D.C. Tax Revision Commission

MEETING MINUTES—DRAFT

Subject: D.C. Tax Revision Commission Meeting

Date: June 17, 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
Teresa Hinze	Ed Lazere
Stefan Tucker	Tracy Gordon
Nicola Whiteman	Pauline Schneider
Catharine Collins	

Invited Speakers:

William Fox, University of Tennessee, Knoxville, William Stokely Distinguished Professor of Business

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

Richard Rybeck, Tax Revision Commission, Just Economics, LLC

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 3:15pm. He began by thanking the Office of Revenue Analysis (ORA) and Office of Tax and Revenue (OTR) for their continued support of the Commission, as well as the mayor's office who had agreed to film the afternoon's meeting for the public. He took a brief moment to note that the Commission is meeting in the same room next Monday (June 24, 2013) for a public hearing from 5pm to 8pm. Mr. Williams then explained that three topics would be discussed at the meeting: sales taxes, property tax expenditures and infrastructure funding. 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 June 3, 2013 Commission meeting were approved without amendment.

III. Presentation: Sales Taxes

Mr. Williams then welcomed Mr. William Fox to the meeting for a discussion of sales taxes in D.C. Mr. Fox, who is a professor at the University of Tennessee, also presented research on sales taxes for the 1998 D.C. Tax Revision Commission. Mr. Fox began by identifying four issues he wished to put before the Commission: 1) the role of sales taxes in D.C. and other states; 2) the goal of sales taxes; 3) policy options for D.C.'s general sales tax; and 4) excise taxes.

Sales taxes contribute roughly 17% of D.C.'s own-source revenue, a relatively small percentage for a state (when measuring combined state and local revenue). D.C.'s general sales tax rate (6%) is equal to the median state rate but lower than the combined state and local rate in most states—and equal to the rate in Maryland and Northern Virginia.

Mr. Fox noted that a state's sales tax base is just as important as its rate, though. Each state and locality creates its own exemptions from the sales tax. Specifically, services, as opposed to goods, have very disparate degrees of taxation from state to state. D.C.'s base, which includes 73 services in addition to most goods, is slightly larger than the average state's tax base. For example, Virginia only taxes 18 services.

Overall, state and local sales tax revenue has shrunk as a share of the economy over the past few decades. Mr. Fox stated this is the result of three parallel trends. First, states are exempting more and goods (such as food or clothing) from their sales tax base. Second, services (exempt from most tax bases) are growing as a share of the economy. As a percentage of personal consumption, services grew from 47.4% in 1979 to 66% in 2011. In fact, Mr. Fox later noted that some economists believe the growth in the service sector is specifically because it is exempt from most sales taxes. Third, remote purchases, specifically internet transactions, are rapidly rising across the country. (E-commerce is expected to total more than $5 trillion in 2015.) States currently cannot collect sales taxes from these transactions. These trends have not only shrunk the sales tax base and sales tax revenues but also led to compensatory rate hikes in most states and localities.

Mr. Fox then asked the commissioners to take a moment and consider the goals of sales taxes. He said the tax is supposed to be a tax on transaction and consumption, and therefore the Commission must focus on aligning the D.C. tax base with this objective. Under his ideal system all household purchases (including food, currently exempt in D.C.) would be taxed, all vendors (including government and non-profits) that sell to consumers would be taxed and all methods of transaction (including the internet) would be taxed. Business purchases are the only exception to such a model sales tax system as these taxes raise the cost of doing business and change economic behavior. He argued that such a system allows for lower tax rates, spreads the tax burden across consumers and does not affect economic decisions.

Mr. Fox conceded that such a system is also regressive, and therefore may run counter to the Commission's stated goal of "fairness." But he argued that the current system is hardly fair as exempted goods, such as food, benefit both rich and non-rich residents alike. He said a model sales tax is a tax on transaction and not people. Therefore, fairness can be more fairly addressed through taxes on people such as the income tax. Furthermore, he said the Commission must focus on the fairness of the overall tax system of D.C. and not the abstract merits of any particular tax.

Mr. Fox them suggest a few specific options for reforming D.C.'s sales tax. He began by noting that rate changes, whether an increase or decrease, is not a reform. Instead, he advised the Commission to focus its attention on the sales tax base. Are there any goods that D.C. ought to tax but does not? He again specifically mentioned food and non-prescription drugs as possible goods that should be a part of the tax base. At the very least, Mr. Fox advised, the Commission should not recommend further exemptions from the sales tax.

