COUNCIL OF THE CITY OF PHILADELPHIA
PUBLIC HEARING AND PUBLIC MEETING
BEFORE THE COMMITTEE OF THE WHOLE

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Room 400, City Hall
Philadelphia, Pennsylvania
Wednesday, June 14, 2000
1:35 p.m.

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BILL 000336 - Amending Chapter 19-2600 of the Philadelphia Code, entitled "Business Privilege Taxes," by adding the definition of "information technology company" and by excluding from the definition of receipts any receipts from the specific business conducted by an information technology company, under certain terms and conditions.

BILL 000354 - Amending Chapter 19-1500 of the Philadelphia Code, entitled "Wage and Net Profits Tax," by exempting certain stock options from the tax, under certain terms and conditions.

BILL 000451 - Amending Chapter 19-2800 of the Philadelphia Code, entitled "Pennsylvania Intergovernmental Cooperation Authority Tax on Wages and Net Profits" by exempting certain stock options from the tax, under certain terms and conditions.

PRESENT: COUNCIL PRESIDENT ANNA C. VERNA, Chair
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COUNCILWOMAN MARIAN B. TASCO

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P R O C E E D I N G S

COUNCIL PRESIDENT VERNA: Good afternoon, everyone. We do have a quorum. So this is a public hearing of the Committee of the Whole, and I would ask Mr. McPherson to please read the titles of Bill No.'s 000336, 000354, and 000451.

MR. MCPHERSON: Bill No. 000336, an ordinance amending Chapter 19-2600 of the Philadelphia Code, entitled "Business Privilege Taxes," by adding the definition of "information technology company" and by excluding from the definition of receipts any receipts from the specific business conducted by an information technology company, under certain terms and conditions.

Bill No. 000354, an ordinance amending Chapter 19-1500 of the Philadelphia Code, entitled "Wage and Net Profits Tax," by exempting certain stock options from the tax, under certain terms and conditions.

Bill No. 000451, an ordinance amending Chapter 19-2800 of the Philadelphia Code, entitled "Pennsylvania Intergovernmental Cooperation

Authority Tax on Wages and Net Profits" by exempting certain stock options from the tax, under certain terms and conditions.

COUNCIL PRESIDENT VERNA: Thank you.

Today, Council considers two bills to exempt from the wage tax certain stock options received as compensation by employees. I would like to briefly explain why I cosponsored an support these bills.

The City has experienced an economic and cultural renaissance in recent years and is becoming an increasingly desirable place to live. However, there is a consensus that the City's tax structure continues to be a reason that some businesses leave the City and certainly is a major impediment to attracting new businesses to the City. This is a problem that City Council can, and should, address.

Studies show that companies locate where their chief executive officers choose to live. Locally, we saw the phenomenon of the Route 202 corridor of the western Philadelphia suburbs. If Philadelphia is to be successful in its efforts to have companies locate in the City, it must attract and retain the talented people who run and work in these companies. The City's tax climate must not hinder that goal.

The taxability of stock options is an issue of particular importance to the high-tech new-economy companies that Philadelphia should be especially eager to attract. The fact is that for these companies, especially during their start-up phase, stock options represent an increasingly significant component of the compensation of employees at all levels, from the programmers to the top executives. By exempting stock options from the wage tax, the City can take a significant step in encouraging high technology companies to locate in the City from neighboring jurisdictions, either to not impose any wage tax on stock options or impose it at a much lower rate than Philadelphia's 4 percent for nonresident or 4.6 percent for residents in wage tax rates.

The first stock option bill before this committee is Bill No. 354, which would exclude stock options from the City wage tax set forth in Chapter 19-1500 of the Philadelphia Code. The bill would only exclude stock options that do not have a readily ascertainable market value when granted. The purpose of this provision is to prevent the stock option exclusion from becoming a loophole sheltering of the wage tax. The intent of this bill is to include only the type of stock options which are of uncertain value when granted, and which, in effect, link a portion of the employee's compensation to the future success of a company.

Since Bill No. 354 was introduced, the need for two changes has been brought to my attention, and I will propose an amendment to the bill to incorporate those changes.

First, there was some uncertainty as to what the phrase "readily ascertainable market value" meant. That amendment would correct problems by incorporating the definition used in federal IRS regulations. This change will provide a clear definition of what stock options are and are not excluded from the page tax.

Second, the amendment would add language to make it clear that stock options are exempt from wage tax, not only when granted, but also when they are exercised. It is not the intent of this ordinance to simply lay in position of the wage tax on stock options until the stock options are exercised, but to completely exempt stock options and any related gains from wage tax.

The second stock option bill before the committee is Bill No. 451, which would exclude stock options from the PICA wage tax set forth in Chapter 19-2800 of the Code. Bill No. 451 is otherwise identical to Bill No. 354, except that it already contains the language that I will propose be added to Bill No. 354 by way of amendment.

In summary, I believe that passage of these bills would be an important step to assist the City in its efforts to attract and retain the best and brightest who can provide our city a competitive advantage over other regions' economic development.

At this time, I would ask Mr. McPherson to please call our first witness.

MR. MCPHERSON: Mr. Kimmel?

(Witness comes forward.)

COUNCIL PRESIDENT VERNA: Good afternoon, sir. Kindly identify yourself for the record.

MR. KIMMEL: Good afternoon. My name is Wayne Kimmel. I'm Managing Director of the Eastern Technologies Fund.

COUNCIL PRESIDENT VERNA: And you wish to testify on the bills before us?

MR. KIMMEL: Yes. A couple things I wanted to talk about regarding both the bill regarding the gross receipts tax as well as the stock option tax.

COUNCIL PRESIDENT VERNA: Please do.

MR. KIMMEL: I think I'd like to start off with kind of a general overview of the whole Philadelphia area Internet scene. This area is one of the hottest areas in the world today regarding Internet and technology companies. The people that will be following my testimony will go into detail about some of the companies that they run in this area that are leaders in the Internet and technology business throughout the world. We have companies that we have testifying after me, companies like e-Cal, that are leaders in the Internet calendaring in the whole world. We also have companies in this area like Safeguard

Scientifics and Internet Capital Group and VerticalNet. These are companies that are world-renowned companies that have been reported in all the trade industry magazines as being the top companies in the world, and they're all located in this area.

One of the other things I wanted to talk about that, being a venture capitalist and being associated with Safeguard Scientifics and the whole group and family of funds in that area, this year, we will be investing up to $5 billion into Internet companies throughout the world. A lot of that money will be invested in this region, and one of the problems is, is that a lot of companies that we invest in will not locate their offices in Center City, Philadelphia because of the different tax implications.

And it's very tough for us to tell them that they have to start their company in this area because one of the things that a lot of these companies will talk to you about is that at the beginning, they're not profitable at first. They simply have revenues and these companies, when they're taxed on their gross receipts, it really hurts the company and hurts the growth of these companies. These companies need to grow as quickly as possible to become one of the leading companies in the world.

One of the other things that these companies do to help attract and retain their employees is to issue stock options to their employees, and the stock options help them bring in some of the world's leading people to run their companies. For example, a company like VerticalNet, which is located in Horsham -- they're not in Center City -- they hired Mark Walsh, who is now probably one of the -- he was named by Business Week as one of the top 25 people in the whole Internet industry. They're located in this area, but they brought him in as the CEO of the company, and part of the whole attraction to bring him was the stock option plan. So stock options are very important to attract employees, high-end employees, as well as just regular employees for the companies.

And people like students who go to University of Pennsylvania, Temple University, Drexel, LaSalle, St. Joe's other schools located in this area, one of the reasons why a lot of these students will leave the area is because some of the companies can't offer as good stock option plans as companies that are in the suburbs or in New York City or in San Francisco. So what we want -- what we hope to have done is that the companies will be able to offer much better plans to help keep some of our students here in the greater -- in the whole Center City area.

COUNCIL PRESIDENT VERNA: From your testimony, I am gathering that you feel this legislation would help the growth of the technology companies in the City?

MR. KIMMEL: I believe it absolutely would.

COUNCIL PRESIDENT VERNA: And it would certainly help to attract or retain our students from our local universities?

MR. KIMMEL: Yes.

COUNCIL PRESIDENT VERNA: Thank you.

Any questions from members of the committee?

(No questions.)

COUNCIL PRESIDENT VERNA: Thank you

very much, sir.

MR. KIMMEL: Thank you.

COUNCIL PRESIDENT VERNA: Oh, one moment please.

The Chair recognizes Councilwoman Tasco.

COUNCILWOMAN TASCO: Good afternoon.

Companies are planning to move into Center City as opposed to moving on the border?

MR. KIMMEL: Well --

COUNCILWOMAN TASCO: Do we have an indication that they really -- that they really will move into the City?

MR. KIMMEL: I think companies certainly will. We have an organization that I'm the director of e-commerce on, and Rob McCord is the President and CEO of the Eastern Technology Council, which is an organization of over a thousand Internet and technology companies here in this area, and we have a division of that called the "Philadelphia Area New Media Association." And also, Tom Bonnie will be able to speak to what has been put together in e-Philadelphia. And there's a whole movement here in Philadelphia to keep Internet companies in this area.

