



D.C. Tax Revision Commission

MEETING MINUTES

Subject: D.C. Tax Revision Commission Meeting
Date: Feb. 4, 2013
Time: 3:00 p.m. to 6:00 p.m.
Location: Room 412, John A. Wilson Building, 1350 Pennsylvania Avenue, NW,
Washington, D.C. 20004

Members Present:

Anthony Williams	Teresa Hinze
David Brunori	Fizroy Lee
Catherine Collins	Ed Lazere
Mark Ein	Pauline Schneider
Tracy Gordon	Nicola Whiteman

Invited Speakers:

Robert Cline, National Director of Ernst & Young LLP's State and Local Tax Policy Economic Practice

Robert Zahradnik, Director, Research, Pew Center on the States

Note: Mr. Zahradnik was unable to attend the meeting. Jeff Chapman, Research Manager, Pew Center on the States, made a presentation in his place.

Jeffrey Oakman and Lindsay Clark, Office of Revenue Analysis, Office of Chief Financial Officer

Staff:

Kevin Clinton	Richard C. Auxier
Mike Bell	Rick Rybeck
Steven Rosenthal	Ashley Lee

I. Call to Order (Commission Chairman)

Mr. Anthony Williams, Chairman of the D.C. Tax Revision Commission (the “Commission”), called the meeting to order. At the outset of the meeting, Mr. Williams asked that the meeting’s agenda be amended so that an invited speaker, Councilmember Jack Evans, be allowed to address the Commission on the recent announcement of a \$400 million budget surplus in the District of Columbia.

II. Testimony of Councilmember Jack Evans

Mr. Evans opened his comments by congratulating and commending the members of the Commission for dedicating their time and service to the cause of improving the District’s tax code, and stated that he is looking forward to the Commission’s recommendations. After thanking the members for giving him the opportunity to address the meeting, Mr. Evans announced that he was in attendance to announce the city’s \$400 million budget surplus. Mr. Evans noted that he remembered a time when audits of the District’s finances were not so transparent and encouraging, and stated that the city owed a great deal of gratitude to Mr. Williams for his service—including as both chief financial officer and mayor—to the city. The councilmember then added that he and other city officials will soon be meeting with representatives on Wall Street, with the good fiscal news in hand, about improving the District’s bond rating; hopefully achieving a long-desired AAA rating. He tied these comments to his personal commitment to dedicating the surplus to the city’s fund balance, which he stated is not as large as it needs to be, and not additional government spending.

Mr. Evans then asked to place a few issues before the Commission for their consideration. The first was a report from the *Wall Street Journal* highlighting the efforts of policymakers in other states who are seeking to eliminate state income taxes. Mr. Evans, citing the report, asserted that states without an income tax saw greater economic growth than those with an income tax and that the District should therefore consider lowering its income tax rates. The second issue, also coming from the *Wall Street Journal*, were details of Minnesota’s effort to collect taxes from residents (mostly seniors) who live in one state but also keep a second residence—and then pay their taxes in—in another lower-tax state. Mr. Evans said the District is home to many such residents and the city should discover means for collecting taxes from such individuals. Finally, Mr. Evans described recent media reports detailing how California Gov. Jerry Brown is using additional tax revenue to pay down debts rather than for more government spending. The councilmember stated that this was a model that D.C. should follow. Wrapping up his comments, Mr. Evans asked that the Commission to specifically address four relevant issues: 1) lowering the sales tax rate to both keep the rate competitive with surrounding jurisdictions and maintain a pledge the Council made about “sun setting” a recent rate increase; 2) lowering the income tax rate so that the city “stops taking [revenue] when it does not need it;” 3) addressing the

city's high estate tax that prompts high-income residents to leave the city before dying; and 4) addressing taxes on municipal bonds, specifically out-of-state bonds.