He also endorsed expanding the list of services that D.C. taxes (specifically citing construction contractors, barber services and carwashes among others) but noted that numerous states have tried unsuccessfully to make such changes. Mr. Fox said the problem is that while all goods are taxed until exempted, all services are exempt until they are taxed—creating acute political opposition. If possible, however, Mr. Fox advised D.C. to tax services that are linked to physical property that is tied to the city (air conditioning and deck repair) rather than professional services (law and accounting) that can easily flee the city. He also noted these services are often used by businesses and therefore do not belong in the sales tax base.

With respect to taxing internet transactions, Mr. Fox noted that states can only require a vendor to collect taxes if the vendor has a physical presence in the state (as established by the Supreme Court in *Quill vs. North Dakota*). He added that D.C. already has a use tax that requires resident to pay taxes on such transactions but that most residents do not pay such taxes. At this point Mr. Williams asked Mr. Fox to reaffirm that the law states that these transactions should be taxed but there is simply no collection mechanism available to the government. Mr. Fox said this is correct and that D.C. can only require companies with nexus to collect the tax from residents. So a company located in D.C., such as Macys, must collect the tax no matter where the transaction takes place while an organization with no presence, such as Amazon, does not.

Mr. Fox said states are attempting five methods for collecting taxes on remote sales:

1. Joining the Streamlined Sales and Use Tax Agreement (SSUTA), an agreement among 24 states to simplify sales and uses taxes in an attempt to reduce the burden of tax compliance. (The cost of tax compliance was cited by the Supreme Court in its decision demanding physical presence.)
2. Expanding the nexus definition of physical presence by including markers such as a P.O. Box or bank account.
3. Enforcing the use tax by offering a line for such tax payments on income tax forms. (Mr. Fox warned that while this is a good idea, based on the experiences of other states, it will not raise much revenue.)
4. Increasing tax reporting requirements by asking that vendors who undertake remote transactions report what is sold within D.C.
5. Supporting federal legislation (Marketplace Fairness Act of 2013) that gives states the ability to require vendors to collect sales taxes. The current legislation includes an exemption for vendors with less than $1 million in American e-commerce, omitting up to 5 million online sellers and reducing the tax base, but Mr. Fox considers the legislation a good first step in the process of taxing remote sales.

Mr. Fox concluded his prepared remarks by commenting on a few of D.C.'s select sales taxes. He noted that D.C.'s taxes on tobacco and alcohol are comparatively high but are likely having little influence on consumption. He said the city is most likely experiencing some casual smuggling of cigarettes, though. He also generally endorsed recent changes to the city's gas tax—transitioning from a per gallon tax to a tax on wholesale gasoline—but cautioned that increased elasticity also can create more volatility.

Mr. Williams began questioning by asking Mr. Fox to define the differences between sales taxes, value added taxes (VAT) and excise taxes. Mr. Fox said sales taxes and VATs are both consumption taxes but with different methods of administration: a sales tax is levied only on the consumer while a VAT is applied at each stage of production. An excise tax is also a consumption tax but levied on a select set of commodities. Mr. Williams followed this by asking if VATs encourage saving over consumption. Mr. Fox said it depends on what the VAT tax is replacing. Creating a VAT will not encourage savings on its own but possibly replacing an income tax with a VAT may. But consumption taxes have other problems, including but not limited to slow revenue growth, that income taxes do not. Mr. Williams then asked for Mr. Fox's thoughts on a gross receipts tax. Mr. Fox said that unlike a sales tax (only on consumption and with several exceptions) a gross receipts tax is levied on all transactions. He said gross receipts taxes are not substitutes for sales taxes but rather a replacement for business income taxes. He cited Ohio's gross receipts tax as a success story because of the tax's simplicity. Business tax forms in Ohio can fit on a postcard and include just three lines of data: revenues, tax rate (0.26%) and tax liability. He said this creates a lot of tax revenue and very low compliance costs.

Mr. Fitzroy Lee then asked about D.C.'s multiple sales tax rates (for different goods such as restaurant meals and hotels) and if they'd prevent D.C. from joining the SSUTA. Mr. Fox said that members of the SSUTA are required to have only one sales tax rate but that the city can create news taxes or fees (as long as they are outside the sales tax structure) for restaurants and hotels that function in the same way as the current multi-rate sales tax structure. (He later clarified that members of the SSUTA have complete control over their tax base.) Mr. Lee also asked about the political feasibility of taxing professional services. Mr. Fox said that D.C.'s geographic location—and the ability of professionals to leave—makes the possibility of such taxes very remote.

