

**Government of the
District of Columbia**



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Review of Economic Development Tax Expenditures

**Produced by the
Office of Revenue Analysis**

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We welcome feedback on the report. Please contact Lori Metcalf or Charlotte Otabor with questions or comments at (202)727-7775.

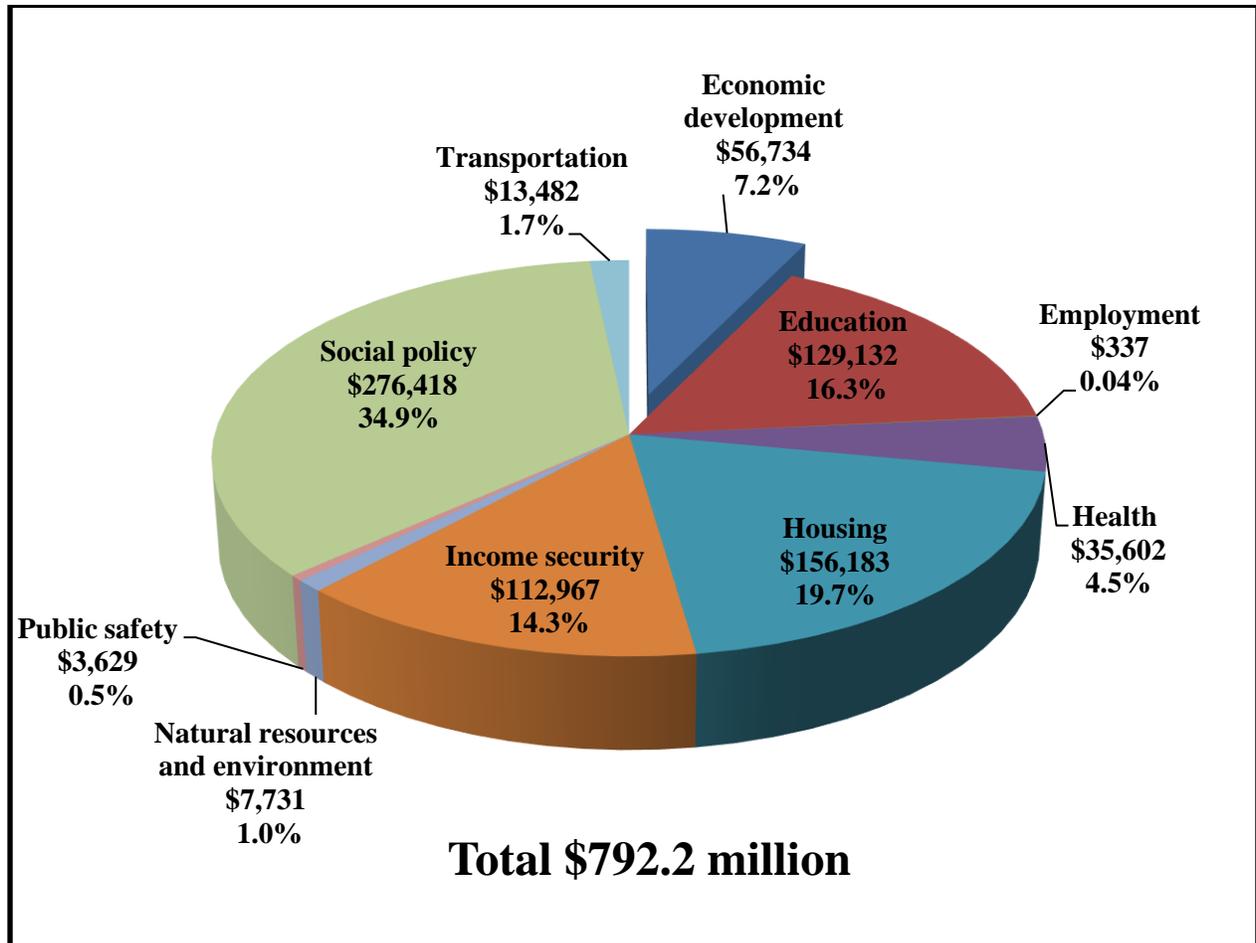
Author's Note: On December 19, 2018, post-publication updates were made to pages 119-120 to correct the expected timing of The Advisory Board's abatement and to add a footnote regarding legislation passed by Council on December 18 that will affect the abatement.

Executive Summary

Introduction

The following report is published pursuant to D.C. Law 20-155, which requires the Office of the Chief Financial Officer (OCFO) to review all D.C. tax expenditures (such as abatements, credits, and exemptions) on a five-year cycle. For the third report fulfilling the requirement, the Office of Revenue Analysis (ORA) conducted a review of the District's economic development tax expenditures.¹

Chart 1: Local FY 2017 Tax Expenditures, Aggregated by Policy Area, \$000



Source: ORA Analysis. Note: Chart does not include tax expenditures not assigned to a policy area, such as the exemption of Federal and D.C. Government property from taxation, or those more akin to base defining measures, such as the exemption of professional and personal services from the sales tax, as well as tax provisions to assist in tax administration. In this way, the pie chart differs from those presented in previous editions of this report. Further, summing tax expenditures does not consider possible interactions among individual tax expenditures, so it does not produce an exact estimate of the revenue that would be gained were any specific provision removed.

¹ The first report reviewed the District's housing tax expenditures and was released in 2015. The second report reviewed the District's environment, public safety, transportation, and tax administration-related tax expenditures and was released in 2017.

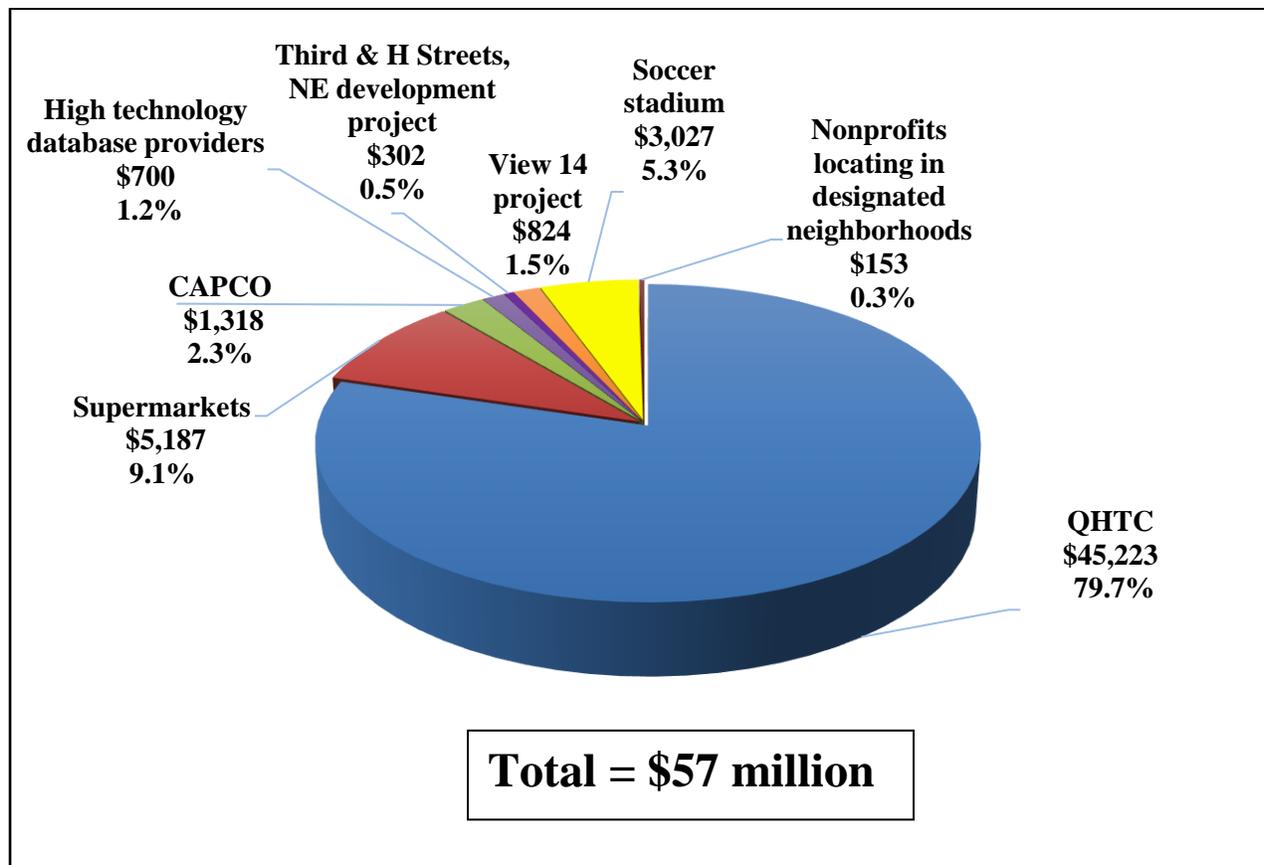
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Following the trend across many state and local jurisdictions, policymakers use various types of tax expenditures or tax incentives, such as abatements or credits, to promote a wide range of policy goals in the District of Columbia. Tax expenditures are used to convey financial benefits to certain taxpayers, yet they are less visible than direct spending and do not have to be approved annually in the budget process. Tax expenditures decrease the tax base and therefore reduce government resources available for other priorities. Tax expenditures should be reviewed just like government spending to ensure effectiveness and accountability.

Tax expenditures decrease the tax base and therefore reduce government resources available for other priorities.

Chart 1 above presents an aggregation of all the District’s tax expenditures for fiscal year 2017. Economic development tax expenditures—covered in this report—comprise just over seven percent of the total. Chart 2 below presents those tax expenditures in more detail, including the Qualified High Technology Company (QHTC) tax incentives (making up almost 80 percent of all economic development tax expenditures in FY 2017), Supermarkets tax incentives, the Certified Capital Companies (CAPCO) incentives, as well as several smaller tax expenditures and those tax incentives written for specific entities.

Chart 2: All FY 2017 Economic Development Tax Expenditures, \$000



Source: ORA Analysis. Note: Summing tax expenditures does not consider possible interactions among individual tax expenditures, so it does not produce an exact estimate of the revenue that would be gained were any specific provision removed. Includes categorical and individual tax expenditures.

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The tax expenditures are categorized in two main groups. *Categorical* tax expenditures are available to any entity that is eligible for them and include:

- the Qualified High Technology Company (QHTC) tax incentives,
- the Qualified Supermarket tax incentives,
- the Certified Capital Investment by Insurance Companies (CAPCO) program, and
- a few smaller tax expenditures.

The categorical provisions totaled about \$53 million in foregone revenue in FY 2017 (and are listed in Table 1 on page 34). These provisions generally support: 1) attracting and retaining high technology businesses in D.C., 2) attracting and retaining supermarkets in D.C., and 3) encouraging private capital investment in new or expanding small businesses in the District of Columbia. The QHTC program represents the largest dollar amount of revenue foregone of all District economic development tax incentives, and thus a significant portion of the report is dedicated to evaluating this incentive.

Next, the report reviews *individual* economic development-related tax expenditures, or those which are written for a specific entity and are generally smaller in their fiscal impact. Each section is summarized below, followed by the report's overall summary and recommendations.

Qualified High Technology Companies

The Qualified High Technology Company (QHTC) tax incentives were adopted in 2000 to grow the District's high technology sector. QHTCs may take advantage of several tax incentives, including:

- a five-year corporate franchise tax exemption;
- a franchise tax rate reduction to six percent after the five-year exemption period;
- three franchise tax credits, including one for wages paid to employees;
- a real property tax abatement;
- a personal property tax exemption; and
- sales tax exemptions.

A qualified company considering moving to D.C. would not pay any corporate income taxes for the first five years it has income tax liability and would have a permanently lower rate of six percent thereafter.² In addition, tax credits for existing and new employees would allow the company to offset a portion of taxes owed after it begins paying the six percent tax rate. For example, if an eligible company moves to D.C. with 100 employees, it may take \$10,000 in credits over two years for each employee, thus offsetting a total of \$1,000,000 in tax liability (and even more, if the company hires and retrain a qualified disadvantaged worker, such as a veteran, or relocates an employee who becomes a District resident). Any part of the credit not used because tax liability is not high enough that year may be carried forward for 10 years and used later against tax liability. Further, the value of the company's property for tax purposes would not increase for

² The franchise tax rate was 9.975% in 2014; 9.4% in 2015; 9.2% in 2016, 9.0% in 2017 and falls to 8.25% for tax year 2018.

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the first five years - representing a tax abatement of any taxes owed on the assessment increase, and it would not pay any personal property taxes for 10 years. All sales the company makes in D.C. would be exempt from the District sales tax, and purchases it makes of qualified technology equipment would also be sales tax free.

As no agency was tasked with administering the QHTC program, the only source of data on the QHTC program is the data gathered by the OCFO's Office of Tax and Revenue (OTR) in the administration of the taxes to which the QHTC incentives apply. Still, there are gaps in our knowledge given that that no agency was mandated to collect detailed information or track the incentives.

Many companies are taking advantage of the QHTC incentives and are at the same time contributing to the District's economy.³ The QHTC tax incentives likely attracted some of those companies to move into or start up in the District and prompted other existing companies to hire more workers or expand technology activities. It is also possible the incentives helped prevent some QHTCs from leaving D.C. But because we are not able to reasonably identify what new actions were taken due to the incentives, we cannot determine what economic benefits are attributable to the incentives.

The QHTC tax incentives may have induced some companies to make new investments in D.C.'s economy, yet they also amount to tax breaks for existing companies with no subsequent new investments.

As such, this report provides some research from which to indirectly infer benefits from the QHTC program, and a descriptive analysis of what is known about the costs of the program and some structural issues with the incentives. The main findings and recommendations about the QHTC incentives are summarized below.

Gains in D.C.'s High Tech Sector and Some QHTC Payrolls Cannot Be Attributed to QHTC Incentives Due to Untargeted Nature of Incentives. A review of outside data on technology firm hires shows D.C.'s tech sector has done well over the life of the QHTC program and an indirect analysis of some QHTCs' payrolls shows that some of D.C.'s QHTC payrolls have grown more than their non-QHTC counterparts in D.C. and the U.S.⁴ As noted above, the untargeted design of the QHTC provisions make it difficult if not impossible to answer the "but for" question of whether these gains would have happened without the incentive. It is possible existing technology firms that already met the eligibility requirements can claim QHTC credits without making new investments, such as relocating or expanding their business in the District.

It is difficult to glean from the QHTC data whether new firms moved in after the program began and started taking QHTC credits the first year they filed corporate taxes in D.C. A review of the top 50 credit awards between 2001 and 2015 (representing \$115 million in QHTC credits taken) shows that only a handful of firms began simultaneously filing corporate franchise taxes and taking

³ From 2001-2015 more than 1,200 companies certified that they were QHTCs and nearly 500 of those took advantage of corporate franchise tax benefits (any of the 1,200+ firms may have received sales or personal property tax benefits). In both 2012 and 2013, over 1,000 unincorporated businesses also certified that they were QHTCs.

⁴ A regression analysis found that when comparing the payrolls of QHTC companies with the payrolls of comparable non-QHTC companies both in D.C. and nationwide, the D.C. QHTC's payrolls performed better.

the QHTC credits after 2001 when the QHTC program started, a possible indication those firms were responding to the QHTC incentives. On the other hand, over \$100 million in QHTC credits was taken by 24 companies that were either already located in D.C. and paying corporate franchise taxes before becoming a QHTC or were already in the District and paying taxes in 2001, the first year for which we can electronically track both franchise tax filers and QHTC-related data.⁵ Further, many firms receiving credits stopped claiming QHTC eligibility in subsequent years, possibly leaving the District.

In addition to not requiring *new* investments, the QHTC program is not well targeted to firms with a typical high-tech profile because the threshold for QHTC eligibility requires only 51 percent of a company's District activities to be qualified. Rather it could be a windfall to large companies that have both QHTC and non-QHTC activities, such as those that provide technology consulting for the federal government by detailing employees to Federal agencies in the District.

Assessing benefits and potential firm responsiveness to the QHTC incentives is difficult, but we do know that from 2001 to 2015, the District has foregone \$184 million in corporate franchise tax revenues from QHTCs.

This represents five percent of franchise tax revenue over that period that the city did not collect due to QHTC franchise tax incentives. This does not include revenue foregone to QHTCs under the sales or personal property taxes, which is estimated to be tens of millions of dollars per year in recent years. If no changes are made, ORA estimates the QHTC program will continue to represent at least \$40 million per year in foregone revenue.

From 2001 to 2015, QHTC credits totaled at least \$184 million, representing 5 percent of franchise tax revenues over that period that the District did not collect.
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The data also reveal that some large companies are taking disproportionately large amounts of QHTC credits without evidence of commensurate economic benefit to the District. Several large consulting firms are receiving some of the largest credit amounts. And as mentioned above many credits were claimed by companies that were already in D.C. when they first received QHTC credits and it is not clear whether they engaged in any new economic activities because of the incentives. While a small number of large firms claimed most of the total credits each year (in 2015, eight QHTCs claimed 56 percent of credits taken in that year), on average from 2001 to 2015 most firms claiming credits received smaller dollar amounts of credits, often less than \$100,000. Assessing the credit recipients' headquarters showed that in all but two years of the data, more QHTC credits were claimed by companies headquartered in Virginia than companies headquartered in D.C.

The QHTC program has structural issues that expose the District to fiscal risks and hinder administration and compliance enforcement. A lack of fiscal caps on the dollar value of benefits that QHTCs can receive or time limits across the QHTC incentives may jeopardize the District's future revenue streams. Further, the QHTC does not require a company to pay back incentives it

⁵ While firms were supposed to file franchise taxes and certify as QHTCs to take any of the other QHTC incentives even if they owed no franchise taxes (such as sales taxes or personal property taxes), it is theoretically possible a firm moved to D.C. or started up here because of the incentives but did not have franchise tax liability right away so only filed taxes in order to pay the minimum tax and did not certify as a QHTC. If the firm did not certify in the initial year, it would appear in the data that it was already here and not taking advantage of the incentives.

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received if it leaves the District. If a significant number of QHTCs are leaving the District soon after receiving QHTC credits, the city will receive no further economic benefits from those foregone revenues.

Because no agency was assigned to administer the QHTC program, the lack of a verifiable standard to determine eligibility coupled with the fact that firms self-certify as QHTCs puts the burden on OTR staff to deny eligibility rather than on the company or a certifying agency to prove eligibility. Some firms could be claiming QHTC credits when they do not qualify for them, pointing to the need for increased monitoring and auditing by OTR staff.

In summary, the gains in D.C.'s tech sector and some QHTC payrolls cannot be directly attributed to the QHTC incentives but they raise the possibility that the incentives are having a positive effect on firms that do stay in D.C. Even if the incentives caused these results the fact remains that a small number of large companies have claimed a disproportionate share of the credits without evidence of commensurate economic benefit to the District. This is due in part to various structural issues with the QHTC program that expose the District to fiscal risks while also preventing a thorough review of the program.

The QHTC program demonstrates how poorly designed incentives can have significant fiscal costs for a jurisdiction, require additional administrative resources, and preclude an evaluation of outcomes. To obtain better results and improve accountability, the QHTC could be amended in a variety of ways outlined in the recommendations below.

- 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 D.C. 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.

Qualified Supermarkets

For nearly twenty years, the District has offered tax incentives to supermarkets with the goal of decreasing food deserts, thereby increasing D.C. residents' access to healthy food and leading to longer-term improvements in health outcomes of District residents. A food desert is an area with limited access to affordable and nutritious food, particularly an area with predominantly lower income neighborhoods and communities.⁶ As of 2010, a qualified supermarket must be in census tracts where more than half of the households have incomes below 60 percent of the area median income, as determined by the U.S. Department of Housing and Urban Development and meet the definition of a supermarket in D.C. Code.⁷

Data on all supermarket exemptions taken was not readily available, however data show that the amount of revenue foregone from 2010 to 2017 through the real property exemptions is \$21 million. Adding in the estimates of revenue foregone through the personal property and sales taxes the total for the tax incentives reaches almost \$29 million from 2010 to 2017.⁸

From 2010 to 2017, the supermarket tax incentives represented almost \$29 million in foregone revenue.

Only two supermarkets receiving incentives opened in Wards 7 and 8 between 2000 and 2015, and one of those closed after two years. The continuing shortage of supermarkets in food deserts, especially in Wards 7 and 8 means that many lower income families still lack access to healthy food and a full-service grocery store. While the District experienced significant declines in the number of food deserts, the more significant declines are in areas not eligible for the supermarket incentives. Further, new research shows that simply improving food access by opening supermarkets has little impact on low-income persons' eating habits, thus additional policy interventions such as nutrition education may be needed to improve long-term health outcomes.⁹

This new research aside, assessing the incentives based on their original goals shows that almost \$29 million of foregone District revenues cannot be shown to have affected supermarkets' location decisions, generally, or produced economic or other benefits that would not have happened but for the incentives. As such, this report recommends that policymakers change the supermarket tax incentives to better target supermarkets that would not otherwise locate in an area of highest need. Such targeting would also prevent taxpayer dollars from going to supermarkets that would have located in eligible areas regardless of the incentives. Further, any modification should consider whether more of an incentive is needed for supermarkets that would locate in areas of highest need,

⁶ This report cites research that operationalizes the definition as: a census tract where more than 33 percent of census block groups considered were more than a ½ mile away from a supermarket. The census blocks considered were those with a median household income of 80% of Area Median Income (AMI) for a 3-person household (\$78,624). That analysis does not include Virginia or Maryland supermarkets. See footnote 99 on page 88 for more detail.

⁷ A supermarket is defined in the D.C. Code as a self-service retail establishment, independently owned or part of a corporation operating a chain of retail establishments under the same trade name, that is licensed as a grocery store; sells a full line of meats, seafoods, fruits, vegetables, dairy products, dry groceries, household products, and sundries; occupies the address under a certificate of occupancy with the use declared as a grocery store, and include related service departments, such as a kitchen, bakery, pharmacy, or flower shop.

⁸ The sales and use tax exemption is for building materials necessary for construction. This figure does not include an exemption that has been approved for a future supermarket in Census Tract 94.

⁹ Florida, Richard. "It's Not the Food Deserts: It's the Inequality." January 18, 2018. *CityLab*. <https://www.citylab.com/equity/2018/01/its-not-the-food-deserts-its-the-inequality/550793/>

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given that the tax incentives appear to have not been enough to attract supermarkets to food deserts or low-income areas of highest need.

A recently passed law takes the District's supermarket policies in this direction. The East End Grocery and Retail Incentive Program Tax Abatement Act of 2017 takes steps to create greater access to grocery stores in Wards 7 and 8 by encouraging the development of a new anchor grocery store, which would serve as a catalyst for additional business development in the neighborhoods. The law provides a package of incentives that include: a 30-year exemption from real property taxes, personal property taxes, and corporate franchise taxes; and a sales and use tax exemption for purchases of property or services to construct the store.¹⁰ Based on best practices of tax incentives identified in this report, a specific agency should own the program and be charged with collecting and analyzing data on the incentives to ensure compliance to the law (such as monitoring the requirement that 50 percent of employees are D.C. residents) to promote the accountability of taxpayer dollars.

Certified Capital Investment by Insurance Companies

The Certified Capital Company (CAPCO) incentive program was enacted in 2004 with the goal of increasing the volume of private investment in new and/or expanding businesses located in the District. The primary objectives of the program include:

- stimulating the flow of capital to early-stage businesses that are unable to access traditional financing;
- building venture capital infrastructure;
- creating high-paying jobs; and
- increasing the District's tax revenue.¹¹

Beginning in 2004, insurance companies that invested in a CAPCO were entitled to receive up to \$50 million in insurance premium tax credits equal to the amount of the insurance company's total debt and equity investment in the CAPCO. A CAPCO is a partnership, corporation, trust, or limited liability company, whether organized on a profit or not for profit basis, that has as its primary business activity the investment of cash in qualified businesses (defined below).¹² Because insurance companies typically have large pools of funds available from collecting premium payments yet are also typically risk averse, CAPCO programs are used as an economic development tool to incentivize insurance companies to invest in local communities.

Under the CAPCO program a 'qualified business' must be headquartered in and conduct their principal business operations in the District or certify that they will relocate to the District within 90 days after receiving an initial investment from a CAPCO. At least 25 percent of the employees of a qualified business must live in the District, and at least 75 percent of their employees must

¹⁰ A22-0254, effective March 29, 2018.

¹¹ Fuller, Stephen. "The Economic and Fiscal Impact of CAPCO-Funded Companies on the District of Columbia." Center for Regional Analysis, George Mason University. November 2009.

¹² D.C. Law § 31-5231

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work in the District. Qualified businesses must also be small businesses as defined by the Small Business Administration¹³ and must certify that they are unable to obtain conventional financing.

The \$50 million in insurance premium tax credits could be redeemed beginning in 2009 with a limit of \$12.5 million per company per year on usage of the credits. As of the end of FY 2017, insurance companies had claimed \$48 million in insurance premium tax credits from the District (based on their investments into the CAPCOs), making this the cost to the District in foregone revenue. Three investment companies applied for and received certification from the Department of Insurance, Securities, and Banking (DISB) to be CAPCOs. To date, the CAPCOs have loaned or invested about \$33.5 million in 36 qualified companies in the District.¹⁴

As of FY 2017, insurance companies had claimed \$48 million in insurance premium tax credit while CAPCOs had loaned or invested about \$33.5 million in 36 qualified companies in D.C.
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Economic and fiscal impact studies have shown that the CAPCO program had some impact on the District of Columbia. In an evaluation prepared for DISB, Dr. Don Phares used an input-output model to estimate that from 2004 to 2012, the economic impact of the CAPCO program included the creation and maintenance of an annual average of 79.2 jobs, almost \$120 million in total new spending due to new business investments, and \$41 million in total labor income. Using his model, the CAPCO program also generated an estimated \$9 million in total new revenue. A major caveat to this research is that it is unknown how much of this business activity would have happened anyway. Further, the study assumed some economic impacts of follow-on investments that have not materialized making those assumptions an overestimate, while it also lacked full data from participating business, representing a possible underestimate of some impacts.

A few companies that received CAPCO investments failed while other companies still in operation have yet to reach the point where CAPCOs can receive a return on their investment. Further, two CAPCOs have been unable to invest 100 percent of the certified capital to new or expanding businesses. Part of the problem is the structure of the CAPCO program. The two CAPCOs have little incentive to invest the remainder of the certified capital as there is no penalty if the remaining \$16.5 million is not invested. Additionally, some of the qualified companies that received investments and decided to move out of the District or failed to fulfill the CAPCO program employment requirements were not penalized. The 2010 amendments made continuing operations in the District a requirement for businesses to receive funding from the CAPCOs, but this requirement did not apply to businesses that received funding before the amendments became effective on May 27, 2010.

In general, the impacts of CAPCO incentive programs in the United States have been controversial. There are 14 states with a CAPCO incentive program including the District of Columbia. Evaluations of the CAPCO program in other states have shown the net impact of the incentive program to be either minute or negative.

¹³ 13 C.F.R. § 121.201 details the maximum allowed number of employees and annual receipts, by business subsector.

¹⁴ Phares, Don. "The Economic and Fiscal Impact of the District of Columbia's CAPCO Program." Prepared for the District of Columbia's Certified Capital Companies Program and the District of Columbia Department of Insurance, Securities, and Banking. University of Missouri-St. Louis, November 2013.

Executive Summary

The District's CAPCO incentive program was amended in 2010 to address some of the issues with its program. The legislation required CAPCOs to invest 100 percent of the certified capital into qualified businesses, but the amendments have not produced further investments in potential qualified companies. The legislation provided DISB with the authority to obtain information from CAPCOs to conduct an annual economic impact analysis, however, a DISB official notes 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.¹⁵ Further, the amendments have not solved the structural issues within the incentive program causing it to stall. The only recent activity in the CAPCO incentive program has been that the insurance companies are still redeeming their earned insurance premium credits. The remaining unclaimed insurance premium credit is about \$2 million, which is projected to be claimed in FY 2018.

In summary, the District's CAPCO program is a complex tax incentive representing nearly \$50 million in foregone revenue thus far over the life of the program. Incomplete and unverifiable reports of the resulting economic impacts make it hard to determine the program's effectiveness. Some of the lessons learned from this program echo those found in other programs reviewed for this report. Tax incentive programs that are overly complex are hard to administer and even harder to evaluate. The CAPCO program also illustrates that if a tax incentive is not carefully structured at the beginning, it can be difficult if not impossible to change midway through. CAPCOs are not subject to penalties if they do not invest the full amount of CAPCO money and it appears that nearly \$17 million of the \$50 million in District investment (through foregone revenue) will not be invested into qualifying businesses. Further, when the companies receiving the investments were under no obligation to remain in the District to keep the funding, some of them closed or left the District. If firms receiving tax credits or funds tied to the tax credits are not legally required to report data or information justifying their benefits, they are likely not to do so and may refuse if the requirement is enacted after the program began. The complex CAPCO structure with multiple entities and levels of transactions prevented the District from being able to obtain information on the results of its investments and should be avoided in the future.

Individual Economic Development Tax Incentives

Individual tax provisions result from legislation written for specific companies or organizations that receive tax incentives in exchange for providing some social or economic benefit to the District, such as neighborhood revitalization, employment opportunities, supermarkets, and affordable housing. Eight Individual provisions are covered in this report and represent an estimated foregone revenue of \$4.2 million in FY 2017. Individual tax provisions make up only seven percent of total tax revenue forgone in the local economic development policy area. Tax incentives for Audi Field Soccer Stadium comprise about 73 percent of the total forgone revenue in FY 2017 for individual economic development tax provisions. However, future tax abatements to The Advisory Board Company and The Line Hotel represent over \$100 million.

¹⁵ Nevertheless, DISB contracted out an economic analysis in 2013, the findings of which are reported on the previous page. Almost half of the companies did not respond to his survey; therefore, a lack of data was a factor in that evaluation.

Executive Summary

Generally, individual tax incentives are conditional on an organization meeting specific economic development deliverables like job creation and should have a monitoring process in place to track whether such deliverables to the District are being met. For example, assigning an agency to track and monitor the new employment that a company receiving incentives creates annually in the District would help in determining whether the organization is meeting its obligation to the District. If the requirements are not being met, best practices suggest that the legislation should include a claw back provision so that the District can recoup its losses. Additionally, when individual tax provisions are targeted to a specific company to keep it in the District this violates the principle of horizontal equity, which requires that similarly situated taxpayers be treated the same under the tax code.¹⁶

Summary of Overall Findings and Recommendations

Overall, the District's economic development tax incentives support the District's broad economic development goals as designed, however various issues with each of the incentives prevent an assessment of their effectiveness in meeting the respective incentive goals. The inability to measure the effectiveness of these incentives prevents policymakers from making informed decisions on the best allocations of scarce financial resources.

The District's economic development incentives are not administered by a single agency, so they represent an ad hoc set of provisions that are not coordinated in a meaningful way. If no entity owns a tax incentive program, it is likely that future tax incentives will have similar problems as those highlighted here. Just as in many other jurisdictions, the District's tax incentives are not well tracked and monitored, adding another impediment to evaluation and accountability. This review compiled a wealth of data on the extent of the immediate fiscal impacts of these tax expenditures; however, more data would be needed to be able to report on the full scope of the programs and their results.

This report found that QHTC and Supermarket tax incentives are not well targeted, meaning many companies may be receiving benefits—sometimes very large sums, in the case of several large QHTCs—to do what they may have done without the incentive. Targeting incentives only to firms that would make *new* investments to grow the economy would better ensure the evaluation of the incentives and accountability of taxpayer resources. This review also found that complex tax provisions are difficult to implement and challenging to monitor and analyze once in place. Policymakers should consider these lessons for new tax incentives and avoid creating complex incentives in the future.

Recommendations

¹⁶ The District primarily finances individual economic development projects through tax increment financing projects (TIFs) or bonds; however, TIFs and bonds are not categorized as tax expenditures and as such are not included in this report. See Appendix 1 of the FY 2017 Unified Economic Development Report (Year-End). Office of the Chief Financial Officer. February 20, 2018.

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Based on these general findings, this report recommends 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 the District within a certain amount of time, it will have to repay the District what it received.

Outline of the Report

Part I of the report introduces tax expenditures and their evaluation, including a brief discussion evaluating economic development tax incentives, the District's economic development goals, and the methodology used in this report. Part II provides a review of the District's economic development tax incentives, starting with the categorical incentives in Chapters I - VI—which represent most of the foregone revenue—and followed by a brief overview of each Individual tax provision in Chapter VII. Part III summarizes each section and offers overall findings and recommendations. An Appendix presents related resources that readers seeking more information may find useful.

Part I: Introduction

Legal Requirement

The following report is published pursuant to a subtitle of D.C. Law 20-155, the “Fiscal Year 2015 Budget Support Act of 2014.” Also called “Tax Transparency and Effectiveness,” the legislation requires the Office of the Chief Financial Officer (OCFO) to review all D.C. tax preferences (abatements, credits, and exemptions, among others) on a five-year cycle. To comply with this requirement, the OCFO must summarize the purpose of each provision, estimate the revenue foregone, examine the impacts on the District’s economy and social welfare, and offer recommendations about whether to maintain, revise, or repeal the tax preference. The full text of the legislative requirement is presented in the Appendix. This is the third such report issued to meet the legal requirement. The first report reviewed the District’s Housing Tax Expenditures in 2015. The second report reviewed the District’s Environment, Public Safety, Transportation, and Tax Administration-Related Tax Expenditures and was released in early 2017.

Overview of Tax Expenditures and Their Evaluation

Tax expenditures are often described as “spending by another name.” They are ‘preferences’ in the tax code that convey a benefit to certain individuals or businesses. As such, the terms ‘tax expenditure’ and ‘tax preferences’ will be used interchangeably throughout this report. Policymakers use various specific types of tax expenditures, including tax abatements, credits, deductions, deferrals, exclusions, and incentives to promote a wide range of policy goals in education, human services, public safety, economic development, environmental protection, and other areas. Instead of pursuing these objectives through direct spending, policymakers reduce the tax liability associated with certain actions (such as hiring new employees) or conditions (such as being elderly) so that individuals or businesses can keep and spend the money that would otherwise be used to pay taxes. For example, a program to expand access to higher education could offer tax deductions for college savings instead of increasing student loans or grants. Regardless of the approach, there is a real resource cost in terms of forgone revenue or direct expenditures. Tax expenditures decrease the tax base and therefore reduce government resources available for other priorities. Tax expenditures should be reviewed just like government spending to ensure effectiveness and accountability.

Tax expenditures decrease the tax base and therefore reduce government resources available for other priorities.
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Tax expenditures are frequently used as a policy tool in the District of Columbia. There are two broad types of tax expenditures: (1) federal conformity tax expenditures, which apply U.S. Internal Revenue Code provisions to the D.C. personal and corporate income taxes, and (2) local tax expenditures authorized only by D.C. law. By conforming to the federal definition of adjusted gross income (with several exceptions), the District adopts most of the exclusions and deductions from income that are part of the federal personal and corporate income tax systems. Most other states with an income tax also use federal adjusted gross income as the basis for their income tax.

An example of a federal conformity tax expenditure is the home mortgage interest deduction. The District follows the federal practice of allowing taxpayers to deduct home mortgage interest payments. In addition to the 107 federal conformity provisions covered in the most recent Tax

Part I: Introduction

Expenditure Report (TER) produced by the OCFO's Office of Revenue Analysis (ORA), there are 169 tax expenditures established by local law. An example of a local tax expenditure is the homestead deduction, which allows all D.C. taxpayers who live in their own home to deduct a certain amount (\$72,450 in 2017) from the taxable value of the home. Both federal conformity and local tax expenditures warrant regular scrutiny to make sure they are effective, efficient, and equitable, and to highlight the tradeoffs between tax expenditures and other programs.

Tax expenditures differ from direct expenditures in several respects. Direct spending programs in the District receive an annual appropriation and the proposed funding levels are reviewed during the annual budget cycle. By contrast, tax expenditures remain in place unless policymakers act to modify or repeal them; in this respect, they are like entitlement programs. Direct spending programs are itemized on the expenditure side of the budget, whereas revenues are shown in the budget as aggregate receipts without an itemization of tax expenditures.

ORA has produced a biennial tax expenditure report since 2002; it was required by D.C. Law 13-161 in the "Tax Expenditure Budget Review Act of 2000." The itemization of tax expenditures provides policymakers with a more complete picture of how the government uses its resources, so they may consider how to allocate resources more effectively. For example, if ineffective or outmoded tax expenditures were eliminated, policymakers could free up resources to expand high-priority direct spending programs or cut tax rates. The tax expenditure report is designed to provide policymakers with the information they need about tax expenditures to make sound fiscal policy decisions.

The different types of tax expenditures are as follows:

- abatements, which are reductions in tax liability (typically real property tax liability) that are often applied on a percentage basis or through a negotiated process.
- adjustments, which are reductions in taxable income that are available to all tax filers who meet certain criteria, whether they itemize their deductions or not. Adjustments are also known as "above-the-line" deductions and are entered on the tax return.
- credits, which reduce tax liability directly instead of reducing the amount of income subject to taxation. Credits can be refundable (if the amount of the credit exceeds tax liability, the taxpayer gets the difference as a direct refund) or non-refundable (the amount of the credit cannot exceed tax liability).
- deductions, which are reductions to taxable income that must be itemized on the tax form. This option is not available to those who choose the standard deduction.
- deferrals, which delay the recognition of income to a future year or years. Because they shift the timing of tax payments, deferrals function like interest-free loans to the taxpayer.
- exclusions, which are items that are not considered part of a taxpayer's gross income for tax purposes, even though they increase his or her resources or wealth. Exclusions do not

Part I: Introduction

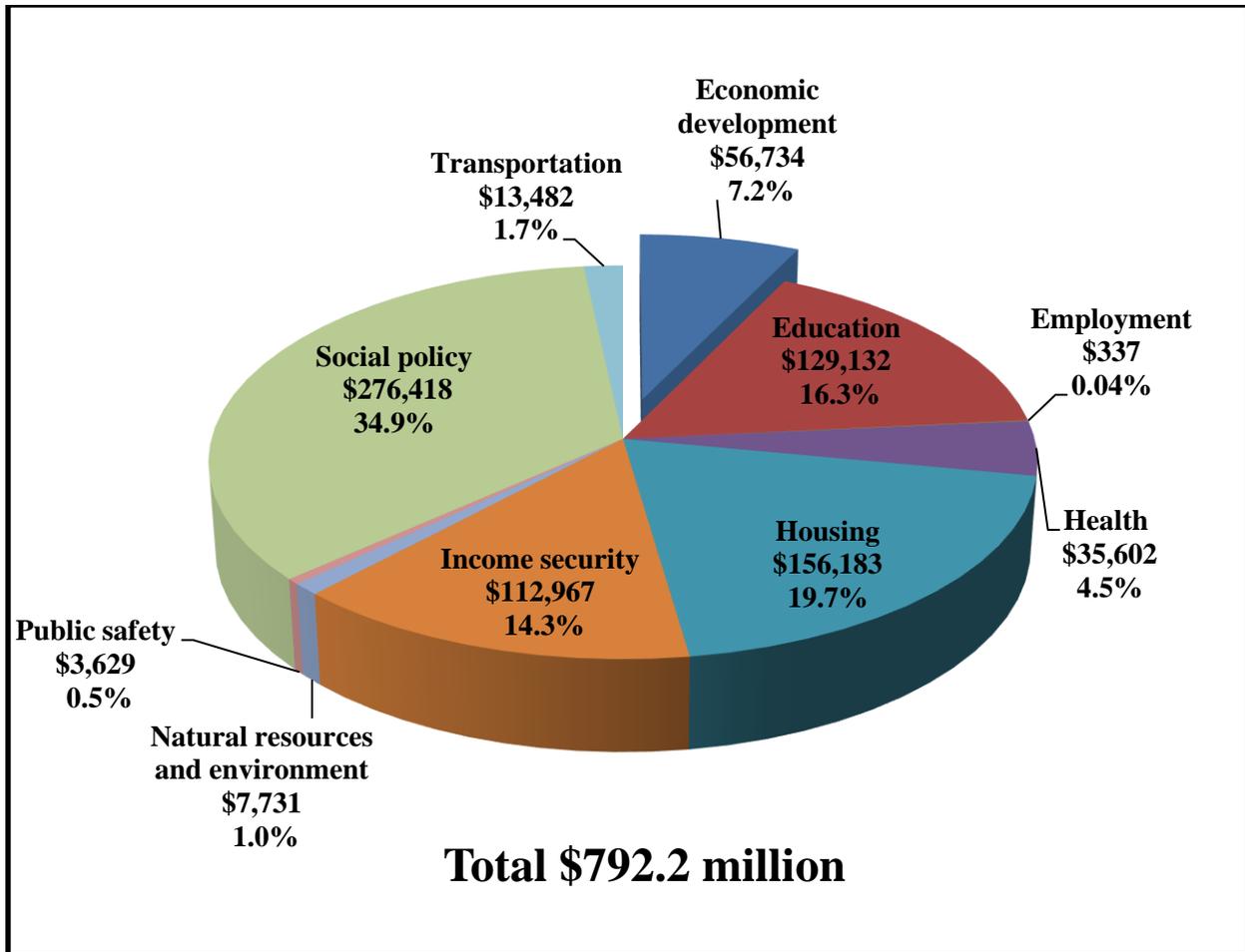
have to be reported on a tax return but still cause adjusted gross income to be lower than it otherwise would be. Employer contributions to health and retirement plans are examples.

- exemptions, which are per-person reductions in taxable income that taxpayers can claim because of their status or circumstances (such as being a senior citizen).
- rebates, which are refunds provided to qualifying taxpayers as a separate payment (as contrasted with tax credits that are first applied as a reduction of tax liability).
- special rules, which is a category used for federal tax expenditures that involve blended tax rates or special accounting procedures and do not fit neatly into any other category.
- subtractions, which are reductions from federal adjusted gross income that are used to derive District of Columbia adjusted gross income. Subtractions reflect income that is taxed by the federal government but not by the D.C. government.

Any of these terms may also be broadly referred to as tax incentives, especially when the tax provision being granted has the goal of offering an incentive to a company or individual to take an action they otherwise would not have.

As Chart 3 below shows, tax preferences targeted to economic development make up seven percent of District “spending” through the tax code and will be the focus of this 2017 report. This presentation excludes the sales tax exemption for professional and personal services, as well as transportation and communications services, which are labeled as ‘economic development’ tax expenditures in the biannual Tax Expenditure Report, however, are excluded from the definition in this report. Tax preferences for social policy, including sales and property tax exemptions for churches and nonprofit organizations, as well as the sales tax exemption for groceries, comprise the largest aggregate amount of spending through the tax code by policy area and will be reviewed in a future report. Assessing all District tax expenditures in this way, the total of those targeted to housing is the second largest group, and those preferences were described in detail in the 2015 D.C. Housing Tax Expenditure Review.

Chart 3: Local FY 2017 Tax Expenditures, Aggregated by Policy Area, \$000



Source: ORA Analysis. Note: Chart does not include tax expenditures not assigned to a policy area, such as the exemption of Federal and D.C. Government property from taxation, or those more akin to base defining measures, such as the exemption of professional and personal services from the sales tax, as well as tax provisions to assist in tax administration. In this way, the pie chart differs from those presented in previous editions of this report. Further, summing tax expenditures does not consider possible interactions among individual tax expenditures, so it does not produce an exact estimate of the revenue that would be gained were any specific provision removed.

Evaluating Tax Expenditures

Knowing how much is being spent on a program alone does not provide enough information to assess its effectiveness. For this reason, there is a growing awareness of the need to evaluate tax expenditures—just as a government’s direct spending should be evaluated—to allow policymakers to ensure that a government’s spending is efficient, equitable, and effective at meeting the goals for that spending. The Pew Charitable Trusts and National Council of State Legislatures are leading an effort to track states’ efforts in this area and to serve as a resource for state and local governments that are embarking on tax expenditure evaluation. As Pew notes on its web site, “[S]tate leaders need better information to avoid unexpected budget challenges, identify effective incentives, and reform or end programs that are not meeting expectations.”¹⁷

¹⁷ “Economic Development Tax Incentives,” The Pew Charitable Trusts.
<http://www.pewtrusts.org/en/projects/economic-development-tax-incentives>

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While data availability precludes a full-scale evaluation, this report lays the groundwork for future evaluation by compiling all the relevant tax expenditures and reviewing them using a logic model, which was first introduced in ORA's 2015 Housing Tax Expenditure Review.

Understanding the framework and logic behind an evaluation is critical for assessing tax expenditures; further, the logic of how a tax incentive should work should also be part of the conversation around its creation, so that each one is constructed in a way that allows monitoring and measuring for effectiveness. The U.S. Government Accountability Office (GAO), the primary federal agency charged with evaluating government programs, has several evaluation guides¹⁸ that were used as a model for setting up an evaluation framework. Following their documentation, we developed a set of questions that should be considered when evaluating tax expenditures:¹⁹

- Is the program reaching targeted recipients as intended?
- Have feasibility or management problems emerged?
- Are desired outcomes obtained?
- Have there been unintended side effects/consequences?
- Do outcomes differ across approaches/components, providers, or subgroups?
- Are resources being used efficiently?
- Did the program cause the desired impact?
- Is one approach more effective than another in obtaining desired outcomes?

Beyond asking these questions specific of a provision and whether it is meeting its goals, GAO notes that broader questions related to the criterion for assessing good tax policy should also be applied to tax expenditures. These include fairness, economic efficiency, transparency, simplicity, and administrability.²⁰

In a report for the New York State Tax Reform and Fairness Commission on evaluating business tax incentives, Marilyn M. Rubin and Donald Boyd explain the principles and how they relate to tax incentives:

“Six widely accepted principles against which to judge tax policies are economic neutrality, equity, adequacy, simplicity, transparency, and competitiveness. An economically neutral tax does not influence economic behavior — individuals and businesses make decisions based on economic merit rather than tax implications. An equitable system treats similarly situated taxpayers similarly. An adequate tax system raises enough revenue to support desired government services and investments. A simple and transparent system is easy to understand, relatively inexpensive for taxpayers to comply with, and relatively inexpensive for the government to administer. A competitive tax system does not impede the ability of companies to compete with those located outside the state and does not limit the state's ability to attract new business.

¹⁸ “Tax Expenditures: Background and Evaluation Criteria and Questions.” GAO-13-167SP (Washington, D.C.: United States Government Accountability Office, November 29, 2012).

¹⁹ “Designing Evaluations,” GAO-12-208G. Washington, D.C.: United States Government Accountability Office, January 2012. p 15.

²⁰ “IRS Data Available for Evaluations Are Limited,” GAO-13-479. (Washington, D.C.: United States Government Accountability Office, May 30, 2013). p 5.

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Almost by definition, business tax incentives violate these principles. Their explicit goal is to alter decisions, encouraging more of a particular activity in a state or a given area than private markets would undertake absent the incentives. Depending on the activity, this may be appropriate, but it places great responsibility on public officials to understand how the market is “wrong” and how the tax system can fix it. By lowering taxes for some taxpayers while keeping them higher for others, incentives may treat similarly situated taxpayers differently and can make it harder to raise adequate revenue with minimum public resistance. Finally, myriad eligibility rules and credit calculations violate the simplicity principle for taxpayers and tax collectors.”²¹

While their report is focused on business tax incentives, the reality they describe applies to most tax incentives, even if they are focused on social, rather than economic goals. Rubin and Boyd posed a list of questions to ask about each tax incentive that incorporates both elements from GAO’s questions as well as the criterion for good tax policy.

- What is the purpose of the tax credit?
- Assuming the purpose is achieved, is the tax credit good policy?
- How does the credit relate to other state programs?
- Is a credit more effective at meeting its goals than a spending program would be?
- Is a credit more effective at meeting those goals than more-general tax reduction would be?
- What are the consequences for the state budget of the credit?²²

Another issue to consider when evaluating a policy includes asking what might have happened if the policy did not exist, (also a ‘counterfactual’ or ‘alternative history’). Isolating the impacts of a specific policy often involves estimating an econometric model that includes an array of related variables. Thus far we have not had data that would be required for such an analysis. However, qualitatively examining contextual events and assessing broad indicators about the area that this policy is trying to change (for example, if homeownership is a goal, it is useful to know the trend in this area) can be useful in the absence of data on the specific policy. Finally, the question that the last few questions in the list above are directed at answering is ‘what was the opportunity cost of a policy?’ For example, what else could have been done with the same amount of government resources?

A recent evaluation conducted by Matthew N. Murray and Donald J. Bruce (2017) for several tax incentive programs in Alabama offers a set of general characteristics of good incentive programs. These factors presented in the box below capture the essential elements of incentive programs and can be applied to incentive programs broadly, not just tax credit incentives.

²¹ Rubin, Marilyn and Donald Boyd. “New York State Business Tax Credits: Analysis and Evaluation.” November 2013. Pp. 1-2. http://www.capitalnewyork.com/sites/default/files/131115__Incentive_Study_Final_0.pdf

²² *Ibid.*, 96.

Characteristics of Good Tax Incentive Programs

- **EFFICIENT.** A good incentive will provide a well-defined *return on investment* to the [jurisdiction].
- **TRANSPARENT.** Incentives should be *transparent* so that benefits to taxpayers and costs to the state are clear.
- **CERTAIN.** Policy *certainty* is important in terms of the magnitude and timing of tax relief for business taxpayers and the realization of tax losses that impact the state budget.
- **PROSPECTIVE.** The state should avoid *retroactive policy changes* that may penalize firms for previous investment decisions.
- **SIMPLE.** Incentives should be *easy to administer and easy to comply with*.
- **TARGETED.** Incentives should be *targeted* and provided on a *discretionary* basis in order to promote economic activity that might not otherwise take place.
- **PROTECT PUBLIC FUNDS.** *Fiscal exposure* to the state should be minimized through such constraints as annual financial caps or time limits on the use of credits.
- **LEVERAGE.** Some incentives produce a *leveraging* effect, drawing in additional resources from local government resources, private sector resources, or federal resources.
- **ACCOUNTABILITY.** *Performance-based incentives* should be built into the program.
- **EVALUATION.** Incentives should include a built-in framework for *evaluation*, which should seek to identify the extent to which incentives induced new economic activity rather than rewarding existing economic activity.
- **OWNERSHIP.** A state agency or agency partnership must *own* the incentive program to ensure proper administration and to conduct or support a thorough program evaluation.

Source: Murray, Matthew N, and Bruce, Donald J. "Evaluation of Alabama's CAPCO Credit and Historic Rehabilitation Tax Credit." 2017. Prepared for the Alabama Department of Revenue. P. 5. Retrieved on April 23, 2018 from: https://revenue.alabama.gov/wp-content/uploads/2017/05/TaxIncentives_CAPCO_201701.pdf

Methodology: How This Review Was Conducted

To complete the first tax expenditure review of housing-related tax expenditures in 2015, ORA used the groupings of the District's tax expenditures by policy area that is found in previous Tax Expenditure Reports. This classification that largely mirrors the categories used by the Joint Committee on Taxation (JCT), and it continued to serve as the basis for selecting policy areas for the current review. For the second report, tax expenditures in the areas of environment, public safety, transportation, and tax administration-related tax expenditures, we grouped together.

For the current report categorical tax expenditures from the Tax Expenditure Reports were compiled, except for the sales tax exemption for professional and personal services, which is more like a base defining measure than a tax incentive for the purposes of this report.

