D.C. Tax Revision Commission

MEETING MINUTES

Subject: D.C. Tax Revision Commission Meeting

Date: Sept. 16, 2013

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

Location: 441 4th Street, NW, Washington, D.C. 20001

Members Present:

Anthony Williams	Fitzroy Lee
David Brunori	Ed Lazere
Catherine Collins	Stefan Tucker
Pauline Schneider	Nicola Whiteman

Invited Speakers:

Councilmember Mary Cheh (Ward 3)

Robert Aceituno and Karen Yingst, Councilor Buchanan & Mitchell, P.C

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 3:05pm. 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, Sept. 30, from 3 p.m. to 6 p.m.

Mr. Williams took a moment to note the significance of the recent series in the *Washington Post* documenting stories of D.C. residents losing their homes over small tax bills. He said that while the mayor and Council seem prepared to take emergency action on the issue that the Commission—tasked with making D.C. taxes more fair and simple among other goals—will join the effort to improve this system.

Finally, Mr. Williams announced that Tracy Gordon is leaving the Commission to join the president's Council of Economic Advisers. He read a section of Ms. Gordon's resignation letter in which she thanked the Commission and the District for providing such an incredible opportunity for public service and the chance to learn so much about D.C. taxes. Ms. Gordon is being replaced by Kim Reuben, a senior fellow at the Tax Policy Center, who will join the Commission on Sept. 30 for the first round of Commission deliberations. Ms. Reuben's transition will be aided by Steve Rosenthal, who is both a member of the Commission staff and a visiting fellow at the Tax Policy Center.

II. Approval of Minutes

The minutes from the June 24, 2013 Commission meeting were not approved because they were not circulated prior to the meeting. They will be circulated before the Sept. 30 meeting.

III. Testimony of Councilmember Mary Cheh

Mr. Williams then welcomed Councilmember Mary Cheh (Ward 3), chair of the Committee on Transportation and the Environment, to the meeting. Ms. Cheh began her testimony by stating that there is little in government as reviled but also as necessary as taxes. In addition to funding social services such as schools and police, taxes affect behavior. She said the goal for policymakers is to ensure that our taxes reflect our social values.

One such value that Ms. Cheh would like to promote is incentivizing residents to stay in D.C. as they age, and that reforming D.C.'s estate tax is crucial to achieving this goal. She argued that while the D.C. estate tax provides significant revenue to the city, it may also drive residents to states without such a tax. Ms. Cheh noted this is especially likely given that seniors can continue to enjoy the benefits region and avoid the tax by moving to Northern Virginia. Virginia does not have an estate tax while both D.C. and Maryland tax estates larger than $1 million. She acknowledged that much of her evidence for such movement is anecdotal, but later noted how she's often surprised how many homes in her ward are occupied by people who officially reside in another jurisdiction.

To mitigate movement out of the District but limit the revenue losses that a completely repeal would engender, she presented two reforms to the estate tax:

1. Raise D.C.'s threshold for paying the tax from $1 million to the federal level of $5 million.
2. Raise D.C.'s threshold to $2 million so that it's higher than Maryland's (also $1 million).

A second value that Ms. Cheh wants promoted is the city's diversity by ensuring that residents at lower income levels are able to afford the cost of living in the city. Ms. Cheh put forward two ideas for addressing this objective:

1. Expanding the D.C. Earned Income Tax Credit (EITC).
2. Raising D.C.'s standard deduction and personal exemption.

D.C.'s EITC provides eligible taxpayers 40% of the federal credit and therefore follows the federal EITC guidelines. Ms. Cheh noted the EITC allows low-income workers to keep more of their paycheck—and provides cash payment for some—and has been credited with raising millions of people out of poverty. One way to expand the benefits of the EITC is to make it more generous for workers without children. The EITC currently provides little to such workers. For example, a worker with no children earning more than $16,000 receives no tax relief under the current system. In contrast, a worker with children can receive tax relief with an income as high as $35,000. Ms. Cheh also advocated for providing tax relief to workers at higher levels of income than the federal government credit does. Ms. Cheh noted that both proposals would force D.C. to decouple from the federal standards—making the tax more difficult to administer—but she said that such changes are necessary as D.C.'s cost of living is 40% higher than the national average, making the federal standards inadequate.

Ms. Cheh also asked the Commission to consider raising the D.C. standard deduction and personal exemption to the federal levels. She pointed commissioners to a recent report published by the D.C. Fiscal Policy Institute that outlined the benefits to low- and middle-income residents if both were raised and noted that six states have already moved to the federal level.

Ms. Cheh then raised the issue of tax administration, saying that as the recent reports in the *Washington Post* make clear, tax policies do not work unless they are implemented properly. She stated that she did not consider the D.C. Office of Tax and Revenue (OTR) to be well run, and said she is constantly contacted by constituents who have had trouble with OTR. She said the problem is not just complaints about service but that merely communicating with OTR may take months. Ms. Cheh said that careful thought must be given to hiring better personnel, and that modernization of the tax system will not work if administration is not addressed.

