



D.C. Tax Revision Commission

MEETING MINUTES—DRAFT

Subject: D.C. Tax Revision Commission Meeting
Date: May 20, 2013
Time: 3:00 p.m. to 6:00 p.m.
Location: 441 4th Street, NW, Washington, D.C. 20004

Members Present:

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

Invited Speakers:

Councilmember Tommy Wells (Ward 6)

Michael Bell, MEB Associates and Research Professor, George Washington Institute for Public Policy

David Sjoquist, Professor of Economics, Andrew Young School of Policy Studies, Georgia State University

Daphne Kenyon, Principal, D.A. Kenyon & Associates

Staff:

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

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 3pm. After noting the meeting was being recorded for Channel 16, he thanked the mayor’s office for their continuing support of the Commission’s work. He also took a moment to thank the Office of Revenue Analysis (ORA) and Office of Tax and Revenue (OTR) for their continued and excellent assistance. He then announced the meeting would consist of three presentations about property taxes (overview, tax caps and classification) as well as a discussion with Councilmember Tommy Wells. He also noted that all materials presented at the meeting are available on the Commission’s website, www.dctaxrevisioncommission.org.

II. Approval of Minutes

The minutes from the May 6, 2013 Commission meeting were approved without amendment.

III. Testimony of Councilmember Tommy Wells, Ward 6

Mr. Williams then welcomed Councilmember Tommy Wells, who represents Ward 6 on the D.C. Council, to the Commission meeting. He also noted that all members of the council have been encouraged to address the Commission as it continues its work. Mr. Wells began by thanking the members of the Commission for their time and service to D.C. He said that in addition to the stated goals of tax equity and fairness the Commission must work to square the fact that D.C. is doing very well but still faces, as a recent Brookings report noted, a “structural deficit.” More specifically, Mr. Wells asked the Commission to recommend changes that will make the tax system fairer for neighborhood retailers. He asked, “Should small D.C.-based businesses pay the same property tax rate as the large corporations?” As context, he noted that 80 new businesses have opened in his ward, and that these businesses—in contrast with large corporations downtown—hire D.C. residents and directly contribute to safer and walkable communities. These local businesses also typically sign triple net leases and therefore bare the full burden of property taxes.

Mr. Wells said transportation congestion cannot be solved through roads alone and that the city must ensure residents can walk, rather than drive, to local stores for amenities. He said taxes play a part in reaching these goals. For example, Mr. Wells noted that much of the new development at Southwest Waterfront is driven by special tax abatements that made the region economically viable. He then thanked the Commission again and asked if there were any questions.

Ms. Nicola Whiteman asked if tax expenditures for small businesses should come with an expiration date or end when a neighborhood is flourishing. She also asked about nuisance abatement changes and if they were relevant to the city’s tax system. Mr. Wells said that the tax burden on local

businesses should be reduced across the city and not just in economically underdeveloped neighborhoods. These policies, he said, promote “five-minute living” and age-in-place; outcomes that are beneficial to all D.C. residents. As for nuisance abatement, he said the revitalization of H Street, a neighborhood that had been stagnant since the riots of the 1960s, is credited to both the D.C. Department of Consumer and Regulatory Affairs (DCRA) and increased property taxes on vacant and blighted properties. Ms. Tracy Gordon asked why this was not solely a regulatory process. Mr. Wells said the tax penalty in combination with the work of DCRA is a “heavy hand” but that the tax makes an incredible impact and the resulting growth is overwhelming.

Mr. Williams asked, given the city’s record of losing companies to surrounding jurisdictions, if there is value in tax incentives for large businesses. Mr. Wells responded that there is more value, including from a revenue perspective, in concentrating on residents and not business. He contrasted Living Social, a company with a workforce full of D.C. residents, with the FBI, where most employees live outside the city.

