D.C. Tax Revision Commission

MEETING MINUTES—DRAFT

Subject: D.C. Tax Revision Commission Meeting

Date: June 3, 2013

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

Location: 1101 4th Street, SW, Washington, D.C. 20024

Members Present:

Anthony Williams	Fitzroy Lee
Teresa Hinze	Ed Lazere
Mark Ein	Stefan Tucker
Tracy Gordon	Nicola Whiteman

Invited Speakers:

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

LaTanya Brown-Robertson, Associate Professor of Economics at Bowie State University

Rodney Green, Executive Director of the Howard University Center for Urban Progress

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 3:20pm. He began by thanking the Office of Revenue Analysis (ORA) and Office of Tax and Revenue (OTR) for their continued support of the Commission. Mr. Williams then explained that three topics would be presented at the meeting : real property tax exemptions, transitional neighborhoods and deed recordation and deed transfer taxes. 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 20, 2013 Commission meeting were approved without amendment.

III. Presentation: D.C. Properties Exempt from Real Property Tax

Mr. Williams then welcomed Mr. Michael Bell, a member of the Commission staff who was appearing for a second time before the Commission, to present his analysis of properties exempt from real property taxes 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 said his presentation was a continuation of his previous presentation on the real property tax in D.C. That discussion had focused on an ideal: a uniformly administered tax that treated all taxpayers equitably. Today's discussion was meant to demonstrate how current policy, driven mostly by political decisions, often deviates from that goal. He added that the Commission was established explicitly to step back and think about such deviations—and their efficacy—in a non-political way.

Mr. Bell then explained that there are two means for exempting properties from property taxes:

1. By right: A property is categorized as a type that is historically exempt from such taxes (for example, schools and churches).
2. By appeal: Congress of the D.C. Council declares a property exempt from such taxes.

Mr. Bell explained that D.C.'s exempt property was split roughly 50-50 between by right and by appeal properties. He then described how out of an estimated $227 billion in estimated property value, $83 billion (37%) is exempt from property taxes in D.C. He noted that such numbers must be approached with caution, however, as roughly $48 billion of that $83 billion is "immune" from property taxes. (For example, properties owned by the federal government will never be eligible for D.C. taxation.) Mr. Bell then presented a table that further broke down exempt properties in D.C. He asked the Commission to note that 80% of the properties exempted by legislation are related to low-income tax relief. (Note: This is 80% of properties and not 80% of property *value*. In fact, these properties account for a very small share of exempt property value.)

Mr. Bell then presented the Commission with three scenarios for collecting revenue from exempted properties. The first scenario showed that if D.C. could collect property taxes (at current rates) from all exempted properties the government would collect over $1.4 billion in additional revenue. The second scenario removed all "immune" properties (e.g. federal government properties) from the tax base but kept current rates. This scenario produced $396 million in additional revenue. This scenario is still unlikely given political restraints, though. As such, scenario No. 3 assumed that all the properties in the base of scenario No. 2 but taxed them at only 25% of their value. (This scenario mirrors a PILOT program in Boston—considered a "best practice"—that asks exempt properties to pay taxes on 25% of value because the city calculates that it spends 25% of its revenue on goods and services that benefit all residents.) This scenario is estimated to raise $99 million in additional revenue for D.C.

After laying out these scenarios Mr. Bell said the central question is whether these properties *should* pay taxes. He said these properties currently consume services but do not contribute to the government. Furthermore, by not paying taxes the burden is not erased but rather shifted to other taxpayers—making the system unequally and distorting economic behavior. He said other states and localities have addressed this question by asking for voluntary contributions or implementing user fees/charges on such property owners. Mr. Bell then listed six possible policy options for the Commission to consider.

1. Do nothing. (The justification being that rules have been set and changing them will create new problems and disadvantages.)
2. Establish clear criteria for legislative exemptions. (Mr. Bell pointed to Arizona and Boston as jurisdictions that have successfully implemented such criteria.)
3. Limit the value of real property exempt from taxation for individual properties. For example, no exemption for property value over $10 million. Such a change would generate $200 million in revenue. (Twelve states have some sort of exemption limit.)
4. Reevaluate using property tax exemptions to promote low-income housing. He suggested the Commission evaluate all low-income tax relief programs.
5. Develop a traditional PILOT program along the lines of the program in Boston. (Note: Current PILOT programs in D.C. are not "traditional" PILOT programs. They are more like TIF programs and do not apply to the discussion of exempt properties.)
6. Phase out all property tax exemptions for all non-federal, non-D.C., non-foreign, non-religious, non-educational, non-hospital and non-profit organizations over a 10-year period starting in 2024.

These options were not presented as recommendations but rather a range of options created to spur debate and discussion. He also noted that most if not all of these changes should be phased in over a given period of time. With that note Mr. Bell concluded his comments and welcomed questions from the Commission.

