

THE DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT

HEARING
BEFORE THE
SUBCOMMITTEE ON THE
DISTRICT OF COLUMBIA
OF THE
COMMITTEE ON GOVERNMENT
REFORM AND OVERSIGHT
HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTH CONGRESS
SECOND SESSION

—————
JULY 31, 1996
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THE DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT

WEDNESDAY, JULY 31, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Thomas M. Davis (chairman of the subcommittee) presiding.

Present: Representatives Davis, Gutknecht, McHugh, LaTourette, Flanagan, Norton, and Collins.

Ex officio present: Representative Clinger.

Also present: Representatives Morella, Moran, Wynn.

Staff present: Ron Hamm, staff director; Howard Denis, counsel; Roland Gunn, professional staff member; Ellen Brown, clerk; and Cedric Hendricks, minority professional staff member.

Mr. DAVIS. Good morning. Welcome to this informational hearing on H.R. 3244, the District of Columbia Economic Recovery Act, sponsored by the ranking member of this subcommittee, Delegate Eleanor Holmes Norton.

As we begin to approach sine die adjournment of the 104th Congress, I strongly believe that this subcommittee can take pride in its accomplishments to date. Together we have worked in a collegial atmosphere, avoiding partisan bickering, and have succeeded in making great progress toward our common objectives.

While we cannot be blind to the fact that we still have a long way to go before decisive changes will be more apparent in the District of Columbia, we're on the right track.

As I said last week at our hearing on the District's renewed ability to borrow in the private market, we are not at the beginning of the end, but rather at the end of the beginning.

The District of Columbia did not get into its present condition overnight, and it will not recover overnight. Feel-good, expensive, untested quick fixes should be avoided lest they raise unrealistic expectations and make it even more difficult for the next Congress to deal with the consequences.

The financial and budget crisis in the District was caused by poor management and failure of its local government to face reality and make hard choices when the real estate boom collapsed in 1989.

Prior to this Congress, the response of the Federal Government was essentially to enable poor performance with more money. As

I've said before, and I'll say it again, the District's problems did not result from lack of resources but from lack of accountability.

When the GAO testified under oath to this subcommittee last year that the District was insolvent, it was clear that Congress had to act and to do things differently. There was thus no real alternative to the landmark legislation we passed establishing the Control Board.

With patience and perseverance, the Control Board is working. The city's recent return to the private markets for a \$220 million loan is ample evidence that what this Congress did is finally producing more credible numbers and better performance.

I am grateful to Delegate Norton for her many significant contributions to the subcommittee. We're here today as a courtesy to her and to Speaker Gingrich to hold an informational hearing on H.R. 3244, the District of Columbia Economic Recovery Act.

As this bill seeks to amend the Internal Revenue Code, it has been referred to the House Ways and Means Committee chaired by my good friend, Bill Archer. But because of the great interest in flat tax proposals generally and in the application of this bill to the District of Columbia, I felt it was entirely appropriate for us to air out the issue in a public forum.

The basic rules indicate that there is no free ride. Greater fairness and simplification is possible, but require careful step-by-step examination.

I have a much lengthier statement, and I would ask unanimous consent that it be inserted in the record.

[The prepared statement of Hon. Thomas M. Davis follows:]

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MINORITY—(202) 225-6061

OPENING STATEMENT

TOM DAVIS, CHAIRMAN
DISTRICT OF COLUMBIA SUBCOMMITTEE

JULY 31, 1996

As we begin to approach *sine die* adjournment of the 104th Congress I strongly believe that this Subcommittee can take great pride in its accomplishments. Together we have worked in a collegial atmosphere, avoiding partisan bickering, and have succeeded in making great progress towards our common objectives. While we can not be blind to the fact that we still have a long way to go before decisive changes will be more apparent in the District of Columbia, we are on the right track. As I said last week at our hearing on the District's renewed ability to borrow in the private market, we are not at the beginning of the end but rather at the end of the beginning.

The District of Columbia did not get into its present condition overnight, and it will not recover overnight. Feel-good, expensive, untested quick-fixes should be avoided lest they raise unrealistic expectations and make it even more difficult for the next Congress to deal with the consequences.

The financial and budget crisis in the District of Columbia was caused by poor management and the failure of its local government to face reality and make hard choices when the real estate boom collapsed in 1989. Prior to this Congress, the response of the Federal Government was essentially to enable poor performance with more money. I have said it before, and I will say it again and again--the District's problems did not result from a lack of resources but from a lack of accountability.

When the General Accounting Office testified under oath to this Subcommittee last year that the District was "insolvent", it was clear that Congress had to act and had to do things differently. There was thus no real alternative to the landmark legislation we passed establishing the Control Board.

With patience and perseverance the Control Board is working. The City's recent return to the private markets for a \$220 million loan is ample evidence that what this Congress did is finally producing more credible numbers and better performance.

I am grateful to Delegate Eleanor Holmes Norton for her many significant contributions to the Subcommittee. We are here today as a courtesy to her and Speaker Newt Gingrich to hold an information hearing on H.R. 3244, the District of Columbia Economic Recovery Act. As this bill seeks to amend the Internal Revenue Code it has been referred in its entirety to the House Ways and Means Committee chaired by my good friend Bill Archer. But because of the great interest in flat tax proposals generally and in the application of this bill to the District of Columbia, I felt it was

entirely appropriate for us to air out the issue in a public forum.

The basic rules of tax reform indicate that there is no free ride. Greater fairness and simplification is possible, but require careful step by step examination. Federal income taxes represent about one-half of all federal taxes and one-third of all federal, state and local taxes--not counting the many fees and premiums charged by government. Federal, state, and local expenditures are currently 34% of the Gross Domestic Product, and are currently scheduled to rise to over 40% under current law. That is why most flat tax proposals, such as the one contained in H.R. 3244, are not entirely flat, but have elements of progressiveness.

We all know that the District of Columbia, along with many other big cities, has been losing population at an alarming rate. The 1960 Census reported that the number of inhabitants in the District was 763,956. According to the latest Census estimate, the City's population as of July, 1995 was 554,256. The exodus during the first half of the 90's equals the entire population loss for the 80's. Middle-income flight accounts for the greatest concentration of those leaving. At the same time the population in the suburbs surrounding Washington has been growing. In 1960 there were 275,002 people in Fairfax County. By the 1990 Census that number had grown to 818,584. Similar growth patterns can be seen for the other subdivisions in Northern Virginia and Suburban Maryland.

But there is great uncertainty as to what the major reasons are for moving out of the District, or for moving per se. It would appear that concerns about personal safety, public education, and other basic services are significant factors in addition to total tax burden. The wealthy can insulate

themselves with security, private education, and other amenities. Others can not.

It should be well understood that this bill does not directly translate into more money for the District government. The District would benefit from any increase in disposable income produced by the bill to the same extent that local and state governments would benefit elsewhere. To what extent this would result in less taxable and disposable income in surrounding or other states is one of the unanswered questions. As such a change to the Federal tax code has never been previously attempted, perhaps because of the Uniformity Clause of the United States Constitution, there is no econometric model that would presently provide adequate data. Concerns have also been raised about the overall net growth of economic activity in the region, as opposed to the potential of merely shifting it from one jurisdiction to another.

The progressive flat tax in the bill would only apply to District residents who work in the metropolitan area. Would this be a magnet for the highest income taxpayers to move into the District, depriving their states, counties, and the federal treasury of revenue? That is also unclear.

The bill is silent on property tax assessments and local taxes in the District. There is likewise no reference to changes in local business regulations or policies. We therefore need more information about how the bill would help to solve the District's budget, managerial, and programmatic problems. For example, how would this bill help the District fix its streets, schools, buildings, and prisons? These are legitimate concerns.

It is unclear how long this legislation would have to be in effect in order for its hoped-for substantial impact to be realized. The bill has been described as an experiment. If so, how long would the experiment continue before being evaluated, what are the criteria for evaluation, and would tax reform for all others be put on hold as we await the result? We are seeking more information on these issues.

I commend the advocates of this bill for their interest in being willing to invest substantial funds in the District of Columbia. But the ultimate issue for the Subcommittee to evaluate is whether or not this bill is the best way to spend precious and limited resources for the District of Columbia.

Mr. DAVIS. I notice one of our witnesses is here. We have a vote on the floor, and we want to move as quickly as we can, so I'm going to now yield to our ranking member, Delegate Norton, for any statements she wishes to make.

Ms. NORTON. I want to thank Chairman Tom Davis for his courage and cooperation in calling this hearing. For the people I represent, this is a historic day. No bill will pass today. In over 200 years of our existence, however, the Congress has never taken any step toward reconciling our maximum financial obligations with our minimal citizenship rights and shrinking financial capabilities. We take this step today in no small part because we must.

The days of the District as a stand-alone, self-sufficient orphan are over. As best I can tell, the District's extraordinary self-sufficiency lasted so long only because taxpayers remained so long.

These local D.C. taxpayers tolerated steep local taxes that were necessary to pay State, county, and municipal costs without help from a State. Now those days, too, are over. Fleeing the beautiful city they still love, they take with them the city's only reliable means of support.

Thus America faces a true constitutional conundrum. Most Americans, including most Members of Congress and other officials, are simply unaware of exactly what is different about the District except for its status as the Nation's capital.

They see Washington, DC, as another big city, like those in their own States. Even the best and brightest among them are genuinely surprised to learn of the unique features that set the District apart and are taking the District down.

Even the most unfortunate of cities share none of the District's built-in disabilities—no State to recycle income from wealthier areas or fleeing taxpayers, no exception granted from State responsibilities, no commuter tax allowed by mandate of the Congress, no full self-government or representation in the Congress of the United States. God bless America.

The only wonder is that the Capital of the United States lasted in its present form with these disabilities for so long. It will not last much longer. Even with a congressionally mandated financial authority or Control Board in place, the city is going down on our watch. The financial authority is helping to fix the city's government. It has no power to fix its economy.

The sine qua non of that economy, a tax base, is disappearing fast. Between 1990 and 1995, 46,000 Washingtonians left, compared with 33,432 for the entire 1980's—or significantly more in half a decade than left during the entire 1980's.

This is probably the last chance to do anything about it. There is no precedent for rebuilding a tax base once it has been completely depleted. There is plenty of experience that shows it can't be done.

We have three choices. One, we can try to impose a commuter tax from suburban residents who use city services but carry two-thirds of the income to the surrounding counties without leaving any revenue here to help pay for the services they use. To make up even partially for the erosion of the city's tax base, this commuter tax would have to have a feature allowing it to rise automatically.

Two, the Congress can increase the Federal payment or provide another subsidy that increases annually to make up for the loss of taxpayers.

Three, the Congress can forgive a portion of Federal income taxes to encourage residents to remain and revive the city the old-fashioned way—by living in the District, paying local taxes, and spending their disposable income in the city. Of the three remedies, only this one has any precedent.

The Tax Code is replete with tax breaks, most to individuals and entities far better off than the District. Moreover, the four territories that, like the District, have one nonvoting delegate in Congress, pay no Federal income taxes.

This feature apparently was meant to keep faith with the founding principle of no taxation without representation. In denying that principle here, we have risked the city itself.

The bill before us, of course, does not apply that principle. A substantial amount of Federal income taxes would still be paid by District residents. They would, however, no longer be second per capita in Federal income taxes.

These alternatives leave out two options that I believe will be necessary no matter what we do—financial help with State function such as Medicaid and State prison responsibilities, and funding the pension liability that Congress alone built up when it ran the District before home rule. These huge structural problems, far more than our dysfunctional government, took the District into insolvency.

Necessary as these problems are to face if the city is to return to solvency, even meeting these Federal obligations cannot substitute for taxpayers. Taxpayers guarantee that, as costs rise, there will be the increased revenue to pay those costs.

Because salaries and property values increase, local tax collections increase without raising taxes. No subsidy has such a natural escalator. The District's Federal payment, for example, has been increased only once in 10 years.

I did not develop the District of Columbia Economic Recovery Act until I was left without any other alternative. As a genuine plea for help, I have challenged any and all to suggest other ideas that would do the job. I have heard only the sound of silence.

The DCERA has already had an extraordinary confidence-restoring effect in this city. It has united blacks, whites, and Hispanics, and struggling and well-to-do people. Anyone who goes into the District's neighborhood will tell you, from ward 1 through ward 8, the enthusiasm and the chorus is the same—do it and we will stay.

I believe that my bill, with its large exemptions, takes half of the taxpayers off the Federal income tax rolls because so many of our remaining residents have low incomes. A huge and increasing number are unemployed and on welfare.

Those who need the break most to meet the District's high local taxes and cost of living would get nearly an 80-percent reduction in tax liability. The more a taxpayer earns, the less the tax break, breaking at about a one-third cut at the upper end.

The tax break must be proportionately large for every income group if it is to be an effective incentive, given urban conditions and the District's multiple problems. The bill is targeted progres-

sively toward taxpayers in every income group because taxpayers in every income group are abandoning the city.

The DCERA significantly increases the present progressivity of the Federal tax burden in the District. The Federal tax burden on the 5.1 percent of District residents who earn more than \$100,000 shifts from 51 percent of the burden to 60 percent of the burden. Mortgages and charitable deductions remain to encourage stable taxpaying residents that it will take to rebuild the city's schools and solidify the neighborhoods.

The DCERA and local law will also contain many features to correct unintended consequences. For example, the D.C. City Council, in response to my introduction of the DCERA, has already enacted a bill that freezes income property and sales taxes for 5 years.

My bill also contains the seeds for a new tax-based urban policy. However, it must be modeled somewhere first, and there is no better place to begin than the Nation's Capital.

Urban policy based on Federal funding has been dead for almost 10 years. Elements of the DCERA should be carefully studied when operative to identify features that might be used elsewhere. I would also encourage States to offer a break in State taxes to encourage residents to remain in cities.