Her final proposal was for more analysis of tax abatements and exemptions the city provides to businesses. Ms. Cheh noted that after the D.C. Council passes these tax breaks they have little knowledge of how well the legislation is working and if the legislation achieved its stated goals. This prevents councilmembers from both ending a poorly designed program and expanding a successful one. She asked the Commission investigate the research on tax incentive analysis from the Pew Charitable Trusts.

Mr. Williams thanked Ms. Cheh for her testimony. He then asked her what changes she'd make to the tax system, if any, if the city enjoyed a budget surplus over the next few years. Ms. Cheh said D.C. should respond to any surplus by revisiting any action that was delayed under less prosperous circumstances. She also said that in addition to social needs and economic development the city should not lose sight of quality of life issues such as the arts and schools program. Mr. Williams asked if there are states that review tax incentive programs particularly well that D.C. can emulate or use as guidance. Ms. Cheh said that the best idea is for the Commission to work with Pew and use their report when making recommendations.

Stefan Tucker, who noted that he is a constituent of Ms. Cheh in Ward 3, said that in his experience as a tax lawyer that the estate tax is having an even bigger impact on resident movement than Ms. Cheh presented. He said the tax is driving residents out of the District and that, as a result, the city is losing other tax revenue such as property taxes. He also noted the Commission must focus on lowering the income tax burden for middle-income residents (who pay relatively high rates on income above $40,000) as well as low-income workers. Mr. Tucker then mentioned that while Ms. Cheh works at a university in the city, that he believes the Commission should recommend creating a payment in lieu of taxes (PILOT) program so that these institutions (exempt from property taxes) contribute something to the city's revenues. Ms. Cheh responded that he was "preaching to the converted." While she is very familiar with the objections of universities, Ms. Cheh said it is only fair for these schools to pay their fair share.

Mr. David Brunori then asked how much taxes should be used to influence behavior. He said that while analyzing tax incentive programs is a worthy cause that even the best intentioned program may interfere with the market. Ms. Cheh said that what is important is the goal of the program. Some good ideas face immovable obstacles, and if tax policy is the best means of addressing a problem then it should be used.

Mr. Ed Lazere then added his support for Ms. Cheh's proposals for expanding the D.C. EITC—specifically for workers without children—and providing more scrutiny of tax incentive programs after they are enacted. He said such programs, that cost the government money, must be analyzed just as on-budget programs are.

Ms. Pauline Schneider asked Ms. Cheh if the Commission endorsed several tax relief measures, such as she had proposed, where it can balance such a proposals. What tax increase could she and the D.C. Council support? Ms. Cheh said the Commission should consider taxes that can be exported by placing a disproportionate burden on non-residents who work and visit the city. She said that while some decry these taxes as unfair, what is actually unfair is that D.C., unlike other cities, is prevented from taxing non-resident income by the Home Rule Act.

Ms. Nicola Whiteman asked Ms. Cheh for her thoughts on the city's property assessment process. Ms. Cheh said that that side of tax administration is not as efficient as it should be and as a result the city is losing tax revenue. Asked by Catherine Collins how the real property tax administration system can be improved Ms. Cheh again pointed to better management.

At the conclusion of these questions Mr. Williams again thanked Ms. Cheh for her time and contributions to the Commission.

IV. Presentation: Regional Tax Competitiveness with Business Case Studies

Mr. Williams then welcomed Mr. Robert Aceituno and Ms. Karen Yingst, of Councilor Buchanan & Mitchell, P.C, to discuss the business case studies they prepared to analyze tax competitive in the Washington region. Mr. Williams noted that such studies are, by their very nature, full of assumptions and difficult to produce. He applauded Mr. Aceituno and Ms. Yingst for their research and new contribution to the Commission's work.

Mr. Aceituno began his remarks by noting that the conventional wisdom is that D.C. has the highest business tax burden in the region and that Virginia is the most desirable jurisdiction for tax purposes. The case studies, however, show that the situation is far more complicated and that D.C.'s reputation as a high-tax jurisdiction may not square with reality.

The case studies analyzed taxes such as business income, commercial property, personal property and gross receipts. Mr. Aceituno noted that some of these taxes have a disproportionate effect on perception. For example, in conversations he's had with clients, many businesses are aware that D.C.'s business income tax rate (9.975%) is higher than Virginia's rate (6%) but few understood that D.C.'s gross receipts tax (capped and limited to high-earning firms) is far less burdensome than Virginia's (not capped and applied to all businesses—with some exceptions).

Ultimately, he concluded that:

1. D.C. is competitive on business taxes with Arlington County, Alexandria and Fairfax County (except for software companies) in Virginia.
2. D.C. is slightly less competitive with Montgomery and Prince Georges Counties in Maryland for most companies.
3. The recently enacted Qualified High Technology Companies (QHTC) tax incentives make D.C. significantly more competitive than local jurisdictions in Maryland and Virginia. The DC QHTC business tax rate is be zero for the first five years of profitability (and 6% thereafter) and QHTC unincorporated businesses are not required to file a business tax form.

