D.C. Tax Revision Commission

MEETING MINUTES

Subject: D.C. Tax Revision Commission Meeting

Date: Apr. 15, 2013

Time: 3:00 p.m. to 6:00 p.m.

Location: Room 1107, One Judiciary Square, 441 4th Street, NW, Washington, D.C. 20004

Members Present:

Anthony Williams
David Brunori
Mark Ein
Tracy Gordon
Nicola Whiteman
Fitzroy Lee
Ed Lazere
Pauline Schneider
Stefan Tucker

Invited Speakers:

Muriel Bowser, D.C. City Councilmember and Chair of the Committee on Economic Development

Richard C. Auxier, Research Analyst, D.C. Tax Revision Commission

Dr. Sally Wallace, Chair, Department of Economics, Georgia State University

Staff:

Gerry Widdicombe
Richard C. Auxier
Mike Bell
Ashley Lee
Rick Rybeck
Steven Rosenthal
Daniel Stoops

I. Call to Order (Commission Chair)

Mr. Anthony Williams, Chair of the D.C. Tax Revision Commission (the "Commission"), called the meeting to order at 3:05pm. Mr. Williams acknowledged the presence of Mayor Vincent Gray's TV crew, and thanked the Mayor for his support of the Commission and its work. Mr. Williams noted that all meeting materials are available on the Commission's website, www.DCtaxrevisioncommission.org. Mr. Williams concluded his opening remarks by thanking both the Office of Revenue Analysis and the Office of Tax and Revenue in the city's Office of the Chief Financial Officer (CFO) for their continued and exceptional support of Commission and its staff.

II. Approval of Minutes

The minutes from the March 4, 2013 Commission meeting were approved without amendment.

III. Testimony of Councilmember Muriel Bowser, Ward 4

Mr. Williams welcomed Councilmember Muriel Bowser, Ward 4 Councilmember and Chair of the Committee on Economic Development, to the meeting. Ms. Bowser thanked Mr. Williams and the entire Commission for their service. Ms. Bowser stated that the District's economic position has improved greatly since the last Tax Revision Commission, yet the District must seek to remain competitive in order to maintain the growth experienced over the past ten years. Ms. Bowser pointed out that homeownership rates and prices are on the rise, and although unemployment is too high, trends are favorable. Ms. Bowser cited the District's capital plan, which calls for $2 billion in spending in fiscal year 2014, to demonstrate the tremendous need for funding over the next 40 years including: $22.6 billion for WMATA, $1.5 billion for streetcars, $2.5 billion for WASA's combined sewer overflow reduction program and $1 billion for drinking water treatment and distribution, $5 billion for undergrounding of PEPCO lines, and $1 billion for affordable housing. Ms. Bowser emphasized that funds and borrowing capacity must be available in order to maintain the quality of life enjoyed in the District today into the future.

Ms. Bowser highlighted the importance of ensuring that people who have lived in the District for decades can continue to afford to live in the District as they age. Many Ward 4 residents are senior citizens and long-time property owners, who face pressure from increasing property tax burdens as property values rise. Therefore, Ms. Bowser has introduced the Age in Place and Equitable Real Property Tax Act in the Committee on Economic Development. Ms. Bowser stated that existing legislation provides a 50 percent tax break for seniors earning less than $100,000 per year, but many seniors earn just over that threshold, which has not been revised since inception. Ms. Bowser's legislation proposed that the threshold be increased to $125,000 per year, which would cover an additional 15,000 households. The revised threshold has been incorporated in Schedule H legislation which the Mayor has recommended for approval this year. Ms. Bowser stated that her bill had not been funded during the past two budget seasons because of a debate between using funds for low-income seniors or low-income residents. Ms. Bowser noted that a tax break for low-income seniors would allow them to make much needed investments in their aging properties. Ms. Bowser concluded by requesting a comprehensive review of all tax policies regarding their impacts on seniors. Ms. Schneider commented that she is against the removal of the vacant and blighted property tax classifications. Mr. Williams asked Ms. Bowser for her perspective in response to the argument that special exemptions, such as the senior citizen property tax break, tend to distort tax systems, create advantages for only certain groups, and add complexity. Ms. Bowser said the homestead deduction and senior credit have been effective incentives for residents to remain in the District, and that her bill simply allows a few more residents to benefit from the program.