What I was saying with this whole organization that we have, a lot of young people that -- people like myself, my peers and others who want to start Internet companies would rather start them in Old City, West Philly, right by Penn and Drexel. They would like to have that because they would like for their employees to be able to walk to work instead of drive and park in some kind of a suburban strip mall type area in Suburbia, where they have to go and drive to the pizza shop instead of where a company, for example, that's located in Old City or like e-Cal on Delaware Avenue, they are able to walk across the street and go and have lunch after work, and after work, go out and have a drink. Those are the types of things that a lot of these Internet companies like, and I believe that a lot of companies would see it as an advantage if they could economically figure out a way of moving into the City.

COUNCILWOMAN TASCO: What taxes would be imposed on their stocks, other than City wage taxes, to be garnered from the stock options?

Certainly it's a -- they sell their capital gains tax, but are there any other taxes or fees or --

MR. KIMMEL: Well, just the fact that a --

COUNCILWOMAN TASCO: -- or costs associated with stock options?

MR. KIMMEL: Yes. I'm -- just the fact that a person is issued a stock option, even though they're not worth anything at this point, they are taxed. And that's -- it -- that's an issue to a lot of companies.

COUNCILWOMAN TASCO: How do we -- how is the tax determined?

MR. KIMMEL: I believe --

COUNCILWOMAN TASCO: On the amount -- I mean, if a person -- well tell me, how is it determined, this tax?

MR. KIMMEL: I believe -- I believe it's 5 percent. I don't have it in front of me, I'm not sure.

COUNCIL PRESIDENT VERNA: The Chair recognizes Councilman Nutter.

COUNCILMAN NUTTER: Thank you, Madam President.

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I just wanted to maybe suggest that either, as a way of getting some framework around this for Councilwoman Tasco's question, that at some point, if we have either anyone from Revenue or possibly the Law Department give us the background on how does the department or how does the City deal with this particular issue now, if they're dealing with it at all, and how do they make those kinds of determinations, and then use that as a comparison for what will happen going forward, should these bills pass, and what it would mean to the individual.

COUNCIL PRESIDENT VERNA: Do we have someone from the Administration here to testify?

Would you please approach the table.

(Witness comes forward.)

COUNCILWOMAN TASCO: Just tell how it works and the financial impact to the City.

MS. MARX: I'm Nikki Marx, Deputy Revenue Commissioner.

I have testimony here on the subject, which I can either wait till I give my full testimony or just distribute now, but I can also answer your question.

Stock options are considered part of total compensation, and in general, in accordance with the IRS rules, unless they have a readily ascertainable fair-market value, they are not taxed at the time of grant. And IRS requires, in order for them to have a readily ascertainable fair-market value, that they be listed on a -- that they be listed stocks.

We have taken a very -- I don't know whether you would call it aggressive or conservative position, but -- do you want me to give my prepared testimony now or --

COUNCIL PRESIDENT VERNA: Why don't you just walk us through it.

COUNCILWOMAN TASCO: Could she just give us her testimony.

COUNCILWOMAN TASCO: Could she give us her testimony 'cause it opens up the whole discussion for me.

COUNCIL PRESIDENT VERNA: If her testimony is going to do that.

COUNCILWOMAN TASCO: Mm-hmm.

COUNCIL PRESIDENT VERNA: Will your testimony do that?

MS. MARX: Yes.

COUNCIL PRESIDENT VERNA: Then please proceed with your testimony.

MS. MARX: Okay. As written, these bills would exempt stock options that do not have a readily ascertainable fair-market value on the date the stock option is granted from the definition of salaries, wages, commissions, and other compensation subject to wage tax. As was said, Bill No. 451 provides a definition for readily ascertainable fair-market value and I understand -- and also excludes from taxation any gain later realized from the exchange, sale, or disposition of options, whether or not they had a readily ascertainable fair-market value when granted. And as has been indicated, Bill No. 354 will be amended to provide the same definitions.

The Internal Revenue Service defines readily ascertainable fair-market value as being actively traded on an established market. A number of conditions must be met for an option that is not so traded in order to meet IRS standards for having a readily ascertainable fair-market value. These conditions are seldom

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satisfied. As a result, if the option is not actively traded, the IRS considers the taxable event to occur when the stock is purchased or exercised -- or the option is exercised. At that time, the value of the stock purchased, minus any amount paid for the stock or the option, is recognized as ordinary income.

It has generally been assumed that the City followed the IRS on this. This is not correct. The Department of Revenue has been applying a broad interpretation to the definition of readily ascertainable fair-market value. The Department will accept an appraisal that may take into consideration any restrictions placed on the option. Such an appraisal would set a tax -- set the taxable value of the stock at the date of grant when presumably the value is low.

There's also been a general misconception about whether the City has been collecting wage tax on stock options. The City has consistently included stock options in the definition of compensation for the calculation of wage tax. We review records on stock options when performing business tax audits in order to verify compliance.

The City was not affected by the recent court case concerning the inclusion of stock options in the compensation subject to an earned income tax. The state enabling legislation, challenged in the Marshallen case, is not the authorizing legislation for the City's wage tax.

Suburban areas do impose the tax on stock options, just as they do on compensation, but since their rate of tax on compensation is lower, also their rate of tax on stock options is lower, and they do impose the tax generally at the maximum that they're allowed to under the State enabling legislation.

Bill No. 451 and the proposed amendments to 354 provide that any gain from the exercise, exchange, sale, or disposition of stock options, whether or not they had a readily ascertainable fair-market value when granted, shall also not be taxable under this chapter.

There's one concern with this section. If a stock option is not taxed at the time of grant because it has no readily ascertainable fair-market value but, rather, is taxed at the time of exercise, the employee recognizes ordinary income in the amount of the value of the stock purchased, minus any amount paid for the stock or the option. This amount is considered compensation, not gain and, therefore, the section of the bill that says "we will not tax gain" wouldn't prevent taxation because gain has a very specific meaning. And it's not gain that we're taxing, it's -- the option is going to be later taxed, so that term should be changed if these bills are going to be passed and if we want to do what we intended to do.

One of the amendments that --

COUNCILMAN NUTTER: Could you go back over that you said about the amendments?

MS. MARX: One of the amendments that was going to be proposed for Bill 354 is the last sentence of the new Section F that's in Bill 451. And that says that any gain -- and it uses the word "gain" -- from the exercise, exchange, sale, or disposition of stock options, whether or not they had a readily ascertainable fair-market value when granted, shall also not be taxed under this chapter.

I'm suggesting that to do what I believe was the intent to do, that word should be any "compensation" from the exercise, exchange, not any "gain," because if an option is not taxed at the time of grant but later taxed at the time of exercise, that's not considered a gain, that's considered compensation.

And so, if you don't want it to be taxed, we would have to say "any compensation" at that point is not going to be taxed.

COUNCILMAN NUTTER: I'm sorry, and you're in 451 or are you in 354?

MS. MARX: That's -- well, that's the last sentence of 451 that I understand is going to be added as an amendment to 354, because the idea is to make Section F in 354 look the same way Section F looks in 451.

COUNCILMAN NUTTER: 451, right, of course. All right.

MS. MARX: So the amendment would have to be changed and an amendment would have to be introduced to 451 to change that.

COUNCILMAN NUTTER: All right. I don't think we've seen those amendments yet so you might be a little farther along in this.

MS. MARX: Yes. I've gone a little further than the question that was asked.

COUNCILMAN NUTTER: Right.

MS. MARX: Let me just say -- and then I'll go back to the other part -- we understand that this method that I've just described, we understand that Philadelphia's perceived method of taxing stock options has been a concern to start-up companies considering locating in Philadelphia. This legislation -- and while we don't believe that what we're doing really affects them, we understand that they were not aware of how we were taxing it.

This legislation with the two minor changes, one of which I just mentioned and another which I'll go into later, would signal to the business community that Philadelphia welcomes the new economy; and, therefore, with those changes, we would have no problem with the legislation.

COUNCILWOMAN TASCO: Could I continue with my questioning, Madam President?

COUNCIL PRESIDENT VERNA: Yes, please.

COUNCILWOMAN TASCO: So how many

surrounding counties still charge -- is it done by county in terms of the taxation?

MS. MARX: All counties that have an earnings tax or the tax compensation, tax stock options.

COUNCIL PRESIDENT VERNA: But their taxes are much lower.

MS. MARX: Yes. The rate on compensation is much lower, so their rate of tax on stock options is lower. Generally, it's limited to 1 percent.

COUNCILWOMAN TASCO: So is the rate -- would our rate of taxation have to be in line with the wage tax? Would it have to be the same?

MS. MARX: This provision, as well as any other provision, would be a matter of the uniformity clause of the constitution, and the Law Department would have to determine whether you could establish a different rate on different types of compensation. They have, I understand, given an opinion that they believe that you can exclude from tax stock options. Even though the uniformity clause of the Pennsylvania constitution requires all taxes to be equal, they have opined that they could support an exclusion for stock options. I don't know whether the same thing would be true for a different rate on stock options.

COUNCILWOMAN TASCO: So if we don't tax the stock options at all, at any rate, does that make it better for Philadelphia to attract companies here as opposed to the counties, going to the counties?

MS. MARX: I would think so.

COUNCILWOMAN TASCO: Well, if they're still paying a 4 percent or a 4.6 percent sales tax and they still pay a lower tax --

COUNCILMAN NUTTER: Wage tax.

