

**ORAL TESTIMONY
OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION
REGARDING PRESIDENT CLINTON'S TAX PROPOSALS
FOR THE DISTRICT OF COLUMBIA**

**FOR A HEARING OF
THE SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA
OF THE HOUSE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
105TH CONGRESS
ON
MAY 22, 1997**

**PRESENTED
BY
KENNETH J. KIES
CHIEF OF STAFF
JOINT COMMITTEE ON TAXATION
U.S. CONGRESS**

JCX-16-97

INTRODUCTION

My name is Ken Kies. I am Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the staff of the Joint Committee on Taxation at this hearing concerning the Administration's proposed tax and nontax initiatives to revitalize the District's economy.

I will briefly describe the Administration's tax proposals and will discuss certain issues raised by the proposals. I then will discuss the revenue analysis of the proposals prepared by the staff of the Joint Committee on Taxation.

DESCRIPTION OF THE PROPOSAL

The key features of the tax proposals are as follows:

- The proposal would establish a new District of Columbia Economic Development Corporation to develop and oversee a comprehensive economic development strategy for the District of Columbia.
- The proposal would provide four new tax incentives for businesses conducting business activities in the District of Columbia--a new employment credit and extension of the proposed welfare-to-work credit, additional section 179 expensing, expanded tax-exempt development bonds, and tax credits for certain equity investments in and loans to District businesses.
- The employment credit would provide employers a 40-percent credit on \$10,000 of first-year wages paid to employees who are District residents and who meet certain other requirements. Thus, the maximum credit would be \$4,000 per employee.
- The proposal also would extend the welfare-to-work credit proposed in the Administration's fiscal year 1998 budget for an additional two years with respect to

certain District residents.

- Qualified District businesses would be eligible to receive up to \$20,000 of additional expensing under Code section 179 for certain depreciable business property placed in service during the taxable year.
- Qualified District businesses also would be permitted to borrow proceeds from the issuance of a new category of tax-exempt, private activity bonds.
- The new Economic Development Corporation would be authorized to allocate \$95 million in tax credits to taxpayers that make certain equity investments in, or loans to, businesses conducting business activities in the District.
- Finally, the proposal would clarify and expand the District's authority to issue general revenue bonds.

My written testimony describes each of these proposals in detail. The tax incentives generally would be effective upon enactment, and would terminate December 31, 2002. The Economic Development Corporation would be required to terminate its affairs on or before September 10, 2010.

POLICY ANALYSIS

Effect on District Economy

It is generally acknowledged that the District faces two key problems--residents migrating from the District and insufficient economic development activity. The Administration's proposals directly address the second of these problems, but would not have a direct effect on stemming migration of District residents. In any event, the efficacy of tax incentives to address one or both problems is severely limited absent fundamental structural reform of the District's government and economy.

Compliance and Administrative Issues

The proposals would raise a number of compliance and administrative issues. These arise primarily because slightly differing residency and work-location tests apply to determine a taxpayer's eligibility for each tax incentive. For example, for an employer to claim the proposed employment credit with respect to an employee, three tests must be satisfied--the residence test, the work-location test, and an income test. To satisfy the residence test, the employee must live in the District throughout the first year of employment. If the employee moves out of the District at any point during the year, no credit would be available with respect to that employee. To satisfy the income test, the employee must either be a member of a targeted group for purposes of the work opportunity tax credit, or the employee must live in a census tract in the District that has a poverty rate of 15 percent or more and reasonably expect to be paid less than \$28,500. Finally, to satisfy the work-location test, substantially all of the services provided by the employee must be in the District or the employer's principal place of business must be located in the District.

Every one of these tests requires extensive recordkeeping and verification procedures throughout the period the credit is earned. The difficulties inherent in collecting and maintaining necessary information to ascertain credit eligibility mean that there is a high probability of noncompliance--intentional, as well as unintentional. Similar complexity and compliance issues arise with respect to each of the other proposed tax incentives, all of which incorporate slightly different requirements with respect to employee residency or the location of business activities. In addition, because the complex eligibility tests are not based on one-time determinations, but rather must be satisfied over a period of time, business owners would have to speculate at the time the employment or investment decision is made whether they would be able to claim the

special tax incentives at the end of the year. The combination of high compliance costs and uncertainty associated with the residency and work location requirements significantly limits the incentive effects of the proposals.

Potential Constitutional Issue

The provision of special tax treatment to certain District business activities would raise a potential constitutional issue. Pursuant to the Constitution, Congress has broad powers to impose taxes. However, the Uniformity Clause requires that taxes "be uniform throughout the United States." The Uniformity Clause operates to prevent Congress from exercising the power to tax with the purpose of providing undue preferences for one region of the country over other regions. It is clear from the case law that the Uniformity Clause applies to the District.

Under the Uniformity Clause, if a tax provision is framed in geographic terms, a court will examine the classification closely to determine if there is actual geographic discrimination. In anticipation of a Uniformity Clause challenge, a clear record would have to be made that Congress determined that the preferential tax treatment for District business activities is necessary to address specific unique circumstances existing with respect to the District. The more detailed the record is on these issues, and the stronger the required nexus between the tax incentives and high poverty rate census tracts, the more likely a court is to give deference to the judgment of Congress in enacting such legislation.

REVENUE ANALYSIS

The staff of the Joint Committee estimates that the tax proposals would reduce Federal budget receipts by just over \$300 million in the ten-year budget period from fiscal year 1998 to fiscal year 2007. The proposed tax incentives attempt to encourage the start-up and retention of business in the District of Columbia, and the hiring of lower-income District residents. In

general, the proposed incentives are sufficiently modest in scope so that it is not anticipated that they will result in a major increase in the growth of the economy of the District metropolitan area as a whole. However, concentrated allocation of the capital incentives by the Economic Development Corporation could result in significant revitalization of targeted areas within the District. In addition, the removal of current obstacles that inhibit the District's ability to issue debt and the creation of a new category of private activity bonds should enable the District to make substantial use of its private activity bond volume cap within four or five years. These private activity bonds will provide a cheaper source of funds for both "start-ups" and business expansions within the District, as will the start-up capital generated by the tax credits. Finally, the revenue estimate also assumes that there is likely to be some confusion about the exact boundaries of eligible areas, the residency of particular employees, and the work-location requirements, that will result in some ineligible businesses claiming the expensing and/or wage credits.

CONCLUSION

The issues that I have touched on this morning are discussed in more detail in my written testimony. I would be happy to answer any questions.