Mr. David Brunori then asked whether the councilmember favors differentiating tax rates by neighborhood for sales, income and property taxes. Mr. Well said he was speaking only of property taxes. He cited the neighborhood of “NOMA,” which has seen economic growth following very targeted and time-limited tax incentives, as a promising example. When asked if this type of policy creates “winners and losers” Mr. Wells said that ultimately tax incentives grow the city and produce tax revenues (and social services) that are beneficial to all of D.C. residents. Mr. Fitzroy Lee also asked about the inequities engendered by tax incentives. Mr. Well said the goal is incentivizing sustainable neighborhoods. He asked the Commission to consider whether liquor stores and grocery stores should face the same property tax burden. Following a question from Ms. Catharine Collins, Mr. Wells endorsed differentiating tax rates by zoning codes. After this exchange Mr. Williams thanked Mr. Wells for his time and contributions to the Commission.

IV. Presentation: Overview of the Real Property Tax in D.C.

Mr. Williams then welcomed Mr. Michael Bell, a member of the Commission staff and consultant to numerous tax projects (including the 1998 D.C. Tax Revision Commission), to present an overview of the real property tax in D.C. Mr. Bell was joined by Mr. Daniel Muhammad, a fiscal analyst with ORA who assisted Mr. Bell with his research. Mr. Bell began his presentation by noting that when commissioners were solicited for tax topics of interest many had raised issues related to property taxes. He said that concentrating on property taxes was both good, as there is a wealth of information available, and bad, as everyone has a different interpretation of that information. Mr. Bell said his report is a consensus view of all the relevant issues.

According to Mr. Bell, the property tax scores well as a revenue source: it is fair, transparent and does not distort economic behavior. He said any derivations from these principles are political decisions. With respect to D.C., the city relies on property tax revenues more than most state and local governments (including those in Maryland and Virginia). D.C. also has high-quality assessments of residential property. Commercial property assessments are not as close to market value but the system is improving. The city's residential rates are the lowest in the region while its commercial property rates are the highest.

The D.C. system includes numerous tax relief programs (exemptions, abatements, credits, etc.) that provide relief to taxpayers but also distort the system. Mr. Bell said these programs are very ad-hoc and never reviewed by the council. As a result, the system is less fair (horizontal equity), confusing and distorts economic behavior. To illustrate his point, he shared a graph displaying the effective tax rates for different taxpayers: seniors paid far less than homestead families who paid far less than commercial property owners. Furthermore, he noted that there was much variation within each group. For example, within "seniors" there are taxpayers who pay eight times the effective property tax rate of other taxpayers in that group. Some may highlight these disparities as a policy achievement, though. Mr. Bell said his only goal was to demonstrate that there are costs associated with such decisions that must be weighed. Mr. Bell gave a brief description of the Commission's property tax agenda going forward before concluding his comments.

Mr. Brunori asked Mr. Bell for his thoughts on Bob Strauss's research showing a nationwide shift from commercial to residential tax burdens as state and local governments pursue economic development programs. He also asked about the commercial-residential split in D.C. Mr. Bell noted that while 42% of the D.C. property tax base is commercial fully 67% of the tax burden is commercial. This means political leaders have decided to lower the residential tax burden in D.C. at expense of raising the commercial tax burden.

V. Presentation: Residential Property Tax Caps

Mr. Lee then introduced Mr. David Sjoquist, a professor at Georgia State University and member of a recent tax commission in Georgia, who was in attendance to discuss D.C.'s residential property tax cap. Mr. Sjoquist began with some background: the policy is officially called a tax credit and was created in 2002 when both property values were rapidly increasing and the city was transitioning from a three-year to one-year assessment schedule. The credit prevents assessed value from increasing by more than 10% (the original rate was 25%) and applies only to homestead properties. (The actual process involves a more detailed calculation that Mr. Sjoquist described for the Commission.) There is no application for the tax credit as each resident claiming a homestead deduction is eligible. The policy recently was altered so that no property can have a taxable value of

less than 40% of its assessed value. He also noted that 19 other states have some form of property assessment limitation.

Mr. Sjoquist then turned to how the tax credit affects D.C.'s economy and revenue. He said the current revenue loss is sizeable but not huge relative to total property tax revenues. There is a strong relationship between the housing market and revenue loss, though. For example, the revenue loss was roughly three times as large in 2007 as it was in 2011. He also discussed how the credit injects inequity into the property tax. In 2011, most homeowners had a capped value below the assessed value of their home, but the range of capped-to-assessed values was very wide. As with revenue, the disparity is exacerbated during a better housing market. In 2007 more than four-in-five homeowners had a lower capped value than assessed value and the capped-to-assessed range was substantially wider. Finally, he noted that studies have found that tax caps such as D.C.'s reduce the probability of a home being sold, but not by a substantial margin.