COUNCILWOMAN TASCO: And they still pay a lower tax in the counties, have we done any analysis of what that does to Philadelphia, what that means? Would it still be better to go to the suburbs?

MS. MARX: I think that the industry would have to address that.

MR. KIMMEL: I think it would certainly help, because as I said before, a lot of companies would like to be here but there is an economic reason that it's a hindrance, and if there's anything to help a company to stay here -- as I said, a lot of companies and their employees enjoy being in Center City. At a lot of these companies, people don't work your normal 9-to-5 type hours. Sometimes people will come in at 10 o'clock and then they won't leave their office until 10 o'clock at night, and they want to be able to walk home.

So to be in Center City, this -- it certainly would help. And when I say "Center City," I mean Philadelphia. It would certainly help companies.

COUNCILWOMAN TASCO: What's your name again?

MS. MARX: Nikki Marx.

COUNCILWOMAN TASCO: Miss Marx, you didn't read your testimony, all of it, but you talked about how the City did receive refund requests. Do you know how much money we've collected from any stock options, the financial impact on the City?

MS. MARX: It's not possible to determine the amount of wage tax collected by the

City from the grant of stock options because the compensation is included in the compensation line of their W2. Neither the federal, State, nor the City receive that number broken out.

When the Marshallen case was brought in the suburbs --

COUNCILWOMAN TASCO: What's the Marshallen case?

MS. MARX: The Marshallen case was a case that said that the taxation of stock options was illegal under the State enabling legislation that allows suburbs to impose their tax. It didn't affect us, but some people -- people who knew about the Marshallen decision and didn't realize that it didn't affect us filed refund claims and we received refund claims for four years -- '95, '96, 97 and '98 that totaled 8.3 million.

COUNCILWOMAN TASCO: So we got about 2 million a year.

MS. MARX: About 2 million a year. But, of course, that's only people who knew about Marshallen but didn't know that it didn't affect us. So that is a subset of all of the stock option -- of all of the tax on stock options that we receive. So it's sort of a base but it really doesn't tell us how much there is.

COUNCILWOMAN TASCO: Mm-hmm, okay. Thank you.

COUNCIL PRESIDENT VERNA: I understand that there are three witnesses in the audience that are on a time constraint. If we could just call the three up to the panel, I'd appreciate it. Then we'll get back to the questioning.

COUNCILMAN NUTTER: Sure.

COUNCIL PRESIDENT VERNA: Who are the three witnesses? If they could come up as a panel, if they will.

MR. MCPHERSON: Yeah. Rick Razanski, and Carmen DiCamillo, and Tom Bonnie.

(Witnesses come forward.)

COUNCIL PRESIDENT VERNA: Good afternoon.

MR. RAZANSKI: Good afternoon.

COUNCIL PRESIDENT VERNA: Good afternoon.

MR. RAZANSKI: Good afternoon.

COUNCIL PRESIDENT VERNA: Please

identify yourself for the record.

MR. RAZANSKI: My name is Rick Razanski. I'm the founder, President and CEO of e-Cal Corporation.

MR. DICAMILLO: I'm Carmen DiCamillo, President of VoiceNet.

MR. BONNIE: My name is Tom Bonnie, and I'm the President of Polaris Consulting by day, and by evening, I'm the President of e-Philadelphia, which is a technology lines here in Center City, in Philadelphia County basically a collective group of tech companies.

COUNCIL PRESIDENT VERNA: Are you going to testify, sir?

MR. RAZANSKI: Yes, I'm ready.

As I said, my name is Rick Razanski. I'm the founder, President and CEO of e-Cal Corporation, a locally based Internet calendar communications company. e-Cal this month is three years old and currently employs 250 people. More than 175 of those work in Philadelphia. We employed just 12 people at the beginning of 1999.

Of these people that work in Philadelphia, the vast majority of them live outside the City limits and commute into work each and every day. All of our employees are the life blood of our company and our most valuable asset. We would not exist if it were not for these dedicated people; nor would Philadelphia, I'm sure prosper if it weren't for the millions of other people who work in this great city.

With e-Cal's explosive growth comes the need to expand our base of operations -- specifically, additional real estate to house our staff. It should be noted that e-Cal currently leases about 23,000 square feet of space on Columbus Boulevard and has recently expanded into about 25,000 square feet of additional short-term space at the Penn Mutual building at Fifth and Walnut Streets in Philadelphia. This expansion, however, will not accommodate e-Cal's growth in the future.

Accordingly, and as most of you know, e-Cal is sincerely interested in expanding its operations in Philadelphia and is actively analyzing space near Penn's Landing, in addition to acquiring a parcel at the Philadelphia Naval Business Center.

With all this said, several months ago, an article appeared in the Philadelphia Daily News that spoke of the City's intention to tax employees' stock options. Needless to say, this article sparked significant concern amongst the e-Cal staff and caused numerous requests for us to rethink our position of remaining in Philadelphia.

I must tell you today that I am greatly relieved that the City Council is addressing this issue. We as a Philadelphia-based company have as a matter of law collectively and individually a significant higher tax burden than others have had in other locales. In 1999, we paid $77,000 in wage tax, jumping to more than half a million dollars in wage tax this year alone. What this means is that for e-Cal to recruit the best talent, we are constantly having to explain these additional tax burdens and ultimately increase our wages to negate the issue for our employees. e-Cal cannot continue to supplement wages in this manner much longer.

Stock options are used as a recruiting tool for our employees, not as a way to reduce any wage tax. For example, we have granted in total about $5.3 million in stock options, of which less than 25 percent is in the hands of senior management. The rest is in the hands of the rest of our company employees. The vast majority of the remaining options are distributed to the rest of our employee base, as I spoke of.

And it should be noted that I, in fact, have no options whatsoever in e-Cal. This is a recruitment issue not a compensation issue.

In summary, I believe that the proposed bill is a huge step in the right direction to help Philadelphia attract the most important asset that any city needs to thrive and survive growing businesses with growing workforces. The passage of this bill will surely cause e-Cal to focus on remaining in the City.

Thank you, Council President Verna, for giving us the opportunity to speak on behalf of our employees at e-Cal and other businesses in our great city. I'm also here to answer any questions that you may have.

COUNCIL PRESIDENT VERNA: Thank you.

You indicated your desire to expand

your business. If you were to do that, how many people would you employee?

MR. RAZANSKI: Like I said, we currently employee 250 worldwide, with approximately 170 here in Philadelphia. That number was 12 at the beginning of 1999, and our growth is not impeding in any respect, so I would say that if you look the at our track record, we would probably double that in the next year.

COUNCIL PRESIDENT VERNA: And would you be offering stock options to the new employees?

MR. RAZANSKI: That is absolutely correct. Again, it's a recruitment tool. Every employee in our organization has stock options, ranging from the people that clean up at night to, you know, our chief financial officer.

COUNCIL PRESIDENT VERNA: What do you think the long-term effect would be if we do not pass this legislation?

MR. RAZANSKI: All I can say is that it gets harder and harder for us to recruit the best people to stay in Philadelphia, with all of the tax burdens that are in effect in Philadelphia today. On an ongoing standpoint, if there are other options to move the company to other places where these burdens are nonexistent, I think that that would be something that we would look at, or any other company would look at in the future.

COUNCIL PRESIDENT VERNA: Thank you.

Are there any questions from members of the committee?

(No questions.)

COUNCIL PRESIDENT VERNA: Thank you.

Please proceed with your testimony.

MR. DICAMILLO: Madam President and Councilmembers, it's a privilege to have this opportunity to discuss the tremendous impact that Bills 336, 354 and 451 will have on the City of Philadelphia's economy.

My name is Carmen DiCamillo. I'm President and founder of VoiceNet, the region's largest Internet service provider and an emerging national communications provider. I'm also a native of Philadelphia.

I'd like to begin with a few statistics regarding the technology industry.

High technology has driven more than a quarter of all economic growth since 1993. Technology-related ventures turbocharged the country's productivity doubling from 1.4 percent annual increase between 1973 to 1975 to 2.8 percent growth between the years 1995 and 1999.

Our country's increased reliance on IT or information technology-oriented businesses has lowered inflation and created highways jobs for U.S. workers. A University of Texas study claims 36 percent job growth from 1998 to '99, growing from 1.8 million to nearly 2.5 million jobs.

Quoting Sysco Systems Chief Executive Officer, John Chambers, "The Internet will change the nature of economies, education, domestic and social life. It's time for Philadelphia to join the technology revolution by embracing initiatives to attract and maintain e-businesses."

The Philadelphia suburbs have enjoyed high profile Internet and technology companies and felt the surge of new revenues from this attractive tax base. The suburbs team with venture capital groups, e-retailers, Internet start-ups and budding communication companies.

Last summer Voicenet made an important strategic decision to relocate significant portions of our business to Center City from our company's Ivyland, Bucks County headquarters. Before I detail that decision, let me tell you a little about Voicenet.

We were formed in 1990 when the Internet was virtually unknown. We've been around for about ten years. We have grown into what's called a Tier 1 provider, a designation reserved for about one percent of all Internet providers. To our customers, this translates into the fastest, most reliable Internet connections available.