Mr. Stefan Tucker asked why applying the sales tax to business transactions is problematic if that tax is eventually passed on to the consumer. Mr. Fox said that the taxes get built into different product in strange and disparate ways. As a result some products have few taxes built into their price while some have numerous taxes—creating very different effective tax rates for products.

Ms. Teresa Hinze noted that many low-income residents—particularly seniors—who benefit from sales tax exemptions (such as the one for food) do not have taxable income. She asked how such residents can receive tax relief if exemptions are eliminated. Mr. Fox said this is a large concern but that sales tax exemptions are still very poorly targeted tax relief. He advocated that exemptions be replaced with refundable tax credits equal to a typical sales tax burden or creating a means-tested smart card to exempt only low-income residents. He admitted these proposals are not simple but stressed that tax relief must be targeted at people and not goods for the tax relief to have its intended effect.

Mr. Ed Lazere then asked for Mr. Fox's opinion regarding recent changes to D.C.'s gas tax. Mr. Fox said adding some elasticity to the tax makes a lot of sense given recent price growth but also warned about price volatility. He suggested D.C. follow Maryland's example and include a revenue floor. Mr. Lazere also asked about how much travel people are willing to undertake to avoid sales taxes. Mr. Fox said the research in this area was fairly old but that it suggests that for a 1% increase in the tax there is a corresponding 2% decrease in business activity. He endorsed taxing services but encouraged the Commission to carefully examine each one within the context of D.C. and the region. Mr. Lazere asked if his list of services would include art and theater. Mr. Fox said that leaving such things out of the tax base makes little sense unless it is obvious they'd leave D.C.

This concluded Mr. Fox's remarks and Mr. Williams thanked him for contributions to the Commission and its work.

IV. Presentation: Property Tax Expenditures

Mr. Mike Bell, a member of the D.C. Tax Revision Commission staff who had joined the Commission twice before on property taxes, was then welcomed to present on property tax expenditures. Mr. Bell began his presentation by stating the definition of a tax expenditure from the D.C. Code:

> "the revenue losses attributable to provisions of federal law and the laws of the District of Columbia that allow, in whole or in part, a special exclusion, exemption, or deduction from taxes authorized in this title, or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." [47-318(6)]

Mr. Bell said tax expenditures give certain taxpayers preferential treatment, create different effective tax rates for taxpayers and lose revenue. He also stated that they undermine the fairness, efficiency and transparency of the property tax system. As such, he said it is important for D.C. to weight both the costs and benefits of tax expenditures.

A good way of addressing such tradeoffs is through a tax expenditure report (such as the one compiled by D.C. ORA). These reports identify and explain the city's tax expenditures as well as make expenditures a part of the budget process. Mr. Bell said D.C.'s report is one of the most comprehensive in the country and just one of 15 that looks specifically at property tax expenditures.

In addition to property tax exemptions (which Mr. Bell discussed at the June 3 meeting) the other large property tax expenditures are property tax abatements. He said that while an exemption removes a property from the tax base, an abatement forgives the tax payment for an established period of time. In order for an abatement to pass into law a fiscal note and "but for" analysis must be completed to measure the revenue loss and business effect of the proposed tax relief.

Other important property tax expenditures include tax credits and deferrals. Mr. Bell explained that, unlike exemptions and abasements, credits and deferrals do not reduce the property tax base but instead supply financial relief to established tax bills. He said tax credits and deferrals are more transparent than exemptions and abatements.

Mr. Bell laid out the following policy options for improving how property tax expenditures are handled:

1. Improve D.C. property tax expenditure oversight.
2. Reduce the funds allocated to property tax expenditures.
3. Improve D.C. property tax abatement oversight by creating ex-post evaluations of tax expenditures.
4. Limit the number or total value of property tax abatements.
5. Adopt strict criteria for granting property tax abatements.

Ms. Pauline Schneider opened the questioning by asking what types of properties typically receive property tax abatements in D.C. Mr. Bell said that most abatements are provided for low-income housing projects. Mr. Lee asked if there is an economic rationale for tax abatements and if there is a model project that is ripe for abatements. Mr. Bell stated that the system for delivering abatements is more important than identifying any particular project. He said a cost-benefit analysis is necessary for every potential abatement to discover if the project is a worthwhile investment for D.C. Furthermore, an analysis must be performed both before and after the project is created to see if its goals are actually realized.

Ms. Nicole Whiteman then noted that, no matter what system is put in place for studying abatements, the final decision still lies with the mayor and council. She asked what can be done beyond review to ensure D.C. is making the right decisions on providing abatements. Mr. Bell said that D.C. has some good methods in place already, such as requiring that abatements be funded before enactment. (There are abatements that have passed but not implemented because they lack funding.) He said that ultimately transparency is the best method for improving the property tax abatement process.