The current report involved a review of the following documents, as relevant:

- D.C. Code enacting the provision and accompanying committee reports;

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- Tax Expenditure Reports and other relevant ORA reports, such as Tax Facts, for information or data;
- Fiscal Impact Statements;
- Tax Abatement Financial Analyses;
- Unified Economic Development Report;
- Corporate franchise tax data and tax forms;

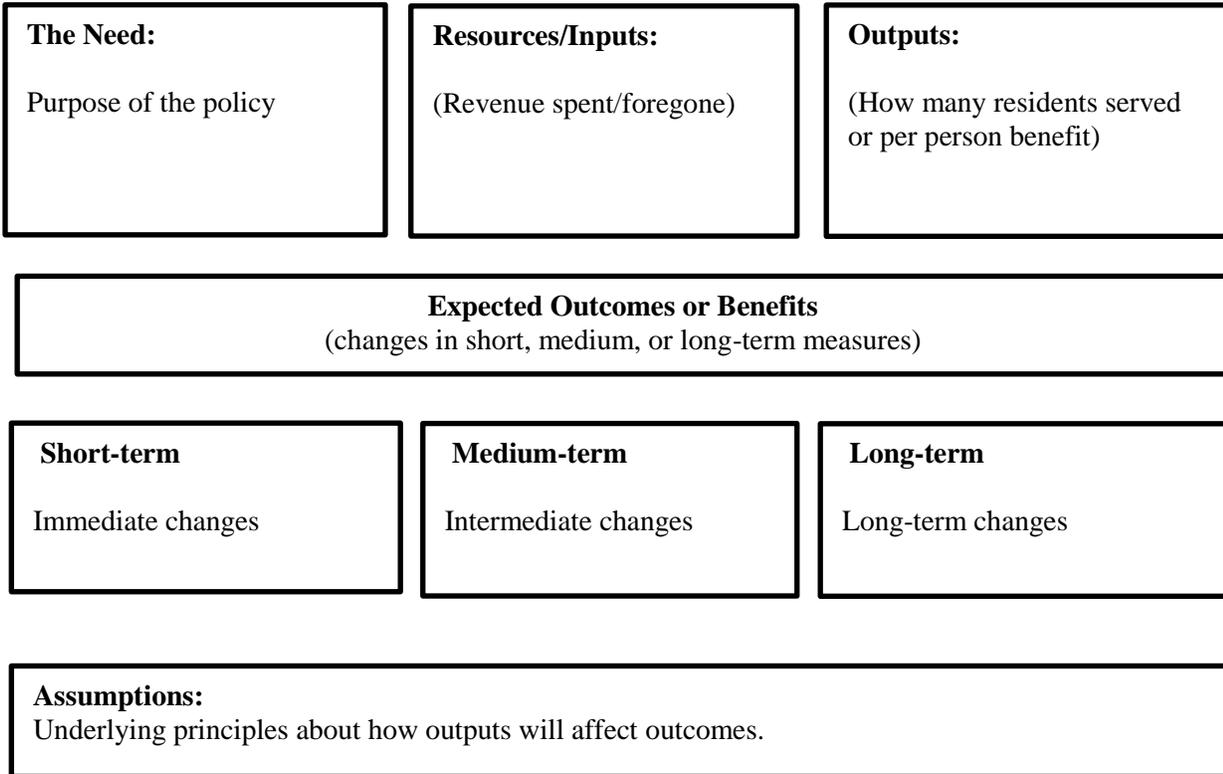
Additionally, we:

- Reached out to representatives of each agency involved in the policy areas of the report, and spoke with representative(s) from the District's Deputy Mayor for Planning and Economic Development; Department of Insurance, Securities and Banking; Department of Small and Local Business Development; and the District of Columbia Office of Planning;
- Had extensive meetings with OTR colleagues about the QHTC program over the span of more than a year;
- Had meetings with representatives from The Pew Charitable Trusts, D.C. Fiscal Policy Institute, D.C. Hunger, D.C. Greens, Community Foodworks, Freshfarm, and two teams of masters' students at The George Washington University's Trachtenberg School of Public Policy and Public Administration;
- Reviewed data available for each tax expenditure;
- Analyzed tax expenditures in each policy area as a group, after they were presented individually.

Below is a logic model that we use in this report to organize each tax expenditure to assist with evaluation. Such a model is frequently used to evaluate programs and policy. This serves as a visual tool to quickly summarize the need for the policy, the inputs (what the District is contributing toward the need with this provision), the outputs (what citizens receive due to this policy), and what various short-, medium-, and long-term outcomes are (what effect or impact did the policy have). The model also includes assumptions that are made in filling in the logic model.

It is important to point out that for this review, multiple barriers, including a lack of data, prevented us from assessing *actual* outcomes. Instead, we have filled in the outcome boxes with *expected* outcomes or benefits and where possible provided any assumptions underlying the policy and these expected outcomes. These statements are not empirically proven facts, rather, they provide the logic behind why the policy was enacted and what it intends to do. Ideally, these statements would be part of the implementing legislation when a policy is first enacted, and oftentimes they are in the case of the tax expenditures that we reviewed. Having this information is the first step in evaluating outcomes, and in lieu of procuring the data required to adequately evaluate each provision, we have filled in these assumptions in the logic models as a starting point for an interim assessment.

Sample Logic Model:



Economic Development Tax Incentives

States and cities have long used economic development incentives and particularly tax incentives to entice businesses to locate in their jurisdictions and create new jobs, thereby bolstering the local economy, contributing to local GDP, tax revenues, and more.

According to Timothy J. Bartik, states and local governments are increasingly relying on business incentives, and their costs have tripled since 1990.²³ In a recent paper providing a first of its kind panel database of state and local incentives as well as an analysis of the data, Bartik notes that business incentives are large, potentially in the ballpark of \$45 billion nationwide per year.²⁴ Further, these incentives are often not targeted as well as they could be in some areas, though this may be improving over time. Bartik notes several ways that reforming incentives' structures can reduce their costs. While eliminating or limiting them is one way to do so, costs could also be reduced by limiting their 'refundability' and restricting them to the first few years of a companies' investment.²⁵

Overview of the District's Economic Development Goals

The Economic Strategy released in 2017 for the District has two main goals, to grow private sector GDP to \$100 billion (by 20 percent) by the end of 2021; and to reduce unemployment across wards, races and educational attainment levels, bringing rates below 10 percent in all segments by the end of 2021.²⁶ The new Strategy, put out by the Deputy Mayor for Planning and Economic Development (DMPED) lists five top priorities for the year:

- 1) Increase affordable housing;
- 2) Grow [D.C.'s] technology and innovation employment sector;
- 3) Achieve significant progress on large-scale and neighborhood real estate development projects;
- 4) Create a vibrant and competitive place for job creation, relocation, and growth; and
- 5) Make DMPED a more open and transparent agency.²⁷

The District's economic development work cuts across many agencies, primarily due to the cross-cutting nature of so many economic development goals. However, in the executive branch, the Deputy Mayor for Planning and Economic Development (DMPED) is the primary agency charged with executing the Mayor's economic development strategy. Reporting up through DMPED are nine agencies such as the Department of Housing and Community Development, the Department of Consumer and Regulatory Affairs, the Department of Transportation, and the Office of Planning, among others, whose various missions and programs overlap with many economic development goals and activities.

²³ Bartik, Timothy. "Improving Economic Development Incentives." 2018. W.E. Upjohn Institute for Employment Research. P. 1.

²⁴ Bartik, Timothy. "A New Panel Database on Business Incentives for Economic Development." 2017 W.E. Upjohn Institute for Employment Research. P. 2-3.

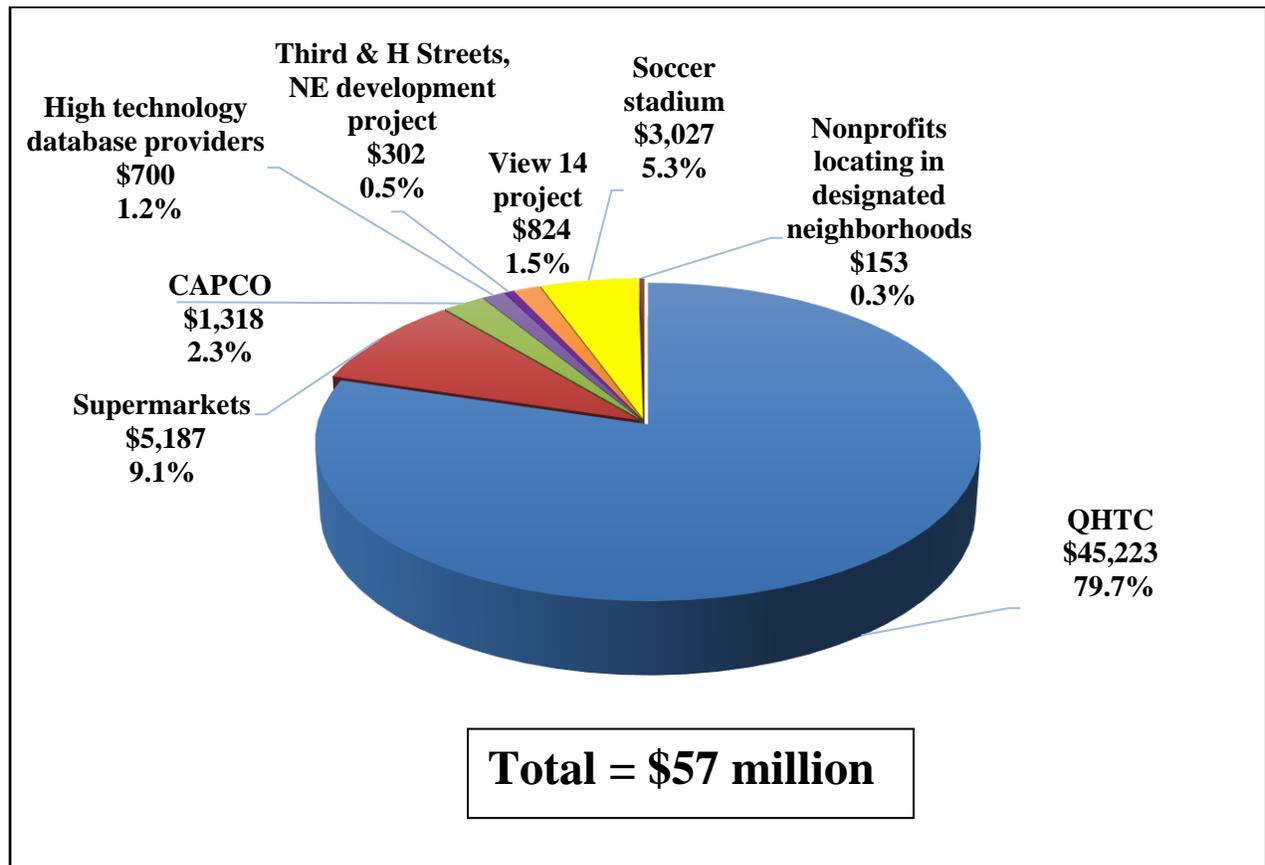
²⁵ *Ibid.*, 4.

²⁶ <http://dceconomicstrategy.com/>

²⁷ <https://dmped.dc.gov/page/about-dmped>

In addition to using tax incentives to spur economic development, the District employs an array of other tools such as tax increment financing (TIF), payments in lieu of taxes (PILOTs), revenue bonds, grants, and contracts. The District’s FY 2017 Unified Economic Development report calculated that in FY 2017, the District spent \$691 million on economic development incentives (counting those above \$75,000 each). This did not include almost \$1 billion of new (future) incentives that did not impact the FY 2017 budget.²⁸ Expenditures on contracts (\$427.6 m) and revenue bonds (\$115.6 m) make up most of the \$691 million, with revenue foregone to tax abatements and credits (the topic of this report) making up just under \$60 million in FY 2017.

Chart 4: All FY 2017 Economic Development Tax Expenditures, \$000



Source: ORA Analysis. Note: Summing tax expenditures does not consider possible interactions among individual tax expenditures, so it does not produce an exact estimate of the revenue that would be gained were any specific provision removed.

²⁸ FY 2017 Unified Economic Development Report (Year-End). Office of the Chief Financial Officer. February 20, 2018. Retrieved on April 23, 2018 from: <https://cfo.dc.gov/node/1310196>.

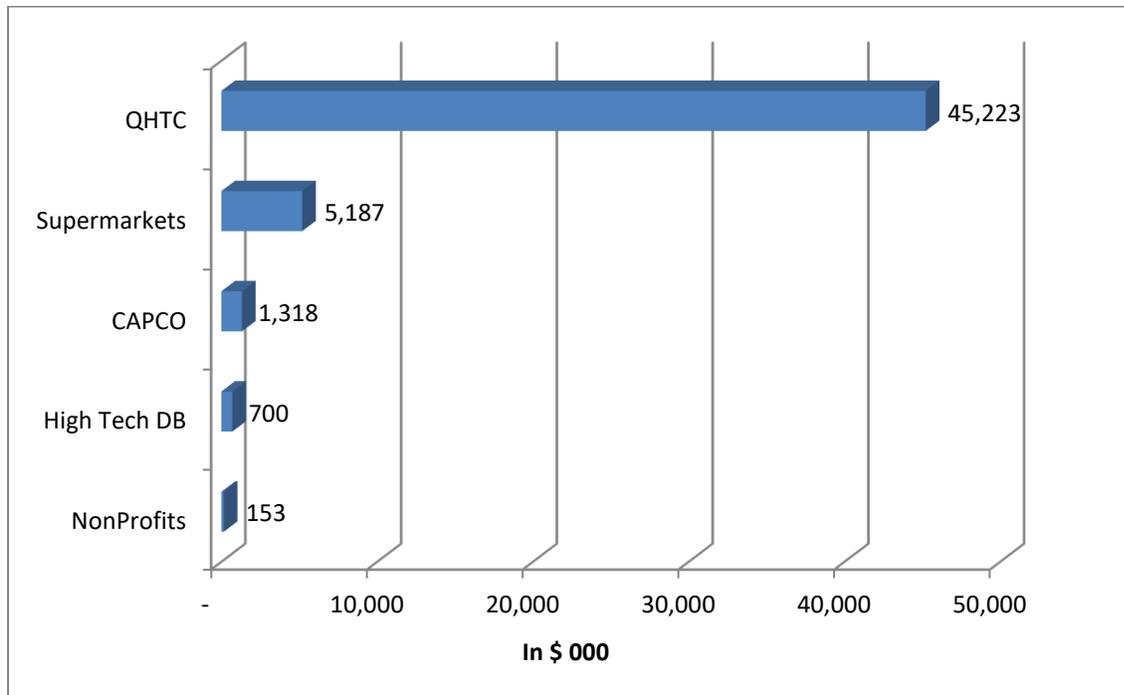
Part II: Review of the District's Economic Development Tax Expenditures

Economic Development-Related Categorical Tax Expenditures

Categorical economic development-related tax provisions, or those which anyone who is eligible may take advantage of, represented nearly \$53 million in foregone revenue in FY 2017. This is considered a low bound estimate as some lost revenue is not being tracked. There are 11 categorical economic development-related tax expenditure provisions, which generally support three main goals, including attracting and retaining high technology businesses in D.C., attracting and retaining supermarkets, and encouraging private capital investment in new or expanding small businesses in the District of Columbia.

Chart 5 below groups categorical tax expenditures by similar purposes. For example, the various franchise tax, real and personal property tax and sales tax expenditures available through the Qualified High Technology Company incentives are rolled up into one bar, as are a series of tax incentives for supermarkets. By far, the largest categorical economic development tax expenditure is the set of incentives for QHTCs, representing over \$45 million in foregone revenue in FY 2017.

Chart 5: FY 2017 Estimated Revenue Loss of Categorical Economic Development Tax Expenditures



Source: ORA Analysis.

Table 1 below presents all categorical economic development-related categorical tax provisions, the relevant tax, the type of tax expenditure, the date enacted, the D.C. Code reference, and an estimate of revenue foregone for FY 2017. This table is presented with related tax expenditures grouped together, and the analysis follows this order.

Table 1: Categorical Economic Development-Related Tax Expenditures

Name of Tax Expenditure	Tax	Type of Provision	Date Enacted	D.C. Code	FY2017 Revenue Loss Estimate (\$)
Qualified High Technology Company (QHTC)	Franchise	Exemption/ Rate Reduction (Credit)	2001	§ 47-1817.02-.06	\$35,392,129
QHTC	Franchise	Credits, Deferrals, Deductions	2001	¹	\$273,000
QHTC	Real Property	Exemption	2001	§47-811.03	\$37,000
QHTC	Personal Property	Exemption	2001	§47-1508 (a)(10)	\$112,000
QHTC	Sales	Exemption	2001	²	\$9,409,000
Supermarkets	Real Property	Exemption	1988/2000	§ 47-1002(23)	3,831,227
Supermarkets	Sales	Exemption	2000	§ 47-2005(28)	1,034,000
Supermarkets	Personal Property	Exemption	2000	§ 47-1508(a)(9)	322,000
Certified Capital Companies (CAPCO)	Insurance Premium	Credit	2004	§ 31-5233	1,318,000
High-technology commercial real estate database and service providers	Property	Exemption	2010	§ 47-4630	\$700,000
Economic Development Zone Incentives	Franchise	Credit	1988	²	\$0
Nonprofit Organizations locating in designated neighborhoods	Property	Abatements	2010	§ 47-857.11	153,168
TOTAL					\$52,581,524

Source: ORA Compilation from 2016 Tax Expenditure Report with some updates from more recent data.

Note: Summing tax expenditures does not consider possible interactions among individual tax expenditures, so it does not produce an exact estimate of the revenue that would be gained were any specific provision removed.

¹ §47-1817.02-.05; §47-1803.03 (a)(18); §47-1817.07-.07(a) 1803.03 (a)(18)

² §47-2001(n) (2)(G) and §47-2005 (31)

³ § 6-1501, § 6-1502, § 6-1504, and § 47-1807.06

Chapter I: Qualified High Technology Companies

Section I: Introduction and Overview

The following sections of the report provide a review and assessment of the District’s Qualified High Technology Company (QHTC) program. This package of tax incentives was adopted in 2000 with an interest in growing the District’s high technology sector. Most of the District’s economic development resources that are delivered through the tax code flow through the QHTC program and include the following incentives.

- a five-year corporate franchise tax exemption;
- a franchise tax rate reduction to six percent after the five-year exemption period;
- three franchise tax credits, including one for wages paid to employees;
- a real property tax abatement;
- a personal property tax exemption; and
- sales tax exemptions.

The largest dollar amount of tax benefits has been realized through the corporate franchise tax exemption and rate reduction, totaling over \$184 million from 2000 to 2015 (five percent of franchise tax revenue over that period) and estimated to be near \$35 million in both 2016 and 2017.²⁹ Insufficient data precludes a precise accounting of the tax dollars foregone for QHTCs through the sales tax exemption for sales and purchases over the years, though it is estimated to be nearly \$9.5 million in FY 2017 alone. The revenue foregone through the real property tax exemptions and personal property tax exemptions for QHTCs is estimated to be \$37,000 and \$108,000, respectively, in FY 2017.

A central characteristic of the QHTC law that affects how it has been implemented, monitored, and analyzed is the high level of complexity involved. Making a multifaceted set of incentives even more complicated, there have been significant changes over the years which have both broadened and restricted different aspects of the provisions and made tracking the tax benefits a more confusing exercise. Such a complex tax incentive is inconsistent with established best practices in tax policy and tax incentives and has significant implications for its administration and accountability. This analysis aims to provide a review of the main parts of the QHTC program, with a focus on the provisions for which fiscal impacts can be identified and quantified.

In addition to a discussion of the complexity and design issues of the incentive, the key finding of this analysis is that a few large companies are taking a large share of the QHTC credits without evidence of commensurate economic benefits. Further, many companies receiving QHTC credits were already in D.C. and it is unknown whether they engaged in new activities because of the credits. While there have been notable gains in the District’s high technology sector and D.C.’s QHTC payrolls have grown more than their non-QHTC counterparts, the design of the incentives and a lack of data about them preclude us from analyzing their effectiveness. If no changes are

²⁹ According to ORA analysis of Office of Tax and Revenue D.C. Corporate Franchise Tax data.

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made, ORA estimates the QHTC program will continue to represent at least \$40 million per year in foregone revenue.³⁰

In the following pages, Section I includes an Introduction and Overview of the history, purpose, and eligibility requirements of the program, as well as summary descriptions of each QHTC tax incentive. The descriptions include estimates of past fiscal impact and projected future fiscal impacts, where data allow such a presentation. Next, Section II presents an evaluation of QHTC benefits and costs, where data are available. Section III details various structural issues with the program. Finally, Section IV summarizes the findings and recommendations.

Overview of QHTC Legislative History

The “New E-conomy Transformation Act of 2000”³¹ authorized various provisions for QHTCs, the largest being a five-year franchise tax exemption and subsequent permanent franchise tax rate reduction to six percent for eligible QHTCs. While only QHTCs located in certain high technology development zones originally could take the five-year exemption, any eligible QHTC within the District could take advantage of the reduced rate.

The Technology Sector Enhancement Act of 2012 removed the geographic restrictions making all QHTCs eligible for the five-year franchise tax exemption, and further enhanced the terms for taxpayers by providing a five-year window for a QHTC to earn income before the credit “clock” begins on the five-year franchise tax exemption.³² The 2012 law also added a requirement that firms taking the credits have employee presence and economic activity *in the District* and changed the requirement that 51 percent of a company’s *total* gross revenues having to meet the standard for qualified high technology activities, making it 51 percent of a firm’s *District* revenues that must meet the standard. The 2012 law also reduced the capital gains tax rate for the sale of stock in QHTCs to three percent from the top rate of 8.75 percent for D.C. residents. In addition to these changes generally making the 2001 law more generous to QHTCs, the 2012 law restricted the scope by adding a \$15 million cap on the amount a single firm could receive in franchise tax exemptions. Up to 2012, no firm had exceeded \$15 million in exemptions.³³

In apparent response to a court case granting QHTC status to BAE Systems Enterprise Systems, Inc., a VA-based firm with no physical office in D.C., the Fiscal Year 2015 Budget Support Act of 2014 replaced the phrase “maintaining an office, headquarters, or base of operations,” with “leasing or owning an office.”³⁴ (The rationale for these changes will be further detailed in the evaluation section. See more on QHTC legislative and judicial actions in Appendix Table 1). Chart 6 provides data on the benefits provided through the franchise tax provisions. The sharp uptick in credits in 2007 results from a single firm’s claim, while major legislative changes in 2012 opened the way for more companies and higher claims.

³⁰ See pages 24-27 for a discussion of what experts consider principles of good tax policy and best practices for tax incentives.

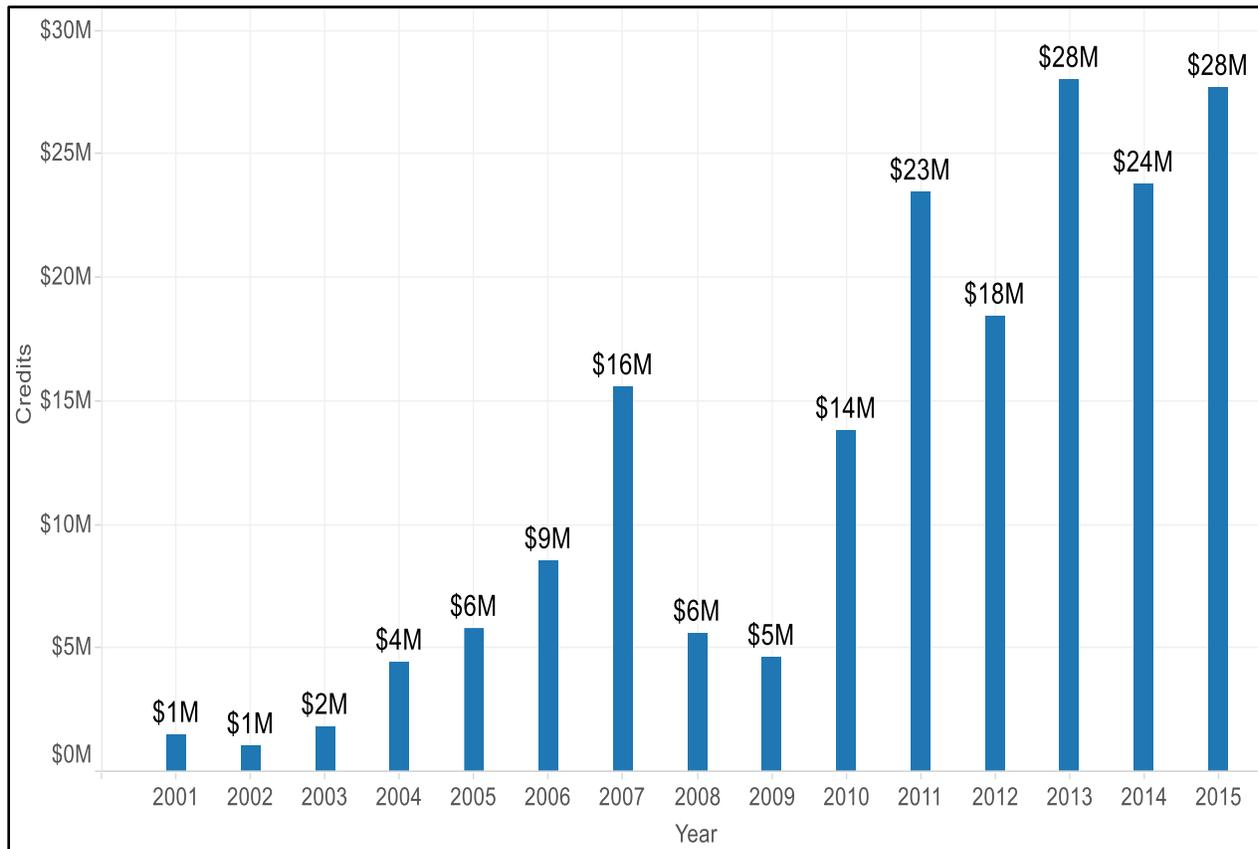
³¹ D.C. Law 13-256

³² D.C. Law 19-0211

³³ Tax Abatement Financial Analysis of Bill 19-747, “Technology Sector Enhancement Act of 2012.” May 29, 2012. Office of the Chief Financial Officer, p. 2.

³⁴ *BAE Systems Enterprise Systems Inc. v. District of Columbia Office of Tax and Revenue*, 56 A.3d 477 (D.C. 2012).

Chart 6: Total QHTC Corporate Franchise Tax Credit Claims, 2001 – 2015



Source: ORA analysis of D.C. Corporate Franchise Tax Data. Includes franchise tax exemption, rate reduction, and credits. 2015 is the latest year for which complete franchise tax data were available at the time of analysis.

Purpose of the QHTC Program

The original QHTC legislation introduced by the D.C. Council noted that “the Washington D.C. metropolitan region is a leader in the ‘new’ high technology economy and is projected to be one of the top three national centers of this new economy in the 21st Century,” yet it notes that much of this growth was based on businesses in Northern Virginia.³⁵ Given that growth in this sector represented a new source of jobs and revenue for the District, the legislation discusses the need to overcome existing barriers to the sector’s growth, which included having a trained workforce, affordable facilities, and the existence of better incentives offered by other jurisdictions.³⁶ The legislation makes clear that the QHTC program as introduced is intended to address these barriers by providing District residents with workforce training, making office space more affordable to “entrepreneurs and high technology start-up” companies that wish to begin or expand operations

... “to encourage high-technology firms to locate, expand, and stay in the District of Columbia, thereby strengthening the employment and economic base.”

³⁵ <http://lims.dccouncil.us/Download/8211/B13-0752-Introduction.pdf>; page 3. See Appendix for excerpt.

³⁶ Ibid.

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in the District, and to create a more competitive legal and regulatory structure to make D.C. more attractive to businesses comparing the prospect of starting a business in D.C. versus the suburbs.³⁷

The original legislation states that it is “intended to apply to high technology companies whose products or services depend to a significant extent on the application of scientific or technological skills or knowledge, whether it be a novel application of advanced technology to provide a totally new product or service, or an application of existing technology in an innovative manner.” Over the years, based on the implementing legislation, the primary purpose of all the QHTC-related incentives has been summarized as follows in ORA’s Tax Expenditure Reports: “to encourage high-technology firms to locate, expand, and stay in the District of Columbia, thereby strengthening the employment and economic base.”

Description of a Qualified High Technology Company

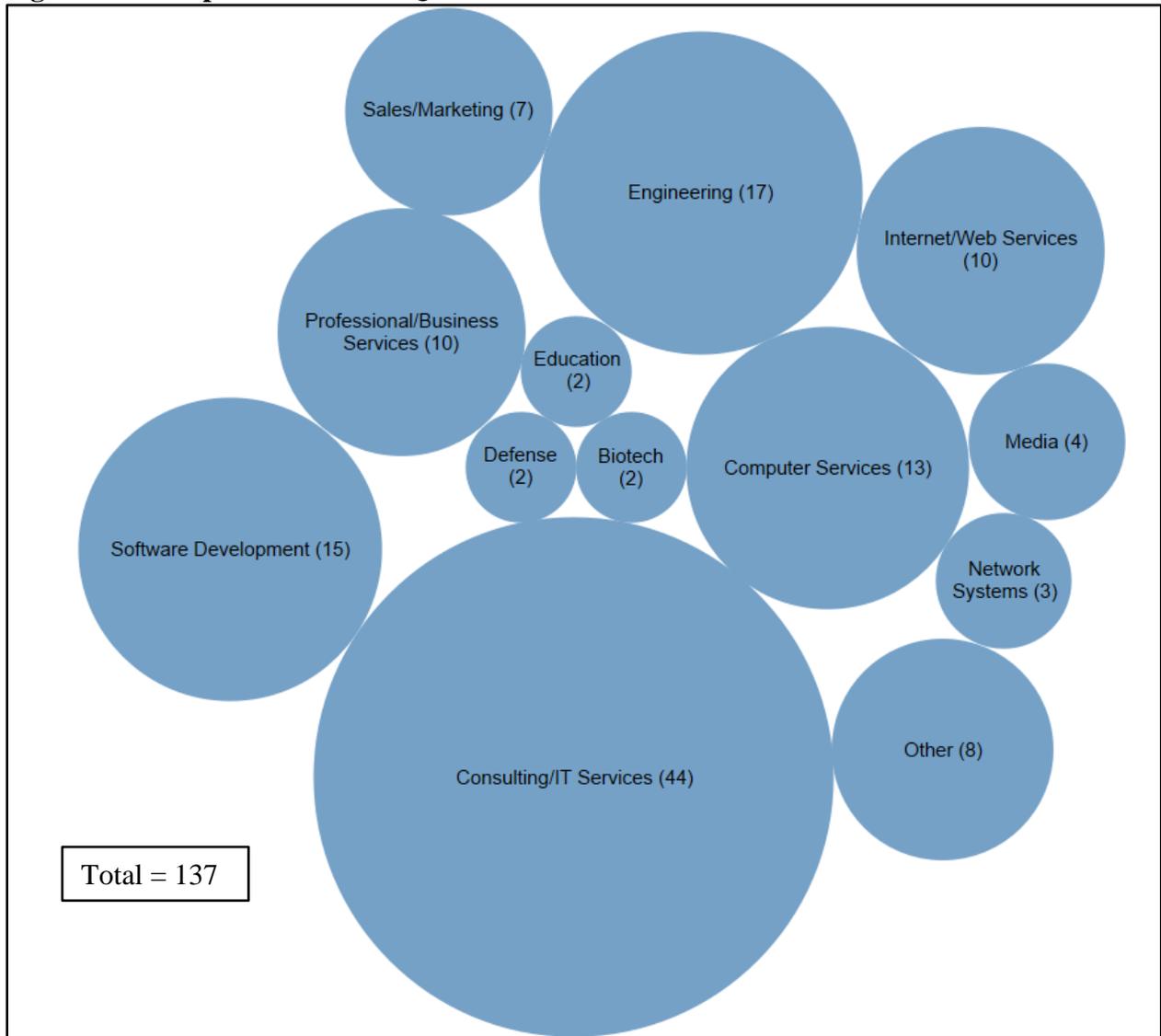
A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; advanced materials and processing technologies; engineering, production, biotechnology, and defense technologies; and electronic and photonic devices and components. See Appendix Table 2 for a longer description.

Confidentiality of companies’ corporate franchise tax returns precludes the disclosure of QHTC recipients’ names (unless a company was previously disclosed in a court case). Companies are required to file a certification form with the Office of Tax and Revenue (OTR) in order to certify as a QHTC and this form asks for the firm’s ‘Principal Business Activity.’³⁸ Figure 1 below presents ORA’s analysis of the terms that QHTCs submitted on this form in 2015 (most recent year available); similar and overlapping activities are grouped together with the number in parenthesis representing how many companies listed that principal activity. “Consulting” and “IT Services” are grouped together since several variations were presented, such as “IT consulting,” “technology consulting,” “Information technology consulting,” “technology services,” and “IT services.”

³⁷ Ibid., 4.

³⁸ In 2015, 137 of the 191 QHTC eligible companies filing the franchise tax filled out this field of the certification form (in 2015, only 150 companies claimed franchise tax credits).

Figure 1: Principal Activities of QHTCs in 2015



Source: ORA Analysis of 2015 QHTC Franchise Tax Returns. Out of 150 claimants, 137 companies reported a principal activity on their 2015 franchise tax return.

Description of Specific QHTC Tax Provisions

In the sections below, each QHTC tax incentive will briefly be described separately, and the impact and evaluation discussion for all the incentives will be discussed in a single section following the individual descriptions and will primarily focus on the franchise tax incentives. Table 2 below provides a high-level summary of the QHTC tax provisions.

Table 2: Summary of QHTC Tax Provisions

	QHTC Incentive	Description	FY17 Estimated Revenue Foregone (\$)
Corporate Franchise (Income) Tax			
1	QHTC business income tax exemption and tax rate reduction §47-1817.06	<ul style="list-style-type: none"> • QHTCs commencing business in D.C. between January 1, 2001 to January 1, 2012 are exempt from the franchise tax for 5 years after the date of commencement • QHTCs commencing business after January 1, 2012 are exempt from the franchise tax for 5 years after the date the QHTC has taxable income • Total exemptions shall not exceed \$15 million per QHTC • After 5-year period or \$15 million is reached, incorporated QHTCs pay a reduced franchise tax rate of 6%; no limit on amount of reduction of tax 	\$35,392,129*
1a	Credit for Employee relocation §47-1817.02	<ul style="list-style-type: none"> • Relocation reimbursements of up to \$5,000 for each employee relocated to D.C. and \$7,500 if the employee also relocates his or her principle residence to D.C. • No credit if the relocation costs are claimed as a deduction by the corporation • Unused credit may be carried forward for 10 years. (maximum annual credit = \$250,000 for non- D.C. employees and \$1,000,000 for D.C. resident employees) 	
1b	Credit for Wages to Qualified Employees §47-1817.03	<ul style="list-style-type: none"> • 10% of the wages paid to a qualified employee hired in the District after December 31, 2000 and employed in D.C. in any of the listed permitted activities • Wages must be paid during the first 24 calendar months of employment • Credit is limited to \$5,000 in a taxable year for each qualified employee (no other limitation) • Unused credit may be carried forward for 10 years 	
1c	Credits to retrain and employ disadvantaged workers §47-1817.04-.05	<ul style="list-style-type: none"> • Credit against franchise tax for expenses a QHTC paid or incurred during a taxable year after Dec 31, 2000 for retraining qualified disadvantaged employees • Credit may be taken as a refundable credit for up to 50 percent of any unused portion in the year incurred or it may be carried forward for 10 years • Credit is limited to \$20,000 for each qualified disadvantaged employee retrained during the first 18 months of employment • Credit for wages paid to a qualified disadvantaged employee may not exceed \$15,000 per employee per taxable year 	

*Credits claimed for 1a-c are included in the estimate; if credits have not been claimed and are being carried forward, those amounts are not included. See pages 44-46 for more detail.

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Table 2: Summary of QHTC Tax Provisions, Continued

	QHTC Incentive	Description	FY17 Estimated Revenue Foregone (\$)
2	Section 179 Deduction of depreciable business assets ¹	<ul style="list-style-type: none"> Deduction up to \$40,000 for Internal Revenue Code (IRC) section 179 expenses. 	\$273,000
3	Capital Gains deferral §47-1817.07-.07(a) 1803.03 (a)(18)	<ul style="list-style-type: none"> Qualified capital gain from the sale or exchange of a QHTC’s capital assets held for more than 5 years is not taxable Rollover (deferral) of certain capital gains Reduced tax rate of 3% for sales or exchanges beginning in 2019 	No estimate
Real Property Tax			
4	Abatement for new or improved buildings used by high-technology companies ²	<ul style="list-style-type: none"> Five-year freeze on assessed value of real property Reduction in real property tax for qualified leasehold improvements made by, or for, a QHTC tenant. 	\$37,000
Personal Property Tax			
5	Exemption for certain purchases of QHTCs ³	<ul style="list-style-type: none"> Qualified tangible personal property purchased and used or held for use by a QHTC (corporate and unincorporated) after December 31, 2000 is exempt from personal property tax for 10 years beginning with the year of purchase 	\$112,000
Sales Tax			
6	Exemption of certain sales and technology purchases ⁴	<ul style="list-style-type: none"> Exemption from sales tax for sales by QHTCs of intangible property or services, as well as exemption for certain technology purchases 	\$9,409,000
	TOTAL		\$45,223,129

Source: ORA estimates.

¹ §47-1803.03 (a)(18);

² §47-811.03;

³ §47-1508 (a)(10);

⁴ §47-2001(n) (2)(G) and §47-2005 (31)

1. QHTC Corporate Franchise (Income) Tax Exemption and Tax Rate Reduction

District of Columbia Code: D.C. Official Code § 47-1817.06

Sunset Date: None

Year Enacted: 2001

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax	\$18,469	\$28,051	\$23,756	\$27,723	\$35,181	\$35,392	\$30,650	\$31,477
Personal Income Tax	0	0	0	0	0	0	0	0
Total	\$18,469	\$28,051	\$23,756	\$27,723	\$35,181	\$35,392	\$30,650	\$31,477

Source: ORA Analysis. Estimate includes franchise tax exemption, tax rate reduction, and the three tax credits in the following sections. FY12-FY15 are actuals, FY16-FY19 are estimates.

Description

High-technology companies are eligible for a five-year exemption of business franchise taxes and a tax rate reduction to six percent thereafter.³⁹ For a business that was certified as a QHTC before January 1, 2012, the five-year tax exemption begins when the company commenced business in the District of Columbia, whether the company has taxable income or not. A change in the law allowed for a business that was certified as a QHTC on or after January 1, 2012 to begin the five-year tax exemption when the company has taxable income. The 2012 law change also removed the geographic location requirement, allowing a QHTC to be located anywhere in the District (except in the Ballpark TIF⁴⁰).

When a QHTC company files its tax return, it calculates the amount of tax it owes and if it is in the five-year exemption window, then that full amount is its “QHTC credit” for that year. If it receives a reduced tax rate, then the tax savings it receives from the tax rate reduction is considered its “QHTC credit.”⁴¹ The total amount of franchise tax that a QHTC may exempt shall not exceed \$15 million; however, the reduced QHTC franchise tax rate of six percent continues after the exemption limit is reached.

³⁹ The general corporation and unincorporated business franchise tax rate was 9.975% in 2014; 9.4% in 2015; 9.2% in 2016, 9.0% in 2017 and falls to 8.25% for tax year 2018. These are the final rate reductions resulting from the District’s revenues achieving “triggers” passed by the D.C. Council following recommendations from the 2013 Tax Revision Commission.

⁴⁰ DC Code 2-1217.12a.

⁴¹ There are franchise tax credits which are more like traditional income tax credits; discussed below.

Table 3: Total QHTC Franchise Tax Credit Amounts, 2001 – 2015

Tax Year	Total Franchise Tax Revenue (all DC corporations) (\$)	Number of Companies Claiming QHTC Eligibility	Number of QHTCs Receiving Credit > \$0	Total QHTC Credit Amount (\$)	Median Credit Amount (\$)	QHTC Credit as a % of Total Franchise Tax Revenue
2001	\$233,237,000	41	41	\$1,479,569	\$3,393	0.63%
2002	\$142,647,000	52	52	\$1,051,260	\$1,642	0.74%
2003	\$156,777,000	539	48	\$1,853,446	\$6,541	1.18%
2004	\$168,353,000	112	56	\$4,461,028	\$15,386	2.65%
2005	\$195,492,000	61	41	\$5,778,522	\$24,088	2.96%
2006	\$215,283,000	83	68	\$8,504,262	\$7,713	3.95%
2007	\$255,511,000	123	81	\$15,580,051	\$3,098	6.10%
2008	\$286,204,000	108	47	\$5,592,239	\$10,598	1.95%
2009	\$221,882,000	114	50	\$4,617,924	\$19,884	2.08%
2010	\$207,292,000	142	83	\$13,836,739	\$16,739	6.67%
2011	\$216,280,000	191	84	\$23,460,563	\$29,648	10.85%
2012	\$302,924,000	292	117	\$18,469,291	\$27,026	6.10%
2013	\$298,993,000	244	141	\$28,050,770	\$23,260	9.38%
2014	\$280,186,000	272	169	\$23,756,483	\$27,590	8.48%
2015	\$308,027,000	249	150	\$27,722,902	\$33,699	9.00%
Total	\$3,489,088,000	--	--	\$184,215,049	--	5.28%

ORA Analysis. Note: “Total QHTC Credit Amount” includes 5-year tax exemption, tax rate reduction to 6%, and any tax credits taken. Credit amounts capture all credits marked as QHTC in data. There was no “certified QHTC” field in database 2001 and 2002, so all firms taking the credit were counted as eligible in those two years.

Impact

In tax year 2015, 249 companies filed as eligible to be QHTCs,⁴² while 150 companies claimed total credits of \$28 million and in 2014, 272 companies claimed eligibility, while 169 claimed credits totaling \$24 million. The estimated revenue loss presented in the table on the previous page, as well as the “QHTC credit” listed in Table 3 above (and in Charts 6,7, and 8 on pages 37, 54, and 55) cover the tax exemption and tax reduction, as well as all the business tax credits available to QHTCs. The bulk of the revenue loss results from the business income tax five-year exemption and tax rate reduction to six percent, which generally makes up more of the revenue loss to QHTCs than the credits or the tax expenditures through other taxes for QHTCs. As Table 3 above shows, the total “cost” to the District in terms of revenue foregone of the QHTC credits from 2001 to 2015 was about \$184 million.

⁴² Companies must certify they are QHTCs to receive sales, personal property or real property tax benefits, so there is a reason to do so even if they do not take franchise tax credits in a given year.

1a. QHTC: Corporate Franchise (Income) Tax Credit for Employee Relocation

District of Columbia Code: D.C. Official Code § 47-1817.02

Sunset Date: None

Year Enacted: 2001

Description

A QHTC may claim franchise tax credits for the relocation costs paid to, or on behalf of, a qualified employee to reimburse actual moving expenses, to assist in financing the purchase of a home, or pay for the required security deposit or lease payments for the first year of a lease. The credit may not exceed \$5,000 per taxable year for each employee relocated to the District from another state, or \$7,500 per taxable year for each employee relocated to the District from another state if the employee also relocates his or her principal residence into the District. Unused credit may be carried forward for 10 years. The maximum annual credit is \$250,000 per firm for employees not residing in the District, and \$1,000,000 for employees residing in D.C.

A company may not claim the credit until it has relocated at least two qualified employees and employed them for at least six months in the District. The credit is not available for employees who work less than 35 hours per week, and the company may not claim the credit if it has claimed a deduction for the relocation costs. If the amount of the credit exceeds the amount otherwise due, a company may carry forward the unused amount of the credit for 10 years.

Impact

A review of available data from 2010-2015 shows that this credit has not been widely used in recent years. The credit was claimed for five employees total in 2010 and in 2014. There is no field on the tax return for a carryforward amount related specifically to this credit before 2016; however, the lack of credit claims in the six years of data reviewed indicates that there is likely no credit being carried forward, though there could be a carry forward from credits claimed but not used in the years prior to 2010.

1b. QHTC: Corporate Franchise (Income) Tax Credit for Wages to Qualified Employees

District of Columbia Code: D.C. Official Code § 47-1817.03

Sunset Date: None

Year Enacted: 2001

Description

A QHTC may claim a credit against its franchise tax liability equal to 10 percent of the wages paid during the first 24 calendar months of employment to a qualified employee hired after December

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31, 2000. A qualified employee is “a person who is employed in the District by a QHTC.”⁴³ The credit for each qualified employee may not exceed \$5,000 per taxable year. If the credit exceeds the amount of tax otherwise due from a high-technology company, the unused amount of the credit may be carried forward for 10 years.

Impact

In 2015—the latest year of data available for analysis—49 firms claimed 2,852 eligible employees with aggregate wages of \$178.1 million, qualifying the firms for \$12.6 million in tax credits. Any company still in the five-year exemption period (or whose tax liability was less than their credit amount) could carry forward these credits for up to 10 years to use them against future tax liability. As of 2015, nearly \$50 million in wage credits were carried forward. See Table 4 below for a summary of the wage credit from 2010 to 2015.

Table 4: Analysis of QHTC Wage Credit, 2010 to 2015

Year	Firms Claiming Credit (#)	QHTC Employees claimed (#)	QHTC Wages Paid (\$)	QHTC Wage Credits Claimed (\$)	Credit Carryforward (\$)
2010	21	861	\$29,671,053	\$2,505,124	\$12,566,023
2011	22	1,305	42,869,709	3,536,408	16,149,987
2012	39	2,542	135,642,575	8,897,672	21,583,205
2013	39	2,865	141,127,425	16,376,651	39,251,548
2014	60	3,480	174,426,547	11,625,257	50,317,695
2015	49	2,852	178,132,228	12,560,516	49,792,528
Total	--	--	--	\$55,501,628	--

Source: ORA analysis of D.C. Corporate Franchise Tax returns of QHTC companies.

Note: Not all required fields were filled out by companies claiming credits. The total of \$55.5 million in wage credits is included in the total of \$184.2 million in overall QHTC credits claimed through 2015. Credit carryforward is not cumulative.

1c. QHTC: Corporate Franchise (Income) Tax Credits to Retrain and Employ Disadvantaged Workers

District of Columbia Code: D.C. Official Code § 47-1817.04-05

Sunset Date: None

Year Enacted: 2001

⁴³ D.C. Official Code § 47–1817.01 (4)

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Description

A qualified high technology company may take credits against its franchise tax liability equal to 50 percent of the wages paid to a qualified disadvantaged employee during the first 24 calendar months of employment. The credit may not exceed \$15,000 in a taxable year for each disadvantaged employee, and the credit is not allowable if the company accords the qualified employee lesser benefits or rights than it accords other employees in similar jobs. The credit may be taken as a refundable credit for up to 50 percent of any unused portion in the year incurred or it may be carried forward for 10 years.

The credit is limited to \$20,000 for each qualified disadvantaged employee *retrained* during the first 18 months of employment. Credit for wages paid to a qualified disadvantaged employee may not exceed \$15,000 per employee per taxable year. A qualified disadvantaged employee refers to a District of Columbia resident who is receiving benefits from the Temporary Assistance to Needy Families (TANF) program; was a recipient of TANF in the period immediately preceding employment; was released from incarceration within 24 months of being hired by a qualified high-technology company; or qualifies for the Welfare-to-Work Tax Credit or the Work Opportunity Tax Credit under the U.S. Internal Revenue Code (this includes veterans).⁴⁴

Impact

There is a field for the refundable relocation credit in the tax data, and it appears to have been used fewer than ten times in small amounts over the life of the credit -- and it isn't clear each of those weren't filing mistakes. A review of five years of paper tax returns filed by QHTC companies from 2010 to 2015 confirmed this assessment. This is notable because the refundable credit is often touted as a key feature of the QHTC program to enhance workforce development, yet it is not being used signaling a lack of effectiveness.

2. QHTC: Corporate Franchise (Income) Tax Subtraction for Depreciable Business Assets

District of Columbia Code: D.C. Official Code § 47-1803.03(a)(18)

Sunset Date: None

Year Enacted: 2001

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0	\$260	\$273	\$288	\$304
Personal Income Tax Loss	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Total	\$0	\$0	\$0	\$0	\$260	\$273	\$288	\$304

Source: ORA Analysis.

⁴⁴ D.C. Official Code § 47-1817.04.

Description

QHTCs benefit from more generous rules regarding the franchise tax deduction for personal property expenses. Whereas other businesses can subtract the lesser of \$25,000 or the actual cost of the property for the year the property is placed in service, a QHTC can subtract the lesser of \$40,000 or the actual cost of the property for the year the property is placed in service.

The accelerated depreciation for high-technology companies means that amounts available for deduction in later years will be smaller; nevertheless, the companies benefit because the enhanced deduction gives them resources immediately that they can put to productive use. The provision violates the principle of horizontal equity because companies in other industries with similar levels of income and personal property expenses cannot subtract the same amount.

Impact

This provision has not been previously estimated in ORA reports. Based on taking a share of the amount that QHTCs report as depreciation on their franchise tax forms it is now estimated to represent foregone revenues of \$260,000 in FY16, and slightly increasing from there.

3. Capital Gain Deferral and Exclusion

District of Columbia Code: D.C. Official Code § 47-1817.07- 1817.07(a)

Sunset Date: None

Year Enacted: 2001

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	*	*	*	*	*	*	*	13,000

Source: ORA Analysis.

Description

Qualified capital gains from the sale or exchange of QHTC assets held for more than five (5) years are excluded from the computation of District gross income and therefore not taxable. This does not include a gain attributable to real property or an intangible asset which is not an integral part of a QHTC, or a gain that occurs before January 1, 2001 or after December 31, 2007. Under the original QHTC legislation, if a gain was not held for at least five years, it was to have been taxed as regular income.

In 2012, D.C. Law 19-0211 (The Technology Sector Enhancement Act of 2012) reduced the capital gains rate for the sale of stock in QHTCs to 3 percent from the top rate of 8.75 percent for D.C. residents beginning in 2019 if the investment was made after March 11, 2015, held for at least 24 continuous months, the stock of the QHTC was not publicly traded, and the investment is in common or preferred stock of the QHTC.

Part II: Review of Economic Development Tax Expenditures – QHTC Tax Incentives

If a non-corporate taxpayer sells a qualified stock issued by a QHTC and held for more than six months, the gain from the sale shall be recognized if the amount realized on the sale exceeds the cost of qualified stock purchased by the taxpayer within 60 days of the date of the sale. The gain from the sale would be reduced by the amount of the gain, not to exceed such cost, that was previously deferred under this section.

4. Real Property Tax Abatement for New or Improved Buildings Used by High-Technology Companies

District of Columbia Code: D.C. Official Code § 47-811.03
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$35	\$36	\$37	\$37	0	0

Source: ORA Analysis.

Description

Two types of non-residential or mixed-use buildings are eligible for a freeze on property taxes for a five-year period, if more than 50 percent of the tenants are qualified high-technology companies, or at least 50 percent of the aggregate square footage is leased to a qualified high-technology company using the premises as an office or retail space.

First, new buildings which received their initial certificate of occupancy after December 31, 2000, are eligible for the property tax freeze. In addition, existing buildings that were improved to adapt or convert the property for use by a qualified high-technology company are also eligible for the tax abatement.

Impact

From 2014 and 2017, one property in the District of Columbia received the tax abatement for leasing space to a QHTC. The revenue loss estimated above assumes that no new properties will receive this abatement.

Box 1: Creative and Open Space Modernization Tax Rebate - (§ 47-4665)

Recognizing that many QHTCs lease rather than own the space that they use, yet need to make significant renovations, the Creative and Open Space Modernization Amendment Act was passed in 2015 (and later amended in 2016). QHTCs (as well as non-QHTC firms) may apply to the Deputy Mayor for Planning and Economic Development (DMPED) for an interior renovation tax rebate if they lease their space but make renovations or improvements. Firms may receive the lesser of the following three amounts, annually: their portion of the property tax paid, or 10 percent of the value of the qualified improvements, or \$1 million (maximum award per property per year). Companies must lease at least 50,000 square feet and make a 12-year commitment to receive the rebate (and must reapply each year).

As of mid-2018, DMPED reported that one company had received an award and a few other applications had been received. According to tax incentive best practices, this program represents an improvement on many aspects of the QHTC tax incentives in that it is administered by an agency and the terms are targeted and specific. Further the funds were in the budget, are limited each year, and DMPED must certify all eligible abatement recipients annually. Companies must commit to stay for 12 years so while not explicitly containing a claw back provision this requirement does give the District grounds on which to recoup its payments if the company moves or does not meet the terms of the rebate.

5. QHTC: Personal Property Tax Exemption

District of Columbia Code: D.C. Official Code § 47-1508(a)(10)

Sunset Date: None

Year Enacted: 2001

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$100	\$104	\$108	\$101	\$104	\$112	\$111	\$111

Source: ORA Analysis.

Description

The personal property of a QHTC is exempt from personal property taxation for the 10 years beginning in the year of purchase, for personal property purchased after December 31, 2000. In addition, qualified personal property leased to a qualified high technology company under a lease-purchase or security-purchase agreement is also exempt from personal property tax for a period not to exceed 10 years.⁴⁵

Impact

⁴⁵ The property is not exempt from the personal property tax if it is leased to a qualified high-technology company under an operating lease.

