Washington Square Citizens League

Discussion Group
7:00-8:30 pm, Monday, November 6, 2023

Tax Abatement

Gary Mucciaroni, moderator

Tax abatements are part of the economic reality in Philadelphia. In fact, our city leads the nation in offering tax abatements. It's safe to say that tax abatements are not well understood by the general public. Let's learn about the obscure topic of tax abatements and ask some questions.

- How do they work?
- Are they a good public policy for Philadelphia?
- How do they impact tax receipts?
- Who benefits? Who loses?
- Where should abatements be offered?
- Have they had the intended effect?

What Is Abatement? How It Works With Taxation, and Examples

By Will Kenton, Investopedia, September 4, 2021

What Is an Abatement?
An abatement is a reduction or an exemption on the level of taxation faced by an individual or company. Examples of an abatement include a tax decrease, a reduction in penalties, or a rebate. If an individual or business overpays their taxes or receives a tax bill that is too high, it can request an abatement from the tax authorities.

How Abatements Work
Abatement is a taxation strategy usually used by various governments to encourage specific activities, such as investments in capital equipment. A tax incentive, for example, is a type of tax abatement.

Abatements are often utilized in real estate. Some cities have property tax abatement programs that eliminate or significantly reduce property tax payments on a home for years or even decades. The purpose of these programs is to attract buyers to locations with lower demand, such as areas of the inner city that are in the midst of revitalization efforts.

Some cities only offer tax abatements in designated areas, and some may limit these programs to low-to-middle-income property owners.

You can buy a property that already has an abatement, or you can purchase an eligible property, make the required improvements, and apply for the abatement yourself. The former option is considerably easier because it means someone else has endured the headaches of construction and bureaucracy and all you have to do is move in.

Abatements typically won't completely eliminate your property tax bill—you'll still have to pay taxes on the value of the property before it was improved. But the savings can be substantial. For example, the Portland, OR, Housing Bureau said its tax abatement program could save property owners about $175 a month, or about $2,100 a year, for a total savings of $21,000 over 10 years. Without abatement, they might spend about $3,100 a year in property taxes; with it, they might spend about $1,000 a year.

Special Considerations
Properties often must remain owner-occupied to continue qualifying for the tax abatement. In addition, if the property is sold from one owner-occupant to another, the tax abatement will remain with the home. The abatement period does not start over when the property changes hands, however. If the seller has received seven years of abated property taxes, the new buyer would receive the remaining three years of a 10-year abatement.

The easiest way to find out if there are any property tax abatement programs in the area where you want to buy is to do an internet search for "property tax abatement" and the name of your city. For large cities, a neighborhood name might be a more effective search term than a city name. The name of your city or neighborhood plus "real estate listings" plus "property tax abatement" is another effective search string. Knowledgeable real estate agents will also be aware of these programs.

Examples of Tax Abatement
Often, a local government wants to attract or keep businesses in its community. To achieve this, the government can offer a tax abatement in the form of a temporary reduction in general business taxes.

For example, the Ratner Steel Company was given a tax abatement from the city of Portage, Indiana, on the expansion of a local plant and purchase of a $2.5 million steel cutter. In terms of the latter, the abatement stipulated that the company pays no taxes on the equipment in the first year, and is responsible for the total tax amount only after the five-year period is finished.

For the plant expansion project, meanwhile, the tax abatement stretched to 10 years. The city said it signed off on the incentive because the company pledged to add 30 new jobs, boosting the local economy and future property tax revenues.1

Another common scenario of tax abatement is property tax abatement. If an individual believes that the assessed value of their property is too high, they can appeal to their local tax assessor for an abatement.

Some localities offer property tax abatement to owners who restore or improve historic properties in designated neighborhoods. Some types of properties, such as those containing nonprofit businesses, can be granted tax abatements based on the owner's tax-exempt status.

Most governments grant abatements to individuals or businesses who bring something of value to the community. They are intended to incentivize positive economic activity.

Benefits of Tax Abatements
Usually, a government only offers a tax abatement when a business or individual provides something of high value to the community. For example, a city government may give a tax break to a business in return for an investment in the city, such as a new retail location, factory, or warehouse.

