Government of the
District of Columbia

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Summary Report on the District's First Cycle of Tax Expenditure Reviews

Issued March 2022

Executive Summary

The District of Columbia Council passed a law in 2014 requiring the Office of the Chief Financial Officer (OCFO) to review all DC tax preferences (abatements, credits, and exemptions, among others) on a five-year cycle.[1] With the release of the last of five reports in January 2022, the Office of Revenue Analysis (ORA) completed the first full tax expenditure review cycle.

DC's Varied Tax Expenditures Aim to Make DC a More Affordable Place to Live and Do Business While Promoting a Wide Range of Policy Objectives

A common thread among the District's tax expenditures is that they represent choices to reduce taxes for specific groups of taxpayers, such as homeowners, low-income seniors, high technology businesses, small retailers, among many other groups receiving tax preferences in DC. By using tax expenditure policy to make DC a more affordable place to live or do business, District leaders provide certain taxpayers with a financial incentive to remain in DC (or move into DC from elsewhere), given the ease with which individuals and businesses can relocate to neighboring jurisdictions.

Beyond that broad goal of increasing affordability by reducing taxes, which is at its core the definition of a tax expenditure, most tax expenditures have another, more targeted goal. For example, the homestead deduction and property assessment increase cap shield homeowners from rising property taxes that could drive some to sell and leave the city. Income and property tax programs targeted to senior citizens protect those long-time residents— many of whom are on fixed budgets—from rising tax bills.

> Tax expenditures are preferences in the tax code that convey a benefit to certain individuals or businesses. Policymakers use various types of tax expenditures, including tax abatements, credits, deductions, and incentives to promote a wide range of policy goals in areas such as housing and economic development.

Similarly, tax incentives for qualified high technology companies are aimed at attracting and retaining businesses that are seen as a major driver of economic development and job creation, specifically high paying jobs that are good for both workers and the District's economy. Likewise, incentives for certified capital insurance companies were aimed at providing seed money for local business development, thus aiming to encourage economic development and job creation.

While making the District an affordable city in which to live and do business is certainly a top priority, tax expenditures decrease the tax base and therefore reduce government resources available for other priorities. As such, District leaders should periodically review the tax expenditures written into the tax code to ensure they are meeting their goals as well as continuing to represent the best use of District resources. The District's 2014 requirement to review its tax expenditures marks the first step in analyzing all local tax expenditure provisions.

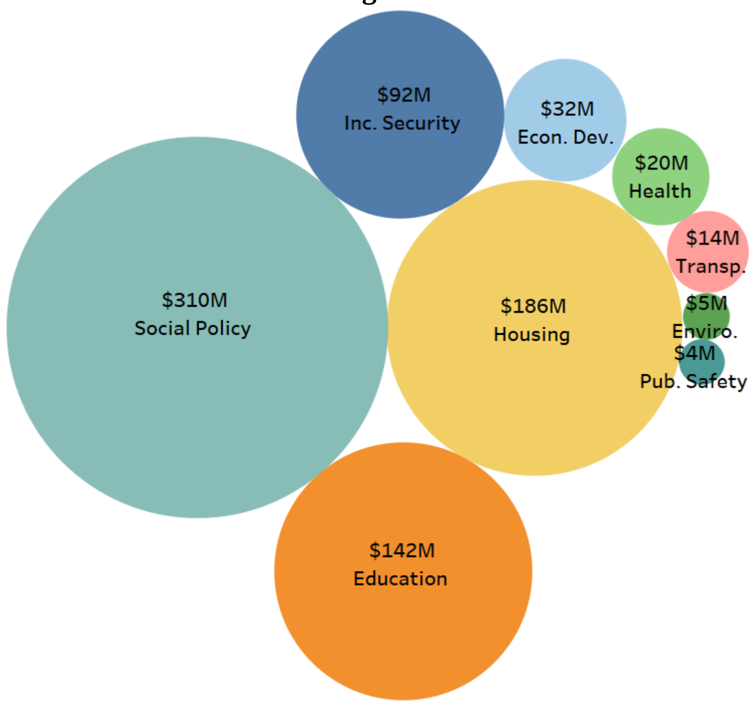
[1] DC Law 20-155 "Fiscal Year 2015 Budget Support Act of 2014." See full text of requirement in Appendix 1.

First Tax Expenditure Review Cycle Produced Inventory of District Tax Expenditures Organized by Policy Area, Led to Increased Collaboration within the OCFO, and Provided Data that Informed the Policymaking Process

The first cycle of tax expenditure reviews produced five reports which covered the following policy areas: 1) Housing; 2) Environment, Public Safety Transportation, and Tax Administration and Equity Provisions; 3) Economic Development; 4) Income Security and Social Policy; and finally, 5) Health and Education. Several reports covered multiple policy areas, and each report is summarized here, including any recommendations that were made. Where possible data from the original reports have been updated for this report.

Reviewing all local tax expenditures for the first time presented opportunities for more collaboration within the OCFO. Intra-agency data sharing increased, such as for property tax expenditure data and corporate franchise (income) tax data, and Office of Tax and Revenue (OTR) and Office of the General Counsel (OGC) colleagues shared expertise on various tax expenditures. Overall, this work fostered an increased understanding across both ORA and OTR/OGC of the offices' different roles regarding tax administration and research, leading to improvements in data collection and more perspectives being included as a new integrated tax system was designed and rolled out within the OCFO.

Chart 1: DC Tax Expenditures by Policy Area, Revenue Forgone in FY 2020



Source: ORA analysis of provisions reviewed in Tax Expenditure Reviews released from 2015 to 2022 (Revenue forgone estimates updated to FY 2020).

In addition to internal impacts of the evaluation process, external experts have commended the ORA reports, invited staff to speak at convenings of other government officials conducting tax expenditure evaluation as well as serve on a national advisory group for tax incentive evaluators. Perhaps the most notable impact of the process was the 2018 Review of Economic Development Tax Expenditures being cited as a rationale when DC Councilmembers amended the nearly two decades old Qualified High Technology Company (QHTC) tax incentives program, two years in a row. Because of the requirement to review and evaluate the program, ORA was able to provide valuable data and analysis to policymakers that shed light on some administrative issues as well as ways the incentive could be improved.

