D.C. Tax Revision Commission

MEETING MINUTES

Subject: D.C. Tax Revision Commission Meeting

Date: Sept. 30, 2013

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

Location: Room W250 1101 4th Street, SW Washington, D.C. 20024

Members Present:

Anthony Williams	Teresa Hinze
David Brunori	Ed Lazere
Catherine Collins	Stefan Tucker
Pauline Schneider	Nicola Whiteman
Kim Rueben	

Staff:

Gerry Widdicombe	Steven Rosenthal
Ashley Lee	Richard C. Auxier

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 3:07pm. He began by thanking the Office of Revenue Analysis (ORA) and Office of Tax and Revenue (OTR) for their continued support of the Commission. He also noted that all materials presented at the meeting are available on the Commission's website, www.dctaxrevisioncommission.org. He announced that the Commission's next public meeting would be on Monday, Oct. 7, from 3 p.m. to 6 p.m.

Mr. Williams welcomed Kim Rueben, a senior fellow at the Tax Policy Center of the Urban Institute and Brookings Institution, as the newest member of the Commission. Ms. Rueben is an expert on state and local public finance and is replacing Ms. Tracy Gordon.

II. Approval of Minutes

Mr. Williams moved for the approval of minutes from the June 24 and Sept. 30 Commission meetings. The minutes were approved unanimously.

III. Discussion of Commission Schedule and Deliberation Process

Mr. Gerry Widdicombe, executive director of the Commission, then called members' attention to the schedule for the rest of the year. Mr. Williams stated that the sales tax was chosen for the first deliberation meeting because it appears to be the least controversial. Mr. Williams added that topics can be revisited at future meetings, and noted that the Commission would have to decide how to use the $18 million in revenue set aside by the D.C. Council to implement the Commission's recommendations. Mr. Williams further stated that there would be five public deliberation meetings, four of which would cover the major tax types, and one that would be a "catch-all" discussion.

IV. Deliberations: Sales Tax

Mr. Williams then turned to Mr. Steve Rosenthal, the staff director of the Commission, to lead the discussion of six sales tax options. Mr. Rosenthal was joined by Mr. Richard Auxier, a research analyst with the Commission. Mr. Rosenthal prefaced the discussion by stating that D.C.'s sales tax rate of 6% would go down to 5.75% tomorrow (Oct. 1st). As a result, D.C.'s general sales tax rate will be lower than the 6% rate in Maryland and Northern Virginia. Mr. Rosenthal also noted that the national median sales tax rate (combining state and local rates) is 6.85%. He added that D.C. also has a number of selective sales tax rates that are higher than the general rate.

Mr. Rosenthal advised the commissioners that D.C.'s sales tax base is relatively broad in terms of services taxed and as a percentage of personal income. Mr. Rosenthal further stated that D.C.'s sales tax base is shrinking, similar to other jurisdictions, because the service sector is growing and

D.C. has a particularly strong service sector. Another factor in the erosion of the sales tax base is the growth of remote sales.

Mr. Rosenthal summarized points made by Mr. William Fox in the sales tax paper he wrote for the Commission. Mr. Fox emphasized that the sales tax is a tax on consumption, not income; that broadening the base and lowering rates is considered the best strategy from an efficiency perspective; that the tax can be used to discourage externalities; that business inputs should not be taxed; and that it is important to minimize administration and compliance costs.

Mr. David Brunori then asked why the taxation of lawyers and other professionals did not seem to be on the agenda, while taxing barbershops was. Mr. Rosenthal stated that the Commission could add taxation of professional services to the agenda, but that the staff had relied on options suggested by Mr. Fox and others in preparing options for this meeting.

Mr. Williams suggested that the Commission deal with a gross receipts tax proposal during its meeting on business taxes. He argued professional services would fall into this category because the gross receipts tax would be the means of taxing professionals.

Ms. Kim Rueben pointed out that there are “different ways of skinning the cat” and that one could consider attorneys and accountant services (and other professional services) as business inputs.

