

**WRITTEN 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-15-97**

**May 22, 1997**

## CONTENTS

	<u>Page</u>
I. INTRODUCTION .....	1
II. DESCRIPTION OF PROPOSAL .....	2
A. Summary of Key Features .....	2
B. Description of the Proposal .....	2
III. DISCUSSION OF ISSUES .....	11
A. Compliance and Administrative Issues .....	11
B. Application of the Uniformity Clause .....	14
IV. REVENUE ANALYSIS .....	18
V. REVENUE TABLE .....	20

## I. INTRODUCTION

This document<sup>1</sup> represents the written testimony of the staff of the Joint Committee on Taxation at a hearing held on May 22, 1997, by the Subcommittee on the District of Columbia of the House Committee on Government Reform and Oversight concerning the tax proposals relating to the District of Columbia initially referenced in President Clinton's fiscal year 1998 budget.

The General Explanation of the Administration's Revenue Proposals prepared by the Department of Treasury states that tax incentives are proposed "to encourage employment of disadvantaged residents and to revitalize those areas of the District of Columbia where development has been inadequate."<sup>2</sup> However, the details of such tax proposals were not available at the time the Administration originally submitted its fiscal year 1998 budget to the Congress. The Administration subsequently has provided details of its proposed tax incentives for the District of Columbia as part of its National Capital Revitalization and Self-Government Improvement Plan.

This testimony describes the Administration tax-related proposals and discusses certain issues raised by the proposals. These include compliance and administrative issues, residency issues, and federalism and other issues. Finally, it discusses the revenue analysis of the proposals prepared by the staff of the Joint Committee on Taxation, and reviews certain behavioral and other assumptions underlying the revenue estimate.

---

<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Written Testimony of the Staff of the Joint Committee on Taxation Regarding President Clinton's Tax Proposals for the District of Columbia*" (JCX-15-97), May 22, 1997.

<sup>2</sup> *General Explanation of the Administration's Revenue Proposals*, Department of Treasury, February, 1997, page 31.

## II. DESCRIPTION OF PROPOSAL

### A. Summary of Key Features

- 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 of Columbia 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 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 would be permitted to borrow proceeds from the issuance of a new category of tax-exempt, private activity bonds.
- The District of Columbia 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 of Columbia.
- The proposal would clarify and expand the District of Columbia's authority to issue general revenue bonds.

### B. Description of the Proposal

In general, the proposal establishes a new District of Columbia Economic Development Corporation charged with developing a comprehensive economic development strategy for the District of Columbia. The proposal also provides four new Federal tax incentives to encourage economic development in the District of Columbia. In addition, the proposal clarifies and expands the District of Columbia's authority to issue revenue bonds. The following briefly describes the powers and duties of the Economic Development Corporation, and outlines the

new Federal tax incentives and the District's expanded revenue bond authority.

### **District of Columbia Economic Development Corporation**

The proposal would establish a new "District of Columbia Economic Development Corporation." The Economic Development Corporation ("EDC") would be an instrumentality of the District government for Federal income tax purposes, and thus would be eligible to receive tax-deductible charitable contributions.

The powers of the EDC would be vested in a board of directors consisting of nine voting members. Five directors would be appointed by the President of the United States, in consultation with the Congress. The five directors would be required to maintain a primary residence in the District or have a primary place of business in the District, and such directors could not otherwise be employees of the District government or of the Federal government. Of the five directors appointed by the President, four directors would be selected from the for-profit business community and one director would be selected from "community-based organizations." One of the five directors selected by the President would be designated as chair of the board. One director would be selected by the Mayor from the for-profit business community or from community-based organizations.<sup>3</sup> The remaining three members of the board of directors would be *ex officio* members, and would include one member chosen by the President from certain Federal agencies, the Mayor or a designee, and the Chairman of the District Council or a designee. The members of the board of directors generally would serve six-year terms.

The EDC would be directed to review and evaluate existing economic development plans for the District, and then to establish a comprehensive strategic plan for carrying out economic development in the District of Columbia. In furtherance of this directive, the EDC would be authorized to provide financial assistance for economic development projects. Such financial assistance would include making loans, extensions of credit, equity investments, or grants; leasing or conveying of land; allocating tax credits for qualified equity investments and loan; issuing tax-exempt private activity bonds; and issuing project revenue bonds for any economic development project approved by the EDC. The total amount of financial assistance provided would be limited to the capital of the EDC (which would include a Federal appropriation of \$50 million for fiscal year 1998) and the value of the land of the EDC. Generally, no one person or project could receive financial assistance valued at more than 15 percent of the total capital and land of the EDC. However, no such limits (aggregate or individual) would apply to tax credits, loans funded from the proceeds of tax-exempt economic development bonds or project revenue obligations, which are subject to separate limits described below. The EDC would be required to provide the lesser of \$20 million or 40 percent of the amount appropriated directly to non-profit organizations (or to nonprofit intermediary organizations) to promote and finance job training,

---

<sup>3</sup> This director also would be required to maintain a primary residence in the District of Columbia, have a principal place of business in the District, and could not otherwise be an officer or employee of the District government or of the Federal government.

placement and related activities for certain targeted residents of the District of Columbia.<sup>4</sup>

In reviewing applications for financial assistance, the EDC would be directed to consider certain factors, including (1) the likelihood the project can be expected to create or retain private sector jobs in the District of Columbia; (2) the contribution of the project to the economy of the District of Columbia; (3) whether the project will serve the interests of the community where it is located; (4) whether the project is located in a distressed area (generally defined as a population census tract with a poverty rate of at least 15 percent); (5) whether the project is consistent with the comprehensive strategic plan developed by the EDC; and (6) whether the project will improve links between the economy of the District of Columbia and the surrounding region. In general, with respect to any project, the EDC would be intended to act as the funding source of last resort, and would commit no more than the minimum capital necessary.