Lack of Data Collection Requirements and Failure to Plan for Evaluation at Start of Tax Expenditures Leads to Need for More Data

In addition to these positive outcomes, our first round of reviews also highlighted how critical data and information are for evaluating tax expenditures. While descriptive data analysis and a review of program administration provided valuable insights into various programs, we commonly found a lack of data that would allow for a full evaluation of impacts. For certain tax expenditures, such as economic development-related incentives, data beyond the effect on tax liability is needed to evaluate the incentives. For example, information about new hires that resulted from tax incentives or increased business activity would allow for more in-depth analysis to measure the effectiveness of the incentives.

Examples from two major tax expenditure provisions covered in the Economic Development Tax Expenditure Review – the QHTC tax credits and the Certified Capital Investment by Insurance Companies (CAPCO) program – highlight issues uncovered with data collection requirements and management. Across both these programs there was voluntary participation among recipients to share data related to economic impacts of the tax incentives with District agencies, and the agencies had no recourse if companies did not willingly submit information.

Changes are underway within OTR with the implementation of a Modernized Integrated Tax System (MITS), which since 2019 requires QHTCs to e-certify their status. Through MITS, OTR now requires that companies submit the requested information before claiming the tax credits. This marks a positive step in the process of holding companies accountable for the tax incentives they claim; however, a next step in the process may be setting up outside verification procedures to corroborate self-reported data given that what companies report is not always consistent even within a single tax form. Currently, it is not feasible for analysts to confirm credit claims if companies report inconsistent or incomplete information on their tax filings.

Continued Improvements to the District's Tax Expenditures Could Include Increased Coordination and Management of Tax Incentives, and Consolidating Certain Requirements

Based on our findings about the lack of data that can result when no agency or office is tasked with administering a tax expenditure from the beginning, we find that assigning agency to administer a tax expenditure, with the authority and the mandate to track, monitor, and report on incentives could improve tax expenditure administration, evaluation, and effectiveness. This would involve having a clear structure for data collection, reporting, and monitoring/evaluation from the beginning of the incentives. Some improvements on this front have occurred since our report was released. For example, the Deputy Mayor for Planning and Economic Development (DMPED) is assigned to certify the eligibility of businesses that request a tax exemption through the East End Grocery and Retail Incentive Tax Exemption Act to OTR before tax benefits are given. As part of our continued research in this area ORA will monitor and report on these improvements as these tax exemptions are used.

Other themes emerging from our reviews include the potential benefit that could arise from a consolidation of requirements for different tax expenditures in the same policy area, such as tenant income requirements across tax expenditures for affordable housing developers. Along the same lines there is opportunity

Box 1: Trends in DC Tax Expenditure Policy

Reviewing DC's tax expenditures is a key step to ensure that spending through the tax code is accountable and effective. The table below offers a timeline of tax expenditure policy actions in DC. Before the tax expenditure evaluation process began in 2015, District lawmakers in the early 2010s were improving tax expenditure policies by including performance measures for various incentives. Such performance measures likely saved millions of tax dollars by preventing tax abatements from going to companies that did not engage in new economic activities in DC.

Pre-2000	Major DC tax expenditures included: sales tax exemptions for medicine, groceries, professional and personal services, and federal government (1949), property tax exemptions for the federal government, educational institutions, and charities (1942), and the residential Homestead Deduction (1978)
2000	DC Law 13-161, "Tax Expenditure Budget Review Act of 2000" requires a Tax Expenditure Report
2000	Two large tax incentive/credit programs introduced: 1) Qualified High Technology Company (QHTC) incentives 2) Earned Income Tax Credit (EITC)
2011	DC Law 19-21 requires a Tax Abatement Financial Analysis (TAFA) to be submitted to Council for all proposed real property tax abatements
2010s	Larger tax incentives began including performance targets: Social E-Commerce Companies (2012); Adams Morgan Hotel (first approved 2010); Advisory Board (2015)/EAB Global (2020); Chemonics (2019)
2014	DC Law 20-155 "Tax Transparency and Effectiveness Emergency Act of 2014" requires review of tax preferences/expenditures by the OCFO
2015	1st TE Review covering Housing-related tax expenditures released
2017	2nd TE Review covering Environment, Public Safety, Transportation, and Tax Administration and Equity-related tax expenditures released
2018	3rd TE Review on Economic Development-related tax expenditures released
2021	4th TE Review on Income Security and Social Policy-related tax expenditures released
2022	5th TE Review covering Education and Health-related tax expenditures released

Source: ORA Compilation

for more coordination and awareness around available tax expenditures within a given area, particularly housing.[2]

Based on these and other findings related to data collection and more broadly related to the structure of economic development incentives, ORA recommended in its Economic Development Tax Expenditure Review that to promote effectiveness and accountability, all future District Tax incentives should:

1) Be assigned an administering agency from the beginning, with the authority and the mandate to track, monitor, and report on incentives.
2) Contain a clear structure for data collection, reporting, and monitoring/evaluation from the beginning of the incentives.
3) Be simple to understand and administer for both taxpayers and tax administrators.
4) Be more transparent and publicly reported.
5) Be better targeted, and not given to companies or entities to do what they were already doing, rather new activity should be undertaken to receive the incentive.
6) Include financial limits or caps to protect the District's fiscal resources.
7) Contain claw back provisions so that if a company receiving tax incentives does not comply with the terms of its tax benefits or leaves DC within a certain amount of time, it will have to repay the District what it received.

Many of these recommendations apply to specific tax expenditures for individual taxpayers as well, though some would not, given the different nature of some tax expenditures for social policy and income security.

The following report offers a summary of each review and recommendations emerging from each report. The report then highlights some of the impacts this new requirement has had, both on internal agency processes and external District policies. Next, it reviews some additional issues uncovered around data availability and looks forward to the next cycle. Two Appendices offer additional resources, including the legislative requirement for tax expenditure reviews and major tax policy changes since the District's 2013 Tax Revision Commission, which overlapped the period of the first tax expenditure review cycle.

[2] A new website launched by the Mayor's office aims to provide a one-stop portal for residents seeking to buy a home and many of the housing tax preferences for homeownership are included. Such a site provides a useful example of the kind of coordination that is needed to advertise tax expenditure policies so that they are used. https://www.frontdoor.dc.gov/save-on-taxes

Releases and Recommendations Made in the First Tax Expenditure Review Cycle

To comply with the requirements of the new law, the OCFO for the first time went beyond estimating the revenue forgone due to tax expenditure provisions to examining the impacts, where possible, on the District's economy and social welfare and offering recommendations about certain tax expenditures.

