

PUBLIC ROUNDTABLE ON
BILL 16-555, “HISTORIC NEIGHBORHOOD RETAIL
BUSINESS PROPERTY TAX RELIEF ACT OF 2005”

Before the
Committee on Finance and Revenue
Council of the District of Columbia

The Honorable Jack Evans, Chairman

January 25, 2006, 11:00 a.m.
Room 412, John A. Wilson Building



Testimony of
Matthew Braman
Director of Operations
Office of Tax and Revenue

Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia

Good morning, Chairman Evans and members of the Committee on Finance and Revenue. I am Matthew Braman, Director of Operations for the Office of Tax and Revenue (OTR). I am pleased to present testimony today on Bill 16-555, the “Historic Neighborhood Retail Business Property Tax Relief Act of 2005.”

Bill 16-555 provides certain real property owners of small, longtime District qualifying businesses in neighborhood historic districts with a 50% real property tax credit. In order for a commercial retail entity to qualify for this relief under Bill 16-555, the entity must satisfy three criteria. First, the entity must be a preferred retail or personal consumer-related business, or an arts uses or arts-related retail and support uses business, as these terms are defined in the District’s Municipal Regulations. Second, the property on which the entity is located must be either a historic landmark or a contributing building in a historic district, as defined under D.C. Official Code § 6-1102(5). Third, the entity must be a business that is independently owned, operated and controlled; must have been continuously owned and occupied by the same business for at least 20 years in a neighborhood outside of the downtown area; must have annual gross receipts not exceeding \$5 million; and must have received from the District a cumulative annual increase of 100% or more in the final assessed value of its property, which increase is attributable to both the current real property tax year and the immediately preceding real property tax year.

Under Bill 16-555, the owner of a qualifying business is eligible to receive a 50% property tax credit for one year, beginning with the next half of the real property tax year following the date the owner applied for the credit, as long as the property:

- Remains a “qualifying business”;
- Is not transferred for consideration to a new owner during the one-year period;
- Does not increase in value due to changes in zoning classification that was initiated or requested by the owner or anyone having an interest in the real property; and
- Does not have an assessment that was clearly erroneous due to an error in calculation or measurement of improvements on the real property.

Any owner who receives the credit and becomes ineligible during the one-year period is also required to reimburse the District by an amount equal to any tax credits received or deductions taken, on a pro rata basis. Furthermore, a property owner who receives this credit who has leased a qualifying business to a merchant (requiring tax increases to be passed through as rent) must compute any rent increases only after deducting any tax credits allowed under this bill.

Tax credits under Bill 16-555 are provided only to those real property owners who are certified. In order to be certified, the owner must submit an application and proof of ownership on or before October 1st of the taxable year.

We have reviewed Bill 16-555. We believe that this bill has serious technical deficiencies that will create multiple administrative problems. We, therefore, recommend that the committee work with the Office of the Chief Financial Officer

to rectify these problems. In the event the committee elects to proceed with the bill as currently drafted, we have a number of comments, which follow.

First, the language of the bill is confusing because it provides a real property tax credit to a “qualifying business.” The District’s system of real property taxation rests on assessment of real property, not a business. A business will pay the real property tax but only if it owns the property.

Second, it is unclear whether a qualifying business owner could receive more than one credit if the assessed value of his property increased again by at least 100%. Thus, it appears possible, under the current language of Bill 16-555 that a property owner could apply for this credit more than once.

Third, there is a terminology problem in Section 3, because the bill refers to a “commercial retail entity” that has been owned and occupied by the same business. Generally speaking, it is the entity or person, such as partnership or LLC, that owns the business, and not the other way around. Section 3(C) also refers to “small business.” The reference to “small business” does not appear anywhere else in the statute and appears to be unnecessary. We recommend deleting the term “small business.”

Fourth, Bill 16-555 fails to define the term “independently owned, operated, and controlled.” The Council needs to define this term so that we can properly administer the law. This definition is particularly important in considering which types of ownership structures qualify for this tax credit. What is meant by “owned”? Are we required to look through the corporate structure to underlying shareholder interests? Should there be a “controlling interest” test? How do we

evaluate family-run businesses? If a father sold his business to his son, is the ownership sufficiently continuous to qualify for the credit?

Moreover, the bill fails to define the term “independently,” which is the key to evaluating the many franchise operations throughout the District. For example, if a McDonald’s outlet is a locally-owned franchise and otherwise meets all the other requirements of Bill 16-555, did you intend that it qualify for the credit?

Fifth, under Section 3(C), it appears that in order to qualify for the tax credit, the business must have been “continuously owned and occupied by the same business for at least 20 years in a neighborhood outside the Downtown area.” This requirement is confusing. Do the drafters intend that the business must be owned by the same owner? Or does the credit still apply, even if the business remains, but is sold to a subsequent owner or owners? Must a business be in the same location, or could the business have re-located from, say, Capitol Hill to Eckington and still qualify for the credit? Furthermore, the bill does not define the term, “Downtown area,” which may mean different things to different people. We recommend the term “Downtown area” be defined to avoid possible administrative problems.