Ms. Bowser invited Gladys Mack, a long time District resident, homeowner, and aging-in-place senior citizen, to make a statement. Ms. Mack asserted her support for Ms. Bowser's Age-In-Place property tax legislation, and cited Dupont Circle Village's support for the legislation as well. Ms. Mack stated that the bill will support intergenerational neighborhoods which enrich communities. Ms. Mack purchased her District home in 1972, which has appreciated considerably since that time, yet she has decided to remain there. Ms. Mack noted ongoing home maintenance costs, and that raising the income cap for the property tax credit would enable seniors to invest in their properties to increase their comfort as well as the beauty of their neighborhoods. Ms. Mack states that the bill will help seniors remain in the District where they have access to public transportation in the event they give up their cars. Ms. Mack notes that the city has been sensitive to needs of its seniors, and requests that such progressive policies be continued. Ms. Mack stated that the 21 year old income threshold for the tax credit needs to be updated to remain in step with economic changes occurring in the District.

Ms. Gordon asked about the income distribution of District seniors, noting that the $100,000 threshold seems high. Ms. Bowser replied that many households in which two members are government retirees—with combined pension income—exceed the current threshold, and noted that part of an affordable housing strategy means enabling seniors to age in place.

Mr. Tucker asked whether Ms. Bowser had considered adding a CPI adjustment to the cap in her bill, whether the current cap was still at the level originally established, and whether different levels of tax credit should be considered for different income tranches. Ms. Bowser replied that the existing cap has not been updated since it was established 21 years ago, that adding tranches based on income could be a strategy, and that a CPI adjustment would be worth considering as the legislation moves forward.

Ms. Whiteman asked whether the current tax structure supports senior housing. Ms. Bowser replied that is does, and that the District government needs to be sure to use its own land to support this issue. For example, redevelopment at Walter Reed should assist builders to construct both affordable and profitable senior housing. Seniors wanting to stay in their homes need help to modernize them, and DHCD provides some grants for this, which may need to be expanded as a large bubble of the population ages.

Ms. Schneider asked if seniors were concerned with the cost of dying and estate taxes in the District. Ms. Bowser replied that there are concerns, and that the government needs to do everything it can to keep citizens here for all their years. She emphasized that seniors are mobile, and the District must be competitive with distant locations that attract seniors. Ms. Bowser noted that the District is attracting empty nesters who want to live in smaller homes and enjoy what the District has to offer. However, certain levels of income cannot support living in the District given housing costs. As to estate taxes, seniors are concerned over their ability to hand down the wealth they built over decades to their children.

Mr. Ein asked about the age test for the tax break. Ms. Bowser replied that the minimum age to qualify is 65 and the income threshold is $100,000 or less in total household income. Mr. Ein requested to see what the income cap would be if it had been adjusted by the CPI over the years, and see the demographic profile of those who do or will soon qualify for the tax break. Mr. Ein asked whether the credit applies to disabled residents. Ms. Bowser confirmed that the credit is available to disabled residents, and expressed the need for a way to address the pressures of gentrification. One potential option would be to reduce the Homestead cap from 10% to 5%, but the cost of this has not yet been estimated by the CFO.

IV. D.C. Fiscal Architecture

Mr. Williams welcomed Dr. Sally Wallace, Chair of the Department of Economics at Georgia State University, to present the findings of her report on the Fiscal Architecture of the District of Columbia. The report was commissioned by the D.C. Tax Revision Commission. Both the draft report and presentation deck are available on the Commission's website. Mr. Williams requested that substantive questions be held until the conclusion of Mr. Auxier's subsequent report.