In three of the reports, multiple policy areas are combined to provide an even distribution among the reports. Summaries of each of the five reports follow and include the number and size of the tax expenditure provisions in each area, as well as the recommendations made in each report.

❖ **October 2015**: **District of Columbia Housing Tax Expenditure Review**

In fiscal year 2015 there were 28 categorical housing tax provisions, with forgone revenue totaling an estimated $116.6 million.[3] Most categorical housing tax expenditures are aimed at promoting homeownership and protecting homeowners from sharp property tax increases. The single largest of these is the Homestead deduction, with an estimated foregone revenue of over $59 million that year aimed at encouraging individuals to own and occupy homes in the District, and to provide tax relief to all resident homeowners, regardless of income. In that same period, we identified 31 specific provisions representing at least $15 million in forgone revenue authorized through legislation to organizations aimed at providing affordable housing.

<u>Housing Recommendations:</u>

1) Standardize affordability requirements across housing tax preferences
2) Clarify which agency is responsible for monitoring compliance with tax expenditure terms and assign a third-party body to oversee the monitoring of District housing tax incentives
3) Require recipients of tax expenditures to remain in compliance with the original terms to keep receiving the tax preference; include claw backs if they do not
4) Require all entities receiving tax preferences to submit an annual report, proving they remain in compliance. Where possible, make this data publicly available, and
5) Use more granular or specific codes for data on tax expenditure recipients in OTR's Integrated Tax System (ITS).[4]

❖ **January 2017: District of Columbia 2016 Tax Expenditure Review - Environment, Public Safety Transportation, and Tax Administration and Equity Provisions**

Environment: Tax expenditures are not a widely used policy tool in the environment area. The revenue loss due to categorical environment-related tax expenditures in fiscal year 2016 was less than $7 million, almost all due to a single tax expenditure providing a credit for trash pick up to condominium and cooperative housing owners that do not receive city provided trash collection.

[3] As noted in all our reports, summing tax expenditures does not consider possible interactions among specific tax expenditures, so it does not produce an exact estimate of the revenue that would be gained were any specific provision removed.

[4] A new Modernized Integrated Tax System (MITS) has been implemented since the Housing report was released, containing a property tax segment called Modernized Real Property Tax System (MRPTS) which replaced ITS.

Environment Recommendations:

1) We recommended that the District Department of Energy and Environment (DOEE) promulgate the regulations necessary to implement some inactive tax provisions, so that taxpayers may take advantage of the incentives.

Public Safety: Tax expenditures are not a widely used policy tool in public safety. The revenue loss due to categorical public safety-related tax expenditures in fiscal year 2016 was just under $4 million, all due to a property tax exemption for the land on which the DC Department of Corrections houses all its female and juvenile prisoners as well as some male prisoners who are a medium-security risk or lower.

Transportation: Similarly, tax expenditures are not widely used as a policy tool in transportation. Roughly $13 million in forgone revenue in fiscal year 2016 was due to transportation-related tax expenditure provisions, including a tax exemption for property owned by the Washington Metropolitan Area Transit Authority and a personal property tax exemption for motor vehicles and trailers owned by District residents.

Tax Administration and Equity: The total revenue forgone due to tax administration and equity tax expenditures was roughly $84 million in fiscal year 2016. Most of these tax expenditures exist to assist with the administration of tax laws in particular circumstances, as well as to prevent double taxation on certain firms for purposes of providing equity. The two tax expenditures in this section with forgone revenue prevent double taxation of public utilities and telecommunications providers.

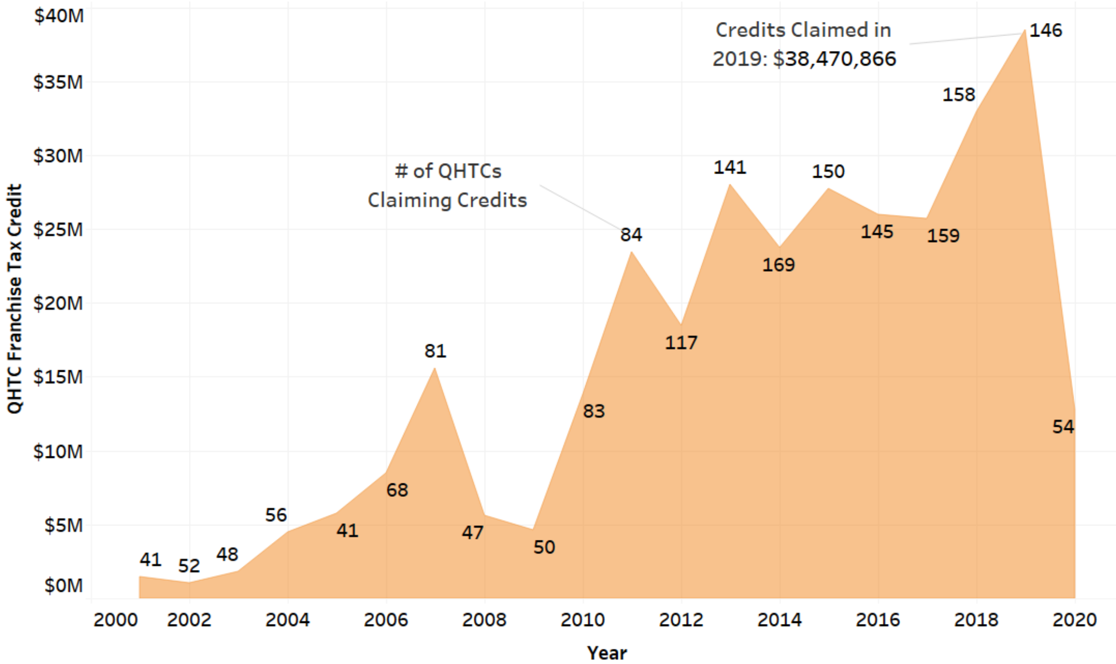
❖ November 2018: Review of Economic Development Tax Expenditures

The categorical tax provisions related to economic development totaled about $53 million in forgone revenue in fiscal year 2017 and generally supported: 1) attracting and retaining high technology businesses in DC, 2) attracting and retaining supermarkets in DC, and 3) encouraging private capital investment in new or expanding small businesses in DC. The Qualified High Technology Company (QHTC) program represents the largest dollar amount of revenue forgone of all District economic development tax incentives (from 2001 to 2015, the District QHTC corporate franchise tax expenditures represented $184 million in forgone revenue[5]), and thus a significant portion of the report is dedicated to evaluating this incentive.