Mr. Aceituno stated one reason business tax comparisons are difficult is because businesses have a choice of entity: corporation or pass-through. He said that by far the more popular option for tax purposes is the later, so that firms can avoid double taxation: paying both corporate income taxes and individual income taxes. D.C. takes away this preference, though. Because D.C. cannot tax non-resident income, it cannot tax pass-through entities conducting business in D.C. but residing outside of the city with an income tax. As a result, it created an unincorporated business tax that taxes pass-through entities just as it does corporations, though it excludes those pass-through entities that generate 80% of their revenues from personal services.

Another reason comparisons are difficult are all of the tax credits jurisdictions provide to businesses. For example, D.C. gives very generous tax breaks to qualified high technology corporations, significantly reducing these businesses tax burdens and making D.C. far more competitive for these firms than its mere tax rate suggests.

Ms. Yingst then presented a summary of the case studies researched. For c-corporations that have taxable income, they found Maryland counties had the lowest tax burden while D.C. and Virginia jurisdictions were equivalent. More importantly, all jurisdictions studied had very similar business tax burdens with no outlier in either direction—the highest and lowest were separated by less than 2% of pre-tax profits. D.C. was even more competitive for c-corporations with no taxable income. She said this is because Virginia's more expansive gross receipts tax puts a larger tax burden on these companies than in D.C. For firms that operate in Maryland, Virginia and D.C. there was no big difference in tax burdens.

Ms. Yingst said the case study for high technology firms showed that D.C.—with its tax credits—was by far the most competitive jurisdiction in the region. After six years, when the tax credits expire, D.C. tax burden increases but is in the middle of the other jurisdictions. An important note for these firms is that if they do not incorporate, they will not pay business income taxes because service firms such as these (as with lawyers and accounts) are exempt from the unincorporated business tax.

Finally, for pass-through entities, Ms. Yingst reported that D.C. is at a disadvantage because it taxes these firms as businesses and not as individuals—as is the case in Maryland and Virginia. Thus, pass-through entities in D.C. are taxed at 9.975%, while the top rate in Maryland (8.95%) and Virginia (6%) is the top individual income tax rate (state and county). And she said the disparity in tax burdens is exacerbated with businesses residing in Virginia. Maryland provides an individual income tax credit to pass-through entities that pay the unincorporated business tax in D.C. but reside in Maryland. Virginia does not.

Mr. Brunori asked for confirmation of his understanding that many businesses in Virginia make deals with local governments to avoid or mitigate their gross receipts tax payments. He added that if true this would substantially affect a business's tax burden. Mr. Aceituno and Ms. Yingst agreed that many Virginia local governments negotiate gross receipts tax bills with many businesses but not all and the negotiations usually do not eliminate the tax. With respect to the study, they had to make assumptions that businesses were paying all tax bills in all jurisdictions. They also added that in their conversations with firms they learned that business in Virginia are indeed paying more in gross receipts taxes than they would be if located in D.C., and that many businesses are unaware of the limits on D.C.'s gross receipts tax and size of Virginia's.

A few commissioners then discussed D.C.'s unincorporated business tax. Some commissioners lamented the tax because no business wants to incorporate for tax reasons. But all commissioners acknowledged that the federal government's prohibition on taxing individual income at its source has left D.C. with few other options. If the city did not have an unincorporated business tax it could not collect any tax revenue from these entities.

After this discussion Mr. Williams thanked Mr. Aceituno and Ms. Yingst for their research and presentation.

V. Discussion of Schedule for Completion of Commission Recommendations

After a small break the Commission reconvened to discuss their schedule. Mr. Williams emphasized that the Commission would not be making decisions in private but rather at public meetings. He said transparency and collaboration remained goals of the Commission.

Mr. Gerry Widdicombe then noted several changes to the Commission's schedule: moving a meeting from Oct. 28 to Nov. 12 and adding an additional meeting on Nov. 18. He also said that commissioners and members of the public can always check the Commission's website for an updated schedule. He then said that a list of policy options for consideration during deliberations—pulled from expert reports and public comment—would be circulated the next day. Commissioners were invited to add their own ideas to the list before a final list of options is made public. He made clear that this list, and the list that eventually is made public, are merely for discussion and that no option is final or favored at this stage. One set of options missing from the list are proposals for improving tax administration. Mr. Widdicombe said such options will be added after the Commission's public meeting on tax administration on Nov. 4.

Mr. Brunori asked how the Commission planned on reaching a consensus. Mr. Williams responded that it is imperative that the Commission move beyond the "lowest common denominator" if it hopes to make a substantial contribution to the city and its tax system. He said the Commission, over the next few weeks, needs to find agreement but also make tough decisions.

Mr. Widdicombe added that during deliberations the staff will submit memos outlining policy options and brief commissioners during the meetings. He also said the staff will continue to reach out for public comment as the deliberations process continues.

VII. Adjournment

Mr. Williams called for adjournment at 5:30pm.