The EDC would have the authority to issue project revenue bonds, including refunding obligations, and to use the proceeds to provide financial assistance to economic development projects in the District. Such bonds would not be obligations of the District of Columbia or of the Federal government, but would be special obligations of the EDC, payable solely from the revenues, assets and property of the economic development project for which the financial assistance is provided. The EDC would not be authorized to issue general obligation bonds and the amount of any project revenue bonds would be excluded from the amount of general obligation bonds the District of Columbia is permitted to issue. In addition, the EDC would have power to acquire and assemble land through condemnation in the name of the District of Columbia (referred to as the "power of eminent domain") to carry out its economic development purposes. The EDC would not have the power to tax or to pledge, encumber or otherwise place a lien on District tax revenues.

The EDC would not be permitted to enter into any commitment to provide new financial assistance or to issue any new project revenue bonds after September 30, 2007. The EDC generally would be required to terminate its affairs on or before September 30, 2010, at which time its assets would be liquidated or transferred to another entity selected by the District Council. If the EDC has not terminated its affairs by September 30, 2010, the Mayor of the District of Columbia would have the responsibility to terminate the EDC and would succeed to all of its power, assets, duties and liabilities in order to effect that termination.

---

<sup>4</sup> For these purposes, "targeted residents" would mean individuals whose principal place of abode is in the District and who either (1) are members of a targeted group for purposes of the work opportunity tax credit (see footnote 6 for list of targeted groups) or (2) live in a population census tract with a poverty rate of at least 15 percent and have an annual income of less than \$28,500. Because nonprofit organizations that are tax-exempt cannot utilize the employment or welfare-to-work credits described below, amounts appropriated under this provision could provide an analogous subsidy to encourage the hiring of disadvantaged District residents.

## **New Tax Incentives**

The proposal would provide four new tax incentives for businesses located or conducting business activities in the District of Columbia--an employment credit and extended District welfare-to-work credit, additional expensing under Code section 179, expanded tax-exempt development bonds, and tax credits for certain equity investments in and loans to District of Columbia businesses.

### **District of Columbia employment credit; extension of welfare-to-work credit**

The proposal would provide employers a 40-percent credit on the first \$10,000 of eligible wages paid to qualified District employees during the employee's first year of employment with the employer. Thus, the maximum credit would be \$4,000 per employee.

An individual would be a "qualified District employee" only if he or she satisfies three tests--a residence test, a work-location test, and an income test. To meet the residence test, an individual must be certified by a designated agency as having a principal place of abode in the District of Columbia.<sup>5</sup> The work-location test would be satisfied if either (1) substantially all of the services provided by the employee for the employer during the year are in the District of Columbia or (2) the employer's principal place of business is located in the District of Columbia. Finally, the income test would be satisfied if either (1) the employee is a member of one of the work opportunity tax credit ("WOTC") targeted groups (including the new food stamp recipient group proposed in the President's fiscal year 1998 budget<sup>6</sup>) or (2) the employee lives in a population census tract that has a poverty rate of 15 percent or more<sup>7</sup> and the employer

---

<sup>5</sup> This residence test must be satisfied throughout the one-year period during which the wage credit is earned. Thus, if an individual establishes a new principal place of abode outside of the District at any time during that one-year period, then the individual would not satisfy the residence test.

<sup>6</sup> For purposes of the present-law WOTC, targeted groups include: (1) members of families receiving assistance (AFDC or successor program); (2) qualified ex-felons; (3) high-risk youth 18-24 years old who reside in an empowerment zone or enterprise community; (4) vocational rehabilitation referrals; (5) qualified summer youth employees 16 or 17 years old who reside in an empowerment zone or enterprise community; (6) qualified veterans; (7) qualified food stamp recipients who are 18 to 24 years old. The President's fiscal year 1998 budget would extend the WOTC for an additional year through September 30, 1998, and would add a new recipient group that includes adults who are 18-50 years old and are subject to the time limits for food stamp receipt under the Administration's proposals (but who have not become ineligible by refusing to work or failing to comply with the work requirements). This new group would be eligible for a 12-month period beginning on the date the time limit is reached.

<sup>7</sup> As with the residence test, the individual must live in such a census tract throughout the one-year period during which the employment credit is earned.

reasonably expects to pay the employee compensation of not more than \$28,500 during the employee's first year of employment. The proposal also would provide that certain employees would not be qualified District employees, including persons related to the employer, prior employees who are fired and rehired, employees who are employed for fewer than 180 days or have completed fewer than 400 hours of service for the employer, and individuals employed by certain businesses (i.e., private and commercial golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetrack or other facility used for gambling, or any liquor store).