America does not know the handicaps under which the Capital is forced to operate. If Americans knew, they would help. They would not want the capital of the United States left without a taxpaying population and without a reliable revenue stream, a withered mockery of a city, a capital unfit for a great Nation.

To the Congress and the White House, I bring word from the street. You can run, but you cannot hide. The Constitution of the United States places on us—not the residents of the District, not even the District government—the responsibility to keep a capital city up and running with people living there.

The District is going down, not up. It has not yet hit bottom. That will come when the taxpaying base is not just dangerously down, as it is now, but is gone, as it will be soon if we do not act soon. You can have that blemish on your record if you like. They will never report, however, that I kept it to myself and did not offer a remedy.

The time for denial and playing around at the margins is past. A bipartisan solution must be found before it is too late. This hearing begins the search. If we do not underestimate the task, we will not fail to reach the shining shore. Thank you, Mr. Chairman.

[The prepared statement of Hon. Eleanor Holmes Norton follows:]

ELEANOR HOLMES NORTON
DISTRICT OF COLUMBIA

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RANKING MINORITY MEMBER,
DISTRICT OF COLUMBIA

OPENING STATEMENT OF CONGRESSWOMAN ELEANOR HOLMES NORTON

**D.C. SUBCOMMITTEE HEARING ON H.R. 3244,
THE DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT OF 1996**

July 31, 1996

I want to thank Chairman Tom Davis for his courage and cooperation in calling this hearing. For the people I represent, this is an historic day. No bill will pass today. In over 194 years of our existence, however, the Congress has never before taken any step toward reconciling our maximum financial obligations with our minimal citizenship rights and shrinking financial capabilities. We take this step today in no small part because we must.

The days of the District as a stand alone, self-sufficient orphan are over. As best I can tell, the District's extraordinary self-sufficiency lasted so long only because taxpayers remained so long. These local D.C. taxpayers tolerated the steep local taxes that were necessary to pay state, county and municipal costs without help from a state. Now those days too are over. Fleeing the beautiful city many still love, they take with them the city's only reliable means of support.

Thus America faces a true constitutional conundrum. Most Americans, including most members of Congress and other officials, are simply unaware of exactly what is different about the District, except for its status as the nation's capital. They see Washington, D.C. as another big city, like those in their own states. Even the best and brightest among them are genuinely surprised to learn of the unique features that set the District apart and are taking the District down. Even the most unfortunate of cities share none of the District's built-in disabilities: no state to recycle income from wealthier areas or from fleeing taxpayers; no exception granted from state responsibilities and costs; no commuter tax allowed by mandate of the Congress; no full self-government or representation in the Congress of the United States, God bless America.

The only wonder is that the capital of the United States lasted in its present form with these disabilities for so long. It will not last much longer. Even with a congressionally mandated Financial Authority or control board in place, the city is going down on our watch. The Financial Authority is helping the city to fix its government. It has no power to fix the city's economy. The sine qua non of that economy, a tax base, is disappearing fast. Between 1990 and 1995, 46,000 Washingtonians left, compared with 33,432 for the entire 1980s -- or, significantly more in half a decade than left during the entire 1980s. This is probably the last chance to do

815 15TH STREET, N.W., SUITE 100
WASHINGTON, D.C. 20005-2201
(202) 785-6486
(202) 783-8211 (FAX)

1424 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515-5101
(202) 225-4070
(202) 225-3022 (FAX)
(202) 225-7829 (TDD)

2041 MARTIN L. KING AVENUE, S.E.
SUITE 300
WASHINGTON, D.C. 20020-6734
(202) 678-8900
(202) 678-8944 (FAX)

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anything about it. There is no precedent for rebuilding a tax base once it has been completely depleted. There is plenty of experience that shows it can't be done.

We have three choices. One: we can try to impose a commuter tax from suburban residents who use city services but carry two-thirds of the income to the surrounding counties without leaving any revenue here to help pay for the services they use. To make up even partially for the erosion in the District's tax base, such a commuter tax would have to have a feature allowing it to rise automatically.

Two: the Congress can increase the federal payment or provide another subsidy that increases annually to make up for the loss of taxpayers.

Three: the Congress can forgive a portion of federal income taxes to encourage residents to remain and revive the city the old-fashioned way -- by living in the District, paying local taxes and spending their disposable income in the city. Of the three remedies, only this one has any precedent. The tax code is replete with tax breaks, most to individuals and entities far better off than the District. Moreover, the four territories, that like the District have one non-voting delegate in Congress, pay no federal income taxes. This feature apparently was meant to keep faith with the founding principle of no taxation without representation. In denying that principle here, we have risked the city itself. The bill before us, of course, does not apply that principle. A substantial amount of federal income taxes would still be paid by District residents. They would, however, no longer be second per capita in federal income taxes.

These alternatives leave out two options that I believe will prove necessary no matter what we do: financial help with state functions such as Medicaid and state prison responsibilities, and funding the pension liability that Congress alone built up when it ran the District before home rule. These huge structural problems, far more than a dysfunctional government, took the District into insolvency. Necessary as facing these problems is if the city is to return to solvency, even meeting these federal obligations cannot substitute for taxpayers. Taxpayers guarantee that as costs rise, there will be the increased revenue to pay those costs. Because salaries and property values increase, local tax collections increase even without raising taxes. No subsidy has such a natural escalator. The District's federal payment, for example, has been increased only once in more than 10 years.

I did not develop the District of Columbia Economic Recovery Act until I was left without any other alternative. As a genuine plea for help, I have challenged any and all to suggest other ideas that would do the job. I have heard only the sound of silence.

The DCERA has already had an extraordinary confidence restoring effect in the city. It has united blacks, whites, and Hispanics, and struggling and well-to-do people. Anyone who goes into the District's neighborhoods will tell you, from Ward 1 to Ward 8, the enthusiasm and the chorus is the same: do it and we'll stay.

I believe that my bill, with its large exemptions, takes half of the taxpayers off the federal income tax rolls because so many of our remaining residents have low incomes. A huge and increasing number are unemployed or on welfare. Those who need the break most to meet the District's high local taxes and cost of living would get nearly an 80% reduction in the tax liability. The more a taxpayer earns, the less the tax break -- breaking at about a one-third break at the upper end. The tax break must be proportionately large for every income group if it is to be an effective incentive, given urban conditions and the District's multiple problems. The bill is targeted progressively toward taxpayers in every income group because taxpayers in every income group are abandoning the city. The DCERA significantly increases the present progressivity of the federal tax burden in the District. The federal burden on the 5.1% of District residents who earn more than \$100,000 shifts from 51% of the burden to 60%. Mortgages and charitable deductions remain to encourage the stable taxpaying residents it will take to rebuild the schools and solidify the neighborhoods. The DCERA and local law will also contain many features to correct unintended consequences. For example, the D.C. City Council, in response to my introduction of the DCERA, has already enacted a bill which freezes income, property, and sales taxes for five years.

My bill also contains the seeds for a new tax-based urban policy. However, it must be modeled somewhere first, and there is no better place to begin than in the nation's capital. Urban policy based on federal funding has been dead for almost 20 years. Elements of the DCERA should be carefully studied when operative to identify features that might be used elsewhere. I would also encourage states to offer a break in state taxes to encourage residents to remain in cities.

America does not know the handicaps under which the capital is forced to operate. If Americans knew, they would help. They would not want the capital of the United States left without a taxpaying population and without a reliable revenue stream, a withered mockery of a city, a capital unfit for a great nation.

To the Congress and the White House, I bring word from the streets. You can run, but you can not hide. The Constitution of the United States places on us, not the residents of the District, and not even the District government, the responsibility to keep a capital city up and running. The District is going down, not up. It has not yet hit bottom. That will come when the taxpaying base is not just dangerously down, as it is now, but is gone, as it will be if we do not act soon. You can have that blemish on your record if you like. They will never report, however, that I kept it to myself and did not offer a remedy.

The time for denial or playing around at the margins is past. A bipartisan solution must be found before it is too late. This hearing begins the search. If we do not underestimate the task, we will not fail to reach the shining shore.

Mr. DAVIS. Thank you, Ms. Norton.

I see the Speaker is not here yet. However Senator Lieberman is here. Since we have a vote going on now and we have about 4 minutes left, I'm going to recess the meeting. As soon as a Member comes back, we will hear from you immediately.

Senator LIEBERMAN. Mr. Chairman, I have a vote, too, so I'm going to take those 4 minutes to go over.

Mr. DAVIS. All right. Why don't we come back. Senator, thank you very much. We appreciate your being here.

Senator LIEBERMAN. It's a pleasure being here.

Mr. DAVIS. The meeting will be in recess.

[Recess.]

Mr. DAVIS. The meeting will come back to order. Let me now yield to any other opening statements Members may wish to make on this issue. Are there any opening statements?

[No response.]

Mr. DAVIS. We're happy to have the chairman of the full committee here today, Representative William Clinger from Pennsylvania. Mr. Clinger, any comments?

Mr. CLINGER. Just, Mr. Chairman, I want to commend you for holding this hearing and Congresswoman Norton for crafting this legislation. I think this is clearly an issue that needs to be explored by this committee.

We recognize we don't have jurisdiction over enacting it into law, but, clearly, this committee and your subcommittee have the greatest expertise in this whole area and certainly are aware—more than aware—of the critical problems facing the District and the need to find some creative and productive solutions to this very serious problem. So I am delighted to be here to hear the witnesses and to get further educated on this very, very serious problem that we face.

Mr. DAVIS. Well, we'll now proceed. Senator Lieberman will be returning, and we will try to accommodate him and the Speaker when they come in. But, meantime, I'm ready for our next panel.

Secretary Kemp, if you're ready, I would like to call for you and Mr. Wade Henderson, the executive director of the Leadership Conference on Civil Rights. I want to just say you're to be commended for pursuing innovative and nontraditional solutions to the grave problems of our Nation's Capital and urban America in general. We need to look at all types of proposals.

It's the policy of this committee that noncongressional witnesses be sworn before they testify. Jack, as a former Member, I think you're exempt, but the parliamentarian said no, so I have to swear you in as well.

Mr. KEMP. I swear to tell the truth.

[Witnesses sworn.]

Mr. DAVIS. Thank you.

Mr. KEMP. You're not going to ask for my FBI file, are you?

[Laughter.]

Mr. DAVIS. You have to ask Chairman Clinger.

Mr. KEMP. Livingstone's not around, is he?

Mr. DAVIS. No, but I am going to ask something more difficult, Jack. We must try to keep you at 5 minutes.

Mr. KEMP. Absolutely.

Mr. DAVIS. We'll be lenient. We're just happy to have you.

STATEMENTS OF JACK KEMP, CO-DIRECTOR, EMPOWER AMERICA; HON. JOSEPH I. LIEBERMAN, A U.S. SENATOR FROM THE STATE OF CONNECTICUT; HON. NEWT GINGRICH, SPEAKER, U.S. HOUSE OF REPRESENTATIVES; AND WADE HENDERSON, EXECUTIVE DIRECTOR, LEADERSHIP CONFERENCE ON CIVIL RIGHTS

Mr. KEMP. As the Hubert Humphrey of the Republican party, I will—Humphrey used to say he enjoyed every minute of his speeches.

Mr. Chairman, thanks for holding these hearings, and may I say it is a great honor to be here with Wade, for whom I have high regard. The Leadership Conference on Civil Rights, in my opinion, is one of the most important organizations in America, recognizing that, were Dr. King here today with us, he would be talking about economic opportunity, jobs, education.

So, without putting words in anybody's mouth, I just want Wade Henderson to know that I'm honored to be in his presence and appreciate his work and leadership.

Mr. Chairman, I'm proud to be a supporter of the ERA—for District of Columbia I agree with Eleanor Holmes Norton, Mr. Chairman. If the American people knew what was happening in the District of Columbia, they would support this on a national referendum. That's how important this is, Mr. Chairman.

It's important not only to the District of Columbia, as was pointed out in the very eloquent statement of the delegate from the District of Columbia—who, in my opinion, should have a vote in the U.S. Congress that counts, Mr. Chairman. But also, in my educated opinion, people in Buffalo, people in Baltimore, people in South Central, people in Motown, people in Chi Town, people in Overtown, every urban resident in America has a stake in what the U.S. Congress does to help solve and resolve an urban crisis in the Nation's Capital.

And Eleanor, I hope this doesn't ruin your reputation in the Democratic party, but I want you to know, I consider you to be one of the most courageous women in the whole U.S. Congress, in this whole country, for advocating not only the Financial Control Board, but the type of an enterprise zone for this District that, in my opinion, really rises or transcends party differences and all of the other artificial differences that occur so often in a Presidential election year.

For the White House, Mr. Chairman—and I think most people know, I am as tough on my own party as I am on the other party—but today I cannot let this day go by without saying to Leon Panetta, who is a friend of mine, that this idea is wrong for our country; it is the equivalent of saying to the District, "Drop dead."

I remember Jerry Ford, in 1975, being accused by the Daily News of New York city of telling New York City residents, "Drop dead," because he had a question about the loan guarantee for New York City, which he ultimately signed into law.

Leon Panetta and the White House should instead be here today testifying on behalf of an empowerment zone, an enterprise zone—

call it the "chapter 2 of the Civil Rights Movement for America Zone."

In my opinion, there is a great need in this city and in this country to support Eleanor Holmes Norton's bipartisan bill, supported by Connie Mack of Florida, Joe Lieberman of Connecticut, Trent Lott, Newt Gingrich.

They'll all speak for themselves, but in my opinion, Lieberman, in the Democratic Leadership Council, has taken a strong position in favor of this enterprise zone. You wanted the distinguished Senator to speak for himself.

Mr. DAVIS. No; you stay there with him and finish, Jack, and then we'll ask the Senator to comment.

Senator LIEBERMAN. He's my inspiration, anyway, so we might as well let him go first.

Mr. KEMP. Two weeks ago, I was called his rabbi, which is a great honor.

