

**TESTIMONY OF ED LAZERE, EXECUTIVE DIRECTOR
At the Public Hearing on
The Proposed FY 2009 Budget for the Office of Tax and Revenue
District of Columbia Committee on Finance and Revenue
April 9, 2008**

Chairman Evans and members of the Committees, thank you for the opportunity to speak today. My name is Ed Lazere, and I am the executive director of the DC Fiscal Policy Institute. DCFPI engages in research and public education on the fiscal and economic health of the District of Columbia, with a particular emphasis on policies that affect low- and moderate-income residents. I appreciate the opportunity to testify on this important issue.

Mayor Fenty's FY 2009 budget proposes an alternative to commercial property tax cut legislation adopted earlier this year. I support the notion of seeking such an alternative, although I have several concerns with the specifics of the Mayor's proposal.

The legislation adopted in January triggers a cut in the commercial property tax rate — with cuts targeted to some extent on small businesses — when certain conditions are met. When this “calculated rate” provision was passed, it was not expected to result in any tax cuts in FY 2009 or in the near future. Yet based on the CFO's revenue forecast in February, the new provision triggered a \$96 million business property tax cut for FY 2009.

Given the slowing national economy and its impact on DC's income, sales, and deed tax collections, implementing a large tax cut at this time is inadvisable and would have thrown DC's FY2009 budget out of balance.

The Mayor's budget proposes to eliminate the calculated rate tax provision because it has quickly proven to be unpredictable and to lead to unexpectedly large tax cuts. The fact that it triggered a large tax cut so soon indicates that it could trigger additional cuts in the future with unknown size and timing. This makes it hard to manage the city's finances.

In place of the calculated rate, the proposed FY 2009 budget includes a \$15 million cut in business property taxes, which would more than double an \$11 million small business property tax cut adopted by the DC Council in the FY 2008 budget. The property tax rate for commercial properties worth less than \$3 million would fall from the current rate of \$1.85 per \$100 of assessed value to \$1.70. The tax rate would fall by a lesser amount — to \$1.84 per \$100 of assessed value — for larger commercial properties.

Replacing a tax cut that triggers under certain conditions with a specific rate cut has a lot of appeal, because its costs are clear and predictable. At the same time, I have several concerns with the new proposal.

First, the proposed tax cuts are not well targeted on small businesses. The budget would cut the tax rate for both small and large properties, with roughly the same amount of tax relief to both groups. Because larger properties comprise an overwhelming share of DC's business property tax base, the one penny tax cut for larger business would cost \$7 million, or nearly as much as the \$8 million cost for the 15 cent rate cut for smaller properties. If the tax cut were solely focused on small businesses, the cut could be almost twice as large. In addition, the proposed tax cut would have little impact on small businesses if they that are tenants in larger buildings.

Second, the fact that the proposed budget would limit the tax cut to properties below \$3 million creates a "cliff" effect that could lead to sudden tax increases for some properties in the future. Properties worth close to but less than \$3 million today maybe worth more than \$3 million at some future point, as part of the natural growth in property values. When this happens the property's tax rate would jump from \$1.70 per \$100 of assessed value to \$\$1.84. We describe such a sudden jump in taxes as a "cliff effect."

Third, setting a far lower tax rate for smaller properties than larger properties may create an incentive for the building owners to have their properties legally divided into smaller subdivisions to take advantage of the lower rate. It is not clear to what extent this will happen, but it is a real concern.

I would like to point out that many of these concerns over targeting small businesses effectively also apply to the calculated rate legislation adopted in January. That law provides tax reductions for the first \$3 million in assessed value of all properties. This does not create a cliff effect as the Mayor's proposal would, but it does suffer from ineffective targeting on small businesses — especially those in larger buildings — and it also creates incentives to subdivide buildings into smaller pieces.

This committee has struggled for more than a year to shape business property tax relief that effectively targets small businesses. It is a challenging issue with no easy answers. I would like to propose one alternative that may have problems of its own but also has several advantages.

I propose that rather than offering a rate reduction, the tax cut should be fashioned as a credit tied to a percentage of the tax bill paid. Eligibility would be limited to small businesses, possibly defined as those with gross receipts below a specified level. I would include small non-profits as well, since they are important small businesses as well. The eligible small businesses and non-profits would qualify for a tax credit equal to some specified percentage of the property taxes they pay, including taxes passed on by their landlord. Businesses would have to apply for the tax credit, presumably annually.

This proposal has the advantages of tying relief directly to property taxes paid, targeting only small businesses, and limiting tax avoidance incentives.

One problem with this proposal is that we do not know how much small businesses currently pay in property taxes, making it difficult to estimate the costs of establishing a credit tied to a percentage of taxes paid. This problem could be addressed by not establishing the credit percentage in advance, at least for the first year of the credit.

Businesses could be asked to apply for the credit and told that the size of the credit would be determined by dividing the available relief among the businesses that apply and the taxes they pay. After one or more years, the city would have a fairly solid base of information on the small business property tax base, so that the credit percentage could be set in advance each year with a relatively predictable cost.

Thank you for the opportunity to testify. I am happy to answer any of your questions.