After the completion of Mr. Evans' testimony, Mr. Williams asked the councilmember for a reaction to evidence that the District has a greater need for government services than Virginia, and therefore must collect more in taxes than its neighboring state. Mr. Evans stated that the city's budget has increased in recent years even as its "needs population" has not changed, demonstrating budget growth that is not tied to such public services. He stated that he is for government spending that helps such groups but that he still feels that the city must spend its resources more efficiently and do so with corresponding lower tax rates. He also stated that lower tax rates will engender greater economic growth and therefore more tax revenue. Mr. Mark Ein followed up these thoughts with a question about whether the city was reaching a "tipping point," where its tax burden will drive residents out of the city. Furthermore, he asked if what the District's tax system would look like if Mr. Evans could construct such a hypothetical system from scratch, with specific attention to corporate taxes. Mr. Evans responded that his concern is not primarily with residents leaving the city but rather with new families deciding to move to other jurisdictions (specifically Northern Virginia) over the District as a result of higher tax burdens. He also stated that if he were designing a tax system it would look like Virginia's, with more competitive tax rates and with a higher business ranking. Finally, he said that the city's high corporate income tax rate is a disincentive for businesses considering locating in the District but that any discussion of business taxes must also include the unincorporated business tax and property taxes on commercial property.

Mr. Williams then thanked the councilmember for his time and testimony and asked that the Commission now return to the official agenda.

III. Approval of Minutes

The minutes from the Jan. 7, 2013 Commission meeting were approved without amendment.

IV. Presentation: Competitiveness of State Tax Systems

Mr. Williams welcomed Mr. Robert Cline, of Ernst & Young, to present the findings of his organization's research on the competitiveness of state tax systems. Mr. Cline, who noted he is a resident of D.C., began his remarks by stating that his presentation was based on the work of 10 years of research into state and local taxes, and that most of its emphasis is on business taxes such as corporate income taxes, commercial property taxes, net-worth taxes, gross receipts taxes and sales taxes. Mr. Cline then asserted that the District collects \$3.3 billion in business taxes and that this equates to 4.9% of the city's economic production. He added that this tax-to-economy ratio is roughly equal to the average across the 50 states. The city's business taxes, however, contribute 60% of all tax revenue in D.C., and this ratio is relatively

high. Mr. Cline noted that this heavier reliance on business taxes is most likely the result of the District's unique inability to tax non-resident income earned in the city. Furthermore, he stated that half of all business taxes in D.C. are property taxes, and that this is also a high percentage when compared with other states. Mr. Cline also remarked that a main contention of his organization is that business taxes are household taxes, and stated that his research has shown that D.C. residents pay 84% of increases in business taxes.

Mr. Cline then detailed his organization's study of state business environments, which is based on an economic model for hypothetical firms such as corporate headquarters and research and development organizations. Mr. Cline said that, according to his study, D.C. ranked "way behind" other states under their set of criteria. He also noted that the poor showing of the District did not change when manufacturing was removed from the model. He specifically cited the District's sales tax base as prohibitive for business investment. Mr. Cline said that too many business inputs are taxed in D.C., and that the city should make a concerted effort to limit retail sales taxes to final purchases. Additionally, while not calling them "recommendations," he listed three options for improving the competitiveness of the city's tax system: 1) lowering property taxes (and eliminated all personal property taxes); 2) utilizing a single sales factor apportionment for corporate tax income; and 3) lowering sales taxes on business inputs.