Part II: Review of Economic Development Tax Expenditures – QHTC Tax Incentives

High-technology companies in the District of Columbia benefit from this provision; though only a handful of QHTCs have claimed the exemption in recent years. (The first \$225,000 of personal property is already exempt in D.C.)

6. QHTC: Certain Sales and Technology Purchases

District of Columbia Code: D.C. Official Code § 47-2001(n)(2)(G) and § 47-2005(31)
Sunset Date: None
Year Enacted: 2001

Revenue Loss (Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Sales	\$7,576	\$7,436	\$7,659	\$8,595	\$8,777	\$9,363	\$9,563	\$9,976
Purchases	\$36	\$36	\$37	\$41	\$42	\$45	\$46	\$46
TOTAL	\$7,613	\$7,472	\$7,696	\$8,637	\$8,819	\$9,409	\$9,609	\$10,023

Source: ORA Analysis.

Note: See Impact section below for a description of estimates.

Description

The gross receipts from certain sales of intangible property or services, which are otherwise taxable, are exempt from the sales tax if the sale is made by a QHTC within the District of Columbia. The list of tax-exempt products and services includes website design, maintenance, hosting, or operation; Internet-related consulting, advertising, or promotion services; graphic design; banner advertising; subscription services; and Internet website design and maintenance services. This exemption does not apply to telecommunication service providers.

Further, certain ‘technology sales’ or purchases, are also exempt, including “computer software or hardware, and visualization and human interface technology equipment, including operating and applications software, computers, terminals, display devices, printers, cable, fiber, storage media, networking hardware, peripherals, and modems when purchased for use in connection with the operation of the Qualified High Technology Company.”⁴⁶

Impact

Data on QHTC sales and purchases were not tracked for tax years 2010 – 2015, therefore the latest data available on QHTC sales and purchases exempted in 2009 was used to project tax expenditures based on actual growth in overall sales tax revenues. (These estimates represent a different methodology than was used in prior ORA reports for estimates of sales tax revenue foregone of the same period, and the current estimates are higher.)

⁴⁶ See D.C. Official Code § 47-2005(31).

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In 2009, 185 companies claimed exempt sales and exempt purchases on their sales tax returns. In that same year, 51 of the companies were not marked in the data as QHTCs; those companies claimed 3 percent of the total exempt sales and 15 percent of total exempt purchases. The 134 of QHTCs claiming exempt sales and purchases in 2009 marked a significant increase in QHTC claims as there were only 28 claiming exempt sales and purchases in 2008, 22 in 2007, and 14 in 2006, and 39 in 2005 (the first year for which we have data). Data on QHTC sales and purchases may be available again beginning for tax year 2017.

Section II: Evaluation of QHTC Benefits and Costs

The overarching goal of the QHTC tax incentive package is to help make the District a hub for high technology business by maintaining and strengthening the high tech workforce in the District, thereby contributing to the long-term economic growth of the city.⁴⁷ Based on these goals, an evaluation of the program should determine whether the incentives have induced firms to take any of the following actions that they otherwise would not have taken without the incentive: a) stay in the District instead of moving out; b) locate in the District instead of elsewhere; or c) hire, relocate, or retrain employees in order to grow the District’s high technology workforce. Next, an evaluation should measure the benefit to the District of these results, allowing an analysis of the incentive’s costs and benefits.

The broad, untargeted nature of the goals and changing and complex design of the QHTC provisions make it difficult if not impossible to answer these “but for”⁴⁸ questions that are often difficult to assess in tax incentive evaluations. A QHTC does not need to be a new firm or hire new employees to receive incentives so any existing high technology firms meeting the eligibility requirements when the law passed are able to claim credits without relocating or expanding their business in the District. We cannot know if the QHTC program compelled businesses to remain in D.C. when they would have otherwise left. This lack of targeting could be addressed by providing incentives on a discretionary basis to promote *new* economic activity that would not otherwise have occurred.

Sometimes data on jobs created after 2000 are reported on QHTC returns (if wage credits are claimed), though it is not known whether these jobs were created because of the QHTC incentive and would not have been created otherwise given that the companies did not have to be new companies to receive them. Even if the jobs were created due to the incentive, consistent and verifiable information is not available on the level of wages,⁴⁹ nor is there consistent information about who is filling the jobs (names or other identifying information), and whether they are D.C. residents (it is not a requirement that they be residents, but this information would be needed to measure the benefit to the District).

The dearth of data on the QHTC program leads to a lack of transparency and prevents us from knowing the full QHTC benefits and costs to the District. Those data issues will be discussed throughout the following sections. First, the following sections analyze the data that are available to assess benefits and costs of the QHTC incentives, including descriptive detail about the types of companies claiming the credits.

⁴⁷ See Appendix for an excerpt from the Introduction of B13-0752 “The New E-conomy Transformation Act of 2000,” <http://lims.dccouncil.us/Download/8211/B13-0752-Introduction.pdf>.

⁴⁸ The “but for” question aims to assess whether an economic impact would have happened “but for” the incentive. This question is difficult to answer even with good data, and in this case, data are not available to directly assess the question.

⁴⁹ The maximum wage that can be claimed for the wage credit is \$50,000 per employee and the credit is 10% of the wage up to \$5,000. Therefore, what gets reported may be an undercount of the total wage if the wage is over \$50,000.

Benefits of the QHTC Incentives

Did QHTC Credits Induce Companies to Locate in D.C.?

The attraction of new companies into a jurisdiction is one of the most sought-after goals of most state and local economic development officials. Yet knowing whether a given incentive caused such moves is almost always impossible. While we do not know whether any companies relocated to or started in D.C. that otherwise would not have but for the incentives, the non-targeted design of the QHTC program means we should be able to find out whether recipient companies were in D.C. before receiving the QHTC credits. It is difficult to glean from the QHTC data whether new firms moved in after the program began and started taking QHTC credits the first year they filed corporate taxes in D.C. A review of the top 50 credit awards between 2001 and 2015 (representing \$115 million in QHTC credits taken) shows that only a handful of firms began simultaneously filing corporate franchise taxes and taking the QHTC credit after 2001 when the QHTC program started, a possible indication those firms were responding to the QHTC incentives. On the other hand, over \$100 million in QHTC credits was taken by 24 companies that were either already located in D.C. and paying corporate franchise taxes before becoming a QHTC or were already in the District and paying taxes in 2001, the first year for which we can electronically track both franchise tax filers and QHTC-related data.⁵⁰ These numbers are likely a lower bound of what existing D.C. companies received, given we did not research whether most QHTCs were already in the District.

Up to 2015, over \$100 million in QHTC credits was claimed by 24 companies that were either already located in D.C. and paying corporate taxes before becoming a QHTC or were already in the District and paying franchise taxes in 2001, the first year of the QHTC program.

It is possible that some of these companies that were already in D.C. could have moved some of their outside business activities or employees into the city to take advantage of the credits, however, we have no evidence to support this. Given that engaging in new activities was not a requirement of the incentives it is possible that some companies claiming the franchise tax credits received a tax break to do what they would have done otherwise. The broad design of the QHTC program made this possible since all existing QHTCs at the time of the legislation were eligible to receive the tax credit if they applied for QHTC status.

Do Companies Stay in D.C After Taking QHTC Credits?

Given that maintaining the QHTC workforce was also a goal of the original QHTC legislation, it is instructive to look at how many firms leave the District after claiming the QHTC credit. The company that received the single largest QHTC credit moved outside of D.C. in the following year. This firm was

The company that received the single largest QHTC credit moved outside of D.C. in the following year.

⁵⁰ While firms were supposed to file franchise taxes and certify as QHTCs to take any of the other QHTC incentives even if they owed no franchise taxes (such as sales taxes or personal property taxes), it is theoretically possible a firm moved to D.C. or started up here because of the incentives but did not have franchise tax liability right away so only filed taxes in order to pay the minimum tax and did not certify as a QHTC. If the firm did not certify in the initial year, it would appear in the data that it was already here and not taking advantage of the incentives.

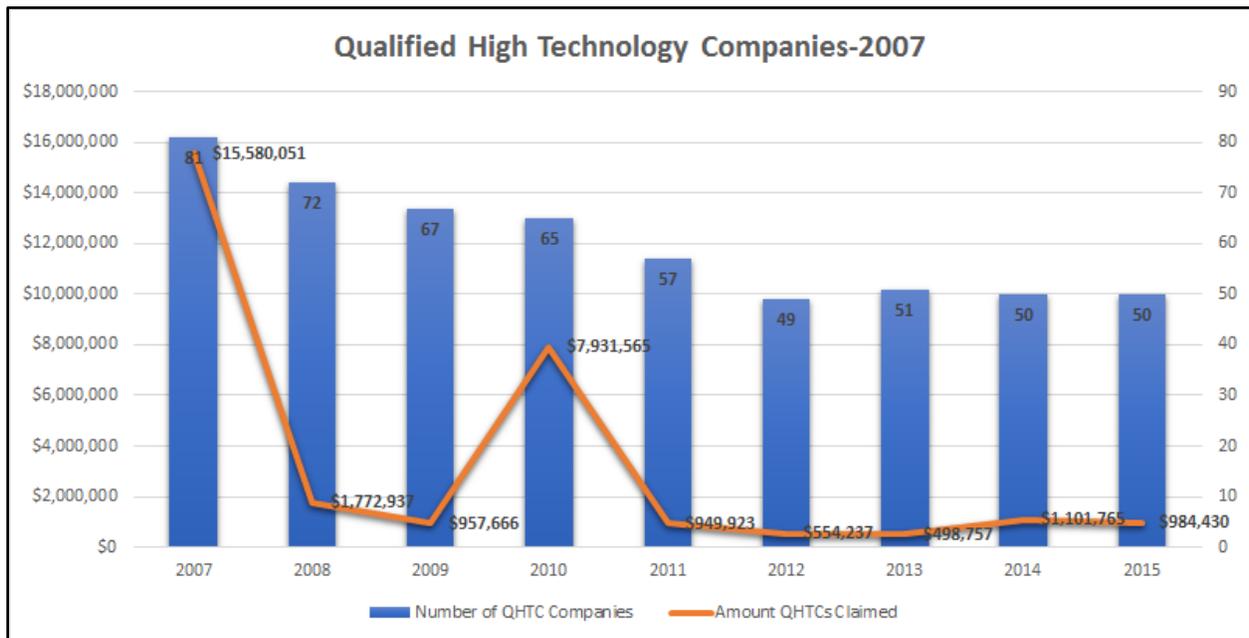
Part II: Review of Economic Development Tax Expenditures – QHTC Tax Incentives

already in the D.C. franchise tax database before it became a QHTC. In this case, it seems that the QHTC incentive was a large windfall to this company. This example is likely not representative of most of the QHTC recipients' behavior; however, the fact that the law allowed for this to occur with no penalty to the company and with no mechanism by which the city could recoup the lost revenue may be a reason to take a closer look at the program's structure.

Previous ORA research on QHTCs from 2001 to 2012 found that a “significant number of companies certified as QHTC in one year would no longer qualify [or claim QHTC status] in the following years and will in other cases stop filing business returns. Companies either stopped doing business in the District during this period or they merged with other companies to change their business structure and become unincorporated.”⁵¹ If companies are staying in D.C. but changing their structure to avoid certain District taxes, there may be implications for the District's ability to reap economic gains created by the incentives. See Appendix 4 for charts tracking QHTCs in the earlier years of the program up to 2012. Those charts illustrate that more QHTC filers left the data in the earlier years than have done so in the more recent two years that were tracked and presented below.

Chart 7 below shows that of the 81 companies that claimed \$15.6 million in QHTC credits in 2007, 72 of them remained in 2008; 67 in 2009; 65 in 2010, and about 50 for the following four years.

Chart 7: Tracking QHTCs from 2007 to 2015



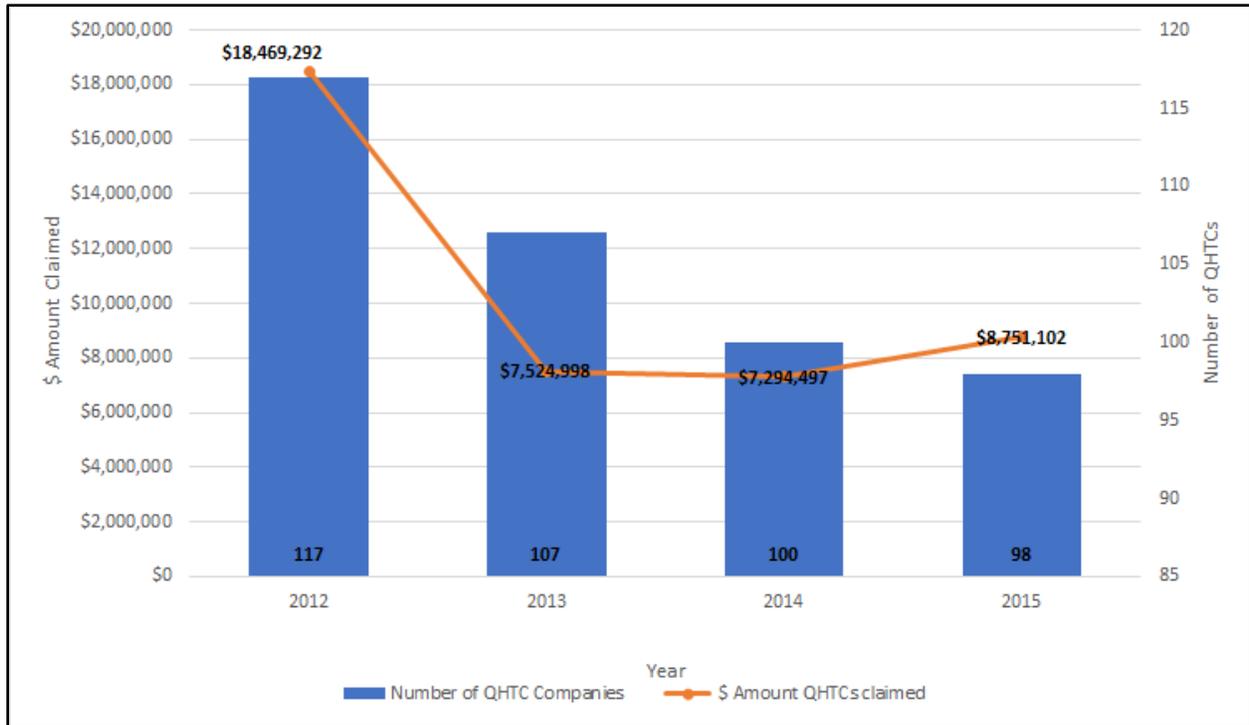
Source: ORA analysis of D.C. Corporate Business Franchise Tax data.

⁵¹Geng, Yi. “Analysis of Effectiveness of D.C. Qualified High Technology Companies (QHTC) Credits.” 2016. Office of Revenue Analysis. P. 1.

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Chart 8 below shows that of the 117 firms that claimed \$18.5 million in QHTC credits in 2012, 107 of them remained in 2013, 100 in 2014, and 98 in 2015.

Chart 8: Tracking QHTCs from 2012 to 2015



Source: ORA analysis of D.C. Corporate Business Franchise Tax data.

Did QHTC Payrolls Increase?

Using an indirect method to try to measure the impact of the QHTC program, the previously mentioned ORA study found that for “QHTC companies that stayed in D.C. and continued to do business in the District, their D.C. payrolls grew faster than their nationwide payrolls, while payroll growth for comparable non-QHTC companies was slower than the nationwide payroll growth.”⁵² This finding raises the possibility that the QHTC incentives were used to increase the payrolls of these firms. To the extent employees on the QHTC payrolls live in the District, the payroll growth of the QHTCs may mean that the District received more in income tax revenues from those employees (and through other taxes) than it otherwise would have without the QHTC incentives.

Many companies stopped doing business in D.C. after receiving QHTC credits; however, the companies that stayed tended to perform better than non-QHTC companies, using payroll growth as a metric.

⁵²Ibid. Geng performed a regression analysis to compare the payrolls of QHTC companies with the payrolls of comparable non-QHTC companies both in D.C. and nationwide, taking into account economic variables.

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These findings on increased QHTC payroll growth of companies that stayed in the District are positive since one of the goals of the QHTC incentives is that the investment in new companies would strengthen the D.C. workforce and thereby increase District tax revenue from QHTCs' employees. However, we do not know if the QHTC credits caused this payroll growth or if it would have happened anyway. Even if the growth resulted from the QHTC program, to measure the benefits to the District we would need to know how many of the QHTC's employees are D.C. residents and what their wages are, which we do not know.

Did D.C.'s High Technology Sector Grow?

Another way to indirectly assess the impacts of the QHTC program involves analyzing technology sector data that have been measured consistently over the time of the QHTC program. This type of descriptive analysis does not provide a direct assessment of outcomes related to the QHTC program since we do not know what would have happened in this sector without the QHTC program. However, viewing the trends in the sector is an important analytical tool to provide context for assessing the QHTC tax incentives.

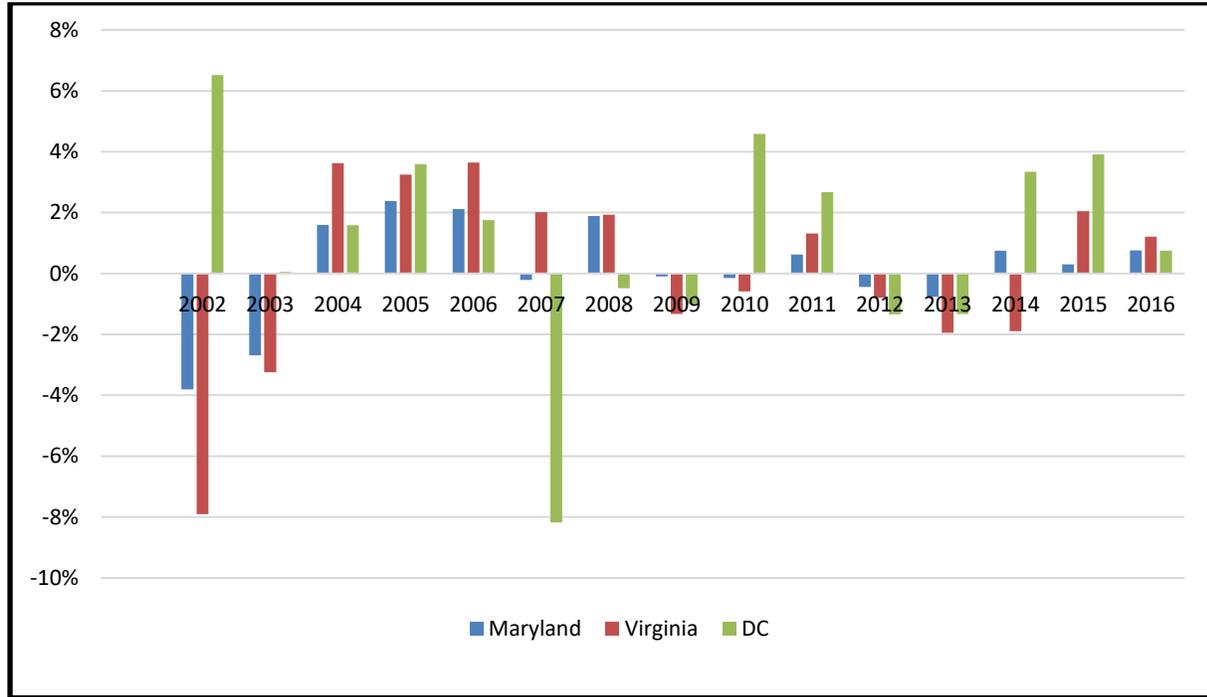
The annual growth in D.C.'s number of technology employees has been higher than in Maryland or Virginia from 2001 to 2016, as well as the U.S.
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A 2016 U.S. Bureau of Labor Statistics (BLS) report on high technology jobs describes that the high-tech sector was hit hard by the 2000–2001 recession and subsequently lost jobs but was more insulated from the 2007–2009 recessions. BLS notes that “while overall high-tech employment has remained relatively stable as a share of total employment, the high-tech sector has seen dramatic shifts from manufacturing to services,” which now account for more than 52.6 percent of all high-tech employment and is projected to rise.⁵³

CompTIA, a nonprofit technology association serving the technology industry and technology workforce, annually publishes the *Cyberstates* report to quantify the technology sector and the technology workforce across multiple vectors. It notes that while there are various ways to measure technology jobs, CompTIA focuses on a more narrowly defined technology subset. CompTIA provided ORA with data (resulting from its analysis of BLS data) showing that the percentage of total U.S. technology employees located in D.C. has grown more than Maryland or Virginia's percentage of technology employees (of the U.S. total). Further, D.C.'s annual growth in the number of technology employees has been higher than in Maryland or Virginia from 2001 to 2016, as well as the U.S. (see Chart 9 and Table 5, below).

⁵³“The high-tech industry, what is it and why it matters to our economic future.” Beyond the Numbers, Bureau of Labor Statistics. May 2016. Vol. 5, No. 8. Retrieved on April 23, 2018 from: <https://www.bls.gov/opub/btn/volume-5/pdf/the-high-tech-industry-what-is-it-and-why-it-matters-to-our-economic-future.pdf>.

Chart 9: Annual Percent Change in Number of Workers Employed by a Technology Industry Firm in DC, MD, & VA, 2001 - 2016



Source: ORA analysis of data gathered and compiled by CompTIA from the Bureau of Labor Statistics (QCEW) for annual *Cyberstates* publications.

Table 5: Growth of Number of Workers Employed by a Tech Industry Firm, by Location

	2001	2016	Compound Annual Growth Rate
DC	32,472	37,914	1.04%
MD	178,872	182,585	0.14%
VA	288,801	290,648	0.04%
US	7,049,456	6,824,602	-0.22%

Source: ORA analysis of data gathered and compiled by CompTIA from the Bureau of Labor Statistics (QCEW) for *Cyberstates* publications.

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The CompTIA data presented above allows for a comparison across time. Even using a conservative estimate of the number of high-tech jobs, D.C.’s number of tech workers increased more than in Maryland or Virginia, and more than the U.S., and it also increased more as a percentage of the U.S. whole.

These findings offer a positive assessment of the sector as it has changed over the time of the QHTC incentives, though cannot address the “but for” question of whether this growth would have happened without the incentives.

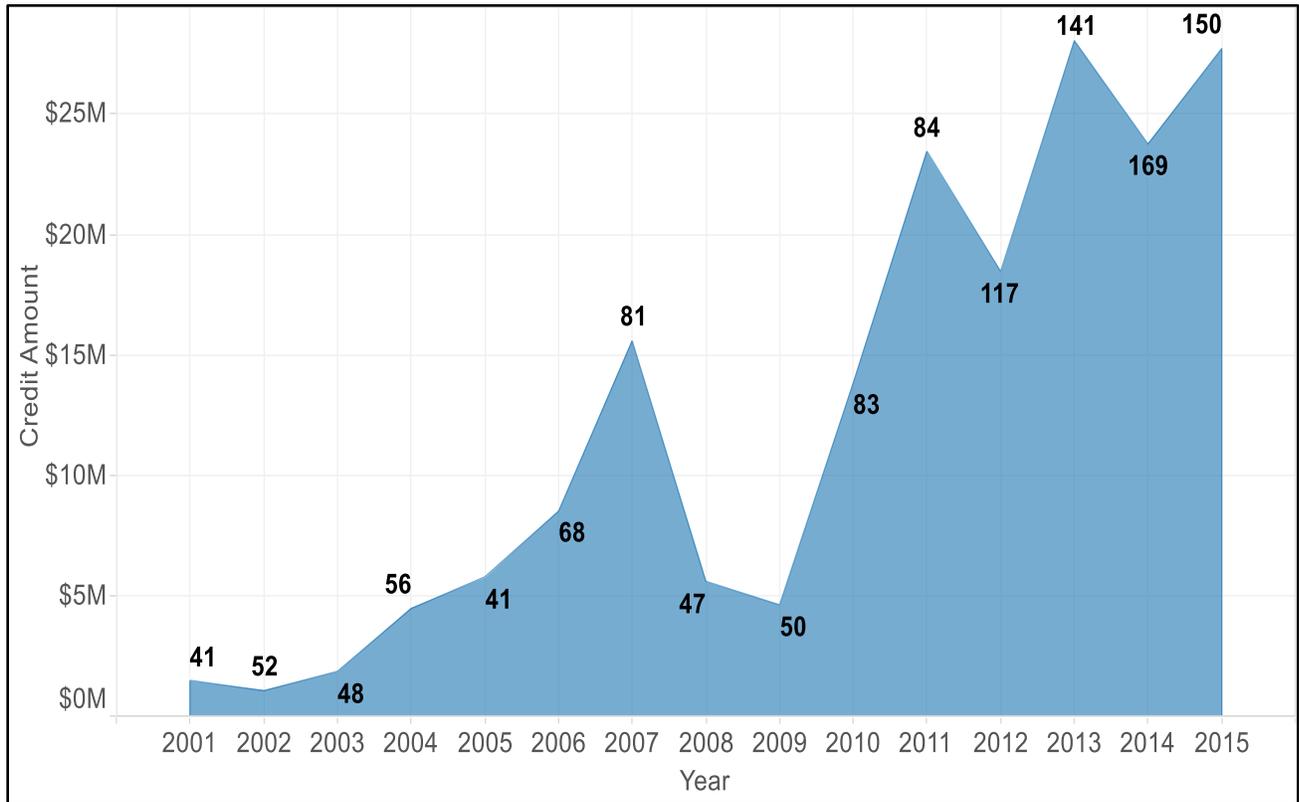
Costs of the QHTC Incentives in Foregone Revenue

While the total fiscal impact of all the QHTC incentives to date is not known, businesses claimed a total of at least \$184 million from 2001 to 2015 through the franchise tax exemption, tax rate reduction, and credits, which makes up the largest part of the incentives. This represents five percent of total franchise tax revenues over that period. Reliable data have not been collected on sales and purchases made by QHTCs that have been exempted from the sales tax; however, companies are estimated to be receiving a benefit worth between \$8 to 10 million per year in recent years.

From 2001 to 2015, QHTC credits totaled at least \$184 million, representing five percent of franchise tax revenues over that period that the District did not collect.

Chart 10 below illustrates that the total level of QHTC credits (exemption + tax rate reduction + credits) claimed each year is generally increasing while the number of firms receiving credits (labeled on the area chart) fluctuates from year to year but remained between 80 and 169 from 2010 to 2015. The general increase over the years is likely a result of the expansion of the program with the lifting of the geographic location requirement in 2012, as well as more companies becoming aware of the program. Current levels of revenue foregone could continue even as eligible companies move from being fully ‘exempt’ to paying the reduced six percent corporate income tax rate because many companies have been carrying forward wage credits (allowable up to 10 years) that can be used against that tax liability. As of 2015 QHTC companies reported approximately \$50 million in carryover credits that could be taken to reduce future tax liability.

Chart 10: Total QHTC Franchise Tax Credit Amounts and Number of Claimants, 2001-2015



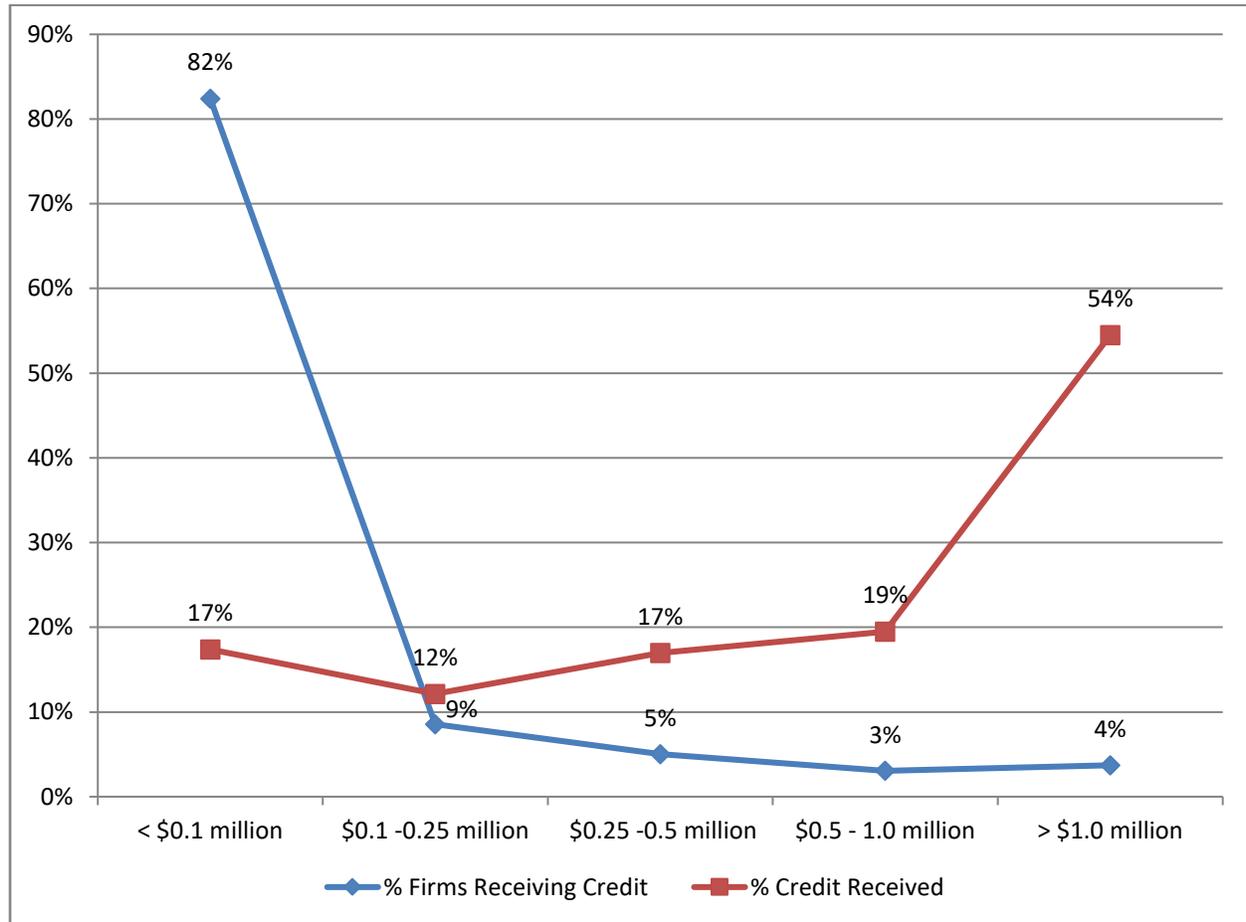
Source: ORA analysis of D.C. Corporate Business Franchise Tax Data. Shaded area includes franchise tax exemption, rate reduction, and credits. Numbers labeled in the area chart represent number of firms claiming that year.

QHTC Credit Distribution by Amount of Credit Received

The structure of the QHTC franchise tax credit as a full exemption or reduced tax rate dictates that the largest tax benefits go to firms with the largest tax liability, regardless of the benefit to the District. However, most firms receiving credits are getting smaller amounts of tax benefits. As Chart 11 below illustrates, from 2001 to 2015, 82 percent of firms received credits less than \$100,000 on average, or 17 percent of credits received in a given year. On the other hand, four percent of firms received credits of over \$1 million each, which represented over half of all credits received in a given year, on average.

A small percentage of QHTCs receives the majority of the QHTC franchise tax credits.

Chart 11: Credit Distribution by # of Firms Taking, and \$ Amount of Franchise Tax Credit Received, Average from 2001 - 2015



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

In the first few years of the program, over 90 percent of firms received credits less than \$100,000 each. By 2015, 73 percent of firms received credits less than \$100,000 for a total of only \$2.9 million. This means that in 2015, 27 percent of QHTCs (40 out of 150) received 90 percent of the total QHTC credits (\$24.7 million out of \$27.7 million). Further, in 2015, eight companies received credits over \$1 million each and claimed a total of \$15.6 million in QHTC credits, (five percent of

In 2015, eight companies claimed 56 percent of the total QHTC franchise tax credits.

QHTCs claimed 56 percent of credits taken in that year). Those same eight firms had median gross receipts of \$4.4 billion in 2015, as can be seen in Table 6 below, while the 110 firms receiving less than \$100,000 in credits had median gross receipts of \$7.85 million. The firms with the largest credits in 2015 had median gross receipts over 500 times larger than most firms claiming credits.

Table 6: Median Worldwide Gross Receipts, by \$ Amount of QHTC Credit Received, 2015

Amount of QHTC Credit Received \$	Median Gross Receipts (\$) and # of Firms Claiming			
	2007		2015	
Firms Claiming:				
< \$0.1 m	\$3,776,352	73	\$7,851,341	110
\$0.1 - 0.25 m	\$49,720,980	5	\$21,252,107	19
\$0.25 – 0.5 m	0	0	\$105,931,281	9
\$0.5 – 1 m	*	1	\$1,138,125,100	4
> \$1m	*	2	\$4,392,415,761	8

Source: ORA analysis of D.C. Corporate Business Franchise Tax data. *The median gross receipts in 2007 of the 3 firms claiming QHTC franchise tax credits over \$500,000 was 539,251,381.

Credit Distribution by Location of Recipient

Examining the data on the QHTC recipients by location of the tax filing entity shows that many companies receiving the credits are not headquartered in D.C. As Table 7 below illustrates, in only two years, 2010 and 2012, were more than half of credits claimed by firms with a D.C. address used to file its taxes. In all but those two years, more credits were claimed by companies headquartered in Virginia than companies in D.C.

In only two of the nine years for which location data are available were more than half of QHTCs headquartered in the D.C.

Table 7: Distribution of QHTC Credit Dollars Claimed by Location of Headquarters

Year	Total QHTC Credit Amount Claimed (\$)	\$ Credits Claimed by DC HQ	DC %	\$ Credits Claimed by MD HQ	MD %	\$ Credits Claimed by VA HQ	VA %	\$ Credits Claimed by Another HQ	Other %
2007	15,580,051	703,477	4.5	120,463	0.8	12,838,738	82.4	1,917,373	12.3
2008	5,592,239	720,364	12.9	1,787,840	32.0	1,819,564	32.5	1,264,471	22.6
2009	4,617,924	747,135	16.2	1,428,822	30.9	2,189,387	47.4	252,580	5.5
2010	13,836,739	7,385,833	53.4	826,191	6.0	2,460,804	17.8	3,163,911	22.9
2011	23,460,563	5,940,256	25.3	1,170,454	5.0	7,061,554	30.1	9,288,299	39.6
2012	18,469,292	10,613,612	57.5	1,904,194	10.3	4,177,500	22.6	1,773,986	9.6
2013	28,050,770	4,372,563	15.6	1,565,860	5.6	4,802,910	17.1	17,309,437	61.7
2014	23,756,484	3,955,531	16.7	1,898,776	8.0	4,710,973	19.8	13,191,204	55.5
2015	27,722,903	4,918,591	17.7	2,041,977	7.4	12,833,534	46.3	7,928,801	28.6

Source: ORA analysis of D.C. Corporate Business Franchise Tax data. 2007 is the first year with a location field.

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However, Table 8 below shows that in terms of *the number of firms* claiming credits (as compared to dollar amount of credits claimed), for the nine years from 2007 to 2015, at least half of the firms claiming a credit were in D.C. for five of those years. And in the other four years firms headquartered in D.C. were around 40 percent of the claimants.

Table 8: Distribution of QHTC Firms Claiming Credit by Location of Headquarters

Year	Total Number of Firms Claiming Credits >\$0	# of Firms with DC HQ	DC %	# of Firms with MD HQ	MD %	# of Firms with VA HQ	VA %	# of Firms with Another HQ	Other %
2007	81	45	56%	8	10%	14	17%	14	17%
2008	47	26	55%	5	11%	8	17%	8	17%
2009	50	32	64%	6	12%	9	18%	3	6%
2010	83	47	57%	7	8%	18	22%	11	13%
2011	84	37	44%	9	11%	22	26%	16	19%
2012	117	52	44%	14	12%	34	29%	17	15%
2013	141	61	43%	16	11%	44	31%	20	14%
2014	169	64	38%	19	11%	56	33%	30	18%
2015	150	75	50%	15	10%	42	28%	18	12%

Source: ORA analysis of D.C. Corporate Business Franchise Tax data.

One explanation for this geographic distribution of QHTC credits could be that some larger firms headquartered in Virginia or Maryland are contracted by federal agencies for technology-related services and their employees are assigned to report to work in the federal agencies located in D.C., allowing the companies to claim QHTC status. In 2012, the D.C. Court of Appeals upheld Virginia-based BAE’s claim to a QHTC franchise tax exemption based on the fact that it had employees detailed to work in Federal agencies that were located in the original high technology zones.⁵⁴ This ruling would allow any company with a similar business model of having a physical location outside of the District, but whose employees are detailed to a federal agency anywhere within the District eligible to receive QHTC credits.⁵⁵ In apparent response to the ruling, the D.C. Council in 2014 strengthened the QHTC location requirement⁵⁶ by requiring a qualifying company to ‘lease’ or ‘own’ an office in the District, as opposed to the language from the original statute which held that a company must “maintain an office, headquarters, or base of operations” in the District. However, that definition still may leave room for ambiguity about what constitutes a company having a ‘physical location’ in the District.

⁵⁴ In *BAE Systems Enterprise Systems Inc. v. District of Columbia Office of Tax and Revenue*, 56 A.3d 477 (D.C. 2012), the District Court of Appeals affirmed an earlier Office of Administrative Hearings decision that the QHTC definition did not require property ownership or the payment of rent or the exercise of predominant authority, dominion, or control over an office or base of operations in the District.

⁵⁵ In 2012 the location requirements were removed, so firms located anywhere in the District were eligible.

⁵⁶ The "Qualified High Technology Clarification Congressional Review Emergency Amendment Act of 2014," passed in the Fiscal Year 2015 Budget Support Congressional Review Emergency Act of 2014.

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There is no legal issue for firms receiving the credit to be headquartered outside of D.C. if they have economic activity in the District. However, larger firms based outside of D.C. may have more avenues for tax planning to maximize their D.C. tax benefits through the QHTC, while possibly not even having a physical location in D.C. (or employees who live in the District). Tax data indicate that many of the firms headquartered outside of D.C. are much larger in terms of gross receipts, and that at least from 2007 to 2015 firms with more gross receipts are now claiming the credits (see Table 9 below). These findings indicate that QHTC credits are reaching many large companies and many that are not headquartered in the District.

Table 9: Median Worldwide Gross Receipts of QHTC Claimants, by Headquarters

Firms' Headquarters Location	Median Gross Receipts (\$) and # of Firms			
	2007		2015	
D.C.	\$1,424,053	45	\$4,351,956	75
MD	\$3,241,994	8	\$18,648,786	15
VA	\$30,520,772	14	\$55,698,873	42
Other	\$35,304,020	14	\$158,193,764	18

Source: ORA analysis of D.C. Corporate Business Franchise Tax data.

Section III: QHTC Structural Issues

Some design issues in the QHTC’s structure such as a lack of targeting, fiscal caps, and claw backs expose the District to fiscal risks. Other features such as the lack of agency ownership, self-certification, and difficulty determining eligibility hinder administration and monitoring of the incentives. All these issues have implications for evaluation of the tax incentives and pose accountability concerns.

Lack of Targeting to Firms Producing New Economic Activity or Typical High-Tech Firms

Allowing companies to claim QHTC credits even if they were already in the District prevents evaluating whether the original goals are being met and assessing accountability of taxpayer funds. Best practices hold that incentives should be targeted to promote economic activity that might not otherwise take place.⁵⁷ In addition to giving tax breaks to some firms to do what they would have done anyway by not requiring *new* economic activity, the QHTC incentives offer a very generous benefit given that only 51 percent of a company’s *District of Columbia* activities must qualify as high technology activities for *all* the company’s D.C. income to be subject to the franchise tax exemption and reduced tax rate. This design feature particularly benefits larger companies with both QHTC and non-QHTC activity (if over half of their activities qualify as QHTC) and represents a lack of targeting of the incentives to typical high-tech firms.

This lack of targeting of the QHTC incentives also could create unintended consequences. For example, a large QHTC and a small QHTC could offer the same technology service and be in competition with each other. However, while a large QHTC can take advantage of significant benefits from the QHTC credits, smaller start-up firms often do not have profits for the first few years and therefore may not be able to initially take advantage of the QHTC credits. Under such a scenario, the QHTC incentive could tip the scales in favor of larger QHTCs, even though the city may be interested in investing in and growing small D.C.-based technology start-ups. This possible result of the QHTC program could be an opposite and unintended consequence from what the authors of the law envisioned given that the larger firms are often headquartered outside of the District and are receiving a larger share of QHTC benefits without any evidence of commensurate benefits.

Definition of High Technology Businesses

In addition to not being well targeted to high technology businesses as defined in the law, the QHTC legislation was written nearly 20 years ago when technology buzzwords included ‘mainframes’ and ‘servers’ and the internet was just becoming a household term. Today’s technology sector includes a whole new set of businesses focused on storing data on “the cloud,” marketing “apps” that link to various social media platforms and run on smart phones, as well as the growing field of “cybersecurity.” Further, with the ever-present role of technology in nearly all aspects of our lives, it has become difficult to differentiate what is a technology business versus any other industry that incorporates technology in its structure. For example, is Uber a vehicle-for-

⁵⁷ Murray, Matthew N, and Bruce, Donald J. “Evaluation of Alabama’s CAPCO Credit and Historic Rehabilitation Tax Credit.” 2017. Prepared for the Alabama Department of Revenue. P. 5. Retrieved on April 23, 2018 from: https://revenue.alabama.gov/wp-content/uploads/2017/05/TaxIncentives_CAPCO_201701.pdf.

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hire business, like taxi cabs, or a technology business based on its app-based payment structure and use of GPS? While the original definition of a QHTC as well as legal rulings since the law was passed provide guidance on what business activities constitute a QHTC, it is not hard to imagine such determinations becoming more difficult to make given the quickly-evolving nature of technology.

Because technology has changed so drastically from 2000 to now and will continue to do so, in addition to the fact that the current QHTC incentives are not well targeted, policymakers may wish to revisit the overall goals and purposes of the QHTC program to ask what type of technology businesses the District would like to encourage. For example, beyond the QHTC program, D.C. has a history of trying to attract innovative businesses, start-ups, or smaller technology firms. However, in a recent letter to the Mayor, a group of D.C. Tech Leaders comprising the Capital Tech Coalition asked the Mayor that the incentives being offered to Amazon to attract its HQ2 be made available to the “District’s native tech companies.”⁵⁸ The fact that many of the incentives the coalition listed in the letter are QHTC benefits already available to eligible firms shows that the program may not be known among some of the very companies the incentives likely were designed to attract and help.

Lack of Fiscal Caps, Claw Backs, and Sunsets

There are caps on the annual amount a company may claim in franchise tax credits for relocating employees and retraining employees, yet there is no cap on the total amount of credit a company may receive for wages to qualified employees. This wage credit has the fewest restrictions and is the most widely used; further, most of that \$50 million in unused carryforward credits reported in 2015 stem from it. In addition to the fiscal uncertainty posed by the fact that such large amounts of credits are being carried forward, and that the most widely used credit does not have a cap, there also is no limit on *total* QHTC tax benefits that a company may receive. There is currently a cap of \$15 million that a firm may receive in full *exemption* from the franchise tax, however, once a company is paying the reduced six percent tax rate the benefits a company may receive are not limited if it maintains eligibility. There is no overall time limit for how long a company may benefit from the reduced franchise tax rate or the sales tax exemptions; however, there is a five-year limit on both the franchise tax exemption and the real property tax abatement, and a 10-year limit on the personal property tax exemption.

A lack of fiscal caps, claw backs, and a sunset provision represent a fiscal risk to the District.

Capping the total amount of dollars that may be foregone through a tax incentive program is considered a best practice and can mitigate the fiscal risk that tax incentives pose. Taking this a step further, the total amount of QHTC benefits could be put into the spending side of the budget and require approval from legislators each year. For example, Maryland puts some of its tax incentives “on budget,” making these dollars more certain, transparent, and accountable.

⁵⁸ Sabin, Sam. “Group of D.C. Tech Leaders Demand Same Incentives as Amazon in Letter to Mayor.” *DC INNO*. March 6, 2018. Retrieved from on March 19, 2018: https://www.americaninno.com/dc/inno-news-dc/group-of-d-c-tech-leaders-demand-same-incentives-as-amazon-in-letter-to-mayor/?mc_cid=a1c79ab377&mc_eid=84dba92d2f.

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Alternatively, the amount of tax benefits a firm may claim could be capped, either for a specific measure, such as the \$15 million cap on the franchise tax exemption, or there could be an overall limit per firm for a package of incentives. The District’s QHTC tax incentives involve various provisions within a tax and across multiple taxes; therefore, an overall limit could include a \$50 million cap on total QHTC-related tax benefits, for example. This would be difficult to monitor administratively, so a concurrent reporting system that puts more of the burden on the tax incentive recipient to report all the benefits it is receiving could aid in this type of exercise.

Previous research on QHTCs found that a significant number of QHTCs filing in one year were not certified as QHTCs in the following years or will in other cases stop filing business returns. This suggests that companies either stopped doing business in the District or may have merged with other companies to change their business structure and become unincorporated.⁵⁹ If a significant number of QHTCs are leaving the District soon after receiving QHTC credits, using a ‘claw back’ provision to recoup revenue foregone or levy penalties on firms that leave within a certain number of years (or that do not meet the terms of the credit) might deter companies from leaving or protect District revenues when a company does leave.

The QHTC law does not have a sunset provision requiring the program to be reconsidered by the D.C. Council in the future. Implementing a sunset provision is a best practice that could reduce fiscal risks to the District’s future revenues and ensure that the program continues to meet the goals of the District.

Options for Limiting QHTC Costs

If policymakers wish to limit the use of QHTC benefits by large firms without requiring more evidence of their commensurate benefits to the District, examples from the previous sections provide potential ideas. For example, franchise tax credits could be limited to \$100,000 per firm per year. Were such a limit in place in 2015, this would have meant that 110 firms (73 percent of the 150 QHTCs that year) would have received the same credit, or a total of \$3 million (11 percent of the \$27.7 million in total claims made that year). Sixty four of the 75 firms with a D.C. headquarters would have received the same credit.

Similarly, if franchise tax credits had been limited to \$250,000 per firm in 2015, 86 percent of firms (or 129 of the 150 QHTCs that year) would have received the same credit, totaling just over \$6 million (22 percent of the \$27.7 million in total claims made that year). Seventy of the 75 firms with D.C. headquarters in that year would have still received the same credit. Policymakers also could consider other characteristics for limiting eligibility, such as number of employees, level of gross receipts, or number of years in existence.

If franchise tax credits had been limited to \$100,000 per company each year, in 2015 73% of firms would have received the same credit. If credits were limited to \$250,000, 86% of firms would have received the same credit.

⁵⁹ Geng, Yi. “Analysis of Effectiveness of D.C. Qualified High Technology Companies (QHTC) Credits.” 2016. Office of Revenue Analysis. P. 1.

No Agency Was Given Ownership of QHTC Program

No agency was assigned to administer the QHTC program when it was passed into law, nor was there a directive to collect detailed data or track the incentives over the years. Further, no agency was assigned to review or evaluate the program until the requirement for the current report was passed in 2014.⁶⁰ The Office of Tax and Revenue (OTR) within the Office of the Chief Financial Officer (OCFO) collects QHTC-related taxes and as such has the only data available on QHTCs. Murray and Bruce note that an agency must own a tax incentive program to ensure proper administration and evaluation.⁶¹

Self-Certification and Monitoring Companies' QHTC Eligibility

Because no agency was assigned to administer the QHTC program, the self-certification provision of the QHTC law giving businesses the benefit of the doubt places the burden on OTR to deny eligibility rather than on a company to prove it is eligible. However, even if an agency were assigned to certify companies' eligibility, it can be difficult to interpret whether a specific company's reported technology activities qualify it based on the definition in statute,⁶² or if its employees represent 'qualified' employees. When OTR took legal action to prevent one firm from claiming QHTC status, as previously mentioned, it was overruled in court in 2012 and the company in question could continue to receive QHTC status.

The difficulty of monitoring companies' technology activities to assess eligibility is further complicated by the fact that only 51 percent of a company's D.C. activities must be high technology-related. Both elements of the definition of a QHTC violate a widely accepted norm of tax policy which holds that a revenue system should be simple to administer.⁶³ If it is not easy to determine whether companies are eligible for QHTC status based on a company's activities as well as whether their division of QHTC and non-QHTC revenues meet the 51 percent criteria, then

The QHTC law allows for self-certification of eligibility, and various judicial and legislative actions over the years also favor a more inclusive definition of eligibility.

it increases the likelihood that some businesses may be incorrectly claiming QHTC credits. Such issues raise questions about accountability for the program and taxpayer resources as well as fairness to other corporate taxpayers and point to the need for further auditing by OTR staff.

A potential way to make the determination of QHTC eligibility more straightforward might be for the QHTC statutes to be amended to include specific NAICS codes⁶⁴ that are eligible for QHTC status. This may be a way to make the question of eligibility easier for companies and OTR staff. Regardless of whether the application of a definition based on NAICS codes is the answer, the task of assessing a company's eligibility as a high technology company places an administrative burden

⁶⁰ As previously mentioned, a requirement for the OCFO to annually assess the QHTC was removed from the original legislation on its passage.

⁶¹ Murray and Bruce, p. 5.

⁶² See Appendix Table 2 for a list of qualified activities.

⁶³ See National Conference of State Legislatures' Principles of a High-Quality State Revenue System: <http://www.ncsl.org/research/fiscal-policy/principles-of-a-high-quality-state-revenue-system.aspx>

⁶⁴ The North American Industry Classification System (NAICS) classifies business by type of economic activity for collecting economic and business data.

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on OTR staff and has implications for the accountability of the incentives. Further, policymakers may wish to explore ways to make it easier to determine that 51 percent of a company's gross revenues are attributable to QHTC-related activities as it is difficult to verify this so OTR relies on a company's self-reported numbers.

QHTC eligibility also requires a company to have at least two “qualified employees,” which are defined as persons employed in the District by a QHTC.⁶⁵ There is no D.C. residency requirement in the definition of a qualified employee.⁶⁶ Employing District residents does make a firm eligible for a larger credit than does employing non-residents for two of the three franchise tax wage credits but use of these more generous credits has not been tracked. This requirement could be better-defined, regardless of residency of the employee, as there may be accountability issues if companies are interpreting it more loosely than intended. For example, can a Virginia (or other state) resident who teleworks full-time for a firm with a small office in D.C. count as a qualified employee? Currently there is little to no verification of this requirement given the self-certification process, and many companies do not provide enough detailed employee information to monitor compliance.

QHTC Certification Process, Data Collection and Tracking, and Auditing

Receiving no instruction to track the tax incentives or measure their effectiveness, OTR did not set up a new system to collect detailed data on the incentives beyond what it would normally collect in the tracking of tax expenditures. This would typically be high level information such as total credit amounts by year. As such, this report finds that more data is needed to fully analyze the fiscal and economic impact and effectiveness of the QHTC incentives. This is a common finding of tax incentive evaluations as states and localities seek answers about their incentives' effectiveness years after they have been in place. While a lack of data limits conclusions that may be drawn at this point, many of the data collection issues identified and discussed below are already being addressed because of an IT system modernization process currently underway in OTR. OTR has been very open to sharing QHTC-related data and getting input on how to increase data collection about QHTCs moving forward now that there is a requirement to review the program.

To apply for any QHTC tax benefits, a company is supposed to file a series of forms in QHTC booklet FR-399 (See QHTC Appendix 6 for a list of forms). Unless those forms have a bar code at the top, the data contained in them are not captured electronically. Further, even for a bar coded form, OTR must request each field on the form to be reported back from the third-party vendor that processes the forms. The vendor charges OTR for each field, so OTR has not typically requested information that it does not plan to use. The QHTC Certification form (see QHTC Appendix 7), which asks a series of questions to verify QHTC eligibility, was the only form that had a bar code until 2017, when the D-20CR form asking for information about credits taken also had a bar code added to it.

⁶⁵ D.C. Official Code § 47-1817.01 (4)

⁶⁶ Having a requirement for D.C. residency could improve the likelihood that the hiring incentives companies receive would have more of an impact on the District economy through taxes and future revenues; however, such a requirement could restrict labor supply if there are not enough qualified workers who live in the District. Workers commuting into the city from surrounding jurisdictions do not contribute as much to the tax base as D.C. residents given they do not pay D.C. income taxes, but they do make up the employment base which fills office space and boosts District real property and sales tax revenues, regardless of residency of the employee.