Sixth, OTR does not currently have an administrative system in place to determine whether an entity meets a specific element of the “qualifying business” test. Specifically, OTR also lacks the resources and internal program structure to determine if an entity has been continuously owned and occupied by the same business continuously for 20 years or more. An applicant should be required to obtain certification of this element of the “qualifying business” test from the Department of Consumer and Regulatory Affairs (DCRA) or some other appropriate agency. OTR would also require additional auditing capacity and

expertise in order to audit businesses once they have been certified for the credit, to ensure proper monitoring and accountability.

Seventh, under Section 3(C)(iv), an owner of a qualifying business must receive at least a 100% cumulative increase in the final assessed value of his or her property in the current and prior real property tax years to qualify for the credit. The statute should be amended to clarify that the 100% increase is a 100% increase over the final assessed value for the real property tax year that immediately preceded the two-year period of measurement referred to above.

Please note that since the 100% increase is measured over a two-year period, if the taxpayer doesn't qualify for the credit, it is unclear whether the increase is then measured over the current year and following year, or whether every two-year period is discrete and must be measured without consideration of the tax of the subject property over prior two-year period. For example, assume that the taxpayer doesn't meet the 100% increase requirement over the required two-year period which ends in 2006. It is unclear whether it was the intent of the drafters to allow the next measurement of the 100% increase to occur over the 2006-2007 two-year period, or to require that the next measurement occur over the 2007-2008 period. It is unclear under the certification provisions of Section 5 of Bill 16-555 whether the taxpayer can apply every two years for the credit. We believe the intention of the bill is to provide just a one-time credit, but this point should be clarified.

Finally, the bill is silent as to which District government agency is charged with certifying real property owners for this tax credit; presumably, it was intended that OTR administer this credit.

We have additional recommendations to this bill that we believe would improve its administration. First, the bill should require a taxpayer that is no longer a qualifying business to notify OTR within 90 days after it no longer qualifies, or be subject to penalty such as an amount equal to the tax credit for the prior year that the taxpayer received under this statute. Furthermore, since property owners may renovate or otherwise add value to their properties such that a supplemental assessment is necessary, we recommend that a new paragraph (E) be added to subsection 4(b) of Bill 16-555 (our proposed language is attached). Finally, we recommend a few additional minor technical corrections that are also included in our attachment.

OTR will have significant operational costs in administering this credit, for which we will need an appropriation. Specifically, given the certifications required by this bill, OTR's Real Property Tax Administration will need to coordinate with or review documents from the Departments of Zoning and the Historic Preservation Review Board, as well as other administrations within OTR. To that end, OTR's Real Property Tax Administration will need at least one additional first-line manager FTE to supervise the administration of this credit, plus one staff. In addition, computer reprogramming, new application forms publication, auditing and community outreach will be necessary to effectively implement this new credit. OTR estimates these costs to be \$400,000 for the first year of implementation, and \$250,000 for each year thereafter.

If the Council elects not to follow our recommendation to require that DCRA or some other agency help certify completion of the "qualifying business" test, we will have to re-evaluate our costs and provide a new estimate of costs based on a

different verification process that includes the certification that DCRA or another agency would otherwise have provided. We will incur substantial additional costs to do such certification.

Fiscal Impact of Bill 16-555

We are unable to estimate the final fiscal impact of the bill at this time, but our research so far identifies about 70 commercial properties that: (1) are preferred retail or personal consumer related business or an arts uses or an arts-related uses business; (2) are a historic landmark or a contributing building in a historic district; and (3) have received from the District a cumulative annual increase of 100% or more in the final assessed value of its property in the current real property tax year and the immediately preceding year. More research is required to determine how many of these properties are also independently owned, have been continuously owned and occupied by the same business for at least 20 years, and have an annual gross receipts tax of \$5 million or less. We estimate that granting the tax credit to the properties identified so far would generate a revenue loss of about \$1 million in FY 2006.

Thank you, Chairman Evans, for the opportunity to comment on this bill. I would be happy to answer any questions you or other councilmembers might have at this time.

Appendix

Proposed Technical Corrections to Bill 16-555

1. Delete “a” on line 2 of Section 3 and insert it before “Preferred” in Section 3(A), before “Historic” in Section 3(B), and before “Small in Section 3(C).
2. Before “contributing building” in Section 3(B), insert the phrase, “Located in or on”.
3. Delete the phrase “Small business that:” in subsection 3(C) and substitute the language in paragraph 3(C)(i) as new subsection 3(C).
4. Re-designate paragraphs 3(C)(ii), (iii) and (iv) as new subsections 3(D), (E) and (F).
5. In subsection (a)(1) of Section 4, after the phrase, “a 50% property tax credit for 1 year,” insert the phrase, “for the real property on which the qualifying business is located,”.
6. Delete “and” in 4(C) and insert “and” after “Property” in 4(D). Add the following sub-paragraph (E) to subsection 4(b) to read as follows: “(E) value was not increased due to a supplemental assessment, as defined in § 47-829.”
5. In subsection (3) of Section 5, after the phrase “October 1st of the taxable year,” and before the phrase “, or as otherwise determined by regulations”, add the phrase “for which the owner seeks the credit described in Section 4”.