DC Tax Revision Commission

Exective Summary

Final Report

May 2014

EXECUTIVE SUMMARY

The District of Columbia's economic picture is largely bright. It weathered the recession better than most jurisdictions, adding businesses, jobs, and residents during the recovery. More and more people are now choosing the District as a place to live, rather than merely work.

Private employment is growing, offsetting a loss of federal government jobs. The current population and private employment strength translates into a relatively stable and growing revenue base. The District's budget is balanced (indeed, in surplus), and its tax system is fundamentally sound.

However, there are challenges on the horizon. The District may not continue to attract and retain residents. In addition, to reduce its dependence on the federal government, the District must diversify its economy. Finally, many commuters and businesses use District services but do not pay District taxes.

Jurisdictions often establish tax commissions to address fiscal crises or to lay foundations for new tax revenues. The Council of the District of Columbia (DC Council) created the DC Tax Revision Commission during a time of fiscal and economic progress and asked the Commission to analyze the District's tax system and propose innovative approaches to meet *future* challenges. The District last received a comprehensive review of its tax system from a tax commission in 1998.

From the fall of 2012 through the end of 2013, the Commission reviewed the major taxes in the District and considered ways to improve fairness, broaden the tax base, increase the District's competitiveness, encourage business and employment growth, and promote simplification, as directed by the Commission's authorizing legislation.[1] The Commission's objective was twofold: to improve the District's tax system and to maintain its fiscal integrity.

The Commission held 26 meetings and three public hearings in its 16 months of activity. Experts in state and local tax policy assisted the Commission's work. They analyzed the District's taxes, compared them with other localities and states, both regionally and nationally, and suggested reform options. Mayor Vincent Gray, members of the DC Council, and the public also offered policy suggestions.

In September 2013, the Commission's staff assembled a list of 63 wide-ranging policy ideas for the commissioners to deliberate during public meetings.[2] Some policy ideas were in conflict with others. The staff identified pros and cons for each idea, and the District's Office of Revenue Analysis (ORA), the revenue-estimating arm of the Office of the Chief Financial Officer, evaluated the revenue impact for each option.

On Dec. 18, 2013, the Commission unanimously approved a set of recommendations designed to improve the District's tax system and help its residents and businesses prosper. The Commission structured its recommendations as a package, and many of the recommendations work in concert. For example, base-broadening measures in some recommendations help fund other tax relief recommendations.

The DC Council allocated $18 million a year to fund tax changes. The Commission worked hard to keep the cost of its recommendations as close to this target as possible to ensure that the District has the resources necessary to adequately fund its public services. Although the final package of recommendations exceeds the DC Council's allocation, the Commission considers its recommendations affordable given the District's recent economic and tax revenue growth.

The Commission identified three challenges for the District's tax system:

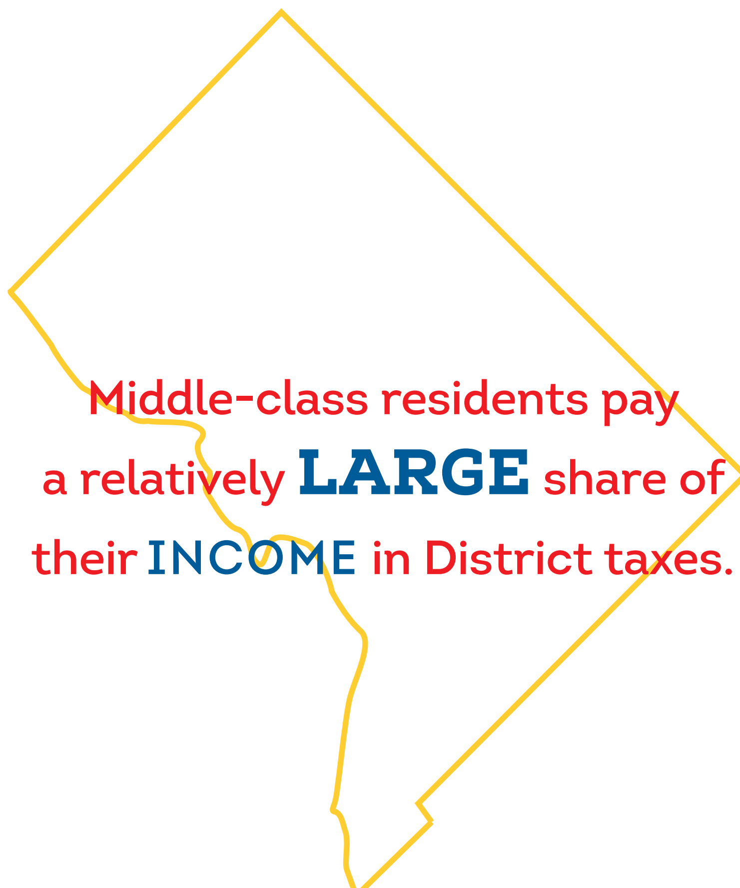
- Middle-class residents pay a relatively large share of their income in District taxes. This undercuts the progressive design of the District's tax system and impedes efforts to attract and retain residents. This disproportionate burden is especially troubling given the rising cost of living in the District. The current tax system often challenges long-term residents hoping to stay in the city, young professionals moving to the District, and growing families seeking to make the District their per

[1] The Commission was authorized by the DC Council on Sept. 14, 2011, through an amendment to DC Code § 47-461. Please see the Appendices for the authorizing legislation.

[2] Three of the original options were related to tax administration. These options are not included in this section of the report, but were presented in a memo to CFO Jeffrey DeWitt, who recently assumed office.

manent home. The Commission recommended increasing the standard deduction and the personal exemption as well as adding a new middle-income tax bracket, with a tax rate of 6.5 percent, rather than 8.5 percent.

- The District's business franchise tax and commercial property tax rates are the highest in the region and among the highest in the nation (although a comparison of the burden from all business taxes is less clear). These tax rates may fuel a perception problem. As it prepares for future challenges, including a shrinking federal government, the District must attract businesses and diversify its economy. The Commission recommended lowering the District's business franchise tax rate to 8.25 percent (from 9.975 percent), the same rate as Maryland and closer to Virginia's 6 percent rate.
- Because of federal limitations, the District cannot tax many businesses and individuals. As a result, taxable District businesses and residents must shoulder a higher burden. The Commission recommended broadening the tax base, which would spread the tax burden more widely and raise revenue more efficiently. To that end, the Commission recommended a local service fee of $25 per employee per quarter to be paid by all employers (except the federal and District governments) with five or more employees. It also recommended an expansion of the sales tax to a handful of additional services.



The first chapter of this report explains the Commission's recommendations, which are organized by type of tax: individual income tax, the estate tax, business taxes, sales tax, and property tax.[3] The chapter also addresses the ideas that the Commission rejected. Following the recommendations are a chapter highlighting the District's key economic trends and a chapter analyzing the District's tax system in more detail, including comparisons with other jurisdictions. Finally, the Appendix includes a revenue estimate for the Commission's package of recommendations, a distribution table for the recommended income tax changes, draft legislation to implement the recommendations, and a list of all the policymakers, experts, residents, and staff who contributed to the report.

[3] Deed recordation and deed transfer taxes are included in the discussion of property taxes.