Eligible wages would include cash wages, as well as amounts paid by the employer for the following: (1) educational assistance excludable from income under Code section 127 (or that would be excludable but for the expiration of section 127); (2) health plan coverage for the employee, but not more than the applicable premium defined under Code section 4980B(f)(4); and (3) dependent care assistance excludable from income under Code section 129.<sup>8</sup>

An employer's District of Columbia employment credit would be reduced to the extent that the employer claims the WOTC and the proposed welfare-to-work credit for any of the same wages paid to qualified District employees.

The proposal would be effective for wages paid to qualified employees hired after the date of enactment and before October 1, 2002.

#### Extension of welfare-to-work credit for certain D.C. residents

The President's fiscal year 1998 budget includes a new welfare-to-work credit. The proposal would provide employers a 50-percent credit on the first \$10,000 of eligible wages<sup>9</sup> paid to qualified long-term family assistance (AFDC or its successor program) recipients<sup>10</sup> for both the first and second years of employment. Thus, the maximum credit each year would be \$5,000 per qualified employee. The proposed welfare-to-work credit would be effective for individuals hired from the date of enactment through September 30, 2000.

---

<sup>8</sup> Under the proposal, it is not clear if this definition of "wages" also applies for purposes of determining whether an employee's "compensation" exceeds \$28,500.

<sup>9</sup> The definition of eligible wages would be the same as for the employment credit, described above.

<sup>10</sup> Qualified long-term family assistance recipients would mean any individual who is certified by the designated local agency as being a member of a family that: (1) has received family assistance for at least 18 consecutive months ending on the hiring date; (2) has received family assistance for a total of at least 18 months (whether or not consecutive) after the date of enactment of this credit if the individual is hired within 2 years after the date that the 18-month total is reached; and (3) is no longer eligible for family assistance because of either Federal or State time limits, if the individual is hired within 2 years after the Federal or State time limits made the family ineligible for family assistance.



The District of Columbia proposal would extend the proposed welfare-to-work credit for an additional two years, from September 30, 2000, to September 30, 2002, with respect to certain residents of the District. To qualify for the extended credit, a qualified long-term family assistance (AFDC or its successor program) recipient's principal place of abode must be in the District during the two years of employment on which the credit is claimed<sup>11</sup> and either substantially all of the services performed by the employee must be performed in the District of Columbia or the employer's principal place of business must be located in the District.

#### **Additional section 179 expensing**

Qualified District businesses would be eligible to receive up to \$20,000 of additional expensing under Code section 179 for qualified District property placed in service during the taxable year. Thus, for 1998, qualified District businesses would be allowed to expense up to \$38,500 of the cost of certain business equipment and machinery.

The allowable amount that could be expensed under the proposal would be reduced by \$.50 for each \$1.00 of investment over \$400,000. Thus, for 1998, the \$38,500 maximum expensing amount allowed under the proposal would be phased out for businesses with investment between \$400,000 and \$477,000.

#### **"Qualified District business"**

A "qualified District business" generally would be required to satisfy a two-part test. First, the business would be required to have a significant portion of its activities in census tracts within the District that have a poverty rate of 15 percent or more. Second, the business would be required to satisfy certain of the criteria of an "enterprise zone business" under Code section 1397B.<sup>12</sup> Thus, a qualified District business would be a corporation or partnership (or proprietorship) that has a significant portion of its activities in census tracts in the District with poverty rates of 15 percent or more if, for the taxable year: (1) at least 80 percent of the total gross income is derived from the active conduct of a "qualified business" within the District; (2) substantially all of the business's tangible property is used within the District; (3) substantially all of the business's intangible property is used in, and exclusively related to, the active conduct of such business; (4) substantially all of the services performed by employees are performed

---

<sup>11</sup> In contrast to the employment credit which requires residency throughout the year of employment on which the credit is claimed, the extended welfare-to-work credit requires residency during the two-year employment period. It is assumed that the requirements are intended to be parallel, and require an individual to maintain a principal place of abode in the District throughout the applicable period.

<sup>12</sup> However, qualified District businesses that are corporations or partnerships would not be subject to the requirement that the sole trade or business of the corporation or partnership be the active conduct of a qualified business within the District.

within the District; (5) at least 35 percent of the employees are residents of the District; and (6) no more than five percent of the average of the aggregate unadjusted bases of the property owned by the business is attributable to certain financial property or collectibles not held primarily for sale to customers in the ordinary course of an active trade or business.<sup>13</sup>

A "qualified business" is defined under present-law section 1397B as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license.<sup>14</sup> In addition, the leasing of real property that is located within the District to others would be treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from qualified District businesses. The rental of tangible personal property to others would not be a qualified business unless substantially all of the rental of such property is by qualified District businesses or by residents of the District.