Senator LIEBERMAN. My rabbi objected. [Laughter.]

Mr. KEMP. Well, my Presbyterian minister chaplain did, too.

Mr. Chairman, very quickly, the argument that is made by some that, somehow, the District of Columbia does not qualify for a special zone of taxation fails the uniformity clause of the U.S. Constitution, article I, section 8, clause 1, which says that it should be uniform across State lines.

The District of Columbia, as the distinguished delegate from the District has told us, is a city. It has no State. It has no State to pick up Medicaid; it has no State to pick up Lorton; it has no State to pick up its unfunded pension liability.

And the question that she put to us is, do we increase spending by the U.S. Congress and bridge loans from the Treasury to save the city from implosion, or do we do something really innovative, progressive, and inclusive in order to put people back to work, bring black and white middle-class families back into this city and create a tax base where people can enjoy the benefits of schools that have schoolbooks, community policing?

I want to introduce into the record, Mr. Chairman, the very outstanding articles in the New York Times which, I think, alerted many in the Congress, hopefully, to the problems of the District of Columbia. They were a series of articles in the New York Times by Stephen Holmes and Michael Janofsky from July 24, 25, and 26.

This series talked about the fact that the city is, indeed, imploding. There is no tax base to speak of. It is over-taxed by the city, itself. That needs to be resolved. But, in my opinion, we ought to treat this great city, at least for tax reasons, as a territory; create an enterprise zone; eliminate the capital gains tax on anybody that invests in this city.

What this city needs is capital investment. How do you get capital investment if you don't use an incentive? It would be a very strong incentive to work, live, and invest in the District of Columbia as our Nation's Capital if we said any man, any woman, of any color that wanted to invest his or her talent, his or her effort, his or her savings and capital, that there would be no tax on the capital gain—No. 1.

No. 2, there would be a sharply lower Federal income tax rate. Some have called it a flat tax. Frankly, I call it a progressive flat

tax, because, for the poor, it means no tax. For those coming off welfare, zero tax; for those who want to invest their time and talent, a sharply reduced tax.

In my opinion, it would be a down payment on some form of an urban policy for the rest of the country, something I've been advocating, Mr. Chairman, since 1979, along with Charlie Rangel, Bill Gray, Bobby Garcia, members of the Conservative Opportunities Society Caucus, the Black Caucus, the Hispanic Caucus.

I'll tell you who stopped it. Dave Stockman stopped it in the Reagan administration, and now OMB apparently is going to stop it or try to stop it in the Clinton administration. We should not let OMB bean counters stop a proposal that will put this city back on the road to prosperity. I want to congratulate Eleanor again for her leadership. Thank you, Mr. Chairman.

Mr. DAVIS. Jack, thank you very much. Senator Lieberman, thank you for coming back. Sorry we couldn't get to you earlier, and it's a pleasure to have you here.

Senator LIEBERMAN. Thank you, Mr. Chairman, Delegate Norton, members of the committee. I'm delighted to be here and was pleased to be here earlier to hear Delegate Norton's stirring words.

Mr. Chairman, last week, the New York Times ran a very disturbing series of articles that chronicled the many problems afflicting the District of Columbia. The series probably brought to the attention of the world the difficulties that residents of this city and region, let alone readers of the local newspapers, know all too well.

Few Americans could come away from reading the Times series without feeling a sense of shame about what has become of our Nation's Capital City. As Members of Congress, charged by the Constitution with an important measure of responsibility for what happens here, we should not only be ashamed, we should be inspired to do something about it, to make it better.

The economic, social, and spiritual meltdown of the District of Columbia has, after all, occurred on our watch. We must share the blame for what has occurred, and we must take responsibility for turning this situation around.

Now, I know some critics have asked, "OK, Washington has problems, but what about Detroit? What about Boston? What about Bridgeport?"

Well, at the risk of being repetitive, I repeat, quite simply, the District of Columbia is not Detroit or Boston or Bridgeport. It has no State with millions of taxpayers to back it up. It has no Senators or Members of Congress. It is different.

All the other distressed communities have several significant things in common that the District of Columbia has not—a State that can and does help it meet its obligations to its citizens and representation here in Congress to carry forth its interests.

But let's be very direct about something else. None of those other cities carries the title of Capital of the United States of America. This is America's city, and so long as we allow it to deteriorate, our country will not achieve the greatness that we want for it. Our people will not achieve the quality we want for them anywhere in this country.

The legislation we are here to discuss today may begin with the District of Columbia, but it need not end here. I believe that this

bill, if passed, would prove so successful that communities around the country will clamor for something similar within their borders, and we in Congress will want to give it to them.

We believe the lessons to be learned from putting this bill into effect in Washington will form the basis of a true urban renaissance across this country. It will, in short, be the beginning of a new urban policy for America, something that this Nation has needed for many, many years.

Mr. President—Mr. Chairman. You know, these are habits we develop on the Senate side.

Mr. DAVIS. That's a good habit; you can keep it up. It's a little premature. [Laughter.]

Senator LIEBERMAN. I have said that the District of Columbia is America's city, and I mean it. If we, the elected Representatives of the people, charged by the Constitution with responsibility for the District of Columbia, do not act to stanch the wound of this bleeding community, who on Earth will?

Who among us did not journey here at some point in our childhood, perhaps with our parents or a school group, and marvel at the shrines of democracy here? All Americans have a special bond with this place, because it is here that the beating heart of our democratic government is on display for all to see. In some sense, all Americans belong here, and it is a shame that we have allowed this place to deteriorate.

Mr. Chairman, we cannot make the streets of Washington perfectly safe. We cannot rebuild the education system overnight here or in any of our other cities around America.

But what Delegate Norton has said to us with this bill, and what Senator Mack and I are saying to our colleagues in the Senate, is that we can make a beginning by trying to entice people back to our cities and businesses to our cities, to rebuild the tax base of those cities, to break the vicious cycle that has drawn almost every city in America down, where businesses left and took tax revenues with them, where social service needs went up, where the tax needs went up.

And who paid? Who was asked to pay? The small number of remaining middle-class taxpayers. And what did they do? They looked across the line, and they said, "I can pay less taxes over there. I can send my kids to the school. Why am I still here?" And so they left.

That has happened in Washington dramatically. It has happened all across America—Hartford, Bridgeport, New Haven, any city you can mention. Until we stop that cycle and begin to bring people and businesses back to the city, there's no hope for our cities.

As long as there's no hope for our cities, there's no hope for our country, because the cities remain the center of American civilization, the place where our cultural and business and health care life are centered. But, too often, the cities are where people come during the day and leave at night and don't leave much when they go.

There is a certain "Field of Dreams" quality to this proposal, not only in the sense of wanting to realize the dreams that America has for all our people and for the renaissance of our cities, but in the sense of the movie. There is a sense that we are suggesting

here that if we offer the incentives, the income tax cuts, the business tax cuts, that jobs and middle-class residents will come back.

We have no clear comparisons. We all know that today Washington is not Hong Kong, so I suppose there is an element of faith that needs to be embraced as we approach this legislation. But nothing ventured, nothing gained.

Delegate Norton said it so compellingly. We've tried just about everything else, and the cities remain in dire straits. Why not try this? Mr. Chairman, why not try it in Washington, DC, America's Capital City? Why not give it a try here, and if it works, we'll try it all over America.

Mr. President, noting the presence of the Speaker, let me just conclude with this point. There are some who express concern, actually, about the effect of this proposal on the suburbs, the nearby suburbs. But what about the effect of doing nothing? Can the suburbs really thrive if the central core collapses? I think the answer is no.

I think the contrary is true. The suburbs will benefit if Washington undergoes an economic rebirth. No city on Earth has undergone a period of economic and social expansion and improvement without its neighboring communities going along for the ride.

This next line is for Jack Kemp. I want to propose here today that a rising city will raise all its suburbs.

Mr. KEMP. All right. That actually came from John F. Kennedy, but I shamelessly quote it.

Senator LIEBERMAN. Mr. Chairman, finally, people may not agree with every detail of this approach, but in disagreeing, I hope those who do will assume some responsibility for demonstrating what other proposals you think are better suited to solve the deep and terrible problems of this city and most of urban America.

I know we can try to put the lid on this particular boiling pot for a while longer, but in some fashion or other the lid is going to come spinning off, and when it does, the cost in remedies we're going to be debating here on that future day will be much higher and much more radical than anything proposed in the very sensible and hopeful recommendation that Delegate Norton has made to this committee.

I thank the Chair, and I will stand by if you have any questions.
[The prepared statement of Hon. Joseph I. Lieberman follows:]

N E W S R E L E A S E



U.S. SENATOR JOE LIEBERMAN CONNECTICUT

PRESS OFFICE: (202) 224-4041 or (202) 224-9965 (after 6 p.m.) • *Actuality Line:* (202) 224-6095

Jim Kennedy (202) 583-5697 (H) • Kathie Scarrah (703) 845-2874 (H)

Home Page: <http://www.senate.gov/~lieberman/> • email: senator_lieberman@lieberman.senate.gov

FOR RELEASE

July 31, 1996

TESTIMONY OF SENATOR JOSEPH I. LIEBERMAN before the District Oversight Subcommittee of the House Committee on Government Reform and Oversight

Mr. Chairman, I'm delighted to be here today to talk about tax incentives for the District of Columbia. The District of Columbia Economic Recovery Act (DCERA) was first introduced in April of this year. At the time of that introduction, the Washington Post editorialized that the proposal, H.R. 3244, "is at once imaginative enough to attract bipartisan support in Congress and realistic enough to make a serious difference over time." I believe that glowing description also aptly describes the person who introduced H.R. 3244, D.C. Delegate Eleanor Holmes Norton.

Last week, the New York Times ran a disturbing series of articles chronicling the many problems afflicting the District of Columbia. The series brought to the attention of the world the difficulties that readers of local newspapers, and residents of this region, know all too well.

Few Americans could come away from reading the Times series without feeling a sense of embarrassment about what has become of this nation's capital city. As members of Congress, charged by the Constitution with an important measure of responsibility for what happens here, we should not only be embarrassed, we should be inspired to take action. The economic, social and spiritual meltdown of the District of Columbia has occurred on our watch. We must share the blame for what has occurred, and we must take responsibility for turning the situation around.

Critics ask, "what about Detroit? What about Boston?" At the risk of being obvious, I can best answer by saying the District of Columbia is not Detroit. It has no state of Michigan with its millions of taxpayers to back it up. And it has no Senator Levin or Abraham representing it in the United States Senate. The same with Boston or Bridgeport or the Bronx. All those distressed communities have several significant things in common that DC has not: a state that can and does help it meet its obligations to its citizens, and representation in the Congress to carry forth its interests. And none of those cities possess what DC has: the title of capital of the United States of America.

The legislation we are here to discuss today may begin with the District of Columbia, but it need not end at its borders. I believe this bill, if passed, would prove so phenomenally successful that communities across the country will clamor for something similar within their borders.

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And when they do, Senator Abraham and I have something to offer them: an enhanced enterprise zone bill that includes several key features of the DC Economic Recovery Act. We believe the lessons to be learned from putting this bill into effect in Washington will form the basis for an urban renaissance all across this country. It will, in short, be the beginning of an urban policy -- something this nation has not had in many years, and our cities are the poorer for it.

To those members of Congress who ask, "how can I explain giving the District of Columbia a tax break to my constituents?" I answer: I have, and they understand. In fact, a columnist for the Hartford Courant praised this effort, because he recognizes in it the seeds of hope for places like Hartford and New Haven and Bridgeport. If it makes it here, it can make it there.

We should also remind critics who say this bill exhibits a favoritism towards the District of Columbia that Washington is unique -- not only because it has no state government and has no representation in Congress. It is unique, as I said before, because no other community in this country or the world is the capital of the United States of America. This is America's city

If we, the elected representatives of the people, charged by the Constitution with responsibility for the District of Columbia, do not act to stanch the wound of this bleeding community, who on Earth will?

Who among us did not journey here at some point in our childhood, perhaps with our parents, or with a school group, and marvel at the shrines of democracy? Who among us did not thrill at the site of the Washington Monument, the Lincoln Memorial, the Capitol dome? All Americans have a special bond with this place, unlike any other place on Earth, because here is where the beating heart of our democratic form of government is on display for all to see. We all belong here. Almost every American comes here. It's the Mecca of the American Republic. The Jerusalem of democracy. And it is a shame that we have allowed it to deteriorate.

On July 24, Senators Mack and I were joined By Senators Abraham, Lott, Hatch and Bennett in introducing S. 1988, our idea for bringing the District back from the brink of disaster.

At the heart of it, this bill is about urban policy. We can't make the streets perfectly safe or rebuild the schools overnight in our cities. What we can do is try and entice the people back to our cities who can rebuild the tax base in those cities - the middle class. And if they return, it is not unreasonable to assume that safer streets and better schools will follow. To be sure, there is a certain "Field of Dreams" feel to all of this - a sense that if you offer an incentive, jobs and the middle-class will return. Because we have no clear comparisons, because we all know that Washington is not Hong Kong, there is an element of faith that needs to be embraced. But that is why we are not asking for this treatment for 100 cities or 50 cities or even five cities. New urban policy needs to be tried in Washington.

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Undoubtedly, you will hear today from people who oppose a flat tax. I do not really have a dog in that fight; at best I am an agnostic on the flat tax issue. I've always believed in the equity of progressive rates so I am pleased that both H.R. 3244 and S. 1988 retain elements of that progressivity by providing such a generous personal exemption. The effect is to exempt a married couple filing jointly and making up to \$30,000 a year, from federal taxes.

This "progressive" flat tax may be just the tool we need to address a pressing problem that most of our big cities face: the flight of the middle class. The people we are really anxious to bring back to our cities are the 28 percenters, that is, the people who are in the 28 percent federal tax bracket. Under current law, a typical family in the 28 percent bracket would be a couple with two children who make roughly between \$39,000 and \$95,000 after deductions. Both H.R. 3244 and S. 1988 would create a very favorable tax incentive for these people to stay in, or move to, the District.