Mr. Brunori expressed the view that the sales tax should fall on all personal consumption, professional or otherwise.

Mr. Stefan Tucker expressed concern that lawyers, accountants, and other professionals would move out of the District if they were taxed.

Discussion of Option No. 1: Expand Sales Tax to Additional Services

Mr. Rosenthal reiterated that the sales tax expansions included under this option were suggested by Mr. Fox. He added that policymakers have discussed taxing other services as well, such as information services and the “cloud.”

Ms. Teresa Hinze expressed concern about the possible impacts on barbers, many of whom are self-employed and rely on cash transactions who now would have to collect and remit sales tax.

Mr. Ed Lazere urged Commission members to start with a broad set of services to avoid a situation in which particular sectors believe they are being targeted unfairly. He added that businesses should not be ruled out just because they are small.

Ms. Pauline Schneider stated that she would be troubled by a tax on water consumption at home, but not by the taxation of diverse services such as spas or bowling that are purchased outside the home. Mr. Rosenthal clarified that the option being presented would only affect bottled water, not water that is piped into the home.

Ms. Rueben suggested that the Commission examine what Maine did when it expanded its sales tax, or what Maryland tried (unsuccessfully) to do when it considered sales tax expansion proposals. Ms. Nicola Whiteman suggested that Maryland and Virginia specifically be included in the comparison. For example, if the staff examined what Maine did, it should also gather information on whether Maryland and Virginia tax the services that Maine decided to tax.

There was a brief discussion about the taxation of construction services in D.C. Mr. Tucker stated that he had been taxed on home improvements. Several commissioners wondered if the tax applied only to materials, or to labor as well. There seemed to be agreement that clarification was needed.

Mr. Lazere urged his colleagues to think about whether consumption would shift if a service were taxed. Mr. Rosenthal observed that members seem interested in broadening the sales tax base but would like more information about specifics.

Mr. Brunori expressed skepticism that the nine services presented under this option would generate much revenue. He noted that it is hard to collect sales taxes from any cash-based businesses. Ms. Schneider expressed concern about the cost of collecting taxes on what seem like fairly narrow segments of the economy. Mr. Lazere differed somewhat with Ms. Schneider, stating that it makes sense to ask businesses pay taxes that other businesses pay, even if the business or industry is small.

Mr. Williams summarized the discussion by saying that the group seemed committed to pursuing Option No. 1 as a matter of fairness, absent huge administrative or competitiveness problems.

Discussion of Option No. 2: Expand Sales Tax Base on Goods—Grocery Foods, Snacks and Non-Prescription Drugs

Mr. Rosenthal noted that D.C., Maryland, and Virginia are all part of the minority of states that do not tax non-prescription drugs. Most states don't tax food, but Virginia imposes a partial tax on food (lower than its general sales tax rate).

With regard to non-prescription drugs, the Office of Revenue Analysis (ORA) was unable to estimate the revenue that would be generated by taxing these items because sales tax receipts are not broken down that way. For example, when someone buys batteries and non-prescription drugs at CVS, we don't know how much was spent on non-prescription drugs.

Ms. Rueben expressed skepticism about the merits of taxing food, noting that wealthy people might be able to purchase food in Maryland and Virginia more readily because they have greater mobility.

Mr. Williams noted that D.C. officials had spent a lot of time and effort trying to bring retail and grocery stores into the city; therefore, taxing food would be a negative. He expressed the view that grocery stores are an engine of neighborhood economic development.

Ms. Catherine Collins suggested that groceries should be taken off the list.

Mr. Brunori expressed the view that from the perspective of sound tax policy, all final consumption should be taxed. He acknowledged that it would be bizarre to tax food while lawyers, realtors, and other professionals "off the hook."

Several members described a possibly "snack tax" as unworkable, noting quirks in the application of the tax in the 1990s. For example, one member noted that when D.C. had a snack tax M&Ms were not taxable if they were used for baking, but were taxable if used for immediate consumption.