#### "Qualified District property"

Qualified District property would be defined to mean any property that would constitute qualified zone property under present law section 1397C, with certain modifications. Thus, qualified District property would be depreciable property acquired by the taxpayer by purchase after the date of enactment, substantially all of the use of which is in the active conduct of a

---

<sup>13</sup> The President's fiscal year 1998 budget also contains a proposal to modify section 1397B so that rather than requiring that "substantially all" tangible and intangible property (and employee services) of an enterprise zone business be used (and performed) within a designated zone or community, a "substantial portion" of tangible and intangible property (and employee services) of an enterprise zone business would be required to be used (and performed) within a designated zone or community. Moreover, the proposal would further amend the section 1397B rule governing intangible assets so that a substantial portion of an entity's intangible property must be used in the active conduct of a qualified business within a zone or community, but there will be no need (as under present law) to determine whether the use of such assets is "exclusively related to" such business. However, the present-law rule of section 1397B(d)(4) would continue to apply, such that a "qualified business" would not include any trade or business consisting predominantly of the development or holding of intangibles for sale or license. The proposal also would clarify that an enterprise zone business that leases to others commercial property within a zone or community may rely on a lessee's certification that the lessee is an enterprise zone business. Finally, the proposal would provide that the rental to others of tangible personal property shall be treated as a qualified business if and only if at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of a zone or community (rather than the present-law requirement that "substantially all" tangible personal property rentals of an enterprise zone business satisfy this test).

<sup>14</sup> Also, a qualified business does not include certain facilities described in section 144(c)(6)(B) (e.g., massage parlor, hot tub facility, or liquor store) or certain large farms.

qualified District business. Property that is substantially renovated could constitute qualified District property if, during any 24-month period after the date of enactment, additions to basis with respect to the property exceed the greater of (1) an amount equal to 15 percent of the adjusted basis of the property in the hands of the taxpayer at the commencement of the 24-month period, or (2) \$5,000.

The additional expensing would be available for property placed in service after December 31, 1997, and before January 1, 2003.

### **Tax-exempt economic development bonds**

A qualified District business (defined above) would be permitted to borrow proceeds from the issuance of a new category of tax-exempt, private activity bonds. The proceeds from such bonds could be used to finance certain business property, including commercial and retail facilities as well as the land underlying such facilities. The aggregate amount of outstanding bond proceeds that could be borrowed by any qualified District business could not exceed \$15 million.

The bonds would be subject to the District's present-law, annual \$150 million private activity bond volume cap. The EDC (described above) would have authority to allocate \$75 million of the District's annual private activity bond volume cap (i.e., 50 percent of the District's annual \$150 million private activity bond volume cap).

The special tax-exempt bond provisions would apply to bonds issued after the date of enactment and prior to January 1, 2003.

### **Tax credits for equity investments in and loans to businesses located in the District of Columbia**

The EDC (described above) would be authorized to allocate \$95 million in tax credits to taxpayers that make certain equity investments in, or loans to, businesses (either corporations or partnerships) engaged in a trade or business in the District. Such credits would be nonrefundable and could be used to offset a taxpayer's alternative minimum tax (AMT) liability.

Under the proposal, the amount of credit could not exceed 25 percent of the amount invested (or loaned) by the taxpayer. Thus, the EDC could allocate the full \$95 million in tax credits to no less than \$380 million in equity investments in, or loans, to District businesses. The EDC would allocate the credits pursuant to criteria established by the EDC itself. Such criteria would include, among numerous factors, whether the project is located in a distressed area (defined as a census tract with a poverty rate of at least 15 percent) or benefits the residents of a distressed area.

Under the proposal, credits could be allocated to loans made to District businesses only if the business uses the loan proceeds to purchase depreciable tangible property and any

functionally related and subordinate land. Any credits allocated to a taxpayer making an equity investment would be subject to recapture if the equity interest is disposed of by the taxpayer within five years.

The credits could be allocated by the EDC for equity investments or loans made during the period January 1, 1998, through December 31, 2002. However, taxpayers would not be allowed to claim any unused credits in a taxable year that ends after December 31, 2002.<sup>15</sup>

### **Clarification and expansion of District's authority to issue revenue bonds**

The proposal would modify Federal law (other than Federal tax laws contained in the Internal Revenue Code) to expand the District's authority to issue revenue bonds. Specifically, the proposal would authorize the District government to approve the issuance of taxable and tax-exempt revenue bonds to finance, refinance, or reimburse the costs of certain facilities not covered by existing revenue bond authority. These facilities would be: (1) sports, convention, tourism, hospitality and entertainment facilities; (2) manufacturing facilities; (3) industrial and commercial development facilities; (4) facilities to house and equip operation of the District government or its instrumentalities; (5) public infrastructure development and redevelopment; (6) elementary and secondary education facilities; (7) solid and hazardous waste disposal facilities; (8) parking facilities; (9) any other project that will, as determined by the District Council, contribute to the health, safety, welfare, the creation or preservation of jobs, or the economic development of the District of Columbia or its residents; and (10) any facilities or real or personal property used in connection with or supplementing any of the foregoing.

In addition, the proposal would clarify the District of Columbia's authority to provide security and insurance for revenue bonds, and would expand the District's authority to delegate to any instrumentality of the District government the authority to issue taxable or tax-exempt revenue bonds, to borrow money, and to provide insurance for any authorized purpose. Finally, the proposal would exclude the amount of any revenue bonds issued by the District of Columbia or instrumentality thereof from the limitations on the amount of general obligation bonds that the District of Columbia is authorized to issue.

---

<sup>15</sup> As a general business credit, the credit could be carried back three years (but not before the date of enactment) and forward for fifteen years, subject to the limitation that no credit could be claimed in a taxable year ending after December 31, 2002.

