DC Tax Revision Commission

Recommendations

February 12, 2014

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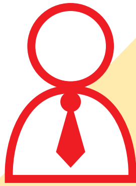
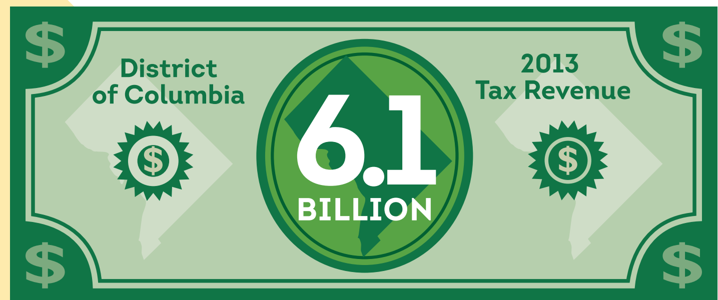
By the Numbers*



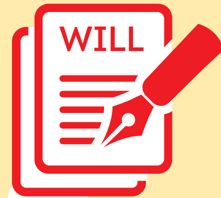
4.0%–8.95%
Individual Tax Rate

5.75%
Sales Tax Rate

9.975%
Corporate Tax Rate



16%
Top Estate Tax Rate

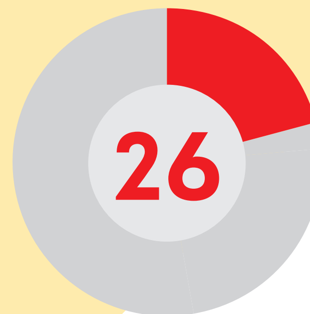


8.95%
Top Capital Gains Tax Rate

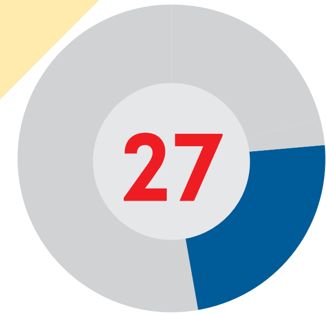
$0.85
Residential Property Tax Rate

$1.65 to $1.85
Commercial Property Tax Rate

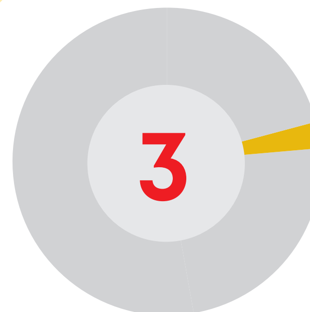
Commission Stats



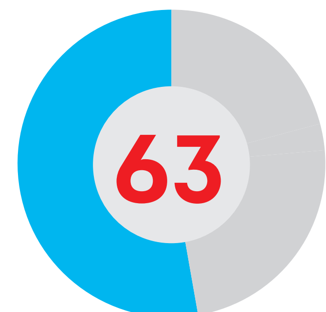
Total Public Meetings



Expert Presentations



Public Hearings



Tax Policy Options Considered

*Source: DC Tax Facts 2013, Office of the Chief Financial Officer

RECOMMENDATIONS

Individual Income Tax 6

- ☆ Conform the District's eight income tax filing statuses to the five federal filing statuses
- ☆ Create separate income tax brackets for singles and marrieds
- ☆ Add a new middle-class tax bracket at 6.5 percent, reduced from 8.5 percent
- ☆ Reduce the top marginal rate to 8.75 percent from 8.95 percent as of Jan. 1, 2016, instead of 8.5 percent as currently scheduled
- ☆ Raise the District's $4,100 standard deduction to the federal level of $6,100 for singles, $8,950 for head of household filers, and $12,200 for marrieds
- ☆ Raise the District's personal exemption to the federal level (from $1,675 to $3,900)
- ☆ Phase out personal exemptions for taxpayers with more than $150,000/$200,000 of adjusted gross income (singles/marrieds)
- ☆ Increase the maximum DC Earned Income Tax Credit (EITC) for childless workers from $195 per filer to $487 and expand coverage
- ☆ Broaden the individual income tax base by eliminating several small deductions and exemptions

Estate Tax 13

- ☆ Raise the estate tax threshold from $1 million to the $5.25 million federal level and then indexed for inflation

Business Taxes 15

- ☆ Lower the business franchise tax rate to 8.25 percent from 9.975 percent
- ☆ Exempt investment funds from the unincorporated business franchise tax
- ☆ Apportion business income to the District based on sales only
- ☆ Levy a local services fee on non-government DC employers of $100 per employee per year

Sales Taxes 19

- ☆ Expand the sales tax to more services
- ☆ Report use tax for online and mail-order purchases on the individual income tax return
- ☆ Raise the general sales tax rate to 6 percent from 5.75 percent
- ☆ Unify taxation of tobacco products

Property Taxes 23

- ☆ The Commission did not recommend any policy changes for the District's property tax

INTRODUCTION

The District of Columbia's economic picture is largely bright. It weathered the recession better than most jurisdictions, adding businesses, jobs, and residents during the recovery. More and more people are choosing the District as a place to live, rather than merely work. Private employment is growing, offsetting a loss of federal jobs. The current population and private employment strength translates into a relatively stable and growing revenue base.

The District's budget is balanced (indeed, in surplus), and its tax system is fundamentally sound. Many jurisdictions establish tax commissions to address fiscal crises or to lay foundations for new tax revenues. But the Council of the District of Columbia (DC Council) created the DC Tax Revision Commission during a time of fiscal and economic progress. The DC Council asked the Commission to analyze the District's tax system and propose innovative approaches to meet future revenue needs. The District last requested a comprehensive review of its tax system from a tax commission in 1998.

From the fall of 2012 through the end of 2013, the Commission reviewed the major taxes in the District and considered ways to improve fairness, broaden the tax base, increase the District's competitiveness, encourage business and employment growth, and promote simplification, as directed by the Commission's authorizing legislation.[1] The Commission's objective was twofold: to improve the District's tax system and to maintain its fiscal integrity. The Commission also sought to prepare the District's tax system for the challenges of the future (including a potentially smaller federal government) and to ensure that the District attracts a vibrant range of residents and businesses. The Commission held 26 meetings and 3 public hearings in its 16 months of activity.

Experts in state and local tax policy assisted the Commission's work. They analyzed the District's taxes, compared them with other localities and states, both regionally and nationally, and suggested reform options. Mayor Vincent Gray, members of the DC Council, and the public also offered policy suggestions.

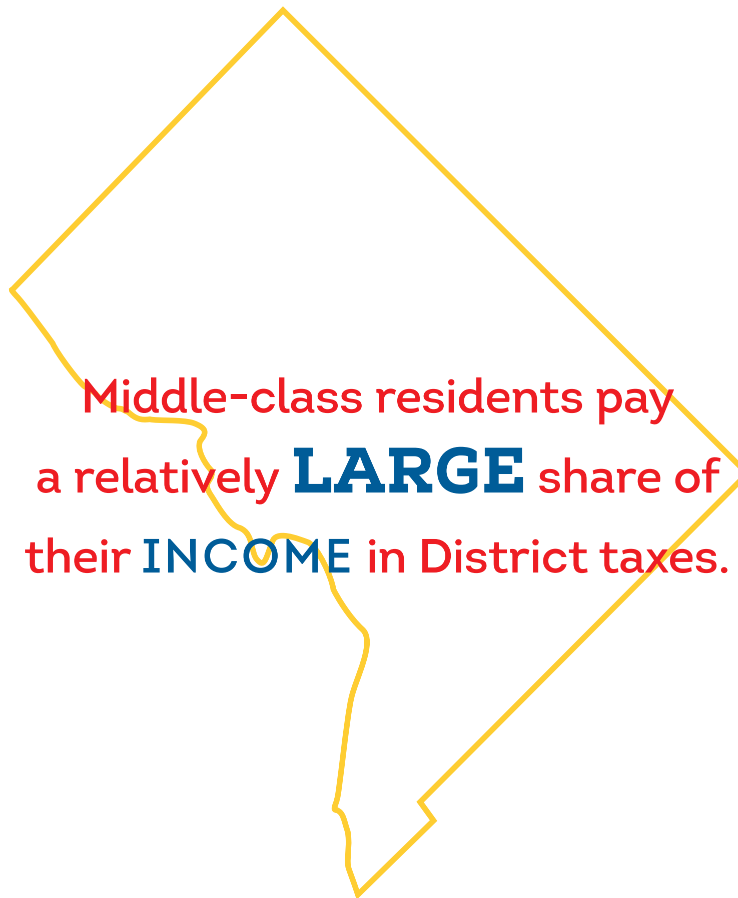
In September 2013, the Commission's staff assembled a list of 63[2] wide-ranging policy ideas for the commissioners to deliberate during public meetings. Some policy ideas were in conflict with others. The staff identified pros and cons for each idea, and the District's Office of Revenue Analysis (ORA), the revenue-estimating arm of the Office of the Chief Financial Officer, estimated the revenue impact for each option.

On Dec. 18, 2013, the Commission unanimously approved a set of recommendations designed to improve the District's tax system and help its residents and businesses prosper. The Commission structured its recommendations as a package, and many of the recommendations work in concert. For example, base-broadening measures in some recommendations help fund other tax relief recommendations.

The DC Council allocated $18 million a year to fund tax changes. The Commission worked hard to keep the cost of its recommendations as close to this target as possible to ensure that the District has the resources necessary to adequately fund its public services. Although the final package of recommendations exceeds the DC Council's allocation, the Commission considers its recommendations affordable given the District's recent economic and tax revenue growth.

In evaluating the District's tax system, the Commission identified three areas of major concern: the tax burden of middle-class residents, the relatively high business taxes, and the limited scope of the District's tax base.

[1] The Commission was authorized by the DC Council on Sept. 14, 2011, through an amendment to DC Code § 47-461. Please see the Appendix.
[2] Three of the original options were related to tax administration. These options are not included in this section of the report. All tax administration issues will be presented in a memo to CFO Jeffrey DeWitt, who recently assumed office.



- Middle-class residents pay a relatively large share of their income in District taxes. This undercuts the progressive design of the District's tax system and impedes efforts to attract and retain residents. This disproportionate burden is especially troubling given the rising cost of living in the District. The current tax system often challenges long-term residents hoping to stay in the city, young professionals moving to the District, and growing families seeking to make the District their permanent home. The Commission recommended increasing the standard deduction and the personal exemption as well as adding a new middle-income tax bracket, with a tax rate of 6.5 percent, rather than 8.5 percent.

- The District's business franchise tax and commercial property tax rates are the highest in the region and among the highest in the nation. As it prepares for future challenges, including a shrinking federal government, the District must attract businesses and diversify its economy. The Commission recommended lowering the District's business franchise tax rate to 8.25 percent (from 9.975 percent), the same rate as Maryland and closer to Virginia's 6 percent rate.

- Because of federal limitations, the District cannot tax many businesses and individuals. As a result, existing taxable DC businesses and residents must pay higher taxes. The Commission recommended broadening the tax base, which would spread the tax burden more widely and raise revenue more efficiently. To that end, the Commission recommended a local service fee of $100 per employee per year to be paid by all businesses and an expansion of the sales tax to a handful of services.

This report summarizes the Commission's recommendations and deliberations. It also addresses the ideas that the Commission rejected. There are five divisions in this section of the report, organized by type of tax: individual income tax, the estate tax, business taxes, sales tax, and property tax.[3]

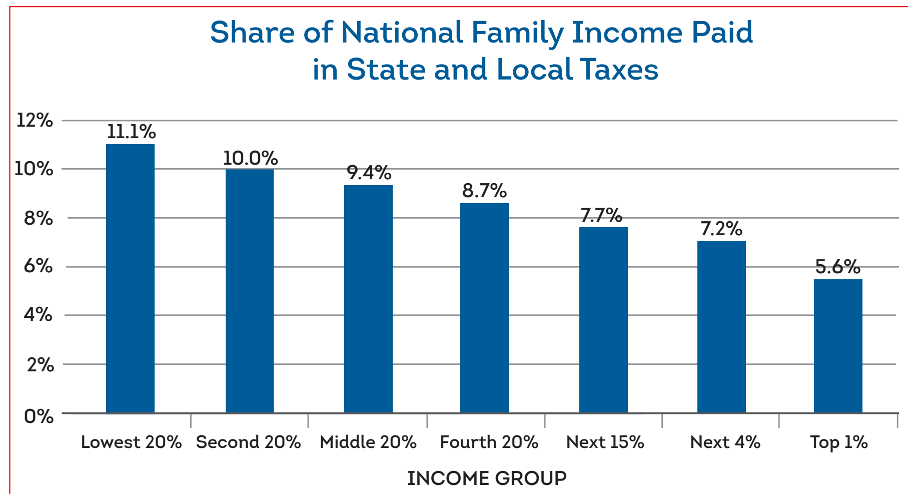
[3] Deed recordation and deed transfer taxes are included in the discussion of property taxes.

INDIVIDUAL INCOME TAX

The District's individual income tax has eight filing statuses and four brackets. For taxpayers of any status, taxable income up to $10,000 is taxed at 4 percent, between $10,001 and $40,000 at 6 percent, between $40,001 and $350,000 at 8.5 percent, and above $350,001 at 8.95 percent.