When raising policy options, Mr. Sjoquist said the Commission must first decide what goal it hopes to achieve by changing the residential property tax cap: reducing property appreciation, eliminating tax inequities, reducing revenue loss or providing tax relief to specific residents. He noted it was impossible to achieve all of these goals and that promoting one would require tradeoffs. For example, the Commission cannot decide to reduce the revenue loss and slow the appreciation of assessed property values.

He then laid out eight possible changes:

1. Make no change;
2. Eliminate the assessment limitation;
3. Phase out the assessment limitation (possibly grandfathering in current homeowners);
4. Make the capped value portable;
5. Change the 40% provision;
6. Change the cap rate;
7. Convert the limitation to one that applies to the aggregate tax base;
8. Change how improvements affect capped value.

Mr. Brunori took a moment before questioning to note that Mr. Sjoquist, in addition to Mr. Bell and Ms. Daphne Kenyon, are all renowned experts in their respective fields and the Commission is lucky to have all of them contributing to this project. He then asked what was causing inequities in the tax credit policy: application, administration or user error. Mr. Sjoquist stated that inequities are mechanical; that different payments are a result of how the law is set up. (Mr. Daniel Muhammad later added that a lot of the inequity is created by when households come into the program.)

Asked if he endorsed tax caps, Mr. Sjoquist said that he does not because of equity concerns. Instead, he endorsed circuit breakers, a policy that bases property tax relief on income rather than home value. Mr. Mark Ein then asked how the city should attack the central problem—raised by the public and members of the council—of residents having to pay property taxes on a non-liquid asset with cash. Mr. Sjoquist again endorsed a circuit breaker program. He said that D.C. has such a program, but members of the commission noted that its income threshold is low and has not been changed for several years. It was also noted that legislation to change the threshold is currently before the council. Mr. Sjoquist added that the income threshold could be as high as \$200,000, but remain a targeted tax credit as long as the percentage of property tax (or rent) to income is kept high. When asked for problems with circuit breakers, Mr. Sjoquist said that income taxes and property taxes are not paid at the same time and that low-income residents are disadvantaged when waiting on the income-tax credit. Furthermore, many low-income residents do not file income taxes and will miss out on the program.

Ms. Gordon then asked if any state has been successful in modifying or repealing a property tax cap. Mr. Sjoquist said no and that once such a program is created it is only expanded or made portable. Mr. Lee asked about the recommendation to change the 40% provision and if such a change could affect administration. Mr. Sjoquist responded that in a stronger economy, with great property value growth, the 40% limit may have a severe effect on revenues. He added that because the cap is based on a routine formula that making such a change will not affect administration.

Mr. Ein then asked about the underlying justification for the property tax. Why should residents continue to pay more in taxes—year after year—as their home value increases? Mr. Sjoquist said that property taxes are a reflection of services: when property values increase so do public services. Mr. Brunori added that this does not have to be the case and political decisions can be made to make property taxes revenue neutral. Mr. Bell argued that governments have costs and property taxes are a better source of revenue than other options. Ms. Gordon added that there is also an inverse relationship: taxes pay for services that then increase home values. She also noted that the tax must be compared with other sources of revenue, such as sales taxes, and not an ideal. After this discussion Mr. Sjoquist was thanked by Mr. Williams for his service and time.

