



April 29, 2016

**Re: Memorandum On Sugar-Sweetened Beverage Tax From Sozi Pedro Tulante, City Solicitor, To James F. Kenney, Mayor, Dated March 1, 2016.**

In his Memorandum regarding the proposed Sugar-Sweetened Beverage Tax, dated March 1, 2016 (“Sol. Mem.”), the Solicitor claims “a high degree of confidence that a court would hold this proposed tax well within the City’s authority.” Sol. Mem. at 1. As explained below, that conclusion is both flawed and based on a deficient analysis of the law. If adopted, the proposed sugar-sweetened beverage tax would conflict with the State’s scheme for taxing the exact same products and also likely violate the Uniformity Clause of the Pennsylvania Constitution.

Beyond those significant issues, the proposed tax would raise other serious legal concerns implicating, among other things, constitutional limits on Philadelphia’s legislative jurisdiction generally, and taxing authorization specifically, given that the proposed tax scheme would have a significant regulatory impact on businesses located outside of Philadelphia (and Pennsylvania). Moreover, the complicated and confusing licensing and notification arrangements the proposed tax would require would be in tension with a host of other State business and tax regulations. Because those issues were not addressed by the Solicitor, they are not addressed in detail here.

**I. The Proposed Sugar Sweetened Beverage Tax Exceeds The Taxing Authorization Granted To Philadelphia**

**a. The Proposed Tax Is Preempted**

Philadelphia has no inherent power of taxation; rather, “[t]he only power that Philadelphia has to impose any tax on its residents is the power the state gives it.” *Marson v. Philadelphia*, 342 Pa. 369, 373 (Pa. 1941). As the Solicitor correctly notes, “the City lacks the power to impose a tax ‘on a privilege, transaction, subject or occupation, or on personal property which is . . . subject to a State tax or license fee.’” Sol. Mem. at 1 & n.1 (citing Act of Aug. 5, 1932, P.L. 45 § 1, as amended, 53 P.S. § 15971).

This division of power is fundamental to Pennsylvania’s constitutional structure and ensures that state revenues will not be encumbered by local taxation. “[W]hen the state decides to enter a specific area for purposes of raising state revenues, a municipal

tax in the same area could pose a threat, either by causing diminution of the taxed activity or by increasing the costs of collection.” *United Tavern Owners v. Phila. Sch. Dist.*, 441 Pa. 274, 285 (Pa. 1971). In such cases, “the state has preempted that area insofar as specially directed taxation is concerned.” *Id.*

Here, the proposed tax would unlawfully infringe upon an area that the State has specifically chosen to tax and threaten to diminish that taxed activity. “Soft drinks” are expressly identified by Pennsylvania Statute as a class of products subject to the Pennsylvania Sales Tax, fully encompassing the beverages that would be covered by the proposed sugar-sweetened beverage tax. *See* 72 P.S. § 7201(a).

Although the drafters of the proposed tax seem to have gone to great lengths to avoid calling it a “sales tax” by using terms like “supply,” “acquisition,” and “delivery,” there is no denying that it would be triggered by the sale of beverages. Retailers selling beverages would be liable for the tax in a number of circumstances (e.g., beverages obtained by retailer from an unregistered distributor; beverages obtained by retailer from wholesaler located outside city limits), *see* Bill 160176, § 19-4105(2)-(3), rendering the tax a quintessential sales tax, *see, e.g., Hellerstein & Hellerstein, State Taxation* ¶ 12.01 (noting “vendor” or retailer taxes are a well-established category of sales taxes). Moreover, the tax also would undeniably apply to, and be triggered by, the sale of beverages from distributors to retailers. *See, e.g.,* Bill 160176 § 19-4101(4) (defining distribution in terms of supply, and supply in terms of “sell”); § 19-4102(1)(a) (prohibiting retail sale of beverages unless the retailer “purchased” the beverages from a licensed distributor); § 19-1403(3) (requiring distributors to declare the tax “as a separate line item on any bills or invoices provided” to retailers). And it is clear that at least a substantial portion—if not all—of the tax will ultimately be paid by consumers, dramatically reducing sales of those products in Philadelphia and driving sales to neighboring areas and other states.<sup>1</sup>