When considering all taxes, most state and local tax systems are quite regressive, meaning that low- and middle-income families pay more of their income in taxes than high-income families. The Institute on Taxation and Economic Policy (ITEP), a non-partisan research organization, examines major state and local taxes by calculating the share of family income paid in these taxes by different income groups.[4] When calculating a national average, ITEP found substantial regressivity. Families in the lowest-income quintile pay 11.1 percent of their income in state and local taxes, the highest share of any income group. Furthermore, as the chart below illustrates, each successive income group pays a smaller share of its income in state and local taxes as income increases.

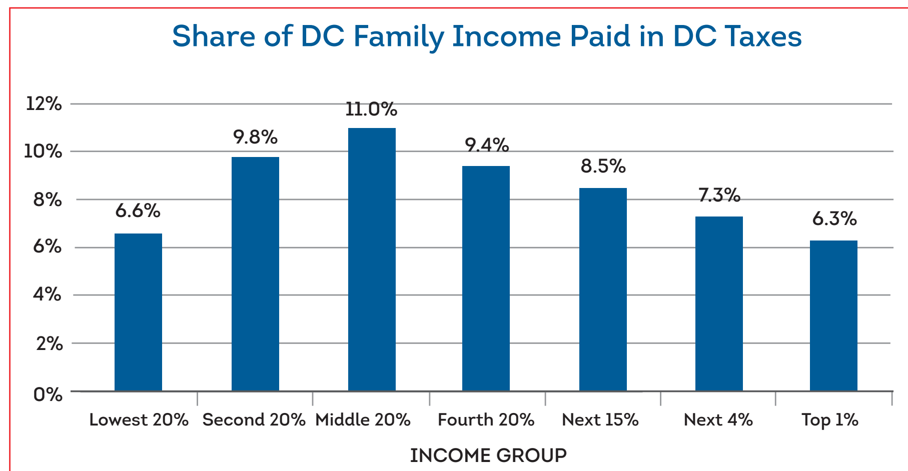
By contrast, the District's tax system is more progressive. District residents in the lowest-income quintile pay 6.6 percent of their income in District taxes—substantially lower than the national average. Furthermore, taxes as a share of income rise from the lowest-income quintile to the middle-income quintile, making the tax system progressive at these levels. However, as the below chart for the District illustrates, District tax liabilities as a share of income *fall* from the middle-income group to the highest-income group.



The rise and fall of tax liabilities over the income range disproportionately burden the District's middle-class residents. In fact, the tax burden for middle-class residents is relatively large both when compared to that of the District's high-income residents and when compared to middle-income residents in other jurisdictions. The high tax burden for middle-class residents stems, in part, from a relatively high income tax rate that begins at a relatively low income level.

The Commission recommended reforms to the District's individual income taxes to (1) conform District tax filings to federal filings, (2) simplify the District's individual income tax, and (3) improve the progressivity of the District's tax system.

The individual income tax is only one of the District's major taxes, but is the one most easily modified to adjust tax burdens across income levels.



[4] The "major tax" model in the ITEP study combines five tax models: the personal income tax model (including special rates for capital gains, exclusions of various income, deductions, credits, etc.); the consumption tax model (including more than 250 base items); the property tax model (both residential and business); the corporate income tax model; and the local taxes (an aggregation of statewide revenue). It uses income data from 2010 and tax laws as of Jan. 2, 2013. For more information on the study's methodology, please see the full report at http://www.itep.org/whopays/.

What the Commission Recommended

Conform the District's individual income tax filing statuses to the federal options

Four of the District's eight income tax filing status options are shared with the federal government (single, married filing jointly, married filing separately, head of household) and four are not (married filing separately on the same return, domestic partners filing jointly, domestic partners filing on same return, dependent claimed by someone else). Residents can select their District status without regard to their status for federal filing.

The "married filing separately on the same return" status allows each member of a married couple to calculate tax liability separately but make one joint payment or receive one refund. This status may also help the couple avoid a "marriage penalty," which may occur if the couple's combined income on a tax return results in a greater tax obligation than if each member of the couple had filed separate returns. However, "married filing separately on the same return" is easily confused with "married filing separately," a status that is not eligible for many tax relief programs. The Commission recommended establishing a two-schedule tax system, with one set of brackets for married couples filing jointly (and head of household filers) and another set of brackets for single filers, to better address the marriage penalty.

The Commission recommended REFORMS to the District's individual income taxes to (1) CONFORM District tax filings to federal filings, (2) SIMPLIFY the District's individual income tax, and (3) IMPROVE the progressivity of the District's tax system.

The District created the two statuses for domestic partners in 2006, in part to provide same-sex partners with the same treatment enjoyed by married filers. Since the District subsequently legalized gay marriage and the Defense of Marriage Act was ruled unconstitutional, the Commission determined that the domestic partner options can be eliminated. However, the domestic partner options are not exclusive to married gay couples. For example, two sisters living together, both senior citizens, can choose this option. Under the Commission's recommendations, each of these taxpayers would file as single–as they currently would do for their federal returns. For the Commission, the benefits of all the recommended income tax changes outweighed possible negative effects, such as those that might result from a taxpayer filing as single rather than as a domestic partner. Furthermore, only 100 District filers used domestic partner status options in 2010, meaning this change would affect very few taxpayers.

DC Individual Income Tax Filing Statuses

Current Law	Commission Recommends
1. Single	1. Single
2. Head of Household	2. Head of Household
3. Married Filing Jointly	3. Married Filing Jointly
4. Married Filing Separately	4. Married Filing Separately
5. Married Filing Separately on the Same Return	5. Qualifying Widow(er) with Dependent Child
6. Domestic Partners Filing Jointly	
7. Domestic Partners Filing on Same Return	
8. Dependent Claimed by Someone Else	

Create a two-schedule tax system

Single and married filers in the District use the same set of tax brackets. The federal government and many states, by contrast, use different tax brackets for different family types, in large part to reduce the "marriage penalty." As noted earlier, two married adults, both earning income, might pay more tax if they file jointly than if they file separately because their combined income could place them into a higher tax bracket or subject more of their income to a higher tax rate.

Current DC Individual Income Tax Rates	
Income	**Tax Rate**
$0 to $10,000	4%
$10,001 to $40,000	6%
$40,001 to $350,000	8.5%
$350,001 and above	8.95%

For example, District taxable income above $40,000 is taxed at 8.5 percent for both a single filer and a married family. Therefore, a married couple with two adults each having $40,000 in taxable income (a combined $80,000) might pay more in District taxes if they file jointly than if those same two adults filed separately.

The Commission recommended creating a two-schedule tax system, one for single filers and one for married couples filing jointly and head of household filers, and then adjusting rates to reduce the potential marriage penalty.[5]

Establish a new middle-class tax bracket

The District's current tax rates are progressive but not uniformly so. In presenting a paper on the District's individual income tax to the Commission, Professor Robert Buschman, a senior research associate at the Andrew Young School of Policy Studies at Georgia State University, noted that "the current structure is most steeply progressive going from the lowest to the second and third income quintiles, with more limited progressivity from there to the higher quintiles."[6]

This is because residents begin paying a relatively high tax rate of 8.5 percent on a relatively low amount of income. Furthermore, this tax rate applies to all taxable income between $40,001 and $350,000. (Before a new top tax rate was added in 2012, the old top rate applied to all taxable income above $40,000.) This means a family with annual taxable income of $50,000 pays the same marginal income tax rate as a family with $340,000 of taxable income.

Accordingly, the Commission recommended a new tax bracket to relieve middle income residents. This bracket would lower the 8.5 percent rate to 6.5 percent for taxable income between $40,001 and $60,000 for single filers and $40,001 to $80,000 for married filers. Income above these thresholds would be taxed at an 8.5 percent rate, until the 8.95 percent rate (which would be 8.75 percent in 2016).

The Commission also recommended starting the 8.95 (or, in 2016, 8.75) percent rate at $200,001 for single filers and $350,001 for married filers. The split is designed to reduce the marriage penalty.

Commission's Recommended Individual Income Tax Rates		
Single Filers Income	**Married Filers Income**	**Tax Rate**
$0 to $10,000	$0 to $10,000	4%
$10,001 to $40,000	$10,001 to $40,000	6%
$40,001 to $60,000	$40,001 to $80,000	6.5%
$60,001 to $200,000	$80,001 to $350,000	8.5%
$200,001 and above	$350,001 and above	8.75%[7]

While some single taxpayers would move into higher tax brackets at lower income levels (e.g., the top rate at $200,000), the tax bills of almost all single taxpayers would be reduced under the recommended changes.[8] This is because the benefits of the new tax bracket, the increased standard deduction, and the personal exemption are greater than the costs of taxing some income at the higher rates.

[5] Residents filing as "married filing separately" would use the tax schedule for "single" filers. Residents filing as "head of household" and "qualifying widow(er) with dependent child" would use the same tax schedule as "married" filers. For simplicity, this report uses only "single" and "married" when describing the two tax schedules. A taxpayers who previously filed as "dependent claimed by someone else" would file as single but not be eligible for a personal exemption

[6] Buschman, Robert D., "The District of Columbia Individual Income Tax: Structure, Competitiveness, and Potential Improvements," July 2013. (p. v)

[7] This is the tax rate the Commission recommended the District permanently adopt on Jan. 1, 2016. For single filers with more than $200,00 of income, the rate will increase to 8.95 percent from 8.5 percent until the end of 2015. For married filers, the 8.95 percent rate will remain until the end of 2015. Then, for both filers, the rate will become 8.75 percent.

[8] The tax bills of substantially all married taxpayers also would be reduced.

The top marginal individual income tax rate

In 2012, the District increased its top rate from 8.5 percent to 8.95 percent, which is scheduled to expire at the end of 2015 and return to 8.5 percent in 2016. The District's top rate is relatively high, and some believed that allowing it to expire as scheduled would send a positive signal about the District's commitment to controlling taxes. (Maryland's top rate is 8.95 percent and Virginia's is 5.75 percent.[9])

Others argued that the District's relatively large number of high-income residents appears little affected by the higher top tax rate. Some also proposed raising the top rate above 8.95 percent. Such an increase could help fund the recommended changes or pay for additional low- and middle-income tax relief to make the system more progressive. The Commission rejected this proposal.

The Commission compromised: It unanimously supported a higher top tax rate for taxable income above $200,000 for single filers and $350,000 for married fliers but recommended lowering that top rate to 8.75 percent, rather than allowing it to drop to 8.5 percent (from 8.95 percent) as scheduled on Jan. 1, 2016. The Commission saw this compromise as a way to maintain the integrity and progressivity of the income tax system while fulfilling a commitment to make the 8.95 percent rate temporary.

Raise the District standard deduction and personal exemption to the federal levels[10]

The District allows a standard deduction of $4,100 and a personal exemption of $1,675 ($3,350 for married couples filing jointly and head of household filers). The Commission recommended raising the standard deduction to match the federal levels of $6,100 for single filers, $8,950 for head of household filers, and $12,200 for married couples filing jointly. It also recommended increasing the personal exemption to $3,900, matching the federal level. As with the federal standard deductions and personal exemption, the new District deductions and exemption would be adjusted for inflation each year.

DC Standard Deduction and Personal Exemption

	Current Law	Commission Recommends
Standard Deduction	$4,100	$6,100 (single); $12,200 (married)
Personal Exemption	$1,675 (single); $3,350 (married)	$3,900

Low-income residents would benefit greatly by these increases. For example, under the recommended system, the income of a married family with two children would be reduced by $27,800. Under the current tax system, that reduction is $10,800. A single parent with one child would have his or her income reduced by $13,900 instead of the current $9,125.[11]

Middle-class taxpayers also would benefit because more of their income would be shielded from any tax and because less of their income would fall into higher-rate brackets. However, because nearly nine-in-10 District filers with more than $75,000 in income choose to itemize their deductions, a change in the standard deduction would have little effect on higher-income residents.

Phase out personal exemptions for high-income earners

The main obstacle to raising the standard deduction and personal exemption was the revenue cost. To offset this, the Commission considered increasing the District's current limitation of itemized deductions and creating a phase-out of personal exemptions.

The District already reduces allowable deductions as income increases. A taxpayer earning more than $200,000 in adjusted gross income (AGI) must reduce his or her itemized deductions by an amount equal to 5 percent of AGI over $200,000.

After consideration, the Commission decided to maintain the current limitation on itemized deductions. The Commission rejected a more aggressive limitation of itemized deductions.

[10] All federal tax items, such as the standard deduction, are from tax year 2013.

[11] This calculation assumes the single parent is eligible to file as "head of household" on the District income tax return. This status allows the taxpayer to claim the same personal exemption as a married couple ($3,350). Parents who do not qualify as "head of household" file as "single" and claim the $1,675 exemption.

All District residents, regardless of income, currently claim a personal exemption. By contrast, the federal tax system phases out the personal exemption for singles with AGI above $250,000 and married filing jointly with income above $300,000. The Commission recommended phasing out personal exemptions in order to improve the progressivity of the income tax and to reduce the revenue loss resulting from an increased personal exemption.

The Commission recommended a phase-out that begins at $150,000 of AGI for single filers and $200,000 for married filers and that reduces personal exemptions by 2 percent for each $2,500 in excess of the threshold. This roughly matches the federal phase-out of personal exemptions, also 2 percent for each $2,500, beginning at slightly higher income levels. The District's phase-out is set at lower income levels than that of the federal government so as to better align with the Commission's proposed tax brackets for District taxpayers.