This provides the added benefit of increased jobs in the area. If Target Corporation is given a tax abatement on property taxes and, in return, builds a retail location in the local community, it ends up adding many job opportunities. Additionally, it increases public good by adding convenience to the city.

A company that benefits from a tax abatement might invest in local infrastructure. A new company may need to increase the number of roadways, water lines, or power lines in the area in order to operate efficiently. While this benefits the company itself, it also benefits the community where the added infrastructure is built.

If cities want to develop land, they can designate development zones. These zones give tax abatements to any housing development in the area, incentivizing people to build homes.

Potential Drawbacks of Buying a Tax Abated Property

Tax abatement lowers your property taxes. How could saving money while getting to live in a new or recently rehabbed property possibly have any drawbacks? Well, there are a few things that could go wrong.

A significant issue is that tax-abated properties are sometimes in less desirable neighborhoods. The tax abatement is an incentive to encourage people to redevelop and move into these areas. Whether revitalization efforts will ultimately prove successful is a big question mark. If the neighborhood doesn't improve, your property value could remain flat or even decline, which could make it difficult for you to sell and possibly cause you to lose a lot of money.

If you continue to live in the home past the end of the abatement period, you'll experience a significant jump in your annual housing expenses. It's imperative that you keep an eye on this deadline and plan for the increase, so you'll be able to afford it when the time comes. If you sell the property after the abatement period ends, you may have to lower your asking price to account for the increase in taxes.

Also, a tax abatement doesn't give you complete certainty over what you'll spend on property taxes. Even during the abatement period, your tax bill could change. Since you're still paying tax on a portion of your property's value, a change in the tax rate or a special assessment could cause your property tax bill to increase.

Since you're being taxed on a lower dollar amount and property taxes are based on a percentage of that amount, any increase probably won't hit your budget too hard, but you should be aware of the possibility for an increase. Of course, changes in tax rates or property values could also cause your bill to decrease, which wouldn't be a problem.

Finally, the city may reserve the right to end your tax abatement if you become delinquent on your property tax payments. If you're responsible for the payments, don't miss any. Alternatively, if your mortgage company pays your taxes, watch your monthly statements carefully to make sure your tax bills get paid.

Most tax abatements expire after a predetermined number of years. If you purchase an abated property, be ready for sharp tax increase sometime in the future.

The Bottom Line
Abatements are special exemptions intended to reduce the tax burden of certain economic activities, generally related to housing and construction. By reducing the price tag of building new housing, local governments seek to make housing more affordable for their population.

Philadelphia's controversial 10-year tax abatement soon could change for the first time. Here's what you need to know.

A major Philadelphia real estate tax break is close to seeing its first changes in the almost 20 years since it became law. Here's everything you need to know about the 10-year tax abatement, what it does, and how it could change.

By Laura McCrystal, Philadelphia Inquirer, November 27, 2019

A major Philadelphia real estate tax break is close to seeing its first changes in the almost 20 years since it became law.

City Council is considering changes to the controversial 10-year tax abatement. A flurry of negotiations and lobbying is underway in City Hall to influence legislation that could pass before the end of 2019. Council President Darrell L. Clarke hopes to see enacted a bill that would effectively halve the exemption for new construction of residential properties.

The abatement has long had vocal supporters and critics. But the legislation introduced in November marks the first time a reform measure has had a good chance of passing.

Here's what you need to know about the abatement.

What does the 10-year tax abatement do?

The 10-year tax abatement began in the late 1990s as a program for tax breaks on existing buildings. It was expanded to its current form in 2000 to include all new construction and rehabilitation projects. Officials wanted to encourage development, expand the city's housing stock, and boost the local economy.

Under the abatement, owners of new construction pay taxes only on the value of the land underneath their buildings for 10 years, not on the value of the buildings themselves. And owners of rehabilitated properties are exempt from taxes on the value of the improvements.

For example, a rowhouse near Frankford Avenue and Palmer Street in Fishtown that was built in 2012 has a market value of $498,600, according to the Office of Property Assessment. But the owner only pays taxes on the assigned land value of $135,942, so the annual tax bill is about $1,900 instead of almost $7,000.