Because the proposed beverage tax would substantially overlap with, and threaten to diminish revenue from, the State’s taxation of the same beverages—which

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<sup>1</sup> *See, e.g.,* Julia Terruso, “Would consumers bear full brunt of soda tax?” *Philly.com*, Apr. 1, 2016, available at [http://articles.philly.com/2016-04-01/news/71955401\\_1\\_soda-tax-soda-industry-sugary-drinks-tax](http://articles.philly.com/2016-04-01/news/71955401_1_soda-tax-soda-industry-sugary-drinks-tax); Kenneth Hilario, “Kenney admin breaks down sugary drink tax revenue estimates, but opponents find flaws,” *Phila. Business J.*, Mar. 4, 2016, available at <http://www.bizjournals.com/philadelphia/news/2016/03/14/kenney-admin-breaks-down-sugary-drink-tax-revenue.html>; “Letter: Don’t choke on higher soda prices – go to Jersey,” *Philly.com*, Mar. 14, 2016, available at [http://articles.philly.com/2016-03-14/news/71479052\\_1\\_sugar-sweetened-beverages-grocery-bills-john-holub](http://articles.philly.com/2016-03-14/news/71479052_1_sugar-sweetened-beverages-grocery-bills-john-holub); Scott Drenkard, “Philadelphia Mayor Proposes Gigantic Soda Tax,” *Tax Foundation*, Mar. 2, 2016, available at <http://taxfoundation.org/blog/philadelphia-mayor-proposes-gigantic-soda-tax>.

the State has expressly authorized and capped for Philadelphia already—it exceeds Philadelphia’s tax authorization; “the state has preempted that area insofar as specially directed taxation is concerned.” *United Tavern Owners* 441 Pa. at 285. To conclude otherwise would grant Philadelphia a license to impose taxes on virtually anything already taxed by the State merely by shifting a notch ahead in the chain of commerce and inventively devising a measure to serve as a proxy for whatever measure the State uses. That would upend the Pennsylvania Constitution’s division of powers and confer upon Philadelphia the power to lessen—and effectively syphon—State revenue. That is not how the law works.

### **b. The Solicitor’s Preemption Analysis Is Incorrect**

The Solicitor argues that there would be no tension between the taxes due to distinctions among the payers of each tax and how each tax would be measured. *See* Sol. Mem. at 1-2. Neither argument has merit.

The Solicitor’s contention that “there is no City ‘intent’ that the tax will be borne by the consumer; nor evidence that it *will* be borne by the consumer,” Sol. Mem. at 1, overlooks the proposal’s mandate that the tax be itemized on invoices, effectively requiring its pass-through. *See* Bill § 19-1403(3). Perhaps more significant, the Solicitor’s position is undercut completely by the fact that “the mayor’s revenue projections assume . . . that the entire 3-cents-an-ounce tax gets passed on to consumers.” Terruso, *supra* n.1; *see also* Hilario, *supra* n.1 (noting deputy revenue commissioner assumes that “[t]he tax would result in a decline of 55 percent in sales in the first year”). And the Solicitor’s inexpert beliefs as to how “market forces” may unfold, Sol. Mem. at 1, is belied by the evidence from Berkeley—the only jurisdiction in the United States to impose a similar tax at the far lower level of one cent per ounce—where the tax *is* being borne by the consumer, and at a rate *even higher* than what the city prescribed—between 32% to 171% *more*. *See* Public Health Institute, *Berkeley Evaluation of Soda Tax (BEST) Study Preliminary Findings*, Nov. 3, 2015.<sup>2</sup>

The Solicitor asserts that because the legal incidence of the tax will be at the “distributor-retailer level . . . *not* at the retailer-consumer level,” the tax would be “imposed on a different taxpayer,” and thus avoid tension with the state sales tax. Sol. Mem. at 2. But such a technical distinction was rejected when the Pennsylvania Supreme Court construed Philadelphia’s taxing authority in *United Tavern Owners*. In that case, the Court held that a Philadelphia tax imposed on liquor at the retailer-

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<sup>2</sup> Available at <http://www.phi.org/uploads/application/files/qi9zljgph8jvfuu6g8qj703sk5v6ei1tzy2jdkds8s87kpfm.pdf>.

consumer level was preempted by the state’s taxation of liquor at the distributor-retailer level, expressly rejecting the argument that the taxes were “imposed on . . . different transaction[s].” 441 Pa. at 285.