At the conclusion of Mr. Cline's testimony, Mr. David Brunori asked if the elimination of the corporate income tax and/or sales taxes on business inputs would help the District in competing for business. Mr. Cline responded that since D.C., like many jurisdictions, has such a broad sales tax base that merely a reduction in the sales tax rate would assist the city in attracting business. On corporate income taxes, he said this tax amounts for less than 10% of business taxes, and therefore the city cannot solely focus on this kind of business tax if it hopes to attract businesses. Finally, he said that whenever a tax is reduced the manner in which that tax cut is paid for is just as critical a decision. Mr. Williams then asked if Mr. Cline was a believer in the "Laffer effect," the idea that lower tax rates will engender higher tax revenues through greater economic growth. Mr. Cline stated that lower business taxes will lead to the creation of jobs but that he has never found a tax cut that "paid for itself." Mr. Williams then asked if, as other researchers have asserted, too much emphasis is placed on taxes given all the other inputs that go into business decisions. Mr. Cline stated that, regardless of how important taxes are, they are certainly becoming *increasingly* important in business decisions as capital and labor becomes less rigid. Related, he advised that the District focus more on comparisons with its neighbors (Maryland and Virginia) than comparisons with the nation. Mr. Fitzroy Lee then asked Mr. Cline about his assertion that fully 84% of business taxes—or 84% of new business taxes—are passed on to residents of D.C. Mr. Lee was curious how Mr. Cline's organization arrived at this number given that his organization, the Office of the Chief Financial Officer, had come to the conclusion that more than half of such activity leaks to the city's suburbs. Mr. Cline stated that such differences are the result of different methodology. Mr. Ed Lazere then asked Mr. Cline to explain how D.C. has experienced such large economic and population growth in the past few years given what was being described as an outsized tax burden for its residents. Mr. Cline responded that the focus of the Commission should be on the future, not the past, and that the city must also ensure that it gets its fair share of regional economic and population

gains. Mr. Lazere concluded his questions and comments by asking that the Commission further investigate evidence tying the city's competitiveness with its tax rates before making any related recommendations.

V. Presentation: State Tax Incentives

Mr. Jeff Chapman, of the Pew Center on the States (PCS), was then welcomed to testify before the Commission on state tax incentives. Mr. Chapman was appearing in the place of Mr. Robert Zahradnik, also of PCS, who was scheduled to speak but had to miss the meeting on account of an illness. Mr. Chapman's presentation was based on two recent PCS studies of state tax incentives: "Evidence Counts" and "Avoiding Blanks Checks." Mr. Chapman began his testimony by noting that PCS is dedicated to ensuring that governments work well. As such, his organization established a three-step program for governments that wish to create successful and accountable tax incentive programs: 1) plan carefully; 2) examine efficacy; and 3) ensure policymakers use such examinations in budget decisions. The first step is necessary to protect jurisdictions against future revenue losses because the cost of tax incentives can grow exponentially. Mr. Chapman cited tax incentives that in fact grew in cost from millions of dollars to hundreds of millions of dollars in only a few years. Furthermore, he added that a key component to careful planning is ensuring a long-term evaluation process is established at the outset. This helps establish goals and benchmarks by which to measure the tax incentive in future years. The second step, carried out during the life of the tax incentive, is to consistently measure the efficacy of the program and to do so against a "but for" standard. This standard seeks to answer a question such as: What decisions would businesses have made "but for" the tax incentive? Additionally, the benefits of the program must always be measured against its cost. For example, it is possible for governments to create tax incentives that successfully catalyze business growth but do so at a cost to the government that far outweighs any additional economic growth. Mr. Chapman also stressed that these examinations must draw clear conclusions that are designed specifically to guide policymakers. Furthermore, these evaluations must be built into the budget process (for example, sunset tax incentives) so that legislatures are forced to address these policies. Mr. Chapman noted that his research shows that no matter the quality of a study, no tax policies were acted upon unless policymakers were forced to update or extend such tax incentives.

Finally, Mr. Chapman graded the District with respect to the criteria he had just laid out, saying that the city both does some things well and other poorly. On planning, he noted that D.C. produces fiscal impact studies on proposed legislation. The city, however, does not consistently cap tax incentives. With respect to evaluating incentives and linking results to decision-making, Mr. Cline stated that the District has so far taken no action on either of these principles.

Mr. Williams opened questioning by asking Mr. Cline how the city can analyze incentives, such as tax increment financing (TIF), which make “but for” analyses very difficult. Mr. Cline agreed such studies are inherently difficult but that governments still must search for meaningful data so that there is some analytical basis for keeping or ending such programs. Ms. Nicola Whiteman then asked if the District’s focus on project-driven incentives factors into PCS’s study. Mr. Cline said that, overall, D.C. is doing a good job of collecting more information but that the city must now focus on what to do with that information and how to insert it into the budget process. Mr. Lazere, following up on this point, asked about additional resources required for such evaluations. Mr. Cline responded by noting that D.C. is fortunate in that it already has—especially when compared with other states—a large staff and capacity for conducting good, nonpartisan policy analysis.