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Data is electronically captured for one credit—the retraining cost credit—which may be used as a refundable credit; however, it was rarely used between 2001 and 2015. No data is captured electronically on the amount of credits claimed on the other two franchise tax credits (including the wage credit, which is the most widely used), making it hard to track the credits at an aggregate level. This includes any reported carryforward that businesses are collecting and can use at a future date. The lack of bar coding on most forms also means that any supplemental information

Some information about QHTC’s tax benefits is not collected at all, and much of the data that is submitted by QHTCs has not been tracked or monitored. An OTR IT system modernization will allow more data about QHTCs to be collected and tracked.

submitted by taxpayers to OTR to claim any of the three franchise credits is not collected electronically (this includes information such as name and identification number of employees hired, date of hire, wages paid, and retraining or relocation costs).

As previously noted, an IT system modernization has been underway in recent years and OTR is using this effort to enhance data collected about QHTCs. Starting with tax year 2017, a company using e-filing will have

to certify that it is a QHTC before it can move through the online filing process for sales taxes, and all data fields will have to be filled out before continuing through the tax return.

Then, starting with tax year 2018 the implementation of the IT system modernization for franchise tax returns will overhaul the entire cycle of QHTC data submission, collection, and reporting from what is currently in place, and will provide OTR with many more tools for automated verification and auditing of companies and credits claimed. OTR has been working with ORA to identify which fields and data points should be captured and reported out to better track and evaluate QHTCs.

Despite the lack of electronic information available for this review, OTR gave ORA full access to six years of paper QHTC corporate franchise tax returns. ORA’s review of these forms revealed that many companies do not fill out all required fields on the tax forms to prove eligibility for overall QHTC status or the various QHTC franchise tax credits. Some companies used their own format for submitting jobs and/or wage information to justify the dollar amount of credits taken, though not the type of wage or salary information that would allow an evaluation of economic impact (or personal information that would allow for an audit of the jobs information). Generally, the limited jobs information seemed to be presented to justify the carryforward of credits for future use, and it was often aggregated. (An analysis of aggregated data reported on these forms was presented in Table 4 on page 45).

Given the difficulties around determining QHTC eligibility and since firms self-certify and no agency is assigned to assist with these activities, OTR should consider increasing its auditing of the QHTC incentives, especially as more companies have claimed increased dollar amounts in recent years, and in case there is any confusion caused by changes in data collection due to MITS. Further, OTR should consider having specific auditors assigned to QHTCs and require all QHTCs to be audited after five years.

Non-Corporate QHTCs

In addition to the corporate franchise tax, the District levies an unincorporated franchise tax on unincorporated businesses with gross income over \$12,000.⁶⁷ However, a non-corporate QHTC cannot be an unincorporated business for purposes of the District’s franchise tax,⁶⁸ which means the non-corporate QHTC cannot be taxed at the entity (or business) level, rather it is taxed at the ownership level. Therefore, an owner of a non-corporate QHTC reports the “flow up” QHTC income for tax purposes and would claim the profits on his or her personal income tax filing. When the owner of a non-corporate QHTC is not a District resident or is a non-nexus owner (partner or member of an LLC) the income of a non-corporate QHTC is reported to their state of residency and the District receives less tax revenue from this QHTC.

This represents a large loophole in the QHTC law, and further, the tax structure for non-corporate QHTCs creates a horizontal inequity between two similar D.C.-based firms by subjecting the owners to two different tax rates depending on whether the owner is a resident or not. Both businesses may take QHTC sales and personal property tax exemptions. This scenario illustrates one of many ways the QHTC incentives can be used in tax planning to minimize taxation of income -- scenarios that likely were not envisioned when the original law was passed.

There are some gaps in the data on how many non-corporate QHTCs there are. Because non-corporate QHTCs are not required to file at the entity level, as previously mentioned, OTR is not able to easily track them. For a number of years OTR required non-corporate QHTCs to file a D-30 (the unincorporated business (UB) franchise tax form) strictly for tracking purposes (since they were not paying the UB franchise tax).⁶⁹ After 2010, non-corporate QHTCs could also file Partnership Returns (form D-65) or an Individual Income Tax Return (D-40) as applicable, yet there was no way to track whether QHTCs were filing either of these forms because the forms did not ask tax filers if they were a QHTC.⁷⁰ Data on the number and size of non-corporate QHTCs were scheduled to be captured again for tax year 2017 as part of the Modernized Income Tax System (MITS), however ORA has not yet obtained this data.

QHTCs and Combined Reporting

Beginning in tax year 2011, all companies filing income and franchise taxes in D.C. were required to use the combined reporting method of reporting income when filing their taxes.⁷¹ Combined reporting requires a company with multiple subsidiaries to combine the income of all of the subsidiaries (or members of the unitary group) and report it together; it is designed to limit tax

⁶⁷ Per § 47-1808.01, other exemptions and allowances apply.

⁶⁸ The term unincorporated business does not include a non-corporate QHTC per § 47-1808.01(5). This means it cannot be taxed at the entity level as an unincorporated business. See footnote 79 below for data on the number of unincorporated businesses certifying as QHTCs.

⁶⁹ Based on ORA Analysis, from 2004 to 2010, a total of \$511,433 in QHTC tax credits were taken by about 100 businesses filing the UB tax. It is unclear whether these businesses should have taken these credits. From 2011 to 2013, there was no field for QHTC credits in the UBF data, though 51 companies certified as QHTCs in 2011, 1,195 did so in 2012, and 1,519 did so in 2013. These firms could have taken advantage of sales and personal property tax benefits for QHTCs.

⁷⁰ Form D-65 includes a QHTC indicator beginning in tax year 2015.

⁷¹ The Fiscal Year 2012 Budget Support Act of 2011 (D.C. Law 19-21).

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avoidance and shifting.⁷² When the law enacting combined reporting was passed, it disallowed QHTCs from filing combined reporting, presumably because this would make it harder to identify a company's gross receipts in the District. The fact that a new method used for simplifying corporate income reporting and preventing corporate tax avoidance was not allowed for companies claiming the QHTC incentives provides another example of how the incentives complicate the District's tax administration.⁷³

Confidentiality of QHTC Data

Taxpayer confidentiality laws preclude the disclosure of which companies receive QHTC benefits and the dollar amounts that companies receive. This lack of disclosure inhibits transparency and accountability both within the District government and to District taxpayers broadly. Confidentiality concerns not only preclude broad transparency in reporting, they can also have the effect of limiting data collection and aggregation in the first place. To the extent there are criminal penalties for disclosing taxpayer data, while at the same time very few requirements or requests for reporting information on QHTC incentives, these realities could further contribute to a culture of not collecting and reporting comprehensive QHTC-related data.

The current report marks the first major requirement for information related to the QHTC program's effectiveness to be reported on and published. OTR and to a lesser extent ORA are the only District government agencies with detailed information about QHTC recipients. The Deputy Mayor's Office for Planning and Economic Development (DMPED), the agency administering much of the city's economic development efforts, does not have access to QHTC data and thus is unaware of which companies are receiving QHTC incentives unless companies disclose this to them. DMPED should be able to access at least basic non-tax QHTC data to carry out its own economic development work, as well as to help policymakers assess the effectiveness of the QHTC tax incentives just as it does for direct spending on economic development efforts.

Broadening the transparency of current QHTC recipients may pose legal issues mid-way through the program. However, if revisions are made to the QHTC incentives, policymakers could consider writing a transparency requirement into any new legislation as a condition of receiving the incentives moving forward. Such a provision could range from requiring that any QHTC recipient's name be publicly reported to one requiring public disclosure of dollar amounts received by each QHTC. The District does not have a precedent for this type of reporting on other corporate tax incentives unless the tax benefit is offered through the real property tax or sales tax, but other jurisdictions have moved in this direction.⁷⁴

⁷² "Combined Reporting of State Corporate Income Taxes: A Primer." Institute for Taxation and Economic Policy. February 24, 2017. Washington D.C. Retrieved on March 23, 2018 from: <https://itep.org/combined-reporting-of-state-corporate-income-taxes-a-primer-1/>; and D.C. Office of Tax and Revenue. Notice of Final Rulemaking for D.C. Law 19-21. 59 DCR 10509, August 31, 2012. Retrieved on March 23, 2018 from: https://otr.cfo.dc.gov/sites/default/files/dc/sites/otr/publication/attachments/otr_notice_of_final_rulemaking_091712.pdf.

⁷³ A search of the corporate franchise tax data revealed that about a dozen firms filed combined reporting and claimed QHTC credits in both 2014 and 2015. Auditors in OTR are currently reviewing these cases and may require those firms to amend their filings.

⁷⁴ See examples for Connecticut, Indiana, and Maryland in "Show Us the Subsidized Jobs," Good Jobs First. January 2014. Retrieved on March 26, 2018 from: <https://www.goodjobsfirst.org/showusthesubsidizedjobs>.

Section IV: Summary of Findings and Recommendations

The broad and complex design and lack of targeting of the QHTC program, as well as a lack of data on certain activities of the franchise tax credit recipients prevent a more thorough evaluation of its effectiveness. However available data allows for an assessment of the program up to this point and areas for improvements can be gleaned from a review of the fiscal impacts and the discussion of the law's provisions and administration.

Benefits and Costs

A review of outside data on technology workers and an indirect analysis of companies' payrolls indicate D.C.'s tech sector has done well over the life of the QHTC program—better than its neighbors or the U.S. average—and that D.C.'s QHTC payrolls have grown more than their non-QHTC counterparts in D.C. and the U.S. While the lack of targeting of the incentives means these findings cannot be directly attributed to the QHTC incentives, they raise the possibility that the incentives are having a positive effect on firms that do stay in D.C. But even if the incentives caused these results, a small number of large companies have claimed a disproportionate share of the credits without any evidence that they are producing commensurate economic benefits. Better targeting QHTC incentives to ensure that benefits are reaching companies that are making *new* investments may provide more economic benefit to the District.

Over \$184 million in QHTC franchise tax credits were claimed from 2001 to 2015 representing five percent of the franchise tax revenue received over that time, and this does not include any of the tax benefits conveyed through the sales, real property, or personal property taxes, which over the same time are estimated to be in the tens of millions of dollars. As of 2015, companies were carrying forward an aggregate of \$50 million in franchise tax credits that they have earned but have not yet applied to their tax liability. They are expected to do so once their five-year exemptions end and they begin paying the reduced franchise tax rate. If no changes are made, ORA estimates the QHTC program will continue to represent at least \$40 million per year in foregone revenue when taking franchise tax, real and personal property tax, and sales tax provisions into account.

On average from 2001 to 2015 most firms claiming credits are receiving smaller dollar amounts of credits, often less than \$100,000, while a small number of large firms are claiming the bulk of the total credits each year. Assessing the credit recipients' headquarters showed that in all but two years of the data, more QHTC credits were claimed by companies headquartered in Virginia than companies in D.C. However, in terms of the number of firms claiming credits roughly half of the firms claiming a credit were headquartered in D.C.

The District's QHTC program could very well be attracting new firms and those firms could claim that this incentive impacted their decision. Nevertheless, it is the case that a significant portion of the dollars claimed have gone to companies that were already in the District without any evidence of increased benefits to the District. Over \$100 million in QHTC credits was claimed by 24 companies that were either already located in D.C. and paying corporate taxes before becoming a QHTC or were already in the District and paying franchise taxes in 2001, the first year of the QHTC program. It is unknown if any of these credits caused those companies to remain in D.C.

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rather than move out of the city or engage in activities that produced new economic benefits. However, given such activities were not required to receive the credits, it is possible some of these companies received tax breaks for doing what they would have otherwise done without the tax incentive.

QHTC Structural Issues

The QHTC program has structural issues that expose the District to fiscal risks and hinder administration and compliance enforcement. The incentives are not well targeted to companies making new investments, or to companies with a typical high-tech profile. Allowing companies to claim QHTC credits if they were already in the District also prevents evaluating whether the original goals are being met and assessing accountability of taxpayer funds and fairness to other District corporate taxpayers. The threshold for QHTC eligibility requiring only 51 percent of a company's District activities to be qualified is generous to companies that have both QHTC and non-QHTC activities and is a key reason the tax incentives are not targeted to firms with a typical high-tech profile. Rather it could be a windfall to large companies that have technology as part of their D.C. activities as contractors for the federal government.

Additionally, policymakers may wish to revisit the definition of a high technology company and ensure the QHTC law adequately accounts for changes in technology that have occurred in the preceding 17 years and is being used by the companies it wishes to attract. At the same time, using the research assembled in this report, the law could be reassessed to ensure it continues to meet the economic development goals of the District while also meeting standards of tax incentives that have become accepted best practices since the QHTC was adopted. (See QHTC Appendix 7 for a summary of key criterion for evaluating tax incentives which serves as a list of best practices.)

A lack of fiscal caps on the dollar value of benefits received or time limits across the QHTC incentives poses financial risks for the District's revenue streams. Options could be considered for limiting the tax benefits to larger companies that are taking a disproportionate share of QHTC credits without providing evidence of commensurate benefits to the District. For example, 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 credits under either scenario.

Further, many firms receiving credits have stopped claiming QHTC eligibility in subsequent years, possibly leaving the District. No claw back provisions exist to recoup tax dollars foregone to QHTCs that leave the city. Such provisions would protect District resources if a firm leaves the District or fails to meet eligibility requirements.

Because no agency was assigned to administer the QHTC program, the lack of a verifiable standard to determine eligibility coupled with the fact that firms self-certify as QHTCs puts the burden on OTR staff to deny eligibility rather than on the company or a certifying agency to prove eligibility. Some firms could be claiming QHTC credits when they do not qualify for them, pointing to the need for increased monitoring and auditing by OTR staff.

A lack of data limited the fiscal and other impacts that could be covered in this review; however, many of the data shortages identified are currently being addressed through the IT system modernization project underway within OTR. Once the new reporting systems are in place and a

few years of data have been collected, another review will likely be better able to assess economic outcomes. OTR should continue to receive support to audit the QHTC incentives, especially as more companies are claiming increased dollar amounts in recent years, and in case there is any confusion caused by changes in data collection due to MITS.

QHTCs that are not incorporated are taxed at the ownership level (as compared to the entity level) and if the owner does not live in D.C. then the District captures less revenue from that QHTC even though the business is eligible for the sales and property tax exemptions. QHTCs are not allowed to file using combined reporting, which was adopted in D.C. in 2011 to simplify income reporting and curtail tax avoidance and shifting. Each of these characteristics creates additional complexity for tax administration.

The QHTC program demonstrates how poorly designed incentives can have significant fiscal costs for a jurisdiction, require additional administrative resources and preclude an evaluation of outcomes. To obtain better results and improve accountability, the QHTC could be amended in a variety of ways as outlined in the recommendations below.

QHTC Recommendations

- 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 D.C. 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. **Further, consider placing limits that preclude very large companies from continuing to take disproportionate QHTC benefits without evidence of commensurate benefits to the District.** Examples for these criteria could include limits based on amount of credit allowed per year, numbers of employees, level of gross receipts, or number of years in existence.
- 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. QHTCs that claim credits and then move out of the District within, for example, five years could be required to pay back some or all their tax benefit. Administering such a claw back provision could be difficult, so focusing on companies that receive credits over a certain threshold may be more realistic.

Part II: Review of Economic Development Tax Expenditures – QHTC Tax Incentives

- 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. Consider adopting a standard for verifying that a company is eligible to be a QHTC to assist OTR in its administration of the QHTC incentives. A potential standard could be a set of NAICS codes that a company must satisfy to be QHTC-eligible. Better standards may be available and other options should be explored.
- 6) **Improve the transparency and accountability of the incentives by allowing company names and QHTC incentive amounts received to be publicly released.** Develop a standard set of information that is deemed appropriate to make publicly available, while continuing to safeguard confidential tax data.

QHTC Logic Model

Qualified high-technology companies: All provisions summarized

The Need:
To encourage high-technology firms to locate, expand, and stay in the District of Columbia, thereby strengthening the employment and the economic base.

Resources/Inputs:
Franchise tax credits, from 2001 – 2015 totaling at least \$184 million in revenue foregone. Estimates of revenue foregone over that time through the sales, real property, and personal property taxes is unclear, but estimated to be in the tens of millions.

Outputs:
Between 40 to 169 companies claimed franchise tax credits each year, with more companies and higher amounts of credits claimed in later years. In 2009, 134 companies claimed sales tax exemptions, and a handful of companies claimed personal property tax exemptions in 2015. Only one company has claimed a real property tax exemption.

Expected Benefits
(changes in short, medium, or long-term measures)

Short-term:
Companies already in or those moving to D.C. that qualify as a QHTC would receive tax benefits, some may be new to the city.

Medium-term:
New or existing firms may hire QHTC employees to take advantage of credits, thereby boosting D.C. revenue base if they are new employees and are District residents.

Long-term:
If QHTCs remain in or move to D.C., the sector will grow and contribute to the District’s economic growth and strengthening of the workforce and revenue base.

Assumptions:
Incentives encourage new QHTCs to locate in D.C. and existing firms to hire more employees.

Chapter II: Qualified Supermarkets

Personal Property Tax, Real Property Tax and, Sales Tax Exemptions

District of Columbia Code: D.C. Official Code § 47-3801-§ 47-3805; § 47-1002(23); § 47-1508(a)(9); and § 47-2005(28)

Sunset Date: None

Year Enacted: 1988; 2000; 2010

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$2,976	\$3,032	\$4,544	\$4,651	\$4,572	\$5,187	\$5,744	\$5,732
Number of Beneficiaries	10	15	18	17	15	14	12	10

Source: Estimates from past Unified Economic Development Reports; projections for FY18-19 based on ORA analysis. Includes data on real property tax exemptions through 2017 and estimates of personal property and sales tax exemptions for all years.

Section I: Introduction and Overview

Description

A qualified supermarket,⁷⁵ restaurant, or retail store⁷⁶ is eligible for a real property tax exemption for 10 consecutive years beginning with the tax year in which a certificate of occupancy was issued for the development. As of 2010, qualified supermarkets, restaurants, and retail stores must be in census tracts where more than half of the households have incomes below 60 percent of the area median, as determined by the U.S. Department of Housing and Urban Development. The property must continue to be used for the original purpose to maintain the exemption.

If the real property is not owned by the supermarket, restaurant, or retail store, the owner of the property can qualify for the real property tax exemption (also valid for 10 years) if the owner leases the land or structure to the supermarket at a fair-market rent that is reduced by the amount of the tax exemption. The authorizing statute also provides that a qualifying supermarket, restaurant, or retail store that leases real property which is part of a larger development can receive a rebate from the D.C. government for its pro-rata share of the property tax paid, if the owner of the property has already paid the tax.

⁷⁵ A supermarket is defined in the D.C. Code as a self-service retail establishment, independently owned or part of a corporation operating a chain of retail establishments under the same trade name, that is licensed as a grocery store; sells a full line of meats, seafoods, fruits, vegetables, dairy products, dry groceries, household products, and sundries; occupies the address under a certificate of occupancy with the use declared as a grocery store, and include related service departments, such as a kitchen, bakery, pharmacy, or flower shop.

⁷⁶ Any new exemptions for a qualified restaurant or retail store beginning on or after October 1, 2010, shall not be granted “until the fiscal effect of any such new exemptions is included in an approved budget and financial plan.” See D.C. Official Code § 47-3802(b)(1), as amended by D.C. Law 20-61, the “Fiscal Year 2014 Budget Support Act of 2013,” effective December 24, 2013.

Legislative History

Supermarket tax incentives were first introduced in 1988, subject to the First Source Employment Agreement Act,⁷⁷ to encourage supermarkets to locate in underserved areas by providing a 5-year exemption from real property tax and from certain license fees.⁷⁸ The original incentives were expanded upon in the “Supermarket Tax Exemption Act of 2000” (2000 Act), which offered qualifying supermarkets the following benefits:

- 10-year Real property tax exemption;
- 10-year Business license fee exemption;
- 10-year Personal property tax exemption; and
- Sales and use tax exemption on building materials necessary for construction.

The 2000 Act changed the eligible areas to the Priority Development Areas outlined in the National Capital Revitalization Act of 1998 and stipulated that if the supermarket leased the real property where it was located, the owner of the property must reduce the rent charged to the supermarket by the amount of any real property tax exemption it receives for being the site of a qualified supermarket. Also, the supermarket must meet its requirements under the “First Source” program, which requires private organizations receiving D.C. government aid to give priority to D.C. residents in filling new jobs.

The National Capital Revitalization Corporation and Anacostia Waterfront Corporation Reorganization Act of 2008 updated the “Priority Development Areas” and added the phrase “qualified restaurant or retail store” after “qualified supermarket,” if a fiscal effect was included in the approved budget and financial plan.⁷⁹

The Neighborhood Supermarket Tax Relief Clarification Act of 2010 provided “real property tax rebates for supermarkets that would qualify for the real property tax exemption but for the inability of the landlord to pass the tax abatement onto the supermarket.” The property tax rebate was available to eligible supermarkets as of October 1, 2007 and was equal to the supermarket's pro rata share of the tax levied for the tax year on the real property that the qualified supermarket leases if qualified supermarket is liable under the lease for its pro rata share of the tax; and the lessor paid the tax.⁸⁰

The Food, Environmental, and Economic Development Act (FEED-DC Act) of 2010 was passed to address a number of issues related to access to healthy food and economic development in the District, and in particular the FEED-DC Act amended the tax incentives in the Supermarket Exemption Act of 2010 in three ways. First, the Act modified the geographic eligibility to mirror

⁷⁷ The First Source Employment Agreement Act requires that the Mayor shall include in each government-assisted project or contract that receives government assistance totaling between \$300,000 and \$5,000,000, a provision that at least 51% of the new employees hired to work on the project or contract shall be District residents. D.C. Code §§ 2-219.01 - 2-219.52

⁷⁸ “Tax Abatement Financial Analysis – ‘Food, Environmental, and Economic Development in the District of Columbia Amendment Act of 2016,’ Bill 21-836.” Office of Economic Development Finance. Office of the Chief Financial Officer. October 26, 2016.

⁷⁹ 2008 District of Columbia Laws 17-138 (Act 17–289).

⁸⁰ 2010 District of Columbia Laws 18-186 (Act 18-395).

Part II: Review of Economic Development Tax Expenditures – Supermarket Tax Incentives

Federal historically underutilized business zones (HUB Zones)⁸¹ and to add specific census tracts.⁸² Adding HUB Zones effectively replaced the designated census tracts in the Supermarket Exemption Act of 2000 with ‘qualified census tracts’ where more than half of the households have incomes below 60 percent of the area median or have a poverty rate of 25 percent or more.⁸³ Second, it clarified the definition of supermarket “building materials” that are exempt from the sales tax, and lastly it streamlined the supermarket exemption approval process by placing the responsibility for approval solely within the Deputy Mayor for Planning and Economic Development (DMPED) instead of the previously divided process between DMPED and the Office of Tax and Revenue (OTR). This streamlining was expected to shorten approval times from up to two years to as few as 45 days.⁸⁴

In 2016, the Food, Environmental, and Economic Development in the District of Columbia Amendment Act of 2016 added two census tracts (tracts 16 and 94) to the eligible areas in the FEED-DC Act of 2010 with the purpose of “incentivizing supermarkets to locate or remain in food deserts and provide fresh food options to the residents of the District of Columbia.” This amendment allowed two supermarkets – one that had already been approved to locate in Ward 4 and one that was already open in Ward 5 – to claim the supermarket tax incentives.⁸⁵ In 2017, an amendment to the FY18 Budget Support Act of 2017 removed Census tract 16 from the eligible areas.

⁸¹ Historically underutilized business zone (HUBZone) means any area located within 1 or more: qualified census tracts, qualified nonmetropolitan counties, lands within the external boundaries of an Indian reservation, redesignated areas, or base closure areas.

⁸² Census tracts 18.01, 33.01, 95.05, 95.07, or 95.08

⁸³ “Tax Abatement Financial Analysis – ‘Food, Environmental, and Economic Development in the District of Columbia Amendment Act of 2016,’ Bill 21-836.” Office of Economic Development Finance. Office of the Chief Financial Officer. October 26, 2016.

⁸⁴ FEED-DC Act Committee Report, pp.13-14.

⁸⁵“Tax Abatement Financial Analysis – ‘Food, Environmental, and Economic Development in the District of Columbia Amendment Act of 2016,’ Bill 21-836.” Office of Economic Development Finance. Office of the Chief Financial Officer. October 26, 2016. The supermarket located in Ward 5 would receive a limited tax incentive in that the legislation stated that it was “deemed to have begun on January 1, 2015.”

Table 10: Description of Supermarket Tax Provisions and Legislative Changes

<i>Year</i>	<i>Description</i>
1988	Supermarket tax incentives were first introduced to encourage supermarkets to locate in underserved areas by providing a 5-year exemption from real property tax and from certain license fees.
2000	The Supermarket Exemption Act of 2000 expanded existing tax incentives to offer qualified supermarket located in eligible areas: <ul style="list-style-type: none"> • 10-year Real property tax exemption; • 10-year Business license fee exemption; • 10-year Personal property tax exemption; and • Sales and use tax exemption on building materials necessary for construction.
2008	The National Capital Revitalization Corporation and Anacostia Waterfront Corporation Reorganization Act of 2008 updated the “Priority Development Areas” and added the phrase “qualified restaurant or retail store” after “qualified supermarket,” as long as a fiscal effect was included in the approved budget and financial plan.
2010	The Neighborhood Supermarket Tax Relief Clarification Act of 2010 provided that, as of October 1, 2007, the qualified supermarket real property tax rebate applies if a qualified supermarket leases real property (or a portion thereof). The rebate allows the qualified supermarket to receive a rebate of the tax that represents the qualified supermarket’s pro rata share of the property tax.
2010	The Food, Environmental, and Economic Development Act (FEED-DC Act) amended the Supermarket Exemption Act of 2000 by modifying the definition of a qualified eligible area, clarifying the definition of supermarket “building materials” for the sales tax exemption, and reducing the amount of time needed for approving applications by placing the responsibility solely within DMPED.
2016	The FEED-DC Amendment Act of 2016 added two census tracts to the eligible areas in the FEED-DC Act of 2010 with the purpose of “incentivizing supermarkets to locate or remain in food deserts and provide fresh food options to the residents of the District of Columbia.” This amendment allowed two supermarkets – one that has already been approved to locate in Ward 4 and one that was already open in Ward 5-- to claim the supermarket tax incentives.
2017	FY18 Budget Support Act of 2017 removed Census tract 16 from the eligible areas.

Purpose

The general purpose of the 1988 incentives was to encourage the construction and operation of supermarkets in underserved areas of the city, which was defined as an area of no more than one square mile within the District having a ratio of less than two supermarkets per 10,000 residents or having less than one supermarket.⁸⁶ The Supermarket Tax Exemption Act of 2000 updated the eligible areas to the Priority Development Areas as laid out in the recent economic development legislation. The specific changes made in the FEED-DC Act of 2010 to the tax incentives in the 2000 Act updated the geographic areas eligible for the incentives, clarified the definition of “building materials” for the sales tax exemption, and improved the administration of the incentive by reducing approval times.

Overall, the FEED-DC Act of 2010 had three main goals: (1) to improve access to healthy foods in low-income neighborhoods; (2) to encourage green technology in food stores; and (3) to create good jobs in areas with very high levels of unemployment. The first goal of the FEED-DC Act is the most relevant goal to the supermarket tax incentives, yet the success of the supermarket tax incentives would also contribute to the achievement of the third goal to create good jobs. The committee report for the FEED-DC Act noted that in early 2010, D.C. Hunger Solutions and Social Compact issued a report on the grocery gap in D.C. and found a “huge disparity in the availability of healthy foods in neighborhoods across the District.” The grocery gap meant that low income neighborhoods had access to fewer grocery stores than residents in higher income neighborhoods, and significant food deserts⁸⁷ were in lower income areas in Wards 5, 6, 7, and 8. Residents in the food deserts had to travel much further to reach a full-service grocery store compared to other residents living in Northwest D.C.⁸⁸

The committee report also noted that the grocery gap is a leading cause of the obesity epidemic, which in 2010 affected over half of D.C. residents, including 43 percent of D.C.’s children and over 70 percent of residents in both Wards 7 and 8.⁸⁹ In addition, the grocery gap was costing D.C. in terms of both tax revenue and jobs since the residents that lacked grocery access were going to Maryland or Virginia and thereby sending tax revenue out of the District. If those areas had grocery stores, they would provide much needed jobs to some of the same D.C. residents.

While the stated goal of the supermarket incentives has evolved over time, just like the incentives, the most recent legislation outlining the goals is the FEED-DC Act, therefore the goal of improving access to healthy foods in low-income neighborhoods is still considered the main goal of the

⁸⁶ “Tax Abatement Financial Analysis – ‘Food, Environmental, and Economic Development in the District of Columbia Amendment Act of 2016,’ Bill 21-836.” Office of Economic Development Finance. Office of the Chief Financial Officer. October 26, 2016.

⁸⁷ D.C. Hunger Solutions and Social Compact defined a food desert [from the 2008 Farm Bill] as an “area in the United States with limited access to affordable and nutritious food, particularly such an area composed of predominantly lower income neighborhoods and communities.” “When Healthy Food is Out of Reach: An Analysis of the Grocery Gap in the District of Columbia.” D.C. Hunger Solutions and Social Compact. 2010. Retrieved on April 10, 2018 from: <http://dchunger.org/pdf/grocerygap.pdf>.

⁸⁸ Council of the District of Columbia Committee on Government Operations and Environment Committee Report. Bill 18-967, the “Food, Environmental, and Economic Development in the District of Columbia Act of 2010.” Pg. 3.

⁸⁹ *Ibid.*, 3.

supermarket tax incentive. Further, as laid out in the FEED-DC Act, the goals of job creation and increasing revenues would be secondary benefits of the incentives.⁹⁰

Impact

Since 2000, 22 supermarkets have received real property tax exemptions, the value of which totals \$21 million between 2010 and 2017 (data were not readily available before 2010).⁹¹ This number excludes a new exemption that has been approved for a future supermarket in Census Tract 94.

Data on the value of personal property tax exemptions taken were not readily available; however, the estimate of revenue foregone through the personal property exemptions taken by qualified supermarkets totals \$2.9 million for 2010 through 2017, as calculated for ORA’s Tax Expenditure Reports. Similarly, data are unavailable for the value of sales tax exemptions taken by qualified supermarkets and ORA estimates for the value of these exemptions totaled almost \$5 million from 2010 to 2017. Adding the totals for each of these three taxes for 2010 to 2017, the supermarket tax incentives represented estimated revenue foregone of almost \$29 million, as presented in Table 11, below.

The total estimated revenue foregone for the supermarket tax incentives from 2010 to 2017 is \$29 million.

Table 11: Total Supermarket Tax Incentives, By Tax Type and Year, 2010 to 2017

Year	Number of Supermarkets	Real Property Tax Exemptions Received \$	Estimated Sales tax exemptions for building materials \$	Estimated Personal Property tax exemptions \$	Total (by Year) \$
2010	5	1,314,414	118,000	488,000	1,920,414
2011	7	1,481,354	121,000	490,000	2,092,354
2012	10	2,141,682	530,000	304,000	2,975,682
2013	15	2,196,426	528,000	307,000	3,031,426
2014	18	3,415,089	817,000	312,000	4,544,089
2015	17	3,489,979	845,000	316,000	4,650,979
2016	15	3,260,861	992,000	319,000	4,571,861
2017	14	3,831,227	1,034,000	322,000	5,187,227
TOTAL		21,131,032	4,985,000	2,858,000	\$28,974,032¹

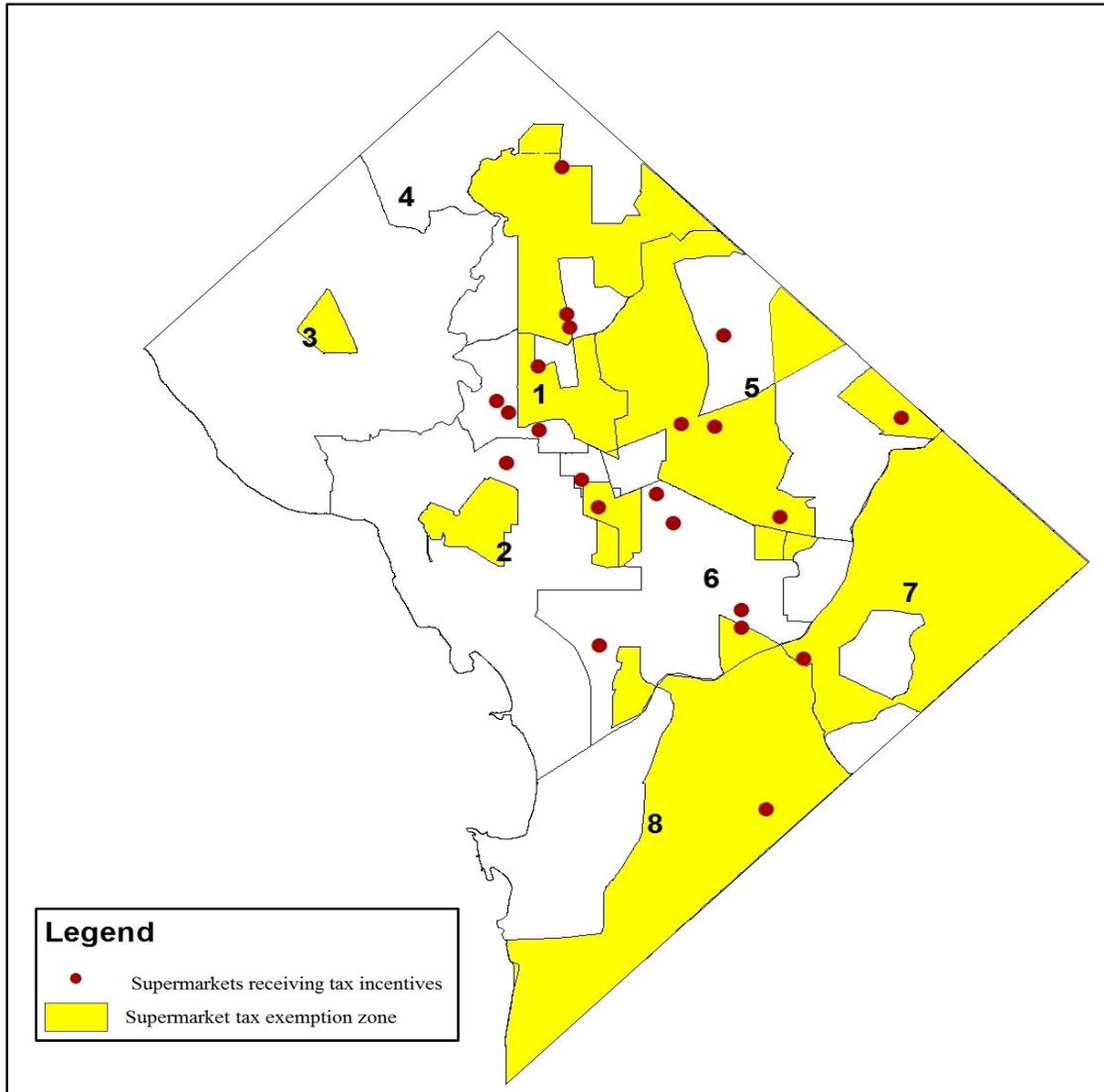
Source: ORA Analysis of Unified Economic Development Reports and Tax Expenditure Reports.

¹ This does not include an approval for a future supermarket in Census Tract 94.

⁹⁰ ORA estimated that the annual average estimated tax revenue a new incentivized supermarket can generate is \$153,956, which is about 1.5 million over the 10-year tax incentive period (or \$1 million less than it would be for a supermarket that opens without the incentive). There would be additional spillover effects of new supermarkets “as anchors” of economic development in different neighborhoods which may include increased traffic into a neighborhood or the development of new housing units and restaurants in the neighborhood around grocery store.

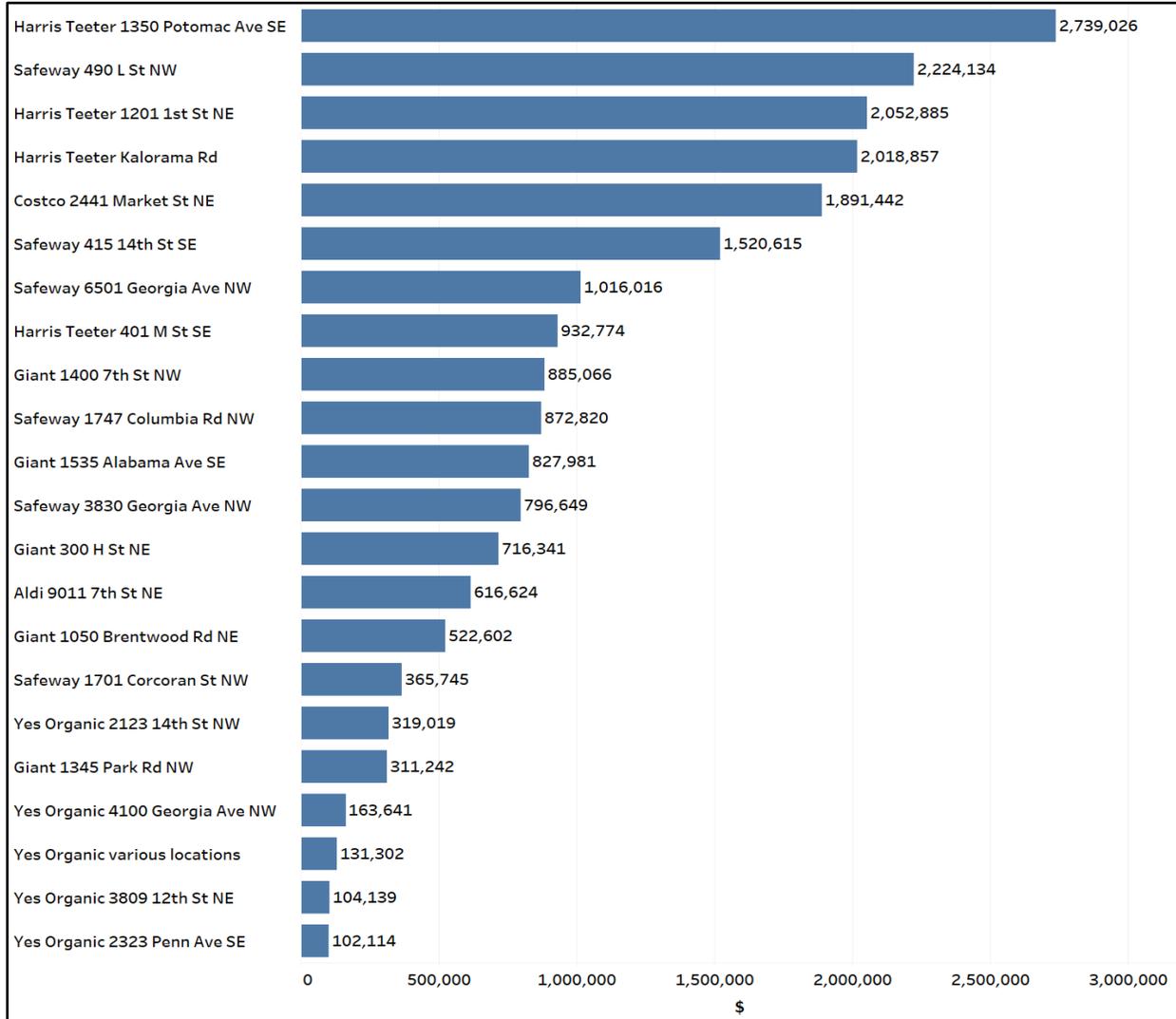
⁹¹ See Supermarkets Appendix 1 for a list of the 22 supermarkets that have received the real property tax incentives and the amounts they’ve received since 2010.

Map 1: Location of Supermarkets Receiving Incentives and Current Eligible Area



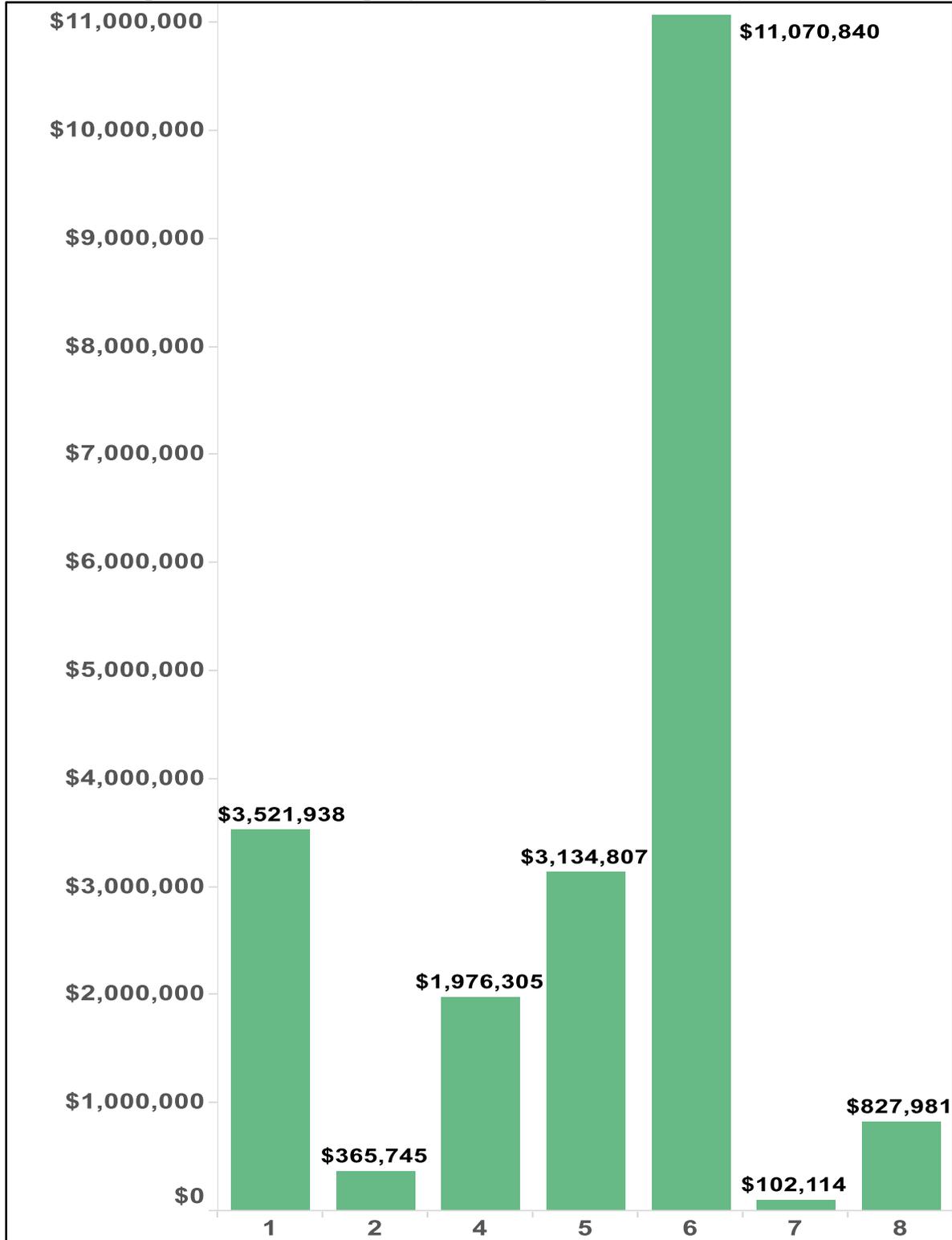
Source: ORA Analysis. Note: Supermarket eligibility areas have changed multiple times, thus some supermarkets located outside of the current yellow supermarket exemption zones were in prior eligible areas.

Chart 12: Supermarket Real Property Tax Exemptions Received, by Supermarket, 2010 – 2017



Source: ORA Analysis. Note: Does not include a future supermarket exemption approved for Ward 5, or data from 2009-10 on exemptions for the Safeway at 415 Rhode Island Ave NE.

Chart 13: Supermarket Real Property Tax Exemptions Received, by Ward, 2010 – 2017



Source: ORA Analysis. Note: Does not include a future supermarket exemption approved for Ward 5, or \$131,302 that went to various Yes Organic Locations across four wards in 2012.

Section II: Evaluation

The Supermarket Exemption Act of 2000 (and its predecessor in 1988) had the stated goal of encouraging supermarkets to locate in underserved areas of the city. Similarly, the FEED-DC Act goal pertaining to the supermarket tax incentives is that of improving access to healthy foods in low-income neighborhoods. An evaluation of the supermarket tax incentives should start by asking if these goals were achieved.

Did Supermarkets Locate in Supermarket Tax Incentive-Eligible Areas?

Since 2000, the number of supermarkets locating into the District has dramatically increased as 38 grocery stores have been constructed or replaced.⁹² However, as can be seen on Map 2 below, many of the new supermarkets located outside of the eligible areas and did not receive tax incentives, indicating that the exemptions offered may not have provided enough of an incentive to affect location decisions. Only one supermarket receiving a tax incentive located into Wards 7 and 8, respectively, between 2000 and 2015, which were areas identified as having the highest need of supermarkets in the 2010 FEED-DC Act (the supermarket in Ward 7 closed in 2014 after being open for two years). The continuing shortage of supermarkets in food deserts, especially in Wards 7 and 8 means that many lower income families still lack access to healthy food and a full-service grocery store.

Map 2 also shows that new and replaced grocery stores since 2000 were mostly being constructed in higher income and transitioning neighborhoods, rather than low-income areas like Wards 7 and 8 hence the need for the 2010 FEED-DC Act. However, the figure also shows that the extension of the Supermarket Exemption Act with the 2010 FEED-DC Act has not necessarily increased the number of supermarkets in lower income neighborhoods. In fact, a demographic study by D.C. Hunger Solutions in 2016 shows that the number of full-service grocery stores in Wards 7 and 8 has decreased since 2010.⁹³ In 2010, Wards 7 and 8 had four and three full-service grocery stores providing services to its residents, respectively. However, in 2016 Ward 7 had only two full-service grocery stores in operation while Ward 8 had one.

While there was a dearth of supermarkets opening in Wards 7 and 8, Chart 13 above shows that eight supermarkets receiving incentives in Ward 6 have received over \$11 million in real property tax exemptions combined over that time. This is by far the most any ward received and is three times more than the amounts received in other wards. Ward 6 is an area where rapid development has occurred in the past 10 years, much of it around the Union Market area. Wards 1 and 4 received the next highest levels of exemptions, with four supermarkets in Ward 1 receiving exemptions and three supermarkets in Ward 4 receiving exemptions (See Supermarkets Appendix 1 for more supermarket-specific detail). A 2017 research paper by graduate students at GWU for the Office of the Deputy Mayor for Planning and Economic Development (DMPED) found that the eligible areas for the tax incentives do generally reflect food deserts⁹⁴ in D.C. (86 percent of D.C.'s food

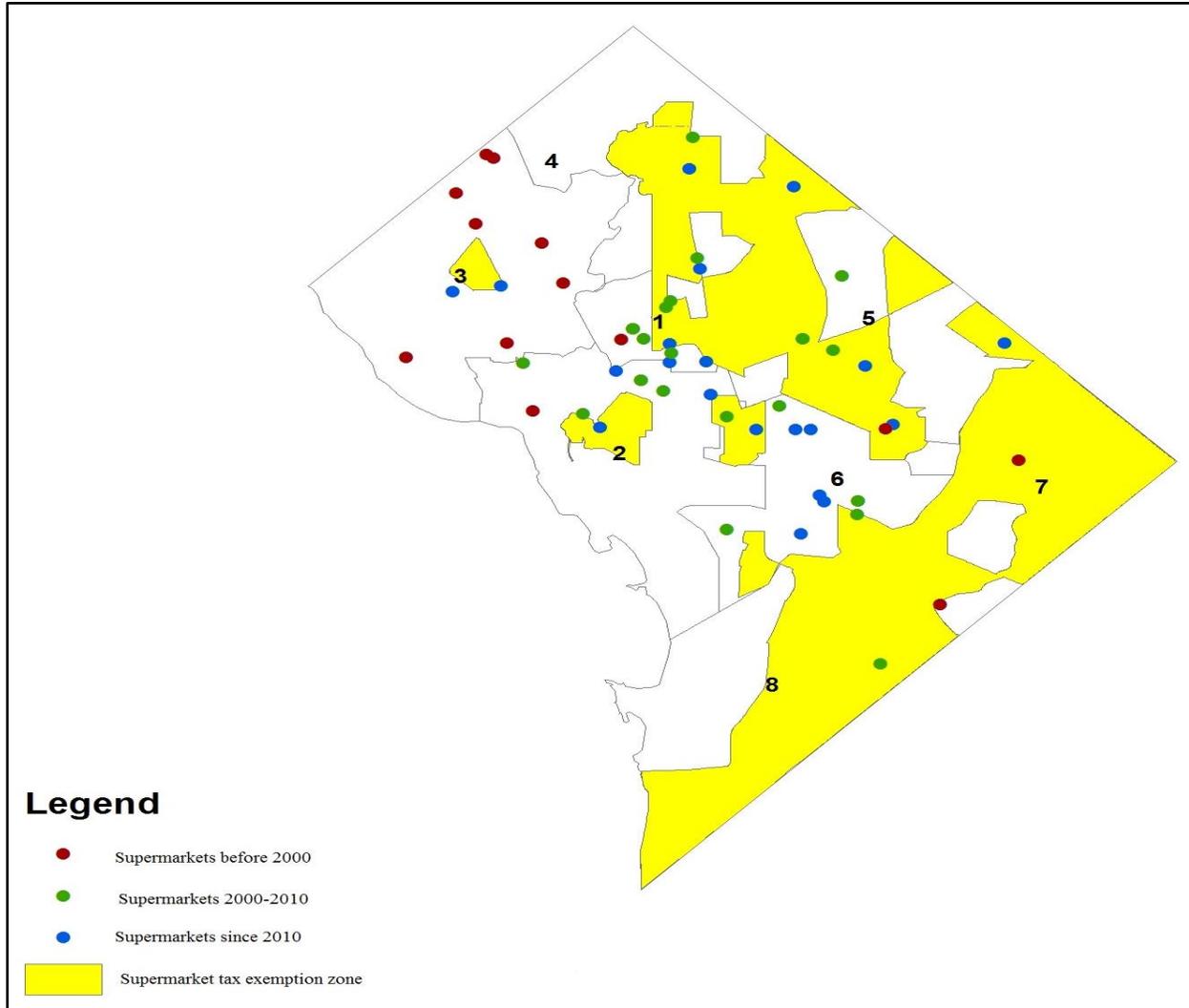
⁹² Washington DC Economic Partnership. "Grocery Store Growth in Washington, DC." Retrieved July 17, 2017 from <http://wdcep.com/industry-initiatives/retail/grocery-stores-washington-dc/>.

⁹³ D.C. Hunger Solutions (2016). "Closing the Grocery Gap in the Nation's Capital." Retrieved on August 17, 2017 from <http://www.dchunger.org/pdf/dchs-closing-grocery-store-gap-report.pdf>

⁹⁴ The report modifies the USDA food desert definition, operationalizing it for their report as: a census tract where more than 33 percent of census block groups considered were more than a ½ mile away from a supermarket. The

deserts are in the supermarket tax incentive eligible areas and 90 percent of severe food deserts are in eligible areas).⁹⁵

Map 2: Location of Supermarkets in D.C., by Opening Date



ORA Analysis. Note: Does not include supermarkets that have closed. Does include supermarkets that did not receive a tax exemption. Supermarket eligibility areas have changed multiple times, thus some supermarkets located outside of the current yellow supermarket exemption zones were in prior eligible areas.

Another question to ask in evaluating any tax incentive is whether the incentives prompted the desired activity--in this case new supermarkets--that would not have happened without the incentive. We do not know whether the supermarkets that opened during this time would have

census blocks considered were those with a median household income of 80% of Area Median Income (AMI) for a 3-person household (\$78,624). A severe food desert is where more than 33 percent of census block groups were more than a mile from a supermarket. A supermarket is defined in §47-3801 of the D.C. Code, see footnote 71 above.

