PUBLIC HEARING ON BILL 17-549, "DISTRICT OF COLUMBIA POSSESSORY TAX STABILIZATION ACT OF 2007"

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

The Honorable Jack Evans, Chairman

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Room 412, John A. Wilson Building

Testimony of
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Good afternoon, Chairman Evans and members of the Committee on Finance and Revenue. I am Michael Cooper, Chief Counsel for the Office of Tax and Revenue ("OTR") of the Office of the Chief Financial Officer of the District of Columbia. I am pleased to present testimony today on Bill 17-0549, the "District of Columbia Possessory Interest Tax Stabilization Act of 2007."

The purpose of this bill is to freeze possessory interest assessments and taxes at their tax year 2007 levels for the following 3 tax years. This freeze is to take effect as of September 30, 2007. The bill further directs the Chief Financial Officer to conduct a study to analyze whether the possessory interest tax has resulted in inequitable and disproportionate increases in the amount of such assessments and taxes paid, whether the tax is paid by a few, or a broader base of, taxpayers, and to determine the number, identity and scope of entities potentially liable for the tax that have not been identified to OTR by the General Services Administration or any other responsible federal entity. This study is to be submitted to the Council before January 1, 2009.

We recommend that the bill not be passed for several reasons. First, freezing the tax at its tax year 2007 levels will result in clear revenue reductions to the General Fund in the amount of $2.3 million in tax year 2008 and $13.1 million over the four year period of tax year 2008-2011. Possessory interest tax billings for tax year 2007 amounted to approximately $5.3 million. Tax billings for tax year 2008 are expected to amount to $7.6 million, and billings can be expected to increase in each of the tax years that this bill would be in effect. Accordingly, this bill will cost the city substantial revenues over tax years 2008, 2009 and 2010. These increased taxes will come from several sources. It is expected that the assessed values for these possessory interests, which represent unique and valuable property rights, will grow faster than other real estate in the District. OTR also expects to continue working to identify additional holders of taxable possessory interests, thereby adding new taxpayers to the tax rolls. Currently, there are approximately 180 taxpayers on the possessory interest tax roll. OTR also will continue to develop better information on actual square footage used by holders of taxable interests, thereby improving the accuracy of the tax computation for existing possessory interest taxpayers.

Second, this bill, instead of correcting a perceived inequity, will initially create and exacerbate over time inequities in the District's real property tax

system. The Council enacted the possessory interest tax as part of the Tax Clarity Act of 2000 in order to close a loophole in the real property tax laws. The District can only impose real property tax on owners of land, and a substantial amount of the land in the District is not taxable because it is owned by the Federal Government, the District Government, or government entities. However, in many cases, the governmental owner leases portions of its real property to private parties that used the property to conduct a business or as a residence. These lessees derived many benefits from use of the real property, including a location in the District, government services, and the benefits and protections of District law, but neither paid nor bore the burden of real property taxes. These private businesses operate in competition with businesses that are located in taxable buildings, and the tax-exempt status of their business premises appear to be source of competitive advantage, in the form of lower rents, over businesses that operate in taxable buildings. It was for these reasons that the Council determined, as a matter of fairness and equity, that persons enjoying the benefits of real property in the District should pay a tax on a basis comparable to that of owners of real property.

The possessory interest tax is generally determined in the same manner as the real property tax imposed on private owners of real property. The statute

directs that the assessed value of the leasehold interest be determined as if the lessee or user of the real property was the owner of the portion of the real property so leased or used and the property was not exempt. D.C. Code §47-1005.01(b). The taxable value is also adjusted to reflect the duration of the interest or use remaining, so that the possessory interest holder is only taxed on the portion of the property over which the holder has a right of use. The rate of the tax is the same as the rate applicable to owners of real property of the same class. The possessory interest tax is designed to ensure that government-owned real property in the District that is used for private purposes bears its fair share of tax. The tax therefore promotes equity among all private users of District real property by eliminating a difference in tax treatment between private users of exempt and taxable real property. If taxpayers are experiencing an increase in their possessory interest tax bills, the increases are attributable to the same factors that are increasing the real property tax bills of District real property owners generally.

Viewed in this light, it seems to us that, rather than reducing inequities in real property taxation, the bill would actually create and expand inequities in tax treatment of private owners and users of District real property. The bill would freeze possessory interest assessments and taxes at current levels, although real property assessments and taxes on privately-owned real

property would continue to be subject to increases as warranted by market conditions and other relevant factors. The same inequities that the possessory interest tax was designed to eliminate would be reintroduced by this bill, with private landowners being more heavily taxed than users of land owned by governments.

Furthermore, freezing of possessory interest assessments and taxation at current levels would appear to preclude OTR from collecting possessory interest tax from new taxpayers added to the tax rolls because they paid no possessory interest tax during tax year 2007. The new law would also bar OTR from adjusting the tax computation for existing taxpayers based on improved information about the characteristics of the taxpayer's possessory interest. For example, OTR recently discovered that it had undercounted the square footage of a building subject to a taxable possessory interest, and had underassessed the taxpayer's tax. The proposed bill would appear to preclude OTR from increasing a taxpayer's possessory interest tax based on such new information. If there is to be relief from increases in real property taxation, such relief should be afforded to all owners and users in a particular property class, and relief should not be granted only to a limited and favored group within the class.

The best way to eliminate any inequities with respect to the possessory interest tax is by improved administration of the tax. OTR is working diligently to identify holders of taxable possessory interests by seeking information from the General Services Administration and other federal agencies with responsibility for property management. Discussions with GSA on this matter are continuing. OTR expects that this process will eventually add additional taxpayers to the rolls and would welcome any assistance that the Council could provide in urging the Federal Government to promptly provide OTR with a comprehensive and up-to-date catalog of District real property that is leased for private purposes. Similarly, OTR intends to continue to seek information concerning the characteristics of taxable possessory interests so that the tax may be more accurately computed and each holder of a taxable interest pays tax on the full extent of its possessory interest.

Fiscal Impact of Bill 17-0549

As noted earlier in my testimony, we estimate that the proposed bill would result in reduced real property tax revenue over the effective period of the proposal. A formal fiscal impact statement on this matter is now being prepared by the Office of Revenue Analysis.

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