The District is losing its middle class wage earners and tax-payers to the suburbs and that loss is accelerating. The loss of residents in the 1990s has already exceeded the loss for all of the 1980s. And they are taking their money with them. As Delegate Norton has noted, in 1993, D.C. had 11.5 percent of its filers with incomes between \$50,000 and \$100,000 compared to 20 percent in this category nationally.

Some say we should wait. Of course, we can wait. We can wait until the situation in the District is so dire, when nearly all of the tax base has fled and we will be asked to take over the city altogether. And make no mistake about it if the worst happens we will be drawn in: unlike Philadelphia or Cleveland or New York, the District has no state relief on which to draw.

Instead of waiting for the worst, we should consider the merits of H.R. 3244 and S. 1988. Both bills double the personal exemption which eliminates federal income taxes for single residents making up to \$15,000 a year and married couples filing jointly making up to \$30,000 a year.

In addition, both bills retain the mortgage and charitable deduction and would allow a taxpayer to file under the old system, if preferred. Steve Twomey, a columnist with the Washington Post, asked Arthur Andersen to figure out just what these bills would mean to a family of four, assuming certain deductions. Under this scenario, a family making \$50,000 would pay \$3,377 in total taxes which is \$1,909 less than in Maryland and \$1,162 less than in Virginia. Under this bill, a family making \$100,000 would pay \$15,625 which works out to \$4,180 less than in Maryland and \$2,622 less than in Virginia.

In contrast to Delegate Norton's bill, the Senate version establishes a zero capital gains tax rate for District investments held by both residents and non-residents of the District for three years. The House version limits this provision to District residents only, but we were concerned this would limit potential investment in the District.

The Senate bill also includes a \$5,000 credit for a first time District home purchase, and includes a provision to support the clean-up abandoned "brownfields" within the District. Members of Congress not representing the District would not be allowed to take advantage of the 15 percent flat tax rate under our bill since our bill limits this treatment to people subject to D.C. taxes and by law members of Congress are not subject to D.C. taxes.

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We would also consider not allowing members of Congress to take advantage of the investment incentives contained in the bill as well although it is hard to find a compelling reason for prohibiting members from investing in the District.

Our bill also assumes that, if the DCERA were to become law, the D.C. government would be bound not to raise taxes to make up the difference. In fact, the D.C. Council has approved a five year freeze on city taxes if this proposal is adopted, at least for now. The truth is, of course, that even if D.C. did try to make up the difference, Congress could overturn it. Congress has explicitly reserved the power to amend or repeal any law in force in the District under the District of Columbia Self-Government and Governmental Reorganization Act.

Even those who harbor some suspicion or cynicism about the District of Columbia government should welcome our approach to addressing the District's problems because the tax cut method transcends the local government. The tax cuts we propose are a matter between an investor or a resident and the IRS. The District will benefit, of course, from every decision by a citizen to buy a home here or invest in a business here -- that's the whole point of the bill. But the legislation does not funnel taxpayer dollars into or through the local government or some social service bureaucracy, local or federal. In a very real sense, it's not about using other taxpayers' dollars at all. A tax cut -- whether it's an income tax cut or a capital gains tax cut -- is really a way to allow someone to keep more of their own hard-earned dollars in their own pocket.

And to those who express concern about the effect of this legislation on the nearby suburbs, I ask this: what about the effect of doing nothing? Can the suburbs thrive if the central core collapses? No. In fact, the suburbs will benefit if Washington undergoes an economic rebirth. No city on Earth has undergone a period of economic and social expansion and improvement without its neighboring communities going along for the ride. A rising city raises all suburbs.

You may not agree that this is the best approach. But in disagreeing, I hope you will assume the responsibility of demonstrating what idea you think is better suited to solving the deep and terrible problems of this city and most of America's troubled urban communities. We can choose to try to put a lid on this issue. But in some fashion or another, the lid will come spinning off. And the costs and remedies we will debate on that future day will be far higher and far more radical than any we are here to address today.

Mr. DAVIS. Senator, thank you very much for your very eloquent and thoughtful statement. I now recognize the Speaker of the House, Speaker Gingrich.

Mr. GINGRICH. I thank you for letting me come by for just a few minutes, and I apologize that my schedule is as tight as it is.

Let me say, first of all, that we have a unique obligation. I want to thank Chairman Davis and all the members of this subcommittee for the time you're putting into the District of Columbia. But I want to start with two premises.

Our goal should be to have the finest Capital City in the world. Our goal should not be to have a city that doesn't collapse; it shouldn't be to have a city that doesn't have potholes; it shouldn't be to have a city where you can drink the water every day. Those are minimalist goals.

Our goal should be, and we should set out to achieve, the finest Capital City in the world. That's what Americans want as their National Capital. That's what it ought to be, and that's what the standard ought to be. Now, how do you get to that goal?

Second, I think we have to recognize in Congress that we have a unique obligation, and this is why, frankly, I was so startled by what Mr. Panetta said on Sunday, because it was so factually wrong. We have a unique obligation. The District of Columbia is not a State.

Particularly all of those of us who have argued against statehood are now, in a sense, hoisted on our own principles. If the District of Columbia is not a State, if it is a free-standing National Capital, then the institution which has the obligation to the District comparable to a State is called the Federal Government.

Now, when Mr. Panetta cites New York City and Boston, he forgets the parallel. New York City has a larger institution, called the State. Governor Pataki ultimately has responsibility for the State of New York.

You can see across the river in New Jersey, where Newark has an institution, and Jersey City has an institution, called the State. In New Jersey, the Governor has stepped in on occasion, in a very defined way, and taken over the schools or done whatever they do, because the State is the ultimate repository of sovereign power.

In Boston's case, Governor Weld and the State of Massachusetts have an ultimate responsibility.

So, if we are not to make the District of Columbia a State, and if we are not going to return the District to Maryland or do something which in some way gives the residents of the District a higher authority, then, by definition, the ultimate authority for the District of Columbia is the Federal Government. So we can't just wash our hands and say, "Well, we hope the residents do all right."

We have a unique relationship in the city, for reasons that, many of you understand, go back to incidents in Philadelphia. The Founding Fathers decided they wanted a district that the Federal Government controlled. That means it's a district the Federal Government has an obligation to.

And then you come to the question, so how do we solve our problem? Now, clearly, some of the challenges in creating the best Capital City in the world involve the city government. I think that Mr. Davis has been at the lead of this, as has Chairman Walsh. We've

worked very closely with Mrs. Norton, who has done a wonderful job and shown great courage.

This is a very hard problem, and all of us who win elected office understand it's a hard problem, but our challenge here is to strengthen the city government and to strengthen the capacity of the citizens of this city, not to replace it.

I think for us in any way to violate home rule would be to simply elevate the problems to the Federal level in a way that, in the long run, we don't have the time; we don't have the expertise; and we don't have the legitimate self-interest. You want people who control their own lives.

We're bringing a welfare bill to the floor which is going to say, "Return power to the States." Well, similarly, we ought to say to ourselves, "What are the deeper problems?"

Now, I think there are demands we can make of the city government. We already have, through the Control Board. We're going to continue to make demands for reform.

I believe, if we were to pass reform that affected the city or tax relief that affected the city, we have a right to say to the city, "You need to have a referendum and lock into your city government certain changes in city tax policy." I am opposed to our doing anything to lower Federal taxes and have the city taxes rise to have the same net effect. I mean that would gain nothing.

But let's say that we could talk with the City Council. We could talk with the Mayor. We could talk with the residents. We could create a common agreement that we want to create the finest Capital City in the world.

I think there are two key things you've got to deal with in order for that to happen, beyond just reforming the city government, because reforming the city government, reforming the bureaucracy, will not, in and of itself, solve the problem. And so I think we have two other obligations.

One is to think through, how can we bring the working middle class back into the city? The fact is we have had an enormous scale of flight from this city, and it's not racial. Solid middle-class blacks have left, largely to go into Maryland. Whites have left.

The fact is, you look around. If you were to go around within a 25-mile area outside the city and say, "And where did you used to live?" you would be astonished how many hard-working people would give you a residence in the city as their former residence. So we've had an enormous scale of middle-class flight involving people of all ethnic backgrounds.

The second problem is that the city, in its current structure, doesn't have enough jobs in the city. You don't just want bedrooms to move back in, because bedrooms by themselves don't generate enough taxes to really sustain an urban government. You've got to have some kinds of industry and some kinds of investment to create the tax base that's necessary.

So I think you have two different challenges. How do you bring the middle class back in, and how do you strengthen private investment and create a bigger and better tax base for the city?

Now, Mr. Panetta made, basically, four assertions on Sunday, and I just want to take them one by one.

The first one, as I said, was, he compared the District of Columbia to Boston and New York. I think that's wrong on the grounds of being a State, having a State responsibility. So, in a sense, the President is to the District what Governor Pataki is to New York City or Governor Weld is to Boston.

Second, this is our National Capital. I don't think it is the same standard. I think, in fact, we have an obligation as a country to worry about our National Capital, which is a place we want every American to visit with a sense of pride and a place where we hope people will draw a sustenance about our national existence and the nature of our country.

We have, for example, the Smithsonian, which we all vote to sustain and support, because it is a unique national museum complex, the largest of its kind in the world. I have yet to hear somebody say, "Well, if we don't have a Smithsonian in every city, how can we have one in Washington?" We've all agreed we can have a center of excellence called the Smithsonian, and we're proud of it.

We sustain the Library of Congress, the largest library in the world. Nobody has said to us, "Well, if you don't place a Library of Congress in every city in the country, how can you have one here?"

This is the National Capital. Let me say it with pride, even though my party has failed to carry the District for every single time since they've been able to vote. [Laughter.]

This is the National Capital. It's the Capital of the United States, and we ought to have a standard appropriate to the Capital of the United States.

Mr. KEMP. Hear, hear.

Mr. GINGRICH. And that standard ought to be as proud as we are of the Olympics. It isn't enough just to applaud the team when they walk in behind the flag. You've got to apply that and make sure they can go back home to a decent place to live and a decent place to work and a decent place to send their kids to school.

Now, let me go a step further. Mr. Panetta had a comment which, even though being chief of staff often rattles one, I can't believe he said this. He said that it was inappropriate—I think, Jack, you may have the exact quote here. He said something to the effect that Congressmen and Senators would get away without paying taxes.

Now, let me say, first of all, I certainly hope that when he was a Congressman—he said, "We're going to go out of our way to help Congressmen and Senators." Let me say I certainly hope when he was a Congressman he paid California taxes, because that's his legal obligation.

I think it's very important to understand that that was just nonsense—and, I mean, from the chief of staff to the President. I assume it was a slip. It was a bad morning. We had had the bombing in Atlanta; he had a lot on his mind. He has been very helpful to us in Atlanta.

But I would assume that Mr. Panetta would want to retract. No Congressman or Senator will benefit from this legislation, because they have their residences back home. Period. So let's make that clear.

Now, let me go to one other point. There is the argument that you either have to help everyone or you have to help no one. Now, we've been down this road for 20 years. We should really help everyone, but we can't, so that explains why we're going to help no one.

So when we help no one, you should realize how fair we're being, because everybody is being kept in equal misery by our inability to do anything. Now, that's just dumb.

Now, frankly, if the President would like to meet later on today or tomorrow—I'm sure Jack would be available; I think Ms. Norton will be available—we could sit down and say, "You want to do a zero capital gains enterprise zone for every city that resembles Anacostia in the country, we'll try to pass it in September." We're available.

We don't want the President to feel that we're not available. "You want to pass an across-the-board flat tax or—my preference—a flat tax with a first home mortgage deduction and a charitable deduction? We'll try to get it done in September. You promise to sign it, and we'll go all-out."

I don't know if Bill Archer will go all-out; I don't know if Bill Roth will go all-out, but we'll try to find a way to work the bill to the floor and to convince the Ways and Means and Finance Committee to move it.

Now, I don't think that's what they're saying. What they're saying is, since they're going to do nothing for anybody, they're going to do nothing for here. Since they're doing nothing for here, they have no obligation to do anything for anybody, so we should all just relax and accept the misery.

Let me just say to you, I have been in this city, working in the Congress, since December 1978. It has gotten weaker as a city. It has gotten poorer as a city. Its problems have gotten worse.

To learn that, in your National Capital, you can't drink the water should alarm every American because of the whole signal it sends to the entire planet. Can you imagine every embassy on the plant wiring home, reporting that in America they couldn't drink the water?

Now, this is partly a problem of government, but it's partly a problem of the collapse of civil society and the flight of everybody. The numbers are astonishing, how few taxpayers there are in the city.

This is, by the way, the great test of dynamic scoring, because if the Congressional Budget Office only scores the cost of this bill for current taxpayers and does to us what they've done to us on every other bill—which is not give us any dynamic expectational changes—this is a very cheap bill.

If they report to us how many people will move in by Thursday, once the bill is passed, it gets to be a more expensive bill. So they are now caught either in staying with the static model—in which case this bill is very cheap—or, for the first time, introducing how people change their behavior. So it's almost worth doing just for that purpose. [Laughter.]

But let me go to one last point. I'm not an attorney, although I've spent a fair amount of my lifetime, unfortunately, studying the history of law and studying laws in general. So I want to make an ob-

servation which you have to get expert counsel on, and that's the uniformity clause.

The uniformity clause was designed so that no State could be ganged up on by other States and prohibits the Federal Government from discriminating against a State in the passing of the laws involving taxes. However, I believe a law which says, "on those Federal territories in which citizens do not have the right to vote for Congress, the following tax code shall apply," would absolutely pass the uniformity requirement.

