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Testimony of Ed Lazere, Executive Director
At the Public Oversight Roundtable on the Matter of
Qualified High Technology Tax company (QHTC) Tax Incentives
DC Council Committee on Finance and Revenue
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Chairman Evans and other members of the Committee, thank you for the opportunity to testify today. My name is Ed Lazere, and I am the Executive Director of the DC Fiscal Policy Institute. DCFPI is a non-profit organization that promotes budget choices to address DC's economic and racial inequities and to build widespread prosperity in the District of Columbia, through independent research and policy recommendations.

I'm here today to support the DC Council's action to reform the Qualified High Technology Company (QHTC) tax incentive program through the fiscal year (FY) 2020 budget, given the clear information that these costly incentives are not working well, and to encourage the Council to take further steps to reform this program after the FY 2020 budget is completed.

Five years ago, the DC Tax Revision Commission recommended that the District undertake a regular review of its tax expenditure programs (for economic development and other purposes), because tax incentives often get little oversight once they are approved and because a report by the Pew Research Center found that the District ranked poorly in terms of its tax expenditure review efforts. As a result, the Council provided funding for the Chief Financial Officer (CFO) to conduct such analyses, which started in recent years.

The CFO's November 2018 report on economic development tax incentives shows why this kind of review is important and long overdue.[1] It found that the District has been operating several incentive programs for decades that had never been evaluated, have substantial costs, and have no signs of accomplishing their goals. The QHTC program is the most significant example.

Before getting into details of the QHTC program, it's important to note that in general it is hard to make economic development tax incentives effective. State and local taxes are a relatively small share of business costs, so tax incentives are unlikely to have a major impact on location decisions. Beyond that, most tax incentives go to businesses for actions they would have taken anyway, meaning that tax incentives are a blunt tool.[2]

These trends are evident in the QHTC program. The CFO review was "not able to reasonably identify what new actions were taken due to the incentives" or "what economic benefits are attributable to the incentives." In short, the CFO found that the program costs $40 million a year without any sign of benefits.

The CFO review found that the QHTC program is poorly targeted and not contributing to growth.

- The QHTC definition of "high tech" is vague and broad.

- The program offers multiple subsidies, with no cap on the total amount a company can claim. This has resulted in a small number of companies receiving most of the subsidies.
- The QHTC program does not require companies to be new or expanding to receive subsidies, and as a result it appears that the subsidies primarily go to existing companies. The CFO found that most QHTC recipients were already in DC before the program was created. This also is a key reason that the program has no evident economic benefits.
- The program only requires companies to have two employees in DC, which has resulted in firms that are based in Northern Virginia receiving subsidies because they maintain a small DC office.
- The QHTC offers permanent tax breaks to qualifying companies, meaning companies continue to receive subsidies long after their initial action to claim them (if they did anything special in the first place).
- The QHTC program has no claw-back provisions, meaning that companies can leave whenever they want with no consequences.

We should fix or eliminate programs that aren't working. When there is clear evidence of ineffective programs—tax programs or on-budget programs—the Council has the responsibility to take corrective action. This is commonsense good government.

The Council's actions to revise the QHTC program is consistent with the CFO's analysis and recommendations. The Council voted to limit the amount of franchise tax subsidy to $250,000 per year per company, following a CFO recommendation. And the Council voted to limit these subsidies to 10 years—five years of paying no corporate tax and five years of paying a reduced corporate tax rate. The Council's changes mean that 86 percent of recipients will continue to claim full benefits.

The Council's actions should be seen as the first step toward revising the QHTC program. The CFO reviews suggests that other reforms would make sense:

- **Further limiting subsidies per company:** Even with the Council's changes, one company can claim up to $15 million in subsidies in its first five years of profitability.
- **Tying subsidies to new activity, with an application process:** Firms should be required to apply for and be certified as a QHTC, and subsidies should be tied to expanded job opportunities for DC residents. This is, in fact, how the District has designed some recent non-QHTC targeted tax abatements, like for the Advisory Board. It is time to apply the same accountability to the QHTC program.
- **Establish clawbacks:** Companies that leave the District after receiving QHTC subsidies should be required to pay back a portion of the subsidies, with the clawback amount being largest for companies that leave within a short amount of time after receiving subsidies.
- **Disclosure:** The QHTC program should be revised to require annual disclosure of companies receiving subsidies and the amounts received.

Thank you for the chance to testify.

[1] Office of Revenue Analysis, Review of Economic Development Tax Expenditures, Government of the District of Columbia, November 2018

[2] See DC Fiscal Policy Institute, "Revenue Revealed: It's Time to Amend DC's Tax Expenditure Programs," March 2019