And a $1.8 million condo overlooking Rittenhouse Square has a tax bill of about $2,200 under the abatement, instead of $25,000.

How much tax money does Philadelphia give up under the abatement?

More than 15,000 properties currently have the abatement. The total value that is exempt from taxes under the abatement is $11.6 billion, according to property records. The city and School District would net about $162 million in annual revenue if those properties were taxed in full.

Proponents of the abatement, including Mayor Jim Kenney, say it pays for itself because it acts as a development incentive that brings more money into Philadelphia over time. Opponents say Philadelphia has changed in 20 years, and the abatement has become a tax break for wealthy residents as well as fuel for the gentrification of neighborhoods.

What are the proposed changes to the abatement?

City Council is considering a bill that would change the abatement only for construction of new residential properties.

Under the proposal, the owner of a new home would be exempt from paying taxes on the value of the building in the first year, the same as under current law. But then that exemption would decrease by increments of 10% annually, reaching 10% by the 10th and final year. The result would essentially halve the value of the current abatement for newly constructed homes.

The changes would take effect in July 2020. . But that date could change as the legislation moves through Council.

What would stay the same under the proposed legislation?

The new legislation would not change the tax break for properties already benefiting from the 10-year abatement.

It also would not change the tax exemptions available for commercial and industrial properties, like hotels and office buildings. Lawmakers have said leaving the commercial and industrial incentives intact is important because those projects create jobs both during and after construction.

Rehabilitation projects of existing homes would still be eligible for the full abatement.

What impact could proposed tax abatement changes have?

Officials expect a decline in residential construction in the city if the proposal becomes law. A City Council study projected a 25% drop in residential construction in the first year after it takes effect.

But because owners of new homes would begin paying some taxes on their houses in the first 10 years, the city could take in about $265 million in tax revenue over the next decade that it otherwise wouldn’t have, the study found.

Who supports the reforms?

Clarke says he's worked with City Council members to form a consensus. Several Council members — including some who have previously called for eliminating the abatement and some who have opposed any changes to it — have voiced support for the bill. Of the 17 Council members, 15 have signed on in support.

"The whole structure of our real estate market and our economy has changed dramatically," Clarke said. "It's time to move the needle forward."

Who is opposed to the proposed legislation?

Developers and the building trades unions already defeated a proposed cap on the total value that could be exempt from taxes, which they feared would end construction of high-end condos and luxury housing. They may still push against the proposal being considered or fight for changes, such as a later enactment date.

Kenney has said he thinks the abatement works, but he's willing to sign a reform bill passed by Council.

Some advocates for eliminating the abatement may also criticize the legislation for not going far enough.

"If people feel like this is the only thing we will do on this issue … I could understand some of the pushback," said Councilwoman Helen Gym, who has long sought changes. "But this is a first step, and there'll be more that we need to do."

What comes next?

Negotiations are likely to continue in City Hall until mid-December, when Council holds its last meeting of the year. To pass a bill this year, the final vote must be held on or before Dec. 12.

Council is scheduled to hold a hearing on the bill next week.

And even if the new bill passes, reform advocates may still push for more action next year, when Working Families Party candidate Kendra Brooks and other new members join Council.

Who Benefits? Philadelphia leads largest cities in property tax breaks

James McGinnis, Philadelphia Tribune, September 21, 2019

Philadelphia's real estate tax breaks benefit some of the wealthiest in the city, a Tribune analysis of property records shows.

In response to a Right to Know request, the city of Philadelphia released a list of all properties receiving tax breaks as of March 30, 2019, the latest numbers available.

The list showed 15,650 properties, which represent less than 4% of the city's real estate. (Philadelphia is home to some 678,876 residential properties with an average home value of $151,500, according to a U.S.

Census 2017 American Community Survey.) The average property on that list was valued at $1.1 million, records show. The middle point (sometimes referred to as the median value) on the list was $443,000.

Forty-five properties receiving tax breaks are valued at more than $50 million.

You'll find most of the tax-abated properties in choice Philadelphia neighborhoods.