I'm not an attorney. Some of you, I suspect, are attorneys, and you can decide later whether that strikes you as good law. I'm pretty sure it's good history. I'm pretty sure that the Founding Fathers would have agreed with that, because they designed the District of Columbia to be unique and separate for reasons that they had painfully learned while serving in Philadelphia as the provisional Capital, as the temporary Capital.

I think they would have said it is not a State. It does not, therefore, come under the uniformity clause the same way as the States, and you can therefore do many things in the District. And historically we have done different things in the District than were done in the States. I don't think the uniformity clause is, in that sense, a final bite.

Let me say one last thing. I really look forward to the work of this subcommittee. I think this is a tremendously important hearing. The principles of lowering taxes, increasing investment, increasing work, increasing incentives, are principles that I have followed Jack Kemp and others for many, many years in advocating.

I believe they're important, and if we got nothing more than a grand effort to test them out in a positive way, I believe the result would be so phenomenal. I have never visited Hong Kong, but those of you who have know, it is astonishing how human ingenuity in a small space can create enormous amounts of wealth because people have the right incentives. I believe it's an experiment worth testing.

Now, I would love to see us put on the ballot on November 5 in the District a choice. Whether the choice is between a pure flat tax and a modified flat tax, whether the choice is for a variety of ways of approaching this, I think it has to include in it that the city government will be bound for the duration of the special tax provision to not raise taxes.

I mean I am unalterably opposed to us lowering Federal taxes just to have the city politicians replace what the Federal politicians give back. But I believe some effort on our part to save the city—and I agree with the challenge that was being made by when I came here by Senator Lieberman.

Those who would not do this, I would challenge with the following question. If this is to be the finest National Capital in the world, and you don't want to use free market incentives so people freely change their behavior because it is in their self interest, then what is your plan? But to tell us you won't let us help, and you have no plan to help, so our National Capital will continue to decay, is just not acceptable.

Mr. KEMP. Hear, hear.

Mr. GINGRICH. I know that's controversial, and I know some of my friends will not be happy with my taking such an aggressive position, but I don't see how any American who applauds the Olympics and whose heart goes out when the Star-Spangled Banner is played for a gold medal winner can then walk through Anacostia and not feel that it is wrong to the people of Anacostia and it is wrong to America to leave our National Capital without help. We have it in our power to bring that help, and we should do it.

Mr. KEMP. Hear, hear.

Mr. DAVIS. Mr. Speaker, thank you very much.

Mr. KEMP. Well said.

Mr. DAVIS. Mr. Henderson.

Mr. HENDERSON. Mr. Chairman, permit me to defer to you and the other members of the committee to question the Speaker and Senator Lieberman. I can certainly give my statement after that if you would like.

Mr. DAVIS. Well, what's your time, Mr. Speaker?

Mr. GINGRICH. If you don't mind, it probably would be helpful. I was supposed to be starting to do something 2 minutes ago.

Mr. DAVIS. All right.

Mr. GINGRICH. But life is like that.

Mr. DAVIS. Well, I'm going to ask a question or two, and then pass to other Members who may have questions. How do you respond, Mr. Speaker, to those who criticize this proposal because, in dollar terms, those earning more than \$200,000 a year get the most benefit—the usual arguments you get in a situation like that?

Mr. GINGRICH. Well, I think, first of all, it is in the long run wrong to discriminate against those who create wealth if, in fact, what you want is to have a lot more people who are doing well, because if you could attract everybody who is successful and entrepreneurial, the scale of change you get is very dramatic.

But second, I think that's negotiable, and there's a way to—I personally would prefer not to. I think a pure test, we would be—as long as it's income earned in the District.

Mr. KEMP. Yes.

Mr. GINGRICH. And as long as it's capital investments in the District. I personally favor, as a test, zero capital gains for investments in the District. I think the city would explode. And I come from the city, by the way, which affected the national employment rate in May and June because of the Olympics. I mean, Atlanta has grown so extraordinarily in the last 3 years that Atlanta is sort of an engine.

Now, if you could take the growth in the northern part of Atlanta, in the Fulton County-Gwinnett-Cobb-Cherokee area, and you could have a tax incentive to create that, the reflow of wealth to the government as people left poverty and began to get a job and as they left public housing and began to pay property tax, the net effect would be so dramatic you would more than gain back what you lost.

I just think that occasionally we ought to be more concerned about helping the poor than we are about punishing the rich.

Mr. DAVIS. I would note that we did invite top elected officials from around the region to testify here today, and administration officials as well. We didn't receive a positive response, although Doug

Duncan, the county executive of Montgomery County, sent a very strong and forthcoming letter. But no one else accepted our invitation to come today. We appreciate your being here.

Senator LIEBERMAN. Mr. Chairman, can I add one surprising fact to the Speaker's answer, which I agree with totally?

Mr. DAVIS. Please.

Senator LIEBERMAN. By the latest breakdown of D.C. taxpayers by income that I've seen, there are only 20 percent that are earning more than \$50,000 a year and only 4,300 taxpayers who are earning more than \$200,000 a year. So this is a bit of a false issue. Those are the facts.

Mr. DAVIS. I guess my other question to all of you would be, looking at the effects on the treasury of this, which is roughly \$700 million a year—I forget what the latest scoring is, but something in that ballpark from CBO—is that the best allocation of resource, by giving it to the pockets of D.C. residents and businesses, as opposed to maybe some direct aid—for example, redoing the water pipes—some infrastructure gains? I guess that's a major question we would want answered.

Mr. GINGRICH. Let me just comment for a second. I appreciate your indulging me. We told the Russians that a free people, pursuing freely a better future, because the incentives work, defeats a centralized command bureaucracy every time.

We begged first Gorbachev and then Yeltsin to get things out of the government and into the private sector because we said it will work better. People will be better off.

Well, guess what? It's true in Washington as well as Moscow. If you want this city to be a healthy, vibrant, exciting city 15 years from now, liberate the private sector and liberate private individuals. As a result, as the tax base rises, revenues will rise.

As the middle class moves back in, the whole structure of government will improve, and you will have, within 15 years, I think, a dramatically more successful government with dramatically better water pipes. But if all you do is replace the water pipes while everybody who's productive continues to flee, you're going to have the whole system, I think, literally implode.

Mr. KEMP. Mr. Chairman, I want to echo the words of the Speaker and Joe Lieberman and make one postscript to this. Money is not going to go into people's pockets. That's not what this bill is all about. This is not a Keynesian cut in taxation to try to stimulate consumption. It is increasing the rate of return on working, saving, investing, and living in the District of Columbia.

So, at the margin, nobody is going to put their money under a pillow. Nobody is going to hide it from circulation. What it's doing is creating a tremendous carrot for this great city to become that which Newt has so eloquently testified.

I just want to assure you, it is not going into people's pockets. It is increasing the rate of return on taking a risk for putting your business and your savings and your capital and your life and your business into this great Nation's Capital.

Mr. DAVIS. Thank you.

Senator LIEBERMAN. Mr. Chairman, just a very brief response.

Mr. DAVIS. Yes, please.

Senator LIEBERMAN. First, the number \$700 million, as an estimate of the cost of this proposal, has been going around. There is no estimate of the cost of this proposal. That is really from the seat of the pants. It's from the edge of the envelope. We're waiting for an estimate.

Matter of fact, I can't believe the \$700 million. Just as the Speaker said, if they don't do it dynamically—this is a startling fact—you've only got slightly over 50,000 Federal taxpayers in the city. The rest are at an income level where they don't pay taxes. So how this could cost that much, I don't know.

Mr. DAVIS. That's a good point. We need to know what numbers we're dealing with.

Senator LIEBERMAN. The other point, briefly, is this. Let me be blunt about it. There are some people who don't have a lot of confidence in the existing government of the District of Columbia. Well, this proposal circumvents or transcends. It goes right to the businesses and the taxpayers to get them to help the District revive.

Mr. KEMP. You know what's really ironic, Mr. Speaker? The State of Maryland is subsidizing the Cleveland Browns to move to Baltimore as an urban project for economic development, and it's considered progressive. If Kemp or Gingrich suggested giving \$250 million to an NFL football team to move to the District of Columbia, we would be considered trickle-down economists, and rightly so.

But the fact is we're calling for a market-oriented, incentive-based tax decision to encourage people to invest in this city and start small businesses and create more jobs, and that somehow is considered to be reactionary. I think it is the one thing about this bill that I really appreciate. It is not black, white, right, left, liberal, or conservative.

The idea really started with Bobby Kennedy in Bed-Stuy in the 1960's. Luis Munoz Marin implemented it in Puerto Rico in the 1940's. It really does transcend the differences, and it seems to me the Congress ought to act, as Newt said, in September and not wait until we have to pick up the pieces.

Mr. DAVIS. Thank you. Let me also note, Governor Glendening did send a letter as well. He responded. Let me just yield for a minute to Mr. Wynn.

Mr. WYNN. Thank you, Mr. Chairman. I just wanted to pursue the issue of the capital gains cut, because that is raised in both the correspondence from County Executive Duncan and from Governor Glendening, with respect to the focus of the capital gains.

It is one thing to create a tax break for residents of the District of Columbia who make capital investment. It is another to give capital gains breaks to those who live outside of the District of Columbia, because our cities in Maryland, in the suburbs and in Baltimore City, need capital investment as well.

I would like you to comment on the potential that a policy that drains capital investment from these other regions might not be the most appropriate way to go.

Mr. GINGRICH. Well, let me make a couple of observations.

Ms. NORTON. Well, wait a minute. Let the gentleman yield for 1 second. That's the difference between my bill and the Senate bill. In my bill, you would have to be a District resident.

Mr. WYNN. I was aware of that, but since we were on the discussion of capital gains, I didn't want that other approach to get too much momentum before I inserted the concerns of Maryland residents.

Mr. GINGRICH. Let me say, first of all, I don't know where the County Commission chairman or the county executive or the Governor are on these issues. I would point out that the area that we're talking about currently was originally Maryland. I don't think that the Governor particularly wants to advocate that the District become part of Maryland, but let's assume that the District was a part of Maryland.

Mr. WYNN. Let's not. [Laughter.]

Mr. GINGRICH. Ah. I mean if either Virginia or Maryland wished to accept the responsibility for the District of Columbia, then I would take more seriously their objections to our helping the District. Let me just start with that, because you can't have neighbors who say, on the one hand, "I'm not going to care about my neighbor in terms of protecting them and developing them, and, by the way, I don't want you to take care of my neighbor, either."

I mean I'm from Georgia. You know, I could argue that we only visit occasionally from Georgia to go the Smithsonian and the zoo and so forth, but I'm arguing a national case here.

But second—if I might, just for a second—second, I believe there's no question—and I think you're making our case—Tom McMillan, a former colleague of ours, indicated that he believed, to somebody in private business, that a zero capital gains would lead to an explosion of job investment and job creation in the District, not just in competition with Baltimore and with Montgomery County and with Fairfax.

It would lead to an explosion in competition with Miami and San Diego and Anchorage and with Toronto and Mexico City and Beijing, that people all over the world would say, "That's a pretty exciting place for me to put my money," and you would have an inflow of capital.

Now, I would be very interested in seeing a study that said, "Would we, in fact, draw so much resources into the District of Columbia that the net increase in the region is actually larger than what it, at the margin, would cost Baltimore and Montgomery County and Prince George's and Fairfax?" I think that's a legitimate question.

Second, I'll make my earlier offer. If the Governor—a good Democrat—would pick up the phone and call Leon Panetta—a good Democrat—and say, "You know, we ought to figure out a zone of impact, and the same capital gains should apply to the whole zone." They can't outbid me on this. [Laughter.]

I'm willing to help.

Mr. WYNN. I don't know that we would try. But I just want to make it clear that the representatives from Maryland, both Mr. Duncan and Mr. Glendening, are not opposed to the legislation and are actually favorable, I think, to the income tax portions of it and to the capital gains portion of it with respect to residents of the

District of Columbia, but have expressed a reservation with respect to nonresident investments.

Mr. KEMP. I would say to my friend from Maryland that I favor this for the District of Columbia; Buffalo, NY—in that order—and then everyone in the United States of America. There should be no tax on capital gains. It is the double and triple taxation that is hurting this country.

But if you talk to Bob Rubin, the Secretary of Treasury, he said it doesn't make any difference in people's decisions. So, on one hand, you've got the Secretary of Treasury saying, "Oh, capital gains rates have no impact upon people's decision to invest," and now you are saying it might have an impact upon people's decision to invest in the District of Columbia.

Either way, you win, because if it is done for the District of Columbia—may I say to the Congressman—and it works, you will want one in Maryland, and Congresswoman Waters will want one in South Central, and it won't be long before we have restored entrepreneurial capitalism to the most democratic country in the world, and that's a recipe for success.

Mr. DAVIS. Thank you. Let me just ask Mrs. Morella.

Mr. KEMP. Small "d" democratic.

Mr. DAVIS. Thank you.

Mrs. MORELLA. Thank you, Mr. Chairman. I want to thank the very distinguished panel for their excellent testimony.

Let me just pose two concerns that we have about people moving to the District of Columbia. What are you going to do about the school system, and what are you going to do about safety? I submit that these are two major decisions that people must make in terms of the quality of life in making that determination.

Mr. GINGRICH. Well, I think there's no question I'm not quite as focused on marginal tax rates as Jack is, and we've had this discussion for many years. I think there are other things people take into account when they make a decision.

Mr. KEMP. What!

Mr. GINGRICH. I rest my case.

Mr. KEMP. I'm shocked.

Mr. GINGRICH. But I would say two things. First of all I think, on crime, we have a Federal obligation, frankly, on the drug front, and I'll be introducing a bill in the near future that has fairly draconian penalties for drug wholesalers. I think we ought to not focus on crime at the local level; we ought to focus on cutting off the people bringing drugs in. But, clearly, that's an issue.

On schools, as you know, we've offered proposals. In fact, we've had fairly good support out of Delegate Norton in offering proposals that, we think, are improvements on the D.C. schools. I think that's an issue people would have to address and work on.