Dr. Wallace thanked Mr. Lee, Mr. Steve Swaim, and other OCFO staff for their assistance in completing the report. She noted that the report centers on identifying demographic trends and projections, which are difficult to detect and can change quickly, such as the aging trends discussed by Ms. Bowser and Ms. Mack. Dr. Wallace discussed a simple framework for thinking about revenue collection: Revenue collection = Rate * Base * administrative or compliance efficiency. She also provided a framework for expenditures: Expenditure need = population * unit cost of production. She noted that revenue collection is the primary focus of her report.

Dr. Wallace noted demographic trends affecting D.C.'s fiscal architecture, including: a population that is not aging as quickly as other U.S. cities, high racial and ethnic diversity (making compliance with complicated tax systems more difficult), and smaller than average households. Economic trends impacting D.C.'s fiscal architecture were also identified, including: global competition for jobs and residents, increasing reliance on capital rather than labor, and the fact that real estate is a more critical component of the economy and tax base than in other cities and states. Dr. Wallace explained that service sector output and capital inputs are harder to get a handle on for taxation because they are both mobile and hard to measure. She also noted that a University of Tennessee study estimated the District loses $36 million per year in sales tax revenue due to online sales. She recommends taking a leadership role in collecting these taxes.

Dr. Wallace asserted the need for a cost benefit analysis of an age in place policy, including accounting for the impacts it would have on necessary investments is transit systems and other services. She noted that elderly residents have more non-taxable income, and more of their consumption is health related and therefore not subject to sales taxes. She believes the District has the luxury of time to design an appropriate policy before the bubble of seniors arrives. Her home state of Georgia did not, and revenue concerns led to a removal of the full exemption from sales taxes for seniors.

Dr. Wallace emphasized that service sector output, which is critical for D.C., is difficult to tax. While many states are trying to adjust their tax codes to cover more services with sales taxes, they have had minimal success. Dr. Wallace believes it is time to look at fees and charges to ensure that citizens are paying for the benefits they get from specific government services.

V. Regional and National Tax Comparisons

Mr. Williams welcomed Mr. Richard Auxier, Research Analyst with the D.C. Tax Revision Commission, to present the findings of his report on District of Columbia Tax Comparisons. Both the draft report and presentation deck are available on the Commission's website.

Mr. Auxier emphasized that his report had three primary takeaways. First, D.C. household tax burdens are comparatively low for the region; specifically, most D.C. families would pay more in taxes if they moved to a neighboring jurisdiction in Maryland or Virginia. Second, the D.C. tax system is relatively flat due to a balance between a regressive sales tax and progressive income tax, while property taxes are flattened by the Homestead tax deduction. Third, D.C.'s statutory business income and commercial property taxes are higher than the rates in neighboring jurisdictions.
Mr. Auxier referenced a Minnesota Taxpayers Association study that found that the effective commercial property tax rate in D.C. was average for a large U.S. city. Unfortunately, the study did not provide a comparison between D.C. and its suburban competitors. Mr. Auxier also noted that the share of state and local taxes paid by the lowest 20% of income earners in the District is relatively low compared to other states, but the share paid by those in the middle of the income distribution is one of the highest.

Mr. Auxier concluded his presentation, and Mr. Williams opened the meeting to questions for both Dr. Wallace and Mr. Auxier from the Commissioners. Mr. Williams began by asking whether businesses that move from D.C. to Arlington are doing so for tax reasons. Mr. Auxier responded that this is a difficult question to answer that goes beyond tax policy, and that he could find no studies specifically examining effective business tax burdens in D.C. compared to its suburban competitors. Mr. Williams asked about comparisons between the costs of doing business in the District versus outlying areas, but Mr. Auxier again said he had not been able to locate such studies.