Itemized Deductions and Personal Exemptions		
	Current Law	**Commission Recommends**
Itemized Deductions	Reduce by amount equal to 5% of adjusted gross income (AGI) above $200,000	No change to current law
Personal Exemptions	No phase-out	Reduce by 2% for each $2,500 above $150,000 of AGI for singles and $200,000 for married couples

Expand the Earned Income Tax Credit for childless workers

The Commission examined multiple proposals to reform the District's Earned Income Tax Credit (EITC). The EITC, a powerful anti-poverty tool, considers a taxpayer's income and family circumstances (such as marital status and number of children). It is available as both a federal and a state credit. The District's EITC is 40 percent of the federal credit but the federal formula is heavily tilted toward workers with children. For example, the maximum federal credit for a worker with three children is $6,044 while the maximum credit for a worker with no children is $487. (Correspondingly, the District's maximum EITC for a worker with three children is $2,418 while the maximum benefit for a childless worker is $195.)

The District's 40 percent EITC match for workers *with children* is one of the most generous state-level credits in the nation, and there was little support for increasing it. Instead, the Commission recommended expanding the EITC benefit for low-income workers *without children*. First, the Commission recommended increasing the District's EITC for childless workers to 100 percent of the federal credit from the current 40 percent of the federal credit. Second, the Commission recommended expanding EITC eligibility for childless workers in the District.

Under the federal formula, a single childless worker may claim the maximum EITC benefit at $6,370 of adjusted gross income (AGI), and the benefit is reduced until the income of the childless worker reaches $14,340 of AGI, at which point the benefit ends. For a married childless worker the upper bound is $19,680 of AGI.

DC Childless EITC			
	Max EITC	**Begin Phase-out**	**End Phase (No EITC)**
Single			
Current	$195	$7,970	$14,340
Recommended	$487	$17,235	$22,980
Married			
Current	$195	$13,310	$19,680
Recommended	$487	$17,235	$22,980

The Commission recommended changing these boundaries for the District's EITC for childless workers. The Commission recommended allowing childless workers to keep the maximum District EITC benefit at incomes starting at $6,325–the current starting point–up to an AGI of $17,235, and then phase out the benefit up to an AGI of $23,265. Expanding the thresholds would make the EITC available to many more childless workers.

Broaden the individual income tax base by eliminating expenditures

The Commission recommended eliminating four tax expenditures to broaden the income tax base.

These expenditures are:

- Low income credit
- District government employee first-time homebuyer credit
- Long-term care insurance deduction
- District and federal government pension exclusions

By raising the standard deduction and personal exemption to match the federal levels, virtually all residents would benefit from substantial tax relief, and the four targeted and exclusive credits would become less necessary.

The low-income credit (LIC) is used by residents with income subject to District taxes but not to federal taxes. In other words, their AGI is less than the sum of the federal standard deduction and personal exemptions, but more than the District's standard deduction and personal exemptions. The LIC reduces the likelihood that such a taxpayer will face District income taxes. The LIC is not refundable. If the District raises its standard deduction and personal exemption to the federal levels, as recommended by the Commission, this disparity will disappear and the LIC will be unnecessary. The elimination of the LIC will make the District's income tax both simpler and fairer.

District taxpayers can currently claim either the LIC or the EITC, but not both. Therefore, a resident must calculate which credit is more beneficial before completing a return. If the District eliminated the LIC—and the need for the LIC by raising the standard deduction and personal exemption—then all eligible taxpayers could benefit from the District EITC, a refundable credit.

Professor Buschman suggested eliminating the other three tax expenditures in order to increase horizontal equity (i.e. to treat similar taxpayers, such as all retired workers, the same). The Commission agreed. It recommended broad-based tax relief through the increased standard deduction and personal exemption rather than more targeted tax relief.

What the Commission Did Not Recommend

More high-income tax brackets

The District has many high income residents. It also has high levels of poverty and unemployment. To increase the progressivity of the District's income tax, the Commission discussed additional high-income tax brackets. Instead of a final tax bracket beginning at $350,000, for example, the District could adopt an 8.95 percent tax rate on income from $350,001 to $500,000, a 9.25 percent rate on income between $500,001 and $750,000, and a 9.5 percent tax rate on all income above $750,000.

These new tax brackets and rates could raise revenue for social programs or provide additional tax relief for low- and middle-income residents. Opponents argued that new tax brackets would discourage affluent residents from living in the District. The Commission decided not to recommend top tax rates that exceed those of Maryland (8.95 percent) or widen the gap between the District's top rate and that of Virginia (5.75 percent).

Reduce upper income tax rates

Conversely, some advocated for lowering the District's top income tax rates to attract more high-income residents. High-income residents contribute substantial tax revenue and, potentially, bring businesses to the jurisdiction where they live. In the District, this might translate into increased business growth and job creation.

Advocates for lower top tax rates also observed that successful entrepreneurs in the region may work in the District but live elsewhere. For example, they can reside in neighboring Virginia, where the top income tax rate is much lower (5.75 percent).

The Commission compromised: It unanimously agreed to lowering the top income tax rate to 8.75 percent in 2016 and to creating a new, lower, tax bracket for middle-income residents of 6.5 percent (reduced from 8.5 percent). The Commission did not recommend further cuts to the upper-income tax rates, in part because of their significant cost. There also was little evidence that the cuts would significantly increase the District's economic performance.

Eliminate exemption for out-of-state bonds

Interest that individuals, estates, and trusts earn from out-of-state municipal bonds is exempt from the District's individual income tax. In 2011, policymakers enacted a tax on interest income from all out-of-state bonds held by District taxpayers, but the tax was repealed in 2013.

The Commission struggled to find a policy justification for the exemption. In public testimony, supporters of the exemption argued that it protects seniors with limited income. However, there is little evidence of that. Rather, it benefits all high-income residents who choose this form of investment.

Some states have reciprocal agreements with other specific states, but the District grants a blanket exemption. Not only does the exemption represent substantial lost revenue for the District, but such broad relief eliminates an incentive for residents to purchase District bonds over those from other jurisdictions. In other words, it essentially subsidizes investments outside the District.

Because the DC Council recently decided to maintain the exemption, the Commission decided not to recommend its elimination. However, the Commission found that the exemption for out-of-state municipal bonds runs counter to the Commission's goals of fairness and efficiency.

ESTATE TAX

The District imposes a maximum tax rate of 16 percent on estates worth more than $1 million that are not passed at death to a surviving spouse or charity. For tax year 2013, the federal government imposes an estate tax rate up to a maximum of 40 percent on estates valued in excess of $5.25 million. The threshold for the federal estate tax is indexed to inflation. The estate tax in Maryland also has a threshold of $1 million and a maximum estate tax rate of 16 percent. Virginia has no estate tax.

What the Commission Recommended

Raise the estate tax threshold to the federal level of $5.25 million, indexed to inflation

The District's estate tax affects estates with homes or other assets valued at more than $1 million. Estates with values exceeding the District's threshold, but less than the federal $5.25 million threshold, must file a return with the District but not with the federal government. The District's threshold has remained unchanged since 2003–the year in which the federal government started increasing its threshold substantially and lowered its tax rates–even though nominal asset values have increased due to inflation.

Under the Commission's recommendation, the District's estate tax threshold would increase to $5.25 million, with annual inflation adjustments starting in 2014. An estate would file a District estate tax return only if it were also required to file a federal return.

The District's estate tax formula is tied to an OBSOLETE federal law.

The District's estate tax formula is tied to an obsolete federal law. Under prior law, the federal estate tax provided a graduated credit for state estate taxes that offset up to 16 percent of an estate's value against the federal tax. As a result, the District and most states had an estate tax with a graduated rate schedule that replicated the credit formula–including the top tax rate of 16 percent. In effect, a taxable estate owed tax to the state but had the entire cost "picked up" by the federal government. This allowed states to collect revenue without imposing additional tax burden on their residents.

Through a gradual phase-out starting in 2001, the federal credit was eliminated in 2005. The repeal of that credit caused the estate tax to disappear in many states. (In those states, the tax only existed because of the credit.) But the District and some other states retained the tax.

Today, the District's estate tax rate schedule is still tied to the outdated federal schedule and crediting mechanism. It has 21 graduated brackets and a top rate of 16 percent beginning at $10,040,000 of estate value.

By lifting the estate tax threshold to $5.25 million, and using fewer brackets, the system would be simplified. The Commission recommended a graduated rate schedule that would apply to the value of an estate above the federal threshold, as adjusted for inflation. Under this recommended schedule, all of an estate's value below the indexed threshold would be tax-exempt. The value between the threshold of $5.25 million, as indexed, and $7.5 million would be taxed at 12 percent while the value between $7.5 million and $10 million would be taxed at 14 percent. Finally, the value of an estate above $10 million would be taxed at 16 percent. As the threshold increases with inflation, the 12 percent bracket and, later, the 14 percent bracket would disappear.

Although simplified, this new rate schedule would keep the general structure of the current rates. The following chart shows the recommended rate schedule for tax year 2013, assuming a $5.25 million threshold.

Estates in the District with a taxable value above the current $1 million threshold, but below the new $5.25 million threshold, would universally benefit because they would no longer be subject to the tax. District estates with a taxable value slightly above the threshold (e.g., $6 million) would also benefit since more of their assets would be exempt from the tax. Estates with very high taxable values (e.g., $100 million) would continue to be taxed at the current 16 percent rate.

Recommended Estate Rates (Tax Year 2013, $5.25 Million Threshold)		
Estate Value	Value Above Threshold	Tax Rate
$0 to $5.25 million	$0	0%
$5.25 million to $7.5 million	$0 to $2.25 million	12%
$7.5 million to $10 million	$2.25 million to $4.75 million	14%
$10 million and above	$4.75 million and above	16%

The Commission's recommendation on the estate tax would also bring administrative uniformity to the review process. Currently, an estate that is required to pay the District's estate tax but not the federal estate tax must file a District return that includes pages from the federal return and its schedules. The audit responsibility for these returns falls entirely on the District government. For estates that exceed both federal and the District's thresholds, the District and the federal government share administrative responsibility. In the latter, the District can also choose to rely on audits conducted by the Internal Revenue Service.

What the Commission Did Not Recommend

Eliminate the District's estate tax

Because many states, including Virginia, do not have an estate tax, some suggested that the District could attract and retain more affluent families by repealing the estate tax entirely. They reasoned that affluent families might remain in, or move to, a jurisdiction where they could avoid the tax.

The Commission recommended raising the threshold for the estate tax but not eliminating the tax. While some affluent residents might move to avoid the tax, the Commission expected many would stay and pay the tax. As a result, the estate tax could generate a lot of revenue, albeit a variable amount of revenue. For example in fiscal year 2012, the estate tax generated more than $100 million in revenue for the District. Furthermore, the Commission received written testimony from academic researchers who found little evidence of estate taxes influencing mobility.[12]

[12] Jon Bakija, Department of Economics, Williams College (Sept. 15, 2013); and Karen Conway, University of New Hampshire, and Jonathan Rork, Reed College (Nov. 18, 2013).

BUSINESS TAXES

Business taxes are important for the District, generating nearly half its tax revenue.[13] Business leaders testified that business taxes are too high. They noted that the District's business franchise tax rate of 9.975 percent surpasses those of Maryland (8.25 percent), Virginia (6 percent), and all but two other states. However, the complete business tax picture is more complicated. For example, many localities in Virginia have a gross receipts tax that pushes their business tax burden above the statutory business income tax rate.

The Commission also recognized that the District has done relatively well over the past decade in both economic and population growth. The Commission heard from Norton Francis, a senior research associate at the Urban-Brookings Tax Policy Center, who reported that the District has enjoyed greater growth in employment, wages, and number of businesses than many of the adjacent counties in Maryland and Virginia through 2012.

In the end, the Commission believed the CURRENT RETRENCHMENT of the federal government requires the District to remain VIGILANT to remain competitive.

In the end, the Commission believed the current retrenchment of the federal government requires the District to remain vigilant to remain competitive. The federal government is a large presence in the District, and a small reduction in the size of the federal government could harm the District disproportionately. This vulnerability underscores the importance of diversifying the District's economy.

The Commission recommended several steps to broaden the District's economic portfolio and bolster its competitive position vis-à-vis regional business.

What the Commission Recommended

Lower the business franchise tax rate

The District has two business income taxes. The business franchise tax (BFT) applies to corporations (including S corporations) carrying on a trade, business, or profession in the District or receiving income from District 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. Both the BFT and UBFT have a tax rate of 9.975 percent.

This high tax rate may deter businesses from locating in the District, although the evidence presented to the Commission was mixed. A study on business taxes found that "tax burden in the District for C-corporations is not significantly different from its Maryland and Virginia neighbors."[14] However, the authors of the study noted in their public testimony that business leaders' perception of tax liability runs contrary to that. Many in the business community believe that the District's business taxes are excessive when compared with neighboring jurisdictions.

The Commission recommended that the District reduce its BFT/UBFT rate to 8.25 percent, from 9.975 percent. This would put the District's headline tax rate on par with that of Maryland and much closer to the rate in Virginia. This large tax cut would signal that the District is "open for business" and, hopefully, boost the city's tax reputation.

Exempt investment funds from the unincorporated business franchise tax

In general, the District can only tax the income of its residents. Unlike states with an individual income tax, it cannot tax

[13] The commercial property tax provides most business tax revenue. This tax is addressed in the "Property Taxes" section of the report.
[14] Aceituno, Robert and Karen Yingst, "Case Studies of Business Taxes in the District of Columbia: A Comparison with Neighboring Jurisdictions," September 2013 (p. 1).

non-residents' income, whether earned directly or via pass-through entities. Through its UBFT, the District taxes income that is earned by unincorporated businesses. Notably, the UBFT does not apply to trade or business in which more than 80 percent of gross income is derived from personal services actually rendered by the individuals or partners, without capital as a material income-producing factor. This exempts professional firms, including doctors, lawyers, engineers, and accountants.