Mr. Stefan Tucker asked Mr. Bell about his breakdown of exempt properties. Specifically, how are there so many charitable and educational properties listed as “residential”? Mr. Bell said he did not have a direct answer but that it was something that can be investigated. Mr. Tucker then asked how D.C.’s unique situation—its inability to tax at the source—might affect its implementation of a PILOT program. Mr. Bell said the PILOT program is essentially a quid pro quo and the fact that many employees who work at D.C. exempt properties do not pay income taxes (in contrast with Boston) would be taken into account during such a negotiation.

Mr. Fitzroy Lee then asked if “fairness” in property taxes also applies to income. Two neighbors may have the same home value but one may have a far higher income than the other. Under such conditions is a uniform property tax system still fair? Mr. Bell said it is because wealth is also a function of home value the uniform system is far. But he said a progressive rate system for properties can be added to further assist with vertical equity. Mr. Williams then asked why a tax-exempt nonprofit organization is deemed to be supplying more benefits to a community than a local business (especially if the latter employs more D.C. residents). Mr. Bell agreed that such an assumption is faulty and that this is why a review—and negotiation about contribution—is needed. The Commission then discussed how many nonprofit organizations located in D.C. provide a national but not a local benefit. Mr. Bell stated that this is why a more direct quid pro quo negotiation about services and contributions is desirable.

Ms. Tracy Gordon then asked about the incidence of user fees and PILOTS: If D.C. adopted such a system who would ultimately pay the tax? Mr. Bell said there has been little incidence analysis performed and much depends on market conditions. Ms. Gordon asked if employees may ultimately face lower wages as a result of the PILOT program and Mr. Bell agreed this is a possibility, but he said capital may also be reduced. After Ms. Gordon asked about the administration of a PILOT Mr. Bell said they are traditionally performed on a case-by-case basis over a set period of time (every few years). He said the biggest advantage of such a system is that it is explicit, structured and transparent. The public knows why one property pays more or less than another.

Ms. Nicola Whiteman commented that a PILOT program could add an additional burden on nonprofits operating in D.C. She said this may provide incentive for organizations to move out of D.C. Mr. Williams agreed but asked why businesses should provide a subsidy for nonprofit organizations. If some of these exempt properties were taxed then current taxpayers would benefit from lower rates. After this discussion Mr. Bell was thanked for his contributions to the Commission.

IV. Presentation: An Analysis of Neighborhoods in D.C.

Mr. Williams then introduced Ms. LaTanya Brown-Robertson, a professor at Bowie State University and former ORA staffer, to discuss transitional neighborhoods in D.C. Ms. Brown-Robertson was joined by Mr. Marvin Ward, a fiscal analysis with ORA, who assisted with the paper's research. Ms. Brown-Robertson began her presentation by nothing that her paper was a companion to the research delivered and presented to the Commission by Ms. Sally Wallace on fiscal architecture. While Ms. Wallace's presentations had provided a broad perspective of economic trends, Ms. Brown-Robertson's focus was on specific neighborhoods (as defined by D.C. property tax assessments) going through dramatic economic change between 2000 and 2010. She began by noting that after half a century of population decline, D.C. has experienced population growth since the turn of the century. Her goal was to see what affect these economic and population gains had had on particular neighborhoods with significant growth. Her analysis defined "transitional" neighborhoods as areas that had a median property value and federal adjusted gross income (AGI) below the city median in 2000 but that had grown faster (property and AGI) than the city average over the following 10 years.

Her major conclusions were that transitional neighborhoods over that time period had experienced a fundamental compositional change in population, now accounted for a greater share of wealth and had seen an increased residential tax burden. With respect to population, transitional neighborhoods experienced a substantial increase in working-age adults but a decrease in residents younger than age 15 and older than 65. (Other neighborhoods experienced a similar increase in working-age adults but a far less dramatic loss of other residents.) As for economic gains, all residents in transitional saw AGI growth but the gains were acutely concentrated in the top 20% of earners. (In all other neighborhoods the lower 80% actually experienced *more* AGI growth than the top 20% of earners.)

As for tax burdens, Ms. Brown-Robertson reported that residents of transitional neighborhoods saw their income taxes as a percentage of AGI decline but their property taxes as a percentage of AGI increase. In fact, residents of these neighborhoods now had a larger property tax burden than income tax burden (not the case in 2000). She said the rapidly rising property values in these neighborhoods are what drove this increased property tax burden (as the city passed a substantial amount of tax relief over this same period). She recommended the Commission recommend a broader circuit breaker program to address these concerns. Ms. Brown-Robertson also noted that her analysis was unable to dig deeper into income distribution and advised more study of low-income households.

Following the recommendation of a broader circuit breaker, Mr. Ed Lazere noted that the D.C. Council had recently expanded the program (specifically raising the income threshold to $50,000). He also noted that the tax burdens in the transitioning neighborhoods, combined with early data presented on tax distribution (which showed that middle-income families face a relatively high burden in D.C.) are another reason the Commission should investigate ways to smooth out the progressivity of the D.C. tax system. After this discussion Ms. Brown-Robertson was thanked for her time and contributions on the Commission's work.

