D.C. Tax Revision Commission Policy Options

Policy Option #28: Eliminate or Reduce Business Income Taxes

MEMORANDUM

Proposal: Eliminate the business and unincorporated business franchise taxes or reduce the tax rate
Tax Type: Business
Origin: Councilmember Jack Evans/Robert Aceituno and Karen Yingst/Public
Commission Goal: Competition and business growth

Current Law

The business franchise tax (BFT) is imposed on corporations (including S corporations) carrying on a trade, business or profession in D.C. or receiving income from D.C. sources.

The unincorporated business franchise tax (UBFT) is imposed on unincorporated businesses (including partnerships and sole proprietors) with more than $12,000 in annual business income. Unlike other states, D.C. cannot tax the owners of the unincorporated businesses via the individual income tax, unless the owners are D.C. residents. The UBFT excludes professionals (such as doctors, lawyers, engineers, accountants and architects) or any other trade or business in which more than 80% of gross income is derived from the personal services actually rendered by the individuals or partners.

The tax rate is for both the BFT and UBFT is 9.975%. The minimum tax is $250 for businesses with gross receipts of $1 million or less and $1,000 for businesses with gross receipts greater than $1 million.

Proposed Change

Eliminate all business income taxes or lower the rate (for both the BFT and UBFT) from 9.975% to 8.25% (Maryland's rate) or 6% (Virginia's rate).

Reason for Change

D.C. has the highest business income tax rate in the region and a higher tax rate than the top rate in all but two other states. Eliminating the business income tax or lowering the rate could make D.C. more attractive to businesses and therefore create jobs and grow the economy.

Pros

- Removing or reducing the BFT and UBFT could make D.C. more competitive with Virginia and Maryland in attracting businesses looking to locate in the region.
- If successful, these changes could also encourage business growth and job creation in D.C.
- Lowering the BFT and UBFT rates could "signal" to the business community that D.C. is business-friendly.

Cons

- Our outside expert (Norton Francis of the Tax Policy Center) reported that "decreasing the rate alone would not, in our view, increase economic activity."
- Business income taxes reimburse D.C. for the services the city provides to the business community. Eliminating or reducing the business income tax would shift more of the city's tax burden to residents or to owners of commercial property.
- Roughly two-thirds of BFT and UBFT taxpayers pay the minimum tax and therefore many businesses would not be affected by a lower tax rate.
- Eliminating or reducing the BFT and UBFT would reduce tax revenue.
- Eliminating or reducing the BFT and UBFT would make the D.C. tax system less progressive.

Revenue Impact

The Office of Revenue Analysis estimates that in the first year of implementation the following policy options would result in these revenue changes:

- Eliminating the BFT and UBFT would cost $491,000,000 in tax revenue.
- Reducing the BFT and UBFT tax rate from 9.975% to 8.25% would cost $57,000,000 in tax revenue.
- Reducing the BFT and UBFT tax rate from 9.975% to 6% would cost $132,000,000 in tax revenue.