However, investment funds operating a stock "trading" business in the District are subject to the tax. This amounts to a 9.975 percent tax on capital gains, dividends, and interest–and represents a liability that would not be imposed on funds in other states. The UBFT effectively precludes investment funds from "trading" stocks or securities in the District.

New York City collects an unincorporated business franchise tax, but it exempts partnerships and other unincorporated entities that purchase, hold, or sell property–both real property and intangible property, like stocks and bonds–for their own account. This creates a "trading safe harbor" that is similar to a federal trading safe harbor.

The Commission recommended that the District adopt such a "trading safe harbor" that would generally exempt investment funds from the UBFT. This step, which would apply only to intangible property and not real property, could position the District to attract a vibrant new industry, spurring growth and diversifying the economy.

Shift to sales only to apportion business income to the District for taxation

To apportion its share of income from a multi-state business, the District looks at three factors: sales, property, and payroll. In 2011, the District decided to double-weight the sales factor in its formula. In other words, a company's sales in the District have a larger effect on its apportionment of income than its property or payroll in the District.

The Commission recommended using sales alone to apportion business income for taxation. If a multi-state business has 10 percent of its sales in the District, it must apportion 10 percent of its income to the District. This change is designed to make the District more attractive to firms that seek to expand their District properties or payrolls. Many other states have already adopted this single-sales strategy. In addition to making the District more attractive, a single-sales factor generates more tax revenue. This is because many multi-state companies sell to District customers but relatively few companies have extensive property or payroll in the District relative to their national footprint. More business income allocated to the District would translate to more tax revenue, and this new revenue would help fund the significant reduction in business franchise taxes that the Commission believed is necessary for the District to become more business competitive.

Levy a local services fee on employers

Under the 40-year-old Home Rule Act, which imposed a layer of federal government oversight to the District's operations, the DC Council cannot "impose any tax on the whole or any portion of the personal income, either directly or at the source thereof, of any individual not a resident of the District."[15] This constraint benefits the thousands of commuters who work in the District and use its services but do not contribute to the cost of those services. Additionally, the District is home to many nonprofit organizations, all of which are exempt from the District's business income tax. Many of these organizations are also exempt from the commercial property tax. These limitations have forced the District to disproportionately shift its tax burden to a smaller base of residents and for-profit businesses.

The Commission studied several alternatives for broadening that tax base, including a program to negotiate payments in lieu of taxes (PILOTs) with nonprofits. Ultimately, the Commission recommended a local services fee on employers. The Commission believed this would broaden the tax base more efficiently, more transparently, and, most likely, more cheaply than a PILOT. After consulting with counsel, the Commission also concluded that a local services fee would be permissible under the Home Rule Act.

Employers would pay $25 per employee (calculated by the number of employees listed on their unemployment filings) every quarter, or $100 a year. Employers with four or fewer employees would be exempt. In addition to its simplicity, the fee would be based on employees, not income, thus more closely correlating with the value of the benefits (including police, fire, and ambulance protection) provided by the District to those employees.

[15] DC Code § 1-206.02

It might be argued that a per-employee fee discourages employment. But the Commission tried to set the fee low enough to mitigate possible economic effects. (Other payroll taxes, such as Social Security taxes, Medicare taxes, and unemployment taxes, are much higher.) The local services fee would also offer a more equitable avenue for spreading the District's tax burden. By asking all employers to pay a little for the services their employees receive from the District, the income tax rate for those businesses—which already contribute revenue to the city—can be reduced. The lower business income tax rate should help spur commercial growth and job creation.

What the Commission Did Not Recommend

Eliminate business income taxes

Advocates of a repeal of business income taxes maintain that the taxes hurt competitiveness, impose compliance burdens, and generate little revenue. While agreeing that a reduction in the business income tax to 8.25 percent, from 9.975 percent, would increase the District's competitiveness, the Commission found little evidence to support a complete repeal. The District's regional competitors, Maryland and Virginia, both have a business income tax. And the District relies heavily on business income taxes, which accounted for 8 percent of the District's general fund tax revenue in fiscal year 2012. Finally, the District's business income tax is relatively simple. It has only four credits, a fraction of the credits offered by Maryland and Virginia.

Replace business taxes with a gross receipts tax

For some, the gross receipts tax represents a simple way to tax businesses. Firms subject to the tax tally their gross receipts, multiply that number by the tax rate, and pay the product.

The Commission examined constructing a gross receipts tax to replace the District's business franchise tax, unincorporated business tax, and personal property tax.[16] The objective was to make the transition revenue neutral. This meant the gross receipts tax would need to raise $550 million in revenue.

In 2007, the U.S. Census Bureau estimated the District's total business tax base at roughly $77 billion. ORA does not calculate an official estimate for the District's tax base but acknowledged that the census figure aligned with the District's current tax base. To make the tax swap revenue neutral, based on a tax base of $77 billion, a gross receipts tax rate would have to be set at 0.71 percent—far too high to be feasible. The gross receipts tax rate in Ohio, for example, is only 0.26 percent.

A gross receipts tax raises other concerns. The tax may be "pyramided," meaning that it could apply at more than one stage of production. The tax could cause businesses and residents to make purchases from non-District suppliers. Moreover, the tax is not sensitive to a business's ability to pay, in that companies would owe taxes whether or not they earn profits in a given year.

Reduce the capital gains tax rate to 3 percent for investors in high-technology firms

The District taxes long-term capital gains the same as all other individual income, with a current top tax rate of 8.95 percent on income above $350,000. The Commission did not recommend reducing that rate to 3 percent for capital gains from the sale of stock of a Qualified High Technology Company (QHTC).[17] Mayor Gray proposed such a reduction in the Technology Sector Enhancement Act of 2012, and the DC Council asked the Commission to consider the proposal.

The Commission supports the diversification of the District's economy, including efforts to attract QHTCs. But targeting capital gains tax benefits to these firms did not seem the best course for achieving this. Targeting capital gains tax benefits is inherently difficult. Some investors might attempt to characterize their income as high-technology capital gains to take advantage of the lower tax rate. Others might invest without the added incentive.

This malleability and, therefore, the unknown response to such a policy option, is why ORA could not provide the Commission with an official revenue estimate. More troubling, a 2012 fiscal impact statement on the proposal from ORA concluded that "if

[16] The District's personal property tax is only paid by businesses. It is not paid by residents.
[17] A high-technology company is considered "qualified" if it (1) has two or more employees in the District and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales, information and communication technologies, equipment and systems that involve advanced computer software and hardware, and advanced materials and processing technologies.

[an eligible high-technology firm] were to have an IPO [initial public offering], depending on the IPO price and the subsequent trading, the revenue losses could be significant."

Rather than add a narrow and complex tax benefit, the Commission preferred to recommend a broad tax cut for all businesses. In addition, the District's recently enacted QHTC legislation has already provided tax benefits to QHTCs.The QHTC legislation primarily sets a QHTC's business income tax rate at zero for the five years after the QHTC achieves profitability, and then at 6 percent thereafter (with a cap on the total tax benefits of $15 million on the zero tax benefit only).

Provide certified business enterprises (CBEs) a tax credit

The District's Department of Small and Local Business Development determines whether an operation is a certified business enterprise (CBE). To qualify, a business's principal office must be located within the District and its top tier managerial staff must operate from this location. There also are requirements related to revenue and employees. Currently, CBEs receive beneficial procurement and contracting treatment but no tax preferences. Because there is no indication that beneficial behavior could be induced through tax credits or preferential tax treatment for CBEs, the Commission made no recommendations in that direction. Additionally, there was concern that preferential treatment could cause administrative problems. For example, new CBEs could manipulate their status (rather than shift locations) to gain preferential tax treatment while current CBEs could collect tax relief without making changes to their business (such as location or employment).

SALES TAX

The District's general sales tax is 5.75 percent, lower than the 6 percent sales tax rate in Maryland and Northern Virginia.[18] The District's tax was raised to 6 percent in October 2009 (from 5.75 percent) but returned to its current rate in October 2013, in the middle of the Commission's deliberations. The District also has a special 18 percent sales tax for commercial parking, a 14.5 percent tax on transient accommodations (hotels), and a 10 percent tax on rental vehicles and restaurant meals.

The District can use the revenue generated by a 6 percent sales tax to help fund more ADVANTAGEOUS TAX RELIEF, such as a middle-class income tax bracket and a lowered business franchise tax rate, and to improve its regional competitiveness—a goal the Commission believed is ESSENTIAL.

The District's sales tax applies to nearly all goods (with a few exemptions, including grocery food) and some services. In presenting a paper on sales taxes to the Commission, Professor William F. Fox, director of the Center for Business and Economic Research at University of Tennessee, Knoxville, noted that District's sales tax base is broader than that of the average state and larger than those of Maryland and Virginia. However, the District, like many states, faces an eroding sales tax base as consumers shift their spending from goods to services. (The sales tax was originally designed as a tax on goods. Services were later added to the tax base.)

At the same time, increasing numbers of purchases are made online, away from "brick and mortar" stores. Only online retailers with a physical presence in the District are required to collect the District sales tax.[19] As the sales tax base shrinks so does sales tax revenue.

The Commission recommended changes that will broaden the sales tax base without hurting the District's competitiveness relative to neighboring jurisdictions.

What the Commission Recommended

Expand the sales tax to more services

Many states have tried to add new services to their sales tax in recent years in response to national trends showing a shift in demand from taxable goods to non-taxable services. The District already has a relatively broad sales tax base for services, covering 74 of a possible 183 services listed by the Federation of Tax Administrators. The District taxes far more services than Maryland (49) or Virginia (29). In fact, the District recently added laundry services, select telecommunications services, courier services, and employment services to its list of services that are taxed.

While a broad tax base is optimal, Professor Fox cautioned that the District must carefully choose any new services to tax in order to minimize the economic effect.

[18] Virginia has a state sales tax rate of 4.3 percent. An additional 1.0 percent sales tax rate in the counties and cities of the Northern Virginia and 0.7 percent for the Northern Virginia Transportation Authority brings the total sales tax rate in these jurisdictions to 6 percent.
[19] The U.S. Supreme Court added the "physical presence" requirement in *Quill vs. North Dakota,* 540 U.S. 298 (1992).

Professor Fox proposed that the following services be considered for taxation:

- Construction contractors
- Carpentry and other construction-related services
- Storage of household goods
- Mini-storage
- Water for consumption at home
- Barber and beautician services
- Carpet and upholstery cleaning
- Health clubs and tanning studios
- Carwashes
- Bowling alleys and billiard parlors

He selected those specific services for two reasons: They are typically a final purchase by consumers, and they are services linked to tangible goods or real property in the District, making them difficult for consumers to purchase online or in another state.

The Commission recommended that the District broaden its tax base by including the services identified by Professor Fox. The DC Council is encouraged to continue seeking additional services to tax in order to make the sales tax as broad and as equitable as possible.

The Commission did not recommend adding professional services, such as accounting, legal advice, and dental work, to the District's tax base. Professional services are a large portion of the District's tax base, but there are questions about whether taxing them would harm economic activity in the District. Maryland and Virginia do not tax professional services, and residents could choose to leave the District for these services if they were taxed, harming local businesses. This negative economic incentive is one reason why only four states–specifically, geographically isolated states such as Hawaii and South Dakota–tax a broad set of professional services.

Add a use tax line to the personal income tax return

Although an online retailer with no physical presence in the District is not required to collect a District sales tax, District residents shopping online are responsible for a use tax equal to the sales tax. However, very few residents pay the use tax–most often because they are unaware of it–and the District cannot effectively enforce the tax.

The Commission recommended adding a use tax line to District's personal income tax return as a simple, non-invasive reminder of the tax obligation. Many states that recently added a similar voluntary use tax line have seen an increase in collections. A majority of states with both an individual income tax and a sales tax have a use tax line on their income tax return.

The Commission also recommended that the District consider a "Use Tax Lookup Table" that allows taxpayers to estimate their use tax liability based on adjusted gross income. Nine states provide such a table to assist taxpayers who may not track their online purchases throughout the year. States with such tables enjoy higher participation rates than states that do not. Research also has found that states that require taxpayers to clearly indicate no liability–writing in "zero" rather than allowing filers to leave the line blank–generate slightly more voluntary use tax payments.

Raise the general sales tax rate to 6 percent

In October 2013, the general sales tax rate in the District was lowered to 5.75 percent after three years at 6 percent. The tax had been increased–with a three-year sunset provision–in 2010 to temporarily stem revenue losses arising from the recession. After a broad examination of the District's tax system, the Commission recommended returning the general sales tax rate to 6 percent.

When the District raised its sales tax in 2010, Northern Virginia's sales tax was 5 percent. However, in 2013 the sales tax rate in Northern Virginia increased to 6 percent. Maryland's 6 percent tax has been in place since 2008. While having the lowest sales tax rate in the region is commendable, the small 0.25 percent difference between the District's sale tax and those of its neighbors is unlikely to affect consumers' choices and, in fact, may not be noticed.

Sales Tax Rates: Regional Comparison

DC	Maryland	Northern Virginia
5.75%	6%	6%

The District can use the revenue generated by a 6 percent sales tax to help fund more advantageous tax relief, such as a middle-class income tax bracket and a lowered business franchise tax rate, and to improve its regional competitiveness–a goal the Commission believed is essential.