But I think we have proven—and Chairman Davis, you have proven, and Chairman Walsh has proven—we want to work with the city to provide the finest education and to provide safety and to provide better quality of life here, and we're going to keep doing that.

We also believe, frankly, that bringing the working middle class back to the city and creating more jobs in the city also, then, creates an environment in which it is easier to solve the problems of

crime and the problem of education. I mean I think it's a circular kind of issue, and this is one piece of the circle. I think it's a very powerful, very optimistic piece.

I have to report, in closing—because I know you're going to have to go vote—I have already had people come up to me and say they stopped the process of moving their business out of the city because of this dialog.

Mr. DAVIS. No question.

Mr. GINGRICH. I mean I believe that this will lead to a dramatic, rapid response by free people moving to the new opportunity and that we should not underestimate how important this discussion is for creating a healthier Capital.

Mr. DAVIS. Thank you. We have got to go vote. We've got 4 minutes left. So I'm going to, at this point, move for a recess.

Mr. Henderson, we'll hear your statement when we return. Mr. Kemp, can you stay?

Mr. KEMP. All right.

Mr. DAVIS. Mr. Kemp, if you can stay. Senator Lieberman, I'll let you make the last comment.

Senator LIEBERMAN. I've got to go on very briefly. Congresswoman Morella's question really highlights why we need this bill. Why are people leaving the District of Columbia and most other cities in America? They're worried about crime and they've lost confidence in the schools.

We need to give them a tax cut to give them a reason to come back, and when they come back, believe me, they will retake some of those neighborhoods that have deteriorated; they will rebuild the schools that have gone downhill; and they will demand and bring about more public safety. So this can break the cycle.

Mr. DAVIS. Thank you very much. We will be in recess for just a few minutes.

[Recess.]

Mr. DAVIS. We will reconvene the meeting. Mr. Henderson, at long last.

Mr. KEMP. Free at last, thank God Almighty.

Mr. HENDERSON. Mr. Chairman.

Mr. DAVIS. At long last, and I appreciate your allowing the Speaker the flexibility to come in and testify.

Mr. HENDERSON. Not at all, Mr. Chairman.

Mr. DAVIS. We are happy to have you here. We wanted to make sure you were on the panel with Jack Kemp, who was excited about it, as well. So we'll go ahead now. We'll have some questions for both of you.

Mr. HENDERSON. Well, thank you for that very gracious invitation and your comments. Good afternoon, Mr. Chairman, Delegate Norton, members of the subcommittee. I'm Wade Henderson, the executive director of the Leadership Conference on Civil Rights.

It is my great opportunity—and I appreciate it—to be here this afternoon to voice the strong support of the Leadership Conference for the District of Columbia Economic Recovery Act, known as the DCERA, which I think is an apt acronym for this important legislation.

First, Mr. Chairman, I want to thank you and Delegate Norton—Delegate Norton, of course, for the introduction of this very innova-

tive, creative, very necessary piece of legislation that will help to provide a genuine opportunity to secure important political rights for District of Columbia residents.

I want to thank you, Mr. Chairman, for taking the time to convene this hearing, for your sensitivity on these important issues, and for the persistence that you have followed the debate surrounding tax relief for District residents.

It is a great honor to be on a panel with the Honorable Jack Kemp, and he was kind to say some nice things about me in his statement. This is not being offered as a reciprocal turn, but it is to say that it's important that he's here. The contribution that I think he has made to this hearing has been tremendous, and I want to commend him for it.

Mr. KEMP. Thank you, Wade.

Mr. HENDERSON. I think it was extremely important to have both Speaker Gingrich and Senator Lieberman. I think their eloquence and their forcefulness with which they address these important issues underscores the significance of what this committee does today with these hearings.

I think their presence also emphasized the important bipartisan dimension which accompanies this legislation, because I think the comments of all three of the preceding panelists emphasized the unique and important role that the District of Columbia plays as the Nation's Capital and the contribution that we all seek to restore the District to its rightful place, including fiscal health.

I want to speak this afternoon, however, in a slightly different context, because I represent an organization in the Leadership Conference on Civil Rights which is arguably the Nation's oldest and most diverse civil rights coalition.

We were founded in 1950 by three extraordinary individuals—Roy Wilkins, who was the executive director of the NAACP; A. Philip Randolph, who was the founder of the Union of Sleeping Car Porters; and Arnold Aronson, who is with the National Jewish Community Relations Advisory Council, and who is still quite active in the affairs of the Leadership Conference.

Since that time period, since 1950, this organization has served as what we like to call the legislative arm of the civil rights movement. There has been no civil rights legislation enacted in this country since 1957 that the Leadership Conference on Civil Rights has not played an important role in helping to secure.

I'm here today, both in that capacity, but also as someone born in the District of Columbia. I'm a native Washingtonian. I still reside in the District. I live in a historic section of Northwest Washington.

I strongly believe in the integrity of the District, both as the Nation's Capital and as a city responsive to those of us fortunate enough to call this place home. I am deeply distressed, both in my capacity as the Leadership Conference executive director, but also as a citizen of this great metropolis, about the current state of affairs that we face.

Now, I won't recite the litany of testament which you've already received this morning about the fiscal and political circumstances surrounding the District and our current difficulty. I think it is fair

to say that much has been documented about the current state of affairs.

I think the articles that have been alluded to from the New York Times recently, as well as many other articles which assess the broad range of pressures and unique burdens that the District bears, provide eloquent testament to the problems, both structural and political, that the city faces.

On the other hand, I think it is important to emphasize that what we are talking about has another dimension, and that is a dimension that involves providing equal rights for the citizens of the District of Columbia.

The Leadership Conference has long been associated with an effort to provide full equality for the citizens of the District of Columbia in achieving their political rights consistent with all other citizens in the United States. We've supported efforts to champion voting rights for District citizens. We've supported the effort to provide popular election for local officials.

I see that my time is running short. I'm going to summarize and ask, Mr. Chairman, that my full text of my remarks be inserted in the record.

Mr. DAVIS. Without objection, so ordered.

Mr. HENDERSON. What I would like to say is that we strongly believe that statehood is certainly the best option for achieving the level of political rights for District citizens that we believe are necessary. We worked with Ms. Norton on her effort to pursue legislation in the 103d Congress to achieve that result. We thought it was important, and we still do.

But see, we recognize something that is also critically important, and that is: the District of Columbia is not now in a position to secure the political rights for its citizens through the statehood process. Politically, it is simply not viable at this time.

We think, therefore, that it is necessary, if we are ever to achieve the full rights that District residents are entitled to have, both as citizens of the United States and then in comparison to those territories in our country that have citizens that are in similar political circumstances of District residents.

That is to say, they don't have voting representation in Congress, but at the same time pay none of the financial contributions to the Federal Government that the District pays, nor do they have the burdens structurally that come with the District's home rule charter.

So I would summarize by saying that we believe it is important and a civil rights issue of the first magnitude to provide full citizenship rights to those District residents who reside here and that, short of statehood, we believe it is important to achieve a level of fiscal stability for the city that helps us move the debate forward in achieving the political result that we all seek.

Now, I thought this morning's testament of the preceding panel with Speaker Gingrich and Senator Lieberman and, of course, Mr. Kemp really laid out the circumstances necessary to consider why this legislation is so important.

We have a number of reasons articulated clearly in our testimony which make that case, but I want to say, first and foremost, that this bill is a bridge between the current morass, both politically

and fiscally, in which the District and its residents find themselves today, and the ultimate objective of providing full voting and other constitutional rights for District residents.

This bridge can only be crossed by seeking to change the structural relationship between the District's residents and the Federal Government. The fact that you, Mr. Chairman, and other members of the subcommittee recognize that and that we're having this debate is an important first step.

I want to commend you and Delegate Norton again for your efforts and to say that we in the civil rights community stand ready to join with you in your effort to create the kind of bipartisan coalition that will be necessary to move this bill forward.

Last, we recognize, of course, that we are coming to the end of this congressional session. We think it is so imperative that this bill receive not just a hearing here in the subcommittee, but actual debate on the House and Senate floor with the idea of moving toward resolution, that we want to work with you, Mr. Kemp, and others to achieve that objective.

Mr. Chairman, thank you, and I'm happy to respond to questions that you have.

Mr. DAVIS. Thank you very much.

Mr. HENDERSON. Thank you.

[The prepared statement of Mr. Henderson follows:]



Leadership Conference on Civil Rights

1629 "K" St., NW, Suite 1010
Washington, D.C. 20006
Phone: 202 / 466-3311
Fax: 202 / 466-3435
TTY: 202 / 785-3859

FOUNDERS
Arnold Aronson
A. Philip Randolph*
Roy Wilkins*

OFFICERS

CHAIRPERSON
Dorothy I. Height
VICE CHAIRPERSONS
Antonia Hernandez
Judith L. Lichtman
William L. Taylor
SECRETARY
Morace Deets
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National Council of La Raza
Daniel Zingales
Human Rights Campaign
COMPLIANCE/ENFORCEMENT COMMITTEE
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STAFF
EXECUTIVE DIRECTOR
Wade J. Henderson
ADMINISTRATIVE ASSISTANT
Lisa M. Heywood
POLICY/RESEARCH ASSOCIATE
Karen McGill Lawson

*Deceased

STATEMENT OF
WADE HENDERSON, EXECUTIVE DIRECTOR
LEADERSHIP CONFERENCE ON CIVIL RIGHTS

ON THE
DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT
H.R. 3244
BEFORE THE
HOUSE DISTRICT OVERSIGHT SUBCOMMITTEE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
UNITED STATES HOUSE OF REPRESENTATIVES

JULY 31, 1996

Mr. Chairman and members of the Subcommittee, I am Wade Henderson, Executive Director of the Leadership Conference on Civil Rights (LCCR). On behalf of the Leadership Conference, I appreciate the opportunity to appear before you to voice our strong support for the District of Columbia Economic Recovery Act ("DCERA"), H.R. 3244. We believe DCERA is a well-crafted, innovative, and necessary step in the process of securing political rights for District of Columbia citizens.

The Leadership Conference on Civil Rights is the nation's oldest and most diverse coalition of civil rights organizations. The Leadership Conference was created by Arnold Aronson, A. Philip Randolph, and Roy Wilkins in 1950¹ as an independent body to promote passage and the implementation of civil rights laws designed to achieve equality under law for African Americans and to improve the quality of life for all Americans.

¹ A. Philip Randolph was the Founder and President of the Brotherhood of Sleeping Car Porters; Arnold Aronson was Program Director of the National Jewish Community Relations Advisory Council, a coalition of major Jewish organizations; and Roy Wilkins was acting Executive Secretary of the NAACP.

"Equality In a Free, Plural, Democratic Society"



Today, the LCCR has over 180 organizations that work together in resolving the significant civil rights problems of the day. These organizations include groups representing persons of color, women, labor organizations, persons with disabilities, older Americans, gays and lesbians, and major religious groups.

The Leadership Conference holds as a guiding tenet that all citizens of the United States must be treated equally under the law. In this regard, the Leadership Conference has long supported the civil rights movement here in the nation's capital, championing voting rights for the District's citizens and the popular election of local officials. The LCCR supports statehood for the District of Columbia, which in our view is a fundamental civil rights issue. Although District residents dutifully comply with the civic responsibilities and obligations required by our democratic form of government, they are blatantly deprived of many of the essential rights and privileges of citizenship enjoyed by all other Americans -- an issue of simple justice and fairness. District residents pay taxes to the federal treasury, and serve their country in times of war, yet they lack decisive voting representation in Congress, and control over their own local affairs. They bear all of the responsibilities and obligations of citizenship, yet receive few of its rights and privileges. It is well past time to put an end to this travesty.

The LCCR was a strong supporter of H.R. 51, the "New Columbia Admission Act", introduced by Delegate Eleanor Holmes Norton (D-D.C.) in the 103rd Congress. The bill would have made the District of Columbia the nation's 51st state -- New Columbia. Although H.R. 51 was defeated in the House of Representatives in November 1993 by a vote of 277-153, the mere consideration of the bill on the House floor was a strategic victory. After all, it was the first congressional vote for statehood for the District, the final tally exceeded all congressional vote estimates, and it provided a solid foundation for future efforts in the House and Senate.

It is in the context of statehood for the District of Columbia that we in the LCCR now voice our support of DCERA. First, as supporters of statehood for the District, we are dismayed by the fiscal insolvency with which the city now wrestles. We recognize that statehood for the District of Columbia, simply put, is not politically achievable as of today. It is at best, a remote possibility in the foreseeable future. Second, we believe that statehood for the District cannot and will not be given serious consideration in the body politic until the District of Columbia achieves economic viability. Third, economic viability for the District of Columbia will require structural changes in the relationship between the federal government and the city, which includes changes in the tax structure governing the city's residents.

We do not see DCERA as the final solution to the District's woes. Rather, we see it as a bold step -- one that will provide District residents with real economic opportunity and will help to restore the District's financial health. We believe it is a critical component in the ongoing struggle for District residents to gain the full rights of citizenship that ultimately will inure to them when the District one day achieves statehood.

Our specific reasons for supporting DCERA are threefold. First, the legislation is narrowly tailored to tackle the unique political, economic, and political quagmire in which District residents are now immersed; a political and fiscal quicksand that leaves District residents trapped in a city becoming ever less able to provide them with the basic services and opportunities they deserve as citizens of the United States. Second, the Congress, although recognizing that it has both historically and presently shackled the District with unique burdens, has demurred until now to consider legislation that would help District residents lift themselves out of poverty and despair. DCERA combats this ongoing legacy of neglect by placing economic power squarely in the hands of District residents. Third, we believe that DCERA has sound historical precedent. In limited and special circumstances, the Congress has utilized the tax code to promote opportunities for corporations such as Chrysler, middle income home purchasers, and lower income persons to achieve economic and social stability – to become participants, rather than mere bystanders, in our Country's dynamic economy. Below we will elaborate on each of these arguments.