### III. DISCUSSION OF ISSUES

#### A. Compliance and Administrative Issues

The Administration's proposed tax incentives for the District of Columbia would raise a number of compliance and administrative issues. Individuals and corporate taxpayers claiming the proposed employment credit or the special District welfare-to-work credit, additional expensing under Code section 179, or tax credit for certain equity investments or loans (or some combination of such tax incentives) would be subject to special tax rules in computing their Federal income tax liability.<sup>16</sup> In addition to the increased complexity in calculating tax due, or any refund, on the taxpayer's annual return, determining the appropriate withholding or estimated tax payments could also be more complicated for taxpayers who may claim one or more of the proposed special tax incentives, assuming that the taxpayer attempts to adjust withholding or estimated tax payments in order to receive the maximum economic value of the tax incentives. However, such increased complexity could be viewed as a justifiable tradeoff for the benefits flowing from the tax incentives.

Complexity also arises under the proposal because different tests for qualifying businesses and eligible employees apply for purposes of the different District of Columbia tax incentives proposed by the Administration. While these differing tests may be designed to further different policy objectives, such as targeting benefits to particular groups, realization of those objectives could be undermined by deliberate as well as unintentional noncompliance with the differing tests for qualifying businesses and eligible employees.<sup>17</sup>

Employee residency tests.--The proposed employment credit and special District welfare-to-work credit, additional section 179 expensing, and tax-exempt financing benefits would not be available with respect to all employees who live or work, or businesses located, in the District. For example, the employment credit could be claimed only with respect to a subset of employees (i.e., employees who not only reside in the District for the entire year the credit is earned, but also are members of a WOTC targeted group, or residents of a census tract with a high poverty rate with expected income of less than \$28,500). In contrast, the additional section 179 expensing and tax-exempt financing benefits would be available only if, with respect to a taxable

---

<sup>16</sup> The proposal to create a new category of tax-exempt, private activity bonds would, from the perspective of taxpayers who hold tax-exempt bonds, not add complexity to the present-law rules that allow taxpayers to exclude interest income on tax-exempt bonds from gross income.

<sup>17</sup> The proposal includes a requirement that the EDC engage an independent consulting firm to evaluate the efficacy of the new tax incentives as aids to the EDC in carrying out its purposes. Such evaluation would be performed in the fiscal years ending September 30, 2001, and 2005, and the EDC would report the results to the Mayor, the District Council, the District Control Board, the President, and the Congress.

year, the business had a "significant portion" of its activities in census tracts with high poverty rates and at least 35 percent of the employees of the business are residents of any census tract within the District (regardless of the poverty rate in the census tract). In order for these proposed tax incentives to have real incentive effects, a taxpayer would, at the time that a hiring or investment decision is made, have to speculate whether, by the end of the year, the required nexus to census tracts with high poverty rates will be satisfied.<sup>18</sup>

With respect to the proposed employment credit, the proposal requires that a qualified employee must be a District resident throughout the one-year period after the employee begins work for the employer. For the proposed special District welfare-to-work credit, an employee must be a District resident throughout the two-year period after the employee commences work. In addition, if the employee is not a member of a WOTC-targeted group, he or she must have his or her "principal place of abode" for the entire year within a population census tract in the District that has a poverty rate of 15 percent or more and expect to be paid less than \$28,500. Determining whether an employee's "principal place of abode" is within such a census tract for the entire one-year period would be difficult. A similar issue arises with respect to employees who are members of a WOTC-targeted group or with respect to whom a District welfare-to-work credit is claimed, although, for these purposes, the employee's "principal place of abode" can be anywhere within the District. An individual may have more than one place of abode, or could claim to reside with relatives or friends for some portion of the one-year (or two-year) period. The Administration's proposal specifically requires that, for each employee with respect to whom the employment credit or District welfare-to-work credit is claimed, the employer must obtain certification from a local designated agency that the employee's principal place of abode is within the District as a whole and, for employees who are not members of a WOTC-targeted group, within a high poverty rate census tract in the District. However, this certification would be obtained before (or shortly after) the time that an employee begins work for the employer and, thus, would not guarantee that the employee satisfies the residency test for the entire one-year (or two-year) period.

In addition, because the proposed employment credit would be available only during an employee's first year of employment with the employer, there would be an incentive for employers to fire existing employees (i.e., those who have worked for that employer for more than one year) and hire new employees (or even trade employees with other employers) and thereby claim the maximum \$4,000 credit with respect to the new employees. The Administration's proposal includes a rule to prevent rehiring of the same employee, but if the proposal were to be modified to prevent the "churning" of different employees to fill the same

---

<sup>18</sup> The nexus to a census tract with a high poverty rate would not be required when an employment credit is claimed with respect to an employee who is a member of a WOTC-targeted group. Nevertheless, even though that employee has been certified as being a WOTC-targeted group member at the start of his or her first year of service, eligibility for the credit could be lost if that employee moves out of the District at any time during the first year of service for that employer.

position, potentially complex anti-avoidance rules could be required.<sup>19</sup>

Business activity tests.--For purposes of the proposed employment credit and District welfare-to-work credit, the business activity itself carried out by the employee need not be conducted in a census tract with a high poverty rate. The business activity engaged in by the particular employee need not even be conducted anywhere within the District if the employer's principal place of business is located in the District. Still, the proposed employment credit and District welfare-to-work credit could raise compliance and administrative issues for businesses that do not have a principal place of business in the District because the proposal requires that, with respect to such a business, "substantially all" services performed by the employee must be performed within the District. For example, it is not clear how such a "substantially all" services test would be applied in the case of a property management company where some clients served by the particular employee are located outside the District but within the same metropolitan area.