Unify taxation of tobacco products

The District has a complement of taxes for tobacco products. A pack of 20 cigarettes is subject to an excise tax of $2.50 ($0.125 per cigarette) and an "in lieu of" sales tax of $0.36, collected at the wholesale level, that brings the total District tax on a package of cigarettes to $2.86. This is an effective tax rate on cigarettes of 80 percent. The "in lieu of" tax is subject to recalculation every year and can be increased if the price of cigarettes increases. This formula results in a tax consistent with the District's general sales tax rate. To simplify administration, the District switched from a retail-level tax to a wholesale-level tax in 2012.

The District imposes a $0.75-per-ounce excise tax on other tobacco products (OTP), such as chewing tobacco, smokeless tobacco, snuff, and roll-your-own tobacco. In addition, OTP are subject to a 12 percent sales tax on their retail price.

Premium cigars (those costing more than $2) and pipe tobacco are not subject to the per-ounce excise tax or the special sales tax rate. They are taxed at the general sales tax rate of 5.75 percent. "Little cigars" are taxed as cigarettes. Cigars that do not fall into the "premium" category and are not considered cigarettes carry a 12 percent sales tax but are exempt from the per-ounce excise tax.

The tax system for tobacco is needlessly complex. The Commission recommended that the District first broaden its definition of OTP to encompass any product that "contains" tobacco or is "made or derived from tobacco." FDA-approved tobacco products for medicinal use (like tobacco-cessation products) would be excluded. The Commission further recommended that the District tax all OTP at the same rate, equivalent to the per-price rate on cigarettes.

To achieve this, a single excise tax of 80 percent of the wholesale price on OTP would replace the current per-ounce excise tax and special 12 percent sales tax rate. The 80 percent rate is equivalent to the current tax on cigarettes, if that tax were calculated as a percentage-of-price. The tax rate would require recalculation annually (or at another established time period) to adjust for cigarette price modifications and or tax changes. However, the collection of OTP taxes at the wholesale level, as is the practice in most states, would simplify administration.

What the Commission Did Not Recommend

Increase the sales tax rate on commercial parking, hotels, rental cars, and restaurant meals

The District has a special sales tax rate of 18 percent for commercial parking, 14.5 percent for transient accommodations (hotels), and 10 percent for rental vehicles and restaurant meals. Nearly all large cities tax these activities at high rates to compensate for costs associated with nonresidents who commute to or visit the city. Because these taxes shift the burden from residents to nonresidents, some suggested they could be increased to fund residential and business tax relief.

In his presentation, Professor Fox concluded that the District did not have the capacity to raise these taxes without harming the industries being taxed and, ultimately, the District's economy. He cited the comparatively lower rates in neighboring jurisdictions of Maryland and Virginia. However, no economic study was produced to support that conclusion. The Commission also heard testimony from hotel and restaurant industry representatives who warned that higher rates would harm their businesses.

The Commission decided that raising these tax rates would run counter to its efforts to make the District's tax policy more competitive, to encourage business growth, and to create jobs. The Commission did not recommend increases in these rates.

Expand the sales tax base to more goods

The Commission did not recommend expanding the sales tax to grocery-type foods and non-prescription drugs.

While a broad tax base is ideal, the Commission believed the current exemption for grocery food provides critical relief for residents who pay a disproportionate share of their income on groceries. Furthermore, policy proposals for taxing grocery food while subsidizing low-income residents proved both complex and inefficient. Maintaining the exemption is a simple way to make the tax system fairer. The Commission also decided that a limited "snack tax" on candy bars, potato chips, and similar products is not worth the administrative challenges that it would create.

The Commission did not recommend taxing non-prescription drugs. The District is similar to 11 states that exempt non-prescription drugs from the sales tax. Since Maryland and Virginia are among the states with the exemption, a District tax could induce consumers to purchase non-prescription drugs in the neighboring jurisdictions. Additionally, as with grocery food, the current exemption benefits low-income residents. In addition, such a tax would generate limited new revenue.

Expand the definition of nexus to require online retailers with District-based affiliates to collect the District sales tax

Many states are currently considering or have implemented so-called "Amazon taxes." These laws have been proposed as a way for states to collect the sales tax on online purchases. Under such a law, a business that had no physical presence in District, but which had a commission-based business relationship with a District-based entity, would be required to collect and remit taxes on all sales to District residents.

Most states that have created such laws have not seen new tax revenue. That is because businesses in those states opt to end commission-based relationships rather than collect the tax. In fact, ORA estimated the revenue increase from passage of such a tax in the District "is likely negligible." Furthermore, "Amazon taxes" in New York and other states are being challenged in court.

Given the uncertain efficacy but certain complexity of such laws, the Commission decided against recommending this change.

PROPERTY TAX

Real property taxes are the largest source of tax revenue for the District, accounting for a third of the District's tax revenue. Residential property is taxed at $0.85 per $100 of assessed value, but due to a variety of measures enacted over time, the effective residential property tax rate for most owner-occupied residential property is significantly less than $0.85 per $100. The tax rate for commercial property is graduated: The first $3 million of assessed value is taxed at $1.65 per $100 of value and any additional amount is taxed at $1.85 per $100. The residential property tax rate is the lowest in the metropolitan region (and the effective owner-occupied residential property tax is substantially lower), while the commercial property tax rate is the highest.

The Commission did not recommend policy changes to the District's property tax. However, the Commission will submit a memo to the new Chief Financial Officer, Jeffrey DeWitt, with suggestions on areas to improve property tax administration.

The Commission did not recommend a cut in the commercial property tax rate because, although the District's rate is comparatively high, the Commission believed there are more efficient ways to improve the District's competitiveness.

The Commission decided that REFORM of the individual income tax is a BETTER MEANS to offer tax relief to District residents.

The Commission did not recommend a reduction in the District's residential property tax rate, largely because the rate is already the lowest in the region. The District also provides substantial property tax relief to its residents, including through the recent significant expansion of the District's circuit breaker program (Schedule H), which provides relief to low-income renters and homeowners whose property taxes claim a too-large share of their income. The Commission believed the best way to assist low- and middle-income residents is through changes in the income tax rather than the residential property tax. The Commission also did not support an option to raise the residential rate as an offset to a reduced commercial property tax rate.

What the Commission Did Not Recommend

Lower the tax rate on commercial property

The District has the highest commercial property tax rate in the greater Washington region. Rates vary among localities—property taxes are generally local taxes rather than state taxes—with neighboring Maryland jurisdictions taxing commercial property at roughly $1.22 to $1.42 per $100 of assessed value and Virginia communities taxing property at just more than $1 per $100 of value.

Commercial property taxes account for a large portion of the District's business taxes. The Commission wanted to reduce business taxes to increase the District's competitive position; however, the Commission discovered that reducing the commercial property tax to match neighboring jurisdictions would be prohibitively expensive. Each one-cent reduction in the top commercial property tax rate ($1.85) costs nearly $6 million in tax revenue annually. Therefore, cuts to align the District's top rate with that of Maryland ($1.42) would cost approximately $258 million. Paring the District's lower rate ($1.65) would also cost additional millions of dollars. By contrast, a reduction of the District's business franchise tax rate to 8.25 percent (Maryland's rate) would costs $57 million.

Considering this through the lens of greater economic growth, the Commission decided that a cut in the commercial property tax would be less effective, dollar-for-dollar, than significantly reducing the business franchise tax. In other words, businesses are more likely to move than buildings.

Dr. Daphne Kenyon, the principal of policy-consulting firm D. A. Kenyon & Associates in Windham, New Hampshire, presented a paper on property taxes to the Commission. She reviewed the economic literature to determine who bears the burden of the commercial property tax. "According to that literature, 55 percent to 100 percent of commercial property tax differentials of a jurisdiction over its neighbors are absorbed by owners of land and buildings, and from 0 percent to 45 percent of the tax differentials are absorbed by those renting commercial properties."[20] In other words, a reduction in commercial property taxes in the District would mainly relieve property owners, including many foreign investors, rather than District-based businesses located in the buildings.

Create a payment in lieu of taxes (PILOT) program

Many District properties face no property tax thanks to a variety of exemptions, most of them based on the status of the owner (e.g., a qualifying nonprofit organization). Such exemptions leave other properties and their owners shouldering a larger share of the tax burden. Some jurisdictions have addressed this by creating a payment in lieu of taxes (PILOT) program. Under a PILOT program, the owners of exempt properties are required to negotiate a payment based on the services provided to them by their local government. The enforcement of this requirement is unclear–perhaps merely moral suasion.

For example, Boston estimates how much city tax revenue is used to fund public services, such as fire protection or public works that directly benefit exempt organizations. Boston calculated this share as 25 percent. The city then negotiates PILOTs with individual organizations based on the premise that each should pay a PILOT equal to 25 percent their hypothetical property tax payment. The organization is allowed to negotiate a lower payment by demonstrating that it provides government-like services that are adequate substitutes for tax payments.

The Commission did not recommend creating a PILOT program for the District. The Commission was concerned about the opaque and arbitrary nature of such programs and anticipated unnecessary administrative burdens for both nonprofit organizations and the DC Office of Tax and Revenue. Instead, the Commission recommended a local services fee as a simpler, more transparent, and less expensive means to achieve the same goals.

Reduce the residential property assessment limitation from 10 percent to 5 percent

If a taxpayer owns a home as a principal residence and, therefore, qualifies for the homestead deduction, then the taxable assessment of that property cannot rise by more than 10 percent annually. This limitation protects homeowners from dramatic property tax hikes from year to year. Concerned that reduction in the limitation would be inequitable since it had no bearing on a resident's ability to pay, the Commission did not recommend reducing the limit to 5 percent. In fact, some of the District's most affluent residents living in the city's most valuable properties would gain the most by a reassessment proposal.

The reduced assessment limitation also would exacerbate equity problems since new homeowners would pay substantially more in property taxes than long-term residents in similarly valued property.

The Commission decided that reform of the individual income tax is a better means to offer tax relief to District residents.

Change the residential property minimum taxable assessment

The taxable assessment of residential property must always be at least 40 percent of the current assessed value of the property, regardless of annual limitations on the assessed value. The 40 percent minimum currently affects few taxpayers. During a period of substantial increases in property values, however, the provision's impact on assessments could become extensive.

The Commission did not recommend increasing the minimum taxable assessment to 50 percent. While an increase might improve the fairness of the property tax, 10 percentage points would affect few properties and raise less than $1 million in tax revenue.

The Commission also did not recommend eliminating the minimum. There is merit in protecting residents from substantial one-year property tax increases, but the long-term effect of this policy can be disruptive and harmful by creating significant horizontal inequity between homeowners of like residential property. For example, two taxpayers with similar property values

[20] Kenyon, Daphne A., Ph.D., "Real Property Tax Classification in Washington, D.C.," Oct. 24, 2013. (p. 24)

might pay very different property taxes solely based upon how long each resident lived in his or her house.[21] In addition, this form of tax relief is poorly targeted: A long-term resident receives a tax benefit regardless of ability to pay.

Eliminate the classifications for vacant and for blighted property

Real property in the District is separated into four classes for taxation. In addition to residential (Class 1) and commercial (Class 2), there are classes for vacant buildings (Class 3) and blighted buildings (Class 4). These latter two classes are taxed at higher rates as an incentive for owners to use their buildings productively and to prevent buildings from falling into disrepair and negatively affecting other properties in their neighborhoods. Although other state and localities do not use such classifications, the Commission recommended keeping them. Repealing the classifications would require the District to increase regulatory enforcement in place of the taxes, and that might prove more burdensome and less effective.

Tax land and buildings at different rates

Total assessed property value is reached by combining the value of land with the value of the building(s) on the property. Taxing land at a higher rate than buildings could reduce the tax penalty for improving the value of buildings. It also might serve as an incentive for new construction and penalize owners of valuable land who fail to develop it. Although taxing land and buildings at different rates is a centuries-old idea, no major jurisdiction currently does this. (Pittsburgh ended its system in 2001.) The Commission decided against such a system on grounds that the benefits were not great enough, particularly in light of added administrative challenges, including the need to value land and buildings separately.

Changes to the deed recordation and deed transfer taxes

Deed recordation and transfer taxes (deed taxes) are imposed when taxable properties in the District are sold or transferred. For all real property other than residential properties valued at less than $400,000, the rate for each tax is 1.45 percent of total consideration or fair-market value. The combined deed tax rate for a transfer of residential property valued at $500,000 or for any commercial property would, therefore, be 2.9 percent. For residential properties valued at less than $400,000, the rate for each tax is 1.1 percent of total consideration or fair-market value, for a total of 2.2 percent.

The Commission considered several changes to deed taxes, among them increasing or decreasing the rate. Ultimately, the Commission decided to make no recommendations. Professor Rodney Green, executive director of the Center for Urban Progress at Howard University, noted that his research found that while deed taxes are higher in the District than in neighboring jurisdictions, they have a minimal effect on transactions. Writing specifically about commercial property, Professor Green said deed taxes "seem like an attractive source of tax revenues with few negative local economic consequences."[22]

[21] Lowering the assessment limitation to 5 percent, from 10 percent, would engender greater inequity in residential property tax assessments. Under such a system, the minimum would become even more important in maintaining a fair tax system.