Chart 2 below shows the total amount of QHTC franchise tax credits claimed by year, with the number of companies claiming credits each year labeled. Below that, Chart 3 illustrates that a small number of companies claimed most of the credits across the first 15 years of the credits.

[5] Including data from 2016 – 2020 brings the total revenue forgone to $320 million.

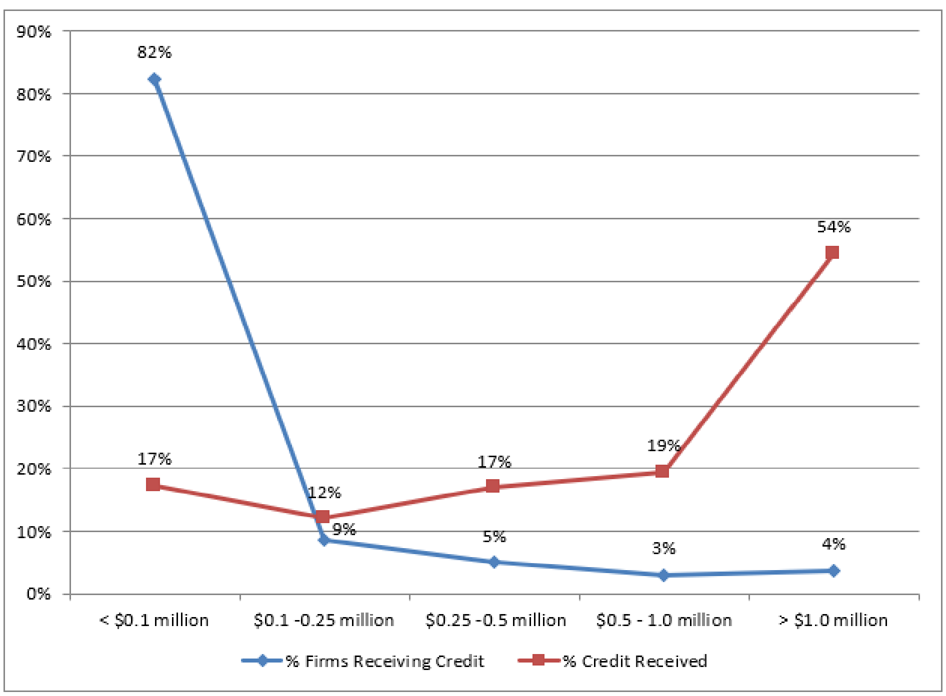
Chart 2: Total QHTC Corporate Franchise Tax Credit Amounts



Source: ORA. Note data updated to 2020 for current report. Labels on chart represent # of QHTCs claiming credits while shading of the area chart indicates dollar amount of credits claimed (with $ on y-axis).

Chart 3: QHTC Credit Distribution by # of Firms Taking Credit, and $ Amount of Credit Received, Average from 2001 - 2015

Chart shows majority (82%) of recipients received less than 20% of credits while small portion of companies (4%) received over half of the total credits



Source: ORA Analysis of D.C. Franchise tax data.

Eight individual, or specific, tax provisions are covered in this report and represent an estimated forgone revenue of $4.2 million in fiscal year 2017. These provisions make up only seven percent of total revenue forgone in this area for that year. Tax incentives for Audi Field Soccer Stadium comprised about 73 percent of the total forgone revenue for individual economic development tax provisions. At the time the report was released, future tax abatements to The Advisory Board Company and The Line Hotel were projected to represent over $100 million in forgone revenue. However, both tax abatements changed and neither have represented the full amount initially expected.

<u>QHTC-specific Recommendations:</u>

1) Better target incentives by requiring firms to engage in new economic activity to receive tax benefits. Further, to better target high technology companies rather than large firms that may have both technology and other activities, consider requiring that more than 51 percent of firm's DC business activities constitute QHTC activities, or only allowing tax credits to apply to income derived from QHTC activities. Consider revisiting the definition of a high technology company to ensure that the QHTC law as written in 2001 adequately takes changes in technology into account and continues to meet the economic development and tax policy goals of the District.
2) Cap the total amount of tax benefits that may be granted, or that a single company may receive. Consider placing limits that preclude very large companies from continuing to take QHTC benefits unless they can be tied to commensurate benefits to the District. If credits had been limited to either $100,000 or $250,000 per firm in 2015, most QHTCs would have continued to receive the same amount of credits under either scenario.
3) Implement a claw back provision that would require a firm to pay back some credits received if it leaves the District within a certain number of years.
4) Continue to support OTR monitoring and enforcement activities, as well as new data collection efforts that are already underway. Consider having specific auditors assigned to QHTCs and require all QHTCs to be audited after five years.
5) Develop a verifiable standard to use for determining a company's QHTC eligibility to ensure that firms that do not meet the legal criteria are not wrongly taking the incentives.
6) Improve the transparency of the incentives by allowing company names and credit amounts received to be public.

This report also recommended that to promote effectiveness and accountability, all future District Tax incentives should:

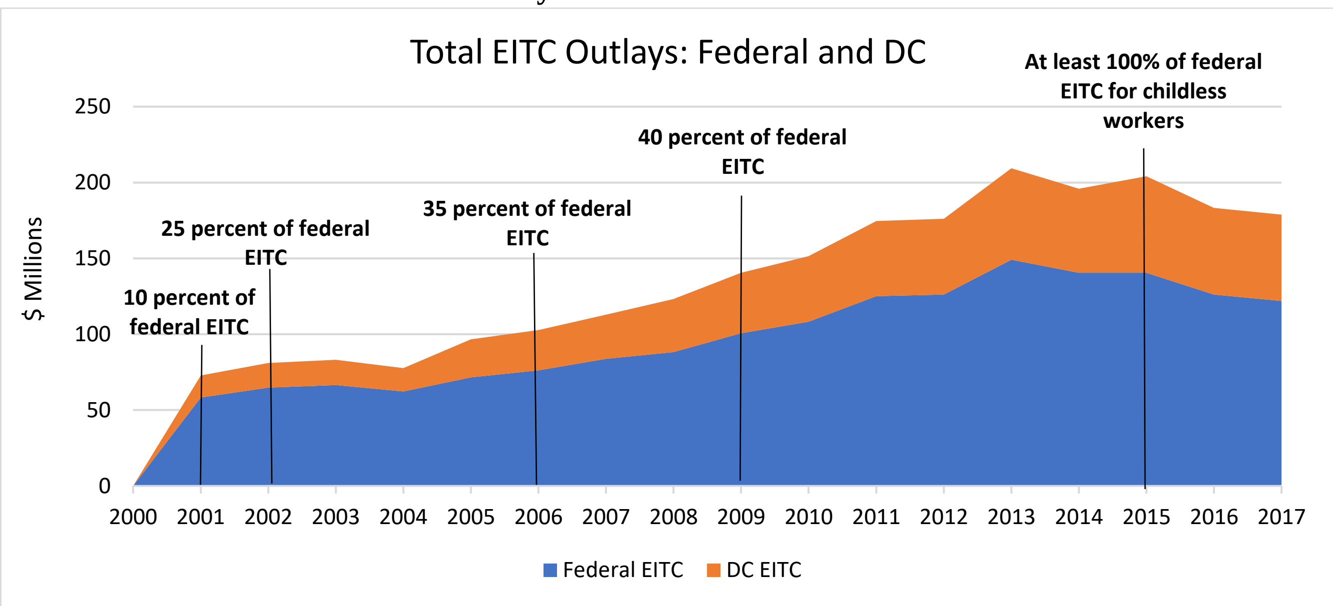
7) Be assigned an administering agency from the beginning, with the authority and the mandate to track, monitor, and report on incentives.
8) Contain a clear structure for data collection, reporting, and monitoring/evaluation from the beginning of the incentives.
9) Be simple to understand and administer for both taxpayers and tax administrators.
10) Be more transparent and publicly reported.
11) Be better targeted, and not given to companies or entities to do what they were already doing, rather new activity should be undertaken to receive the incentive.
12) Include financial limits or caps to protect the District's fiscal resources.

13) Contain claw back provisions so that if a company receiving tax incentives does not comply with the terms of its tax benefits or leaves DC within a certain amount of time, it will have to repay the District what it received.

❖ **August 2021: Review of Income Security and Social Policy Tax Expenditures**

Income Security: Income security tax expenditures are narrowly focused on directly protecting low-income residents, as well as those who are most at risk of becoming adversely affected by loss of income in any number of ways; they totaled $89.8 million in fiscal year 2020. The DC Earned Income Tax (EITC) is the largest of these provisions, both in terms of revenue forgone and numbers of recipients. In this period, an estimated 57,692 Washingtonians claimed about $51 million in earned income tax credits. Chart 4 below shows Total federal and DC EITC outlays from 2000 to 2017, with major EITC policy changes labeled in the timeline.[6]

Chart 4: Total Federal and DC EITC by Year with DC EITC Effective Amendment Dates



Source: ORA. Note: The data labels refer to the years the DC EITC changes became effective.

Social Policy: Generally, tax preferences for social policy make up the largest category of DC's spending through the tax code. A common thread among the tax expenditures with a social policy purpose is that, with a few exceptions, most are for nonprofit organizations. Many nonprofit organizations provide services that may relieve the burden of governments if they would otherwise need to provide those services. The total estimated revenue forgone for all 23 categorical social policy tax expenditures in fiscal year 2020 was almost $363 million.

[6] Changes to the EITC have been made since this report was released and are summarized in Appendix 2.

Income Security and Social Policy Recommendations:

1) Reduce the marriage penalty that exists for married childless workers by extending the DC EITC income eligibility limit for married workers without children.
2) Consider passing legislation to penalize fraudulent tax return preparers. The District could provide more resources to non-profit organizations to raise awareness about the DC EITC and highlight IRS regulated tax preparers that taxpayers can use to file individual income tax returns.
3) Continue to support OTR monitoring and enforcement activities by providing more resources to OTR Criminal Investigation Division for criminal investigation into fraudulent practices and ensuring more access to relevant data, especially federal data with tax preparers' electronic identification number, to properly perform their jobs.
4) Review the income tax subtraction for Social Security retirement benefits and consider limiting eligibility for taxpayers with higher incomes.
5) Review the possibility of a refund system that would provide more transparency and revenue certainty within the sales tax exemption for nonprofits organizations.

- **January 2022: Review of Health and Education Tax Expenditures**

Health: Overall, tax expenditures are not widely used as a policy tool in health care. There are five health-related categorical tax expenditures that represented over $18 million in forgone revenue in fiscal year 2020. These provisions generally support health care access; health care coverage equality; quality health care in underserved areas; lifesaving procedures (through organ and bone marrow donors); and exemptions for medical goods.

Education: There are seven categorical education-related tax expenditures that represented just under $140 million in forgone revenue in fiscal year 2020. These provisions support educational organizations like public charter schools or private universities that educate the public and provide other broad public services; taxpayers who are saving for college or trade school; and nonprofits that provide educational services.

Education recommendations:

1) Consider increasing the public-school teacher expenses income tax subtraction limit for out-of-pocket classroom supplies costs based on an analysis showing that in 2018 a DC public-school teacher spent on average $527 more than what could be reimbursed.

Impacts of the Evaluation Process

Internal Impacts within the OCFO

Undertaking a new evaluation process improved the collaborative environment already in place within the OCFO and provided new opportunities for colleagues in both ORA, OTR and the OGC to gain a better understanding of each other's roles and perspectives.

The release of the first evaluation report on housing tax expenditures pointed to improvements that could be made within property tax data systems in OTR. Subsequently, OTR and ORA conducted a series of meetings about property tax data during which all parties left with a better understanding of the limitations of the data system and current data organization. Further, the report served to foster a broader awareness of how ORA analyzed property tax data on tax expenditure recipients.

OTR recently rolled out phase two of the broader Modernized Integrated Tax System (MITS), which is the Modernized Real Property Tax System (MRPTS). Along with the many other improvements to tax data management and improved functionality for analysis, MITS/MRPTS improves upon data storage and promises to allow for better tracking for tax expenditure administration. One feature of the new system requested by ORA based on our experience tracking property tax expenditures for evaluations was the addition of data identifying the DC Code granting the specific tax relief for new tax expenditure provisions, as well as the ability to track items such as the forms filed for the public charter school property tax rebate. ORA staff recently received access to the system and look forward to having data from MRPTS to enhance our analysis in future reviews.