VI. Presentation: Classified Property Tax System

Mr. Williams then welcomed Ms. Kenyon, of the Lincoln Institute of Land Policy, to the meeting for her presentation on property tax classification. Ms. Kenyon began her presentation by describing D.C.'s current four class system:

- Class 1: Residential property
- Class 2: Non-residential property including vacant land

- Class 3: Vacant buildings
- Class 4: Blighted buildings

She noted that D.C. is the only state that does not have assessors assigning all classes. Instead, DCRA is responsible for assigning Classes 3 and 4. She also described D.C.'s system as more complex than most states and noted the city has either changed rates or structure 19 times since 1976. Starting in 1976, D.C. began taxing commercial property at a higher rate than residential and it now joins nine other states in having explicitly higher tax rates for commercial property. Mr. Williams asked what caused such changes over time. Ms. Kenyon said that in a previous tax revision study an expert argued that commercial taxes are "exported." This thinking was embraced and commercial rates were increased. She also noted that tax relief for residents had risen in recent years and further divided the tax burden between the two classes. Ms. Kenyon then explained that D.C. has a lower residential property tax rate than surrounding jurisdictions in Maryland and Virginia but the city has the highest commercial property tax rate in the region. She noted different organizations calculate different commercial property tax rates but that each reaches the same conclusion.

Ms. Kenyon stressed that the key issues with classification were a tradeoff between economic incentive and simplicity in Classes 3 and 4 and exportation versus competitiveness in Class 2. She argued previous tax commissions have had a shelf life of 10 years and therefore the Commission should plan with that timeframe in mind. She then presented a range of policy options:

- Status quo;
- Reduce Class 2 tax rate relative to Class 1 tax rate;
- Reduce Class 2 tax rate and increase Class 1 tax rate;
- Reduce Class 2 tax rate relative to Class 1 tax rate, financed by reducing property tax incentives;
- Eliminate Class 3 and 4;
- Eliminate Class 3 and lower the tax rate for Class 4 to the current rate for Class 3;
- Eliminate Class 4;
- Phase in the \$10/\$100 tax rate on Class 4

Mr. Lee began the questioning by asking if there is any economic rational (as opposed to political) for a classified property tax system. Specifically, he asked if attacking blight is a valid economic concern. Ms. Kenyon said that blighted properties do have spillover effects. She said the question is what that externality actually costs. A tax should be calibrated to meet that cost, but she doubted this is how or why D.C. choose its tax rates. Mr. Brunori then asked if Ms. Kenyon thought classification is good public policy. She responded that in general she is not a big fan of the system—because of the inequity it creates—but that she understands why the city wants to export taxes. She said the key is keeping business rates high but complete.

Ms. Whiteman then asked if the low revenues produced from Classes 3 and 4 properties pointed to a policy success. Ms. Kenyon said there are a large number of vacant or blighted properties not classified as such and that better numbers are needed for an analysis. Mr. Lazere then asked if there is any difference in taxing blighted properties or levying a fine. Ms. Kenyon said there is not but warned that D.C.'s system requires two organizations (DCRA and OTR) to coordinate while most states have just one organization carrying out this mission. Mr. Lazere then asked how D.C. has experienced such large economic growth with "uncompetitive" tax rates. Ms. Kenyon said the federal government makes D.C. very unique and that she is worried that emerging trends (shrinking government, office space, technology, etc.) will create competition problems going forward.

Ms. Gordon then asked how the city can implement an elimination of all property tax exemptions and abatements (in an attempt to lower property tax rates). Specifically, how should previous commitments be treated? Ms. Kenyon said this is a challenge and that most likely new (rather than old) tax expenditures would be eliminated.

The commissioners then briefly discussed the cause and treatment of blighted property in D.C., and why the city does not simply acquire such property. Mr. Muhammad noted that city has no interest in owning property. He said such property goes to a tax sale, but because such properties have substantial tax bills tied to them they are not purchased. He also said that one reason revenues for Class 3 and 4 properties are so low is because their owners are in financial distress and unable to pay. With owners unable to pay and no one interested in purchasing the expensive properties no one pays the tax.

Mr. Williams then closed out the discussion by noting that D.C.'s classified property tax system is also a reflection of the environment the city must operate in. D.C. is prevented from taxing income at the source and therefore must look for other revenue sources. He then thanked Ms. Kenyon for her time and contribution to the Commission.

VII. D.C. Tax Revision Commission Business

Mr. Gerry Widdicombe updated the Commission on the staff's ongoing community outreach and encouraged commissioners to reach out to interested parties regarding the Commission's upcoming public hearing on June 24. He also noted that the staff is in the process of contacting editing and design firms that possibly can assist the Commission with producing its final report.

VIII. Adjournment

Mr. Williams called for adjournment at 6pm.