VI. Presentation: Tax Policy and Economic Development in D.C.

The next presentation came from Mr. Jeffrey Oakman and Ms. Lindsay Clark, both fiscal analysts with the Office of Revenue Analysis (ORA), who joined the meeting to discuss tax policy as it relates to economic development in D.C. Mr. Oakman opened the presentation by noting that “economic development” is defined here as policies aimed at growing and diversifying the District’s tax base. This includes activities such as constructing real estate, attracting and retaining business, and neighborhood revitalization. With respect to tax policy, this includes bond debt services and tax expenditures but not grants and expenditures on contracts. Tax-specific economic development accounted for 28.7% of D.C. economic development spending and tax expenditures in fiscal year 2012. Mr. Oakman noted that in D.C. tax expenditures for economic development have grown over the past 15 years and that the geographic targets of such policy tools have shifted from mostly downtown to revitalizing other neighborhoods. He also highlighted two differences between D.C. and national tax policy in this area: 1) the District’s TIF programs are project-specific while other jurisdictions use TIFs for communal infrastructure; and 2) D.C.’s payment in lieu of taxes (PILOT) programs are used with previously tax-exempt properties that are set to be privately developed (and eligible for taxation) but remain tax-exempt while other jurisdictions use PILOTS to capture revenue from traditional tax-exempt institutions. The District first authorized TIFs in 1998 while PILOTS were first used by the city in 2004. Both of these programs, as well as general obligation bonds, are restricted by the city’s limit on debt financing. This limit was lowered from 17% of general fund expenditures to 12% in 2009.

Ms. Clark then presented information on ORA’s role in analyzing the fiscal impact of such programs, and how the office conducts “but for” studies of the efficacy of these tax incentives for economic development. She also noted that tax incentives are split into two categories: 1)

by-right incentives that go to projects that meet eligibility criteria; and 2) discretionary incentives that are provided by the city on a case-by-case basis. In concluding remarks, both presenters noted that inherent in such tax incentives are trade-offs, as current tax revenue is traded for future tax revenue (often from a different source). For example, providing a retail organization with a commercial property tax abatement now is done with the expectation that the organization's success will lead to future sales tax revenue. As such, it is critical that evaluations are completed before the implementation of tax incentives so that long-term reviews can be made.

After a question from Mr. Brunori, Ms. Clark explained that the number of "discretionary" tax incentives passed into law by the Council is well below the amount that is actually introduced. She did not have the specific numbers at the moment but said such data is available. Mr. Ein also noted that, given its relation to this importance of the subject, the Commission would be well served to further study the rules surrounding the District's debt limit.

Next Commission Meeting: March 4, 2012

Mr. Williams then requested that the Commission address additional business and asked Mr. Kevin Clinton to update members on the progress of the Commission. Mr. Clinton stated that the D.C. Council is prepared to extend the deadline of the Commission to the end of the fiscal year, Sept. 30, 2013, and that they had given the Commission power to expedite the contracting process. He then thanked the Council for their critical assistance in ensuring the quality of the Commission's work. Mr. Clinton also announced that the Commission, and specifically its chair, Mr. Williams, will increase its engagement with the public and begin meeting with community organizations throughout the city. Mr. Williams added that in addition to meetings the Commission plans to schedule that there is an open invitation to community groups to reach out to the Commission if they wish to contribute to this project. He said this undertaking was a part of the Commission's obligation not only to make recommendations to city leaders but also simultaneously ensure citizens are involved throughout the process.

Finally, Mr. Clinton explained that the Commission's schedule had been altered, and that next month's meeting would focus on competitiveness and not fiscal architecture (as had previously been scheduled). He also noted that the location of next month's meeting will be at Judiciary Square.

VII. Adjournment (Commission Chairman)

Mr. Williams announced the meeting was adjourned.