[22] Green, Rodney D., Ph.D. and Judy Mulusa, Ph.D., "The Deed Recordation and Real Property Transfer Taxes in the District of Columbia: A Comparative Analysis of Their Rates, Rationale, Structure, and Implementation with policy Options," Howard University Department of Economics, July 3, 2013. (p. 3)

CONCLUSION

After a lengthy review, with the help of experts, elected officials, and members of the public, the Commission identified three major problems with the District's tax system:

1. Middle-class residents bear a disproportionate tax burden.
2. The District's high business taxes could hinder future economic and job growth.
3. Many individuals and businesses are not included in the District's tax base, which shifts a greater burden to existing taxpayers.

On Dec. 18, 2013, the Commission unanimously approved the package of tax reform measures that it believed would address these challenges and is fiscally responsible.

The Commission's recommendations are a roadmap to a more fair, competitive, and efficient tax system. They benefit District residents and businesses, while maintaining fiscal integrity. The Commission strongly believes that this package of reforms would build on the success of the past and allow residents and businesses in the District to prosper in the face of future challenges.

APPENDICES

More and more people are **CHOOSING** the District of Columbia as a place to live, rather than merely work. The current population and private employment strength translates into a relatively **STABLE AND GROWING** revenue base.

FOUR-YEAR REVENUE IMPACT PROJECTION: FY 2015 – FY 2018 (a)

	Revenue Impact (in millions)			
	FY 2015	FY 2016	FY 2017	FY 2018
RECOMMENDATIONS				
Sales Tax				
1 Expand the sales tax to eight new services (construction services, barber and beautician, Health clubs and tanning studios, water consumption at home, bowling alleys and billiard parlors, storage of household goods/mini storage, carpet and upholstery cleaning, and car washes)	$28.2	$29.3	$30.4	$31.5
2 Add use tax line to personal income tax return for mail order or online purchases	1.0	$1.0	$1.1	$1.1
3 Unify taxation of tobacco products (tax all tobacco products at approximately 80%)	7.0	6.9	6.8	6.6
4 Increase the general sales tax rate from 5.75% to 6%	20.5	21.3	22.1	23.0
Individual Income Tax				
5 Create a middle-class tax bracket, increase the standard deduction/personal exemptions, expand the EITC for childless workers, and other reforms	(124.8)	(103.7)	(109.0)	(111.8)
Estate Tax				
6 Raise threshold to $5.25 million (federal level) from $1 million	(13.9)	(13.9)	(13.9)	(13.9)
Business Taxes				
7 Reduce Business Franchise Tax/Unincorporated Business Franchise Tax rate from 9.975% to 8.25%	(57.0)	(59.9)	(62.6)	(65.4)
8 Exempt passive investment vehicles from Unincorporated Business Franchise Tax	-	-	-	-
9 Apportion national business pre-tax income using single weighted sales formula	20.0	21.0	22.0	22.9
10 Levy a local services fee on all non-government employers at $25/employee per quarter	45.0	45.5	45.9	46.2
Total Revenue Increase (all black numbers)	121.7	125.0	128.3	131.4
Total Tax Relief (all red numbers)	(195.7)	(177.5)	(185.5)	(191.1)
Total Net Package	(74.0)	(52.5)	(57.3)	(59.6)
Current Funding for Commission Recommendations ($18 million per year)	36.0 (b)	18.0	18.0	18.0
Need for Future General Fund Revenue	(38.0)	(34.5)	(39.3)	(41.6)

(a) The revenue estimates presented in this table are preliminary estimates, and not the official fiscal impact analysis. The Office of Revenue Analysis will prepare fiscal impact statements on these changes to the District's tax policy once it receives them as legislative proposals.

(b) Includes FY 2014 and FY 2015 funding of $18 million per year.

COMMISSION PROCESS AND SCHEDULE

The D.C. Tax Revision Commission was authorized by the D.C. Council on Sept. 14, 2011, through an amendment to D.C. Code Section 47-460. Please see the Appendix. The D.C. Council asked the Commission to analyze the District's tax system and to propose innovative solutions to meet the District's revenue needs.

Over the course of 2013, the Commission conducted a comprehensive review of the major taxes in the District and considered ways to improve fairness, broaden the tax base, increase D.C.'s competitiveness, encourage business growth, and promote simplification, as directed by the Commission's authorizing legislation.

The Commission balanced improving D.C.'s tax system and maintaining D.C.'s fiscal integrity. The Commission also sought to prepare the District's tax system for the challenges of the future (including potential reductions in federal spending) and to ensure that D.C. attracts a vibrant range of residents and businesses.

Experts in state and local tax policy assisted the Commission's work. They analyzed D.C.'s taxes, compared them with other localities and states, both regionally and nationally, and provided suggestions for reform. Mayor Vincent Gray, members of the D.C. Council, and the public also offered policy suggestions.

In September 2013, the Commission's staff assembled a list of 63 wide-ranging policy ideas for the commissioners to consider during public deliberations. The staff identified pros and cons for each idea, and the commissioners deliberated. Some policy ideas were in conflict with others. The District's Office of Revenue Analysis (ORA), the revenue-estimating arm of the Office of the Chief Financial Officer, worked closely with the Commission, including in providing revenue estimates for each of the policy options.

At the end, the Commission unanimously approved a set of recommendations aimed at moving the District forward and helping its residents and businesses prosper.

Commission Meeting Schedule

March 2014	Commission publishes final report
Feb. 12, 2014	Commission presents recommendations and final report to DC Council
Dec. 18, 2013	Commission votes on final recommendations
Dec. 9, 2013	Commission discussion of final recommendations
Dec. 3, 2013	Commission deliberations: Consensus on recommendations
Nov. 18, 2013	Commission deliberations: Review
Nov. 12, 2013	Public Hearing
Nov. 4, 2013	Testimony from outside consultants and the DC Office of Tax and Revenue on Tax Administration
Oct. 30, 2013	Commission deliberations: Real property taxes

Oct. 21, 2013	Commission deliberations: Business taxes
Oct. 7, 2013	Commission deliberations: Individual income taxes and estate tax
Sept. 30, 2013	Commission deliberations: Sales taxes
Sept. 16, 2013	Councilmember Mary Cheh Robert Aceituno and Karen Yingst (CBM): *Regional Tax Competitiveness with Business Case Studies*
June 24, 2013	Public Hearing
June 17, 2013	William Fox: *Sales taxes* Rick Rybeck: *Infrastructure financing* Mike Bell: *Property tax expenditures*
June 3, 2013	LaTanya Brown-Robertson: *An Analysis of Neighborhoods in DC* Mike Bell: *Exempt properties* Rodney Green: *Deed recordation and deed transfer taxes*
May 20, 2013	Councilmember Tommy Wells Mike Bell: *Introduction to the real property tax* David Sjoquist: *Residential property tax caps* Daphne Kenyon: *Property tax classification*
May 6, 2013	Norton Francis: *Business franchise taxes* Robert Buschman: *Individual income tax*
April 15, 2013	Councilmember Muriel Bowser Sally Wallace: *Fiscal architecture* Richard C. Auxier: *Tax comparisons*
March 4, 2013	Councilmember David Grosso Garry Young: *Economic competitiveness*
Feb. 3, 2013	Councilmember Jack Evans Robert Cline: *Competitiveness of state tax systems* Robert Zahradnik: *State tax incentives* Jeffrey Oakman and Lindsay Clark: *History of economic development in DC*
Jan. 7, 2013	Stephen Fuller: *Regional economic trends in the Washington region* Carol O'Cleireacain: *National, state and local trends in fiscal policy* Jason Juffras: *D.C. tax expenditures*
Dec. 3, 2012	Public Hearing

Nov. 19, 2012	Steve Swaim: *DC economy and tax base* David Zipper and Jenifer Huestis Boss: *D.C. Technology Sector Enhancement Act*
Oct. 1, 2012	Yesim Yilmaz: *DC fiscal structure* Steve Swaim: *DC revenue system* Jim Spaulding: *DC operating and capital budget*
Sept. 10, 2012	Councilmember Jack Evans Darryl Gorman: *Office of Boards and Commissions*
Aug. 6, 2012	Mayor Vincent Gray Councilmember Phil Mendelson DC CFO Natwar M.Gandhi

EXPERT PRESENTATIONS AND PAPERS

The DC Tax Revision Commission received numerous presentations and papers from tax policy experts, economists, and business professionals throughout its tenure. The experts and their presentation topics are listed below. If the expert delivered a paper to the Commission in addition to his or her public presentation, a "(P)" is listed next to the presentation's title.

All presentations and papers delivered to the Commission are available on the Commission's website: dctaxrevisioncommission.org.

Robert Aceituno and Karen Yingst	CPAs, Councilor Buchanan & Mitchell, P.C *Case Studies of Business Taxes in the District of Columbia; A Comparison with Neighboring Jurisdictions (P)* Sept. 16, 2013
Richard C. Auxier	Research Analyst, DC Tax Revision Commission *District of Columbia Tax Comparisons (P)* April 15, 2013
Michael E. Bell	Research Professor, The George Washington Institute of Public Policy *Real Property Tax Expenditure in DC (P)* June 17, 2013
Michael E. Bell	Research Professor, The George Washington Institute of Public Policy *"Properties Exempt from Paying Real Property Taxes in DC (P)* June 3, 2013
Michael E. Bell	Research Professor, The George Washington Institute of Public Policy *Overview of Real Property Taxes in the District of Columbia (P)* May 20, 2013
LaTanya N. Brown-Robertson	Associate Professor of Economics, Bowie State University *An Analysis of Neighborhoods in the District of Columbia (P)* June 3, 2013
Robert Buschman	Senior Research Associate, Andrew Young School of Policy Studies, Georgia State University *The District of Columbia Individual Income Tax: Structure, Competitiveness, and Potential Improvements (P)* May 6, 2013
Stephen M. Cordi	Deputy Chief Financial Officer, DC Office of Tax and Revenue *Presentation of the Office of Tax and Revenue* Nov. 4, 2013
William F. Fox	Chancellor's Professor and Director, Center for Business and Economic Research, University of Tennessee, Knoxville *Sales Taxes in the District of Columbia (P)* June 17, 2013

Norton Francis	Senior Research Associate, Urban-Brookings Tax Policy Center *Business Franchise Taxes in the District of Columbia (P)* May 6, 2013
Stephen Fuller	Director, Center for Regional Analysis, School of Public Policy, George Mason University *Regional Economic Trends in the Washington, DC Region* Jan. 7, 2013
Rodney D. Green	Executive Director, Center for Urban Progress, Howard University *The Deed Recordation and Real Property Transfer Taxes in DC (P)* June 3, 2013
Jason Juffras	Fiscal Analyst, Office of Revenue Analysis *District of Columbia Tax Expenditures* Jan. 7, 2013
Daphne A. Kenyon	Principle, D. A. Kenyon & Associates *Real Property Tax Classification in Washington, DC (P)* May 20, 2013
Carol O'Cleireacain	Senior Fellow, Brookings Institution *National, State & Local Trends in Fiscal Policy* Jan. 7, 2013
Jeffrey Oakman and Lindsay Clark	Office of Revenue Analysis *Tax Policy and Economic Development in DC (P)* Feb. 4, 2013
Richard Rybeck	Director, Just Economics, LLC, *Funding Long-Term Infrastructure Needs for Growth, Sustainability & Equity (P)* June 17, 2013
David L. Sjoquist	Professor of Economics, Georgia State University *The Residential Property Tax Credit: An Analysis of the DC Assessment Limitation (P)* May 20, 2013
Jim Spaulding	Office of the Chief Financial Officer *General Fund Expenditure Trends, FY 2001 – FY 2011, and Looking Forward* Oct. 1, 2012
Stephen Swain	Financial Economist, Office of Revenue Analysis *Overview of the District's Economy and Tax Base* Nov. 19, 2012
Stephen Swaim	Financial Economist, Office of Revenue Analysis *Update on DC's Economy and Revenue Outlook* Nov. 18, 2013
Stephen Swain	Financial Economist, Office of Revenue Analysis *DC Revenue System* Oct. 1, 2012

Linda L. Tanton	Tax Administration Review Consultant *Review of the DC Office of Tax and Revenue (P)* Nov. 4, 2013
Sally Wallace	Chair, Department of Economics, Georgia State University *Fiscal Architecture of the District of Columbia (P)* April 15, 2013
Yesim Yilmaz	Director of Fiscal/Legislative Analysis, Office of Revenue Analysis *DC Governance Structure and Fiscal System* Oct. 1, 2012
Garry Young	Director, The George Washington Institute of Public Policy *The District of Columbia and Economic Competitiveness* March 4, 2013
Robert Zahradnik	Director of Research, Pew Center on the States *Creating Fiscally Sound and Economically Effective Tax Incentives* Feb. 4, 2013

LIST OF PUBLIC TESTIMONY

The District Tax Revision Commission received testimony from public officials, tax policy experts, economists, business professionals, and individual citizens during its three public hearings.

The individuals who testified before the Commission are listed below by public hearing date. If they submitted written testimony, a "(P)" is listed next to their name. If the individual represented an organization and submitted that organization's name to the Commission, the organization is listed next to the individual's name.

All written testimony delivered to the Commission is available on the Commission's website: dctaxrevisioncommission.org.