Some of our larger customers include the Pennsylvania State System of Higher Education, which includes all publicly-funded colleges and universities in the Commonwealth of Pennsylvania, as well as Federal Reserve Bank, University of Delaware, in addition to thousands of small and mid-sized businesses throughout the region.

We're also growing a significant

book of businesses throughout the U.S. by offering these innovative services. Voicenet currently has about 40 percent of its work force based out of Philadelphia; our sales and marketing office located in the Mellon Independence Center at 7th and Market.

These are newly-created jobs. They include folks such as inside and outside sales representatives, marketing executives and administrative staff. Our decision to relocate sales and marketing from Bucks County to Philadelphia was designed to access a larger job pool.

As many of you are aware, human resources are scarce in today's economy. Qualified, experienced, dedicated employees are precious commodities. Recruiting and retaining this type of worker is a goal. Meanwhile, we recognize the importance of attracting, training and nurturing employees who are new to the technology field. By promoting a positive learning culture, we've been rather successful in finding good, hard-working associates.

Our Center City location affords

luxuries of a reliable transportation system, a safe, attractive work environment with all the amenities of a world-class city, including parks, restaurants, shopping and lodging accommodations.

Additionally, the City's premiere colleges and universities produce qualified graduates, many skilled in technology and seeking these desirable positions.

Overall, Voicenet's experience in Philadelphia has been very positive. We've had success finding employees from office staff to executives. Recently we've contemplated moving even more departments into Philadelphia, including more technical positions such as systems administration, network operations and customer support.

A move of this magnitude is a major decision for our company. However, the cost of doing business in the City of Philadelphia is extremely high. Pro-business plans similar to the bills we are discussing today reduce these barriers of entering into Philadelphia, and make Philadelphia a much more appealing location for doing business.

Bill 336 would be a pro-active move towards attracting technology-based businesses to Philadelphia. The abatement could be considered an investment in Philadelphia's economy since businesses that would emerge or relocate to the City would more likely produce higher salary positions. As the statistics I mentioned in the beginning of my statement professed, the number of jobs that will be created would be enormous.

My recent discussions with potential investors have centered on Voicenet's network and products. There have been pointed questions regarding human resources and our ability to attract and maintain a qualified, productive work force.

Bills 354 and 451 will certainly play a key role in our business decision and will make Philadelphia a more attractive City to allure prospective employees. At this time, Voicenet is a privately-held company; however, we recognize the value of offering incentives such as options to potential employees.

Employees in this technology field

are in great demand. Most applicants are savvy negotiators seeking high salaries, bonuses and options. Presently this is a difficult sell for Philadelphia-based firms. Why would a perspective employee even consider a position if his or her option would be taxed, not to mention a higher wage tax, if offers from suburban firms were on the table?

If Philadelphia is seriously vying to attract technology companies, this bill must be passed to attract and maintain a high-quality, skilled work force. These initiatives recognize the value of a techno-sentric economy making Philadelphia a viable location for businesses that occupy this space.

We've witnessed tremendous wealth and prosperity and quality of life generated in a region surrounding the Silicon Valley and the technology hot beds of Virginia and Seattle. What City will be next to prosper by this technology revolution? I believe the decision is yours.

A vote for these bills paves the way for Philadelphia to become a more technologically friendly City.

Thank you for this opportunity.

COUNCIL PRESIDENT VERNA: Thank you. I did hear you say that 40 percent of your employees do, in fact, work in Philadelphia. How many employees are there?

MR. DICAMILLO: Currently there are about 35 or 40 jobs.

COUNCIL PRESIDENT VERNA: What percentage of your employees have stock options?

MR. DICAMILLO: Currently, now about five to ten percent. That number will be expanded as we move forward.

COUNCIL PRESIDENT VERNA: If this bill were passed, do you have any intentions of expanding your business in Philadelphia?

MR. DICAMILLO: Well, frankly, we are at this very stage contemplating whether to move additional folks from our Bucks County location into Philadelphia.

Over the next five years we project creating about a thousand new jobs. A very significant consideration right now for us is the cost of bringing this business into

Philadelphia.

COUNCIL PRESIDENT VERNA: Thank you. Just tell us, why do people want stock options?

MR. DICAMILLO: Well, technologists in the technology arena feel that they want to have a vested interest in the project that they're working on. They feel they can put time and energy, work around the clock, accomplish great things. If they accomplish great things, they should receive benefits as well.

COUNCIL PRESIDENT VERNA: Thank you.

Are there any questions of this witness?

(No questions.)

COUNCIL PRESIDENT VERNA: Kindly identify yourself again, because we have a new stenographer now.

MR. BONNEY: I'm Tom Bonney. I appreciate the opportunity to speak today on these matters.

I'm the President of Polaris Consulting. We are a Center-City-based technology consulting firm employing about 35 full-time employees at 7th and Spring Garden.

We started our business in 1996, and actually moved into offices over on 7th and Spring Garden with three people. We moved out of a loft department and into proper office space. Since then, we've grown our business through no venture money, but just through a bootstrap operation.

The two bills that are before us here, the Gross Receipts Bill and also the Stock Options Bill have relevance to my company today because we do have a stock option plan in which 100 percent of our employees participate. Also, the Gross Receipts Tax is something that I signed a check for.

Just to give you an idea of the thought process behind the entrepreneur in regards to the Gross Receipts Tax, I think we paid about $13,000 or $14,000 this year in gross receipts tax. My thought process is I back into the amount of revenue that I had to go and get to actually drop $13,000 to the bottom. When I think about that, to me it's a big number.

In addition to my role as

president of Polaris Consulting, I'm also the president of e-Philadelphia, which is a 501C6 organization focused on technology companies here in Philadelphia County.

In mid 1999, we actually did the survey of our members. We have about 50 members in the technology community. We found a couple of things; one, through the survey, the 50 members basically represented about 1200 jobs here in Philadelphia County, and that the average salary at these companies was $50,000.

What we found was the whole indeed was greater than some of its part. The third item we found was that taxes were a real burden for the community, and a significant decision-making factor in having companies locate here in Philadelphia.

With respect to why we at Polaris decided to locate in Center City, our management team -- I'll call them urbanites -- we like the City. All things being equal, we would prefer to be here. The economics associated with the Wage Tax and the Gross Receipts Tax in particular calls us to reflect on that at times.

When I was reading the paper this morning, I read that Half.com, which is a one-year-old Internet start-up located in Conshohocken, was sold to e-Bay for somewhere around $300 million. I was reminded of a quote that the CEO of that company had that was in the Philadelphia Daily News, that he had actually considered locating in Manyunk, but because of the Gross Receipts Tax actually chose to locate in Conshohocken.

So the relevance for the City is that right now the Philadelphia area -- a good thing -- has a subsidiary of e-Bay located in the area. The downside for Philadelphia County is that that could have been here.

In summary, for our industry and for our company, as the other two gentlemen have indicated, our assets are our people. Our people are mobile. Our knowledge is everything.

The passage of these two bills here before Council can help us to attract and retain employees here in the City and continue to grow our businesses here in the City.

Thank you for the opportunity to

speak.

COUNCIL PRESIDENT VERNA: Thank you very much. Any questions?

(No questions.)

COUNCIL PRESIDENT VERNA: Our next witness is Charlie Pizzi. Good afternoon and welcome.

MR. PIZZI: Madam President, Members of City Council, with me are Joe Mahoney, Senior Vice President for Public Policy, and Ashly Andrews, our Administrator and Director of City Public Policy.

I would just like to say that the Chamber of Commerce, which represents 6300 members, is enthusiastically supportive of Bills 336, 354 and 451. Rather, if you will allow me, Madam President, not speak from the text, because I really need to speak to you from...

COUNCIL PRESIDENT VERNA: From your heart.

MR. PIZZI: That's what I was thinking of. It's been since 1975 that I've been working in one capacity or another to try to bring jobs to this City.

As we know, there have been past City Councils and administrations which would never have phathomed the idea that Philadelphia is no longer the center of business. They have shifted. It's moved out to the northwest or the west. We're not the center of that.

Yet I would equate these bills' importance to the important bill this Council and the past administration had in 1993, approximately eight years ago when they placed the PICA legislation, which ensured our survival as well. It's not only ensured our survival, it ensured a foundation in which we could really reinvent ourselves.

These bills will ensure our future growth. I want to say to the Members of City Council and the administration, by doing this you send the strongest of signals to the business community, to the investors who are closely monitoring what is happening under a new administration and new City Council, that this is going to be a competitive city.

We can become competitive for the first time in a long time with our suburban neighbors by ensuring the growth of jobs. This is essentially not about companies; it is really about jobs for the residents of our City, who also have left.

In 1960, we had over 2 million people. Today, we have a million four. The people follow their jobs. As you know, Madam President, you have worked hard for economic development in your district and you have seen how it has transcended to something we think we can renew now. That's why I want to give you a lot of credit.

This sends an incredibly strong signal. I was just at lunch with two major investors who are watching and looking at what is happening in Philadelphia. This can also have a very strong positive effect on our neighborhoods with the keystone opportunities zones you pass with the State, where dot com companies, technology companies would say this is a great place to work. And we can then anchor on to our universities in our neighborhoods.

Essentially, our universities are really our manufacturing sector back in the '50s and '60s. The universities are the ones today providing jobs, which are also springboarding companies for high-technology companies.

