live and in which, in many cases, they have become wealthy.[13] That research shows that wealthy people rarely move from one community or state to another and that they almost never do so to escape higher taxation. One low-tax state—Florida—is a common destination for the relatively few wealthy people who do move. But because other low-tax states—Louisiana, Texas, Montana, and Alaska—are not such destinations, it is clear that the appeal of Florida is mostly its weather and communities of retiring seniors, not its low taxes.

Why don't wealthy people leave their communities or states? Mostly, it appears, because the economic activities that have made them wealthy—and continuously make them wealthier—are place-specific. Economic theory abstracts from the specific relationships—technical, legal, scientific, financial, and commercial—that are critical to the work of the best paid men and women of our time. And when one looks at them abstractly, avoiding taxes might seem to be a motivation to move from one place to another. But high incomes and wealth are not made by abstract economic actors but by real people whose expertise—such as a lawyer's expertise in state law or a businessman's connection to local suppliers and customers—are critical to their work. They are made by scientific and technical workers who work in concert with others with similar skills and knowledge in and outside their own firm.

The whole history of urban economics–the Italian city state of the 16th century; the financial centers of London and New York; the high-technology corridors in Silicon Valley and centered on Route 128 in Massachusetts; the movie and television industries in Hollywood–shows us that economic activity, and the knowledge, skills, and personal connections that make for economic productivity, are place-based. That is why, even as manufacturing spreads out across the globe, the most highly paid financial and technology workers at the center of major corporations have become ever more concentrated in

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13. Here are some of the critical sources of this new research: Cristobal Young, "The Myth of Millionaire Tax Flight," Stanford University Press, 2018; Cristobal Young *et al.*, "Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data," *American Sociological Review*, Vol. 81 No. 3, 2016, https://web.stanford.edu/~cy10/public/Jun16ASRFeature.pdf; Adam Nagourney, "Two-Tax Rise Tests Wealthy in California," *New York Times*, February 6, 2013, https://www.nytimes.com/2013/02/07/us/millionaires- consider-leaving-california-over-taxes.html; Cristobal Young and Charles Varner, "Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment," *National Tax Journal*, June 2011; Roger S. Cohen, Andrew E. Lai, and Charles Steindel, "A Replication of "Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment," 2014, https://journals.sagepub.com/doi/abs/10.1177/1091142114537893?journalCode= pfrb; and Cristobal Young and Charles Varner, "A Reply to 'A Replication of Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment,'" 2015, https://web.stanford.edu/~cy10/public/Reply-Public- Finance-Review-2015.pdf.

major urban areas. The men and women who lead Philadelphia's educational institutions and medical centers, our legal and financial services firms, and our communications and entertainment corporations made their money in our city. And for most of them, their wealth can only continue to grow through their continued connection to Philadelphia.

Finally, age is a major variable in determining whether someone moves from one place to another. Young people leaving college and starting out in their careers move to new communities at far higher rates than those who have made their fortune and are typically well into middle age. Young people will not pay a wealth tax. Those who will do so are the Philadelphians who have made homes, established their families and friendships, and built their careers in our city.

What would keep young people in Philadelphia is not low taxes and but a dynamic, clean, and safe city that provides economic opportunities to everyone. We need more resources to create that kind of city—the resources that a modest wealth tax would bring us.

The impact of a wealth tax on Philadelphia

The importance of creating a Philadelphia that is attractive to young people who are deciding where to make their lives and careers reminds us that any time we talk about the economic burdens of a tax on the wealthy—on anyone—we also have to consider what the additional revenues would enable us to accomplish that would otherwise be impossible.

An intangible wealth tax would raise a substantial sum of money that would allow the city to make the critical investments we need. Of course, it's important to spend that money well—and we look forward to taking part in debates on how best to spend the new revenues. But one thing we should remember is that any spending by the city funded by the accumulated wealth of the richest Philadelphians will, by itself, stimulate our city's economy. As economists from across the political spectrum have pointed out, the growth in income and wealth inequality, and in the propensity of the very wealthy to save much of their income, has returned us to the pre-World War II era when underconsumption led to slower economic growth. Despite the accumulation of savings and a low cost of capital, businesses have little incentive in machinery or worker training to increase their capacity to produce when consumption is growing slowly. Wealth taxation—in Philadelphia and beyond—is a way for government to increase consumption, and generate business investment, and spur economic growth.