Mr. Lazere noted that he agrees with the recommendations put forward by Mr. Bell regarding sunlight and transparency in the tax expenditure process. He asked if other states had successfully made tax expenditures part of the budget process, though? Mr. Bell said he could not think of a state that does and noted that unfortunately only 14 states even keep a property tax expenditure budget. Mr. Lazere then asked for the rationale for phasing out low-income housing tax relief. Mr. Bell said his recommendation is not to eliminate such tax relief but to consolidate the numerous projects D.C. currently maintains. He said the Commission should look for the most efficient way of achieving the policy goal. After Mr. Lazere asked if Mr. Bell's recommendation for capping total tax expenditures referred to the number or the cost Mr. Bell said that either is acceptable and that the goal is to force debate about abatements on the council. Mr. Williams, noting he wanted to explore the other side of this debate, asked why a program—if it's deemed worthy by a cost-benefit analysis—should ever be capped. In response several commissioners added that at the least all such projects, even those believed to be beneficial, must be analyzed both before and after they are created to ensure that goals are met. Mr. Daniel Muhammad also ensured the Commission that multiple government groups can assist in these analyses and that they should not overburden any one department.

After this discussion Mr. Bell was thanked for his presentation and work for the Commission.

V. Presentation: Funding Long-Term Infrastructure

Mr. Rick Rybeck, a staffer with the Commission, was then welcomed to discuss the funding of long-term infrastructure. Mr. Rybeck said his goal was to make D.C. more sustainable and competitive over time by transforming the city's taxes into fees. He said that general taxes, such as sales taxes, make consumers oblivious to the consequences of their actions and the relationship between funds and government services. As an example of where fees already are working in D.C., he noted that water and sewer services could be paid for out of the general fund but that this would remove the incentive for consumers to save water. Instead, a fee is tied to a consumer's use.

Mr. Rybeck then stated that the value of land is affected by the reach of government services and therefore this should be incorporated into how government is funded. He said that while residents pay taxes and fares to support public transportation, they must also pay higher rents in order to live in transportation-accessible neighborhoods and take full advantage of the good. He asked if that rent premium should go to the landowner or to the government service (in this instance Metro). In the current system, tenants pay twice (in taxes and in rent) while landowners capture the value created by the service. Mr. Rybeck argued that access fees are a method of having landowners pay in proportion to the benefits they receive from the service. To illustrate the point, he noted that the land value Metro has created has surpassed its construction costs. Therefore, if D.C. took better advantage of access fees the transportation system could be financially self-sustaining.

Access fees not only create necessary funds for services but also reduce the city's reliance on taxes on wages and capital. They also can reduce the price of land as the landowners are no longer exclusively benefiting from the positive externalities generated by the service.

As for particular access fees that D.C. can implement, he pointed commissioners to his full paper but noted that there are opportunities in transportation, solid waste and water among other services. He also said the property taxes can be transformed into access fees by reducing the property tax on buildings and increasing it on land. Under such a system the public would benefit from the land value created by public services and not punish private developers from improving buildings.

Mr. Williams asked Mr. Rybeck how such changes would affect the equity of the D.C. tax system—as some moderate- and low-income residents cannot afford such fees. Mr. Rybeck said that his full paper addressed such concerns in far more detail and also noted that studies have shown that shifting from taxing buildings to taxing landowners lowers the tax burden for moderate- and low-income residents. Mr. Bell also noted that the distributional effects of such a change depend heavily on the circumstances and timing related to such a change.

Mr. Williams then asked that Mr. Rybeck explain the concept of an "externality" for citizens following his presentation. Mr. Rybeck said an externality is a cost or benefit that is not incorporated in the price of a transaction. For example, a negative externality is created by a factory that pollutes and causes illness but does not compensate the effected residents. Transportation services such as Metro, in contrast, create positive externalities for people who do not ride transit. Drivers experience less congestion, everyone gets cleaner air, and landowners obtain higher land prices and rents near the stations.

Mr. Rybeck was then thanked for his time and contributions to the Commission's work.

VI. D.C. Tax Revision Commission Business

Mr. Gerry Widdicombe announced that the Commission is holding a public hearing, also at One Judiciary Square, on Monday, June 24. He said that 24 people had already asked to testify before the Commission and that if the list grew to more than 30 a second public hearing would be held in September. Mr. Widdicombe also noted that additional meeting dates in September are still to be determined.

VII. Adjournment

Mr. Williams called for adjournment at 6:20pm.