This means just as much in those neighborhoods in West Philadelphia, North Philadelphia, Northwest Philadelphia and South Philadelphia as it does in downtown. This is a bill that's good for everyone. It does take some courage.

There is some risk in this. That means we have to control our City budget so that we don't anticipate the needs of these funds. But I can tell you, throughout the years we only have to look at the importance that this will play to the growth of this City and the job base that we have in this City.

This sends an incredibly strong signal. As I said, this legislation, this administration, the Street Administration along with City Council will send an incredibly strong signal that we want to be competitive, we want your jobs; therefore, we want our people to work. That's the bottom line.

I now would be happy to answer any

questions on the technicalities of the bills.

COUNCIL PRESIDENT VERNA: If this were passed today, do you think the two gentlemen you had lunch with would locate in the City if they're not already here? If they are here, would they be interested in expanding their business?

MR. PIZZI: I think what would happen is that the price, the value of property in the City would go up; and therefore, they would get a larger return on their investment, so absolutely.

COUNCIL PRESIDENT VERNA: So would we.

MR. PIZZI: Yes, we would.

COUNCIL PRESIDENT VERNA: Thank you. Any questions of Mr. Pizzi?

(No questions.)

COUNCIL PRESIDENT VERNA: Good afternoon, Mr. Ellison.

MR. ELLISON: Good afternoon. I'm Keith Ellison. I'm the director of Consulting Services at the Wharton Small Business Development Center. We represent a little over a thousand SBDCs throughout the country. There are 16 here in Pennsylvania, two in the City. Temple has one as well.

Our mission is we teach people how to be entrepreneurs and we teach entrepreneurs how to be better. We provide consulting services. That means we help write business plans as well as conduct feasibility studies, assist with marketing research. We also have a series of seminars and classes for people who have existing businesses and who want to go in business.

I fully support these bills that are on the table, particularly for technology firms, but really for any kind of business. Let's talk about the Business Privilege Tax.

Most of the companies that come to us, about 30 percent are within the first year or two of being in business. They're taking a loss. They have all kinds of struggles. They're trying to grow. The Business Privilege Tax, relaxing it, particularly for high-tech companies, makes the burden of growing the business a lot easier to deal with.

COUNCIL PRESIDENT VERNA: Mr. Ellison, I think you deserve a little more respect than you're getting. The noise level is much too high.

MR. ELLISON: Thank you.

Our consultants are MBA students from the Wharton School. They look for jobs. Most of the MBAs -- we have about 1500. The hottest thing right now are high-tech Internet start-up companies. What really brings them in and induces them to join those firms are the stock options.

One of the biggest complaints in the investment community here is that all the MBAs are going out to the Silicon Valley, New York or Massachusetts. I strongly believe that the bill to relax the taxes on the stock options would strongly encourage some of this talent to stay here in Philadelphia.

That is my testimony. Thanks a lot for allowing me to testify. I'll handle any questions you may have.

COUNCIL PRESIDENT VERNA: Thank you. The Chair recognizes Councilman Kenney.

COUNCILMAN KENNEY: One quick question. I believe that the passing of these three bills will certainly improve our standing in competitiveness in the region. What will it do from a national perspective, do you believe, as far as changing the image of the City and the region on a national level?

MR. ELLISON: I think it would improve. I think it would be a very good starting point to improve our reputation as a City.

Again, most of the talent, the MBA talent as well as technical talent, is leaving the City as well as the State. The last statistic I heard is the State of Pennsylvania has a negative growth rate of about three or four percent.

These kinds of pro-incentives would solidify and help build our reputation that we are open to the new economy and we are an innovative City.

COUNCILMAN KENNEY: Thank you.

COUNCIL PRESIDENT VERNA: Any other questions?

(No questions.)

Thank you for coming.

COUNCIL PRESIDENT VERNA: Is Mr. Melchionni present?

(No response.)

COUNCIL PRESIDENT VERNA: Good afternoon.

MR. DANA: Good afternoon. My name is William Dana. I'm the chief administration officer of Ben Franklin Technology Centers of Southeastern Pennsylvania. With me is Rich Miller, Vice President of Marketing of Ben Franklin. We're pleased to be here this afternoon to testify in favor of Bills 336, 354 and 451.

I have been the chief administrative officer of Ben Franklin for about two months now. Previously in my career I was a partner at Coopers and Lybrand both in the Philadelphia and Baltimore offices and worked with a number of emerging business clients in those locations.

Ben Franklin partnerships were created by the Pennsylvania General Assembly in 1982 to promote technological innovation in order to spur our economic growth and prosperity in the Commonwealth. The partnership consists of four non-profits, of which Ben Franklin here in

Philadelphia is the largest. We're located at 1835 Market Street.

We fund various early-stage companies at the very beginning part of their lives. Just as importantly, we provide significant consultation related to programs, business planning, innovation, marketing, organizational structure and technology.

Last year we commissioned a study to be done of the partnerships, and I wanted to hit on some of the results of that study and the impact the technology had on the State of Pennsylvania.

One point was that on the average, our clients employed five more people each year than funding from other sources. Every public dollar that was invested in the Ben Franklin program yielded almost $14 more of additional income in the State.

Also, we had a positive impact on the State revenues. The State increased $168 million in tax revenue during 1989 and 1996. We have made a difference. Technology companies have made a difference in the economic growth of the State.

Almost all of our clients have stock option plans. And they...

(Inaudible.)

MR. DANA: I would say almost a hundred percent of our beginning companies have some form of stock option plan which is used to bring in qualified employees or staff into their companies.

MR. MILLER: As the marketing director and vice president for communications for our companies, it is critical, as you've heard in the testimony, that the quality of life in Philadelphia and the City of Philadelphia meets the needs of these young companies, the technology resources available through the Eastern Technology Council, Ben Franklin Partners and several other areas and research centers meet the needs of these young companies.

Third, the educational infrastructure is critical so these companies can grow and have the resources to do it. Part of the issues that you've heard and have been discussed today is the growth and retention of the employees in these companies. For us, as Mr. Rosansky obviously talked about, the e-Cal company was a part of Ben Franklin program that grew out of four employees to the number of employees it has.

The three major issues that are at stake today are critical for the growth of the new economy in the City of Philadelphia. Thank you very much.

COUNCIL PRESIDENT VERNA: Any questions from Members of the Committee?

(No questions.)

COUNCIL PRESIDENT VERNA: Do we have any other witnesses to testify on any of the bills before us?

(No response.)

COUNCIL PRESIDENT VERNA: I would ask the representative from the revenue department approach the table again.

(Representative takes witness seat.)

COUNCIL PRESIDENT VERNA: I must tell you something. This truly upsets me in that we introduced these bills on May 18th, and I don't know that was any secret. It certainly wasn't any secret this hearing was being held today. We did not receive your testimony until you appeared in this Chamber today, and when you come in you tell us there are some concerns. I truly resent that.

MS. MARX: I'm sorry. I didn't know until yesterday that our testimony was needed. We were in Boston last week at a conference.

COUNCIL PRESIDENT VERNA: Who in the department would be handling that?

MS. MARX: There was some miscommunication. I apologize.

COUNCIL PRESIDENT VERNA: That's happening much too frequently lately. I resent how this is being handled.

Would you proceed with what you were testifying to earlier.

MS. MARX: Yes. On Bills No. 354 and 451, I just wanted to add that the other change that we were suggesting was that Section 2 of the bill...

COUNCIL PRESIDENT VERNA: Do you have copies of the proposed changes that you're suggesting so we can have it before us?

MS. MARX: No. We didn't write them up. I did discuss them with someone from your organization. They're very simple changes.

COUNCIL PRESIDENT VERNA: We're not going to do business like this in the future. You're suggesting some changes in Bill No. 354. Is that what I understand you to say?

MS. MARX: Yes.

COUNCIL PRESIDENT VERNA: What are those changes, please?

MS. MARX: The changes in the amendment to 354 and also to 451 as it exists is merely that the last sentence of Section F which says, "Any gain from the exercise, exchange, sale, et cetera," be changed to read, "Any amount that would otherwise be considered compensation from the exercise, exchange, sale or disposition."

COUNCIL PRESIDENT VERNA: The Chair recognizes Councilman Nutter.

COUNCILMAN NUTTER: I'm trying to follow Ms. Marx. Are you talking about what was just handed out a little while ago, Proposed Amendment to 354?

MS. MARX: Yes.

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COUNCILMAN NUTTER: We're going through the pieces of that?

COUNCIL PRESIDENT VERNA: Apparently.

MS. MARX: It's also in 451 as it was originally introduced, that same language.

COUNCILMAN NUTTER: You're saying the language you want to put in 354 already exists in 451?

MS. MARX: No. That same section of 451 would have to be changed. It's the last sentence of F in 451, which says, "Any gain from the exercise, exchange." I'm just suggesting that the term "any gain" be replaced with the phrase that I stated. That also has to be changed in amendment to 354, which is supposed to confirm 354 to the existing 451.

COUNCILMAN NUTTER: Do you have written new language?

MS. MARX: I can provide it in a matter of -- I have it now in a way only I can understand it. I could have it written out in English in a matter of a minute.

COUNCILMAN NUTTER: That would probably be wonderful.

COUNCIL PRESIDENT VERNA: Will you

have someone write that?