Mr. Williams asked Dr. Wallace how she would analyze the senior citizen property tax exemption proposed by Ms. Bowser. Dr. Wallace suggested a full revenue analysis including short- and long-term projections of fiscal impacts. She explained that many states have tried such exemptions and not gotten the economic benefits they had hoped for, while costs of the programs have increased over time. Mr. Williams questioned whether tax relief for senior citizens is most appropriately addressed at a city or federal level, noting that cities should not make policies in areas the federal government should control. Dr. Wallace agreed that it is a difficult issue, made more complex because the District has porous borders and very thin margins of competition between neighboring areas.

Ms. Gordon asked what the role of tax complexity is in regard to administrative burden and compliance. Dr. Wallace replied that administration is up to the government, and challenges include taxing capital and services. Compliance is up to individual and business taxpayers. Ms. Gordon asked how to ensure fiscal capacity in the face of uncertain demographic changes, perhaps through rainy day funds. Dr. Wallace noted that many states are looking at eliminating corporate income or other taxes, but this is difficult to do precisely because it removes any cushion against risk. Demographic changes pose similar risks and may require increasing capacity to support.

Mr. Ein observed that there seems to be a race to the extremes – some jurisdictions are increasing taxes to get their budgets balanced, while others are slashing taxes to try to attract business and residents. Mr. Ein asked how these moves will pan out in the long run, now that capital and residents are extremely mobile. He also asked if the District needs to be worried that places with very low rates will siphon off residents and businesses in upcoming years. Dr. Wallace noted that Louisiana is looking at eliminating their income tax, but most states are coming out of the recession favoring more conservative policies because they no longer have a rainy day fund to cushion against risks. There is a race to the bottom for lower taxes, to a point, but eventually the benefits of being in a place with appropriate infrastructure and services outweigh tax concerns. States are scrutinizing their expenditure and tax relief programs to be sure they deliver benefits. Mr. Ein noted that Mr. Auxier's chart of D.C.'s distribution of taxes seems to go against the popular notion that high income earners could save a lot by moving out of the District. Mr. Ein asked to see a comparison of total tax burden at specific income levels across competitive jurisdictions to see what the reality is, and for the total share of revenue paid by each income group. Mr. Auxier agreed this would be helpful, but no studies have made that specific comparison.

Mr. Tucker agreed that more information is needed about what proportions of revenue come from various income ranges, and questioned how flat D.C.'s system truly is. He noted that D.C. is one of only 20 states that have an estate tax, which Mr. Williams feels is a policy better administered at the federal level. Mr. Tucker questioned whether an estate tax is counterproductive because high income earners will choose to move out, and it could go against the efforts to have citizens age in place, and whether lowering the corporate tax rate would have little impact on revenue since most businesses don't end up paying it, but provide for better competitiveness.

Ms. Gordon believes the focus should be on personal tax burdens rather than the percentage of revenue collected from each income bracket. Mr. Ein carried this idea further stating that the most critical question is about the degree to which existing or proposed tax burdens attract or repel citizens in each income group.

Mr. Lee noted that D.C. is not unique in having very few companies pay the corporate income tax. He believes the question is more about fiscal balance. He asked whether D.C. faces any issues on the expenditure side, including infrastructure, and noted many other states are facing increasing health care costs. Dr. Wallace replied that many states are facing those issues, but D.C. has more of a unique issue around whether families with school aged children will remain in the District and use public education resources. Most infrastructure issues tend to be basic road and structural maintenance, but Dr. Wallace did not investigate this issue for the District.

Mr. Brunori asserted that taxing capital at the state level is ineffective because capital is so mobile. He also noted that few, if any, businesses pay an effective tax rate equal to the statutory rate, and questioned whether corporate income taxes are so easy to avoid it might make sense for D.C. to eliminate them entirely. He noted that businesses do contribute through employment and property taxes. Mr. Brunori asked Dr. Wallace if she was in favor of state level tax incentives, as most economists are not. Dr. Wallace replied that most economic development officers have seen businesses continue to request incentives and credits even if the corporate income tax is lowered or eliminated. She believes the real question is whether businesses would be paying their fair share in return for the benefits they get from the District if the tax were eliminated. She also noted that there may be a need to simplify the corporate income tax payment structure since there are so many opportunities to avoid it. Dr. Wallace acknowledged that incentives change behavior, but believes they are appropriate where markets are not functioning. However, the incentives must be well monitored and their benefits evaluated, and she does not recommend them as a way of attracting specific firms.