With respect to the proposed additional expensing under Code section 179 and new category of tax-exempt, private activity bonds, only "qualified District businesses" would be eligible for such special tax incentives. A "qualified District business" would be required to have a "significant portion" of its activities in census tracts that have poverty rates of 15 percent or more. It is not clear how this "significant portion" test (which applies to particular census tracts) would be compared to the "substantially all" test (described above for the proposed employment credit and District welfare-to-work credit and which applies on a District-wide basis). Applying this "significant portion" test could be difficult, particularly in cases of businesses that do not have one fixed business location where most business activities are conducted. For example, would a taxpayer who stores repair equipment in a high poverty rate census tract satisfy the "significant portion" test if most or all of the repair work is performed at the location of clients who live outside the census tract? Even when this "significant portion" test is satisfied, a qualified District business must satisfy the additional requirement that at least 35 percent of its workforce be residents of the District (as well as certain criteria from Code section 1397B). In this regard, the residency test--in contrast to the proposed employment credit for employees who are not members of a WOTC-targeted group--is not tied to census tracts with high poverty rates, but rather is determined by looking at the District in its entirety. Nonetheless, similar problems of determining (and verifying) where each employee resides will arise, as discussed above. As a result, a taxpayer may not know until the end of a taxable year whether the "significant portion" test or 35-percent resident workforce test will be satisfied, even though the decision to invest in section 179 property or to utilize tax-exempt financing may have to be made at a much earlier time.

With respect to the proposed tax credits for equity investments in, and loans to,

---

<sup>19</sup> In contrast, the present-law employment credit available in empowerment zones under Code section 1396 is not limited to the first year of an employee's work for the employer and, thus, does not create an incentive to fire employees simply because they have completed more than one year of employment for an employer in the empowerment zone.

businesses engaged in trade or business activities in the District, taxpayers that wish to make an investment (or loan) and claim the credit would first have to obtain a credit allocation from the EDC. In contrast to the proposed additional expensing under Code section 179 and special tax-exempt bond financing, there is no requirement that the business that is allocated this special tax benefit be a "qualified District business." Thus, in theory, any business located anywhere in the District (and any investor located inside or outside the District) could seek an allocation from the EDC of tax credits to subsidize investment in such business. Applying for such a credit allocation (regardless of whether the application formally is submitted by the investor/lender or the business that will receive the funds) will result in transaction costs that will invariably lessen the value of the maximum 25 percent subsidy that could be allocated in the form of a tax credit to a particular investment. On its face, the Administration's proposal would allow the EDC to allocate tax credits (up to an aggregate amount of \$95 million) to any business located anywhere within the District. However, the proposal specifically provides that the EDC will allocate credits pursuant to criteria it establishes, including, among numerous other factors, "whether the project is in a distressed area or benefits the residents of a distressed areas." Thus, projects that are not targeted to particular distressed areas within the District, but rather are located in relatively affluent areas of the District, may be reluctant to incur the transaction costs of applying for a credit allocation if it is likely that other applicants will be judged more favorably by the EDC.

### **B. Application of the Uniformity Clause**

The provision of special tax treatment to certain business activities conducted in the District of Columbia as contemplated in the Administration proposals raises a potential constitutional issue. Because the proposals provide preferential tax treatment based on a geographic classification, it would be subject to potential challenge as a violation of the requirements of the Uniformity Clause of the United States Constitution.

Pursuant to the Constitution, Congress has broad powers to impose taxes. However, the power to tax is not without limits. In particular, the Uniformity Clause requires that taxes "be uniform throughout the United States."<sup>20</sup> The Uniformity Clause operates to prevent the Congress from exercising the power to tax with the purpose of providing undue preferences for one region of the country over other regions.<sup>21</sup>

The requirement of uniformity in taxes extends not only to the States, but also to the District of Columbia. In considering the application to the District of Columbia of Congress'

---

<sup>20</sup> Article I, section 8, clause 1.

<sup>21</sup> Although there historically has been some debate over the application of the Uniformity Clause in the case of income taxes, there is now a consensus that income taxes are within the scope of the Uniformity Clause. See Brushaber v. Union Pacific Railroad Co., 240 U.S. 1 (1916).



power to tax and the limiting requirement of uniformity, the Supreme Court noted that "the [D]istrict of Columbia . . . is not less within the United States, than Maryland or Pennsylvania...."<sup>22</sup> The Supreme Court revisited this issue in Downes v. Bidwell, 182 U.S. 244 (1901), a case involving the question of the application of the revenue clauses of the Constitution to the territories of the United States. In Downes, the Court cited with approval the earlier determination in Loughborough that the power to tax and the related requirement of uniformity are applicable to the District of Columbia, noting that such result is consistent with the fact that the District of Columbia had been part of the States of Virginia and Maryland: "[i]ndeed, it would have been a fanciful construction to hold that territory which had been once part of the United States ceased to be such by being ceded directly to the Federal government."<sup>23</sup>

In contrast to its application to the District of Columbia, the Uniformity Clause is not necessarily applicable to the U.S. territories. In the case of the territories, its application depends upon the status of the particular territory. The Supreme Court in Downes concluded that the Uniformity Clause is not applicable to those territories that are not explicitly incorporated into the United States.<sup>24</sup> On this basis, the Court held that the Uniformity Clause did not bar the imposition of duties on imports from Puerto Rico.<sup>25</sup> Because the Uniformity Clause is not applicable to the Commonwealth of Puerto Rico, the special tax provisions of present law for residents of, and corporations doing business in, Puerto Rico do not give rise to issues under the Uniformity Clause.

