

# CITY OF PHILADELPHIA

## PROGRAM

Philadelphia Pre-K (PHLpreK)

## FUNDING MECHANISM

Tax On the Distribution of  
Sugared Sweetened Beverages

---

## OPPORTUNITY

Only one in three of Philadelphia's 42,500 three-and four-year olds had access to affordable quality PHLpreK. That was one of the findings of a 17-member Philadelphia Commission on Universal Pre-Kindergarten created by voters to propose a universal PHLpreK program for the City. The commission concluded that in order to expand services there was a need for a stable and credentialed work force, quality facilities in locations convenient for families, and recurring dedicated funding. It recommended several sources of revenue that could be used to expand PHLpreK—property tax, sales tax, use and occupancy tax, cigarette tax or a tax on sugar-sweetened beverages. Considering the options, Mayor Kenney and the Philadelphia City Council agreed to implement the “Sugary Drink Tax,” later known as the “Philadelphia Beverage Tax” (PBT).

## SUMMARY

In June 2016, the City Council passed its five-year budget that included the implementation of PBT. Through the PBT initiative, the City charges distributors of sugar sweetened beverages a 1.5-cents per ounce tax on beverage distribution, including syrups and concentrates. Products like soda, diet soda (with no caloric sugar intake), energy drinks, Gatorade, sweetened almond milk, and non-100% fruit drinks with added sweeteners are taxed. However, beverages considered by the FDA as milk substitutes (such as lactose-free milk and certain soy milk) are not taxed. Other exceptions include medical food marketed for use by people with dysphagia, or swallowing dysfunction, baby formula, products with 50% fresh fruit or vegetable smoothies, or coffee and tea that consumers ask retailers to add honey or syrup.

The tax is projected to create 5,500 new locally funded PHLpreK slots by 2023. During the first year, the PBT created 2,000 quality PHLpreK slots. Continued expansion includes other factors such as the program's investment in improvement of provider quality. Litigation challenging the PBT prevented the program from expanding in its second enrollment cycle, but the tax has been upheld in three courts, including the Pennsylvania State Supreme Court. With litigation resolved in the City's favor just months before a new school year, the program added 250 additional seats in September 2018. The Mayor's Office of Education will continue expand the program over the next three years.

In its first full year, the PBT generated nearly \$79 million in new revenue for the City, which was used for PHLpreK and several other educational and neighborhood revitalization initiatives.

While potential health benefits were not the impetus for PBT, health advocates and experts argue that PBT will have a positive impact on health outcomes. According to Harvard University's analysis, the PBT can save 700 lives, reduce cases of diabetes and obesity, and lower medical costs to about \$200 million in the next decade.

In media interviews, Mayor Kenney regards the PBT as a "corporate tax" providing a unique revenue source that does little harm to the economy. He believes that it will not disrupt the city's ongoing effort to reduce wage and business taxes, nor impact a large taxpayer base, as taxes only apply to distributors of sugared sweetened beverages.

## CHALLENGES

**Soda Tax Unpopular** // In 2010, former Mayor Nutter proposed a 2-cents per ounce tax on soda to reduce childhood obesity. The controversy surrounding the new tax pressured the City Council to vote against it. Instead, the Council approved to increase property tax by about four percent to fund K-12 education.

**Soda Industry Files Lawsuit** // Pennsylvania Retailers Association, National Association of Theatre and Tri-State Automatic Merchandising Council filed lawsuits against Kenney's Administration. The lawsuits argue that the tax violates the Sterling Act by double taxing beverages since the soda tax is levied on distributors and beverages are taxed again under the Commonwealth's sales tax when sold to consumers. The lawsuit against the PBT also claims that it violates the uniformity clause in Pennsylvania, which prohibits unequal taxing of similar products.

The lawsuit has gone to two appeal courts including the Pennsylvania Supreme Court which upheld the constitutionality of the PBT. The industry sued again in January of 2018 and while the Pennsylvania Supreme Court decided to hear the case, it upheld the tax.

**Soda Tax Rate Changed** // In July 2016, as part of its budget process, City officials lowered the beverage tax to 1.5-cents per ounce from the initial proposal of 3-cents per ounce.

**Soda Tax Higher Than Beer** // The PBT represents 24 times the Pennsylvania excise tax rate on beer, making some non-alcoholic beverage more expensive than beer.