Ms. Whiteman asked what was driving the trends in elderly populations, and whether people were leaving the District at certain ages. She also asked what other jurisdictions are doing in terms of phasing in new taxes. Dr. Wallace reiterated that the elderly population of D.C. is growing, but not as quickly as a percentage of total population compared to the national average due to an influx of young professionals. She noted the national trend of attempting to expand the sales tax base to include services, but all such efforts have failed. Tax exemptions for the elderly are a more recent phenomenon, but already Georgia has had to halt the growth of their exemption. Kentucky initiated more aggressive means testing and is trying to raise the age threshold for eligibility.

Mr. Lazere asked for more details about what size companies are paying the minimum corporate income tax and the distribution of payers by company revenue. He noted that most businesses are probably small and contribute marginal tax revenue, but there may be large corporations that are paying substantially more than the minimum. If that is the case, eliminating the tax could have revenue consequences. He recalled that D.C. corporate income tax collections increased 40 percent in 2012 when combined reporting was implemented, which may be evidence that the tax is not ineffective. Mr. Lee noted that the minimum tax was also increased that year. Mr. Lazere stated that D.C. is competing for businesses and residents, but new employees must live in the District to generate personal income tax revenue. He asked if getting more residents would help bring jobs, and what alternatives to the corporate income tax might exist. Dr. Wallace noted that even with combine reporting there are opportunities for tax avoidance, and that alternative minimum tax thresholds are generally high with fairly flat taxes on gross receipts thereafter. Dr. Wallace believes the District's demographics make it well poised to grow residents if it can retain the younger professionals moving here, who offer a comparative advantage in terms of attracting certain businesses.

Mr. Lazere noted that middle income groups have a high tax burden in D.C., which could make it difficult to attract residents, and that with the exception of the lowest income levels, the D.C. tax system appears regressive. He believes the focus should not only be on bringing in businesses. He noted that simply having higher rates or tax burdens doesn't answer the question about what impact taxes have on people's choices of where to live. He noted New Jersey's large increase in its top income tax rate did not cause many residents to relocate.

Mr. Williams thanked the presenters, and moved to address commission business.

VI. D.C. Tax Revision Commission Business

Mr. Widdicombe noted the new proposed schedule, and that a poll of the commissioners had yielded a 10 to 1 vote in favor of requesting an extension of the Commission through the end of the calendar year. Public hearings are scheduled for June 24th and September 30th, and the Commission's next meeting will address business income taxes and individual income taxes. Mr.

Widdicombe stated that independent contracting authority has been helpful in keeping work products from experts on schedule. He pointed out the addition of Harley Duncan's work on tax administration to the research schedule, and thanked Mr. Brunori for suggesting Mr. Duncan.

Mr. Rybeck provided an update on community outreach and press strategy. A letter was sent from Mr. Williams on April 2nd to 40 Advisory Neighborhood Commission chairs and 60 community organizations. The letter outlined the origin and mission of the Tax Revision Commission, provided the website address, invited community participation, and offered briefings from Commissioners or staff at organizational meetings. No responses have yet been received. The next steps involve the press strategy, including reaching out to journalists who cover tax issues and providing them with background briefings about the Commission, research results, and to be sure they are aware of key meetings and deliberation dates.

Mr. Lazere asserted that the next public hearing should also be scheduled in the evening so that the public has the best opportunity to attend. Mr. Williams agreed.

Ms. Gordon commended the presenters work, and suggested that some of the graphics from their reports should be placed front and center on the Commission's website to draw interest.

VII. Adjournment

Mr. Williams called for adjournment at 5:15pm.