Public Hearing: Nov. 12, 2013

G. Lee Aikin (P)
Thais Austin (P)
David Jonas Bardin (P)
Kari Bedell, *Executive Director, Greater Washington Society of CPAs* (P)
Janet Brown (P)
Orelia Busch (P)
Ruth Caplan (P)
Tanja Castro, *DC Building Industry Association* (P)
John Cavanaugh, *President and CEO, Consortium of Universities* (P)
Peter Fisher, *Vice President for State Issues, Campaign for Tobacco-Free Kids* (P)
Matt Gardner, *Institution on Taxation & Economic Policy* (P)
Campbell Johnson, *Chair, Urban Housing Alliance* (P)
Solomon Keene, *President, Hotel Association of DC* (P)
Andrew Kline, *General Counsel, Restaurant Association of Metropolitan Washington* (P)
Keshini Ladduwahetty (P)
Barbara Lang, *President and CEO, DC Chamber of Commerce* (P)
Jesse Lovell (P)
Robert Malson, *President, DC Hospital Association* (P)
Beth Marcus (P)
Elizabeth C. McNichol, *Center on Budget and Policy Priorities* (P)
Brianne Nadeau (P)
Bonita Pennino, *American Heart Association* (P)
Katalin Peter (P)
Robert Pohlman, *Coalition for Nonprofit Housing and Economic Development* (P)
Jessie Posilkin (P)
Ed Rehfeld (P)
Andrea Rosen (P)
Rick Rybeck, *Just Economics, LLC* (P)
Jim Schulman (P)
David Schwartzman, *DC Citizens for Tax Justice* (P)
Gerald Schwinn (P)
Stuart Solomon, *Federal City Council* (P)
Dick Suisman, Chair, *Our Nation's Capital* (P)
Ericka Taylor (P)
Dan Wedderburn, *DC for Democracy* (P)
Rob Wohl (P)

Public Hearing Testimony: June 24, 2013

G. Lee Aikin (P)
G. Thomas Borger, *Chairman, Borger Management, Inc.* (P)
David J. Chitlik, *Senior Director, Apartment and Office Building Association* (P)
Jerry N. Clark (P)
Marie Drissel, *Member of the 1998 DC Tax Revision Commission* (P)
Alma Hardy Gates (P)
Ferdinand Hogroian, *Legislative Council, Council on State Taxation* (P)
Campbell Johnson, *Chair, Urban Housing Alliance* (P)
Jeremy Koulish (P)
Sally Kram, *Director of Public & Government Affairs, Consortium of Universities of the Washington Metro Area* (P)
Edward Krauze, *CEO, DC Association of Realtors* (P)
Kesh Ladduwahetty (P)
Barbara B. Lang, *President & CEO, DC Chamber of Commerce* (P)
Rabbi Gilah Langer, *Jews United for Justice* (P)
Lora J. Leavy (P)
Jesse Lovell (P)
Beth Marcus (P)
Jim McGrath, *Chairman, DC Tenants' Advocacy Coalition* (P)
Tom Murphy, *Former Mayor of Pittsburgh, PA* (P)
Edward Rehfeld (P)
Dianah Shaw, *DC Association of Realtors* (P)
Chad Shuskey, *Senior VP for Research & Visual Communications, DC Economic Partnership* (P)
Micheal Tacelosky, *DC Tobacco Free Coalition* (P)
Benjamin B. Terner (P)
Mitch Wander (P)
Dan Wedderburn, *Chair of Government Reform Committee, DC for Democracy* (P)
Howard White (P)
Neil Williams (P)

Public Hearing Testimony: Dec. 3, 2012

David Jonas Bardin, *former member of board of directors, DC Water and Sewer Authority* (P); Supplemental statement (P)
George W. Beatty (P)
Cheryl Cort, *Policy Director, Coalition for Smarter Growth* (P)
Jim Dinegar, *CEO, Greater Washington Board of Trade*
Marie Drissel, *Member of 1998 DC Tax Revision Commission* (P)
Campbell Johnson, *Urban Housing Alliance* (P)
Sally Kram, *Director of Government and Public Affairs, Consortium of Universities of the Washington Metropolitan Area* (P)
Barbara B. Lang, *President & CEO, DC Chamber of Commerce* (P)
W. Shaun Pharr, Esq., *Senior Vice President of Government Affairs, Apartment and Office Building Association of Metropolitan Washington* (P)
Simon Rakoff, *Fortify Ventures LLC*
James Rooney, *Avenir Corporation* (P)
Bart Uze, *Legal Counsel, Ryan, LLC* (P)
Dan Wedderburn, *Chair of the Tax Reform Committee, DC for Democracy* (P)
Gerry Widdicombe, *Director of Economic Development, Downtown Business Improvement District* (P)

PUBLIC LETTERS

The DC Tax Revision Commission received numerous letters from the public and public officials during its tenure. The letters listed are available on the Commission's website: dctaxrevisioncommission.org.

Letter from Mayor Vincent Gray on the Technology Sector Enhancement Act of 2012. (Oct. 14, 2012)

Letter from Mayor Vincent Gray on the inaugural DC Tax Revision Commission meeting. (Aug. 3, 2012)

Letter from Councilmember Jack Evans requesting inclusion of "Technology Sector Enhancement Act of 2012" in the Commission's research agenda. (Sept. 21, 2012)

Letter from 13 high-income-earning individuals expressing their support for more progressive income tax brackets. (Dec. 2, 2013)

Letter from Jon Bakija, Department of Economics, Williams College, sharing his research on the impact of state-level estate and inheritance taxes on the migration of high-wealth individuals. (Nov. 15, 2013)

Letter from David Bardin, attorney, asking the Commission to consider a local services tax. (June 24, 2013)

Letter from David Bardin, attorney, related to the DC Water and Sewer Authority. (Oct. 24, 2012)

Letter from Kari Bedell, Executive Director, Greater Washington Society of CPAs, sharing results of a membership survey on doing business in the District; Full survey results. (Sept. 25, 2013)

Letter from John Capozzi , consultant, recommending a review of an annual payment in lieu of taxes (PILOT) provision for the District's private universities. (November 2012)

Letter (and attachment) from the Consortium of Universities of the Washington Metropolitan Area in response to the May 29, 2013 report on tax-exempt properties and specifically the proposal to implement a payments in lieu of tax (PILOT) program in the District (Oct. 18, 2013)

Letter from Karen Conway, University of New Hampshire, and Jonathan Rork, Reed College, on how differences in tax policies between states affect resident migration. (Nov. 18, 2013)

Letter from the District Building Industry Association on the commercial property tax. (Dec. 4, 2013)

Letter from William E. Davis, on behalf of a collection of prominent District estate tax practitioners (pro bono), providing alternatives for improving the District estate tax. (Aug. 26, 2013)

Letter from William E. Davis, on behalf of a collection of prominent District estate tax practitioners (pro bono), describing major issues with the District estate tax. (July 26, 2013)

Letter from Charles Debnam, Chair of the DC Tobacco Free Coalition, offering feedback and additional information on the proposal to unify how tobacco is taxed. (Nov. 20, 2013)

Letter from Charles Debnam, Chair of the DC Tobacco Free Coalition, recommending changes to how the District taxes cigarettes and other tobacco products. (Aug. 27, 2013)

Letter from Richard Franklin and Michael Savage, members of the DC Bar, advocating for the elimination of the District estate tax. (Sept. 24, 2013).

Letter from John H. Graham IV, President and CEO of the American Society of Association Executives, arguing against the creation of a local services fee. (Nov. 5, 2013)

Letter from Kathy E. Hollinger, President of the Restaurant Association of Metropolitan Washington, providing arguments against increasing the restaurant meals sales tax. (Oct. 18, 2013)

Letter from the International Premium Cigar & Pipe Retailers Association on tobacco taxes. (Dec. 6, 2013)

Letter from Edward Krauze, Chief Executive Officer of the District of Columbia Association of Realtors (DCAR), recommending changes to the District's deed recordation and transfer taxes. (Oct. 22, 2013)

Letter from Dave Oberting, Chair and Executive Director of the District Economic Growth Action Fund, recommending the District increase taxes on products and services used by non-residents so the District can lower the tax burden on residents. (Sept. 11, 2013)

Letter (with attachments) from David Schwartzman of DC Citizens for Tax Justice, advocating for a more progressive tax system. (Sept. 19. 2013)

Letter from Joseph Sternlieb, CEO of the Georgetown BID, proposing DC collect tax data at the neighborhood level to aid neighborhood development organizations. (Sept. 17, 2013)

Letter from Allan Wendt, former U.S. ambassador, recommending an expansion of the exclusion for DC and federal government pensions. (Oct. 2, 2013)

Letter from Robert Zahradnik, Director, State Policy at the The Pew Charitable Trusts, with recommendations for evaluating the District's tax expenditures, including tax incentives for economic development. (Oct. 4, 2013)

AUTHORIZING LEGISLATION

DC Code § 47-461

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*** Current through Sept. 18, 2013, and through DC Act 19-682 ***

DIVISION VIII. GENERAL LAWS
TITLE 47. TAXATION, LICENSING, PERMITS, ASSESSMENTS, AND FEES
CHAPTER 4. COLLECTION AND DISBURSEMENT OF TAXES
SUBCHAPTER VI. TAX REVISION COMMISSION

DC Code § 47-461 (2013)

§ 47-461. Council findings

The Council of the District of Columbia finds that:

1. Many District residents and businesses are already overburdened by current taxation levels.

2. The health of the District's tax base and its potential for economic growth require the maintenance of a competitive tax burden between the District and neighboring jurisdictions.

3. Present tax policies and laws are in need of evaluation with respect to their equitability, productivity, efficiency, and effect on economic growth.

4. New or broadened revenue sources must be explored as possible substitutes for current uncompetitive rates to meet the District's revenue needs, but they must be evaluated carefully in terms of their equity and their effect on economic growth.

5. The last comprehensive study of District taxes occurred in 1998, and more recent tax changes have been somewhat piecemeal and sometimes made without regard to the system as a whole or knowledge of long-term effects.

HISTORY:

- June 13, 1996, DC Law 11-143, § 2, 43 DCR 2170; enacted, Apr. 9, 1997, DC Law 11-254, § 2, 44 DCR 1575; Sept. 14, 2011, DC Law 19-21, § 7062(a), 58 DCR 6226.

NOTES:

- PRIOR CODIFICATIONS.–1981 Ed., § 47-461.
- EFFECT OF AMENDMENTS.–DC Law 19-21, in par. (5), substituted "in 1998" for "in 1977."
- EMERGENCY LEGISLATION.–For temporary addition of sections 47-461 through 47-464, see § 2-5 of the Tax Revision Commission Establishment Emergency Act of 1996 (DC Act 11-259, April 18, 1996, 43 DCR 2166).
- LEGISLATIVE HISTORY OF LAW 11-143.–Law 11-143, the "Tax Revision Commission Establishment Act of 1996," was introduced in Council and assigned Bill No. 11-383, which was referred to the Committee of the Whole. The Bill was adopted on first and second readings on March 5, 1996, and April 2, 1996, respectively. Signed by the Mayor on April 18, 1996, it was assigned Act No. 11-383 and transmitted to both Houses of Congress for its review. DC Law 11-143 became effective on June 13, 1996.

- LEGISLATIVE HISTORY OF LAW 19-21.–For history of Law 19-21, see notes under § 47-305.02.
- SHORT TITLE.–Short title: Section 7061 of DC Law 19-21 provided that subtitle G of title VII of the act may be cited as "Tax Revision Commission Reestablishment Act of 2011."

§ 47-462. Tax Revision Commission—Established; Submission of recommendations

a. There is established a Tax Revision Commission ("Commission") with the purpose of preparing comprehensive recommendations to the Council and the Mayor which:

   1. Provide for fairness in apportionment of taxes;
   2. Broaden the tax base;
   3. Make the District's tax policy more competitive with surrounding jurisdictions;
   4. Encourage business growth and job creation; and
   5. Modernize, simplify, and increase transparency in the District's tax code.'

b. Specific functions of the Commission shall include the following:

   1. To analyze the District's current tax system in terms of revenue productivity and stability, efficiency, equity, simplicity of administration, and effect upon the District's economy;
   2. To propose innovative solutions for meeting the District's projected revenue needs while recommending potential modifications to tax rates;
   3. To identify economic activities which are either beneficial or detrimental to the District's economy and which should be either encouraged or discouraged through tax policy;
   4. To recommend changes in the District's current tax policies and laws;
   5. To establish criteria and a conceptual framework for evaluating current and future taxes;
   6. To identify unused and duplicative tax credits and tax abatements and recommend policy changes to improve the way the District utilizes tax expenditures; and
   7. To analyze a proposal to tax the capital gain from the sale of common or preferred shares of a Qualified High Technology Company, as defined in § 47-1817.01(5)(A), at the rate of 3% if the:
      a. Shares of the Qualified High Technology Company were held by the investor for at least 24 continuous months; and
      b. Qualified High Technology Company was headquartered in the District of Columbia on the date of sale.

c. The Commission shall submit its recommendations in the form of a report or reports similar in form and scope as those transmitted by the District of Columbia Tax Revision Commission by letter dated June 2, 1998, and entitled "Taxing Simply, Taxing Fairly." The report or reports shall be accompanied by draft legislation, regulations, amendments to existing regulations, or other specific steps for implementing the recommendations.

d. The Commission shall submit to the Council and the Mayor its final report no later than 9 months after the Commission's appointment.

HISTORY:

- June 13, 1996, DC Law 11-143, § 3, 43 DCR 2170; enacted, April 9, 1997, DC Law 11-254, § 2, 44 DCR 1575; Sept. 14, 2011, DC Law 19-21, § 7062(b), 58 DCR 6226; Sept. 26, 2012, DC Law 19-171, § 114(c), 59 DCR 6190; March 5, 2013, DC Law 19-211, § 2(a), 59 DCR 13281.

