

# Tax Systems Resilience and Sustainability

## Presentation to the District of Columbia Tax Revision Commission

Kim Rueben, Sol Price Fellow  
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# Characteristics of a good tax system



- Fairness, adequacy, simplicity, transparency, and administrative ease
- A government wants to raise money to provide services in a way that is fair across taxpayers and generally does not distort economic activity
  - Exception: Used to change behavior (e.g., cigarette tax)
- This is generally easier to achieve with multiple taxes performing multiple roles
  - **broad base and low rates** minimizes changes in economic behavior

- Need to examine who we tax
  - Check specific burdens across representative individuals or businesses
    - Policy example: Offer property tax caps or deferrals for people house rich, income poor
  - Target funds to offset burden
    - Policy example: Soda taxes disproportionately affect low-income households, target resulting revenue at those communities
- As a jurisdiction's economy and population evolve, policymakers must adjust or change taxes to keep up
  - And ideally anticipate where things are heading
    - Skating to where the puck will be

# Challenges to DC's system

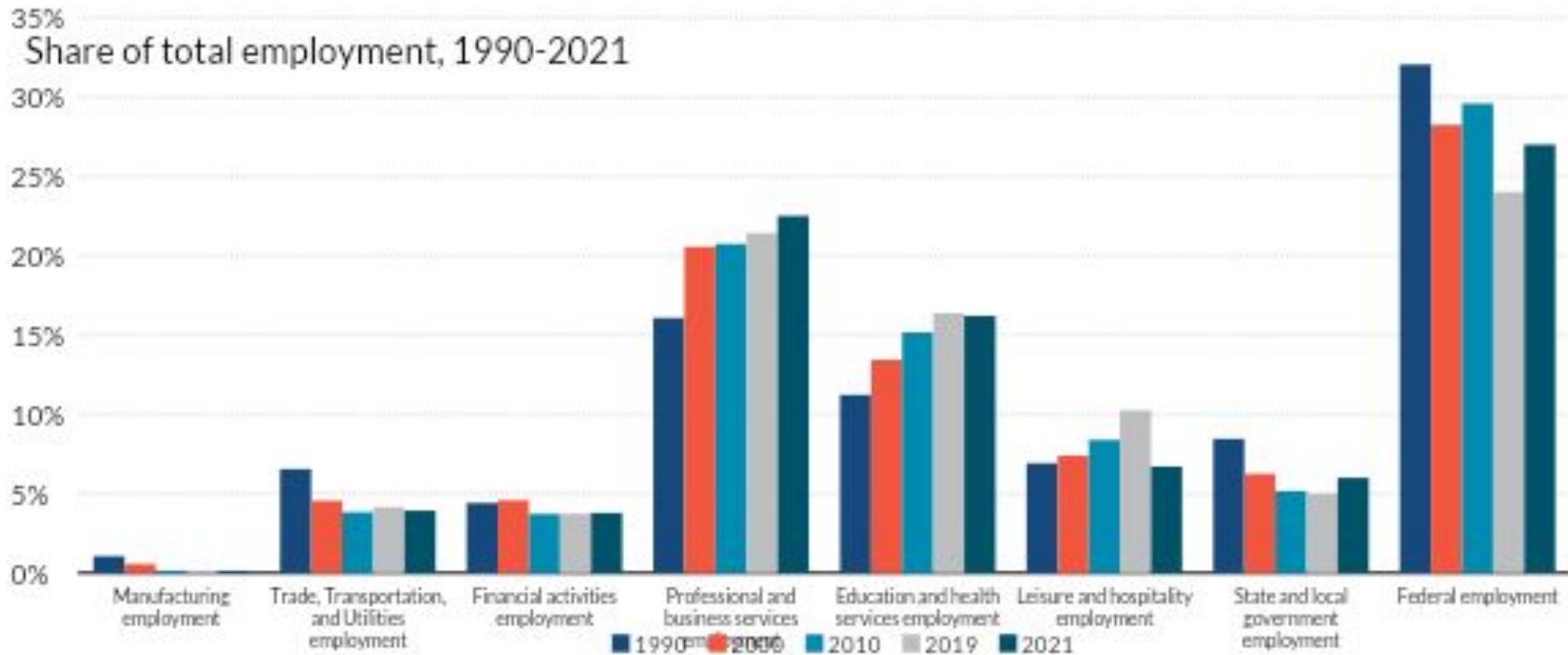


- DC only city-state so limited geography and space
- DC also broad variation in population
  - Has highest per capita income in country (\$96,483 vs \$63,444 in US)
  - But also high poverty rate (15.5% vs. 12.8% in US)
  - Variation across wards, racial groups wide
  - Desire to raise revenues but also provide opportunities
- Federal limitations on the District's tax system
  - Inability to tax income earned by nonresidents
    - Part of multi-state metro
  - Congressional intervention in District lawmaking can limit options (e.g., Congress prevents DC from taxing cannabis)

- DC has very progressive income tax system in the country
  - By far the most generous EITC
  - Schedule H property tax credit is refundable and available to renters (interaction of property and income tax systems)
- DC recently expanded sales tax to more services
- Corporate income tax in line with neighbors and competitors
- District faced challenges before and has institutions in place to help fiscal sustainability