The Solicitor’s claim that *United Tavern Owners* has “no precedential value” is unpersuasive, *see* Sol. Mem. at 2 & n.2, and presumably would come as a surprise to the judiciary given that *United Tavern Owners* has been cited *more than fifty* times since it was decided, including most recently by the Pennsylvania Supreme Court in 2011. *See Hoffman Mining Co. v. Zoning Hearing Bd.*, 612 Pa. 598, 609, 611 (Pa. 2011) (citing *United Tavern Owners*). And the Solicitor’s view relies on the *dissenting* opinion in *Wilsbach Distributors*, which the Solicitor erroneously identifies as a “concurring opinion.” *Compare* Sol. Mem. at 2 n.2, with *Commonwealth v. Wilsbach Distributors, Inc.*, 513 Pa. 215, 232 n.2 (Pa. 1986) (opinion of Flaherty, J., *dissenting*). In any event, other courts have similarly rejected attempts by localities to avoid preemption by arguing that a tax technically falls on a payer or class of payers different from those specifically covered by the state law at issue. *See Pocono Downs v. Catasauqua Area Sch. Dist.*, 669 A.2d 500, 502-03 (Pa. Commw. Ct. 1996) (holding that local tax imposed on patrons for the “privilege of” wagering, and based on individual wager amounts, was preempted by state tax imposed on OTB operators, and based on overall volume of business/wagers); *Lakelands Racing Assoc. v. Fairview Township*, 320 A.2d 391 (Pa. Commw. Ct. 1973) (municipal amusement tax preempted by state tax on racetrack admissions despite argument that municipal tax applied to different class of taxpayers).

Lastly, that the proposed beverage tax would be measured “not by the price of the beverage or syrup, but by its volume,” Sol. Mem. at 2, is also a distinction without a difference. Otherwise, Philadelphia would be free to tax any item subject to the state sales tax merely by imposing a tax that escalates with the size, weight, or some other characteristic that increases in relative parallel with price for that item. Whether measuring the tax on a “per cent” or a “per ounce” basis, both taxes are triggered by the sale of a virtually identical set of beverages. In other words, “the subject matter of *both* taxes” is the sale of beverages, and “the measure of the taxes” i.e., the amount of beverage sold, “is clearly the same.” *See Pocono Downs*, 669 A.2d at 503. Consequently, the proposed tax is preempted.

## **II. The Proposed Sugar-Sweetened Beverage Tax Also Likely Violates The Uniformity Clause In The Pennsylvania Constitution**

Article 8, Section 1 of the Pennsylvania Constitution (“Uniformity Clause”) provides that “[a]ll taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws.” As the Pennsylvania Supreme Court explained, “the imposition

of taxes which are to a substantial degree unequal in their operation or effect upon similar kinds of business or property, or upon persons in the same classification, is prohibited. . . . ‘A tax to be uniform must operate alike on the classes of things or property subject to it.’” *Allentown Sch. Dist. Mercantile Tax Case*, 370 Pa. 161, 170 (Pa. 1952) (citation omitted).

The Solicitor contends that the Uniformity Clause would not be violated because there is a “legitimate distinction between the classes’ of sugared versus unsweetened beverages particularly in light of the significant evidence that the former promotes obesity and other health problems.” Sol. Mem. at 2. But, putting aside the factual inaccuracies of that statement, that rationale is articulated nowhere in the text of the tax proposal, and has nothing to do with how beverages are distributed or sold by retailers—the class of payers the tax purports to target. Even assuming, for the sake of argument, that a health justification could be gleaned from the tax deterring purchases of sugar-sweetened beverages, that would be at odds with the Solicitor’s earlier claim that “there is no City ‘intent’ that the tax will be borne by the consumer; nor evidence that it *will* be borne by the consumer,” Sol. Mem. at 1, and merely confirm further that the proposal impermissibly overlaps with the State Sales Tax. Either way, it would be unlawful.

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