⁹⁵ Cheng, Y., Meni, D., Robin, L., Thombs, R., Wimsatt, M., and Zhai, Z. (2017). A Program Evaluation and Policy Analysis of the Supermarket Tax Exemption Act of 2000. Prepared for the Office of the Deputy Mayor for Planning and Economic Development., p. 25.

done so but for the incentives. According to an interview GWU graduate student researchers had with a representative of a supermarket receiving the tax incentive, the supermarket incentives did not influence the supermarket’s decision to locate where it did.⁹⁶ Similarly, the general manager for a large supermarket chain claimed that in his 29 year career in supermarket management he was confident that a “tax mechanism had never been a deciding factor.”⁹⁷ The manager noted that other factors, like space availability, would be a primary consideration for locating a supermarket in an urban area.⁹⁸

... “the share of the population living in food deserts in eligible areas only declined by 10% [while] the share of the population living in food deserts in ineligible areas declined by 58% between 2011 and 2014” ...

Did Levels of Food Insecurity Decline?

A second question to ask in evaluating supermarket tax incentives, based on the goal of improving D.C. residents’ access to supermarkets for reducing their food insecurity, is whether the level of food insecurity of D.C. residents in the incentives’ eligible areas decreased. In this case other policies have been implemented in the same time frame and with similar policy goals, further complicating any review of the tax incentives on their own (in addition to not knowing the counterfactual without the incentives). For example, the FEED-DC Act implemented a variety of initiatives related to the supermarket tax incentives, including a structure for grants and loans to grocers through the Healthy Food Retail Program; designated grocery ambassadors within DMPED to provide market research and data on areas with insufficient grocery store access and provide other assistance to grocery stores as needed; and the Act recommended flexibility in zoning for supermarkets. (See Supermarket Appendix B for a map and description of the Healthy Food Retail Program). Any of these activities could have impacted the level of residents’ access to supermarkets as well. However, knowing the level of this metric is important for evaluating the supermarket incentives and considering it in the context of all the policy interventions currently aimed at the goals.

Cheng et al. found that from 2000 to 2014 the total number of residents in the District living in food deserts declined by at least 17 percent.⁹⁹ However, there is a disparity in the levels of decline in eligible and ineligible areas of the supermarket tax incentives, especially in recent years. For example, “the share of the population living in food deserts in eligible areas only declined by 10%, from 63% in 2011 to 57% in 2014. In comparison, the share of the population living in food deserts in ineligible areas declined by 58% between 2011 and 2014, a reduction of over 40,000 residents compared to a reduction of only slightly over 5,000 residents in eligible areas.”¹⁰⁰ Chart 14 below

⁹⁶ Cheng et al., p. 34.

⁹⁷ Ibid., 34.

⁹⁸ Ibid.

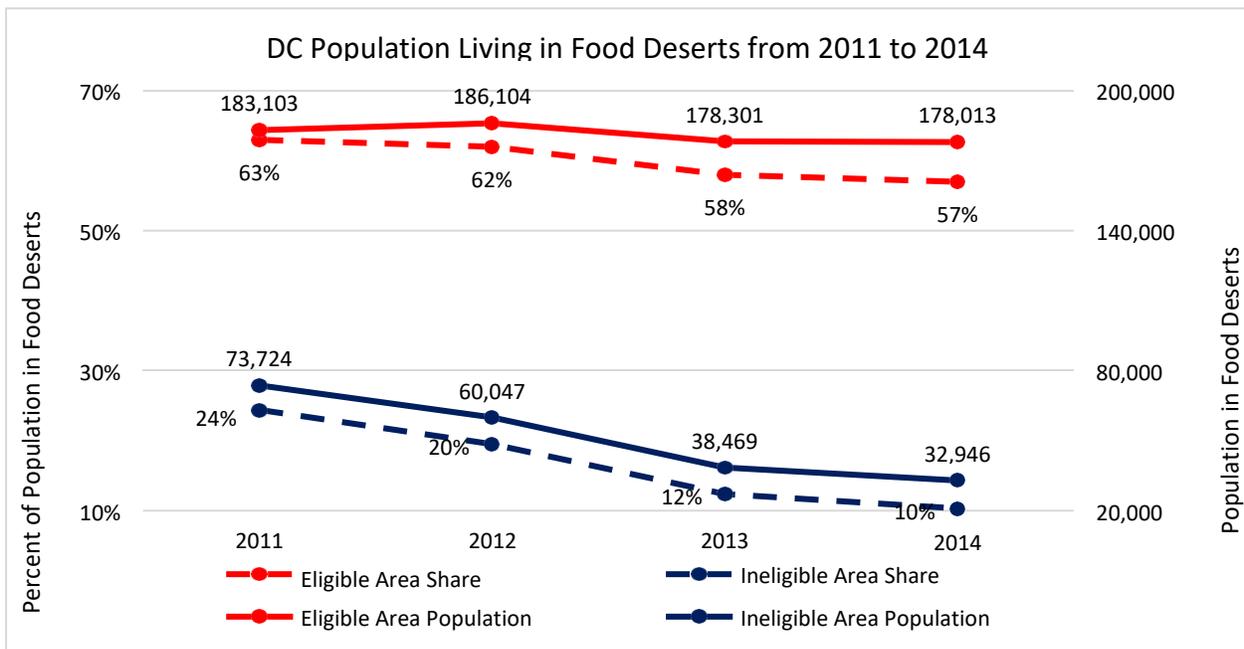
⁹⁹ Cheng et al. did not include Maryland or Virginia supermarkets in their analysis of D.C. food deserts. Some D.C. residents living in food deserts at the edge of the D.C. border may live within ½ mile of a supermarket in Maryland or Virginia. For this analysis we focus on D.C. supermarkets as those are the only ones receiving the D.C. tax incentives. There are a handful of supermarkets just over the D.C. border in Maryland and to the extent that they would impact another supermarket’s decision not to locate within a D.C. a food desert, that is something to consider when assessing supermarket location decisions. However, if D.C residents go to Maryland or Virginia for food shopping, that represents economic activity that is lost to the District.

¹⁰⁰ Ibid., 27.

illustrates this decline in the population and percentage of the population living in food deserts in eligible and ineligible areas from 2011 to 2014.

The fact that the number of residents living in food deserts has declined is certainly good news for the District and may reflect the many supermarkets opening in the District over this time, or other intervening policies to address food insecurity. However, the fact that the decline was particularly significant in areas that were not eligible for the supermarket tax incentives does appear to indicate that the supermarket incentives were not a factor in attracting supermarkets to the areas of highest need, and therefore the levels of residents living in food deserts in those areas did not decline as much as those levels reduced in other areas of the city.

Chart 14: D.C. Population Living in Food Deserts from 2011 - 2014



Source: Cheng et al., pg. 28. Note: The dashed lines show the share of the eligible and ineligible populations living in food deserts over time and are associated with the axis on the left. The solid lines show the same population in numbers and are associated with the axis on the right. The axes are truncated to better fit both eligible and ineligible populations on the same graph.

The charts below show that the geographic areas in D.C. that are considered food deserts¹⁰¹ has changed dramatically from 2000 to 2014, with Wards 1, 4, 5, and 6 showing large declines, just as significant development has occurred in many areas in these wards.

While increasing District resident’s access to healthy food and thus removing food deserts has been the goal guiding much of the food policy and related interventions covered here, recent research questions the efficacy of these interventions alone for improving the nutrition and thus health of people with low incomes. Richard Florida (2018) describes a study finding the problem goes deeper than access to food; rather, the biggest reasons for disparate eating habits between higher and lower income people, besides income, are fundamental differences in “educational and

¹⁰¹ See footnote 83 above for the definition of a food desert used in this report.

nutritional knowledge, which shape our eating habits and in turn impact our health.”¹⁰² The article goes on to note that “[o]pening new supermarkets has little impact on eating habits of people in low-income neighborhoods: Even when residents do buy groceries from the new supermarkets, they buy products of the same low nutritional value.”¹⁰³

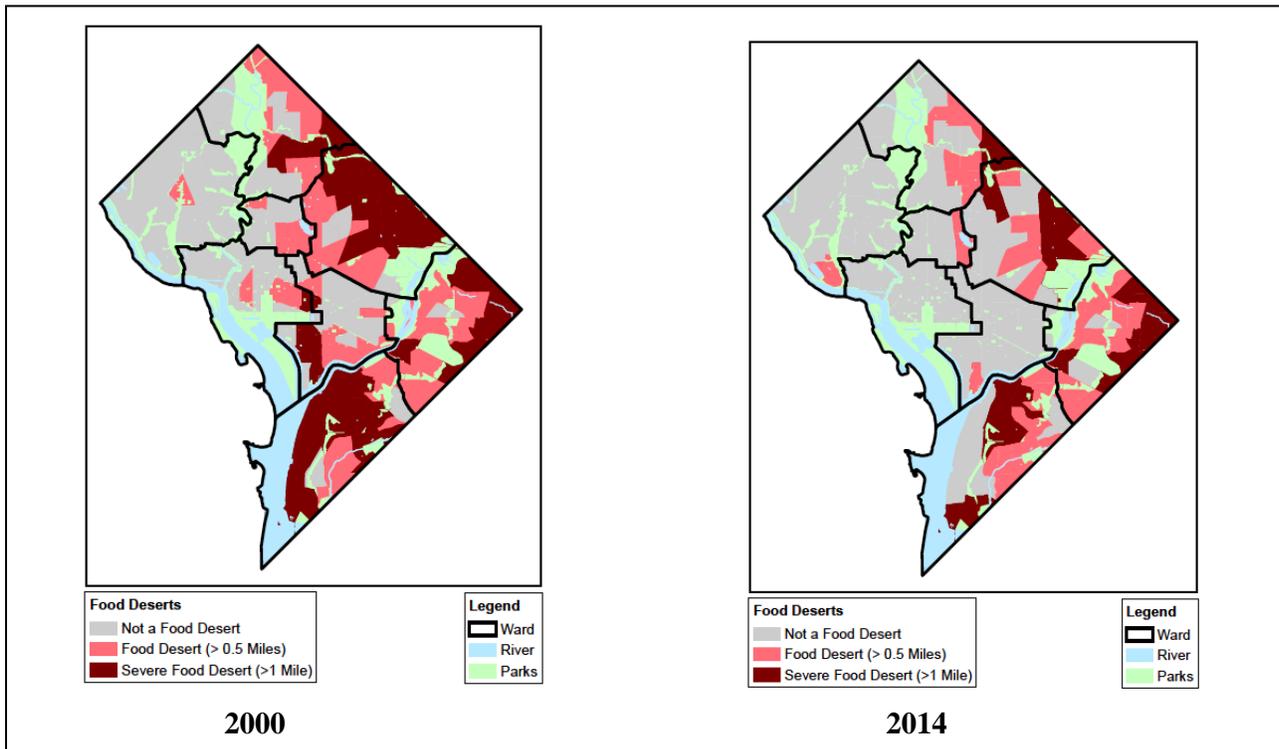
Improving access to healthy food is clearly part of the equation, however such findings suggest additional strategies like targeted nutrition education may be needed to complement the existing policies aimed at improving the nutrition and health problems facing low-income District residents. In fact, the Committee Report on the FEED-DC Act of 2010 noted that the city should continue to examine the grocery gap in the future and that as funds become available, “other creative programs to promote healthy eating” should be explored given the need for substantial nutrition education.¹⁰⁴

¹⁰² Florida, Richard. “It’s Not the Food Deserts: It’s the Inequality.” January 18, 2018. CityLab. <https://www.citylab.com/equity/2018/01/its-not-the-food-deserts-its-the-inequality/550793/>

¹⁰³ Ibid.

¹⁰⁴ FEED-DC Act Committee Report, p. 10.

Chart 15: Food Deserts in D.C. in 2000 and 2014



Source: Cheng et al., p. vi – xi.

Note: as footnote 98 points out, Maryland or Virginia supermarkets are not considered in this analysis, which may mean that a couple of the darker red areas along the border of D.C. would be lighter if non-D.C. supermarkets are included. There are least two supermarkets within a ½ mile of the southern D.C. border with Maryland, and one within a ½ mile of the border on the northeastern border with Maryland (and one food co-op).

Section III. Other Factors Affecting Effectiveness of Supermarket Tax Incentives

Restrictive Covenant in Ward 7

Another reason new supermarkets did not locate in one particular area in Ward 7 may have been the now-released restrictive covenant between Safeway, Inc. and Skyland Development LLC from 1997 to 2015,¹⁰⁵ which limited the type of businesses that could locate to Skyland Development Center in Ward 7 and prevented another supermarket from opening within 500 feet of the Safeway in the Good Hope Shopping Center.¹⁰⁶ The covenant restriction clearly worked at cross purposes with the incentives. The lessons learned from this experience led to the Grocery Store Restrictive Covenant Prohibition Congressional Review Emergency Act of 2018, which expired for the second time on October 16, 2018. If re-enacted, the bill will prohibit property owners from using a restrictive land covenant or restriction in a contract to prevent the use of a property as a grocery store; as well as property owners from restricting abutting or adjacent properties from being used as a grocery store or restaurant.¹⁰⁷

Supermarket Tax Incentives Not a Key Factor in Location Decisions

Cheng et al.’s study outlines the decision-making process a supermarket will engage in before making a location decision. They found that supermarkets look at a variety of factors in their decisions of where to locate, such as space requirements, demographics, population density, traffic, vehicle access, and cost modeling, among other factors.¹⁰⁸ Most importantly, tax incentives did not factor into the analysis until later stages of the process, when the location may have already been determined. Similarly, research prepared by the Office of Economic Development Finance for the recent 2016 amendments to the FEED-DC Act notes that “supermarket site selection depends primarily upon income of the nearby population, distance and type of competing food markets, and access for customer and supplier vehicles,”¹⁰⁹ providing further evidence that a supermarket tax incentive alone is not likely to be a large factor in the decision to locate in a specific area.

¹⁰⁵ In October 2015 the District was released from the restrictive covenant with an agreement to pay Safeway, Inc. \$900,000 a year for four years totaling \$3.6 million, beginning in 2019. Neibauer, Michael. “D.C., Safeway ink Skyland deal. Here’s what that means for the Wal-Mart-anchored project.” October 7, 2015. *Washington Business Journal*. Retrieved from https://www.bizjournals.com/washington/breaking_ground/2015/10/d-c-safeway-ink-skyland-deal-what-that-means-for.html

¹⁰⁶ The restricted covenant, signed by both parties in June 2001, required that “for fifty years following the date of the deed, no portion of the property conveyed hereby shall be occupied or used, directly or indirectly, for the purposes of a general market or a grocery store, meat market, fish market, fruit store, vegetable store, prescription pharmacy or any combination thereof. Notwithstanding the foregoing, nothing herein set forth shall limit or impair occupancy or use of the property for a non-prohibited primary use which may include incidental sales of food items including in an area not to exceed 500 square feet.”

¹⁰⁷ Bill 22-60, Committee Print provided to the Office of Revenue Analysis on February 5, 2018. Fiscal Impact Statement – Grocery Store Restrictive Covenant Prohibition Act of 2018.

¹⁰⁸ Cheng et al., p. 29.

¹⁰⁹ “Tax Abatement Financial Analysis – ‘Food, Environmental, and Economic Development in the District of Columbia Amendment Act of 2016,’ Bill 21-836.” Office of Economic Development Finance. Office of the Chief Financial Officer. October 26, 2016.

Availability of Lots for Supermarkets

Cheng et al.’s study also analyzed available lot sizes and spaces in Washington, D.C. to identify where supermarkets could locate since research shows that supermarkets are more inclined to open large outlets because it is profitable. It is however “difficult to find adequately sized sites in inner city poor neighborhoods due to fragmentation of property ownership.”¹¹⁰ Therefore, lot size and zoning are barriers

The study found that the average lot size a large chain supermarket requires is around 40,000 square feet, while the size of the smallest grocery store receiving tax exemption benefits from the District is about 15,000 square feet. Table 12 below shows that in eligible areas, there are 10,238 commercially zoned available lots in D.C. Of those, only 351 are commercially zoned above 40,000 square feet. 157 commercial zoned lots above 40,000 square feet are in eligible areas, and less than a third of those are in food deserts. Using a smaller threshold of square footage between 2,500 and 15,000, the number of lots in food deserts in eligible areas increased from 52 to 623 available lots.

Table 12: Results of Lot Size Analysis

	Number of Lots	Percent of Commercial Lots
All Lots in D.C.	147,117	-
Only Commercial Lots	10,238	100%
Commercial Lots > 40k ft²	351	3.4%
Within an Eligible Area	157	1.5%
<i>Within a Food Desert</i>	52	0.5%
Outside of a Food Desert	105	1.0%
Commercial Lots 2,500 - 15,000 ft²	1108	10.8%
Within an Eligible Area	811	7.9%
<i>Within a Food Desert</i>	623	6.1%
Outside of a Food Desert	118	1.2%

Source: Cheng et al., p. 37.

¹¹⁰ Cheng et al., p. 37.

Section IV. Issues with Data Collection and Tracking of the Incentives

Data Availability

Data on the dollar value of the real property tax exemptions received were not readily available and had to be compiled manually from various spreadsheets that were not all in one location or held by a single person. For this reason, the data represent lower bounds as some information is missing for some supermarkets for a few of the years. Further, data on personal property and sales tax exemptions for supermarkets have not been tracked, precluding a precise accounting of the total amount of revenue foregone.

First Source Employment Agreement Act

Both the 1988 and 2000 Supermarket Tax Exemptions laws subjected qualified supermarkets to the First Source Employment Agreement Act requiring businesses receiving government incentives over \$300,000 to have at least 51 percent of new employees be District residents. The D.C. Department of Employment Services (DOES) administers the First Source agreements. ORA requested information from DOES on whether supermarkets receiving tax benefits complied, but confirmation has not been received as of the time of publication.

Section V. Summary of Findings and Recommendations

For nearly twenty years, the District has offered tax incentives for supermarkets. The tax incentives were enacted to increase the number of supermarkets and decrease food deserts, thereby increasing D.C. residents' access to healthy food. These intermediate measures were expected to lead to the longer-term improvements in health outcomes of District residents.

Not all data on supermarket exemptions taken is tracked or readily available, however data show that the amount of revenue foregone from 2010 to 2017 through the real property exemptions is about \$21 million. Adding in the estimates of revenue foregone through the personal property and sales taxes the total for the tax incentives reaches almost \$29 million from 2010 to 2017. This does not include \$3.9 million that has been approved for a future supermarket in Census Tract 94.

While there has been an increase in the number of supermarkets in the District, the increase has been concentrated in transitioning and higher income neighborhoods and many of them opened without the help of the tax incentives. The supermarket tax incentive provisions have changed multiple times to reflect the District's changing economic environment, yet there is little in the way of results that can be definitively attributed to the incentives. Given the rapid economic development occurring in many areas of the District through this time, it is not clear whether the incentives alone were a factor in any of the recipient supermarkets' decisions to locate where they did, and anecdotal evidence suggests they do not play a major role in supermarket location decisions, in general.

Only two supermarkets receiving incentives located into Wards 7 and 8 between 2000 and 2015, and one of those closed after two years. The continuing shortage of supermarkets in food deserts, especially in Wards 7 and 8 means that many lower income families still lack access to healthy

food and a full-service grocery store. While the city experienced significant declines in the number of food deserts, the more significant declines are in areas not eligible for the supermarket incentives, further indicating that the supermarket tax incentives are not enough to attract supermarkets to the areas with the highest need. Further, new research shows that simply improving food access by opening supermarkets has little impact on low-income persons' eating habits, thus additional policy interventions such as nutrition education may be needed to improve long-term health outcomes.

This new research aside, assessing the incentives on their original goals shows that almost \$29 million of foregone District revenues cannot be shown to have affected supermarkets' location decisions, generally, or produced economic or other benefits that would not have happened but for the incentives. As such, this report recommends that policymakers change the supermarket tax incentives to better target supermarkets that would not otherwise locate in an area of highest need. Such targeting would also prevent windfalls of taxpayer dollars from going to supermarkets that would have located in eligible areas regardless of the incentives. Further, any modification should consider whether more of an incentive is needed for supermarkets that would locate in areas of highest need, given the evidence that the tax incentives alone have not been enough of an attraction for supermarkets to locate in food deserts or low-income areas of highest need.

[T]his report recommends that policymakers change the supermarket tax incentives to better target supermarkets that would not otherwise locate in an area of highest need.
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A recently passed law takes the District's supermarket policies in this direction. The East End Grocery and Retail Incentive Program Tax Abatement Act of 2017 takes steps to create greater access to grocery stores in Wards 7 and 8 by encouraging the development of a new anchor grocery store, which would serve as a catalyst for additional business development in the neighborhoods. The law provides a package of incentives that include: a 30-year real property tax exemption from real property or possessory interest taxes, including leases; a recordation and transfer exemption; a 30-year exemption on license fees, personal property taxes, and franchise corporate taxes on income received in operation of store, but not including capital costs or operating expenses incurred; and a sales and use tax for purchases of property or services to construct the store. The law also includes a real property tax rebate for businesses that lease their property. Eligible locations include Capitol Gateway, East River Park, The Shops and Penn Hill, Parkside Planned Unit Development, St. Elizabeth's East Campus, and the United Medical Center.¹¹¹

Experience from the current supermarket tax incentives and other tax incentive programs outlined in this report highlight the need for better data tracking and reporting mechanisms. Based on best practices of tax incentives identified in this report, a specific agency should own the program and be charged with collecting and analyzing data on the incentives to ensure compliance to the law (such as monitoring the requirement that 50 percent of employees are D.C. residents) to promote the accountability of taxpayer dollars.

¹¹¹ A22-0254, effective March 29, 2018.

Qualified supermarkets

The Need:
Construction or renovation of full-service grocery stores in food deserts to reduce the number of food insecure residents in the District.

Resources/Inputs:
For 10 years:
• Real property tax exemption;
• Business license fee exemption;
• Personal property tax exemption;
• Sales and use tax exemption on building materials necessary for construction

Outputs:
Since 2000, 22 supermarkets have received the incentives. Available data from 2010 to 2017 show estimated foregone revenues of \$28,974,032. An additional real property tax exemption has been approved for a future Supermarket in Census Tract 94.

Expected Benefits
(changes in short, medium, or long-term measures)

Short-term:
Increase in the number of grocery stores in the District

Increase in the number of jobs available to District residents

Medium-term:
Decrease in number of food insecure residents

Increase in economic activity in areas with new supermarket as the supermarket attracts other development.

Long-term:
Decrease in long-term health problems associated with food insecurity, such as obesity of residents.

Increase in economic activity in areas with new supermarkets.

Increase in total tax revenue coming into the District.

Assumptions: Improving food access will improve nutrition and health outcomes, and more grocery stores will increase economic activity and tax revenue to the District.

Chapter III: Certified Capital Investment by Insurance Companies

Insurance Premium Tax Credit

District of Columbia Code: D.C. Official Code § 31-5233-§ 31-5238
 Sunset Date: None
 Year Enacted: 2004

	2012	2013	2014	2015	2016	2017	2018	2019
Estimated Revenue Foregone (\$000) Fiscal Year	\$8,073	\$7,497	\$3,736	\$2,637	\$3,251	\$1,318	\$2,030	n/a

Source: CAPCO funds remaining as of September 2017, DISB.

Section I: Introduction and Overview

Description

The Certified Capital Companies Act of 2003 became effective on March 10, 2004. Beginning in 2004, insurance companies that invested in or loaned funds to a certified capital company (CAPCO) were entitled to receive up to \$50 million in insurance premium tax credits equal to the amount of the insurance company’s total debt and equity investment in the CAPCO. A CAPCO is a partnership, corporation, trust, or limited liability company, whether organized on a profit or not for profit basis, that has as its primary business activity the investment of cash in qualified businesses (defined below).¹¹²

Because insurance companies typically have large pools of funds available from collecting premium payments yet are also typically risk averse, CAPCO programs are used as an economic development tool to incentivize insurance companies to invest in local communities. Unlike depository institutions such as commercial banks and savings associations, insurance companies are not required under the Community Reinvestment Act to invest in the local communities in which they operate.¹¹³ By allowing insurance companies to claim premium tax credits, the District generated a pool of investment capital flowing through the CAPCOs that qualified small businesses could access to start or expand their businesses.

Under the CAPCO program a ‘qualified business’ must be headquartered in and conduct their principal business operations in the District or certify in an affidavit that they will relocate their headquarters and principal business operations to the District within 90 days after receiving an initial investment from a CAPCO. At least 25 percent of the employees of a qualified business must live in the District, and at least 75 percent of their employees must work in the District. Qualified businesses must also be small businesses as defined by the Small Business

¹¹² D.C Law § 31–5231

¹¹³ William Werkmeister. "Smart Stimulus Amid Deepening Debt: Future-Flow Tax Credit Programs" *Harvard Kennedy Review* Vol. XII (2012). Retrived from: http://works.bepress.com/william_werkmeister/7/.

Administration¹¹⁴ and must certify in an affidavit that they are unable to obtain conventional financing.

CAPCOs had to apply for certification from the District’s Department of Insurance, Securities, and Banking (DISB), and demonstrate that they met statutory requirements for equity capitalization, venture capital experience, and other criteria. In 2004 DISB certified the three CAPCOs, Wilshire D.C. Partners, Advantage Capital Partners, and Enhanced Capital Partners.

Amendments to the CAPCO statute enacted in 2010 created four tiers of qualified businesses, based on their primary line of business and the location of their headquarters.¹¹⁵ The size of the credit earned by a CAPCO will depend on the tier of business; for example, each dollar invested in a Tier One business will yield a credit of \$1.25. The amendments also require CAPCOs to invest all their certified capital within 10 years of the allocation date of the tax credits tied to that capital. If a CAPCO fails to make the full investment within 10 years, it is barred from using its certified capital to pay its management fees.

In any tax year, an insurance company may not claim insurance premium tax credits that exceed 25 percent of its premium tax liability, but the unused premium tax credits can be carried forward indefinitely until they are utilized. There is an aggregate limit of \$50 million on the premium tax credits that may be granted and a \$12.5 million limit per year. Tax year 2009 was the first year that insurance companies could claim the tax credits. The D.C. Code stipulates a claw-back clause that allows the District to take back tax credits if a CAPCO fails to invest more than half the certified capital it raised from the insurance companies (See §31-5234 and 31-5231 (3)), though all three CAPCOs have met this requirement.¹¹⁶

Purpose

The purpose of the credit was to encourage private capital investment in new or expanding small businesses in the District of Columbia. More generally, the CAPCO program was intended to strengthen and expand the District’s economic and tax base.

¹¹⁴ 13 C.F.R. § 121.201 details the maximum allowed number of employees and annual receipts, by business subsector.

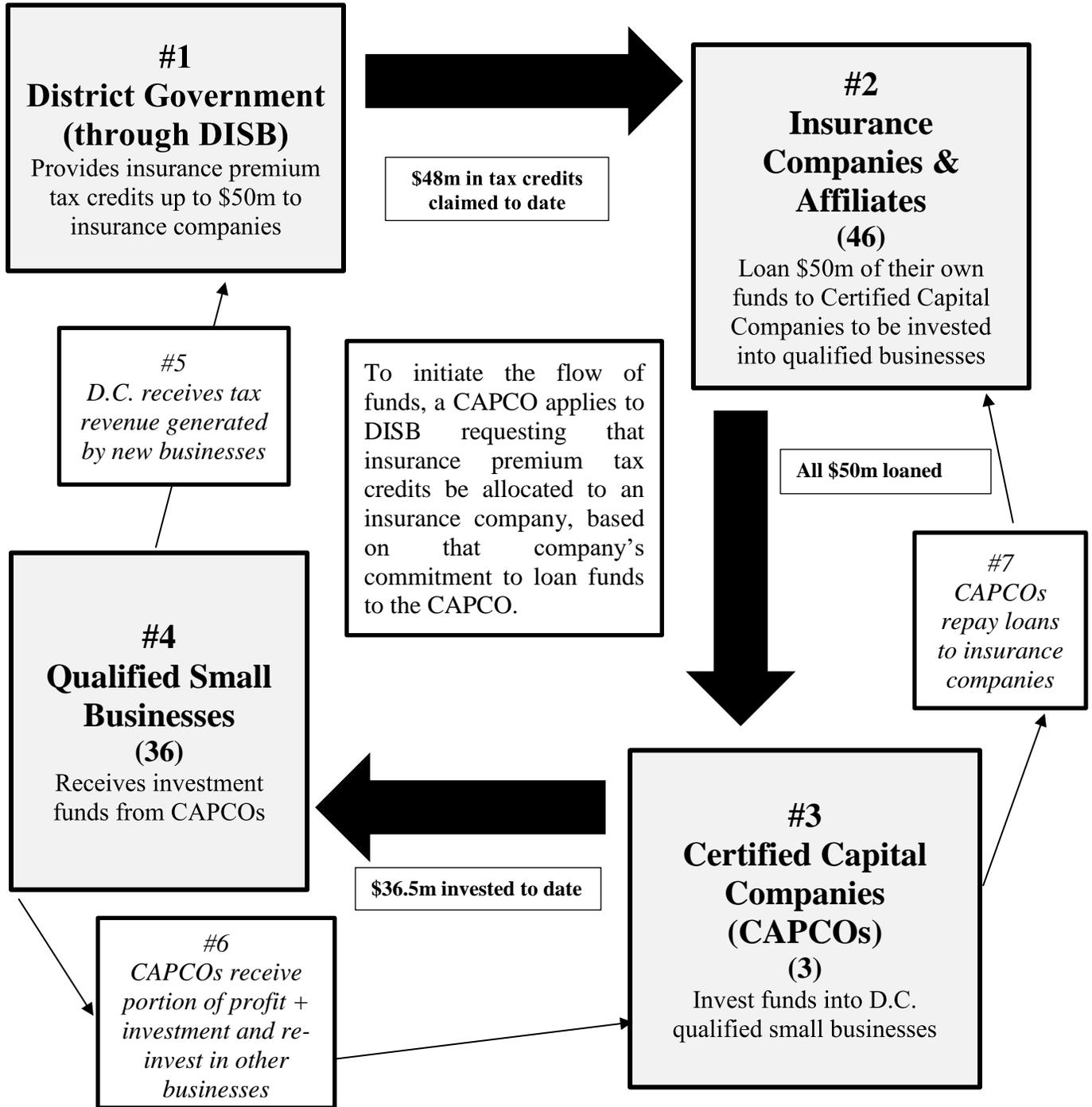
¹¹⁵ D.C. Law 18-181, the “Certified Capital Companies Improvement Amendment Act of 2010,” took effect on May 27, 2010.

¹¹⁶ To protect themselves against the possibility that the CAPCOs failed to meet the required level of investment, the insurance companies purchased insurance on the tax credits.

Table 13: Description of CAPCO Tax Provisions and Changes

CAPCO Incentive	District Code	Description	FY17 Estimated Revenue Foregone
Insurance Premium Tax Credit	§31-5231- §31-5238	<ul style="list-style-type: none"> • 2004: A premium tax credit is awarded to a certified investor (insurance company) that loans or invests money to a certified capital company (CAPCO) which invests funds into to qualified businesses in the District; • The aggregate amount of premium tax credits allowed for all insurance companies is capped at \$50 million. • 2010: Program amendments include an evaluation requirement. DISB to conduct annual economic impact analysis statement. 	\$1,319,336

Figure 2: The Flow of Funds of the CAPCO Program^{117, 118}



¹¹⁷ ORA analysis of the structure of the CAPCO program from interview with Dana Sheppard, Acting Deputy Commissioner for Market Compliance, District of Columbia Department of Insurance, Securities and Banking. (February 08, 2018)

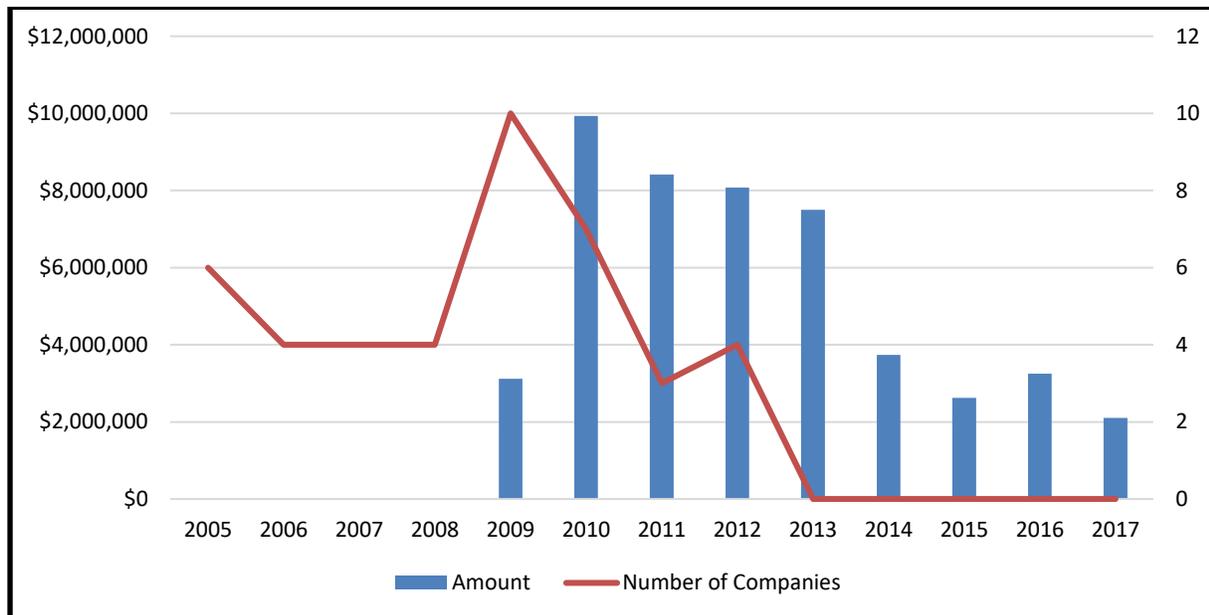
¹¹⁸ Box #5 represents the economic impact of the program to the District and is the amount that should be measured in an evaluation. Two estimates have been made that did not have full data, made several assumptions about the program that cannot be verified, and include estimates of funds that did not materialize. Box #6 represents a flow of funds that was expected but to date has not occurred.

Section II: Impact and Evaluation

Impact

From 2009 to 2017, insurance companies claimed \$48 million in District insurance premium tax credits based on \$33.5 million in investments that CAPCOs made into 36 qualified businesses prior to 2012.¹¹⁹ Chart 16 below shows that no investment has been made by CAPCOs to a qualified company since 2012. The chart also shows the amount of premium insurance tax credits claimed by insurance companies since 2009. Insurance companies are expected to claim the remaining \$2 million in tax credits in FY 2018.

Chart 16: Number of Qualified Companies and \$ Amount of Insurance Companies’ Claims Per Year

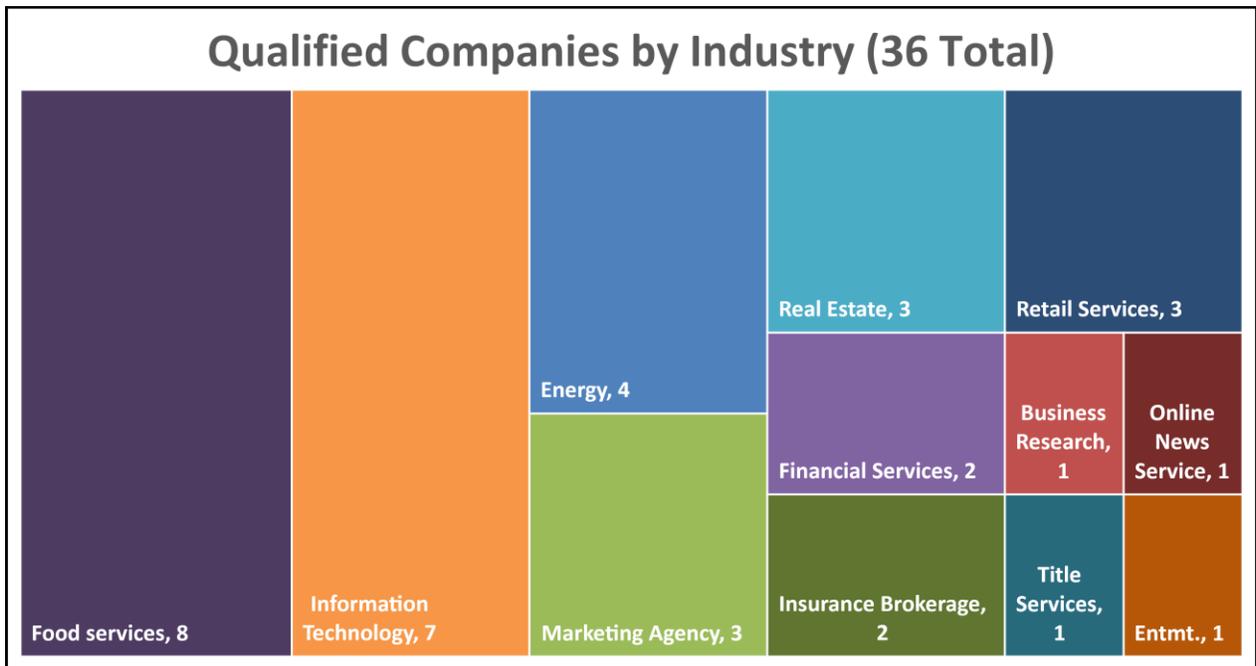


Source: Number of qualified companies for years 2005-2008 retrieved from Stephen S. Fuller (2009) *The Economic and Fiscal Impact of CAPCO-Funded Companies on the District of Columbia*. Page 15; 2010-2012 data retrieved from Appendix II, *Detailed Economic Development Budget by Agency*, District of Columbia Unified Economic Development Reports. Fiscal Years 2010-2012; 2009 and 2011 data retrieved from the Department of Banking and Insurance Annual Review of Enhanced Capital District Fund, LLC, Wilshire DC Partners, LLC, and Advantage Capital DC Partners I, LLC for the period of January 1, 2009 through December 31, 2009; and for the period of January 1, 2011 through December 31, 2011. The amount of money claimed per year is retrieved from the Department of Banking and Insurance.

¹¹⁹ Phares, Don. “The Economic and Fiscal Impact of the District of Columbia’s CAPCO Program”. prepared for the District of Columbia’s Certified Capital Companies Program and the District of Columbia Department of Insurance, Securities, and Banking. University of Missouri-St. Louis, November 2013.

Figure 3 below shows the types of qualified companies that have received CAPCO investments by industry. The largest numbers of qualified companies to receive CAPCO investments were in the food service and information technology industry, at eight and seven companies, respectively. The food service industry businesses consist mostly of restaurants and lounges, while information technology includes software development and web design.

Figure 3: List of D.C. CAPCO Investment Companies

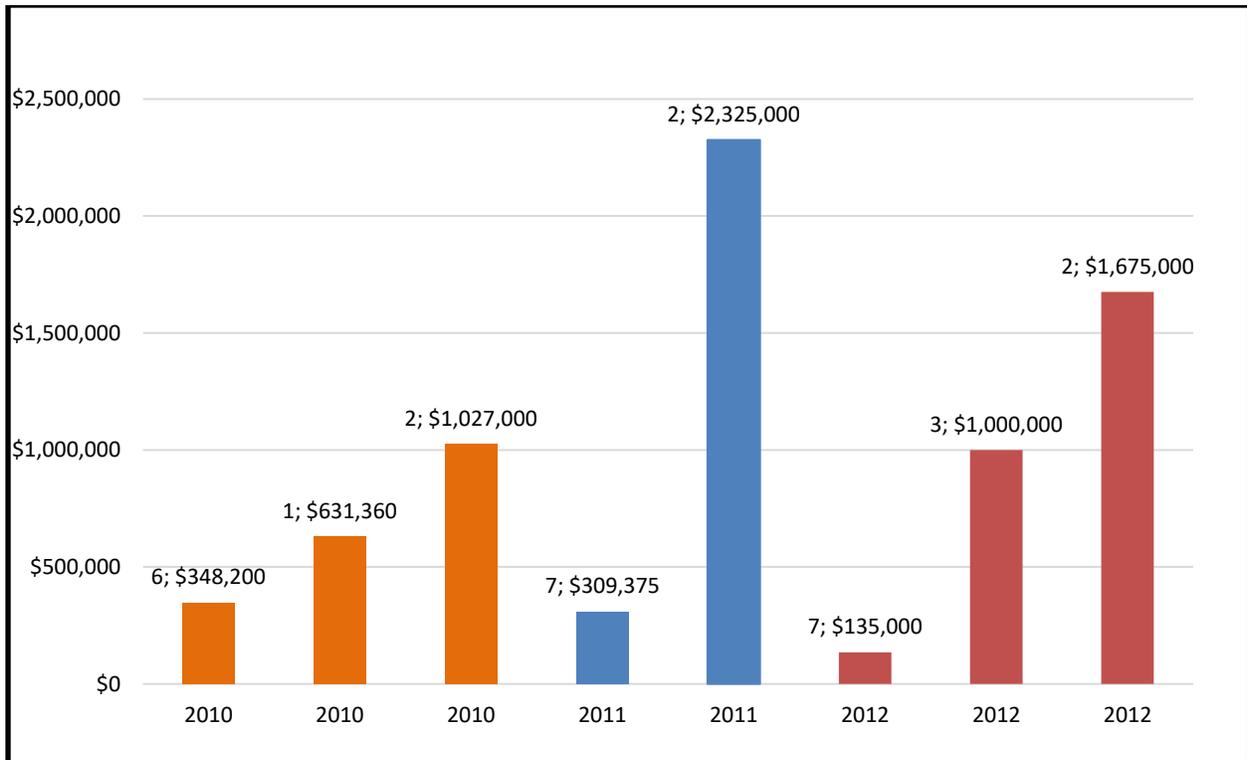


Source: ORA Analysis of data retrieved from Office of the District of Columbia Auditor, “Certified Capital Companies Program,” March 12, 2009, available at www.dcauditor.org and DC CAPCO Investments Made To-Date. Retrieved from http://dccapco.com/made_to_date_investments.html.

One CAPCO fulfilled its investment obligation by investing 100 percent of funds received from insurance companies in 2011, and the other two have not made any investments since 2012. Chart 17 below shows the last three years of CAPCO investments to qualified companies by ward and year from fiscal years 2010 to 2012. Wards 2 and 3 received the largest CAPCO investments within that period at \$5,027,000 and \$1,000,000, respectively. It is uncertain if the remaining two CAPCOs will make additional investments in the District. They are legally obligated to invest 100 percent of the capital they received within 10 years of their allocation date, however, there are no penalties if they do not (beyond the prohibition from using any of the funds to pay its management fees). Given the passage of time and the previous lack of participation, it is highly unlikely there will be any new investments.¹²⁰

¹²⁰ Interview with Dana Sheppard (February 08, 2018). Acting Deputy Commissioner and Associate Commissioner, Risk Finance Bureau, District of Columbia Department of Insurance, Securities and Banking.

**Chart 17: CAPCO Loans Awarded to Qualified Companies by Year
(Ward and Dollar Amount in Label)**



Source: Appendix II, Detailed Economic Development Budget by Agency, District of Columbia Unified Economic Development Reports. Fiscal Years 2010-2012.

Evaluation

Over the years, the impact of the CAPCO program has been the subject of some dispute. As Figure 2 on page 100 shows, the structure of the program is complicated, making administration difficult. In fact, prior to the enactment of the legislation in 2004, Lawrence Mirel, DISB Commissioner, testified in support of the program but expressed concern about the administration and monitoring of certified capital companies urging that such tasks were beyond the ability and expertise of DISB.¹²¹

A 2009 report by the Office of the District of Columbia Auditor (ODCA) echoed concerns about DISB’s ability to administer the program and concluded overall that the CAPCO program was ineffective, having created only 31 jobs over four years while costing the district about \$76 million, \$54 million in set-up costs and \$22 in investments, and recommended termination of the

¹²¹ Council of the District of Columbia, Committee on Consumer and Regulatory Affairs, Report on Bill 15-20, the “Certified Capital Companies Act of 2003,” June 27, 2003, pp. 2.

Part II: Review of Economic Development Tax Expenditures – CAPCOs

program.¹²² ODCA reached its conclusion by reviewing applications and payroll reports of CAPCO funded companies, D.C. official code, D.C. municipal regulations, and interviews with the Deputy Mayor for Planning and Economic Development, the Director of the Department of Small and Local Business, the Commissioner of the DISB, and CAPCO executives.

ODCA found inconsistencies between the applications companies filled out to qualify for funding and their payroll reports (such as the number, and residence of employees; and company location). Such self-reported information was not verified by DISB before granting some companies the certification to participate in the CAPCO program.

Also relying on self-reported survey data from CAPCO-funded businesses and the CAPCOs themselves, Professor Stephen Fuller of George Mason University offered a more optimistic assessment in November 2009, contending that CAPCO “has achieved its initial goals ... in spite of a declining economic environment and the collapse of the conventional capital markets.”¹²³ Fuller’s 2009 study of the economic and fiscal impact of CAPCO-funded companies in the District of Columbia showed that since the inception and initial funding of the program in 2005, 25 companies had received CAPCO investment with three companies going out of business prior to the study. The study analyzed 18 of the remaining 22 active companies as four companies received their initial CAPCO investments too recently to be included.

Fuller credited the program with supporting early-stage businesses and helping those businesses attract additional capital.¹²⁴ Further, Fuller noted that the CAPCO companies reported that they “had been able to raise \$186.8 million in new investment capital since receiving their initial CAPCO investments amounting to \$7.50 in follow-on investment for each \$1 of CAPCO investment.”¹²⁵ Based on an economic analysis using a multiplier for estimating induced spending, he credited the CAPCO-funded companies for generating \$14.4 million in tax revenues for the District, inclusive of the personal income taxes paid by the D.C. resident employees.¹²⁶

Regarding job creation, a main objective of the CAPCO program, Fuller reports that CAPCO-funded businesses created 131 full-time and 188 part-time jobs held by District residents between 2004 and 2009. He also notes that many jobs were saved by the CAPCO investment that would have been lost during the 2008 recession. Additionally, Fuller writes that the CAPCO companies were able to increase D.C. resident salaries 100 percent in 2008, from the year prior to receiving CAPCO funding.^{127, 128} However, it is unknown whether any of these estimated economic benefits would have happened but for the incentive.

¹²² Office of the District of Columbia Auditor, “Certified Capital Companies Program,” March 12, 2009, available at www.dcauditor.org.

¹²³ Fuller, Stephen. “D.C. CAPCO: Progress Report and Assessment,” prepared for The D.C. Coalition for Capital, April 3, 2009, Council of the District of Columbia Committee on Public Services and Consumer Affairs Report on Bill 18-402, the “Certified Capital Companies Improvement Amendment Act of 2010,” February 24, 2010, p. 265.

¹²⁴ Fuller, Stephen. “D.C. CAPCO: Progress Report and Assessment,” prepared for The D.C. Coalition for Capital, April 3, 2009.

¹²⁵ Fuller, Stephen. “The Economic and Fiscal Impact of CAPCO-Funded Companies on the District of Columbia.” Center for Regional Analysis, George Mason University. November 2009.

¹²⁶ *Ibid.*

¹²⁷ *Ibid.*

¹²⁸ In 2003 testimony on the original CAPCO legislation, Fuller projected that the CAPCO program would produce economic impacts including over 5,100 new jobs and increased revenues to the District of \$96.1 million from 2004-

In a Committee Report issued for The Certified Capital Companies Improvement Amendment Act of 2010¹²⁹ which offered amendments to strengthen the CAPCO program, the D.C. Council's Committee on Public Services and Consumer Affairs provided a summary of actions the previous year, including the 2009 ODCA report, a public hearing on March 13, 2009, and a joint public oversight roundtable chaired by two Councilmembers on April 3, 2009.¹³⁰ The Committee Report acknowledged Fuller's November 2009 Study, and the fact that it was "at odds" with the Auditor's report. The Committee noted, however, that the Fuller report was based on data provided "by the businesses that received CAPCO funding ... that are also eligible for additional CAPCO funding. Additionally, documentation to verify self-reports, such as tax information, receipts, contracts, and pay stubs, was not required."¹³¹ The Committee Report noted that there were suggestions "the ODCA's data analysis is imperfect," however, it supported its findings that the "CAPCO program is an ineffective mechanism to create jobs and promote economic growth."¹³²

The Committee Report concluded that the CAPCO program's design included "misaligned incentives" because the "CAPCO's are not well-incentivized to make productive investments that will result in the type of economic development that the Council envisioned when it passed the CAPCO Act."¹³³ Further, the law offered "little in the way of risk protection for the District government" from poor investment decisions by the CAPCOs.¹³⁴ The Committee Report stated that the structural deficiencies in the program probably could not be cured by the amendments it was offering, however, the Committee had deemed that elimination of the tax credits at that point would present legal challenges.¹³⁵ The Committee Report stated that "(U)nder no circumstances should the duration of the CAPCO program be extended through the allocation of any additional premium tax credits beyond those allocated pursuant to the original act."¹³⁶

"(U)nder no circumstances should the duration of the CAPCO program be extended through the allocation of any additional premium tax credits beyond those allocated pursuant to the original act."

The Certified Capital Companies Improvement Amendment Act of 2010 was enacted to correct unforeseen problems associated with the original legislation that were revealed by the audit conducted by the ODCA in 2009, including the administrative complexity and subsequent challenges DISB had in administering the program, certifying companies, and monitoring enforcement. The 2010 law mandated DISB to conduct an Economic Impact Study with relevant information received from the Certified Capital Companies once a year, beginning with the year

2012. Council of the District of Columbia, Committee on Consumer and Regulatory Affairs, Report on Bill 15-20, the "Certified Capital Companies Act of 2003," June 27, 2003, pp. 3.

¹²⁹ Bill 18-402.

¹³⁰ Council of the District of Columbia, Committee on Public Services and Consumer Affairs, Report on Bill 18-402, the "Certified Capital Companies Improvement Amendment Act of 2010," February 24, 2010, p. 3.

¹³¹ *Ibid.*, 5.

¹³² *Ibid.*, 2.

¹³³ *Ibid.*, 6.

¹³⁴ *Ibid.*, 3-5.

¹³⁵ *Ibid.*

¹³⁶ *Ibid.*, 6-7.

Part II: Review of Economic Development Tax Expenditures – CAPCOs

ending December 31, 2009, and ending with the year ending December 31, 2014, to determine the economic impact of the CAPCO program on the District's economy.¹³⁷

DISB conducted one economic and fiscal impact analysis of the CAPCO program in 2013 and noted to ORA that conducting a yearly assessment was unrealistic based on lack of investment activity by the CAPCOs since the first study. Further DISB noted that several businesses that received funding from the CAPCOs were either unable or unwilling to share information with the government, and with no regulatory authority over the businesses that received funding, it was unable to force compliance from the businesses and get the full data that would be necessary for a more thorough evaluation.¹³⁸

The one economic and fiscal impact study DISB conducted was contracted out to Dr. Don Phares, a retired professor of Economics and Public Policy at the University of Missouri, St. Louis and published internally in November 2013. Phares' estimates assume that "initial CAPCO investments and follow-on investments enabled by CAPCO investments have stimulated their full impact on the District."¹³⁹ However, we know that most of the businesses failed and as such the expected follow-on investments did not materialize. Using these assumptions and an input-output model with unspecified multipliers to estimate the direct, indirect, and induced impact of the CAPCO program on the District, Phares generally found that between 2004 and 2012, the CAPCO program had a net positive economic and fiscal impact on the District. The study focused on the program's impact on employment, household income, output (GDP), and government revenue (taxes, charges, and fees).

Phares estimated that the total economic impact of new business investments due to the CAPCO program on output from 2004 to 2012 was \$119,729,000; the average annual impact on jobs totaled about 79.2 jobs; while the impact on labor income is \$40,880,943 in the nine-year period. The investment created by the CAPCO program over the nine-year period generated total estimated revenue of \$8,689,298 for the District, according to his model. Specifically, the two largest sources of revenue through the CAPCO program for the District are the property tax and sales tax at \$3,922,643 and \$3,633,193, respectively. There are several important caveats to these estimates. In addition to using estimates of impacts of investments that never materialized, Phares also noted that almost half of the 36 businesses did not respond to requests for data and thus some estimates are understated.¹⁴⁰ Further, even if these were reliable estimates it is unknown how much of this business activity would have happened but for the incentives, given some of these businesses may have found other ways to open.

While Phares' study presents a positive picture of the program and its long-term outlook, a DISB official recently noted that many of the businesses that received funding from the CAPCOs have gone out of business with a zero percent rate of return on the investment for both the CAPCO companies and the District to date, making it unlikely that the CAPCO companies will recycle

¹³⁷ D.C. Code § 31-5238.02. Compliance and economic impact.