Over the course of the first cycle, collaboration with OTR colleagues and information exchange increased, both regarding property tax expenditure data as well as corporate franchise (income) tax data related to our review of the QHTC tax incentives. OTR gave ORA access to original franchise tax documents which allowed for more thorough research than could be done solely with the data that is captured electronically and saved into a single data extract for research purposes. This process led to ORA staff working on the evaluations having an opportunity to request that additional information on tax forms be captured and stored in MITS. Further, many OTR staff, as well as staff from the Office of General Counsel (OGC), offered their time and expertise related to QHTC provisions and data over multiple years of researching the program. During the process, ORA has not only requested data of OTR, but is now able to provide information/data analysis that may assist OTR and OGC colleagues in their work as well, such as recommending expired or unused tax expenditure provisions for repeal.

External Impacts

In the years since the first tax expenditure review was released, the team at the Pew Charitable Trusts' tracking state and city tax incentive evaluations has written about the District's tax expenditure reporting efforts,[7] and ORA's economic development review was cited in local media outlets[8] and commended by an expert on economic development incentives.[9] Further, ORA researchers were invited to speak at multiple conferences about the experience of starting a tax

[7] Reports from the Pew Charitable Trusts citing DC: https://www.pewtrusts.org/en/research-and-analysis/articles/2019/03/11/tax-incentive-review-in-washington-dc-offers-insights-recommendations; https://www.pewtrusts.org/-/media/assets/2017/05/edti_how_states_are_improving_tax_incentives_for_jobs_and_growth.pdf; https://www.pewtrusts.org/en/about/news-room/press-releases-and-statements/2017/05/03/pew-states-make-progress-in-evaluating-tax-incentives.

[8] https://wamu.org/story/18/12/03/d-c-gives-tech-companies-millions-of-dollars-in-tax-breaks-are-they-worth-it/; https://www.washingtoncitypaper.com/news/city-desk/article/21035027/district-line-daily-give-em-a-break; https://dcist.com/story/18/12/03/tech-companies-get-big-tax-breaks-to-come-to-the-district-is-the-city-benefiting/; https://wamu.org/story/19/05/27/tax-incentives-for-d-c-tech-companies-poised-to-be-slashed/; https://dcist.com/story/20/07/07/in-last-minute-budget-scramble-d-c-council-to-consider-tax-increases-to-pay-for-housing-and-homeless-services/

[9] https://smartincentives.org/tech-incentive-evaluation-prompts-program-changes/

expenditure evaluation process from scratch, how to present descriptive tax expenditure data in a useful way, as well as to discuss the impacts of the tax expenditure reviews.[10] ORA was also invited to have a representative join the inaugural Pew Evaluators Network Advisory Group, which convened in June of 2019 and consists of five members from across the country.

After the publication of the *2018 Review of Economic Development Tax Expenditures*, the findings and recommendations in the report were cited as the rationale for changes the DC Council passed in 2019 to amend the QHTC tax incentives.[11] Further, ORA's report was again cited as the basis for continued changes to the QHTC incentives in 2020.[12]

Issues with Data Access and Availability a Major Theme in First Tax Expenditure Review Cycle

A common finding in our reviews was a lack of data that would allow a full evaluation of a tax expenditure. The reviews we publish are only as good as the data that go into them. While there is often no shortage of administrative and descriptive tax data to sort through, we also uncovered certain areas where data shortages and issues abound.

As part of our biennial tax expenditure reporting, ORA already produces estimates of the revenue forgone from tax expenditures, using actual tax data to make projections where possible. However, for certain tax expenditures, such as economic development-related incentives, data beyond the effect on tax liability is needed to evaluate the incentives. For example, information about new hires that resulted from tax incentives or increased business activity would allow for more in-depth analysis to measure the effectiveness of the incentives.

Examples from two major tax expenditure provisions covered in the Economic Development Tax Expenditure Review – the Qualified High Technology Company (QHTC) tax credits and the Certified Capital Investment by Insurance Companies (CAPCO) program – highlight issues uncovered with data collection requirements and management/architecture. Across both these programs there was voluntary participation among recipients to share data related to economic impacts of the tax incentives with District agencies, and the agencies had no recourse if companies did not willingly submit information.

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[10] ORA staff have presented about the tax expenditure evaluation process at various conferences, including multiple Pew-National Conference of State Legislatures (NCSL) Tax Incentive Evaluators Roundtables, the Eastern Economic Association conference, the Federation of Tax Administrators' Revenue Estimation and Research conference, the Association for Budgeting and Financial Management, a convening of the American Tax Policy Institute on tax expenditures, and a George Washington Center for Washington Area Studies/Pew convening to discuss DC metro area economic development tax incentives.

[11] Downloading Lost Revenues Amendment Act of 2019, https://lims.dccouncil.us/downloads/LIMS/42120/Other/B23-0209-Amendments42.pdf These changes included: reducing the wage credit amount; limiting the wage credit carryforward to credits based on employees hired before Oct. 1, 2019; capping the maximum credit a QHTC could use against their tax liability to $250,000 per tax year; limiting the reduced tax QHTC corporate tax rate of 6 percent from "in perpetuity" to 5 taxable years; and repealing the sales tax exemptions.

[12] Councilmember Brianne Nadeau's mention of ORA's report on twitter in 2020. Changes included increasing the number of qualified employees required for eligible QHTCs from 2 to 10; repealing employee relocation incentives; reducing the credit for retraining costs for qualified disadvantaged employees; and repealing the carry forward for the retraining credit as well as the credit for wages paid to qualified disadvantaged employees.

Under the QHTC program, tax forms requested some data from companies filing their taxes as a QHTC, however neither OTR nor ORA were tasked with collecting or analyzing this data (before the evaluation requirement) and therefore OTR was not capturing these lines of data electronically until over a decade into the program. Further, because the information was not being tracked for a particular purpose, OTR typically did not analyze paper tax forms to look for the information nor follow up with a company that did not submit it.

With the implementation of MITS which required QHTCs to e-certify beginning in 2019, OTR now requires that companies submit the required information before claiming the tax credits.[13] This marks a positive step in the process of holding companies' accountable for the tax incentives they claim; however, a next step in the process may be setting up outside verification procedures to corroborate self-reported data given that what companies report is not always consistent or complete within a single tax form, raising questions about the information provided.

The CAPCO legislation provided the DC Department of Insurance and Banking (DISB) with the authority to obtain information from CAPCOs to conduct an annual economic impact analysis. However, a DISB official noted that it did not have regulatory authority over the businesses that received funding from the CAPCOs and was unable to force compliance from the businesses and get the full data that would be necessary for a more thorough evaluation.