V. Presentation: Deed Recordation and Deed Transfer Taxes

Mr. Williams then welcomed Mr. Rodney Green, executive director of the Howard University Center for Urban Progress, to discuss D.C.'s deed recordation and deed transfer taxes. It was noted that Mr. Green had also been a consultant on the 1998 Tax Revision Commission. He was joined by Ms. Judy Mulusa who assisted him with the research paper and presentation.

Mr. Green explained that the deed recordation tax (DRT) and property transfer tax (PTT) are levied when real property is sold or commercial property is refinanced for more than its current balance on outstanding loans. In D.C. the DRT is 1.45% and the PTT is 1.45% for a combined rate of 2.9%. If a residential property is sold for less than $400,000, however, the combined rate is 2.2%. Mr. Green reported that the combined D.C. rate was five to six times larger than the rates in Virginia (it is a local tax) but roughly equal to the rates found in Maryland. The D.C. rate is also substantially lower than the rate in New York City, nearly equal to the rate in San Francisco and higher than the rate in Seattle. He also noted that many states out west completely lack such taxes.

D.C.'s DRT and PTT contribute between 3.5% and 8% of the city's tax revenue. The revenue contributions vary with business cycles (growing and falling with property sales). A key aspect of D.C.'s taxes is that 15% of the revenue is earmarked for the Housing Production Trust Fund (HPTF). This trust fund was established to address affordable housing in the District. Mr. Green said such earmarking is very common across jurisdictions.

Mr. Green also noted that most studies have found that taxes such as the DRT and PPT have a negligible effect on housing sales. He attributed this to the fact that these are one-time payments and add up to just $40 a month if rolled into a mortgage. Mr. Green said academic literature has estimated that a 1% increase in these taxes leads to a 0.2% reduction in housing sales (which equates to 16 sales per year in D.C.). He also said the effect on the commercial market is also considered small. As for progressivity, he said that D.C. maintains a lower rate for homes valued at less than $400,000 but that this may not be enough relief for many residents.

Mr. Green then offered policy options—not recommendations—for consideration. The first option was the complete elimination of these taxes. Such a change would result in $150 million to $300 million in lost revenue and harm the HFPT. In contrast, the tax could be increased by 2% and the city would gain $83 million in revenue (and still remain below New York City's rate). Another option is to eliminate the "bump" at $400,000 for residential property. If a marginal tax was instituted (each additional dollar—not property—above $400,000 was taxed at 2.9%) the city would lose $5.6 million in revenue per year but economic decision would not be distorted.

He also proposed several ways to increase the progressivity of such taxes:

- Raise maximum income for exemption from 120% to 200% of the Housing and Urban Development rate.
- Waive taxes for first-time homebuyers (as in Maryland).
- Raise the maximum tax rate on higher cost properties.
- Increase bracketing in the system.

Mr. Green asked the Commission to "strongly" consider the last option. He noted that Hawaii has seven brackets (with higher marginal rates on higher property values) and that New Jersey has five brackets. More brackets, with marginal tax rates, would both increase the progressivity of the tax and remove the "bump" in the current system. He also advised the Commission to index brackets to inflation.

Returning to the HFPT, he also noted that Alice Rivlin recently proposed that a third of all property tax revenues resulting from increased property values go to such funds. He said such a plan creates far more stability in the financing of the fund.

Mr. Mark Ein then asked what was the justification for these taxes. Mr. Green responded that the justification is tax revenue. He noted that there is an additional fee paid when recordation occurs, and the revenue from this fee roughly pays for the office in charge of the recordation (so it's not tied to the service). He also noted that these taxes used to be federal, but were recently ended and moved to the local level. Mr. Ein then noted that while the tax is small that it still contributes to an investor's tax burden and exacerbates D.C.'s tax differences with Virginia.

Ms. Tracy Gordon noted that many localities were immediately harmed by declining revenue from such taxes at the start of the recession and asked about the volatility of DRT and PPT. Mr. Green said volatility is certainly a problem and one that is especially concentrated with respect to the HPFT. Ms. Gordon also asked about how less liquid homebuyers are affected by the one-time fee (no matter how small it is). Mr. Green said this is a good point and another argument for introducing more brackets into the system. He added that these brackets may add to the complexity of the taxes but will make them fairer.

VI. D.C. Tax Revision Commission Business

Mr. Gerry Widdicombe then announced that the next meeting was scheduled for June 17 and would held at One Judiciary Square. He also reminded commissioners that a public hearing is scheduled for June 24 and noted that the meeting had been mentioned by the Washington Business Journal. Mr. Widdicombe then updated the Commission on recent D.C. Council budget news such as the decisions to not tax out-of-state bonds and increase the reach of the Senior Tax Credit.

VII. Adjournment

Mr. Williams called for adjournment at 6pm.