¹³⁸ Interview with Dana Sheppard on February 08, 2018. Acting Deputy Commissioner and Associate Commissioner, Risk Finance Bureau, District of Columbia Department of Insurance, Securities and Banking.

¹³⁹ Phares, Don. "The Economic and Fiscal Impact of the District of Columbia's CAPCO Program," prepared for the District of Columbia's Certified Capital Companies Program and the District of Columbia Department of Insurance, Securities, and Banking. University of Missouri-St. Louis, November 2013, p. 6.

¹⁴⁰ *Ibid*, 8.

most of the original investments to other qualified businesses.¹⁴¹ While there are still about four viable companies presently operating in the District, it is not clear if the District or CAPCO companies will reap any further benefits from those companies in terms of gains to be reinvested.

The two CAPCOs left in the program have little incentive to invest the remainder of the certified capital as there is no penalty if the remaining \$16.5 million is not invested. Additionally, most of the qualified companies that received investments and decided to move out of the District or fail to fulfill the CAPCO program employment requirements are not penalized. The 2010 amendments made continuing operations in the District a requirement for businesses to receive funding from the CAPCOs, but this requirement did not apply to businesses that received funding before the amendments became effective on May 27, 2010.

The District's CAPCO incentive program was amended in 2010 to address some of the issues with the program. The legislation required CAPCOs to invest 100 percent of the certified capital into qualified businesses, but the amendment has not produced further investments in potential qualified companies. The legislature also provided DISB with the authority to obtain information from CAPCOs to conduct an annual economic impact analysis, however, a DISB official notes 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, the amendments have not solved the structural issues within the incentive program causing it to stall. The only recent activity in the CAPCO incentive program is that insurance companies are still redeeming their earned insurance premium tax credits. The remaining unclaimed insurance premium credit is about \$2 million which is expected to be claimed in FY 2018.

In general, the impacts of CAPCO incentive programs in the United States have been controversial. There are 14 states with a CAPCO incentive program including the District of Columbia. Evaluations of the CAPCO program in other states have shown the net impact of the incentive program to be either minute or negative. Audits of CAPCO programs in Alabama, Colorado, Missouri, and New York found that the programs created fewer jobs and less revenue than promised, should not be extended, or should be shut down.¹⁴² Most states have found CAPCO programs to be expensive and inefficient; a report on Louisiana's CAPCO noted that it did not provide the adequate features to encourage investments that bring about the greatest potential economic benefit to the state.¹⁴³ As this summary of the program illustrates, D.C.'s CAPCO program shares many of these characteristics and lessons from it should be taken for any similar future tax credits aimed at economic development.

Section III: Summary and Lessons Learned

¹⁴¹ Interview with Dana Sheppard on February 08, 2018. Acting Deputy Commissioner and Associate Commissioner, Risk Finance Bureau, District of Columbia Department of Insurance, Securities and Banking.

¹⁴² Fifield, Jen. "In Search of Rural Jobs, States Weigh Strategy with a Checkered Past." *Stateline*. The Pew Charitable Trusts. March 30, 2017. Retrieved from: <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2017/03/30/in-search-of-rural-jobs-states-weigh-strategy-with-checkered-past>

¹⁴³ Postlethwaite & Netterville. "CAPCO Study." Prepared for Louisiana Department of Economic Development. Retrieved from [http://www.lipcurrent.com/dcn/lc.nsf/b4967bfe087a19e486257567008208d1/bb19e8d746c6135b862568e60056a644/\\$FILE/CAPCO_StudyFinalReport.pdf](http://www.lipcurrent.com/dcn/lc.nsf/b4967bfe087a19e486257567008208d1/bb19e8d746c6135b862568e60056a644/$FILE/CAPCO_StudyFinalReport.pdf)

Part II: Review of Economic Development Tax Expenditures – CAPCOs

The CAPCO incentive program was enacted in 2004 with the goal of increasing the volume of private investment in new and/or expanding businesses located in the District.¹⁴⁴ The primary objectives of the program include: stimulating the flow of capital to early-stage businesses that are unable to access traditional financing; building venture capital infrastructure; creating high-paying jobs; and increasing the District's tax revenue.¹⁴⁵ The CAPCO program allowed insurance companies to invest a total of \$50 million in certified capital companies and earn premium tax credits equal to the amount of the insurance company's total debt and equity investment in the CAPCO. The \$50 million in insurance premium credits could be redeemed beginning 2009 with a limit of \$12.5 million per year on usage of the credits. Three investment companies applied for and received certification from the Department of Insurance, Securities, and Banking (DISB). To date, the CAPCOs have loaned or invested about \$33.5 million in 36 qualified companies in the District.¹⁴⁶ And as of 2017, insurance companies had claimed \$48 million in insurance premium tax credits from the District, making this the cost to the District in foregone revenue.

In 2009, the D.C. Auditor concluded that the CAPCO program was ineffective overall and recommended termination, and in 2010 the Committee on Public Services and Consumer Affairs supported those findings but noted that the program could not be eliminated due to potential legal ramifications. At that time the Committee further noted that the CAPCO should not be expanded under any circumstances.

The few studies done over the years leave many questions about the full scope of the CAPCO program and as such what the results of the investments were. The most recent economic and fiscal impact study by Dr. Don Phares estimated that from 2004 to 2012, the economic impact of the CAPCO program included the creation and maintenance of an annual average of 79.2 jobs, \$119,729,000 in total new spending due to new business investments, and \$40,880,943 in total labor income. Using his model, Phares estimated that the CAPCO program additionally generated \$8,689,298 in total new revenue for the District. However, there are various reasons those estimates are unreliable, and it is unknown how much of this business activity would have happened but for the incentives, given some of these businesses would have likely found other ways to open. Further, several companies that received CAPCO investments have failed while other companies still in operation have yet to reach the point where CAPCOs can receive a return on their investment. Further, two CAPCOs have been unable to invest 100 percent of the certified capital to new or expanding businesses.

In summary, the D.C. CAPCO program is a complex tax incentive representing nearly \$50 million in foregone revenue thus far over the life of the program. Incomplete and unverifiable reports of the resulting economic impacts make it hard to determine the program's effectiveness. Some of the lessons learned from this program echo those found in other programs reviewed for this report.

¹⁴⁴ Phares, Don. "The Economic and Fiscal Impact of the District of Columbia's CAPCO Program." Prepared for the District of Columbia's Certified Capital Companies Program and the District of Columbia Department of Insurance, Securities, and Banking. University of Missouri-St. Louis. November 2013.

¹⁴⁵ Fuller, Stephen. "The Economic and Fiscal Impact of CAPCO-Funded Companies on the District of Columbia." November 2009. Center for Regional Analysis, George Mason University.

¹⁴⁶ Phares, Don. "The Economic and Fiscal Impact of the District of Columbia's CAPCO Program". prepared for the District of Columbia's Certified Capital Companies Program and the District of Columbia Department of Insurance, Securities, and Banking. University of Missouri-St. Louis, November 2013.

Tax incentive programs that are overly complex are hard to administer and even harder to evaluate. The CAPCO program also illustrates that if a tax incentive is not carefully structured at the beginning, it can be difficult if not impossible to change midway through. CAPCOs are not subject to any penalties for not investing the full amount of CAPCO money and it appears that nearly \$17 million of the \$50 million in District investment may not be invested. Further, when the companies receiving the investments were under no obligation to remain in the District to keep the funding, some of them closed or left the District. If firms receiving tax credits or funds tied to the tax credits are not legally required to report data or information justifying their benefits, they are likely not to do so and may refuse if the requirement is enacted after the program began. The complex CAPCO structure with multiple entities and levels of transactions prevented the District from being able to obtain information on the results of its investments and should be avoided in the future.

Certified capital investment by insurance companies

The Need:

Lack of private capital investment available for small businesses based in the District

Resources/Inputs:

Allocation of \$50 million in Premium Tax Credits to Insurance Companies that invested \$50 million in CAPCOs. As of FY2018, nearly \$48 million has been claimed by qualified insurance companies.

Outputs:

Three CAPCOs received \$50 million and have invested \$33.5 million into 36 small businesses, four of which remain open. Data on specific jobs created and other economic impacts are unclear. There is no requirement that the CAPCOs invest the remaining \$16.5 million.

Expected Benefits

(changes in short, medium, or long-term measures)

Short-term:

Increase capital investment available to small businesses in the District.

Medium-term:

Increase the number of small businesses, jobs, and private capital investment in small businesses based in the District.

Long-term:

Increase District revenues and improve long-term economic health.

Assumptions: Providing Insurance companies with premium tax credits will incent them to invest funds through Certified Capital Companies into qualified District businesses that might otherwise not be able to obtain funding, bringing economic benefits to the district.

Chapter IV: High-technology Commercial Real Estate Database and Service Providers
Real Property Tax Abatement

District of Columbia Code: D.C. Official Code § 47-4630
 Sunset Date: None
 Year Enacted: 2010

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$700	\$700	\$700	\$700	\$700	\$700	\$700	\$585

Description

Real property that is leased and occupied by a high-technology commercial real estate database and service provider qualifies for a 10-year exemption from the real property tax, subject to certain conditions. The real property must be in an enterprise zone or a low- or moderate-income area, must have been occupied by December 31, 2010, and must continue to be occupied by the high-technology database and service provider. In addition, (1) the lease for the real property must last at least 10 years, (2) the tenant must employ a minimum of 250 employees in the District of Columbia, (3) the tenant must enter into an agreement with the Department of Small and Local Business Development about small and local business participation in any design, buildout, or improvement of the real property, and (4) the real property owner must pass the exemption through to the high-technology database and service provider.

To claim the exemption, the firm had to certify to the Department of Employment Services that it increased the number of new employees residing in the District of Columbia by at least 100, relative to a baseline employment level as of January 5, 2010. The firm must maintain employment at greater than the baseline level throughout the term of the abatement. The value of the exemption is capped at \$700,000 annually and at \$6,185,000 over 10 years.

Purpose

According to the Committee on Finance and Revenue report on the authorizing legislation, “The purpose of this legislation is to encourage business relocation into the District. The legislation will enable the attraction of a niche technology industry to the District.”¹⁴⁷ The Office of the Deputy Mayor for Planning and Economic Development also expressed the view that the provision would increase employment, business activity, and tax revenue.¹⁴⁸

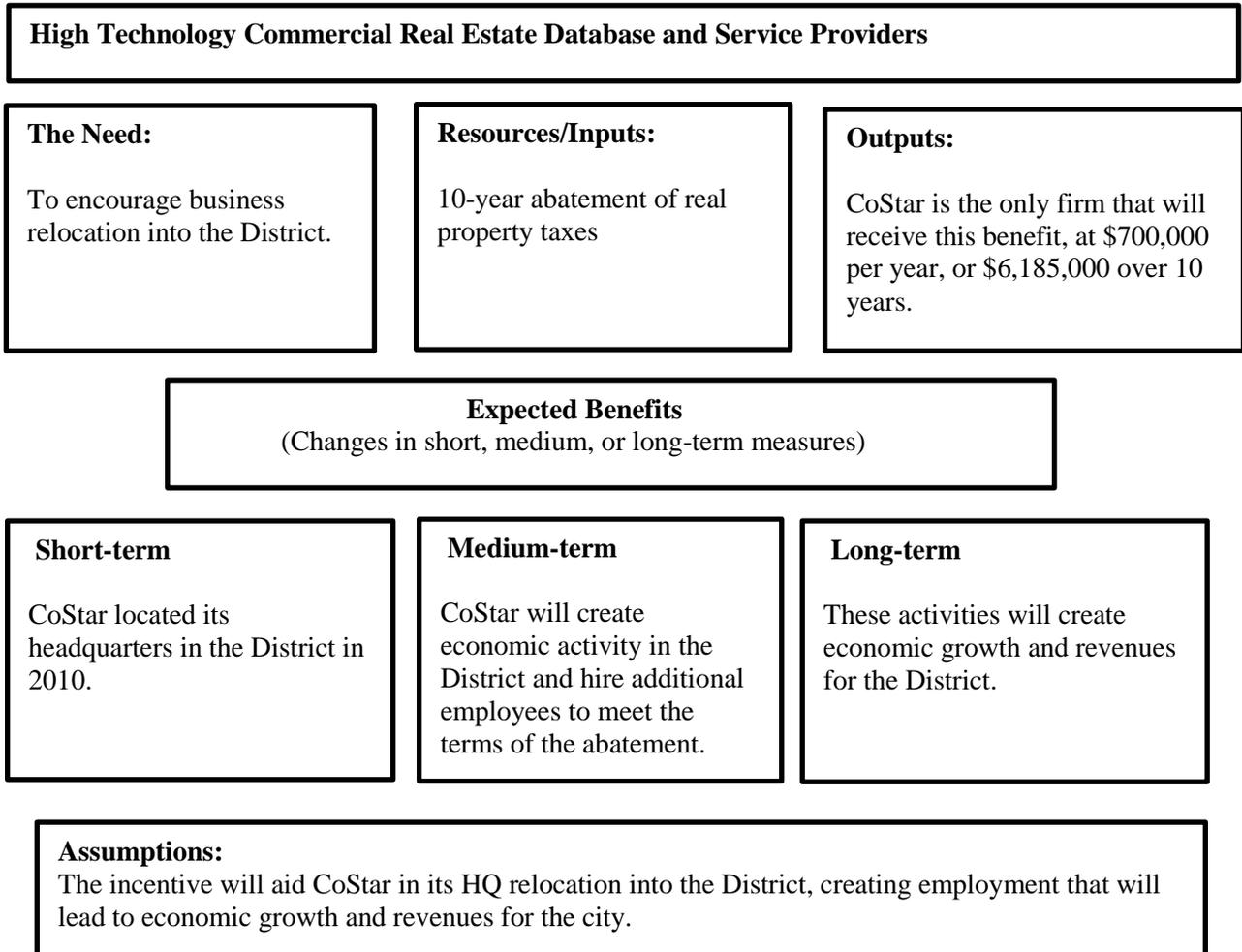
Impact

The CoStar Group, which leases space at 1331 L Street, N.W., has benefited from a \$700,000 exemption each year since 2011. Because the authorizing statute provides that the property must have been occupied by December 31, 2010, there will be no additional beneficiaries. ORA requested information from DMPED on the annual certification of CoStar’s employment levels, as required by the law, but no response was received as of the time of publication.

¹⁴⁷ Council of the District of Columbia, Committee on Finance and Revenue, Report on Bill 18-476, the “High Technology Commercial Real Estate Database and Service Providers Tax Abatement Act of 2008,” November 24, 2009, p. 1.

¹⁴⁸ *Ibid.*, 3.

Part II: Review of Economic Development Tax Expenditures – High-Technology Commercial Real Estate Database and Service Providers



*Part II: Review of Economic Development Tax Expenditures – Non-profit Organizations
Locating in Designated Neighborhoods*

Chapter V: Non-profit Organizations Locating in Designated Neighborhoods

Real Property Tax Abatement

District of Columbia Code: D.C. Official Code § 47-857.11 - § 47-857.16
 Sunset Date: None
 Year Enacted: 2010

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	N/A	N/A	N/A	N/A	\$153	\$153	\$153	\$153

Description

Non-profit organizations, as well as property owners who lease office space to non-profits, can qualify for real property tax abatements for a period of 10 years if they are in an “eligible non-profit zone.”¹⁴⁹ The authorizing statute defines five non-profit zones and allows the Mayor to designate additional zones, which must be approved by act of the Council.

Eligible non-profits or property owners can receive a real property tax abatement of \$8 per square foot for 10 consecutive years if they: (1) purchase or lease at least 5,000 square feet of office space, (2) occupy at least 75 percent of the space, (3) purchase or lease the space at the market rate, and net of any real estate taxes, (4) do not receive any other real property tax abatement or tax-increment financing for the office space, and (5) occupy the new space by September 30, 2013, if located in the Capitol Riverfront, Mount Vernon Triangle, or NOMA zones, or by September 30, 2016, if located in the Anacostia zone, the Minnesota-Benning zone, or a zone designated by the Mayor.

Eligible non-profits or property owners cannot claim the abatement for more than 100,000 square feet of office space, and the annual abatement cannot exceed their real property tax liability. The total annual abatement is capped at \$500,000, and the total abatement for each zone over 10 years is capped as follows: \$600,000 for the Anacostia zone, \$2.6 million for the Capitol Riverfront zone, \$800,000 in zones designated by the Mayor; \$600,000 in the Minnesota-Benning zone, \$1.2 million in the Mount Vernon Triangle zone, and \$2.6 million in the NOMA zone. Non-profits must apply to the Mayor and receive a certification of eligibility to claim an abatement.

Purpose

The purpose of the abatement is “to provide an incentive for (non-profits) to locate their offices in emerging commercial neighborhoods of the District of Columbia.”¹⁵⁰

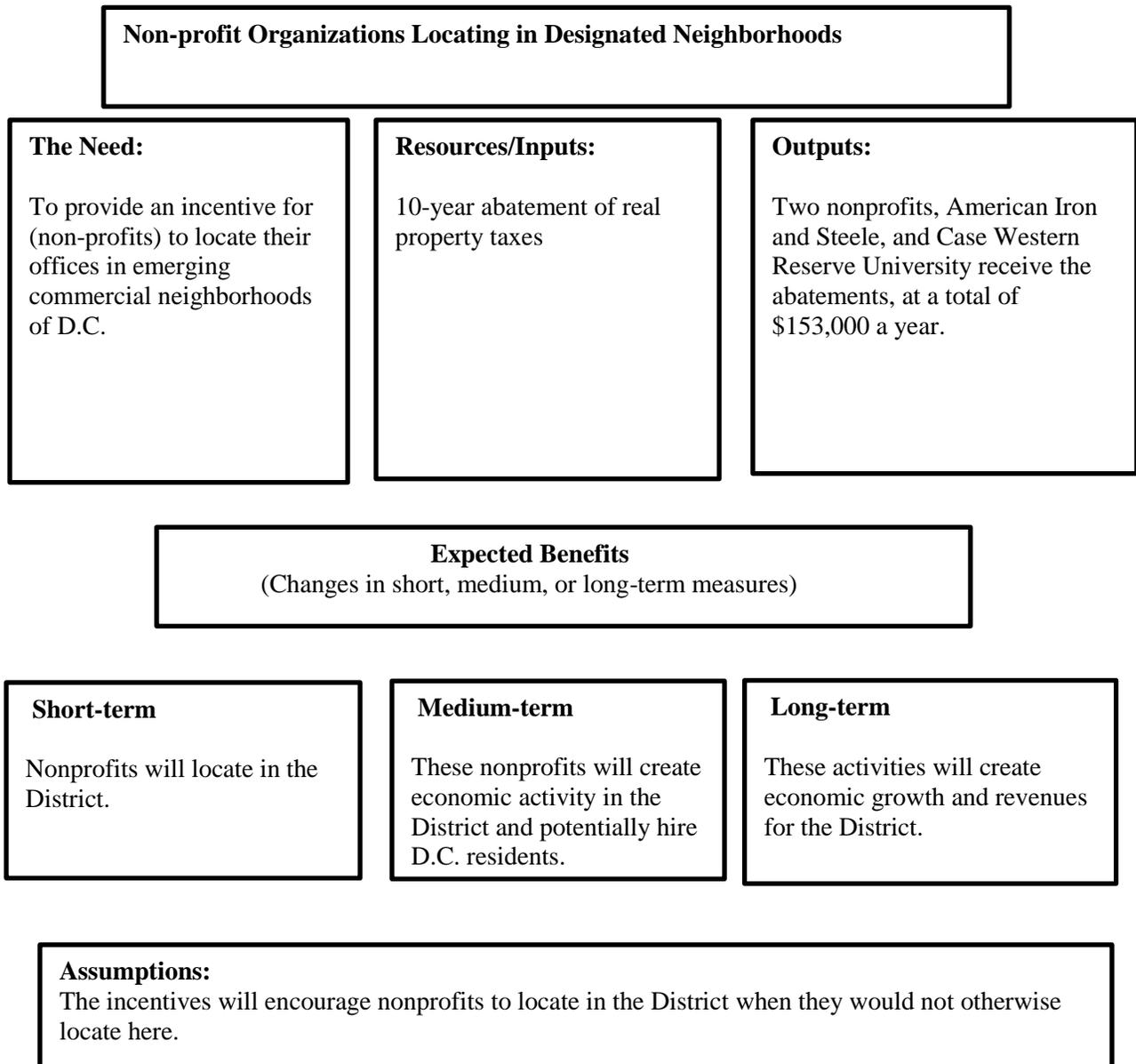
¹⁴⁹ For purposes of this program, eligible non-profit organizations are those that are exempt from federal income tax under sections 501(c)(3), (4), and (6) of the U.S. Internal Revenue Code.

¹⁵⁰ See Title 10-B, Section 6300.1 of the D.C. Municipal Regulations.

*Part II: Review of Economic Development Tax Expenditures – Non-profit Organizations
Locating in Designated Neighborhoods*

Impact

Eligible non-profits and property owners who lease space to the non-profits benefit from the abatements. Two non-profits, the American Iron and Steel Institute at 25 Massachusetts Avenue, N.W., and Case Western Reserve, at 820 First Street, N.E., have been approved for the abatements, but there are no plans to approve additional abatements at this time.¹⁵¹



¹⁵¹ Although the Office of Revenue Analysis normally does not provide tax information about specific individuals or organizations, D.C. Official Code § 47-1001 allows disclosure of tax-exempt properties.

Part II: Review of Economic Development Tax Expenditures – Economic Development Zone Incentives

Chapter VI: Economic Development Zone Incentives for Businesses

Income Tax Credits

District of Columbia Code: § 6-1501, § 6-1502, § 6-1504, and § 47-1807.06

Sunset Date: None

Year Enacted: 1988

(Dollars in thousands)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Total	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0

Description

D.C. law designates three economic development zones that are eligible for tax and other development incentives: the Alabama Avenue zone, the D.C. Village zone, and the Anacostia zone. The Mayor may also designate additional economic development zones (subject to Council approval), based on evidence of economic distress such as high levels of poverty, high levels of unemployment, low income, population loss, and other criteria set forth in the law.

A business entity that is located within an economic development zone is eligible for corporate franchise tax credits or unincorporated business franchise tax credits if (1) the business has signed a “First Source” agreement with the D.C. government pledging that 51 percent of new hires shall be D.C. residents, and (2) the business is subject to the D.C. franchise tax.

The available credits include (1) a credit equal to 50 percent of wages paid to low-income workers who are D.C. residents, up to a maximum of \$7,500 per employee per year, (2) a credit equal to 50 percent of the workers’ compensation premiums paid on behalf of workers who are D.C. residents, and (3) a rent credit for businesses that rent space to a non-profit child care center. The value of the rent credit is equal to the difference between the fair market value for the space and the actual rent charged to the child care center. If the rent credit exceeds the tax liability of a business, it can carry the credit backward or forward for up to five years.

The Mayor must submit, and the Council must approve a resolution that qualifies the business for the incentives. The resolution must identify the business, specify the types of incentives to be granted, and estimate the annual dollar value of each franchise tax credit.

In 1997, the federal government established an enterprise zone in the District of Columbia, which provided businesses operating in the zone with federal wage tax credits, expensing and capital gains tax benefits, and tax-exempt bond financing. The authorization for the federal enterprise zone expired on December 31, 2011.

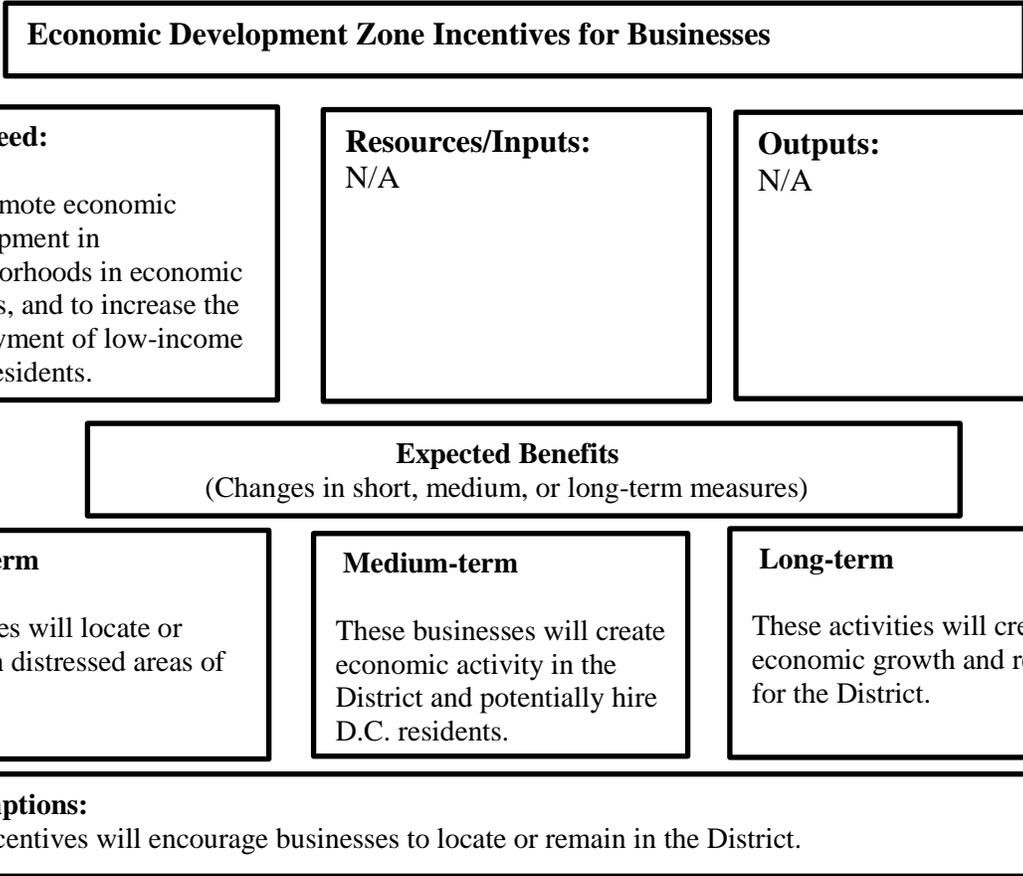
Purpose

Part II: Review of Economic Development Tax Expenditures – Economic Development Zone Incentives

The purpose of the incentives is to promote economic development in neighborhoods in economic distress, and to increase the employment of low-income D.C. residents.

Impact

Businesses located in an economic development zone are eligible to benefit from these incentives, as are low-income residents. Nevertheless, only two incentive packages have been approved since the economic development zones were created, and neither package included business tax incentives (both packages included real property tax incentives). In the years since, ORA has listed the estimated revenue loss as \$0 given that no entities were eligible to claim this credit, to our knowledge. However, in the process of analyzing data for the current report, ORA discovered that some entities appeared to have claimed economic development zone credits over the years. The information was submitted to OTR auditors who verified that some of these claims were keying errors in the data system, while others appeared to be credits taken by companies that were also certified as Qualified High Technology Companies (QHTCs) and therefore should not have been claimed. At the time of publication, OTR was in the process of acting to deny the credits to the companies erroneously claiming the credits.



Chapter VII: Individual Economic Development Tax Provisions

Individual provisions, or provisions resulting from legislation passed for the construction, renovation or rehabilitation of a specific project, are one of the avenues used to spur economic development in the District of Columbia. Individual economic development provisions provide tax exemptions, abatements, credits or refunds to specific projects for the redevelopment and revitalization of the District, either by bringing in new companies, keeping existing companies and organizations from leaving the District, or through providing services not readily available to residents. In its 2012 five-year economic development strategy, the mayor’s office prioritized transforming the District by “creating 100,000 new jobs and generating \$1 billion in new tax revenue to support city services over the next five years.”¹⁵² This plan has also been adopted into the 2017 Economic Development Strategy and is the driving force behind tax abatements and exemptions given to companies and organizations.

There are eight individual provisions largely intended to promote economic development, affordable and mixed-use housing in the District of Columbia. These provisions are very idiosyncratic because the goals of the individual tax expenditures to foster economic development are different. For example, there are seven individual tax expenditures to provide mixed-use housing, which usually includes affordable housing and a commercial or retail component like a grocery store or office space. The 2015 District of Columbia Housing Tax Expenditure Review covers four of the seven mixed housing projects; thus, they are not included in this report. They include: Park Place at Petworth, Highland Park, and Highland Park Phase II Project; The Heights on Georgia Avenue; Kelsey Gardens Redevelopment Project; and Eckington One Residential Project. The eight individual provisions covered in this report are listed in Table 14.

These mixed-use development projects have increasingly become an important economic development tool in cities because they blend residential and commercial uses which allows for greater housing variety and density.¹⁵³ Mixed-use development projects reduce distances between housing, workplaces, retail businesses; encourage more compact development; strengthen neighborhood character; and promotes pedestrian and bicycle friendly environments.¹⁵⁴ Mixed-use developments “can help revitalize a downtown, increase private investment, lead to higher property values, promote tourism, and support the development of a good business climate.”¹⁵⁵

Most of the single projects in the District that receive a property tax exemption for mixed use development with the affordable housing component are not required to file an annual use report in accordance with D.C. Official Code § 47-1007 (documenting that they are in fact using the property for its intended, tax-exempt purpose). Other single projects focused on housing that was discussed in the 2015 District of Columbia Housing Tax Expenditure Review have a monitoring component, either in compliance with D.C Official Code § 47-1007, or as a condition of assistance

¹⁵² Office of Mayor Vincent C. Gray, the Five-year Economic Development Strategy for the District of Columbia, Executive Summary, November 14, 2012, p. 1.

¹⁵³ Ibid.

¹⁵⁴ Jensen, Aric. “Understanding and Implementing Mixed-Use Development in the West: Case Studies from Bountiful, Utah.” *The Western Planner*, July 01, 2015.

¹⁵⁵ Benefits of Mixed-Use Development. Complete Communities Toolbox. Retrieved from <http://www.completecommunitiesde.org/planning/landuse/mixed-use-benefits/>.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

from the D.C. Department of Housing and Community Development, or the D.C. Housing Finance Agency.

Individual tax provisions make up only about seven percent of total tax revenue forgone in the local economic development policy area and are listed below in Table 14. The total estimated foregone revenue for all economic development-related individual tax expenditures in FY 2017 is almost \$4.2 million.¹⁵⁶ This estimated foregone revenue does not account for all individual provisions under the economic development umbrella. As the following section shows, the revenue forgone for some individual provisions cannot be estimated due to lack of information. Further, future tax abatements to The Advisory Board Company and The Adams Morgan (The Line) Hotel already passed in law represent over \$100 million that is not included in the table below.

The District primarily finances individual economic development projects either through tax increment financing projects (TIFs) or bonds, however, TIFs and bonds are not categorized as tax expenditures and as such are not included in this report.¹⁵⁷ A 2017 ORA report reviewed three economic development projects partially financed by the District through TIF and revenue bonds (Nationals Ballpark Revenue Bonds, Gallery Place TIF Bonds, and Target Shopping Center (D.C. USA) project) and found that compared to control groups in neighborhoods that did not receive District-financed projects, the three economic development projects likely had a positive impact on income and property values in the three neighborhoods.¹⁵⁸

The following section describes each of the District's individual economic development tax expenditures for which enough data are available to provide some level of detail.

¹⁵⁶ Summing tax expenditures does not consider possible interactions among categorical tax expenditures and therefore does not produce an exact estimate of the revenue.

¹⁵⁷ See Appendix 1 of the FY 2017 Unified Economic Development Report (Year-End). Office of the Chief Financial Officer. February 20, 2018. Retrieved on April 23, 2018 from: <https://cfo.dc.gov/node/1310196>.

¹⁵⁸ Alghumgham, Amira; Muhammad, Daniel; Geng, Yi; and Liu, Shenmin. "Are Economic Development Projects Tipping Points for Neighborhood Change in Washington, D.C.?" 2017. Office of Revenue Analysis. D.C. Office of the Chief Financial Officer, Washington, D.C.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

Table 14: Economic Development-Related Individual Tax Expenditures

Name of Development	Type of Provision	Year Enacted	D.C. Code Section	FY2017 Revenue Loss Estimate (\$000)
The Advisory Board Company	Property Tax Abatement	2015	§ 47-4665.01- § 47-4665.05	N/A
Adams Morgan Hotel (The Line D.C.)	Property Tax Abatement	2011	§ 47-4652	\$0
Constitution Square development project	Property Tax Abatement	2008	§ 47-4612	N/A
Gateway Market Center and Residences	Property Tax Abatement; Sales Tax Exemption	2009	§ 47-4621	\$0
Third & H Streets, N.E. Development Project	Property Tax Abatement; Deed and Recordation Tax Exemption; Sales Tax Exemption	2010	§ 47-4634	\$302
Jenkins Row Development Project	Property Tax Abatement; Deed and Recordation Tax; and Sales Tax Exemptions	2005	§ 47-4603	N/A
View 14 Project	Property Tax Abatement and Sales Tax Exemption	2009	§ 47-4623	\$824
Soccer Stadium Development Project	Property Tax Abatement and Deed Recordation and Transfer Tax Abatement	2015	§ 47-4663	\$3,027
Total				\$4,153

Note: N/A means either the abatement/exemption period has not started, or the organization has reached the maximum amount allowed by the incentive.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

The Advisory Board Company

District of Columbia Code Section(s): D.C. Official Code §47-4665.01-§47-4665.05
 Year Enacted: 2015
 Type of Provision: Property Tax Abatement

Revenue Foregone Estimates (\$000) Fiscal Year	2015	2016	2017	2018	2019	2020	2021
	N/A	N/A	N/A	N/A	N/A	N/A	\$3,000

Note: Estimated revenue forgone in FY21 is from the October 28, 2015, Committee Report when the legislation was enacted.

Description

D.C. Law 21-71, the "Local Jobs and Tax Incentive Act of 2015," granted a 10-year abatement of real property taxes of up to \$6 million per year for the future site of the new headquarters of The Advisory Board Company ("Company"). The abatement period starts at the beginning of Fiscal Year 2021 and expires at the end of Fiscal Year 2030.¹⁵⁹

The relevant property is in Square 5926 Lots 25, 39, 41, 800, 825, 830, 831, and 832. Specifically, the Company will relocate its new headquarters to 655 New York Avenue, N.W. Prior to receiving any abatement, the Company was required to sign a 15-year lease for at least 425,000 square feet of office space in the District. The Company signed the lease for 655 New York Avenue, N.W. on December 22, 2015.¹⁶⁰

The legislation also stipulates that to receive the annual abatement of \$6 million, the Company must meet the annual hiring target of 100 District residents--resulting in the cumulative employment of 1,000 District residents by September 30, 2030. If the Company does not meet the annual hiring target, then it will only receive a pro rata share of \$6 million based upon the new hires above the required baseline for that year. Through this approach, the Company does not receive an abatement if it does not meet the performance criteria.

While the Company would have qualified through the QHTC program for some tax incentives, specifically, a five-year franchise and real property tax abatement and a six percent franchise tax

¹⁵⁹ After this report was initially published, Council passed Bill 22-0918, "The Local Jobs and Tax Incentive Amendment Act of 2018" on December 18, 2018. That law repeals the abatement provided by the Local Jobs and Tax Incentive Act of 2015 and provides a property tax abatement of up to \$20 million to Education Advisory Board (EAB), The Advisory Board's education business.

¹⁶⁰ Sernovitz, Daniel. "Advisory Board officially signs lease for new headquarters." *Washington Business Journal*, Wednesday, December 23, 2015. Retrieved from http://www.bizjournals.com/washington/breaking_ground/2015/12/advisory-board-officially-signs-lease-for-new.html.

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rate reduction, the Company chose to forego its QHTC status to receive the longer performance-based abatement.^{161, 162}

Purpose

The purpose of this legislation is to retain the Company within the District and to provide a real property tax abatement to the Company contingent upon the hiring of 1,000 District residents over the course of the 10-year abatement period and providing contractually agreed upon benefits to the community.

Impact

When the legislation was passed in 2015, The Advisory Group was a growing company that had been in the District for over 35 years. The Company actively sought locations for a new headquarters, including possible locations in Virginia for its expanding business. DowntownD.C. Business Improvement District (BID) estimated the probability of the Advisory Board leaving the District without any incentives is about seventy percent based primarily on lower rental rates of \$10 to \$30 per square foot available in the suburbs (Maryland and Virginia).¹⁶³ Keeping the Company in the District would increase employment opportunities for District residents and provide other benefits to D.C per the legislation.

The Office of Deputy Mayor for Planning and Economic Development (DMPED) estimated that the incentive would generate over \$300 million in gross revenue collection (from income, property, and sales taxes) over the 16-year lease.¹⁶⁴ According to DMPED, this estimate was produced by an external consultant using a proprietary model, based on assumptions that included the company's D.C.-based full-time employee count, the average employee compensation, the company's projected tax liability, and business travel taxes generated through the company's operations. Without having more specific information on the assumptions used, we cannot fully assess this estimate.

However, the Tax Abatement Financial Analysis (TAFA) conducted for the "Local Jobs and Tax Incentive Act of 2015" required to be produced for this abatement noted that the Advisory Board had grown its employment at 15 percent per year since 2001, so that all the targets in the incentive would have been reached as a matter of course if the Advisory Board continued its current growth. If the Advisory Board would have ended up staying in the city even without the incentive, then assuming the tax incentive is responsible for all the growth it might have experienced anyway would be an overestimate. On the other hand, if the Company had left D.C. there would have been a cost to the District. Not knowing whether a company is considering leaving or if it is just using

¹⁶¹ Council of the District of Columbia Committee on Finance and Revenue Committee Report on Bill 21-353, the "Local Jobs and Tax Incentive Act of 2015."

¹⁶² The New E-Conomy Transformation Act of 2000 allows QHTCs to qualify for a real property tax abatement for a five-year period (D.C. Law 13-256; D.C. Official Code § 47-1817.01).

¹⁶³ DowntownDC Business Improvement District. Committee on Finance and Revenue Public Hearing on B21-353, "Local Jobs and Tax Incentive Act of 2015". Wednesday, October 28, 2105. Revision of Testimony Submitted on Wednesday October 14, 2015 10:00 a.m. John A. Wilson Building, Room 500.

¹⁶⁴ DMPED Web page. Retrieved on May 22, 2018 from: <https://dmped.dc.gov/release/exclusive-advisory-board-co-picks-new-headquarters-location>. Council of the District of Columbia Committee on Finance and Revenue Committee Report on Bill 21-353, the "Local Jobs and Tax Incentive Act of 2015." p. 3.

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the possibility of a move to secure more tax preferences complicates the measurement and evaluation of tax preferences.

The DowntownD.C. BID estimated the fiscal impact of the Advisory Board Company leaving the District and growing outside the city. The analysis found that it could lead to a present value of negative \$105 million to \$115 million over 15 years (assuming 3 percent growth in salaries and property value and a 5 percent discount rate). This was supposing that there is a reduction in the number of D.C. residents already employed by Advisory Board from 43 percent to 11 percent over three years and the total number of new employees that live in the District is 10 percent of the new hires outside of D.C.¹⁶⁵

The Company also signed a comprehensive Community Benefits Agreement with the District. Part of the incentive requirement is for the Company to have 35 percent of tenant improvement construction costs at the new headquarters go to Certified Business Enterprises.¹⁶⁶ The agreement also requires the Company to partner with the Department of Employment Services, the D.C. L.E.A.P. Academy, or a District-based non-profit to train at least 250 District residents in preparation for healthcare or technology careers. The Company is additionally required to partner with the D.C. Public Schools to create a mentorship program to provide year-long individualized support to students in the college admissions process. The Company will also participate in the Summer Youth Employment Program (SYEP) by hosting an optional enrichment session for all SYEP participants and hire five participants each summer. In addition to these commitments, the Company will also provide 25,000 hours per year of volunteer services to District-based non-profits, including 8,000 hours per year of pro-bono consulting services to District-based non-profits.”

However, as TAFE notes, the Company provides an “extensive number of pro-bono and mentorship opportunities” to employees, therefore many of the community benefits would be realized with or without the tax subsidies.¹⁶⁷ The TAFE further notes that the tax abatement would not affect the Company’s ability to maintain operations or continue its growth.¹⁶⁸

Evaluation

There is no monitoring information available on the Advisory Group since the Company has not started receiving the abatement. However, in January 2017, the Advisory Group laid off more than 200 of its D.C. employees that the Company had promised to keep as part of the tax abatement received.¹⁶⁹ It is unclear how these layoffs will affect the Company’s plan to hire 1,000 new residents over the next 10 years, and the subsequent impact this would have on the value of the tax abatement. DMPED did note that the abatement is solely performance-based, so that there is no

¹⁶⁵ DowntownDC Business Improvement District (October 28, 2015). Committee on Finance and Revenue Public Hearing on B21-353, “Local Jobs and Tax Incentive Act of 2015.” Wednesday, October 28, 2105. Revision of Testimony Submitted on Wednesday October 14, 2015 10:00 a.m. John A. Wilson Building, Room 500.

¹⁶⁶ Ibid.

¹⁶⁷ Tax Abatement Financial Analysis. “Local Jobs and Tax Incentive Act of 2015.” Bill 21-353. October 13, 2015. Office of the Chief Financial Officer.

¹⁶⁸ Ibid.

¹⁶⁹ Council of the District of Columbia Committee on Finance and Revenue Committee Report on Bill 21-353, the “Local Jobs and Tax Incentive Act of 2015.”

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abatement if the Company does not meet the performance criteria for the prior period and will be measured annually, obviating the need for claw-backs.¹⁷⁰ That is, if the Company does not meet its hiring targets, then a pro rata share of \$6 million based on new hires above its current baseline is applied, and if Advisory Board does not increase new hires, it will not receive the abatement.¹⁷¹

The Advisory Board announced that it entered into a definitive merger agreement to sell its health care business to Optum, a leading health services company, and a definitive purchase agreement to sell its education business to affiliates of Vista Equity Partners, a leading investment firm in a deal totaling \$2.58 billion.¹⁷² The business arrangement includes Vista Equity Partners acquiring the education business for \$1.55 billion, while Eden Prairie, Minnesota-based Optum will take the health care business in a \$1.3 billion merger that includes the assumption of debt.¹⁷³ The company announced that the acquisition was finalized November 17, 2017¹⁷⁴ and it has been noted that the company has had trouble maintaining steady revenue growth on the healthcare side following the presidential election and subsequent uncertainty in the market, as some providers dialed back their purchases.¹⁷⁵ It remains to be seen how the merger will affect the incentive agreement between Advisory Board and the District, and if the total benefits the District will receive by granting the company this tax abatement will outweigh the cost to the city in lost revenues.¹⁷⁶

¹⁷⁰ Office of the Deputy Mayor for Planning and Economic Development. “Local Jobs and Tax Incentive of Act 2015.” Project Factsheet 2015.

¹⁷¹ Ibid.

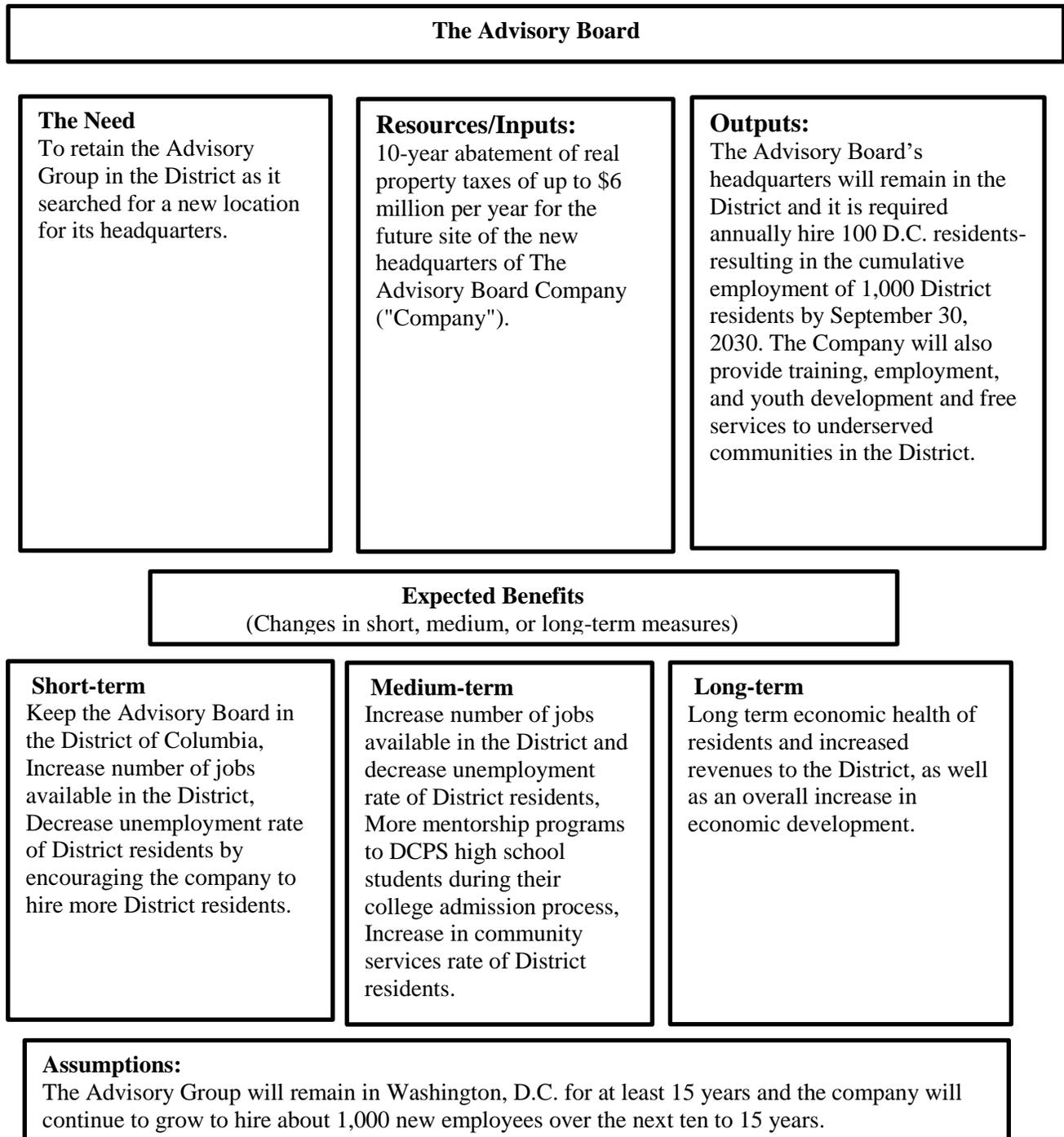
¹⁷² The Advisory Board Company. “The Advisory Board Company Announces Agreements for the Sale of its Health Care and Education Businesses.” August 29, 2017. Retrieved from <https://www.prnewswire.com/news-releases/the-advisory-board-company-announces-agreements-for-the-sale-of-its-health-care-and-education-businesses-300510668.html>.

¹⁷³ Hensen, Drew. “Advisory Board reaches \$2.58B deal to sell education, health care businesses.” *Washington Business Journal*, Aug 29, 2017. Retrieved from <https://www.bizjournals.com/washington/news/2017/08/29/advisory-board-to-sell-its-health-care-education.html>.

¹⁷⁴ Kacik, Alex. “Advisory Board finalizes deal with UnitedHealth’s Optum.” *Modern Healthcare*, November 17, 2017. Retrieved from <http://www.modernhealthcare.com/article/20171117/NEWS/171119893>.

¹⁷⁵ Ibid.

¹⁷⁶ After this report was initially published, Council passed Bill 22-0918, “The Local Jobs and Tax Incentive Amendment Act of 2018” on December 18, 2018. That law repealed the abatement provided by the Local Jobs and Tax Incentive of Act 2015 and provides a property tax abatement of up to \$20 million to Education Advisory Board (EAB), The Advisory Board’s education business. The Tax Abatement Financial Analysis for Bill 22-918, released on November 14, 2018, found that the proposed property tax abatement for EAB is not necessary.



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Adams Morgan (The Line) Hotel

District of Columbia Code Section(s): D.C. Official Code § 47-4652
Year Enacted: 2011
Type of Provision: Property Tax Abatement

Revenue Foregone Estimates (\$000) Fiscal Year	2015	2016	2017	2018	2019	2020	2021
	N/A	N/A	N/A	N/A	\$3,300	\$3,500	\$3,700

Note: Estimated revenue forgone is from the Committee Report when the legislation was enacted.¹⁷⁷

Description

The “Adams Morgan Hotel Real Property Tax Abatement Act of 2010” provides a 20-year property tax abatement to aid in the initial financing of the Adams Morgan Hotel development. The Adams Morgan Hotel, now called the Line Hotel, required the renovation of the First Church of Christ, Scientist building, a parking lot and the former City Paper building, respectively located in Square 2560 on Lots 872, 875, and 127. The hotel is a 10 story, five-star hotel, with 220 rooms, 1,600 sq. ft. health club, 160-space underground garage, and 32,000 sq. ft. of restaurant, bar and event space.^{178, 179}

Purpose

The legislation abates the Adams Morgan Hotel project from real property taxation to preserve, and restore the First Church of Christ, Scientist building. The First Church of Christ, Scientist building is 100 years old and served as a morgue for the Knickerbocker Theatre collapse in 1922. According to the Economic Development Finance Office’s testimony on the bill enacting the original tax abatement, the OCFO requested an independent evaluation of the Adams Morgan Hotel Project which found that “given current market conditions it could be difficult for [the] project to attract significant private investment in the absence of additional financial support.”¹⁸⁰

Impact

The tax abatement is to begin the after the hotel certificate of occupancy is issued and is not to exceed \$46 million in aggregate over 20 years. The conditions of the tax abatement include: the employment of District residents, a minimum of 342 construction full-time equivalent employees to work at least 51 percent of construction hours; have at least 51 percent of the hotel’s permanent

¹⁷⁷ Council of the District of Columbia Committee on Finance and revenue Committee Report on Bill 18-969, “The Adams Morgan Hotel Real Property Tax Abatement Act of 2010.”

¹⁷⁸ Ibid.

¹⁷⁹ <https://dc.curbed.com/2018/1/5/16850628/line-dc-hotel-sydell-group>.

¹⁸⁰ Council of the District of Columbia Committee on Finance and revenue Committee Report on Bill 18-969. “The Adams Morgan Hotel Real Property Tax Abatement Act of 2010,” p. 5.

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jobs filled by District residents with a minimum of 51 percent of the District resident jobs reserved for Ward One residents; establish a job training program through a District non-governmental organization, trade union, or nonprofit organization whose core mission is to train and employ District residents; any apprenticeship positions available in the hotel must be filled by District residents; the hotel must work with an outside auditor or trade union to ensure that local hiring minimums are being met and maintained; and the hotel must build no less than 4,000 square feet of community and nonprofit incubator space at no cost to the community.¹⁸¹

When the legislation was first enacted, The Adams Morgan Hotel was required to hire a minimum of 765 District residents for construction positions but that was later reduced to 342 through “The Adams Morgan Hotel Real Property Tax Abatement Job Requirement Clarification Act of 2013.” The reasoning behind the amendment is that the hotel project will not employ 765 construction workers.

Evaluation

The Line Hotel officially opened its doors to the public on December 22, 2017.¹⁸² Fiscal Year 2019 will be the first year that Adams Morgan hotel can apply for the tax abatement granted in the legislation. Limited information is available on whether the hotel developer met all its requirements to be eligible for the real property tax abatement. However, the construction of the hotel has been controversial as there are reports that the developer hired only 90 city residents, which is just 26 percent of the 342 construction workers stipulated by legislation.¹⁸³ The developers of the hotel nonetheless claim that their obligation is to hire 51 percent of the 342 jobs, or 175 positions, with District residents. The D.C. Office of Tax and Revenue (OTR) is also in a stalemate with the hotel as to whether the hotel has satisfied the requirements of its \$46 million tax abatement. OTR claims that “the hotel has not yet demonstrated that all the requirements of the tax abatement have been met, as a result, the abatement has not been applied.”¹⁸⁴ At this time, it remains to be seen if the full abatement will be granted and therefore a full assessment of the abatement cannot be completed.

¹⁸¹ § 47-4652. Abatement of real property taxes for Adams Morgan Hotel.

¹⁸² The Line Hotel Staff.