Further, up until 2020, there was no central database for most District property tax expenditures, and this research often required finding the individual in OTR responsible for managing data related to a specific tax preference and asking them for data which may or may not have been stored or aggregated in a way to facilitate a multi-year evaluation. With both property and franchise tax incentives, we learned that the data and information collected and stored for administering a tax benefit are generally not the full data needed to do an evaluation. Therefore, planning for evaluation at the very beginning of the life of a tax preference is critical for evaluating it later when it is a mature program. As previously noted, various improvements are being made with new tax data systems. However, there can be long lead times for transitioning to new data systems and it may be some time before we can confirm the systems are set up to produce the tax expenditure data we need.

While data and information sharing within the OCFO has improved since the beginning of this work (see internal impact above), we had mixed success with obtaining access to data from other agencies even with a legislative mandate for agencies to cooperate with our reviews and supply needed data.[14] Several external agencies responded to data and information requests and were very helpful for our reviews. While DISB faced challenges obtaining data from tax expenditure recipients, the agency was very responsive to ORA when we requested information on the now closed CAPCO program. DISB officials met with us in person, were willing to share data and information that helped us understand the history of the program, and reviewed copies of our write up of the program. Similarly, various officials within the office of the Deputy Mayor for Planning

[13] There are still issues with data voluntarily submitted on tax forms as it is unverified and often unclear or incorrect, such as when credits claimed exceed tax liability, making summarizing and analyzing the data difficult.
[14] DC Law 20-155 "Fiscal Year 2015 Budget Support Act of 2014"; sec. 7143 sub-sec. (h). See Appendix 1 for full text.

and Economic Development (DMPED) have met with us in person multiple times throughout our first review process and have continued to share data and information when requested.

However, ORA did encounter challenges obtaining data held by the Department of Housing and Community Development (DHCD). For our Housing Tax Expenditure Review, we did not receive access to key housing data which would have facilitated an evaluation of various affordable housing related-property tax abatements. Ideally, in this situation, the ORA team would request needed data each year, even when we are focused on a different policy area, in hopes of eventually getting the data. However, a lack of resources precluded us from taking on this additional data collection activity. As we begin to review Housing tax expenditures for the second cycle of reports, ORA has met with DHCD officials; we look forward to collaborating to determine data availability.

First Source Data

Another type of data that ORA has sought and not obtained during the review process involves information related to tax expenditure recipients' adherence to the District's First Source Agreement. The law behind the First Source Program[15] requires the mayor to include for every government-assisted project or contract totaling $300,000 or more a requirement that the beneficiary enter into a First Source Agreement with the District of Columbia.[16] The Department of Employment Services (DOES) notes that the First Source Employment Program is an important part of the District's strategy to provide job opportunities and reduce unemployment among District residents.

In ORA's reviews of some tax expenditures with First Source Agreements, acquiring compliance data on projects with employment agreements from DOES have been unsuccessful. At the time of the request, a DOES official noted that this data was confidential and could not be shared. ORA learned that other colleagues within the District government seeking such information were similarly unsuccessful. While a potential fix for this issue could be an inter-agency database that can be accessed with proper clearance, more research is needed on this topic and ORA will continue efforts to obtain First Source-related information for tax expenditure recipients.

In addition to encountering a lack of data, collecting, and analyzing data that is available is time intensive and can be an iterative process. New findings at one stage of the process may lead to the need to go back and collect more information from a previously reviewed data source. Creating new data sets of information gleaned from original tax forms can be difficult and requires interpreting complex tax laws. Further, analyzing large datasets of tax data requires advanced data analysis and graphics skills.[17]

[15] D.C. Official Code § 2-219.03

[16] The same section goes on to lay out the 48 required provisions needed for submission by the program participants to DOES. The law also states DOES must create and maintain a First Source Register that consists of names of unemployed District residents registered with DOES to be a source of labor for First Source Program participants.

[17] The time required for data collection and analysis is extensive. When a new requirement is passed it increases the workload and thus more personnel resources are needed. ORA's analysis is limited by the resources available.

Overall, our experience seeking data from within the OCFO and across other agencies led us to recommend that when new tax expenditures are created, a specific office should be tasked with ensuring needed data is requested from relevant entities, collected regularly, and stored in an accessible way. If no one is tasked with administering a tax expenditure (such as the QHTC), data needed to evaluate it may not be collected or stored in an accessible way for future evaluation.

Improvements are already underway. In recent years new tax exemptions have often required the mayor to certify recipients to OTR before tax benefits can be given. For example, since our 2018 report on Economic Development Tax Expenditures, the East End Tax Exemption Act is now in effect and as eligible retail and supermarkets apply for tax exemptions, the Deputy Mayor for Planning and Economic Development (DMPED) has been charged with certifying the businesses to OTR. As part of our ongoing evaluation process, we will continue to monitor developments and improvements on this front for this and other tax expenditures.

Looking forward

Now that we have released a first round of reports cataloguing all local tax expenditures in DC, we plan to streamline future evaluation reports to be produced annually with current resources, while continuing to deliver high-quality and relevant analysis for policymakers and the public. We will consider producing expedited reviews versus deep dives or presenting only a subset of the TEs in a policy area to focus on a few key tax expenditures. In fact, the legislative mandate for the reports gives the leeway to determine that not all on-cycle preferences merit a full review. The mandate notes that determining which preferences to include for such a 'summary' review should consider the amount of revenue loss, number of claimants, recent changes in revenue loss, recent proposals for repeal, and lastly whether the tax expenditure is included in the Home Rule Act.

As we move into the second round of evaluating the District's tax expenditures, ORA looks forward to continuing our work analyzing and reviewing tax expenditures and providing data and analyses to District officials to help ensure accountability and effectiveness of the District's fiscal resources.

Appendix

Appendix 1: Legislative Requirement

Subtitle N. Tax Transparency and Effectiveness

Sec. 7141. Short title. This subtitle may be cited as the "Tax Transparency and Effectiveness Emergency Act of 2014."

Sec. 7142. Definitions.

For the purposes of this subtitle, the term:

(1) "Categorical preference" means a tax preference that sets eligibility criteria and is potentially available to all entities that meet the criteria, subject to any funding limitations.

(2) "CFO" means the Chief Financial Officer of the District of Columbia.