MS. MARX: Yes.

COUNCILMAN NUTTER: While that's being done, can you tell me what the actual language is?

MS. MARX: What the corrected language is?

COUNCILMAN NUTTER: What do you want it to say?

MS. MARX: I just gave that away.

The language would be in that last sentence of F, "Any amount that would otherwise be considered compensation from the exercise, exchange, sale or disposition of stock options, whether or not they had a readily ascertainable fair market value and granted will not be taxable under this chapter."

COUNCIL PRESIDENT VERNA: Councilman, that verbiage appears in Bill No. 451 on the second page under Section F.

COUNCILMAN NUTTER: I was reading that, but I'm getting from Ms. Marx's testimony that even Bill 451 apparently needs an amendment also.

MS. MARX: That's correct.

COUNCILMAN NUTTER: Ms. Marx is

proposing new language for 451, even though we believed that apparently 451 was okay. She originally wanted us to change 354 to comport with 451, but now Ms. Marx is saying that even 451, as well as 354 will both need new amendments.

Is that what you're saying?

MS. MARX: In effect, yes. The proposal here was to make 354 read like 451. I'm suggesting a change to 451, that will then be incorporated in the proposed amendment to make 354 read like 451.

COUNCIL PRESIDENT VERNA: We have our technical staff that has been looking into this since our witness' prior testimony and they are going to be circulating proposed amendments.

MS. MARX: The other change is just one word. I did talk to your staff about it.

COUNCILMAN NUTTER: Okay.

MS. MARX: The only other thing I wanted to say about this bill, particularly 451, again is we support it, but we do have concerns about the effect on the PICA bonds. Those would have to be resolved before we could give full support to it.

COUNCILMAN NUTTER: Ms. Marx, your

last statement was that you have a -- tell me what your last concern was again.

MS. MARX: Our last concern is merely that we not interfere with the agreements on the bonds that PICA issued through this legislation.

Our PICA agreement says we will not reduce any of the taxes that are to support the bonds that PICA issued. There's some concern that this is a reduction in tax that might violate that agreement.

COUNCILMAN NUTTER: One, I think, as the President mentioned earlier, this bill and the companion bill to this -- you're now speaking specifically, I guess, of Bill 451?

MS. MARX: Correct.

COUNCILMAN NUTTER: 354 was introduced on May 18th, which was almost a month ago. Did anyone have any concern about that at that time?

MS. MARX: As I said, there were communication problems as to whether the hearing was going to be held now on these bills.

COUNCILMAN NUTTER: Were the stock options a part of the tax calculation or the support for the PICA bonds at the time that the PICA bonds were quoted?

MS. MARX: Yes.

COUNCILMAN NUTTER: You're saying still at this point you don't have clarity or definitive response from either revenue or the law department on this particular issue?

MS. MARX: Correct. I understand that council's staff has informally approached PICA and bond council and has received some preliminary assurances that this might not be a problem, but nothing definite.

COUNCILMAN NUTTER: There has to be an answer to the question, right?

MS. MARX: Yes. I don't know that a formal opinion was requested.

COUNCILMAN NUTTER: What's the worst case scenario if this is passed?

MS. MARX: It would be a violation of the PICA ordinance and/or the PICA agreement.

COUNCILMAN NUTTER: Doesn't that just mean you wouldn't be able to exempt the PICA portion of the wage tax on the stock option tax calculation?

MS. MARX: I'm not sure that we could split it that way. I don't know. We have never considered that as an alternative when we have considered something to be a reduction in tax that might affect PICA.

COUNCILMAN NUTTER: Well, if we didn't have Bill 451 and only passed 354, what would be the effect of that?

MS. MARX: A great deal of complication on the part of the taxpayers who had to pay the tax. They would have to break out of the total compensation package the portion that was due the stock options and then calculate a different rate of tax on that than they do -- and we would have to receive that separately, because we'd have to make sure that -- right now when we receive revenue from the wage tax, we split it in its percentage.

We would have to have a separate pot for the non-PICA piece, if it could be done legally.

COUNCILMAN NUTTER: Thank you very much.

MS. MARX: You're welcome.

COUNCIL PRESIDENT VERNA: Let me ask you just one final question, if I may. Do you think that the vigorous collection of the tax as we presently have would hurt the City in attracting new companies to locate in Philadelphia?

MS. MARX: I didn't hear the beginning of the question.

COUNCIL PRESIDENT VERNA: Do you think that bigger selection of this tax would hurt the City in attracting more companies to locate in Philadelphia?

MS. MARX: I would be interested to hear what the companies would say if they were aware of how we were currently taxing stock options.

I think most of them are under the impression that we tax them the way the Internal Revenue Service taxes them. I would be curious to know whether -- if they knew that we will tax the stock at grant based on a low value, whether that would affect their decision.

I think full taxation the way IRS taxes it probably does affect that decision. But I don't know if an individual would separate stock options from wage tax. Our wage tax is higher than anywhere else. If they're going to object to a tax on stock options, they're also going to object to the higher wage tax on all of their compensation.

COUNCIL PRESIDENT VERNA: Ms. Marx, for the record, are you for or opposed to any one of the three bills before us?

MS. MARX: I haven't really said anything about the third bill, which I believe is the technology bill. I haven't specifically addressed that. We have greater problems with that.

As far as the stock option bill...

COUNCIL PRESIDENT VERNA: You're referring to what bill?

MS. MARX: 000336. Is that the third bill you're considering?

COUNCIL PRESIDENT VERNA: Yes.

MS. MARX: I have testimony on that bill, also.

COUNCIL PRESIDENT VERNA: It would be very nice for you to share it with us, since we're supposed to get it 48 hours in advance.

MS. MARX: I'm sorry. I also have testimony on two other bills you're scheduled to hear today at the 2:00 o'clock meeting, if you want those distributed.

COUNCIL PRESIDENT VERNA: No. We're

just considering three bills at the present time.

MS. MARX: To answer your question, with the two changes that were proposed, we are not opposed to 000354 and 451. We're not opposed to those.

Bill No. 336 would add a definition -- 336 amends the Business Privilege Tax by adding a definition of an information technology company and by excluding the receipts of such companies from tax.

I'd like to begin by reiterating the administration's support for providing targeted incentives to encourage new businesses to locate in Philadelphia subject to the need for uniformity under the Pennsylvania Constitution and the limits of the First Class City Business Tax Reform Act, which authorizes the BPT.

There are several things that make review and analysis of this bill difficult. Our understanding is that the bill was intended to aid new economy start-up firms. As drafted, however, there's nothing in the bill that would limit its application to new firms.

Any company that classified itself

as being in the designated codes would qualify for exemption. It's unclear whether the phrase "specific business conducted" is intended to limit the exclusion to the information technology activities of the business, or if all receipts of a business categorized as an information technology company would be excluded. It's also not clear what is added by inserting the phrase "the portion of receipts."

There are also problems related to the use of the North American Industry Classification, NAIC, Codes that are used to identify the primary activity or nature of a business. The codes were established to measure broad economic trends, and they are not generally used to classify specific transactions such as the apportionment of tax receipts.

Without penalties for mischaracterization, businesses would be in a position to simply declare themselves as information technology companies in order to avoid payment of the BPT.

The bill also specifies that the tax exclusion will be effective for tax years

2001 through and including 2006. If the intent is to provide tax relief for six years for start-up firms, this language will need to be changed.

This approach would not provide a six-year exclusion for a firm that started to do business in Philadelphia in 2003. The bill as introduced will provide tax relief for only four years for such a firm. The obvious question for the Department of Revenue regarding this bill is how much current revenue would this City forego if this bill were enacted.

Revenue currently uses standard industrial classification codes, SIC codes, to categorize businesses by sector for economical analysis. NAIC codes were established by the office of management and budget in 1997, but these codes are just now being phased in by users to replace the SIC codes.

The bridge between the two classification systems is at the broad business sector level, and in many instances, especially with the newer technology-related categories, there is no bridge.

Revenue will be initiating a project within the next year to add NAIC codes to our taxpayer identification files, but this will take many months of manual effort to complete.

We would like to work with Council to come up with definitions and other aspects of the technology company that we could support. We were hoping to do this over the summer and have a bill out by the fall.

COUNCIL PRESIDENT VERNA: Chair recognizes Councilman Kenney.

COUNCILMAN KENNEY: Thank you. Listening to this testimony I, too, would have some concern about the issues that have been raised by the representative of the revenue department. Unless the fact that the law department hadn't written the definition for technology company...

Additionally, the opportunity to lie or to misrepresent your company now under the provisions of the Gross Receipts Tax exists. If you are a real estate sales company, you could claim that you're an information technology company. The way in which that's assured is the audit portion which would uncover that, and then

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that information would be adjusted and you would be taxed accordingly.

You could claim you're a retailer, a wholesaler, or an information technology company. You could lie about it, but the audit function of the revenue department would uncover that information and you would be taxed accordingly.

The information technology definition was written by the law department, and we reintroduced a bill on a later date in order to correct that problem. My information from the law department, my consultation and information the law department has given me is we are covered both definitionally and covered from an audit function.

In fact, the problems you are raising exist today within any company that claims they're either a wholesaler or retailer and they may not be either. I don't understand what the delay for the summer would do to change that situation. I've got confidence in the instance the law department has written a definition of ITC, information technology company, in a correct way.