# Industrial mix has changed over time, but still dependent on government

## Employment Industries - District of Columbia



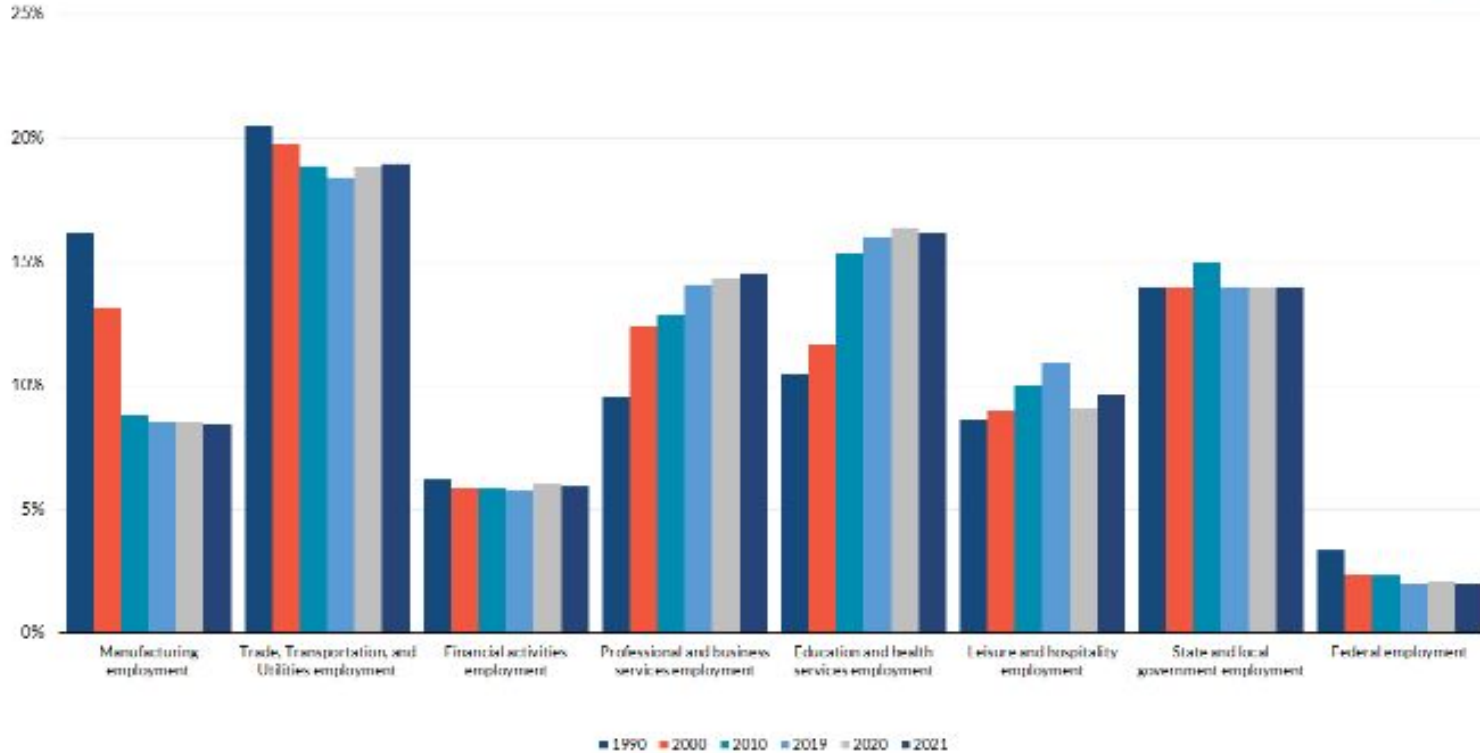
- While reliance on federal employment declined, large share of employment is still in government and in the non-profit sector (education and health-care)
- Professional & technical and leisure & hospitality was growing

# District's economic mix is very different from the country as a whole



## Employment Industries - United States

Share of total employment, 1990-2020



Source: State Tax and Economic Review (2022 quarter 2) data and Federal Reserve Economic data.

# How did the pandemic change things?



- Employment has recovered but not in all sectors
  - Federal employment *currently* declining
  - Slow recovery in leisure & hospitality and professional & tech (below US recovery) of special concern, as those sectors were responsible for pre-pandemic growth
- Declines in commercial occupancy and shifting employment patterns can have multiplier effects
  - CBRE FC2 Office space report highlights office vacancy rates high in District
    - Vacancy especially high for older buildings
- However, residential property values are still strong



- Explore ways to expand tax base to cover all economic activities to the extent allowed by Congress and helps meet District's goals.
  - Per-employee service fee and/or PILOT
    - Goal: Broaden District's tax base, subject to current limits
    - Reason: Recognize not all business activity contributes to the tax base yet all receive services
    - Challenges: Interaction with current charges (Paid Family Leave payroll tax) and effect of more hybrid work or PILOTS voluntary

- Take great care with economic development incentives – don't give away tax base unnecessarily
  - Tax abatements and economic development deals
    - Goal: Encourage businesses to locate in the District, offset lower vacancy rates
    - Challenge: Revenue costs and efficacy (i.e., tax help often does not drive business location decisions)
    - Solution: Examine if breaks are needed for investment
    - Include time-limits and benchmarks
    - Examine what terms are and evaluate that commitments are met – and include clawbacks

# Possible reform – use administrative information to ensure consistency in treatment in tax systems



- Make sure homeowner tax breaks limited to bona-fide DC residents
  - Administratively check residential income tax filing against individuals claiming homestead exemption
  - Goal: Ensure fairness and broaden base
  - Challenges: Push-back from residents. Will there be some who don't need to file? (Schedule H should ensure if primary residence will be in income tax system)

# Principles to keep mind as move forward with commission



- Where is District economy and its employment mix going?
- What are the District's policy goals?
- What tax changes can be made that help the District reach that future?
- And how do we move forward while acknowledging uncertainty and unknown unknowns?