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Testimony of

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to the

District of Columbia Tax Revision Commission

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Thank you for the opportunity to speak to you this evening. My name is Elizabeth McNichol. I'm a senior fellow with the State Fiscal Project of the Center on Budget and Policy Priorities. I'm also a long-time DC resident, so I am both professionally and personally interested in your work.

I am here today to discuss Policy Option #45, "Introduce 'Equal Yield Budgeting' for Commercial Property." As I understand it, this proposal would fix the growth rate in commercial property tax collections at 3 percent per year by adjusting the tax rate up or down as needed to maintain that level. While I understand the goal of stabilizing taxes for any group of taxpayers, I have several concerns about this approach. A 3 percent cap on growth of a major revenue source could significantly reduce the city's ability to finance services on an ongoing basis, because DC's expenditures have grown faster than 3 percent on average. This could lead, in turn, to the need for higher taxes on individuals or other businesses. In addition, a 3 percent cap would limit city policymakers' ability to determine how best to use increased revenues during times of economic growth and how to respond to downturns.

Property taxes are the city's largest source of tax revenues. And commercial property taxes made up over two-thirds of property tax collections last year, totaling $1.2 billion — some 21 percent of DC revenues.

The proposed fixed growth rate for commercial property taxes would have serious consequences.

- **Limit Revenue Growth below the Level Needed to Fund City Services.** Since 2001 the city budget has increased by 6 percent per year, on average. Limiting the growth of a major revenue source to just 3 percent would make it increasingly difficult to fund city services. In addition, the growth in commercial property taxes could likely average less than 3 percent, as there would undoubtedly be opposition to the rate increases needed in bad economic times to maintain 3 percent growth. If commercial property tax collections are reduced, the city will be required to either cut programs, including those that support a strong business climate, or increase other taxes many of which are paid by individuals.
- **Lead to Sharp Tax Increases during Weak Economic Periods:** As designed, this plan would also result in additional taxes on businesses when times are bad and they have less ability to pay. While increased revenues are an important way to close budget gaps during economic downturns, this proposal would reduce policymakers' discretion to design a tax and spending plan that best addresses the specific circumstances of the city's businesses and residents at the time.
- **Prioritize Commercial Property Tax Cuts Over Other Options:** Limiting increases in commercial property tax collections to 3 percent — well below the average growth in this tax for the last decade — essentially puts commercial property taxpayers at the head of the line for tax relief in good times, instead of allowing an open debate among policymakers and the public about how best to use the additional revenue that results from an economic recovery. Rather than automatically cutting business property taxes, the city could also consider cutting taxes for individuals or improving funding for education, infrastructure, or other areas.
- **Result in Unknown Costs that Could Mushroom over Time:** The proposal could have unintended consequences. The effect on business property taxes could differ greatly from year to year, depending on trends in commercial property values. The unknown cost of this proposal may be the reason that the District's tax office provided no revenue estimate for

this proposal. That is troubling, given the importance of the proposed change. Rough estimates suggests that the impact would be significant. If total commercial property taxes grew by only 3 percent per year rather than 6 percent, for example, city revenues from this source would be more than $200 million less after five years. (Since 1999, commercial property tax collections have grown by almost 10 percent per year.)

The possible goals of this proposal could be met in other ways. If the goal of this proposal is to reduce commercial property taxes, it would be far more straightforward and financially predictable to simply adjust the rate. If the goal of this proposal is likely to reduce volatility in commercial property tax collections, the District could create a reserve fund to handle the effects of volatility without losing the benefits of higher revenue growth during good times.

Thank you again for the opportunity to testify.