Thank you.

MS. MARX: May I respond?

COUNCIL PRESIDENT VERNA: Please do.

MS. MARX: Currently, you're correct. There is some tax advantage to calling yourself a wholesaler or retailer. That's generally a more obvious type of business.

There is no benefit today to calling yourself a technology company or anything else, neither in the Internal Revenue Code or State or in the City. We do not allow people to use the benefits of being a wholesaler or retailer based on how they've classified their SIC code.

They may or may not put down an SIC code when they apply for a Business Privilege Tax or Business Privilege License. We still grant them the license. We have done a very large project over the last year of going through and trying to identify SIC codes for all of our taxpayers so that we could use that in an economic analysis, much of which was requested by Council.

There are broad methods the IRS gives for classifying yourself. The incentive to lie about being a wholesaler or retailer is much smaller than the incentive to claim -- I don't mean lie, but I just mean claim you're an information technology company even though it may be a very small part of your business.

To be completely excluded from tax gives you much greater incentive to take some small portion of your business and claim you're a technology company than the different tax method that we allow the wholesalers and retailers, which is a very small difference in tax.

COUNCIL PRESIDENT VERNA: The Chair recognizes Councilman Kenney.

COUNCILMAN KENNEY: Thank you. I understand what you're saying. But if I look at the definition again provided to us by the law department and reintroduced as part of this new bill, it is very specific as to the functions that the definition concludes is an information technology company.

It says, "A person whose business is categorized as electronic data processing services, computer system design and related services, custom computer programming services, computer facilities management services and online information services as set forth in North American Industry Classification System."

If you have a deli guy who claims he's an information technology company in order to beat the tax, I'm sure you'll be able to determine that's the case. I don't imagine there's going to be literally thousands of companies applying for this exemption; should be enough, a manageable number of companies, to determine if, in fact, by determination of audit they are, in fact, an information technology helper.

Madam President, I want to re-echo something you said. These bills have been in the administration's hands for quite some time. The first contact I received was a short, three-paragraph memo yesterday from Ms. Marx, really not telling me anything other than they wanted to hold the bill. I think that could have been done. We may have been able to work out some of the concerns the Administration allegedly now has if we had dealt with this three weeks ago.

I think at this late date, with the calendar looming the way it is, I don't think it's appropriate that we start -- the law department has been clear. I think the people testifying from the business community are clear. This is a special circumstance we're trying to create for a special type of company that we're trying to attract to the City of Philadelphia, in its infant stages.

If you guys didn't read the bill or do any analysis in the last three weeks, what gives me any level of comfort you're going to do anything between now and September? I don't see the rationale, frankly.

MS. MARX: I apologize for the communication problems that we've had. The law department that wrote this doesn't always know how our systems are set up. We don't have NAIC in our systems. We say any person whose business is categorized, but that's a self-categorization.

To say ABC Grocery, yes, we would probably figure if they tried to categorize themselves as an electronic data processing service, we would know. But ABC Company or XYZ Company, we would have no way of knowing.

COUNCILMAN KENNEY: Wouldn't you still have the capability of auditing those businesses?

MS. MARX: Yes.

COUNCILMAN KENNEY: Wouldn't we be able to determine the potential fraud based on the audit?

People misrepresent their federal taxes all the time. It's not until they get audited do they get caught and have to pay a fine and back taxes. I'm sure there's a lot of misrepresentation going on or interpretation by accountants and others that people would have objection to.

If you're looking for an absolutely perfect system where no one is going to misrepresent their company or taxes or their receipts, I don't think you'll find that or we wouldn't have a need for IRS agents.

MS. MARX: We do do audits, but obviously we don't audit everyone. When we select our audits, we use various methods of categorizing companies we should be auditing.

This would have to be put into that. The concern is that a company that might be borderline, an accounting firm, for example, that does some consulting and, therefore, does some services could very well classify themselves in one of these codes and, therefore, would be exempt from taxes they're currently paying.

This is meant to benefit new technology companies and to try to get new industry into the City. It's not necessarily going to do it by using these definitions, because there are a lot of -- we don't know how many, but there are a lot of existing companies that could qualify and could, therefore, claim even though they have been paying this tax in the past, they won't pay it in the future.

COUNCILMAN KENNEY: My suggestion is we deal with that as it goes, do the audits, correct what needs to be corrected as we go along and let's get moving.

Quite frankly, if the revenue department in the administration was that interested in solving the problem, they would have contacted myself or Council's staff a number of weeks ago as opposed to today.

Thank you.

COUNCIL PRESIDENT VERNA: The chair recognizes Councilman Nutter.

COUNCILMAN NUTTER: Ms. Marx, are you aware of any other city or county or municipality that has proposed or, in fact, done what we're proposing to do today through any of these bills?

MS. MARX: I'm not aware of anyone who has tried to use either NAIC or SIC to classify taxable receipts.

COUNCILMAN NUTTER: I'm talking in the broader category of exempting stock options from a particular tax or trying to provide a rather narrow incentive to a particular industry or business sector to invite them to make a better business environment for certain types of industries to come to a particular city.

MS. MARX: I'm not aware. Certainly none in the State of Pennsylvania have done it, merely because of uniformity concerns and other problems.

I'm told there are some other states that have done -- have attempted to do this. One case I see here is New Mexico has enacted a technology jobs tax credit. So they've tried to do it through the credit method.

Certainly, we could look and see if there are others who've done it in other ways. This is just one example of the way one state has tried to do it.

COUNCILMAN NUTTER: In all your experience, and I understand you're trying to do the best you can under apparently some rather difficult circumstances, this is not impossible?

MS. MARX: Correct. We agree with the idea of trying to do something to try to encourage these businesses. We certainly are in favor of that. I'm not sure the NAIC method, without some kind of penalty -- the other thing would be to put in some kind of penalty that said if you misclassify, you'd be subject to a greater penalty.

Otherwise, they can misclassify themselves and if we catch them, fine; if we don't, they've gotten away with it. There's better ways of doing it than this method. We do have problems in this State mainly because of the uniformity clause.

But I think we could still get around that and do this. We would very much be in favor of doing it. We would like to have a little more time to consider it.

COUNCILMAN NUTTER: I understand.

COUNCIL PRESIDENT VERNA: Any other questions or comments?

(No questions.)

COUNCIL PRESIDENT VERNA: At this point, I would request that our technical staff Messrs. Auerbach and Ericson please approach the witness table. Ms. Marx, I suggest you stay at the witness table.

(Mr. Owerback and Mr. Ericson come forward.)

COUNCIL PRESIDENT VERNA: I understand you have proposed amendments to Bill No. 354?

THE WITNESS: Yes. There are amendments to both Bills 354 and 451.

COUNCIL PRESIDENT VERNA: Please read them for the record.

SPEAKER: Starting with the proposed amendment to Bill 451, Amendment No. 1 in Subsection 19-280211 (F) amended the last sentence so it reads as follows: "Any amount that would otherwise be considered as compensation arising from the exercise, exchange, sale or disposition of stock options, whether or not they had a readily ascertainable fair market value when granted, shall not be taxable under this chapter."

Amendment No. 2, amend the second sentence of Section 2 of the bill so that it reads as follows: "The provisions of Subsection 19-280211 (F) of the Philadelphia Code as added by Section 1 of this ordinance exempting certain stock options from tax shall apply only to stock options that are granted after the date this ordinance takes effect and to stock options that are exercised, exchanged, sold or otherwise disposed of on or after the date this ordinance takes effect."

Those two amendments are responding to each of the two points that Ms. Marx raised in her testimony.

COUNCIL PRESIDENT VERNA: Any questions from Members of the Committee on the amendments?

The Chair recognizes Councilman Cohen.

COUNCILMAN COHEN: Could you state very simply what the result is of your two amendments? What did they do to the bill?

SPEAKER: Sure. The first amendment, Ms. Marx expressed a concern with the use of the word "gain." If you look at the last section of Subsection F in the bill, she was concerned that by using the word "gain," it might not exclude compensation, stock options that would be deemed to be compensation.

It's a technical concern that the use of the word "gain" might leave open certain stock option gains to tax. This makes it clear whenever a stock option is later exercised, the Revenue Department wouldn't say it might not be a gain, it's compensation and, therefore, we can tax it. That is to clarify, make it clear that stock options are excluded from tax even when later exercised.

The second amendment, the effective date of the bill said that it would apply to stock options that were exercised after the bill become law. It omitted to say expressly that it also applied to stock options granted after the date the bill became law.

The second amendment simply adds a phrase about stock options granted after the date the bill becomes law. Again, they're technical.

COUNCILMAN COHEN: Does Ms. Marx agree it deals with the questions she raised?

MS. MARX: Yes.

COUNCILMAN COHEN: Adequately?

MS. MARX: Yes. I also agree it's really a technical-type of amendment.

COUNCILMAN COHEN: That's it.

COUNCIL PRESIDENT VERNA: The Chair recognizes Councilman Kenney.

COUNCILMAN KENNEY: I want to go back to an issue that Ms. Marx raised about potential companies who may be a real estate firm claiming they're an information technology company.