¹⁸³ Schwartzman, Paul. “In Adams Morgan, a promise yet to be filled.” *Washington Post*, September 19, 2016. Retrieved from https://www.washingtonpost.com/local/dc-politics/in-adams-morgan-a-promise-unfulfilled/2016/09/19/4df886ec-7c23-11e6-bd86-b7bbd53d2b5d_story.html?utm_term=.4cb941d81802.

¹⁸⁴ Cooper, Rebecca. “Line hotel, D.C. tax office at odds over \$46M tax break.” *Washington Business Journal*. January 10, 2018. Retrieved from <https://www.bizjournals.com/washington/news/2018/01/10/line-hotel-d-c-tax-office-at-odds-over-whether-46m.html>.

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Adams Morgan (The Line) Hotel

The Need

To preserve and provide re-use of the historic First Church of Christ Scientist building into a hotel.

Resources/Inputs:

20-year real property tax abatement capped at \$46 million.

Outputs:

5-star Luxury hotel in Adams Morgan;
Increase in District resident's employment:
At least 51% of construction hours and 342 full-time jobs must be filled by District residents;
At least 51% of permanent jobs in the hotel shall be filled by District residents.

Expected Benefits

(Changes in short, medium, or long-term measures)

Short-term

Increase in the number of construction jobs in the District;
Increase in the number of employed construction workers living in the District.

Medium-term

Increase in the number of construction jobs in the District;
Increase in the number of employed construction workers living in the District.

Long-term

5-star Luxury hotel in Adams Morgan consisting of 220 rooms, garage, restaurant and event space;
Increase in the number of hospitality jobs in the District;
Increase in the number of employed hospitality workers living in the District
Increase in total tax revenues.

Assumptions:

The Adams Morgan Hotel will increase economic activity in the Adams Morgan neighborhood, and restore a 100-year-old historic building.

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Constitution Square Development Project

District of Columbia Code Section(s): D.C. Official Code § 47-4612
Year Enacted: 2007
Type of Provision: Property Tax Abatement

Revenue Foregone Estimates (\$000) Fiscal Year	2010	2011	2012	2013	2014	2015	2016
	\$300	\$5,925	N/A	N/A	N/A	N/A	N/A

Note: Estimated revenue forgone is calculated using property assessment data from the Office of Tax and Revenue’s Real Property Tax Database.

Description

Constitution Square is a mixed-use development which includes residential/retail/commercial office space in First and M Streets, N.E. in Ward 6. The development project at constitution square was granted a property tax abatement with the understanding that the venture would produce about 900-1000 units of residential condominium/apartment house, above a 50,000-square-foot Harris Teeter grocery store, approximately 1.2 million square feet of commercial office, and about 80,000 square feet of retail space. The project is expected to achieve a gold-level certification from the U.S. Green Building Council.

One and two Constitution Square are 3500,000 and 600,000 sq. ft. office buildings completed in 2010 that include street level retail and three levels of underground parking. One constitution square is currently leased by the U.S. General Services Administration while Two constitution square is leased by the U.S. Department of Justice who is also planning to occupy Three and Four Constitution Square, enabling the agency to consolidate several offices in a single location, once the buildings are completed.

Three Constitution Square, a 350,000sq. ft. office building, was completed in 2013. Four Constitution Square is a 500,000sq. ft. office building scheduled to be completed in 2018. In 2016 however, the development partners, StonebridgeCarras and Walton Street Capital, sold Three and Four Constitution Square to a partnership of Met Life and Norges Bank Real Estate Management.¹⁸⁵

Flats 130 at Constitution Square completed in 2013, is a 643-unit luxury apartment community with 50,000 sq. ft. Harris Teeter grocery store, 200-room Hilton Garden Inn, and three levels of underground parking. In 2014, the residential property was sold to TIAA-CREF by joint venture development partners StonebridgeCarras and Walton Street Capital¹⁸⁶ The 10-year tax abatement to provide parking for the supermarket established a baseline of real property taxes that would be

¹⁸⁵ <http://www.stonebridgescarras.com/three-and-four-constitution-square>.

¹⁸⁶ <http://www.stonebridgescarras.com/flats-130-constitution-square-0#>.

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paid based on the 2008 assessed value and would include a growth factor for subsequent years. The growth factor for 2009 was 7 percent, 13.96 percent for 2010 tax year, and 21.25 percent in tax year 2011 and each year thereafter for 10 consecutive years. The real property tax abatement must not exceed an aggregate amount of \$6 million, plus 6 percent per year of the unused amount of the real property tax abatement from the commencement of development.

Purpose

The legislative purpose of the Constitution Square Development Project is to provide parking for the supermarket.

Impact

The inclusion of the grocery store in constitution square provides access to food and creates jobs for nearby residents.

Evaluation

Constitution square's tax abatement is capped at \$6 million, which was exhausted in FY 2011. The tax abatement was granted to provide tax relief to subsidize the full cost of building 150 underground parking spaces for Harris Teeter grocery store in addition to the tax exemption received by the supermarket through the Supermarket Tax Exemption Act of 2000. The addition of grocery stores in neighborhoods without supermarkets is always valuable. However, it is still unclear whether the abatement was needed since the grocer qualified for D.C.'s "supermarket tax incentive" once a lease agreeing to locate in the District was signed. The supermarket tax incentive exempted the developer and the grocer from sales and use taxes on the purchase of all building material related to the development of the supermarket and ten years of property tax payments and license fees, respectively.

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Constitution Square Development Project

The Need

To provide underground parking for a supermarket.

Resources/Inputs:

10-year tax abatement on real property taxes paid based on the 2008 assessed value. The abatement is capped at \$6 million, plus 6% per year of the unused amount of the real property tax abatement from the commencement of development.

Outputs:

Mixed use development with residential, retail and commercial space that includes a supermarket with underground parking.

Expected Benefits

(Changes in short, medium, or long-term measures)

Short-term

N/A.

Medium-term

Provide free parking to the Harris Teeter customers,
Provide access to food and jobs to residents.

Long-term

Provide free parking to the Harris Teeter customers,
Provide access to food and jobs to residents,
Provide energy and vitality to the NoMA neighborhood 18-hours a day by mixing work space with housing and retail.

Assumptions:

To enable Harris Teeter to open a supermarket at Constitution Square and increase resident's access to a full-service grocery store.

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Gateway Market Center and Residences

District of Columbia Code Section(s): D.C. Official Code § 47-4621 and § 47-2005
Year Enacted: 2008
Type of Provision: Property Tax Abatement and Sales Tax Exemption

Revenue Foregone Estimates (\$000) Fiscal Year	2014	2015	2016	2017	2018	2019	2020
	N/A						

Description

D.C. Law 17-359, effective March 2009, grants Gateway Market Center and Residences a 20-year real property tax abatement. The tax abatement includes a freeze on real property taxes for a period of ten years, then a payment of 10 percent of the annual assessment of real property taxes and an increase of 10 percent each year in years 11 through 20 until the annual real property taxation equals 100 percent. Real property taxes for the first ten years are frozen at the amount of tax paid at the date of the application for the building permit for the Gateway Market Center and Residences Project or the date that the Zoning Commission approves the planned unit development application for the Gateway Market Center and Residences Project. Additionally, the provision exempts Gateway Center and Residences from sales tax on building materials for the project. The sales tax exemption on building materials is capped at \$250,000.

Gateway Market Center and Residences is a mixed-use development project with retail, office, and residential uses. The residential component consists of 187 units and 20 percent of the units would be set aside as affordable housing for household incomes of no more than 80 percent of the Area Median Income in perpetuity.¹⁸⁷ The project also includes public amenities like a 100-seat community meeting room, an office for Advisory Neighborhood Commission 5B, and a Metropolitan Police Department community work station for the Fifth District, all rent-free in perpetuity.

The relevant properties are in Square 3587, Lots 3, 800, 802, and 809, and Parcels 129/9 and 129/32. The properties are located on 1240-1248 4th Street, N.E., in Brentwood neighborhood of Ward 5. In 2014, LCOR acquired the property from Edens Realty and Mr. Sang Oh Choi, the original developers of the project. The project has been adjusted to accommodate 187-units of

¹⁸⁷ Urban Turf pipeline of new condos and apartments coming to DC metro area, https://dc.urbanturf.com/pipeline/318/The_Edison.

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residential housing with approximately 28,000 square feet of ground-floor retail space and underground parking. The retail space on the ground floor will still be controlled by Edens.¹⁸⁸

Purpose

The legislation freezes Gateway Market Center and Residences real property taxation at the amount of the real property tax that is required to be paid at the date of the application for the building permit for the Gateway Market Center and Residences Project or the date that the Zoning Commission approves the planned unit development application for the Gateway Market Center and Residences Project to increase the redevelopment of affordable rental units, and bring economic diversity to D.C.'s wholesale food district.

Impact

Gateway Market Center and Residences will be the first residential project in Union Market, “representing a major step in the evolution of Union Market into a unique attraction for D.C. metro residents and visitors alike.”¹⁸⁹

Evaluation

The construction of Gateway Market Center and Residences was completed in 2017 and Trader Joe's supermarket, one of the retailers in the market center, opened its doors March 30, 2018.¹⁹⁰ The development project is expected to attain LEED Silver designation.¹⁹¹ However, it should be noted that the property was acquired by LCOR in 2014. There is a question as to whether LCOR will meet the requirements of the legislation. To date, LCOR has not complied with the legislation which contains requirements under the First Source Program and Local Small Disadvantaged Business Enterprise (LSDBE), that were set forth in the “Application for Economic Assistance” to the District government. If LCOR complies with the legislation in the future, it is assumed that the company would receive the abatement.

¹⁸⁸ Ibid.

¹⁸⁹ LCOR Acquires Mixed-Use Development Site in Washington, D.C.'s Union Market Release Statement, June 3, 2014.

¹⁹⁰ Clabaugh, Jeff. “Trader Joe's will open Union Market store March 30.” *Washington's Top News*, March 14, 2018. Retrieved from <https://wtop.com/business-finance/2018/03/trader-joes-opens-union-market-store-march-30/>.

¹⁹¹ Urban turf Pipeline New condos and apartments coming to DC metro area. Retrieved from https://dc.urbanturf.com/pipeline/318/The_Edison. Note: LEED Silver is a designation by the U.S. Green Building Council to designate excellence in green building; Silver is the second of four levels. LEED stands for Leadership in Energy & Environmental Design.

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Gateway Market Center and Residences

The Need

To construct the first mixed use residential property in the Union Market district of Washington, D.C.

Resources/Inputs:

20-year property tax abatement which freezes real property taxes for a period of 10 years; and an increase of 10% each year in years 11 through 20.
Sales tax exemption on goods purchased in the construction of the project capped at \$250,000.

Outputs:

Mixed-use development consisting of:
About 188 apartments with 20% of residential units dedicated to affordable housing; ground level retail; 100-seat community meeting room; office for the Advisory Commission Board 5B; and Metropolitan Police Department community work station for the 5th District.

Expected Benefits

(Changes in short, medium, or long-term measures)

Short-term

Increase in temporary and permanent jobs in the District for the construction of Gateway market center and residences development.

Medium-term

Increase in the number of affordable housing units available to low income residents in the District
Provide residents with space to meet as a community.

Long-term

Increase in the number of affordable housing units available to low income residents in the District
Provide residents with space to meet as a community
Provide stability and a safer environment for residents because of Metropolitan Police Department community work station.

Assumptions:

Gateway Market Center and Residences provides the first mixed-use housing development in the U Street corridor thereby increasing the number of affordable housing units in the district while increasing the business in the area.

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Third & H Streets, N.E. Development Project

District of Columbia Code Section(s): D.C. Official Code § 47-4634
Year Enacted: 2010
Type of Provision: Property Tax Abatement, Sales Tax Exemption, and Exemption from Deed and Recordation Taxes

Revenue Foregone Estimates (\$000) Fiscal Year	2015	2016	2017	2018	2019	2020	2021
	\$475	\$302	\$302	\$316	\$327	\$338	\$348

Note: Estimated revenue forgone is calculated using property assessment data from the Office of Tax and Revenue’s Real Property Tax Database.

Description

D.C. Law 18-161, effective May 27, 2010, grants Third & H Streets, N.E. development project a 20-year property tax abatement of the portion of the real property tax imposed that is more than the Fiscal Year 2010 real property tax owed to the District of Columbia (“real property tax increase”). The tax abatement includes a freeze on real property taxes at the 2010 tax level for a period of 10 years, and then the payment of the annual assessment of real property taxes is increased at the rate of 10 percent of the increase each year in years 11 through 20 until the annual real property taxation equals 100 percent. The real property tax freeze began when the 1st building permit for the Third and H Streets, N.E. property was issued. Additionally, the legislation exempts sales and rental of tangible personal property that is incorporated in or consumed in the Third & H Streets, N.E. Project. The provision also exempts Third and H Streets, N.E. property from deed recordation and transfer taxes.

Third & H Streets, N.E. Development Project is a mixed-use development project with retail, and residential uses. The residential component consists of 215 apartments.¹⁹² The project includes 42,645 square feet of retail space, a garage for about 250 to 270 cars, other ancillary improvements, including at least a 30,000 square feet supermarket. The total dollar amount of exemptions to the development project is capped at \$5 million.¹⁹³

The relevant property is in Square 776, Lots 54. The address of the property is 360 H Street N.E. in Ward 6.

¹⁹² CBG Building Company. <http://www.cbgbuildingcompany.com/Portfolio/Project/360-H-Street#>.

¹⁹³ Council of the District of Columbia Committee on Finance and Revenue Committee Report on Bill 18-432, “The Third & H Streets, N.E Economic Development Act of 2010.”

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Purpose

The purpose of the legislation is to bring in a major grocery store as part of the revitalization of the H Street historic corridor.¹⁹⁴

Impact

Third & H Streets, N.E. Development Project brings a major grocery store to an underserved area of the H street historic corridor. The legislation is a critical step in finalizing the negotiations to incentivize a national grocer into moving into the location.

Evaluation

Third & H Streets, N.E. Development Project is a mixed-use apartment complex that was completed in 2013. The project includes 197 market rate apartments and 18 affordable units, two stories of below ground parking for retail and residential usage that also promotes public transportation, 42,645 square feet of leasable area on the first floor including a Giant supermarket, and an elevated courtyard and amenity area on the second floor.¹⁹⁵ The purpose of the legislation was to bring a national grocer to an underserved area. Although the legislation accomplished its purpose, it is difficult to analyze whether the abatement for the development project was necessary since supermarkets are already incentivized through the Supermarket Tax Exemption Act of 2000. With its stated purpose, the legislation could have abated only real property taxes of the supermarket only and not the entire building. The provision of the 18 affordable housing units cannot be evaluated as an accomplishment of the legislation since it was never a part of the original legislation.

¹⁹⁴ Ibid.

¹⁹⁵ CBG Building Company. Retrieved from <http://www.cbgbuildingcompany.com/Portfolio/Project/360-H-Street#>.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

Third & H Streets, N.E. Development Project

The Need

To bring a grocery store within the H street historic corridor that has been lacking a major supermarket.

Resources/Inputs:

The legislation abates real property taxes above the FY 2010 real property tax payment for 10 years and exempts a portion of the taxes over the second 10-year period. The project is also exempted from deed recordation and transfer tax and sales tax on construction materials. The total exemption is capped at \$5 million.

Outputs:

215-unit contemporary rental apartment
42,645 square feet of street level retail anchored by the Giant Food grocery store
Below grade parking

Expected Benefits

(Changes in short, medium, or long-term measures)

Short-term

Allow for the construction of a grocery store in the of H street historic corridor
Increase the number of construction jobs available in the District.

Medium-term

Provide a full-service grocery store that can service residents living with H Street Historic corridor
Increase in number of permanent jobs available in the District.

Long-term

Provide a full-service grocery store that can service residents living with H Street Historic corridor
Increase in number of permanent jobs available in the District.

Assumptions:

Third & H Streets, N.E. Development Project will provide a supermarket within walking distance for residents in the historic corridor and reduce the number of food desert areas in the District.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

Jenkins Row Development Project

District of Columbia Code Section(s): D.C. Official Code § 47-4603 and
 Year Enacted: 2005 § 42-1102
 Type of Provision: Property Tax Abatement, Deed
 and Recordation Tax Exemption, and
 Sales Tax Exemption

Revenue Foregone Estimates (\$000) Fiscal Year	2014	2015	2016	2017	2018	2019	2020
	\$339	\$340	\$422	N/A	N/A	N/A	N/A

Note: Estimated revenue forgone is calculated using property assessment data from the Office of Tax and Revenue’s Real Property Tax Database.

Description

Jenkins Row Development Project is a 4-story high-rise building that consists of 247-unit residential condominiums, approximately 52,000 square feet of retail space anchored by Harris Teeter supermarket, other ancillary improvements and a garage for approximately 400 to 500 cars.

D.C. Law 15–294, effective April 8, 2005, granted a real property tax abatement to Jenkins Row Development Project for 10 consecutive real property tax years beginning in the tax year the developer sponsor began development on the Jenkins Row property. The law also exempted Jenkins Row project from sales and use taxes for the sale and rental of tangible personal property incorporated in or consumed in the Jenkins Row Project, whether the sale, rental, or nature of the material or tangible personal property was incorporated as a permanent part of the Jenkins Row Project or the Jenkins Row property.

Moreover, D.C. Law 15-294 exempts Jenkins Row from taxes on deed recordation and transfer, or an economic interest. The total tax abatement of real property and personal property tax to Jenkins Row Development Project is capped at \$3 million. The legislation does not prevent or restrict the developer from utilizing any other tax, development, or other economic incentives available to the Jenkins Row Project or the Jenkins Row property, including an associated supermarket tax incentive. Jenkins Row Project reached the \$3 million capped exemption, and the only residual exemption is for the supermarket, which expires on September 30, 2017.

The relevant property is in Square 1045, Lots 132, 133, 134, 135, 136, 137, 834, 835, 838, and 839. The property is located atop of the Potomac Avenue Metro Station in Capitol Hill at the intersection of Potomac and Pennsylvania Avenues on 1391 Pennsylvania Ave S.E., Washington, D.C.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

Purpose

The legislation exempts the Jenkins Row from real property taxes, sales and use taxes for certain items used in the project, and deed recordation and transfer taxes, to bring a grocery store to the community.

Impact

Jenkins Row development project included the Harris Teeter supermarket that has become an anchor for other retail. There is the belief that supermarkets in grocery-anchored, neighborhood centers drive sales growth because of consumers demand for necessity goods.¹⁹⁶

Evaluation

Jenkins Row reached the \$3 million cap in 2011 and only the supermarket receives real property tax exemption through the Supermarket Tax Exemption Act of 2000. It is unclear why Jenkins Row received a tax preference given its location near Eastern Market and the metro station. It also received exemptions provided by the Supermarket Tax Exemption Act of 2000. This one-off tax incentive provides unfair advantage for certain companies and violates horizontal equity which would require that any such developer building mixed development housing should receive the same tax status.

¹⁹⁶ David Antonelli, MEPT portfolio manager at commercial real estate adviser Bentall Kennedy LP, December 15, 2011, <https://www.law360.com/articles/293854/sc-developer-adds-jenkins-row-piece-to-dc-portfolio>.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

Jenkins Row Development Project

The Need

To bring another grocery store into Ward 6.

Resources/Inputs:

A 10-year real property tax exemption, exemption from sales and rental of tangible personal property to be incorporated in or consumed in the Jenkins Row project; and the total exemption is capped at \$3 million.

Outputs:

Jenkins row project include: Approximately 52,000 square feet of retail space; a garage for approximately 400 to 500 cars; and a Harris Teeter supermarket.

Expected Benefits

(Changes in short, medium, or long-term measures)

Short-term

N/A.

Medium-term

Fulfill the community's desire for a grocery store at the location of at the intersection of Potomac and Pennsylvania Avenues
Increase in the number of permanent jobs in the District.

Long-term

Fulfill the community's desire for a grocery store at the location of at the intersection of Potomac and Pennsylvania Avenues
Increase in the number of permanent jobs in the District.

Assumptions:

Jenkins Row Development Project will reduce the number of food desert areas in the District by providing a full-service grocery store to the neighborhood.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

View 14 Project

District of Columbia Code Section(s): D.C. Official Code § 47-4623
Year Enacted: 2010
Type of Provision: Real Property Tax Abatement and Sales Tax Exemption

Revenue Foregone Estimates (\$000) Fiscal Year	2015	2016	2017	2018	2019	2020	2021
	\$830	\$862	\$824	\$863	\$893	\$922	\$951

Note: Estimated revenue forgone is from District of Columbia Unified Economic Development Budget Report and future projections is calculated by ORA.

Description

View 14 Project is a mixed-use development that was completed in 2009 on Square 2868, Lot 155 in Ward 1.¹⁹⁷ The View 14 Economic Development Act of 2009 provides a maximum of \$5.7 million in real property and sales tax exemptions. The legislation will exempt View 14 from real property taxes for 20 years, 10 years at 100 percent and a 10 percent increase in years 11 through 20 until the annual real property taxation equals 100 percent.

The View 14 Project consists of 185 units of condominiums/apartments totaling 173,765 square feet which includes 6,000 square feet devoted to affordable housing for residents with income no greater than 80 percent area median income, approximately 33,000 square feet of retail space, and a below garage parking.

Purpose

The exemption awarded to View 14 Project is to increase the number of mixed income housing units and retail services to families in the District of Columbia.

Impact

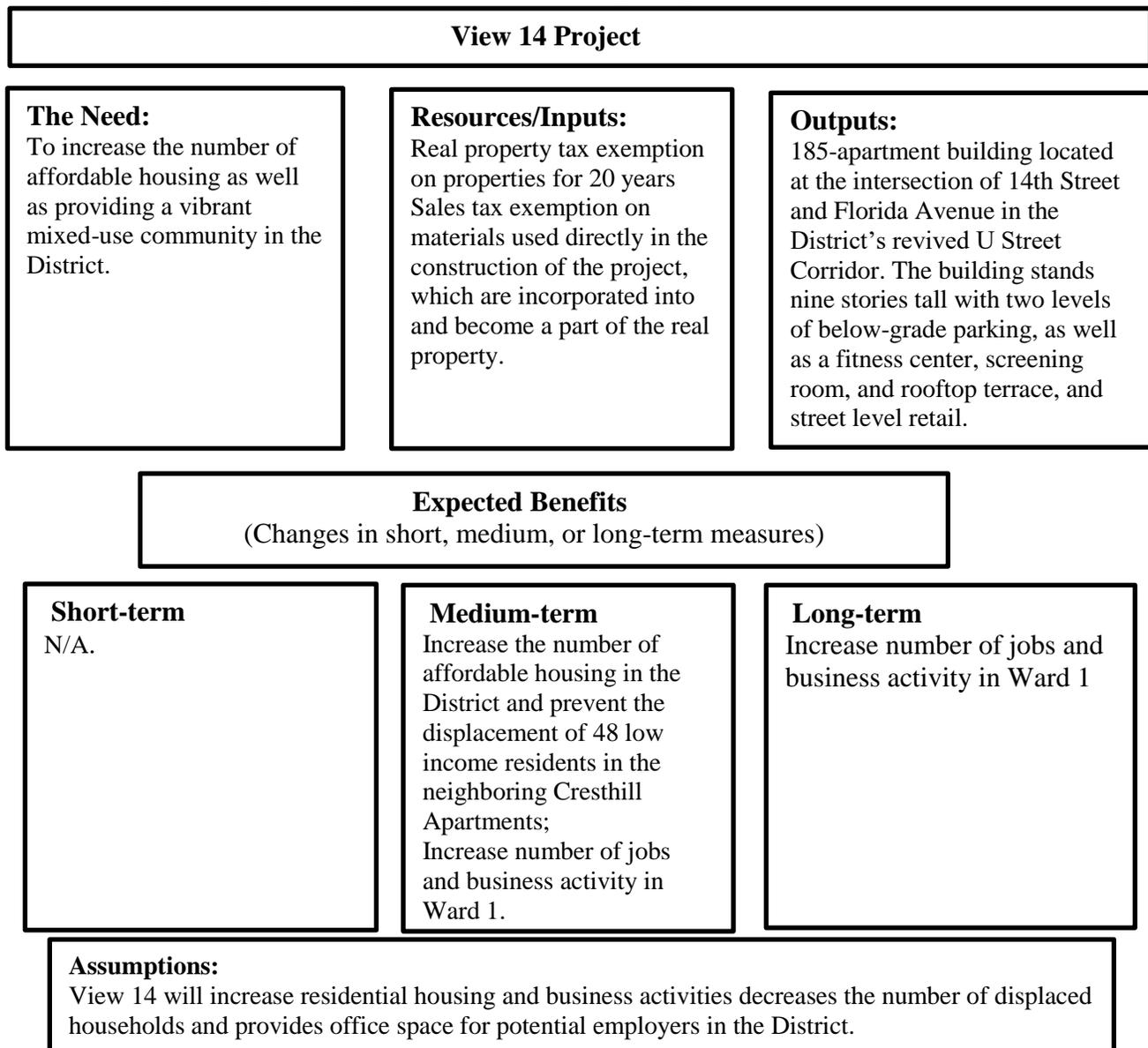
The legislation allows for the construction and development of mixed income housing and retail space in the District’s revived U Street Corridor in Ward 1.

Evaluation

¹⁹⁷ Clark Construction website states that the property was completed in 2009. <https://www.clarkconstruction.com/our-work/projects/view-14>

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

Mixed-used development like View 14 provide a mix of restaurants, office buildings, residences, and shops that deliver easy access via walking or bicycling to a variety of services and amenities helping to efficiently connect the city’s neighborhoods through sustainable transport. Businesses occupying the retail space in View 14 include YogaWorks, Doozy Dog Club, CM Solutions, LLC, to name a few. However, due to lack of data, it cannot be determined whether the benefits provided to the District in the form of tax revenues collected from the retail space outweighs the cost of the development project. If the availability of affordable housing to District residents makes up for the forgone revenue, then a monitoring component should be added to the legislation to make sure that View 14 is providing the targeted affordable housing obligation.



Part II: Review of Economic Development Tax Expenditures – Individual Provisions

Soccer Stadium Development Project

District of Columbia Code Section(s): D.C. Official Code § 47-4663
Year Enacted: 2015
Type of Provision: Property Tax Abatement and Deed
Recordation and Transfer Tax
Abatement

Revenue Foregone Estimates (\$000) Fiscal Year	2016	2017	2018	2019	2020	2021
Property Tax Abatement	\$1,538	\$1,535	\$4,533	\$5,237	\$6024	\$6,928
Deed Recordation and Transfer Tax Abatement	N/A	\$1,492	\$2,376	N/A	N/A	N/A
Total	\$1,538	\$3,027	\$6,909	\$5,237	\$6,024	\$6,928

Note: ORA Analysis of OTR Real Property Data and internal calculations used to derive estimates in the “Tax Abatement Financial Analysis of the District of Columbia Soccer Stadium Development Act of 2014.” November 13, 2014. These projections assume that the abatements begin in FY 2017 and that there is a 15% growth in the value of the land and improvements the first four years after completion.

Description

The Soccer Stadium Development Act of 2014 was signed into law March 11, 2015 to allow the District to proceed with development of a new soccer stadium at Buzzard Point for the D.C. United soccer team.¹⁹⁸ Among other activities authorized by the legislation, the final law included abatements of the real property taxes and deed recordation and transfer taxes on the stadium property.

The property tax abatement on the soccer stadium site is constructed as follows:

- (1) Beginning on June 1, 2016, or the date by which the District acquires title to each portion of the soccer stadium site on which the soccer stadium is constructed, whichever is later, through the fifth lease year -- 100%;
- (2) For lease years 6 through 10 -- 75%;
- (3) For lease years 11 through 15 -- 50%;
- (4) For lease years 16 through 20 -- 25%;
- (5) Beginning with the 21st lease year and for each lease year thereafter -- zero.

The Act also authorizes an abatement of deed recordation and transfer taxes on all transfers of real property in the stadium site through the end of the lease. The Tax Abatement Financial Analysis of the Act notes that if the soccer team extends the lease, the deed recordation and transfer tax

¹⁹⁸ D.C. Law 20-233

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

abatement could be extended for up to 15 additional years.¹⁹⁹ Further, if it splits the ground lease into two leases (one for the stadium land and one for the ancillary land nearby), the abatement on the ancillary portions of land could be extended for up to 99 additional years.

In addition to the tax abatements, the Act authorizes a series of land acquisitions and exchanges that would lead to the construction of a new soccer stadium on Buzzard Point and the redevelopment of the Frank D. Reeves Center property at 14th and U Streets, NW (Reeves Center).

The soccer stadium site is the real property described as Squares 603S, 605, 607, 661, and 661N, and the northwest portion of Lot 24 in Square 665 as described in the letter of intent between the District and Potomac Electric Power Company dated December 27, 2013, and all public alleys and streets to be closed within these squares²⁰⁰. The property is located by Second Street, S.W., T Street, S.W., Half Street, S.W., Potomac Avenue, S.W., and R Street, S.W.

Purpose

In the introduction of the legislation, then-Mayor Gray wrote that from his perspective, “the primary purpose for this transaction is not to construct a soccer stadium, but rather to spur economic development along the Anacostia River and create jobs and economic opportunities for District residents.”²⁰¹ In the final version of the law, the Council also noted in its findings that without the development of new soccer stadium in the District, the team could move elsewhere to develop a new stadium and thus the District would lose of economic and fiscal benefits the team brings to the city.²⁰²

Impact

The final approval for the development project was given by the zoning panel on February 16, 2017 after resolving the design issues (neighbors wanted more attention to retail and public spaces), parking and transportation and environmental concerns.²⁰³ The organization broke ground March 2017 in construction of the new soccer stadium, now called Audi Field, at Buzzard Point three blocks from Nationals Park stadium.

The soccer stadium opened in July 2018 and has a capacity of 20,000 with 31 luxury suites included. There will also be 500,000 square feet of mixed-use retail and residential space. Generally, it is thought that the new stadium will have a positive impact on the District’s economic and fiscal future.

According to former Mayor Vincent Gray, the soccer stadium, when combined with the replacement of the South Capitol Bridge and Nationals Park, will encourage development of the

¹⁹⁹ Tax Abatement Financial Analysis. “District of Columbia Soccer Stadium Development Act of 2014.” Bill 20-805. November 13, 2014. Pg. 3. Office of the Chief Financial Officer.

²⁰⁰ DC Official Code § 47-4663.

²⁰¹ Vincent Gray, Former Mayor, Washington, D.C., Council of the District of Columbia Committee on Finance and Revenue Committee Report on Bill 20-805 “District of Columbia Soccer Stadium Development Act of 2014.” P. 2.

²⁰² D.C. Law 20-233, p. 2.

²⁰³ Goff, K. “D.C. United gets the go-ahead to build Audi Field.” *Washington Business Journal*, February 17, 2017. Retrieved from: https://www.bizjournals.com/washington/news/2017/02/16/d-c-united-gets-the-go-ahead-to-build-audi-field.html?ana=RSS%26s=article_search.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

area between National Park and the redevelopment of the Southwest Waterfront which will serve as a final catalyst for one of the most vibrant and sustainable sports and retail districts in the U.S. and generate jobs for D.C residents from construction through the operations of the stadium. The stadium project is estimated to generate \$72 million in sales and use taxes and more than \$151 million total tax revenue to the District in 30 years.²⁰⁴

Projected Costs

The estimates of revenue foregone projected to result from the property tax abatement (presented above) were estimated in 2014 to be approximately \$59 million over the life of the lease (from 2015 to 2046, includes pre-lease transactions).²⁰⁵ Those estimates included the assumption that the District acquired the land in 2015, the stadium would be 100 percent completed in 2017, and increased assessment values reflecting the improvements made would begin when the stadium was 65 percent complete in 2016. However, the development was delayed from those estimates, and it appears that the abatements began at least one year later than those estimates assumed. The estimates presented in the table above on page 141 reflect these changes and are subject to change in the future when new information on the property value reassessment after the stadium's completion has taken place.

In 2014, the value of the revenue foregone to the deed and recordation transfer tax abatement was projected to be \$3.868 million in FY 2015-2016,²⁰⁶ the table above shifts those estimates out one year. There also was an assumption that future transfers may represent about 0.5 million dollars which would bring the total estimated value of the deed and recordation transfer tax abatement to \$3.9 million over the window of the lease.²⁰⁷

Prior to the 'District of Columbia Soccer Stadium Act of 2014,' the Council requested Conventions, Sports and Leisure International (CSLI), Integra Realty Resources (IRR) and The Robert Bobb Group (RBG) to conduct a cost benefit analysis report of the then-proposed Soccer Development Act. The report found that the new D.C. United Stadium with an estimated cost of \$286.7 million is the most expensive major league soccer stadium in the United States with the District contributing 46 percent or \$131 million of the total cost.²⁰⁸ Given recent experience with the cost overruns during the construction of the Nationals Park stadium (originally projected to cost \$440 million but cost nearly \$700 million), the Council capped its total cost for the Audi Field stadium at \$150 million.²⁰⁹

²⁰⁴ Washington, D.C., Council of the District of Columbia Committee on Finance and Revenue. Committee Report on Bill 20-805 "District of Columbia Soccer Stadium Development Act of 2014."

²⁰⁵ Tax Abatement Financial Analysis. "District of Columbia Soccer Stadium Development Act of 2014." Bill 20-805. November 13, 2014. Pg. 3. Office of the Chief Financial Officer. P. 3.

²⁰⁶ "Revised Fiscal Impact Statement - District of Columbia Soccer Stadium Development Act of 2014," Bill 20-805, December 17, 2014. Office of the Chief Financial Officer. P. 6.

²⁰⁷ Tax Abatement Financial Analysis. "District of Columbia Soccer Stadium Development Act of 2014." Bill 20-805. November 13, 2014. Pg. 3. Office of the Chief Financial Officer. P. 3.

²⁰⁸ Conventions, Sports & Leisure International ("CSL"), Integra Realty Resources ("IRR") and The Robert Bobb Group ("RBG"). Cost-benefit Analysis of the Soccer Stadium Act of 2014, November 5, 2014. Pgs 15 – 18. Retrieved from http://dccouncil.us/DC_Soccer_Cost-Benefit_Analysis_FINAL.pdf.

²⁰⁹ Heller, Chris. "A Safe Bet?" *Washington City Paper*, June 26, 2015. Retrieved from <http://www.washingtoncitypaper.com/news/article/13046971/washington-dc-sinks-money-into-a-dc-united-stadium-following>.

Projected Benefits

The Council-sponsored report by CSLI, IRR, and RBG estimated that the stadium will create net new direct, indirect and induced spending in the District of about \$2.6 billion (net present value) over the period of 2015 through 2046, as well as about 1,683 new full and part-time jobs.²¹⁰ According to the report, the overall fiscal benefits to the District of the Stadium Act are estimated to be about \$294 million (or \$365 million if the proceeds from land exchanges are included).²¹¹ These estimates are based on assumptions of revenues that would be received through sales taxes, personal income taxes, property taxes, business franchise taxes, and ticket fees, that would all result from the new economic activity generated by the Stadium Act.

At the time the figure in that report was produced, the legislation included a sales tax exemption which was later removed from the legislation. Adding that sales tax revenue back to the analysis would increase the fiscal benefits to the District. On the other hand, the economic analysis in the report may overstate the fiscal benefits of the stadium incentives to the District if some of that economic activity would have occurred anyway without the incentive or if some of the impacts are simply transferred from elsewhere in the District. It is impossible to know what the counterfactual would have been without the stadium (or without the tax incentives as a part of the stadium package). However, if the soccer stadium was not developed and D.C. United moved elsewhere, the District would have lost some fiscal and economic benefits associated with having the team in the city. Such uncertainties will make any determination of benefits directly attributable to the stadium and the tax abatement provisions a difficult analytical exercise.

Evaluation

It is too early to evaluate the soccer stadium to determine the effectiveness of the tax expenditure. Policymakers have pointed to the Verizon Center and Nationals Park stadium as successful examples of the use of public funds to bring about economic development into different neighborhoods in the District. Council members believe the Audi Field soccer stadium will similarly ignite development along the Districts' Southwest Waterfront neighborhood. Previous study on the impact of economic development projects on neighborhood change in the District which included the Nationals Ballpark stadium, showed a positive impact of the policies on income and property values.²¹²

Proponents of building sport venues contend that the quantifiable benefits of new stadiums include increased business activity, greater employment and tax revenues in general, import revenues and export services to other regions, and the revitalization of some inner-city areas within the metropolitan region.²¹³ Some research has however shown that stadiums do not serve as catalysts

²¹⁰ Conventions, Sports & Leisure International (“CSLI”), Integra Realty Resources (“IRR”) and The Robert Bobb Group (“RBG”). Cost-benefit Analysis of the Soccer Stadium Act of 2014 Testimony, November 5, 2014, p. 9. Retrieved from http://dccouncil.us/files/user_uploads/documents/DC_Presentation_110514.pdf.

²¹¹ Ibid.

²¹² Alghumgham, Amira, Muhammad, Daniel, Geng, Yi, and Liu, Shenmin. “Are Economic Development Projects Tipping Points for Neighborhood Change in Washington, DC?” 2017. Office of Revenue Analysis. D.C. Office of the Chief Financial Officer, Washington, D.C.

²¹³ Ibid.

Part II: Review of Economic Development Tax Expenditures – Individual Provisions

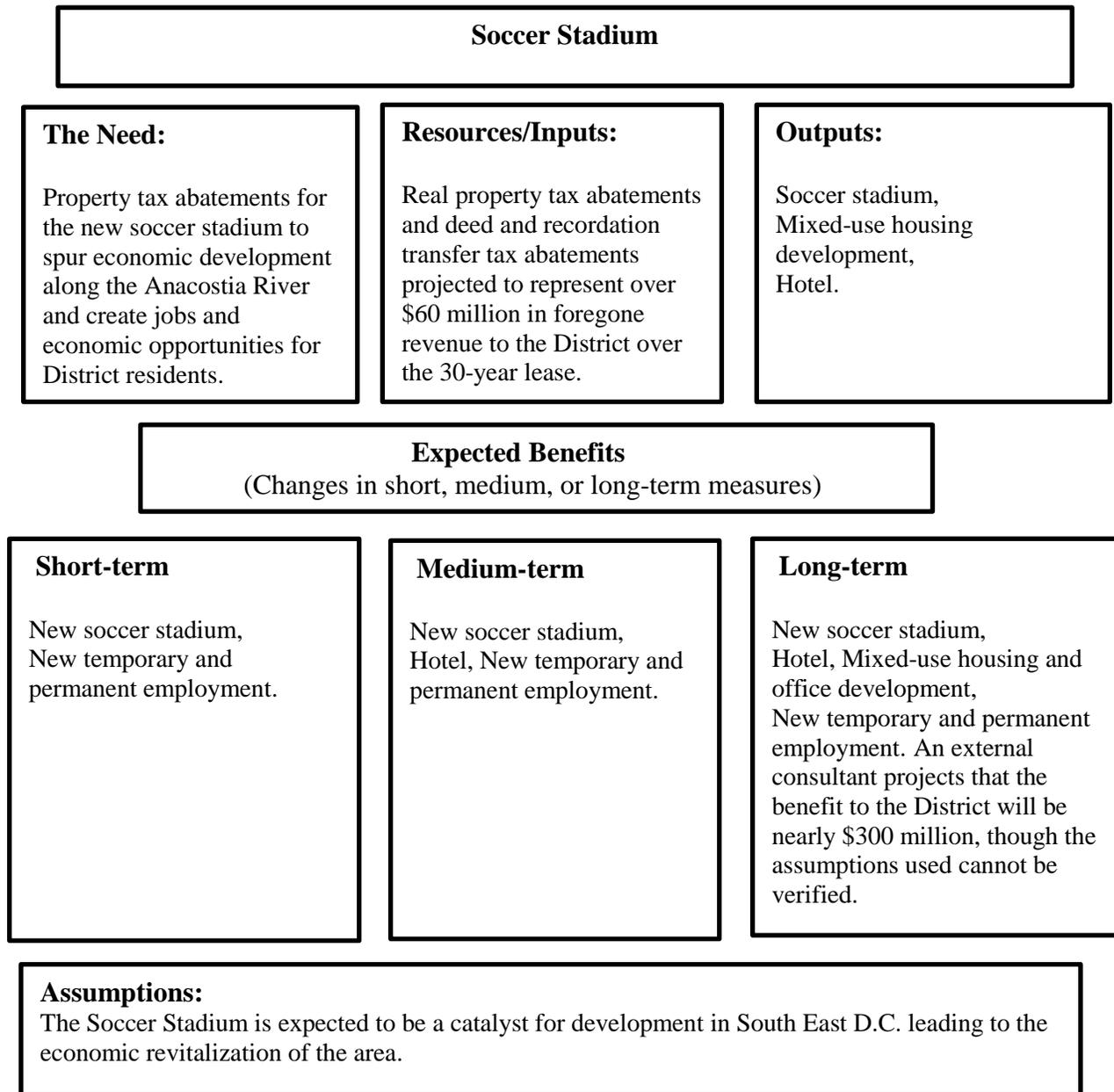
for economic development, nor do they constitute good public investments.²¹⁴ Studies have shown that “while franchises can give the economy a boost in the short term, there are little to no long-term positive effects.”²¹⁵ New stadiums do create jobs but at a relatively high per-job cost. Moreover, “there are substantial leakages—monies that leave the immediate metropolitan area, such as portions of owners’ profits, players’ salaries and revenue-sharing obligations—that significantly reduce the potential expenditure impacts.”²¹⁶

²¹⁴ Sanderson, Allen R., “In Defense of New Sports Stadiums, Ballparks and Arenas,” 10 Marq. Sports L. J. 173 (2000).

Available at: <http://scholarship.law.marquette.edu/sportslaw/vol10/iss2/5>.

²¹⁵ Pierro, Jeffrey. “The Impact of Professional Sports Franchises on Local Economies.” The Honors Program, Senior Capstone Project, April 2014.

²¹⁶ Sanderson, Allen R., “In Defense of New Sports Stadiums, Ballparks and Arenas,” 10 Marq. Sports L. J. 173 (2000) Available at: <http://scholarship.law.marquette.edu/sportslaw/vol10/iss2/5>.



Part III. Summary of Economic Development-Related Tax Expenditures and Recommendations

Following the trend among many state and local governments, tax expenditures have increasingly become a widely used policy tool for economic development in the District of Columbia with an estimated \$57 million in local revenue forgone in FY 2017.²¹⁷ Economic development tax expenditures generally make up seven percent of all revenue foregone through tax expenditures aimed at policy goals in the District. Categorical economic development-related tax expenditures make up 93 percent of this total at \$52.6 million in FY 2017 with qualified high technology companies (QHTC), certified capital investment by insurance companies (CAPCO), and supermarket credits being the three largest categorical economic development-related tax provisions. Individual tax provisions are written for a single entity and as such are much smaller in terms of revenue foregone, representing an estimated \$4.2 million in FY 2017. However, some individual tax provisions can be very large; for example, The Advisory Board Company and The Adams Morgan (The Line) Hotel have already received over \$100 million in promised future tax abatements.

Qualified High Technology Companies (QHTCs)

Since their enactment in 2001, the QHTC tax incentives to attract and retain high technology businesses in the District have been modified and expanded over the years. In addition to a corporate franchise (income) tax exemption and tax rate reduction, QHTCs in D.C. may take advantage of several tax credits offered through the franchise tax, as well as exemptions to the real and personal property taxes and the sales tax.

Overall this analysis finds the QHTC to be a particularly complex tax incentive that was not assigned an agency to administer or track it, therefore the only data available are those collected by the Office of Tax and Revenue by way of collecting QHTC-related taxes. While there have been notable gains in the District's high technology sector and D.C. QHTC payrolls have grown more than their non-QHTC counterparts, the design of the incentives and a lack of data about them preclude us from analyzing effectiveness. A key finding is that some large companies are taking very large amounts of QHTC credits, often companies that were already in D.C., without any evidence of commensurate economic benefits to the District.

Over \$184 million in QHTC franchise tax credits were claimed from 2001 to 2015 (five percent of the franchise tax revenue received over that time), and this does not include any of the tax benefits conveyed through the sales, real property, or personal property taxes, which over the same time are estimated to be in the tens of millions of dollars. As of 2015, companies were carrying forward an aggregate of \$50 million in franchise tax credits that they have earned but have not yet applied to their tax liability. They are expected to do so once their five-year exemptions end and they begin paying the reduced franchise tax rate. If no changes are made, ORA estimates the QHTC program will continue to represent at least \$40 million per year in foregone revenue when taking franchise tax, real and personal property tax, and sales tax provisions into account. A lack of caps

²¹⁷ This excludes some revenue foregone through tax expenditures that are considered tax base defining measures, such as the sales tax exemption for professional and personal services.

Part III: Summary of Economic Development Tax Expenditures and Recommendations

on the dollar value of benefits received or time limits across the QHTC incentives poses financial risks for the District's revenue streams.

On average from 2001 to 2015 most firms claiming credits are receiving smaller dollar amounts of credits, often less than \$100,000, while a small number of large firms are claiming the bulk of the total credits each year. If policymakers were to limit the tax benefits going to companies to either \$100,000 or \$250,000 per firm in 2015, most QHTCs would have continued to receive the same credits under either scenario. Assessing the credit recipients' headquarters showed that in all but two years of the data, more QHTC credits were claimed by companies headquartered in Virginia than companies in D.C. However, in terms of the number of firms claiming credits roughly half of the firms claiming a credit were headquartered in D.C.

The District's QHTC program could very well be attracting new firms and those firms could claim that this incentive impacted their decision. Nevertheless, it is the case that a significant portion of the dollars claimed have gone to companies that were already in the District without any evidence of increased benefits to the District. Over \$100 million in QHTC credits was taken by 24 companies that were either already located in D.C. and paying corporate taxes before becoming a QHTC or were already in the District and paying franchise taxes in 2001, the first year for which we can track both franchise tax filers and QHTC-related data. It is unknown if any of these credits influenced the decision of those companies to remain in D.C. rather than move out of the city or engage in activities that produced new economic benefits. However, given such activities were not required to receive the credits, it is possible some of these companies received tax benefits for doing what they would have otherwise done without the tax incentive. Further, many firms receiving credits have stopped claiming QHTC eligibility in subsequent years, possibly leaving the District. No claw back provisions exist to recoup tax dollars foregone to QHTCs that leave the city. Such provisions would protect District resources if a firm leaves the District or fails to meet eligibility requirements.

The QHTC program demonstrates how poorly designed incentives can have significant fiscal costs for a jurisdiction, require additional administrative resources and preclude an evaluation of results. To obtain better results, the QHTC could be amended in a variety of ways including: better targeting incentives, revisiting the definition of "high technology," capping the amount of credits a firm can receive both annually and overall; implementing claw back provisions to recoup revenue if a company leaves the District; continuing data tracking and monitoring, and finally, increasing transparency and accountability of incentives by making recipient names and credit amounts public.²¹⁸

Qualified Supermarkets

For thirty years the District has offered tax incentives to increase the number of supermarkets and decrease food deserts, thereby increasing D.C. residents' access to healthy food. These measures were expected to lead to longer-term improvements in health outcomes of District residents. Available data show that \$21 million in real property tax exemptions to supermarkets were granted

²¹⁸ The law requiring this report advises the OCFO to make "Recommendations for improving the effectiveness of the tax preference; [and] (6) Recommendations for whether the tax preference should be modified, discontinued, or remain in its existent state." See Appendix 1 for legislative requirement.

Part III: Summary of Economic Development Tax Expenditures and Recommendations

from 2010 to 2017. Adding in the estimates of revenue foregone through the personal property and sales taxes the total for the tax incentives reaches almost \$29 million from 2010 to 2017. This does not include tax exemption that has been approved for a future supermarket in Census Tract 94.

The supermarket tax incentive provisions have changed multiple times to reflect the District's changing economic environment, yet there is little in the way of results that can be definitively attributed to the incentives. While there has been an increase in the number of supermarkets in the District, the increase has been concentrated in transitioning and higher income neighborhoods and many have opened without the help of the tax incentives.

Given the rapid economic development occurring in many areas of the District through this time-period, it is not clear whether the incentives were a major factor in any of the recipient supermarkets' decisions to locate where they did, and anecdotal evidence suggests that tax incentives do not play a major role in supermarket location decisions, in general.

The almost \$29 million of foregone District tax revenues cannot be shown to have affected supermarkets' location decisions, generally, or produced economic or other benefits that would not have happened but for the incentives. As such, this report recommends that policymakers change the supermarket tax incentives to better target supermarkets that would not otherwise locate in an area of highest need. Such targeting would prevent taxpayer dollars from going to supermarkets that would have located in eligible areas regardless of the incentives. Further, any modification should consider whether more of an incentive is needed for supermarkets that would locate in areas of highest need, given that the tax incentives alone do not appear to have been enough to attract supermarkets to food deserts or low-income areas of highest need. A recently passed law takes the District's supermarket policies in this direction. The East End Grocery and Retail Incentive Program Tax Abatement Act of 2017 takes steps to create greater access to grocery stores in Wards 7 and 8 by encouraging the development of a new anchor grocery store, which would serve as a catalyst for additional business development in the neighborhoods.

Based on best practices of tax incentives identified in this report, a specific agency should own the program and be charged with collecting and analyzing data on the incentives to ensure compliance to the law (such as monitoring the requirement that 50 percent of employees are D.C. residents) to promote the accountability of taxpayer dollars.

Certified Capital Investment by Insurance Companies (CAPCO Program)

The Certified Capital Investment by Insurance Companies incentives were enacted in 2004 to increase the volume of private investment in new and/or expanding small businesses located in the District. The primary objectives of the program include: stimulating the flow of capital to early-stage businesses that are unable to access traditional financing; building venture capital infrastructure; creating high-paying jobs; and increasing the District's tax revenue.²¹⁹

²¹⁹ Fuller, Stephen. "The Economic and Fiscal Impact of CAPCO-Funded Companies on the District of Columbia." Center for Regional Analysis, George Mason University. November 2009.

Part III: Summary of Economic Development Tax Expenditures and Recommendations

The program allowed insurance companies to invest a total of \$50 million in certified capital companies (CAPCOs) and earn premium tax credits equal to the amount of the insurance company's total debt and equity investment in the CAPCO. The \$50 million in insurance premium credits could be redeemed beginning 2009 with a limit of \$12.5 million per company per year on usage of the credits. As of 2017, insurance companies had claimed \$48 million in insurance premium tax credits from the District, making this the cost to the District in foregone revenue. Three investment companies applied for and received certification from the District's Department of Insurance, Securities, and Banking (DISB) to be CAPCOs. To date, the three CAPCOs have loaned or invested about \$33.5 million in 36 qualified companies in the District.²²⁰

Economic and fiscal impact studies have shown that the CAPCO program had some impact on the District of Columbia. In an evaluation prepared for DISB, Dr. Don Phares used a model to estimate that from 2004 to 2012, the economic impact of the CAPCO program included the creation and maintenance of an annual average of 79.2 jobs, \$119.7 million in total new spending due to new business investments, and \$40.9 million in total labor income. Using his model, the CAPCO program also generated an estimated \$8.7 million in total new revenue.

However, several companies that received CAPCO investments failed while other companies still in operation have yet to reach the point where CAPCOs can receive a return on their investment. Furthermore, two CAPCOs have been unable to invest 100 percent of the certified capital to new or expanding businesses. Part of the problem is the structure of the CAPCO program. The two CAPCOs have little incentive to invest the remainder of the certified capital as there is no penalty if the remaining \$16.5 million is not invested. Additionally, most of the qualified companies that received investments and decided to move out of the District or fail to fulfill the CAPCO program employment requirements are not penalized. The 2010 amendments made continuing operations in the District a requirement for businesses to receive funding from the CAPCOs, but this requirement did not apply to businesses that received funding before the amendments became effective on May 27, 2010.

In general, the impacts of CAPCO incentive programs in the United States have been controversial. There are 14 states with a CAPCO incentive program including the District of Columbia. Evaluations of the CAPCO program in other states have shown the net impact of the incentive program to be either minute or negative.

The District's CAPCO incentive program was amended in 2010 to address some of the issues with its program. The legislation required CAPCOs to invest 100 percent of the certified capital into qualified businesses, but the amendment have not produced further investments in potential qualified companies. The legislature also provided DISB with the authority to obtain information from CAPCOs to conduct an annual economic impact analysis, however, a DISB official notes 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, the amendments have not solved the structural issues within the incentive program causing it to stall. The only recent activity in the CAPCO incentive program has been that the insurance companies are still redeeming their earned

²²⁰ Phares, Don. "The Economic and Fiscal Impact of the District of Columbia's CAPCO Program." Prepared for the District of Columbia's Certified Capital Companies Program and the District of Columbia Department of Insurance, Securities, and Banking. University of Missouri-St. Louis, November 2013.