NOTES:

- PRIOR CODIFICATIONS.–1981 Ed., § 47-462.
- EFFECT OF AMENDMENTS.–DC Law 19-21 rewrote subsecs. (a)(1), (b)(6), and (d); in subsec. (a)(2), deleted "and" from the end; added subsecs. (a)(4) and (5); in subsec. (b)(2), substituted "recommending potential modifications to tax rates" for "enabling the possibility that general rates might be reduced"; and, in subsec. (c), substituted "June 2, 1998, and entitled 'Taxing Simply, Taxing Fairly'"for "December 5, 1977, pursuant to Council Resolution 1-149."
  - The 2012 amendment by DC Law 19-171 substituted a semicolon for the period at the end of (a)(3).
  - The 2013 amendment by DC Law 19-211 added (b)(7).

- EMERGENCY LEGISLATION. –See Historical and Statutory Notes following § 47-461.
- LEGISLATIVE HISTORY OF LAW 11-143. –For legislative history of DC Law 11-143, see Historical and Statutory Notes following § 47-461.
- LEGISLATIVE HISTORY OF LAW 19-21. –For history of Law 19-21, see notes under § 47-305.02.
- LEGISLATIVE HISTORY OF LAW 19-171. –Law 19-171, the "Technical Amendments Act of 2012," was introduced in Council and assigned Bill No. 19-397. The Bill was adopted on first and second readings on March 20, 2012, and April 17, 2012, respectively. Signed by the Mayor on May 23, 2012, it was assigned Act No. 19-376 and transmitted to Congress for its review. DC Law 19-171 became effective on September 26, 2012.
- LEGISLATIVE HISTORY OF LAW 19-211. –Law 19-211, the "Technology Sector Enhancement Act of 2012," was introduced in Council and assigned Bill No. 19-747. The Bill was adopted on first and second readings on Sept. 19, 2012, and Oct. 16, 2012, respectively. Signed by the Mayor on Nov. 1, 2012, it was assigned Act No. 19-513 and transmitted to Congress for its review. DC Law 19-211 became effective on Mar. 5, 2013.

§ 47-463. Tax Revision Commission—Composition; Selection of Director

a. The Commission shall be a nonpartisan body composed of 11 members, including a Chairperson.

b. The members of the Commission shall be appointed as follows:

1. The Mayor shall appoint five members, of whom:
   - A. Three shall be experts in the field of taxation, such as tax lawyers or public finance economists;
   - B. One shall be a community representative, such as a leader of a public-interest group, labor union, civic association, or a tenant or housing association; and
   - C. One shall be a representative of one or more important sectors of the business community, such as real estate, banking, retail, or high technology.
2. The Chairman of the Council shall appoint five members, of whom:
   - A. Three shall be experts in the field of taxation, such as tax lawyers or public finance economists;
   - B. One shall be a community representative, such as a leader of a public-interest group, labor union, civic association, or a tenant or housing association; and
   - C. One shall be a representative of one or more important sectors of the business community, such as real estate, banking, retail, or high technology.
3. The Chief Financial Officer, or his or her designee, shall be an ex officio member of the Commission.
4. The Chairman of the Council shall appoint one member of the Commission as the Chairperson of the Commission.

c. All appointments shall be made within 60 days of [Sept. 14, 2011]. A vacancy shall be filled in the same manner in which the initial appointment was made.

d. The Commission, by a majority vote, shall select a Director who shall perform the duties required for the day-to-day functioning of the Commission as considered necessary by the members, including appointment of staff, selection of consultants, and the administration of meetings and report production.

e. Each member of the Commission shall serve without compensation. Each member may be reimbursed for actual expenses pursuant to § 1-611.08.F. Members of the Commission shall act with the utmost integrity and professionalism. Each member shall avoid conflicts of interest and may seek the advice of the Office of the Attorney General to ensure that his or her duties are being discharged ethically.

HISTORY:

- June 13, 1996, DC Law 11-143, § 4, 43 DCR 2170; enacted, April 9, 1997, DC Law 11-254, § 2, 44 DCR 1575; Sept. 14, 2011, DC Law 19-21, § 7062(c), 58 DCR 6226; Sept. 26, 2012, DC Law 19-171, § 114(p), 59 DCR 6190.

NOTES:

- PRIOR CODIFICATIONS.–1981 Ed., § 47-463.
- EFFECT OF AMENDMENTS.–DC Law 19-21 rewrote the section, which formerly read:

  "a. The Commission shall be a nonpartisan Commission composed of 17 members drawn from experts in the field of taxation such as tax lawyers and public finance economists; several community representatives such as members of labor unions, public interest groups, civic associations, and tenant and housing associations; and representatives of important sectors of the business community such as real estate, banking, retailing, and public utilities.

  "b. Eight members of the Commission shall be appointed by the Mayor, and nine members shall be appointed by the Council. The Council shall appoint the Chairperson of the Commission from among the Council-appointed members of the Commission. All appointments shall be made within 60 days of June 13, 1996. A vacancy shall be filled in the same manner in which its initial appointment was made.

  "c. The Commission, by a vote in which a majority of the members are in the affirmative, may select a Director who shall perform the duties required for the day-to-day functioning of the Commission as deemed necessary by the members, including, but not limited to, appointment of staff and selection of consultants.

  "d. The Commission may appoint task forces composed of representatives from the District of Columbia, the State of Maryland, and the Commonwealth of Virginia.

  "e. Each member of the Commission shall serve without compensation. Each member, however, may be reimbursed for actual expenses pursuant to section 1108 of the District of Columbia Government Comprehensive Merit Personnel Act of 1978, effective March 3, 1979 (§ 1-611.08)."

  The 2012 amendment by DC Law 19-171 substituted "§ 1-611.08" for "section 1108 of the District of Columbia Government Comprehensive Merit Personnel Act of 1978, effective March 3, 2979 (§ 1-611.08)" in (e).
- TEMPORARY AMENDMENT OF SECTION.–For temporary (225 day) amendment of section, see § 2 of Tax Revision Commission Establishment Temporary Amendment Act of 1996 (DC Law 11-224, April 9, 1997, law notification 44 DCR 2582). For temporary (225 day) amendment of section, see § 2 of Tax Revision Commission Establishment Temporary Amendment Act of 1998 (DC Law 12-79, April 9, 1997, law notification 45 DCR 2114).
- EMERGENCY LEGISLATION.–See Historical and Statutory Notes following § 47-461.
  For temporary amendment of section, see § 2 of the Tax Revision Commission Establishment Emergency Amendment Act of 1996 (DC Act 11-435, Oct. 30, 1996, 43 DCR 6184), and § 2 of the Tax Revision Commission Establishment Congressional Review Emergency Amendment Act of 1997 (DC Act 12-30, March 11, 1997, 44 DCR 1902).
- LEGISLATIVE HISTORY OF LAW 11-143.–For legislative history of DC Law 11-143, see Historical and Statutory Notes following § 47-461.
- LEGISLATIVE HISTORY OF LAW 19-21.–For history of Law 19-21, see notes under § 47-305.02.
- LEGISLATIVE HISTORY OF LAW 19-171.–Law 19-171, the "Technical Amendments Act of 2012," was introduced in Council and assigned Bill No. 19-397. The Bill was adopted on first and second readings on March 20, 2012, and April 17, 2012, respectively. Signed by the Mayor on May 23, 2012, it was assigned Act No. 19-376 and transmitted to Congress for its review. DC Law 19-171 became effective on Sept. 26, 2012.

§ 47-464. Tax Revision Commission – Authority

a. The Chairperson of the Commission, or his or her designated representative, who must be a member of the Commission, shall convene all meetings of the Commission. Six members of the Commission shall constitute a quorum. Voting by proxy shall not be permitted.

b. The Commission shall have the authority to create and operate under its own rules of procedure, consistent with this subchapter and Chapter 5 of Title 2 [§ 2-501 et seq.].

c. All recommendations and reports prepared and submitted by the Commission shall be a matter of public record.

d. The Commission, or committees thereof, may, for the purpose of carrying out the provisions of this subchapter, hold hearings, and shall sit and act at such times and places and administer oaths as required.

e. The Commission shall have the authority to request directly from each department, agency, or instrumentality of the

District Government, and each department, agency, or instrumentality is hereby authorized to furnish directly to the Commission upon its request, any information reasonably considered necessary by the Commission to carry out its functions under this subchapter.

f. The Commission is authorized to use space and supplies owned or rented by the District government. The Commission is further authorized to use staff loaned from the Council or detailed by the Mayor for such purposes consistent with this subchapter as the Commission may determine.

g. The Commission's operations shall be funded by annual appropriations, private sector assistance, or both.

h. If a special fund is established by the Commission for the receipt of operating donations from non-government sources, the fund shall be administered in accordance with established funding and auditing procedures of the District government. The expenditure of such donations shall not be subject to appropriation. The Commission shall keep a record, available to the public for inspection, of all such donations and any substantial non-government in-kind contributions received. The record shall include the full name, address, and occupation or type of business of each donor. "Substantial non-government in-kind contributions" shall include any service reasonably valued at more than $ 5,000 which is received from any source other than the District or federal government.

HISTORY:

- June 13, 1996, DC Law 11-143, § 5, 43 DCR 2170; enacted, April 9, 1997, DC Law 11-254, § 2, 44 DCR 1575; Sept. 14, 2011, DC Law 19-21, § 7062(d), 58 DCR 6226; Sept. 26, 2012, DC Law 19-171, § 114(q), 59 DCR 6190.

NOTES:

- PRIOR CODIFICATIONS.–1981 Ed., § 47-464.
- EFFECT OF AMENDMENTS.–DC Law 19-21, in subsec. (a), substituted "Six members" for "Seven members"; and, in subsec. (e), substituted "information reasonably considered" for "information deemed".
  The 2012 amendment by DC Law 19-171 substituted «this subchapter» for "this act" in (b), (d), (e), and (f); and substituted "Chapter 5 of Title 2" for "the Administrative Procedure Act, approved Oct. 21, 1968 (§ 2-501 et seq.)" in (b).
- EMERGENCY LEGISLATION.–See Historical and Statutory Notes following § 47-461.
- LEGISLATIVE HISTORY OF LAW 11-143.–For legislative history of DC Law 11-143, see Historical and Statutory Notes following § 47-461.
- LEGISLATIVE HISTORY OF LAW 19-21.–For history of Law 19-21, see notes under § 47-305.02.
- LEGISLATIVE HISTORY OF LAW 19-171.–Law 19-171, the "Technical Amendments Act of 2012," was introduced in Council and assigned Bill No. 19-397. The Bill was adopted on first and second readings on March 20, 2012, and April 17, 2012, respectively. Signed by the Mayor on May 23, 2012, it was assigned Act No. 19-376 and transmitted to Congress for its review. DC Law 19-171 became effective on Sept. 26, 2012.
- REFERENCES IN TEXT.–"This act," referred to in subsections (b), (d), (e), and (f) is DC Law 11-143, which is codified at §§ 47-461 through 47-815.

DC TAX REVISION COMMISSION MEMBERS

The D.C. Tax Revision Commission was created in 2011 as part of the fiscal year 2012 budget.

Former DC Council Chairman Kwame Brown selected the Commission's chair and four additional members. Mayor Vincent Gray chose the other five Commission members. The Chief Financial Officer also designated an ex-officio member for the Commission.

The Commission met first on Aug. 8, 2012, and met last on Dec. 18, 2013. In total, the Commission held 26 public meetings, including three public hearings.

The 2013 D.C. Tax Revision Commissioners

Anthony A. Williams, Chair
Former Mayor of the District of Columbia; Current CEO and Executive Director of the Federal City Council

David Brunori
Research Professor of Public Policy, Trachtenberg School of Public Policy and Public Administration at the George Washington University

Catherine Collins
Interim Associate Director/Research Associate, George Washington Institute of Public Policy, the George Washington University

Mark Ein
CEO, Venturehouse Group

Teresa Hinze
Executive Director, Community Tax Aid Inc.

Ed Lazere
Executive Director, DC Fiscal Policy Institute

Kim Rueben[23]
Senior Fellow, Tax Policy Center

Pauline A. Schneider
Special Counsel, Ballard Spahr LLP

Stefan Tucker
Partner, Venable LLP

Nicola Whiteman
Vice President of Government Affairs, Apartment and Office Building Association

Fitzroy Lee *(ex-officio member)*[24]
Deputy CFO, Office of Revenue Analysis, OCFO, Government of the District of Columbia

Tracy Gordon[25]
Senior Economist, White House Council of Economic Advisers

The 2013 D.C. Tax Revision Staff

Gerry Widdicombe[26]
Executive Director

Steven M. Rosenthal
Staff Director

Richard C. Auxier
Research Analyst

Ashley Lee
Administrative Assistant

Elisha Gaston
Law Clerk

[23] Kim Rueben joined the D.C. Tax Revision Commission in August 2013. She replaced Tracy Gordon, and voted on the final package of recommendations.
[24] Fitzroy Lee, as an ex-officio member, did not vote on the final package of recommendations.
[25] Tracy Gordon was an original member of the DC Tax Revision Commission. She resigned from the Commission in July 2013 to join the White House Council of Economic Advisers.
[26] Gerry Widdicombe replaced Kevin Clinton as executive director in March 2013.