The Legislation is Well-Crafted to Address the District's Unique Status as a Quasi-City/State

The District is dying. It is becoming ever poorer and more divided, along racial, income, and geographic lines. It is precariously close to becoming two cities, one closely aligned with its wealthy and well-educated suburbs in which attorneys, federal and local government workers, and high-tech engineers enjoy one of the highest per capita incomes in the nation;² and the other, a starkly different city where many residents are desperately poor, unemployed, reliant on public assistance, live in neighborhoods crippled by crime and violence, and are overwhelmed with the hopelessness that has overtaken a community suffering from an incarceration rate of 1,583 inmates per 100,000 residents³ and an infant mortality rate of 23.2%.⁴ The District of Columbia is becoming the Capital City that no one wants it to be. The Leadership Conference believes that DCERA will help to unite these two cities and restore the District of Columbia to its rightful status as the Nation's Capital.

Although demographically the District looks similar to many major U. S. cities, its history, governing structure, fiscal responsibilities, and unique relationship with the federal government set

²Assessing the District of Columbia's Financial Future: A Report to the Federal City Council, p.3. McKinsey & Company, Inc. and The Urban Institute, Coleaders (October 7, 1994) ("McKinsey").

³Edith R. Horner, Almanac of the 50 States at 437 (1996). This rate is more than four times the national average.

⁴County and City Data Book 1994 at 701 U.S. Department of Commerce, Bureau of Census, Economics and Statistics Administration (Computed as of 1988).

it apart. Congress established the District in its present location in 1790.⁵ For the vast majority of its two-century existence, District residents have been denied the opportunity to elect local officials;⁶ today their representative to Congress has no vote; they have no representation in the United States Senate; and the Congress has final say over all District laws – no matter how large or small.

The District government must perform the functions of both a city and state government – funding traditional “city” functions such as the police department and public works as well as “state” programs such as Medicaid, corrections, and Aid to Families with Dependent Children (AFDC). Unlike other urban centers, the District is forbidden by Congress from taxing the income of persons who work in the District but live elsewhere. This restriction has had dramatic effects on the District, especially since studies estimate that two out of every three dollars earned in the District are earned by nonresidents.⁷ From a purely economic standpoint, this prohibition cost the District an estimated \$471 million in lost income tax in 1995.⁸ From a sociopolitical perspective, this restriction has heightened the barrier that exists between the District and its surrounding communities. Suburban residents who work in the District reap the benefits that living near the nation’s capital brings, but pay no taxes to the District, permitting them to freely disassociate themselves from the city and its problems.

This is not the case with other large urban centers such as Baltimore, where the income of people who work there but live elsewhere is redistributed to the city through state political processes. Nor is it the case in cities like Philadelphia, which directly taxes people who work there regardless of whether they live in the city or the surrounding suburbs (Philadelphia residents pay slightly higher “earnings” tax than commuters). Nor is it true of many cities located near state borders such as New York City, which taxes individuals across state lines based on where they “earn” income rather than where they live. In all of these situations, the tax policy not only captures a portion of nonresidents’ income but also their “political” interest. Even if they are not allowed to vote in the city to which they commute, they may choose to exert political influence in the city in other ways in light of the fact that a portion of their income is accruing to that city.

⁵1 Stat. 130 (1789). This law called for the establishment of a national capital, which was to be located temporarily in Philadelphia from 1790 until 1800, at which time the national government was to move to its present location.

⁶In an ironic historic twist, just shortly after the Civil War, District residents – including thousands of African Americans who had (i) migrated to the District during and after the Civil War and (ii) participated in local District elections beginning in 1868 – lost the right to popularly elect their local officials. See 20 Stat. 103 (1878); 26 Stat. 1113 (1890).

⁷McKinsey at 6.

⁸The Case for a More Fair and Predictable Federal Payment for the District, p.26. D.C. Applesseed Center for Law and Justice (November 2, 1995) (“Applesseed I”).

This restriction is not the only revenue bar that unfairly handicaps the District. Approximately 50% of the property in the District is exempt from local property taxes (including property owned by the federal government, foreign governments, universities, nonprofit associations, and churches), which resulted in an estimated revenue loss of approximately \$690 million in 1995.⁹ Although many state capitals have significant amounts of untaxable land, none approaches the scope of the District and all have the opportunity to “capture” this lost revenue through the redistribution of state taxes.

As a result of these (and other) restrictions on the District's ability to garner revenue, the District government raises almost 50 % of its revenue through local sales, property and income taxes, whereas most cities raise closer to 15% through these means.¹⁰ These constraints have had a devastating effect on middle and lower income residents of the District, where income, property and sales taxes have risen such that today they are among the highest in the nation (compared to the combined state and local rates of other cities and states). But, as discussed below, local taxes coupled with a declining federal payment are not enough to provide for District residents.

City services have begun to crumble. The District's foster care system and department of public housing are governed by receivers; significant aspects of the department of corrections and mental health care delivery system are ruled by court order; the District was forced to reduce trash collection to once a week for a time in 1995; and in each of the last two years the public schools have been closed for numerous days due to employee furloughs.

And the heart of the District has begun to flee. Between 1985 and 1993, the District's population decreased from about 625,000 to 578,000, or 7.5%.¹¹ At the same time the number of employed District residents decreased from 320,000 to 250,000,¹² a decrease of 21.9% (this decline that is particularly troubling since only District residents pay District income taxes). From 1985 to 1990, 35,000 married families and families headed by women left the District while only 13,400 similar households moved into the District.¹³ Households with children were three times more common among households moving out of the District than of households moving into the

⁹Id. at 23.

¹⁰McKinsey at 5.

¹¹Four Years Later – The Rivlin Report Revisited: An Assessment of Progress in the District of Columbia, p.22. KPMG Peat Marwick LLP (December 1994) (“Rivlin II”).

¹²Id.

¹³Comings and Goings in the Washington Area – Report No. 1: Impact of Migration on the D.C. Population, p.4. Greater Washington Research Center (April 1994).

District.¹⁴ The District's African American community lost 17,800 households and its white population declined by 6,200 – representing a substantially greater percentage loss among African Americans.¹⁵

Comparing the District's population in 1990 versus 1985, there were 11% fewer households with income of between \$30,000-\$39,999, 14.8% fewer with income between \$40,000-\$49,999, 11.3% fewer between \$50,000-\$59,999 and 13.1% fewer with income between \$60,000-\$74,999. Departures at the ends of the income spectrum were quite different, though. There were only 9% fewer households with income over \$100,000, 7.7% fewer with income between \$10,000-\$19,999, and only 2.8% fewer with income under \$10,000.¹⁶ As a result, by 1990, almost 25% of the residents of the District households had incomes of less than \$15,000, while only eight percent earned over \$100,000.¹⁷ *In summary, while middle income families fled the city, lower income families and individuals remained.* Absent drastic action, there is no reason to believe this trend will reverse itself. Without change, the future is untenable – a decreasing number of employed residents paying taxes to provide basic services to an increasing number of unemployed lower income residents.

DCERA, which encourages middle income residents to stay in the District and provides significant tax reduction for lower income residents, may help to reverse this trend.

Critics of DCERA generally fall into two camps. The first claims that it is merely an invitation for wealthy suburbanites to move to Northwest D.C., resulting in gentrification, spiraling property values, and a greater disparity of wealth and opportunity among District residents. The second clamors that it is yet another “handout” to the District government, albeit an indirect one.

Although we are sensitive to the concern that an improperly implemented bill could benefit the wrong people, we believe that local leaders working with Congress can ensure that such fears are not realized. Therefore, we view the bill quite differently than its critics. As the statistics above show, it is the middle class that is leaving the District. We see DCERA as an innovative mechanism to convince them to stay, to dig in, and to make their local government responsive to their needs.

There are two reasons why the primary beneficiaries of DCERA would be the middle class. First, DCERA only reduces taxes on wages and capital invested in the District. Because

¹⁴*Id.*

¹⁵*Id.* at 5.

¹⁶*Id.* at 5-6.

¹⁷*Id.* at 5.

many upper income residents likely receive a large portion of their income from returns on investments or dividends that originate outside of the District, these sources of income would continue to be taxed at the normal federal rates. Second, the large personal exemption in DCERA makes the tax decidedly progressive. People earning between \$30,000 and \$50,000 (which is the group from which the city has had the largest population loss) would receive a tax reduction in the range of 50%. By comparison, District residents making over \$100,000 would receive closer to a 35% tax reduction.¹⁸

We also view DCERA as a direct method to provide low-income working families in the District with a level of take-home pay that will allow them to live in a manner befitting U.S. citizens and provide them with the economic clout to have their concerns heard. Under DCERA, individuals (and married separate-filers) earning less than \$15,000, single head of households earning less than \$25,000 and married (joint-filing) couples earning less than \$30,000 would be completely exempt from federal taxes. And finally, we view the bill as an earnest carrot to lure middle and upper income persons who have left the District to come back and to help to rebuild the neighborhoods they left.

Congress Has Failed to Provide Any Significant Relief to District Residents

In 1973, with the passage of the Home Rule Act, District residents were afforded (starting in 1975), for the first time in a century, the opportunity to elect local officials with significant authority to govern the District.¹⁹ In keeping with the mandate of the Constitution, however, Congress maintained a "final say" on all District legislation.²⁰ Although the Home Rule Act was a watershed moment in the fight for suffrage and political autonomy for District residents, in hindsight, we believe it was a less than perfect deal. Congress forbade the District from enacting a commuter tax.²¹ District residents were left to finance a \$2 billion unfunded pension liability, which had grown to \$4.7 billion by 1995.²² In agreeing to make an annual federal payment, which historically had been approximately 40% of District expenditures, the U.S.

¹⁸Eleanor Holmes Norton, Why D.C. Needs a Tax Break, Wash. Post, July 21, 1996, at C7.

¹⁹District of Columbia Self-Government and Governmental Reorganization Act (codified at D.C. Code Ann. § 1-201-1-299.7 (1981)) ("Home Rule Act").

²⁰Section 602 (a)(5) of the Home Rule Act (codified at D.C. Code Ann. § 1-233(a)(5) (1981)); U.S. Const. art. 1, §8, cl. 17.

²¹The statute that forbids D.C. from enacting a commuter tax is section 602(a)(5) of the Home Rule Act (codified at D.C. Code Ann. § 1-233(a)(5) (1981)).

²²The District of Columbia's Pension Dilemma -- An Immediate and Lasting Solution, p.1. D.C. Applesseed Center for Law and Justice (June 26, 1996) ("Applesseed II").

House of Representatives refused to adopt the Senate's proposal that the payment be calculated as a percentage of District expenditures. Instead, the federal payment was to be replaced by a to-be-negotiated annual amount.²³ Recognizing that this process made budgeting in the District unworkable, in 1991 Congress authorized that the payment be restored as a percent (24%) of District revenues.²⁴ But by 1994, Congress ended the percentage based formula, citing differences over the definition of "revenues."²⁵ After increasing between 1989 and 1991, the federal payment has remained virtually unchanged at approximately \$650,000 through 1996.²⁶

We are dismayed that at the time Congress passed the Home Rule Act and subsequent amendments to it some members of Congress may have realized that the limitations imposed on the District to raise revenue, particularly given the unique financial burdens of the District, would one day strangle it²⁷ -- that the federal payment would prove inadequate, that negotiating it each year would make budgeting unworkable, that Suburban residents would face neither economic nor political reasons to care about the city in which so many of them work, that the unfunded pension would drain precious city resources.

We are further frustrated by Congress' failure to act on behalf of District residents during the 1990s, particularly in light of the weight of opinion and research -- by persons and institutions representing a broad array of political and economic viewpoints -- concluding that absent dramatic action, the District's financial situation would reap adverse consequences on District residents -- especially those too poor to "opt out" of public services (i.e., send their children to private schools; hire private neighborhood security patrols, day care workers, and garbage collectors; pay for private health care).

²³Id. at 4-7.

²⁴District of Columbia Budgetary Efficiency Act of 1991 (codified at D.C. Code Ann. § 47-118.1 (1991)).

²⁵Appleseed I at 7.

²⁶Appleseed I, Exhibit 2.

²⁷For an incomplete listing of commentary occurring over the course of twenty years, see e.g., Bills on Home Rule for the District of Columbia, Hearings Before the Committee on the District of Columbia, United States Senate, 89th Cong., 1st Sess. (1965); Statement of Sen. Kennedy advocating for the withdrawal of "self-defeating" strings from any legislation designed to support home rule (Cong. Rec. S 16,801 (1965)); Appleseed I at 5-6, citing the House Report on P.L. 102-102 (1991); and the recent statement of Rep. Collins emphasizing the adverse consequences that the bar on taxing nonresident income imposed on the District as a part of the Home rule Act has had on the District's financial status (141 Cong. Rec. H 4,004-65) daily ed. (Apr. 3, 1995).

In 1990, the oft-quoted Rivlin Report predicted that the District would run out of money by the mid-to-late 1990s without significant reform on the part of local government and increased assistance from Congress.²⁸ In late 1994, McKinsey & Company, working with the Urban Institute, reached a similar conclusion -- that although the District government needed reform, it could not support District residents absent an increased revenue base.²⁹ These conclusions were reiterated by the Rivlin Report II, issued in December 1994,³⁰ and reports of the Applesseed Foundation for Law and Justice on the Federal Payment (1995) and the Pension Fund (1996).³¹ And as recently as July 9, 1996, the General Accounting Office indicated that the District would run out of money and up against its statutorily imposed borrowing limitations by 1998, without increased assistance from the federal government.³²

It is within this historical and political context that we support DCERA. It is the right and just thing to do. It also is politically viable, representing the only tenable means of immediately placing economic and political power where it belongs -- in the hands of District residents. The bill does not automatically put any additional funds in the District government's coffers. Instead, economic clout is vested directly with District residents. The city government will only reap the benefits of the bill if District residents spend their rebates within the city (through property and sales taxes) and if people who currently work in the city move into the District (through income, property and sales taxes). So it will be up to District residents to work among themselves, and with the city government and the U.S. Congress to attract people of all income brackets to live, invest and consume here in the District -- a proposition that we can support.