At 22nd and Walnut streets in Rittenhouse, a single housing block contains seven tax-abated properties, each valued at between $2.4 million and $2.5 million.

Another 15 tax-abated properties on a single block in Old City — on South Front Street between Walnut Street and Sansom Walk, and on Walnut Street between South Front Street and South 2nd Street — have a combined value exceeding $30 million.

Yet, in some of the city's poorest neighborhoods, you'll rarely find a home or business in the program. Just 54 properties in the city's predominantly Black Strawberry Mansion section are enrolled in property tax abatements, city records showed. In Gray's Ferry, only 78 properties are enrolled in such programs.

Of course, Philadelphia isn't alone in offering millions in tax breaks to spur construction and lure developers.

And supporters of the tax breaks — mostly developers, trade unions and some city officials — point to studies showing the property tax abatements spur growth, create construction jobs and eventually lead to increased revenues as tax break programs expire, forcing home and business owners to begin paying taxes on their properties.

The eventual payoff could be big, and elimination of such programs would do little to fill the city's coffers, they argue.

As recently as last year, a city-commissioned report estimated that complete elimination of the tax breaks would generate between $55 million and $65 million per year in a city with $9.4 billion in annual operating expenses. Supporters of the tax breaks say it's just a drop in the bucket.

But others say the city's schools could use that money to make needed infrastructure repairs, hire teachers and counselors, or buy supplies.

Comparing Philadelphia to other cities

Cleveland allows developers and residents to pay no real estate taxes on new construction for 15 years. Chicago offers commercial, industrial and nonprofit tax breaks that can last up to 12 years. Des Moines allows tax breaks of up to 10 years on building additions and renovations of less than $40,000.

St. Louis allows five- to 10-year tax breaks on new construction on all vacant lands and rehabilitated properties.

Portland, Oregon, provides 10-year tax breaks on homes valued at less than $350,000 and only in designed "homebuyer opportunity areas."

California's Mills Act provides tax breaks of 40% to 60% for restoring historic properties. Administered the California parks department, Mills Act tax breaks are "10 years initially with automatic yearly extensions." In New York City, owner-occupied condos can receive tax breaks of between 17.5% and 28%, and those tax breaks also do not expire over time.

All of these tax breaks draw money away from education systems, which are the main reason companies choose to locate to a city, said Greg LeRoy, executive director of the progressive think tank Good Jobs First.

Research from Good Jobs First shows that no big city in the U.S. gives away nearly as much potential revenue to benefit its schools as Philadelphia.

With an estimated 133,000 students, the School District of Philadelphia lost some $61.9 million to real estate tax breaks on homes and businesses in 2017, Good Jobs First estimated.

Comparable in size with 160,000 students, the Dallas public school system lost just $22 million to real estate tax breaks. And the Chicago school district, with three times more students than Philadelphia, lost $37.5 million to tax breaks.

The best way to draw business to your community is to have a highly educated workforce, and tax breaks do just the opposite, LeRoy argues. "Even before today's tight labor market, the supply of skilled labor was the top site location criterion used by most companies. Yet, when costly corporate subsidies undermine local schools, elected officials are actually undermining their own economic development efforts."

Councilwoman Helen Gym argues the tax breaks hurt schools to the tune of $50 million annually. That represents 1.4% of the School District of Philadelphia's 2020 fiscal year budget of $3.36 billion.

"Let me be clear: Nothing on its own can make up for the failure of the state to fund our schools fairly and equitably," Gym said. "Fifty million is a significant sum of money for a school district that lacks librarians, guaranteed music and the arts, and needs more counselors and aides. Anyone who thinks otherwise hasn't visited a public school recently."

Changing the property tax system has been so difficult because it forces Philadelphia to break with two decades of tradition, which has "defined" new construction in the city, Gym added.

The history of Philadelphia's tax abatement

The city created a tax abatement plan in 1976; it was limited to repairs on residential properties. Tax breaks were offered on homes "containing not more than (3) three dwelling units" and one of those units had to be occupied by the property owner.