The Uniformity Clause does not require that a tax must have an equal or proportionate effect in every State and the District of Columbia. Rather, the Supreme Court has stated that "a tax is uniform when it operates with the same force and effect in every place where the subject of it is found."<sup>26</sup> Thus, the imposition of a tax on tobacco, for example, is not forbidden under the Uniformity Clause, notwithstanding the fact that tobacco is grown in some States but not in others. On the other hand, a tax that applies only to tobacco grown in a particular State would raise a potential issue under the Uniformity Clause.

Explicit geographic distinctions in Federal tax statutes are not necessarily invalid under the Uniformity Clause. In United States v. Ptasynski, the Supreme Court first considered the issue of whether the Uniformity Clause represents a *per se* prohibition on Congress defining the subject of a tax in geographic terms. In a unanimous opinion, the Court concluded that the

---

<sup>22</sup> Loughborough v. Blake, 18 U.S. 317, 319 (1820).

<sup>23</sup> Downes at 261.

<sup>24</sup> Downes at 286-7.

<sup>25</sup> Downes at 287.

<sup>26</sup> United States v. Ptasynski, 462 U.S. 74, 82 (1983) (quoting Head Money Cases, 112 U.S. 580, 594 (1884)).

Uniformity Clause does not prohibit Congress from fashioning legislation to address "geographically isolated problems."<sup>27</sup> If a tax provision is framed in geographic terms, the Court "will examine the classification closely to see if there is actual geographic discrimination."<sup>28</sup>

In Ptasynski, the Court considered whether the exemption from the crude oil windfall profits tax for certain Alaskan oil violated the Uniformity Clause. The Court concluded that the special treatment for Alaskan oil was justified based on neutral factors, citing the disproportionate costs and difficulties involved in oil extraction in the particular region.<sup>29</sup> The Court noted that there was no evidence that Congress intended to grant an undue preference to Alaska.<sup>30</sup> The exemption at issue applied not to all oil produced in Alaska, but only to a relatively small percentage of such oil; moreover, the exemption was not limited to Alaska, but applied also to oil produced in certain offshore territorial waters. In this regard, the Court stated that

[t]he exemption thus is not drawn on state political lines. Rather it reflects Congress' considered judgment that unique climatic and geographic conditions require that oil produced from this exempt area be treated as a separate class of oil.<sup>31</sup>

Like the windfall profits tax exemption at issue in Ptasynski, the preferential tax treatment that would be provided to certain business activities conducted in the District of Columbia under the Administration's proposal is couched in geographic terms. Accordingly, the provisions would be subject to scrutiny under the Uniformity Clause. The Uniformity Clause analysis with respect to the proposal would turn on whether the provision of special tax treatment to certain business activities conducted in the District could be justified on the basis of neutral factors. Because of the few judicial decisions in this area, the actual level of scrutiny a court would apply is not clear.<sup>32</sup> Indeed, it should be noted that no Federal tax statute has been

---

<sup>27</sup> Ptasynski at 83-84.

<sup>28</sup> Ptasynski at 85. In this regard, a commentator has suggested that "[b]y 'actual geographic discrimination,' the Court apparently had in mind a situation in which the geographic distinctions were intended simply to benefit one state or region at the expense of others (or to harm one state or region to the benefit of others), rather than to address 'geographically isolated problems.'" Zelenak, "Are Rifle Shot Transition Rules and Other Ad Hoc Tax Legislation Constitutional?", 44 *Tax Law Review* 563 (1989).

<sup>29</sup> Ptasynski at 85.

<sup>30</sup> Ptasynski at 85-86.

<sup>31</sup> Ptasynski at 78.

<sup>32</sup> For a discussion of the level of scrutiny to be applied in light of the decision in Ptasynski, see Zelenak, *supra*, at 590-591.

invalidated under the Uniformity Clause.

To varying degrees, the different tax incentives provided for by the Administration proposal would be tied to high-poverty rate census tracts or the employment of disadvantaged residents of the District. (This is not necessarily the case, however, with the proposed investment credits to be allocated by the EDC, although the EDC would be directed to consider, as one factor, whether the project seeking a credit allocation will benefit a distressed area.) In this regard, the Administration proposal resembles the special tax treatment provided for business activities in areas designated as empowerment zones or enterprise communities under legislation enacted in 1993. The designated empowerment zones and enterprise communities generally are composed of census tracts that satisfy specified poverty and other criteria. To date, the special tax treatment provided for empowerment zones and enterprise communities has not been challenged under the Uniformity Clause.