Wouldn't it be true even if they did that, even if a certain portion of their business was dedicated to something that could be arguably called information technology, they wouldn't exempt all of their gross receipts for all of the other functions of the business they performed, sale of property, any of the other things they do that earns them dollars?

The argument point would simply be focused on the portion of their business that they claim is, in fact, information technology as put forth in the definition of this legislation.

MS. MARX: That is one of the other aspects that was not clear to us. Section 11 says that with the tax years 2000 through and including 2006, any receipts or portion of receipts from the specific business conducted by an information technology company is exempt.

It wasn't clear to us whether that meant all of the business of any company that was otherwise an information technology company, or only the receipts that were information technology receipts, even though the company is otherwise classified as an information technology company. That was just another area we weren't clear on.

COUNCILMAN KENNEY: I think in fairness it's clear that it's the specific business conducted by the information technology company.

So if you had ABC Real Estate Company claiming they were an ITC, the arguing point would only be the portion of the business that's covered in the definition, not the other services that particular company conducts in order to turn income.

MS. MARX: I understand what was intended. In reading it, it wasn't clear that's the way that someone could aggressively interpret it. It says the specific business conducted by a technology company.

Once I'm a technology company, all of my business is my specific business. It doesn't say the technology business. I understand it can be interpreted that way. For an aggressive company, it might also be interpreted the other way?

COUNCILMAN KENNEY: Can I ask who in the law department you've consulted with in preparing your analysis on the legal problems associated with this bill?

MS. MARX: On our concern about some of the language, it was revenue department's concern.

COUNCILMAN KENNEY: None of the

lawyers in the law department had any input?

MS. MARX: We discussed it with -- there are so many bills. I think this one we discussed with Frank Piva, maybe, and Richy Fader (ph).

COUNCILMAN KENNEY: I haven't talked to Mr. Piva directly, but I believe he has no knowledge or recollection talking to anyone in the revenue department about 336.

MS. MARX: One of the problems that we have is that the law department frequently feels that they can't discuss these with us because they're dealing as your counsel. As your counsel, they have confidentiality problems with discussing these things with the revenue department.

We get into that kind of -- we have said and asked the law department to ask the council people with whom they're working if they would mind if they got the revenue department involved in drafting some of this legislation.

They feel frequently the council people don't want to get us involved in advance, and so they're walking the tightrope of their ethical concerns.

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COUNCILMAN KENNEY: Thank you.

COUNCIL PRESIDENT VERNA: The Chair recognizes Councilman Cohen.

COUNCILMAN COHEN: Coming back to the point Councilman Kenney raised, I'd like to address to our technical staff, do you think -- there seems to be full agreement between Councilman Kenney and Ms. Marx as to what's intended to be covered.

Do you think there's any need for any kind of clarifying amendment that we could produce at this time and get that issue clear? Since there seems to be total agreement, there's no disagreement as to the intent.

MS. MARX: There's no disagreement on the intent. We still have concerns about classifying businesses, and I guess in effect benefitting businesses that we didn't think it was your intention to benefit. That's our main concern.

If the intention is to benefit new companies coming into the City...

COUNCILMAN COHEN: That's a separate question. Let's deal with each question, if we can.

Is it the opinion of Mr. Auerbach that the concerns Ms. Marx has are legitimate concerns, and if so, how do we resolve it to carry out the intent of Councilman Kenney?

MR. ERICSON: I'm Thomas Ericson, Council's technical staff. I haven't really looked into this bill. I know we have shared it with people in the technology industry, and they have expressed some concern about whether or not the bill targets their businesses.

I mean, we've gone over the particular code application list with a couple of companies, and they didn't feel comfortable with it. I think it can be corrected eventually. I don't think that we have sufficient knowledge to do it right now.

I would question whether or not some of the problems that were discussed here today about to only tax that part of the receipts that deals with those particular businesses might be able to be resolved by regulations of the revenue department. That could be a possibility to clarify that problem as to is all the receipts of a particular company exempt, or is only that portion of the receipts derived from their information technology portion of their businesses to be exempt.

COUNCILMAN COHEN: Wouldn't it be possible if the bill were enacted in its present form that if there were questions, we would expect the City to refer that back to us with maybe some amendatory language at a later time?

MR. BONNEY: Seems perfectly appropriate to me. It might have to sit over for the summer if you tried a second reading, final passage.

COUNCILMAN COHEN: I think Councilman Kenney makes a good point in expressing the urgency of the situation. There's been no dispute as to the urgency of the situation.

MR. ERICSON: I'm not prepared to answer for the revenue department problems they see in the administration of it.

COUNCILMAN COHEN: Ms. Marx, the suggestion I made that passage of the bill in its present language, couldn't that be changed later? If you found there was a problem, you would refer, as suggested, ordinance to us to amend that section that created the problem?

MS. MARX: The bill...

COUNCILMAN COHEN: The bill has merit.

Most of us feel we ought to move ahead with it.

MS. MARX: The bill has an effective date of July 1, 2000. That in itself presents problems because the tax is a calendar year tax. So if we were to put off doing something in the fall, we could still have an effective date of January 1, 2001, and be effective for the tax year 2001. There's no need to necessarily have it passed before the summer recess.

MR. ERICSON: If the bill were passed now, since the tax returns aren't due until next April or the amendments that the Administration wanted to propose over the summer months, they could be dealt with in the fall and that would be done in sufficient time to allow this to be used in the next calendar year's taxes.

MS. MARX: We'll have problems there. We'll have problems in getting all the rates written and the returns prepared. We would rather have it all done at once so we know what the returns are supposed to look like. It's difficult to tell people how to file their taxes when we don't know what the law is going to look like at the time it's being filed.

COUNCILMAN COHEN: The thing we're worried about is the time you would take might be a year or two years from now.

MS. MARX: There's no reason that should be. We would be very happy to sit down tomorrow or next week to try and come up with language.

COUNCILMAN COHEN: If you do that, why couldn't you use the amendment process?

MS. MARX: It's a concern about doing it in two steps rather than one.

COUNCIL PRESIDENT VERNA: Are there any other questions or comments for members of the committee?

SPEAKER: We had read the proposed amendments to 451 into the read. Would you like the amendments to 354 to be read into the record?

COUNCIL PRESIDENT VERNA: We do have copies. We'll give it to the stenographer. Do all council members have copies of the proposed amendments?

Ms. Marx, I ask again, you have reviewed them and you do concur with the proposed amendments?

MS. MARX: Yes. I have copies, and I do concur.

COUNCIL PRESIDENT VERNA: This will conclude the Committee of the Whole. We will now go into our public meeting.

The chair recognizes Councilman Kenney regarding Bill No. 336.

COUNCILMAN KENNEY: Thank you. I move that Bill No. 336 be reported out of this Committee with a favorable recommendation and a request made for a rule of suspension so as allow first reading at our next Council session.

COUNCILWOMAN BLACKWELL: Second.

COUNCIL PRESIDENT VERNA: It's been seconded. I move that Bill No. 336 be reported out of Committee with a favorable recommendation, also a recommendation for the rules of Council be suspended so as to permit first reading at our next session of Council. All in favor will signify by saying aye; those opposed say nay.

The ayes have it.

The chair recognizes Councilman Nutter regarding Bill No. 354.

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COUNCILMAN NUTTER: I move the adoption of the amendment as read into the record on Bill 354.

COUNCIL PRESIDENT VERNA: It has been moved and seconded that the amendment to No. 354 be adopted.

All in favor, let it be known by saying aye; those opposed say nay.

The ayes have it. The motion is carried.

The Chair recognizes Councilman Nutter.

COUNCILMAN NUTTER: I move that Bill No. 354, as amended, be reported out of this Committee with a favorable recommendation, also a recommendation for the rules of Council be suspended so as to permit first reading at our next session.

COUNCIL PRESIDENT VERNA: It has been moved and seconded. All in favor, let it be known by saying aye; those opposed, say nay.

The ayes have it.

The Chair recognizes Councilman Nutter regarding Bill No. 451.

COUNCILMAN NUTTER: I move the

adoption of the amendment to Bill No. 451 as read into the record.

COUNCIL PRESIDENT VERNA: It's been moved and seconded that the amendment be adopted to Bill No. 451. All in favor, let it be known by saying aye; those opposed, say nay.

The ayes have it.

The Chair recognizes Councilman Nutter.

COUNCILMAN NUTTER: I move that the amended Bill No. 451 be reported out of this Committee with a favorable recommendation, also a recommendation for the rules of Council be suspended so as to permit first reading at our next session.

COUNCIL PRESIDENT VERNA: It has been moved and seconded that Bill No. 451 as amended will be reported out of Committee with a favorable recommendation, also a recommendation rules of Council be suspended so as to permit first reading at our next session of Council.

All in favor by saying aye; those opposed, say nay.

The ayes have it.

This concludes the Committee of

the Whole. Our next hearing will be the Finance Committee. I do apologize for everyone that's been waiting. I'm sorry.

(Hearing adjourned at 2:50 p.m.)

C E R T I F I C A T E

I HEREBY CERTIFY that the foregoing proceedings of the Council of the City of Philadelphia of June 14, 2000, were reported and accurately by me, and that this is a correct transcript of same.

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MAUREEN E. BRODERICK, RPR and
Notary Public

__________________________________,

JOSEPHINE CARDILLO,
Registered Professional Reporter