That program lasted five years with the tax breaks diminishing to 80% in year two, 60% in year three, 40% in year four, and, finally, 20% in year five.

The focus then turned to new construction.

Pennsylvania Act 175 overwhelmingly passed the state's General Assembly (193-3) and Senate (49-0) in 1984. The state law allows tax breaks to developers for new apartments, condos, duplexes, triplexes, townhouses and rowhomes. Builders can receive up to 30 months of tax credits on newly constructed properties. Only the builder gets that tax break, which lasts only until the property is sold.

City Ordinance 961 provides for a 10-year tax break on improvements to existing single-family homes, duplexes, apartments and condos. The tax breaks start in the first year when new improvements would be taxable.

Philadelphia Ordinance 1160 allows a 10-year tax exemption on construction or improvements to "deteriorated" commercial and industrial sites. The tax break starts once use and occupancy permits are issued by the city for the business.

Ordinance 1456-A provides up to 10 years tax abatement on newly built apartments, condos, duplexes and single-family homes.

Councilman Allan Domb, a real estate developer, says the tax abatement is a solution to the city's unfair tax system.

Philadelphia has a total market value of $134 billion but yields tax revenues on only $91 billion of that property, he said.

"You go to sections of the Northeast and other sections of the city who aren't seeing any abated properties, and all they think is that 'those rich people are getting a tax break on my back,'" Domb said. "They're not looking at all the people who are coming into the city and the long-term investment. They're looking at the short-term."

One quarter of the city is in poverty and 33% of its property value is tied to nonprofit and other institutions, such as schools and hospitals, paying no property taxes, "so 41% of our city carries the burden of taxation to a large degree," Domb added.

Domb has repeatedly expressed concerns about potential negative impacts of the tax abatement.

City Council considering changes

Philadelphia's tax abatement is "the most generous program in the country. No other city forfeits taxes in exchange for development like we do," Gym said. "So, it's not a surprise that changing it is a challenge.

“Changing the abatement is not about whether we will or won’t have jobs or development,” she continued. “It’s asking the question about whether we’re going to ensure that the benefits spread across the city or whether we’re just going to limit the benefits to a smaller and smaller portion of the city. I’m not OK with that.”

Changing the abatement was a hot topic in the primary election for City Council.

Many of the challengers for City Council seats said they want to change or eliminate the abatement.

And some City Councilmembers have put forward proposals to reform or eliminate the tax abatement programs. All of the proposals have been referred to the city council finance committee.

If the council takes no action on the proposals by the end of its term in December, the proposals will simply die. City Council President Darrell Clarke recently said in an interview on WURD that he doesn’t think that will happen; he expects some kind of change before the end of the year.

Gym introduced legislation in May 2018 that would limit the property tax abatements to city taxes, requiring property owners and developers to pay real estate taxes to the school district.

Councilwoman Cindy Bass introduced legislation in September 2018 to “terminate” all city real estate tax abatement programs.

Gym has introduced two other proposals: One option would limit the tax breaks on residential properties. Tax breaks could not exceed the Federal Housing Administration mortgage limit for a one-family dwelling in Philadelphia County. (The current FHA mortgage limit is $402,500.)

The other option would scale back the tax breaks, staggering the amount paid over a 10-year period. Under the plan, property owners would pay 0% in year one, 10% in year two, 20% in year three, 30% in year four, 40% in year five, 50% in year six, 60% in year seven, 70% in year eight, 80% in year nine and 90% of the real estate taxes in year 10.

Domb said if he had to offer a “peace offering” on reforming tax abatement programs, he could agree to a plan lasting 10 years with the tax breaks beginning to scale back in year six. Under such a plan, home and business owners would pay no taxes in years one through five, 20% tax in year six, 40% tax in year seven, 60% tax in year eight and 80% tax in year nine, he said.

When it comes to taxation fairness, abatement programs might be just the beginning — the tip of the iceberg, said Clarke, who pointed to yet more studies suggesting many city properties are incorrectly valued.

“Basically, a third of the properties were underassessed,” he said. “One-third were over-assessed. For those one-third of properties that were over-assessed, what do you tell those people? They probably overpaid last year.”