Several members also expressed concern about taxing non-prescription drugs. Mr. Tucker noted that non-prescription drugs are often quite expensive; when a drug is available only by prescription, insurance will usually pay most or all of the cost, but when the drug becomes non-prescription, the consumer has to pay the full cost. Nevertheless, Mr. Lazere urged members not to take non-prescription drugs off the table because many other states tax them. Therefore, he argued further research should be done on the experience of other states.

Mr. pointed out that D.C. already draws a line between food for home consumption and food for immediate consumption, and that it might be difficult administratively to draw yet another line (as between "snack food" and non-snack foods). Ms. Rueben observed that a soda tax (which is already in place) is more feasible than a snack tax. She further suggested that D.C. might wait until a larger state had implemented a snack tax successfully.

Discussion of Option No. 3: Assert Click-Through Nexus: Online Firms with D.C. Affiliates Collect Tax

Mr. Rosenthal noted that legislation pending in Congress, the "Marketplace Fairness Act," would allow for the collection of sales tax from remote sellers. In the absence of legislation, a handful of states have tried to assert nexus on out-of-state retailers more aggressively. This option would follow what New York and other states have already done.

Mr. Williams noted that joint action by states on this issue would be very helpful.

Ms. Rueben predicted that many firms would pull their affiliates out of D.C., rather than comply with the law, because D.C. is so small. New York State and California, by contrast, are large enough to have more leverage.

Mr. Brunori pointed out that we don't even know if we have these affiliates, who provide the basis for click-through nexus, within our borders. Mr. Lazere echoed the point that affiliates would likely move their operations out of D.C. in response to establishing click-through nexus. Therefore, Mr. Lazere believed that the benefits of this option do not outweigh the costs.

Mr. Williams summarized the discussion by noting that there is considerable skepticism about this option among Commission members.

Discussion of Option No. 4: Add a Use Tax Line to the Individual Income Tax Return

Mr. Rosenthal began the discussion by noting that very few people pay the use tax, and that adding a line to the income tax form is a way to encourage payment.

Mr. Rosenthal noted that OTR Director Steve Cordi has stated that adding the line on the tax form will ensnare more tax filers in fraud (because most people still won't acknowledge any use tax liability, and will therefore have perjured themselves). But he suggested that this option might work well in the District, because we have a large consumer base as well as a lot of young professionals who use online shopping. ORA estimated that the change would generate $1 million in annual revenue.

Mr. Tucker stated that this issue came to prominence because of Dennis Kozlowski, the former CEO of Tyco, who was jailed by New York after, among other violations, not paying use tax to the state of New York on $20 million in art purchases.

Mr. Williams expressed the view that since D.C. has a use tax that the Commission should take steps such as this to implement it. Ms. Rueben agreed that this option is a good idea, stating that the government should make it easier for those who would like to comply. She expressed the view that more people in D.C. would pay the use tax than in other states because many want to be "on the up and up" for a potential government appointment. Mr. Williams agreed with the latter point made by Ms. Rueben.

Discussion of Option No. 5: Unified Taxation of Tobacco Products

Mr. Rosenthal noted that we have two components to our cigarette tax, plus a mulit-part and confusing tax on other tobacco products. Unifying the taxation proposal came from the D.C. Tobacco Coalition.

Mr. Williams asked about the elasticity of the tax. Mr. Widdicombe offered some data from D.C. chief economist Mr. Fitzroy Lee showing that revenue surged when we raised the cigarette tax from $1 to $2 per pack. Nevertheless, when D.C. raised the tax per pack from $2 to $2.50, revenue dropped. The latter result might be explained by the recession.

Ms. Rueben expressed the view that equalizing tax rates seems like a good idea because tobacco products can be substituted. Mr. Lazere agreed, and noted that cigarette tax increases deter young people from starting to smoke.

Ms. Collins noted that bootlegged cigarettes come through the northeast corridor, and that decreases in consumption resulting from cigarette taxes may be misleading. There may simply be more illegal purchases and online purchases.