# GETTING TO ACTION

- May 2015** Eighty percent of voters approve and create the Philadelphia Commission on Universal Pre-Kindergarten.
- Jun 2015** Philadelphia Commission on Universal Pre-K reviews current state of early childhood education in Philadelphia.
- Apr 2016** Philadelphia Commission on Universal Pre-K publishes a recommendations report with ways to create a locally funded PHLpreK program and increase funding for PHLpreK including a 3-cents tax for every ounce of sugar-sweetened beverage.
- Jun 2016** Philadelphia City Council approves the passage of the Philadelphia Beverage Tax. Mayor Kenney approves the City Council changes to the Philadelphia Beverage Tax and signs the five-year plan. The changes include a reduced tax from 3-cents to 1.5-cents per ounce of sugar-sweetened beverages. Funding also creates Community Schools and renovations to libraries, recreation centers and parks to broaden constituent support.
- Sep 2016** American Beverage Association files a lawsuit against Mayor Kenney's administration, arguing the legality of the Philadelphia Beverage Tax.
- Dec 2016** Commonwealth Court of Pennsylvania Judge Gary Glazer dismisses the lawsuit against Kenney administration.
- Jan 2017** The Philadelphia Beverage Tax plan takes effect; PHLpreK students begin attending PHLpreK programs across the City.
- Jun 2017** Pennsylvania Commonwealth Court votes to uphold Philadelphia Beverage Tax plan.
- Aug 2017** Philadelphia passes the "City of Philadelphia Sugar-Sweetened Beverage Tax Regulation" in its General Provision.
- Jan 2018** The Pennsylvania Supreme Court agrees to hear another complaint brought by distributors, small retailers and the American Beverage Association. This is now of national interest as it will influence similar levies in other states and cities.
- Jul 2018** The Pennsylvania Supreme Court upholds the Philadelphia Beverage Tax.
- Sep 2018** The City of Philadelphia adds 250 new seats to the PHLpreK program, and revises plans to ramp up to 5500 seats by September 2020.

# RESULT

Since January 2017, the PBT has funded education for over 4,000 children, ages 3 and 4, participating in nationally accredited public and private institutions. About 2,000 children have already graduated to kindergarten and new children have taken the vacated seats. According to a report by the Mayor's Office of Education in December 2017, after the PBT passed, about 38 new teaching positions were created and about 251 more staff were hired, with at least 191 of the positions were teachers. Thirty-three childcare providers have moved from "growth" status to quality status, as indicated by their Keystone STARS rating. This moved over 2,200 PHLpreK seats (City-funded as well as private pay and federal or state-funded) to quality. The PBT provides funding per child, which represents an amount of \$8,500 per child for the traditional six-hour school day and 180-day school year. The cost per child includes the cost of hiring additional staff and adhering to the City's 21st century minimum wage requirements. The City has raised more than \$130 million since the PBT took effect in January 2017. It has come within 85% of projection, which economists say is quite good. The City's current five-year plan for PHLpreK growth is to fund 5,500 seats annually by FY 2023.

## Additional Program Details

- ▶ *All families can apply for PHLpreK, regardless of income or employment status. However, the city prioritizes funding seats in PHLpreK centers located in neighborhoods with the highest concentration of poverty, children at risk of poor academic and life outcomes, and areas with a shortage of free, quality PHLpreK slots.*

# KEYS TO SUCCESS

- ▶ *Consumers can avoid tax by reducing consumption of sweetened beverages.*
- ▶ *Although the opposition invested \$10.2 million against campaign, the City's \$2 million campaign, funded in part by philanthropy, to support the PBT was successful.*
- ▶ *Applied the increased revenue to specific programs to captivate more constituents. Because revenue sources support libraries, community centers, parks, and community schools, this broadened a network of supports from foundations, advocacy organizations (like Fair Future), and advocates in education, parks and recreation, and health to pass the PBT.*
- ▶ *At full implementation, only the three key initiatives, PHLpreK, Community Schools, and Rebuild will be funded by PBT.*



## HOW DO SODA AND GROCERY TAXES WORK IN NORTH CAROLINA?

Groceries and prepared food are subject to special sales tax rates under North Carolina law. North Carolina does not treat candy or soda as groceries, which means they are not subject to reduced grocery sales tax rates. Other items including gasoline, alcohol, and cigarettes are subject to various North Carolina excise taxes in addition to the sales tax.

Counties and cities can charge an additional local sales tax of up to 2.75%, for a maximum possible combined sales tax of 7.5%. About 92 out of the 100 counties in North Carolina collect a local surtax of 2%. Most groceries are taxed at a reduced rate of 2% (excluding things like candy and soft drinks).