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insurance premium credits. The remaining unclaimed insurance premium credit is about \$2 million which is estimated to be claimed in FY 2018.

In summary, the D.C. CAPCO program is a complex tax incentive representing nearly \$50 million in foregone revenue thus far over the life of the program. Incomplete and unverifiable reports of the resulting economic impacts make it hard to determine the program's effectiveness. Some of the lessons learned from this program echo those found in other programs reviewed for this report.

Tax incentive programs that are overly complex are hard to administer and even harder to evaluate. The CAPCO program also illustrates that if a tax incentive is not carefully structured at the beginning, it can be difficult if not impossible to change midway through. CAPCOs are not subject to any penalties for not investing the full amount of CAPCO money and it appears that nearly \$17 million of the \$50 million in District investment will not be invested. Further, when the companies receiving the investments were under no obligation to remain in the District to keep the funding, some of them closed or left the District. If firms receiving tax credits or funds tied to the tax credits are not legally required to report data or information justifying their benefits, they are likely not to do so and may refuse if the requirement is enacted after the program began. The complex CAPCO structure with multiple entities and levels of transactions prevented the District from being able to obtain information on the results of its investments and should be avoided in the future.

Individual Economic Development-Related Tax Provisions

Individual tax provisions result from legislation written for specific companies or organizations that receive tax incentives in exchange for providing some social or economic benefit to the District. Individual tax provisions are intended to provide one or a combination of the following outcomes: neighborhood revitalization, employment opportunities, retail business space/supermarkets, and affordable housing. Individual tax incentives to supermarkets were mostly passed before the FEED-DC Act of 2010 which expanded the Supermarket Incentive Act of 2000 and changed the eligibility criteria for neighborhoods where supermarkets could locate.

Eight Individual provisions are covered in this report and represent an estimated foregone revenue of \$4.2 million in FY 2017. Individual tax provisions make up only seven percent of total tax revenue forgone in the local economic development policy area. Audi Field Soccer Stadium comprises about 73 percent of total individual economic development-related forgone revenue in FY 2017. The value of future tax abatements to The Advisory Board Company and The Adams Morgan (The Line) Hotel already passed in law is estimated at over \$100 million.

Generally, individual incentives are conditional on an organization meeting specific economic development deliverables like job creation or creation of affordable housing and should have a monitoring process in place to track whether such deliverables to the District are being met. For example, a monitoring criterion to track the new employment a company receiving incentives creates annually in the District would help in determining whether the organization is meeting its requirement to the District. An agency should be assigned to monitor whether the companies are meeting the conditions in the legislation that grant them the tax benefits. If the requirements are not being met, the legislation should include a claw back provision so that the District can recoup its losses. Additionally, when individual tax provisions are targeted to a specific company to keep

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it in the District this violates the principle of horizontal equity as similarly situated taxpayers are not treated the same under the tax code. The District primarily finances individual economic development projects either through tax increment financing projects (TIFs) or bonds, however, TIFs and bonds are not categorized as a tax expenditure and as such are not included in this report.

Summary of Overall Findings and Recommendations

Tax expenditures represent District resources and just like spending in the budget, each dollar has an opportunity cost in that it cannot be allocated elsewhere. As such, tax incentives should be studied and evaluated just like other government spending to ensure the tax dollars are accountable for the expected results and to maintain a fair tax system for all residents.

Findings

Overall, the District's economic development tax incentives support the District's broad economic development goals, however various issues with each of the incentives prevent an assessment of their effectiveness in meeting the respective incentive goals. Each section on specific tax incentives lays out recommendations for that incentive. Additionally, several broad recommendations for improving any future District tax incentives is offered based on these findings.

The District's economic development incentives are not administered by a single agency and represent an ad hoc set of provisions that are not coordinated in a meaningful way. The largest program, the QHTC tax incentives, was not assigned to an agency to administer it, leading to data collection shortages. The Supermarkets tax incentives began in a similar way, however, amendments in 2010 assigned the certification process to the Deputy Mayor for Planning and Economic Development (DMPED), which has improved aspects of the program by reducing application time before supermarket approval. The CAPCO program was assigned to the Department of Insurance and Banking (DISB), however the complicated and multi-level structure of the tax incentives meant that even though DISB was required to monitor and evaluate the incentives, it did not have the authority needed to obtain data from the third-party recipients of investment dollars resulting from the tax incentives. Assigning an agency to administer a tax incentive is not enough to ensure success, however, it is an important first step to overcome many of the issues raised in this report. If no entity owns a tax incentive program, it is likely that future tax incentives will have similar problems as those highlighted here.

Just like in many other jurisdictions, the District's tax incentives are not well tracked and monitored, adding another impediment to evaluation and accountability. The QHTC, Supermarkets, and CAPCO tax incentives, as well as some of the individual provisions, each have issues with tracking and monitoring data to ensure compliance to the terms of the incentives or evaluating them for results. This review compiled a wealth of data on the extent of the immediate fiscal impacts of these tax expenditures; however, more data would be needed to be able to report on the full scope of the programs as well as their results.

This report found that QHTC and Supermarket tax incentives are not well targeted, meaning some companies may be receiving tax benefits—sometimes a large share, in the case of several large QHTCs—to do what they would have done without the incentive. Targeting incentives only to firms that would make *new* investments to grow the economy would better ensure accountability of taxpayer resources. Further, there are structural issues within each of the incentives that have implications for their administration and effectiveness. Overall this review has found that complex tax provisions are difficult to implement and challenging to monitor and analyze once in place. Policymakers should consider these lessons for new tax incentives and avoid creating complex incentives in the future.

Recommendations

Based on these general findings, this report recommends that to promote effectiveness and accountability, all future District tax incentives should be assigned an agency to implement, administer, monitor, and review them. Monitoring and evaluation activities should be written into the legislation creating the incentive, making clear where responsibility for such activities rests and what data should be collected to support the monitoring activities. New tax incentives should be simple to understand and administer for both taxpayers and tax administrators. Agencies that are overseeing tax incentive administration should have the authority to require recipients to report data necessary to monitor and review tax incentives, further, agencies assigned to administer, or review tax incentives should be given additional resources to do so. To aid in monitoring and reporting, tax incentive awards should be more transparent, and authorizing legislation should explicitly state that companies receiving tax incentives will be disclosed to the public.

The District's economic development tax expenditures should 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. To protect the District's revenue base, new incentives should include some financial limits or caps. Further, incentives should contain claw back provisions so that if a company receiving tax incentives does not comply with the terms of its tax benefits or leaves the District within a certain amount of time, it would have to repay the District the tax benefits received.

In summary, all new District tax incentives should:

- 1) **Be assigned an administering agency** from the beginning, with 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 the District within a certain amount of time, it will have to repay the District what it received.

Appendix

Appendix 1: Legislative Requirement

From D.C. Law 20-155

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

Appendix

- (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; D.C. 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.²²¹

²²¹ <http://lims.dccouncil.us/Download/31515/B20-0750-SignedAct.pdf>, p 131.

Appendix

QHTC Appendix 1: Timeline of Selected QHTC Legislation and Rulings

Date	Description
2000	<p>D.C. Law 13-256, the “New E-conomy Transformation Act of 2000,” provided a variety of tax preferences to QHTCs across several D.C. taxes, including the corporate franchise tax (income), the real property tax, personal property tax, and sales tax; as well as provisions affecting Sec. 179 expensing and capital gains deferrals. Originally, any eligible QHTC could receive a reduced 6% franchise tax rate, however only QHTCs in ‘high technology development zone’ could receive the five-year franchise exemption.</p>
2012	<p>D.C. Law 19-0211, “The Technology Sector Enhancement Act of 2012” removed the location requirement and thus expanded the 5-year franchise tax exemption regardless of location in the District. This law changed the start date of the 5-year franchise tax exemption to when a firm begins having taxable income (instead of date of commencing business in D.C.) for firms certified after January 1, 2012. This law also capped the total exemption amount to \$15 million per company, though the reduced 6% rate may be taken after the limit is reached.</p> <p>Further limited the scope of companies that can take advantage of tax credits offered to Qualified High Technology Companies (QHTCs) by requiring employee presence and economic activity in the District.</p> <p>This law also reduced the capital gains rate for the sale of stock in QHTCs to 3% from the top rate of 8.75% for D.C. residents beginning in 2019.</p>
2012	<p>In <i>BAE Systems Enterprise Systems Inc. v. District of Columbia Office of Tax and Revenue</i>, 56 A.3d 477 (D.C. 2012),²²² the District Court of Appeals affirmed an Office of Administrative Hearings ruling that the historic QHTC definition did not require property ownership or the payment of rent or the exercise of predominant authority, dominion, or control over an office or base of operations in the District.²²³ (A taxpayer-friendly interpretation by a 2012 D.C. Court of Appeals decision held that a taxpayer has a “base of operations” in the District if it has a fixed D.C. location for a sufficiently extended period of time.)</p>
2013	<p>D.C. Bill 20-337, The Fiscal Year 2014 Budget Support Emergency Act of 2013 amended the District’s combined reporting provisions so that effective January 1, 2011, a taxpayer engaged in a unitary business with one or more other “persons” is required to file a combined District Franchise Tax report. QHTCs were not included in the definition of “person” and therefore should not file ‘combined reporting.’</p>

²²² <http://caselaw.findlaw.com/dc-court-of-appeals/1616919.html>

²²³ [https://www.bdo.com/insights/tax/state-and-local-tax/state-and-local-tax-alert-\(2\)](https://www.bdo.com/insights/tax/state-and-local-tax/state-and-local-tax-alert-(2))

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2014	D.C. Act A20-449, the “Qualified High Technology Clarification Congressional Review Emergency Amendment Act of 2014,” passed in the Fiscal Year 2015 Budget Support Congressional Review Emergency Act of 2014, required that effective January 1, 2015, a company must <u>lease or own</u> an office in the district to qualify, rather than the previously worded legislation which said a company must “maintain an office, headquarters, or base of operations.”
2015	D.C. Act A21-0148, “The Creative and Open Space Modernization Amendment Act of 2015” was passed in the Fiscal Year 2016 BSA of 2015 and affected the maximum property tax abatements and leasing of QHTC spaces. It stipulated that the total amount of property tax rebates for all tenants under this section would be \$3 million per year, beginning in FY 2017. ²²⁴
2015	NBC Subsidiary WRC-TV, LLC v. D.C. Office of Tax and Rev., No. 14-AA-174 (D.C. Ct. App. Oct. 22, 2015). The D.C. Court of Appeals held that a TV station was not eligible for QHTC benefits because its sales of advertising via technology-enabled television programming were not considered a qualifying QHTC activity.
2016	D.C. Law L21-0160, The Fiscal Year 2017 BSA of 2016 contained the “QHTC Digital Media and Boundary Amendment,” which added Qualified Digital Media Companies to the QHTC definition for eligibility for the Creative and Open Space Modernization tax rebate. This followed a 2015 court case in which the D.C. Court of Appeals held that a TV station was not eligible for QHTC benefits because its sales of advertising via technology-enable television programming was not considered at qualifying QHTC activity. ²²⁵

²²⁴ <http://lms.dccouncil.us/Download/33645/B21-0158-SignedAct.pdf>, pgs. 39-43.

²²⁵ NBC Subsidiary WRC-TV, LLC v. D.C. Office of Tax and Rev., No. 14-AA-174 (D.C. Ct. App. Oct. 22, 2015).

Appendix

QHTC Appendix 2: Types of Industry Eligible to be a QHTC

Type	Qualified Industry	Description
I	Internet-related services and sales	Website design, maintenance, hosting; Internet-related services and sales; Internet-related training, consulting, advertising, or promotion services. Development, rental, lease, or sale of Internet-related applications, connectivity, or digital content; or products and services that may be considered e-commerce;
II	Information and communication technologies, equipment and systems	Information and communication technologies, equipment and systems that involve advanced computer software and hardware, data processing, visualization technologies, or human interface technologies, whether deployed on the Internet or other electronic or digital media.
III	Advanced materials and processing technologies	Advanced materials and processing technologies that involve the development, modification, or improvement of one or more materials or methods to produce devices and structures with improved performance characteristics or special functional attributes, or to activate, speed up, or otherwise alter chemical, biochemical, or medical processes
IV	Engineering, production, biotechnology and defense technologies	Engineering, production, biotechnology and defense technologies that involve knowledge-based control systems and architectures; advanced fabrication and design processes, equipment and tools; or propulsion, navigation, guidance, nautical, aeronautical and astronautical ground and airborne systems, instruments and equipment
V	Electronic and photonic devices and components	Electronic and photonic devices and components for use in producing electronic, optoelectronic, mechanical equipment and products of electronic distribution with interactive media content.

Source: D.C. Code § 47-1817.01.

Appendix

QHTC Appendix 3: Text from Introduction of “New E-economy Transformation Act of 2000”:

TITLE I. QUALIFIED HIGH TECHNOLOGY COMPANIES.

Sec. 101. Findings. The Council of the District of Columbia finds that:

(a) The Washington, DC Metropolitan Region is a leader in the "new" high technology economy and is projected to be one of the top three national centers of this new economy in the 21st Century. Almost all of this growth, however, is being driven by -- and is associated with - pre-existing activities in Northern Virginia and surrounding suburbs. Currently, the District of Columbia accounts for only 13.8% of high-tech jobs in the region while the remaining 86.2% of these positions are found in outlying areas.

(b) The creation of new high technology-based businesses represents an important source of new jobs and public revenues for the District of Columbia.

(c) The most significant barriers preventing the growth of the high technology sector in the District include a trained workforce, access to affordable facilities, and a disparity in financial incentives offered by other jurisdictions or regions.

(d) In order to participate in this new high technology economy, the District of Columbia must invest in its citizens and encourage private sector high technology companies to invest in these same citizens in order to secure opportunities for economic development and wealth accumulation. Among other things, our citizens must have access to - and training in - the necessary skills and technology.

(e) The ability to procure suitable office space and competitive lease agreements are important inducements to entrepreneurs and to high technology start-up companies to begin operations or to expand within the District of Columbia.

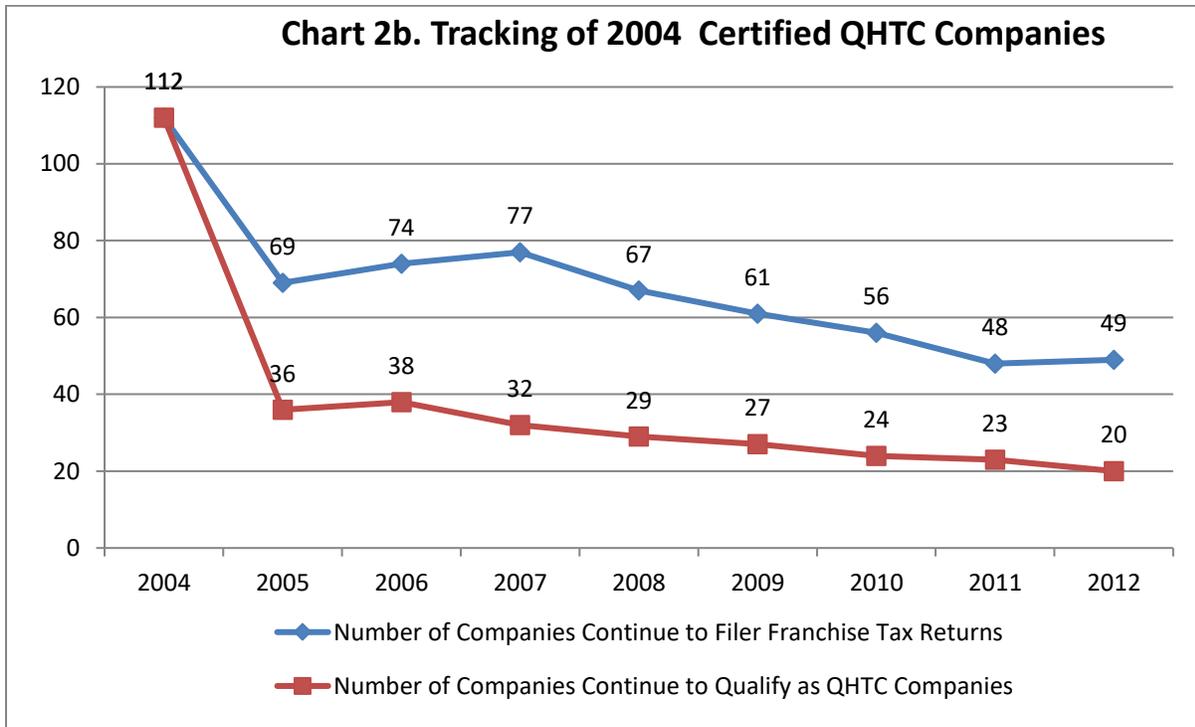
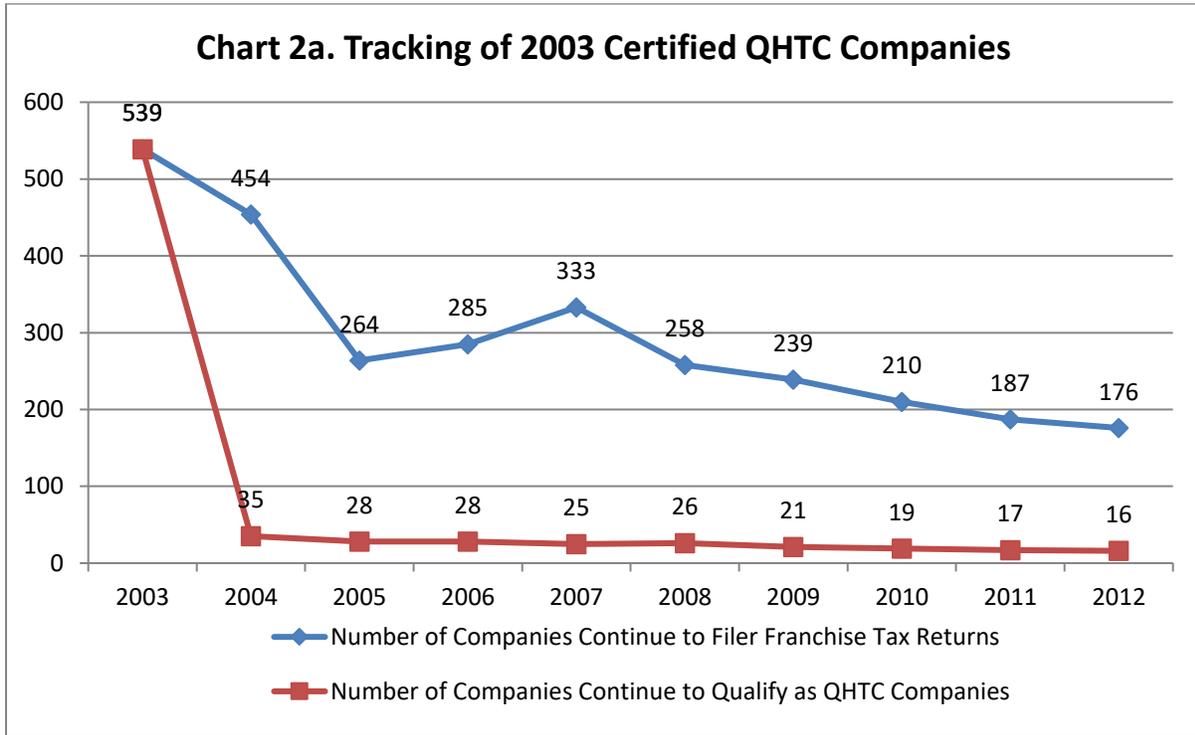
(f) The costs associated with starting and operating a business in the District of Columbia far exceed those in the suburbs. In order to compete for these opportunities, the District must create a more competitive legal and regulatory structure.

Sec. 102. Qualified High Technology Companies.

(a) Purpose. This section is intended to apply to high technology companies whose products or services depend to a significant extent on the application of scientific or technological skills or knowledge, whether it be a novel application of advanced technology to provide a totally new product or service, or an application of existing technology in an innovative manner.

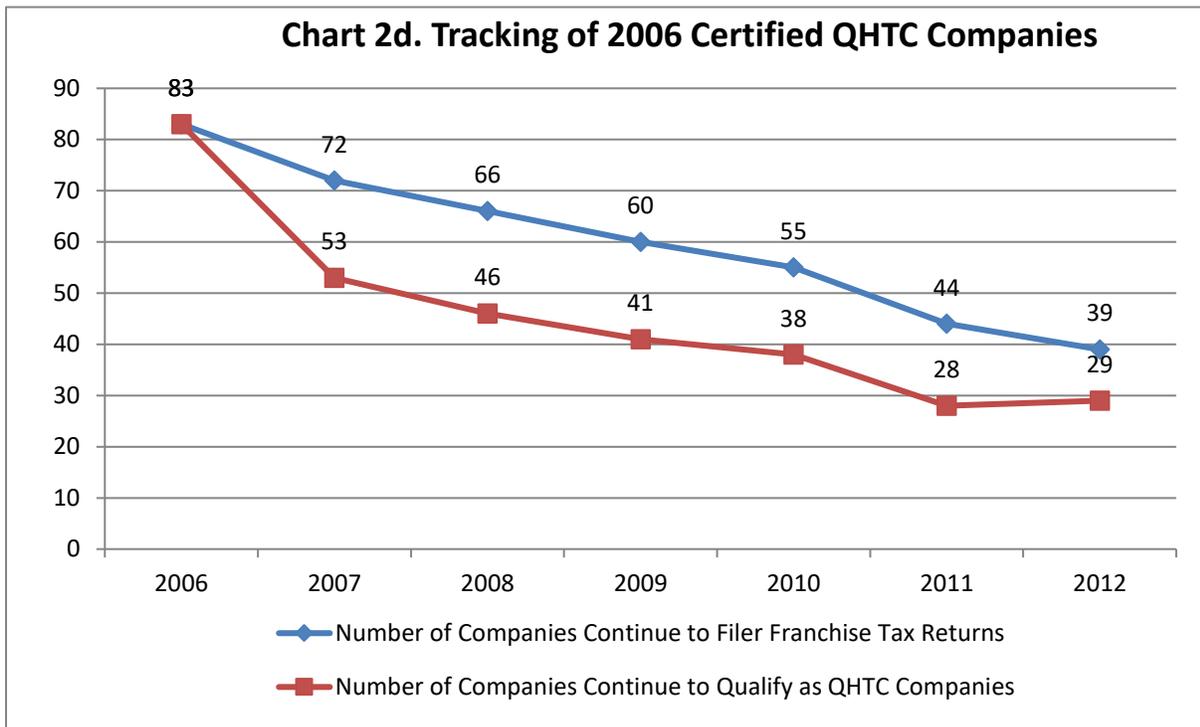
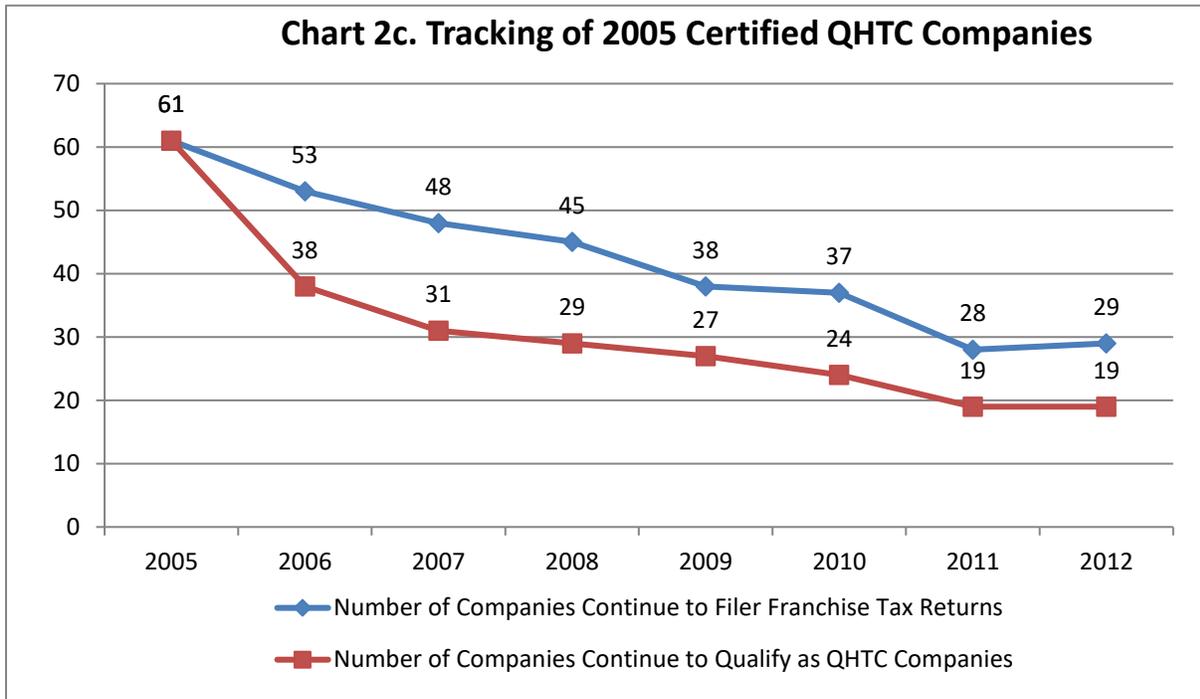
Appendix

QHTC Appendix 4: Tracking QHTCs up to 2012²²⁶

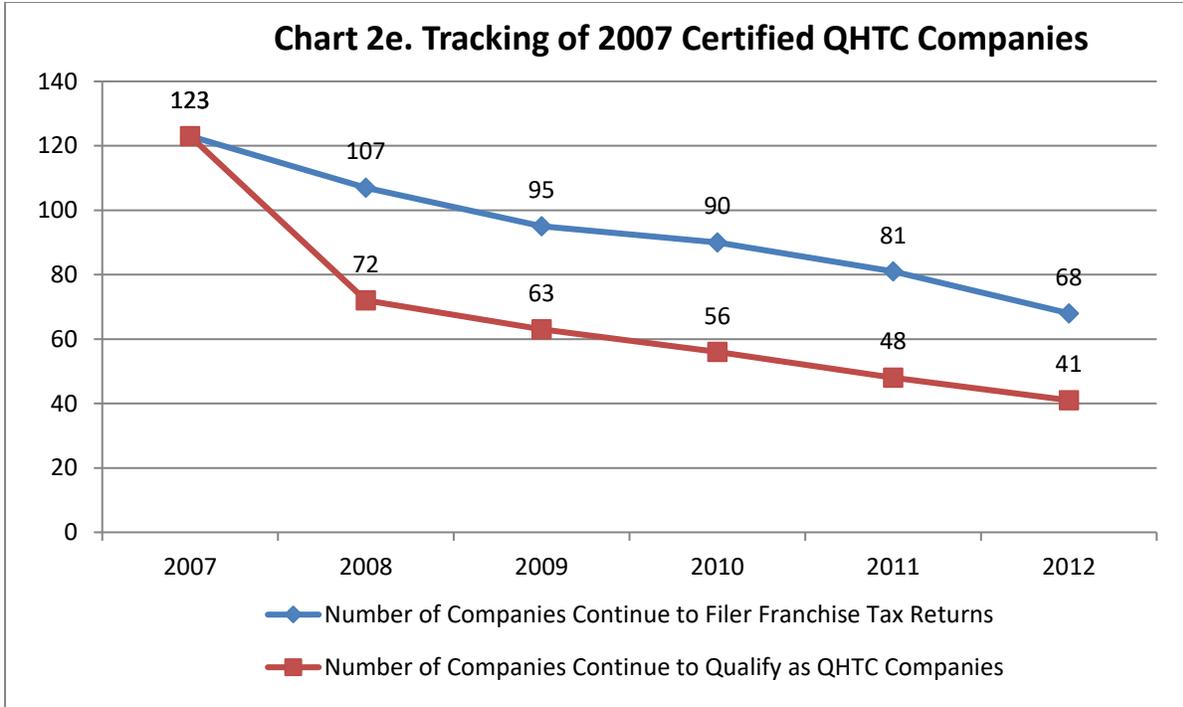


²²⁶ All charts in Appendix 4 are from: Geng, Yi. "Analysis of Effectiveness of D.C. Qualified High Technology Companies (QHTC) Credits." 2016. Office of Revenue Analysis. Pgs. 9 - 11

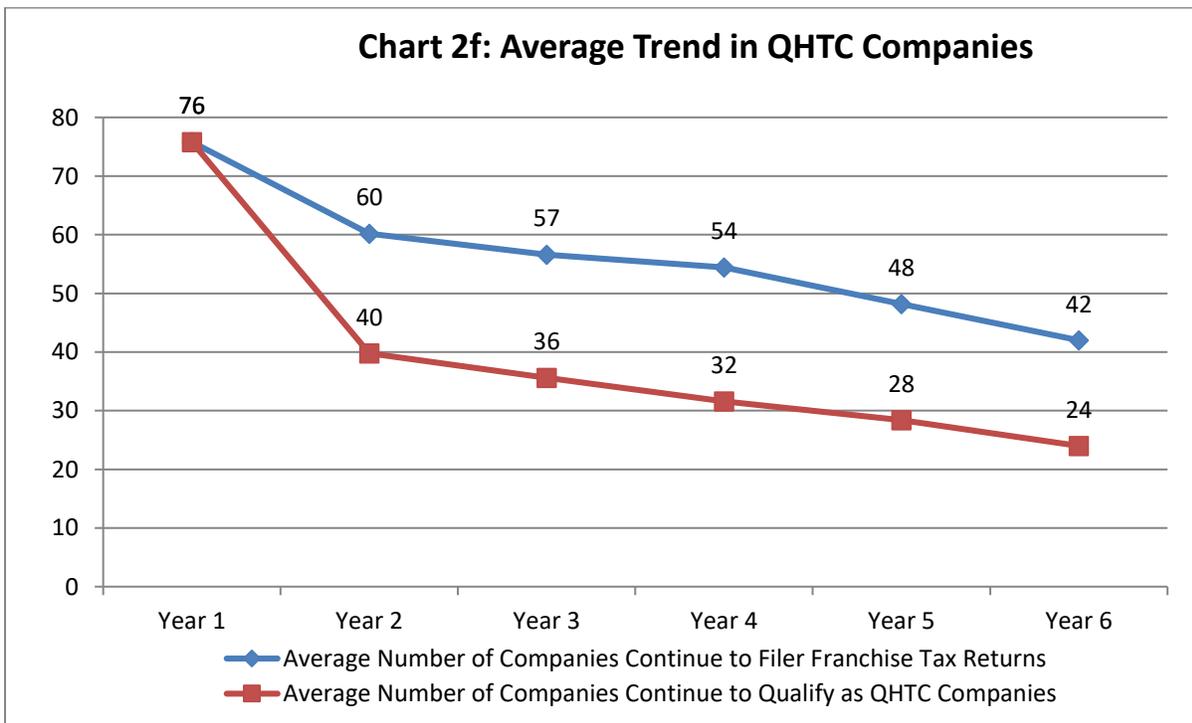
Appendix



Appendix



Note: this chart differs from Chart 7 on page 54 as Chart 2e above contains all *Certified* QHTCs while Chart 7 presents only QHTCs that claimed the QHTC franchise tax credit in 2007.



Appendix

QHTC Appendix 5: QHTC Tax Forms in QHTC Packet FR-399

1. QHTC Certification Form;
2. Form D-20CR: detailed questions pertaining to each credit, summary information, including unused credit being carried forward. (Forms in #1 and #2 are bar coded)
3. Worksheet certifying gross revenue for permitted and non-permitted activities (no form #).
4. Form FR-332: listing of employees claimed for a refund of retraining costs.
5. A form for listing qualified disadvantaged employees claimed for a refund of retraining costs (no form #).
6. Form FR-331 for requesting sales and use tax refund
7. Form FR-337: sales and use tax exempt purchase certificate for QHTCs to present to vendors to receive a sales tax exemption for qualified purchases.
8. Form OTR-368: a certificate of resale verifying that tangible personal property and services are exempt. (Forms 331, 337, and 368 have been removed from the booklet with the rollout of sales and use taxes in the Modernized Income Tax System beginning with tax years 2018 forward.)
9. Form FP-31 (Schedule D-3, D-4): listing personal property that is being exempted.

Appendix

QHTC Appendix 6: QHTC Certification Form

	<p>QHTC-CERT 20_____ Certification for Qualified High Technology Company</p>	 <small>1 7 3 9 9 0 1 1 0 0 0 0</small>	
<small>Official Use Only: VENDOR ID# 0000</small>			
Taxpayer Identification Number <input type="text"/>		Fill in <input type="radio"/> if FEIN Taxable Year Ending (MMYY) <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>	
Fill in <input type="radio"/> if SSN <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>		Initial Year of Certification as QHTC (YYYY) <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>	
Name of Business <input style="width: 100%;" type="text"/>		Real Property Eligible for Abatement	
		Square <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>	Suffix <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>
		Lot <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>	
I certify that this business is a Qualified High Technology Company and that it (check all that apply):			
1. <input type="checkbox"/> Is an individual or entity organized for profit;			
2. <input type="checkbox"/> Leases or owns an office in the District of Columbia, attach copy of lease or proof of ownership;			
3. <input type="checkbox"/> Has two or more qualified employees in the District of Columbia;			
4. <input type="checkbox"/> Derives at least 51% of its gross revenues earned in the District from one or more of the following (check all that apply):			
a. <input type="checkbox"/> Internet-related services and sales, etc., as defined in DC Code §47-1817.015(A)(i)(I),			
b. <input type="checkbox"/> Information and communication technologies, equipment and systems that involve advanced computer software and hardware, data processing, visualization technologies, or human interface technologies, whether deployed on the Internet or other electronic or digital media,			
c. <input type="checkbox"/> Advanced materials and processing technologies that involve the development, modification, or improvement of one or more materials or methods to produce devices and structures with improved performance characteristics or special functional attributes, or to activate, speed up, or otherwise alter chemical, biochemical, or medical processes,			
d. <input type="checkbox"/> Engineering, production, biotechnology and defense technologies that involve knowledge-based control systems and architectures; advanced fabrication and design processes, equipment and tools; or propulsion, navigation, guidance, nautical, aeronautical and astronautical ground and airborne systems, instruments and equipment, or			
e. <input type="checkbox"/> Electronic and photonic devices and components for use in producing electronic, optoelectronic, mechanical equipment and products of electronic distribution with interactive media content.			
5. <input type="checkbox"/> Does not derive 51% or more of its gross revenue from the operation in DC of an online or brick and mortar retail store or an electronic equipment facility as defined in DC Code §47-1817.01 (5)(B)(i)II; or is a building or construction company or professional athletic team.			
6. <input type="checkbox"/> Is not located in the DC Ballpark TIF Area as defined in DC Code §2-1217.12; and			
7. <input type="checkbox"/> Is appropriately registered as a business in DC. (Visit MyTax.DC.gov)			
8. <input type="checkbox"/> Enter description of the principal business activity <input style="width: 150px;" type="text"/>			
Under penalty of law, I declare that I have examined this certificate and, to the best of my knowledge, it is correct.			
Signature of Owner or Officer		Company Name	
_____		_____	
_____		Date	
Company Address		Telephone Number	
_____		_____	
Fax Number		e-mail address	
_____		_____	

Appendix

QHTC Appendix 7: Summary of Key Evaluation Criteria as applied to QHTC program

The following characteristics of good incentive programs from Murray and Bruce’s 2017 evaluation of selected tax incentives in Alabama was filled out for the QHTC program.²²⁷

EFFICIENT	A good incentive will provide a well-defined <i>return on investment</i> to the state [jurisdiction].
	The QHTC is not an efficient credit given that there is no concrete way to calculate the return on investment to the District, much less the full fiscal costs of tax benefits going to the companies. The QHTC law is non-targeted and written in such a way that it could be a windfall to companies that happened to be in D.C. before it was enacted.
TRANSPARENT	Incentives should be <i>transparent</i> so that benefits to taxpayers and costs to the state are clear.
	Benefits to the taxpayer are clear for franchise taxes; however, the full costs to the District are not transparent. The full extent of revenue loss occurring through the sales tax and property tax provisions of the law program remain unknown. The data on franchise tax credits are not comprehensive, as many firms do not fill out all fields about employees hired, etc. Data are not collected with a focus on tracking the tax expenditures overall, so revenue foregone calculations are often estimations, rather than using actual claims reported. IT modernization efforts currently underway will change the way all QHTC-related tax data are collected and reported, significantly improving transparency and accountability. Confidentiality requirement preclude disclosure of companies receiving the credits and amounts received.
CERTAIN	Policy <i>certainty</i> is important in terms of the magnitude and timing of tax relief for business taxpayers and the realization of tax losses that impact the state budget.
	The QHTC program scores well in this category, though various changes along the way may have affected businesses’ planning around the tax credit.
PROSPECTIVE	The state should avoid <i>retroactive policy changes</i> that may penalize firms for previous investment decisions.
	The QHTC program has not seen any retroactive policy changes that would penalize firms, rather the changes made have generally broadened the credit’s applicability.
SIMPLE	Incentives should be <i>easy to administer and easy to comply with</i>.

²²⁷ Murray, Matthew N, and Bruce, Donald J. “Evaluation of Alabama’s CAPCO Credit and Historic Rehabilitation Tax Credit.” 2017. Prepared for the Alabama Department of Revenue. P. 5. Retrieved on April 23, 2018 from: https://revenue.alabama.gov/wp-content/uploads/2017/05/TaxIncentives_CAPCO_201701.pdf.

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	<p>The QHTC program is not simple for the District to administer, by most standards. The changes over the years have made provisions more confusing and complex. Data are not collected in a way to facilitate keeping track of the credits and evaluating the program’s full scope of benefits to firms (or foregone revenues to the District).</p> <p>The QHTC program is simple for taxpayers to comply with, given that they can self-certify their eligibility.</p>
TARGETED	Incentives should be <i>targeted</i> and provided on a <i>discretionary</i> basis to promote economic activity that might not otherwise take place.
	<p>The QHTC incentives are not targeted. They were more geographically targeted in the original legislation, and changes over time have broadened the geographic scope as well as the definitional scope of companies that may apply. The program is available for any company that is eligible to be a QHTC, therefore the District does not require new economic activity from companies receiving the credits. The original legislation stipulated that it can be used for companies that were already located in the city; therefore, it is a windfall to any existing high technology company. It is impossible to know if any firms may have moved out of the city had it not been for the QHTC credits.</p>
PROTECT PUBLIC FUNDS	<i>Fiscal exposure to the state should be minimized through such constraints as annual financial caps or time limits on the use of credits.</i>
	<p>There is a cap on the franchise tax exemption (and various credits in a given year) however; a reduced tax rate may go on in perpetuity. There are no caps on sales tax exemptions, while the personal property tax exemption is limited to 10 years and real property tax abatement is limited to five years. No overall caps of total program cost, or total credits a single firm may receive, or time limits.</p>
LEVERAGE	Some incentives produce a <i>leveraging</i> effect, drawing in additional resources from local government resources, private sector resources, or federal resources.
ACCOUNTABILITY	<i>Performance-based incentives should be built into the program.</i>
	<p>The bulk of QHTC benefits are awarded simply because a company is eligible to be a QHTC and the performance-based incentives in the program are not widely used.</p>
EVALUATION	Incentives should include a built-in framework for evaluation, which should seek to identify the extent to which incentives induced new economic activity rather than rewarding existing economic activity.

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	<p>There is not a clear framework for evaluation built into the program. An evaluation requirement was in the original legislation as proposed but was later removed before the bill became a law. No agency is directly tasked with administering, monitoring, or tracking the incentives outside of the requirement for this current report, which is the first review.</p>
OWNERSHIP	<p>A state agency or agency partnership must own the incentive program to ensure proper administration and to conduct or support a thorough program evaluation.</p>
	<p>No agency owns the incentive program. By way of collecting the taxes administered by the Office of Tax and Revenue (OTR) within the Office of the Chief Financial Officer (OCFO), OTR has gathered the data that we currently have on QHTCs. Further, the ORA, also within the OCFO, by nature of conducting the current tax expenditure review, now administers the evaluation component.</p>

Appendix

Supermarket Appendix 1: Supermarkets Receiving Real Property Tax Exemption

	Address	Ward	Exemption Start Date	Exemption End Date	Exempted Taxes, 2010-17 \$
ALDI	901 17th Street NE	5	8/2/2013	6/30/2021	616,624
COSTCO	2441 Market Street, NE	5	11/16/2012	11/15/2022	1,891,442
GIANT	1050 Brentwood Rd NE	5	10/1/2002	9/1/2012	522,602
GIANT	1345 Park Road NW	1	10/1/2012	9/30/2014	311,242
GIANT	1535 Alabama Avenue SE	8	12/7/2007	9/30/2017	827,981
GIANT	300 H St NE	6	4/1/2013	9/30/2022	716,341
GIANT	1400 7th St NW	6	10/1/2013	9/30/2023	885,066
HARRIS TEETER	1350 Potomac Avenue SE	6	10/1/2007	9/30/2017	2,739,026
HARRIS TEETER	1631 Kalorama Road NW	1	10/1/2007	9/30/2017	2,018,857
HARRIS TEETER	1201 1st Street NE	6	3/24/2011	9/30/2020	2,052,885
HARRIS TEETER	401M St SE	6	10/1/2014	9/30/2024	932,774
SAFEWAY	415 Rhode Island Ave NE	6	5/15/2009	3/6/2010	n/a
SAFEWAY	1701 Corcoran St NW	2	5/15/2009	9/30/2015	365,745
SAFEWAY	415 14th Street SE	6	5/15/2009	9/30/2015	1,520,615
SAFEWAY	6500 Piney Branch Rd NW	4	5/15/2009	9/30/2015	1,016,016
SAFEWAY	490 L Street NW	6	5/15/2009	9/30/2017	2,224,134
SAFEWAY	1747 Columbia Rd NW	1	10/1/2009	9/30/2019	872,820
SAFEWAY	3830 Georgia Avenue NW	4	10/1/2013	9/30/2023	796,649
YES ORGANIC¹	2323 Pennsylvania Ave SE	7	2/16/2010	3/31/2014	102,114
YES ORGANIC	3809 12th Street NE	5	10/1/2006	9/30/2016	104,139
YES ORGANIC	2123 14th Street NW	1	10/1/2008	9/30/2018	319,019
YES ORGANIC	4100 Georgia Ave NW	4	1/1/2009	9/30/2018	163,641

Source: ORA Analysis. Note: Does not include data on exemptions before 2010; \$131,302 that was recorded as one payment to multiple Yes Organic locations in 2012; or \$3,938,112 approved for a future supermarket in Ward 5.

¹ This supermarket closed in 2014.

Appendix

Supermarket Appendix 2: Healthy Food Program

Farmers markets and joyful markets located in food deserts--particularly in Wards 7 and 8--provide low income families more access to healthy fruits and vegetables. The Joyful market is a program organized by Martha's Table and Capital Area Food Bank since 2015 to reduce hunger and increase access to the consumption of fresh fruits and vegetables in Wards 7 and 8, east of the Anacostia River. These markets are held once a month in 29 elementary schools in Wards 7 and 8 and are opened to the families of students enrolled in the schools. Tables in the school gym or cafeteria are filled with baskets of fresh produce, and piled high with healthy non-perishable food, while shoppers move from table to table choosing fruits and vegetables, whole grains, lean protein and beans filling their grocery bags with up to 23 pounds of food (the equivalent of 18 meals) allowed per enrolled child, with a minimum of 40 percent fresh produce.

Through grants under the Healthy Food Retail Program of the FEED-DC Act offered by the Department of Small and Local Business Development (DSLBD), more farmers markets have been able to operate thereby increasing low income families' access to healthy foods in in Wards 7 and 8. However, farmers markets have generally been unable to take advantage of the Healthy Food Retail Program available through the FEED-DC Act of 2010. Much of the problem stems from the fact that the grant request timeline from DSLBD does not match the farmer's market season. That is, the timeline of most farmers market operating in the District is from April to November while DSLBD grant program follows the District Governments' Fiscal Year calendar which is from October through September.²²⁸ Farmers market organizations that apply and qualify for the grant are only able to benefit from the program from January through June which leaves a large chunk of their season where farmers market organizations are unable to ask for help needed through the grant program due to the calendar limitation. The grant timeline includes the time the grant application is made available by DSLBD through the time when the grant is awarded to a farmer's market organization.

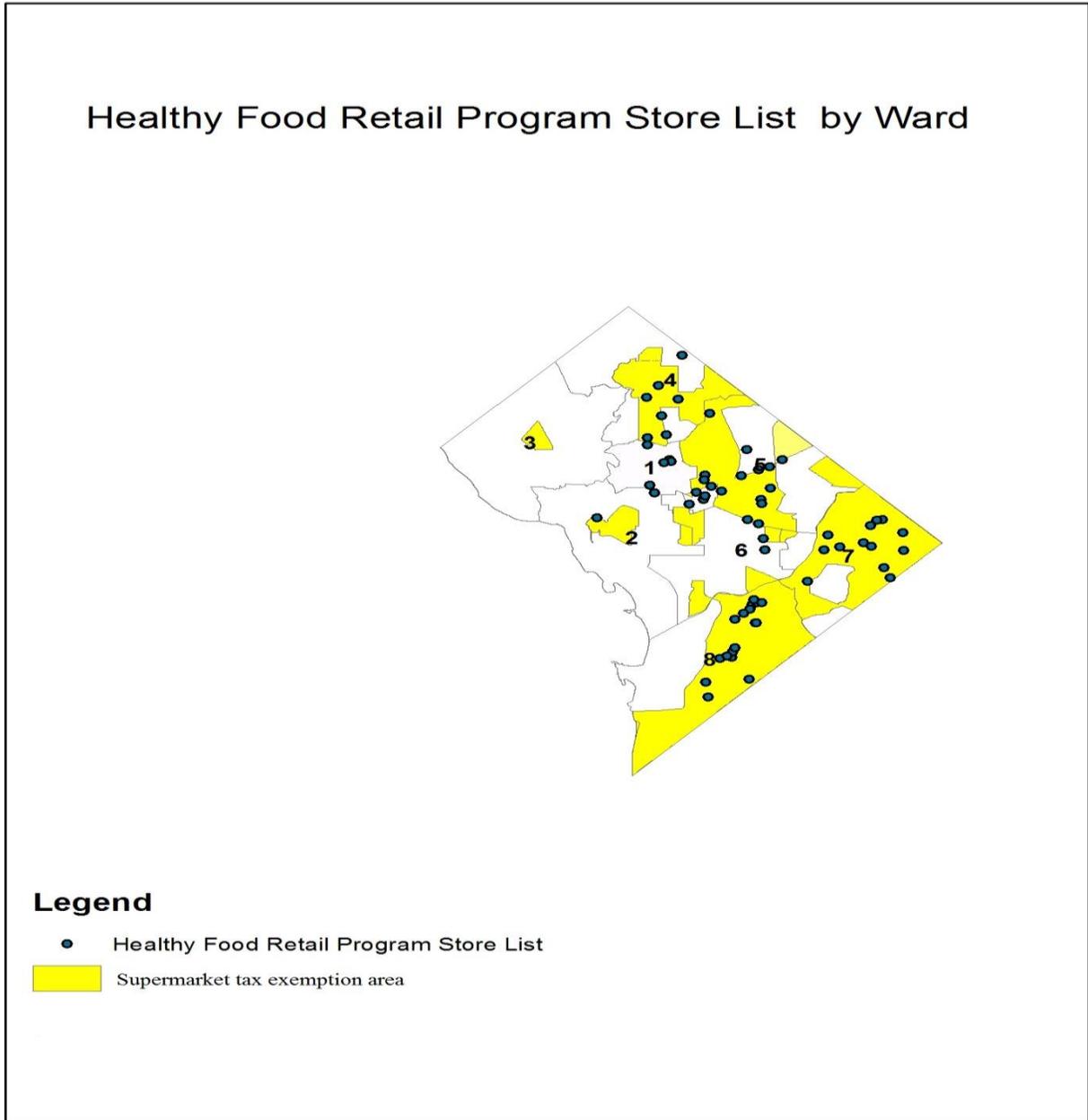
Furthermore, some farmers market organizations are unable to take advantage of the grant program through DSLBD because they are unaware or uneducated about the details of the FEED-DC Act. However, since 2011, about 64 stores have benefitted either directly or indirectly from the FEED-DC Act. Only one store has received a direct grant from the Healthy Food Retail Program, but there were 63 additional stores have benefitted from the fresh produce delivery service operated by the D.C. Central Kitchen which DLSBD subsidized. In spot checks conducted after grants ended, it appears that most of the participants continue to purchase fresh produce from D.C. Central Kitchen. Before the FEED-DC Act, DSLBD awarded grants to nonprofit organizations which provided counseling to 14 stores. These stores also received storefront improvements from the nonprofit organization. Three of these stores participated in the later program. A total of 75 stores have participated in all versions of the Healthy Food Retail Program, before or after the FEED-

²²⁸ Interview with Lillie Rosen, Deputy Director, DC Greens. <http://dcreens.org/>

Appendix

DC Act was enacted and are mostly located within the eligible areas of the supermarket tax incentives as shown below in Supermarkets Appendix 2a.

Supermarkets Appendix 2a: Map of Stores in the DSLB Healthy Food Retail Program



As shown in Supermarket Appendix 2b below, the Department of Small and Local Business Development (DSLBD) have awarded \$846,600 in grants to farmers markets, non-profit organizations, and colleges to either expand a facility, subsidize operations and food purchases, or support cottage food vendors and farmers markets since the FEED-DC Act of 2010. Since the

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FEED-DC Act, the percentage of new stores aided by the Healthy Food Retail Program grant is 1.3 percent while the other 98.7 percent were existing stores.

Supermarket Appendix 2b: Grants Awarded by DSLBD by Fiscal Year

Fiscal Year	Healthy Food Retail Program Grant
2011	\$246,000
2014	\$250,000
2015	\$170,000
2016	\$91,600
2017	\$89,000

Appendix

CAPCO Appendix 1: List of D.C. CAPCO Investment Companies

Company	Mission	CAPCO Investor
D.C. Biodiesel	Alternative Energy	Advantage
Finance Flows	Business Research	Advantage
GridPoint	Energy Management Software	Advantage
AgencyQ	Digital Marketing and Web Design	Advantage
BizConnect	Marketing Consulting Service	Advantage
Greenlight AC	Alternative Energy	Advantage
NuAmerica Bank	Bank	Advantage
A.V. Smoot	Contractor	Advantage, Enhanced
Affinity Lab	Executive Suites	Advantage, Enhanced
ARC Solutions	Information Technology	Advantage, Enhanced
Content Now	Online Retail	Advantage, Enhanced
EnviRelation	Green Recycling/Composter	Advantage, Enhanced
Inside Higher Ed	Online News Service	Advantage, Enhanced
Truist	Support Services for Non-Profits	Advantage, Enhanced
CreateHope	Software company	Advantage, Enhanced
D.H Lloyd & Associates	Insurance Brokerage	Enhanced
Jair Lynch Companies	Developer	Enhanced
Okie Dokie	Restaurant & Lounge	Enhanced
Park Place	Restaurant & Lounge	Enhanced
Prof. Management Consulting Services	Information Technology	Enhanced
RepEquity	Search Engine Optimization	Enhanced
Session Title Service	Title Services	Enhanced
Taurus Renovation and Construction	Construction	Enhanced
Virilion	Interactive Agency	Enhanced
Wine & Spirits Expo	Upscale Wine & Spirits Retailer	Enhanced
Brasil, Inc.	Restaurant & Lounge	Wilshire
Community Financial Services	Financial Services	Wilshire
Home Slice	Mobile Food Kiosks	Wilshire
Members Only Software, LLC	Software development, sales & service	Wilshire
Mumin Productions	Theater Productions	Wilshire
New Economic Development, LLC	Limited Service Restaurant	Wilshire
Newtek Insurance Agency	Insurance Brokerage	Wilshire
Rumba Tivoli	Restaurant	Wilshire
The Mansion on O Street	Hotel, Restaurant & Lounge	Wilshire
PTK Inc	24-hrs Mini Mart	Wilshire
Le Caprice	Café	Wilshire

Source: DC CAPCO Investments Made To-Date. Retrieved from http://dccapco.com/made_to_date_investments.html