(3) "Economic development purpose" means a goal to increase or retain business activity, including attracting new businesses or retaining existing ones, encouraging business expansion or investment, increasing or maintaining hiring, or increasing sales.

(4) "Individual preference" means a tax preference, such as a tax abatement, applied to one entity, project, or associated projects.

(5) "On-cycle tax preference" means a tax preference being reviewed in a current year.

(6) "Tax preference" shall have the same meaning as the phrase "tax expenditures" as defined in section 47-318(6) of the District of Columbia Official Code.

Sec. 7143. Tax preference review.

(a) The CFO shall review all locally adopted tax expenditures on a 5-year cycle and publish annually a report complying with the requirements of this section.

(b) By October 1, 2015, and by October 1 of every year thereafter, the CFO shall submit for publication in the District of Columbia Register a report for on-cycle tax preferences that complies with the requirements of this section.

(d) An on-cycle individual preference shall be analyzed and reported in the following manner:

(1) An individual preference shall be analyzed and reported in groupings of similarly purposed preferences, with the report focusing on collective effects or trends that emerge.

(2) The report shall include the stated purpose of the of tax preferences within the grouping, if clarified in the authorizing legislation. (3) The report shall include the amount of lost revenue due to the tax preferences within the grouping.

(4) The report shall include an assessment of the general effects on the District resulting from the preferences.

(5) The report on groupings of individual preferences shall include recommendations on how to improve similar preferences in the future.

(6) For groupings of individual tax preferences with an economic development purpose, the analysis shall consider the economic impact of the preferences, and where sufficient data are available, take into account factors including:

A) Whether the economic impact of the tax preferences would have been expected without the preferences;

(B) The extent to which the economic impact of the tax preferences was offset by economic losses elsewhere;

(C) The average economic impact for a level of direct expenditures equal to the cost of the tax preferences;

(D) The indirect economic impact of the tax preferences;

(E) The number of jobs created by the preference;

(F) The wages of the jobs created;

(G) The percentage of jobs filled by District residents; and

(H) Whether any terms of the tax preferences have been or are being satisfied.

(e) Except as provided in subsection (f) of this section, on-cycle categorical preferences shall receive a full review that, where sufficient data are available, includes:

(1) The purpose of the tax preference, if clarified in the authorizing legislation;

(2)The tax preference's cost in terms of lost revenue;

(3) An assessment of whether the tax preference is meeting its goals;

(4) An assessment of whether the tax preference is achieving other goals; (5) Recommendations for improving the effectiveness of the tax preference; (6) Recommendations for whether the tax preference should be modified, discontinued, or remain in its existent state; and (7) For tax preferences with an economic development purpose, an analysis that measures the economic impact of the preference, including:

(A) Whether the economic impact of the tax preference would have been expected without the preference;

(B) The extent to which the economic impact of the tax preference was offset by economic losses elsewhere;

(C) The average economic impact for a level of direct expenditures equal to the cost of the tax preference; and

(D) The indirect economic impact effect of the tax preference.

(f) For on-cycle categorical tax preferences that the CFO determines do not merit a full review, the CFO shall instead perform a summary review. In determining which tax preferences are appropriate for a summary review, the CFO shall consider factors including, at a minimum:

(1) The revenue lost due to the tax preference and the number of potential or actual claimants;

(2) Whether the revenue lost due to the preference has increased or decreased since the preference was last reviewed;

(3) Whether the preference has been included in legislative or administrative proposals to modify or repeal; and

(4) Whether the preference is required by the District of Columbia Home Rule Act, approved December 24, 1973 (87 Stat. 774; DC Official Code §1-201.01 et seq.).

(g) A report on a categorical preference designated for summary review shall include:

(1) A narrative summary of the preference, including its purpose;

(2) The source and year of statutory authorization;

(3) The fiscal impact of the preference; and

(4) A description of the beneficiaries of the tax preference.

(h) All District agencies, offices, and instrumentalities shall cooperate with the CFO and shall provide any records, information, data, and data analysis needed to complete the reviews and reports required by this section.[18]

[18] http://lims.dccouncil.us/Download/32103/B20-0849-Enrollment.pdf

Appendix 2: Changes to Individual and Business Taxes Since Tax Expenditure Evaluation Began

The Tax Expenditure Evaluation requirement was passed soon after the District of Columbia's Tax Revision Commission wrapped up at the end of 2013, thus the first tax expenditure review cycle took place concurrently with various tax policy changes, many of which resulted from the Commission's recommendations.

Individual Income Tax Changes:

- The tax rate on income between $40,000 and $60,000 was reduced, and a new tax bracket was added with a lower rate for income between $350,000 and $1,000,000. Further, limitations were placed on allowable itemized deductions for higher income earners
- The Schedule H property tax credit administered through the income tax for lower income renters and homeowners has been increased and eligibility for the credit has expanded

Major Business Tax Changes:

- Between 2014 to 2019 the corporate and unincorporated franchise tax rates gradually decreased incrementally from 9.975 percent to 8.25 percent
- In 2019, the commercial real property tax rate on properties with assessed values greater than $10 million increased to $1.89 per $100 of assessed value

Major Tax Expenditure Policy Changes:

- The District's EITC was expanded to include low-income workers without children, and more recently was expanded to include a 70 percent match of the federal credit in 2022, up to a 100 percent match in 2026.
- In 2019, changes were made to the QHTC credit which limited the reduced corporate franchise tax rate of six percent for QHTCs to five years instead of in perpetuity, and a cap of $250,000 was placed on the credit amount that could be taken in a year.
    - Further, the wage credits were scaled back, and carryforwards were limited, while the exemption of certain sales and technology purchases was repealed.
    - The following year, in 2020, the QHTC law was further amended to remove the preferential six percent corporate franchise tax rate altogether, while also increasing the required number of qualified employees from 2 to 10.
- The law offering supermarket tax incentive credits (through the real property, sales, and personal property taxes) was amended in 2021 to allow the Mayor to expand the investment areas eligible for supermarkets incentives based on several factors. All new supermarkets in the program must meet new requirements, including that
    - they be in an historically underutilized business zone;
    - all new supermarkets as well as those currently receiving incentives must accept Supplemental Nutrition Assistance Program (SNAP) benefits, apply to accept the Special Supplemental Nutrition Program for Women Infants and Children (WIC) benefits; and
    - conduct community listening sessions on the store's offerings and operations.