Mr. Brunori stated that he is opposed to cigarette taxes except to recoup the health-related costs of smoking.

The topic of e-cigarettes came up several times. Some members expressed the view that e-cigarettes should not be taxed like tobacco products because they are less harmful. There also seemed to be a general desire to know more about e-cigarettes.

Mr. Williams expressed concern that puritanical attitudes can have too much influence. If cigarettes are taxed too much, people will start to use other harmful products. Mr. Williams summarized the views of the group as being in favor of harmonizing tobacco tax rates, but uncertain about the merits of including e-cigarettes.

Discussion of Option No. 6: Increase Sales Tax Rate on Parking, Hotels, Rental Cars, and Restaurants

Mr. Rosenthal noted that these selective sales taxes, on products heavily consumed by non-residents, are considered means for "exporting" taxes. He added that a comparison of our tax rates with those of other cities showed that D.C.'s selective sales tax rates are not far from the norm. Mr. Rosenthal also reminded Commission members that they may need to identify revenue sources in order to make other changes that would lose revenue.

Ms. Rueben asked how our selective sales tax rates compare to those in Maryland and Virginia. She also stated that she thinks about hotels and rental cars differently from restaurants and parking. Mr. Auxier provided data on selective sales taxes in Maryland and Virginia which show that their rates are generally lower.

Ms. Hinze suggested that rental cars in D.C. are purchased mostly by residents because tourists get their rental cars at airports outside of the city.

Mr. Tucker expressed skepticism about increasing the parking tax, stating that we don't have enough parking for tourists.

Ms. Whiteman expressed concern about the impact of selective sales tax increases on D.C.'s competitiveness with Maryland and Virginia. She pointed out that the District had just raised its parking tax to 18% two years ago.

Ms. Schneider expressed the view that the city is becoming much more "anti-automobile." She suggested D.C. is forcing people into garages by removing on-street parking for bicycle lanes and by other changes in policy.

Mr. Williams expressed wariness about raising taxes in the abstract and contrasted it with base-broadening, which is supported by economic principles. He stated that tourism is an important growth industry that provides entry-level jobs, and that not everyone likes a bike or can ride a bike.

Mr. Brunori stated that exporting the tax burden is good politically, but that there is no sound tax policy rationale for it. He added that elected officials don't need the advice of a tax commission about how to grab for money.

Mr. Lazere noted that this might be the only conversation during the Commission's deliberations primarily about raising revenue. He added that he is not opposed to tax exporting unless it hurts an industry. Mr. Lazere also contended that the parking tax is inelastic, and that people are not as aware of parking taxes as they are of hotel taxes. Therefore, Mr. Lazere was more concerned about the impact of a hotel tax increase on competitiveness. He also observed that restaurants are popping up left and right around D.C. despite the fact that the city's restaurant tax is higher than in neighboring jurisdictions in Maryland and Virginia. Therefore, restaurants might be able to absorb a tax increase. Mr. Lazere noted that 14th Street and H Street would not collapse if the restaurant tax rose from 10 percent to 11 percent.

Mr. Williams agreed with Professor Brunori that a commission is not needed to patch together some tax increases.

Ms. Rueben observed that taxing restaurants is a way to tax commuters as well as tourists. Ms. Whiteman and Ms. Schneider expressed the view that increasing the restaurant tax could harm efforts to make neighborhoods more vibrant.

Mr. Rosenthal pointed out that raising the general sales tax rate back to 6% would generate approximately $20 million annually, which could be used to lower other taxes. Ms. Schneider stated that this step would seem like a non-starter if the D.C. Council had just lowered the tax to 5.75%.

V. Commission Business

Gerry Widdicombe noted that the Commission is mandated to draft legislation to implement its recommendations. Mr. Widdicombe stated that he had some ideas about who might be engaged to draft the legislation. Mr. Williams urged Mr. Widdicombe to consult with the attorney members of the Commission.

VI. Adjournment

Mr. Williams adjourned the meeting at 4:53 pm.