Providing special tax relief for business activities located in (or with a nexus to) census tracts with high poverty rates can be contrasted to other proposals that would provide an across-the-board income tax reduction for residents of the District.<sup>33</sup> Nonetheless, because the Administration proposal would provide special tax treatment for certain business activities defined in geographic terms, a clear record would have to be made that Congress determined that the preferential treatment to be accorded certain business activities in the District (and not to business activities with ties to similar census tracts located elsewhere) 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 nexus between special tax incentives and economically disadvantaged census tracts and residents, the more likely a court is to give deference to the judgment of Congress in enacting legislation providing preferential treatment for qualifying District business activities. Because the proposed tax incentives contained in the Administration's proposal use different residency and business location tests (with varying ties to high poverty rate census tracts), it is possible that one or more of the tax incentives provided by the Administration proposal could survive challenge under the Uniformity Clause, while one or more other tax incentives could be found by a court to be insufficiently targeted at geographically isolated problems.

---

<sup>33</sup> See H.R. 889, introduced by Ms. Norton on February 27, 1997.

#### IV. REVENUE ANALYSIS

The staff of the Joint Committee on Taxation estimates that the proposal would reduce fiscal year Federal budget receipts by just over \$300 million in the ten-year budget period from fiscal year 1998 to fiscal year 2007.

The staff estimates that these tax incentives will result in a loss of approximately \$300 million in Federal fiscal year budget receipts in the first five years. Because most of the tax incentives are available only during the first five years, the revenue loss in the second five years is minimal; the proposal in its entirety would lose approximately \$325 million over ten years.

The tax proposals attempt to provide incentives both for the start-up and retention of business in the District of Columbia, and for the hiring of lower-income District residents. Several provisions promote the use of tax-exempt financing to lower investment costs for private businesses that are deemed to be desirable additions to the District of Columbia economy, and more start-up capital will be made available by the tax credit for providing loans and equity capital to projects selected by the EDC. To the extent that businesses are generating positive cash flow, increased expensing under section 179 will provide an incentive for investment in equipment, while the wage credits for people who work anywhere in the District but who live only in certain parts of the District is likely to favor the hiring of certain District residents by local firms. In general, these tax provisions are modest enough in scope that it is not anticipated that they will result in a major increase in the growth of the economy of the District of Columbia metropolitan area as a whole, although concentrated allocation of the capital incentives by the EDC could result in significant revitalization of targeted areas within the District.

Currently, several restrictions in the laws governing the authority of the District of Columbia government to issue debt have inhibited the issuance of private activity bonds to provide financing within the District. The removal of these obstacles and the creation of a new category of private activity bond should enable the District to make substantial use of its private activity bond volume cap within four or five years after enactment of these changes. 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 proposed tax credits. These incentives have the potential to serve as a significant economic development tool. The Joint Committee staff's revenue estimate assumes that the EDC will allocate the full \$95 million of proposed investment tax credits by the end of the five-year allocation period, and that most of the credits would be allocated in the third and fourth years after the EDC is created.

The location-specific nature of the additional section 179 expensing and tax-exempt financing benefits should encourage more business development within the favored areas (i.e., census tracts with poverty rates of 15 percent or more) than outside such areas. The criterion that an eligible census tract is one with at least 15 percent poverty allows for the inclusion of some already thriving pockets within the favored areas. Thus, it is unclear whether the business-location tests would directly benefit those areas of the District of Columbia that are most in need of assistance, except to the extent that the overall District tax base is enhanced by tax-subsidized

projects. However, there is no guarantee that projects favored by these incentives would not have located elsewhere in the District of Columbia without the incentives. In fact, it is likely that a significant portion of them would fall into this category.

The Joint Committee staff's 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. For example, two otherwise identical businesses on opposite sides of a street bordering an eligible tract would face substantially different tax liabilities. Because they both have the same street and zip code in their addresses, it will be difficult for the Internal Revenue Service to monitor compliance with the business activity location and employee residency tests. This problem is not unique to the District of Columbia tax incentives; it exists with any sub-city location incentive.

The staff of the Joint Committee on Taxation is currently engaged in a study of the feasibility of including these macroeconomic effects in its revenue estimates. However, it is likely that any net economic growth and increased tax revenues resulting from the tax incentives would be quite small relative to the relocation effects of this proposal. The location-based nature of this proposal creates opportunities both for intensified economic development within the favored location in lieu of some other location. Therefore, increases in taxable income in the District of Columbia resulting from these behavioral responses would not be expected to be replicated in a nationwide application of this proposal.

**ESTIMATED REVENUE EFFECTS OF THE PRESIDENT'S TAX PROPOSALS FOR  
THE DISTRICT OF COLUMBIA**

**Fiscal Years 1998 - 2007**

*[Billions of Dollars]*

Provision	Effective	1998	1999	2000	2001	2002	1998-02	1998-07
<b>The President's Tax Proposals For The District of Columbia.....</b>	<b>DOE</b>	<b>[1]</b>	<b>-0.1</b>	<b>-0.1</b>	<b>-0.1</b>	<b>-0.1</b>	<b>-0.3</b>	<b>-0.3</b>

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column: DOE = date of enactment

[1] Loss of less than \$50 million.