The Bill Has Sound Historical Precedent

Enacting DCERA would comport with Congress' determination to utilize tax incentives to

²⁸ Financing the Nation's Capital: A Report of the Commission on Budget and Financial Priorities of the District of Columbia, pp. 1-1 through 1-3 (November 1990) ("Rivlin Report").

²⁹McKinsey at 10-11.

³⁰Rivlin II at 17-19.

³¹In Applesseed I, the foundation documented the inadequacies of the current federal payment, both the process by which it is now formulated and its amount, and provided an alternative method for calculating it. In Applesseed II, the foundation traced the history of the District's current pension dilemma and proposed that the federal government assume full responsibility for its unfunded portion.

³²Statement of Gregory M. Holloway, Before the House of Representatives Subcommittee on the District of Columbia Committee on Appropriations. GAO Report: District Government: Information on Its Fiscal Condition and the Authority's First Year of Operation, pp. 26-28 (July 9, 1996).

help depressed localities achieve fiscal autonomy and our citizens achieve a base level of economic means. Laws governing federal taxation of the territories and creating Empowerment Zones are two examples of these types of tax incentives.

Residents of the territories receive a number of special tax incentives that are designed to help the territories achieve fiscal autonomy and their residents economic opportunity consistent with that of the majority of U.S. citizens. For example, Puerto Rican residents generally are fully exempt from the federal income tax on income derived from sources within Puerto Rico.³³ Guam and the U.S. Virgin Islands use a "mirror image tax policy," under which all federal income tax payments by residents of Guam and the Virgin Islands are made directly to their respective local governments, instead of to the U.S. Treasury.³⁴ In addition, U.S. corporations that meet specified requirements receive a credit against federal income tax for income earned in Puerto Rico and the Virgin Islands.³⁵

Although we will not attempt to trace the exact rationale for Congress' enactment of these laws in this statement, one theme certainly emerges from the histories surrounding them -- that the Congress has utilized the tax code to ensure that U.S. citizens residing in the territories live under political, social and economic circumstances which comply with a base level of decency required by the very tenets of our nation -- conditions which permit citizens access to economic viability consistent with citizens living on the mainland.³⁶ *District residents deserve no less.*

Congress has also provided geographic-based tax incentives within the 50 states. In 1993, Congress enacted legislation that created nine Empowerment Zones.³⁷ The legislation provides three incentives for businesses to locate within the empowerment zones, including an employment tax credit, an exemption for certain financings, and the ability to deduct rather than depreciate

³³I.R.C. § 933.

³⁴48 USC §§ 1421h (Guam) and 1642 (Virgin Islands) (1994).

³⁵I.R.C. § 936.

³⁶For a brief review of the commentary regarding Congress's reasons for granting the U.S. territories certain tax benefits, see, e.g., *HMV Indus., Inc. v. Wheatley*, 368 F.SUPP 915, 917 (D.V.I. 1973) (citing to numerous prior cases finding that Congress established the tax system in the Virgin Islands to "assist the Islands in becoming self-supporting"), *aff'd*, 504 F.2d 146 (3rd Cir. 1974); H.R. Rep. No. 245, 56th Congress, First Session at 16 (1900) (discussing the need to improve the economic plight of Puerto Rican residents).

³⁷Revenue Reconciliation Act of 1993, Title XIII of the Omnibus Budget Reconciliation Act of 1993 (codified as amended at 26 U.S.C. §§ 1391-1394, 1396, and 1397 (1993)).

certain capital expenses.³⁸

The similarities between DCERA and the empowerment zone legislation are noteworthy. Both Acts are aimed at helping residents of entrenched, undercapitalized communities experience economic opportunity. And both Acts impliedly find that in particular circumstances when, in spite of having the right to vote, depressed communities lack the economic clout to have their interests adequately addressed through local political processes, Congress may use its plenary power to provide legislative relief. At the same time though, empowerment zone-type tax relief would not work in the District because if employees do not live here, the benefit to District residents will be tangential and diluted because nonresident empowerment zone employees will not pay taxes in the District.

In conclusion, we respectfully urge you to consider the LCCR's support for DCERA. As we previously stated, we do not view DCERA as a fix-all for the District or its residents. We feel strongly, though, that the passage of DCERA is critical to the future of our nation's capital. We believe it has the potential to energize the city's residents and begin to restore the city's fractured financial base from the ground up, both of which are necessary ingredients for District residents to realize the long-term goal of full inclusion in our nation's democratic process -- an objective that ultimately will be made real through statehood.

Note: The LCCR wishes to gratefully acknowledge the pro bono assistance of Wilmer, Cutler and Pickering in the preparation of this statement.

*A number of organizations in the Leadership Conference have not taken a position at this time and do not join in this statement.

³⁸I.R.C. §§ 1394, 1396, 1397.

Mr. DAVIS. We've got another vote. It's just unbelievable. We voted to adjourn; we voted whether to appeal the ruling of the chair; we had a vote on whether to allow an exhibit on the floor. It's just delaying tactics and, unfortunately, it has disrupted the hearing.

Let me ask a question that has not been asked yet. I have looked at the testimony we're going to receive later to the subcommittee, presented by the Joint Committee on Taxation and their analysis of this. One of their conclusions is, while the relocation of business and people would improve the economy and income and property tax bases of the District of Columbia, they would cause a contraction in the economies and tax bases of the surrounding suburbs. That's their conclusion.

Now, the next sentence is revealing. It says, "The revenue estimate does not assume any net increase in national income as a result of this proposal." So, basically, it's a very static model. It's a kind of zero sum game.

Mr. KEMP. Right.

Mr. DAVIS. Is that appropriate, or do you feel that this really grows the region?

Mr. KEMP. Well, I've been observing the Joint Tax Committee for a long time, Mr. Chairman.

Mr. DAVIS. They'll get the last word, by the way, when they testify.

Mr. KEMP. Oh, yeah. The last time I heard, this was a Republican Congress, so let me say I am doubly disappointed in the Joint Committee on Taxation because it is, as you say, Mr. Chairman—their approach—predicated upon a zero sum understanding of America and what makes America tick, so to speak.

I haven't had a chance to totally analyze it, but I read on page 15 of their testimony that they introduce behavioral response, and, as you pointed out, Mr. Chairman, suggest that people will move into the city.

The testimony doesn't suggest, however, that A, would stay. B, it doesn't suggest what would happen if you eliminate the capital gains tax on any resident within the city. As Eleanor Holmes Norton has suggested, they might have a chance to get access to the capital and the seed corn to start their own business, their own version of the American dream.

Joint taxation does not take into consideration that a new job might come into being, that a new business might come into being, and there might be a property tax that gets paid or an income tax that gets paid or a FICA tax that gets paid or a sales tax that gets paid. There might be a new consumer, a new producer of income, and somebody making bread in the city.

You know, I faced this question a long time ago when I read the history of Luis Munoz Marin. I mentioned his name earlier. He said in the 1920's, before he became Governor of the island of Puerto Rico, that he sat up as an academic on Mount Olympus at the University of Puerto Rico in San Juan and was a socialist. He admitted that he was a socialist.

All he thought about, he said, as an academic was how we could take a loaf of bread and redistribute it among the people of Puerto Rico, all of whom needed bread to survive. Then, when he became

the Governor, he realized very quickly that you could either redistribute the loaf of bread or you could create more bakeries.

As soon as he said creating more bakeries will feed more people in Puerto Rico, that was the origin of the 936 tax provision that led to the industrialization of the island of Puerto Rico.

It is from that start, humbly speaking, that we—Charlie Rangel; Bill Gray from Philadelphia, now head of the United Negro College Fund; and Bobby Garcia from the South Bronx—joined in one of the most unique coalitions, which, in my opinion, has led to the Norton-Kemp-Gingrich-Lieberman-Mack-Wade Henderson effort on a bipartisan basis to try to create some bakeries in the District of Columbia.

Question—Are we going to simply redistribute one lonely loaf of bread or are we going to create bakeries in the District of Columbia where people can feed and eat and create jobs for this city? I am embarrassed that a Republican-run committee has such a limited view of capitalism, entrepreneurship, that they could come out with such a zero sum approach to their revenue estimate.

Incidentally, for the record, Mr. Chairman, Jim Prost of the firm, Basile, Baumann, Prost and Associates, will be testifying later. They estimate about \$700 million cost to the Federal Treasury. Dick Gephardt commissioned a study which says it would cost \$750 million.

And, of course, the Joint Taxation Committee has come out with a proposal that says it will cost \$12.8 billion by the year 2007. Goodness gracious. Let's go out to the year 3000, and we could sink the U.S. Treasury. I just rely on the good sense of people who understand that creating bakeries ultimately redounds to the benefit not only of the city but of the suburbs. I appreciate your position, Mr. Chairman.

Mr. DAVIS. Well, whether it's bakeries or whether it's bread, that's a lot of dough. [Laughter.]

Mr. KEMP. It's a metaphor, Mr. Chairman.

Mr. DAVIS. Let me yield to Ms. Norton.

Ms. NORTON. I was inclined to enlarge on that metaphor, but have decided not to.

Mr. KEMP. However you slice it, it works.

Ms. NORTON. Just a word for each of you.

Mr. Henderson, your testimony is important, because there are members on both sides of the aisle that don't know how to act when it comes to this bill. That's in part because they've not seen anything like it and because their responses to all bills are entirely ideological.

So your testimony is an act of leadership, and it's important to me, as well, to see how the leadership conference would approach this bill. The last thing I want to do is put in a bill that the civil rights movement, of which I have been a part all my life, did not believe achieved its purposes.

You say, "Second, we believe that statehood for the District cannot and will not be given serious consideration in the body politic until the District of Columbia achieves economic viability."

Now, of course, the leadership conference was central to the statehood vote we were able to get in the 103d Congress. Does this statement in your testimony mean that you do not believe that the

District can achieve statehood or some greater independence without rebuilding it's tax base?

Mr. HENDERSON. Ms. Norton, I think that's absolutely correct. Again, I think, first, you understate your own contribution to the civil rights movement, and indeed you have been a great leader, and we have worked together over many years.

I think that you know quite well, having pursued the course of action to achieve statehood for the District of Columbia, how difficult a task we face in the Congress, even assuming that the city's financial circumstance was stabilized.

At the time that you pursued your legislation, while issues of concern were expressed about the structural impediments to statehood, none of the range of concerns that we face today were amplified at that time, and we did not face those immediate problems.

My own view is that statehood right now is politically untenable only because those that oppose statehood for reasons that may be legitimately associated with fiscal circumstance, as well as those who may oppose it for other reasons, have the city's financial crisis as a legitimate basis of concern.

I think they look at that issue; they see the problems that are built in, inherent with the structure. I think they believe and we believe that unless there is some way of stabilizing our economy, helping it grow, addressing the problems of the people who currently live and pay taxes in the District, then we won't achieve the kind of political critical mass that is necessary to advance the constitutional interests that we're talking about for District residents.

I mean I want to go back and just emphasize one point. When we talk about statehood for the District of Columbia, that's really a metaphor for addressing the constitutional interests that District residents have as citizens of the United States and that we are presently deprived of, and so it's an important step to address that.

Now, for those who have raised concerns about who would benefit from this bill, I remind you, Ms. Norton, that of the 237,000 filers of Federal income tax here in the District of Columbia, 21 percent of them—that is 50,000 individuals—have incomes of less than \$15,000. Under your bill they would pay no Federal income tax.

Thirty-seven percent—or 87,000 individuals—have incomes between \$15,000 and \$30,000, and they would have their Federal income tax reduced by about 79 percent. And then, 22 percent of that population have incomes between \$30,000 and \$50,000.

We're talking about a bill that would benefit primarily middle-income and low-income residents of the District. It would help to stabilize the out-flight migration of District residents. It helps to create a regional economy that can support the kinds of interest that we all share in common and that you've heard here this morning so eloquently stated. And then, last, it advances the agenda of achieving the constitutional rights of District residents in the only way that seems viable under the current circumstance.

Ms. NORTON. Mr. Henderson, does that mean, then, given what you have said, that the leadership conference considers the DC Economic Recovery Act a civil rights issue such that the leadership conference would score a vote on this matter as a civil rights vote?

Mr. HENDERSON. Well, certainly, Ms. Norton, as the executive director of the leadership conference, that would be my recommenda-

tion to our executive committee that would ultimately make the judgment about which votes to consider.

But certainly, as one who has been a long-time advocate for the constitutional rights of District residents and because I know of the history of the leadership conference's interest in these issues, certainly I would hope that that recommendation would be accepted, and certainly, indeed, I would offer it.

Mr. KEMP. Could I interject?

Ms. NORTON. Indeed so.

Mr. KEMP. As a Republican of the Abraham Lincoln and Frederick Douglas variety, that empower America will consider this to be a civil rights empowerment vote.

I personally believe with all of my heart, having not been part of the civil rights movement in the fifties or the sixties—I was out playing football, raising a family, making a lot of money, raised in California, didn't know much about—frankly, didn't take into consideration—the great efforts of Rosa Parks, Dr. King, John Lewis, Eleanor Holmes Norton, Wade Henderson, or the great men and women of the civil rights movement.

But I'll tell you what. I'm here today to say to my party that if they don't do something for urban America, starting with the District of Columbia, we can never, ever, ever again champion the cause of human civil legal voting and equal rights for men and women that started under Abraham Lincoln and was the purpose for which the Republican party started and was the reason why black folks voted Republican up until probably 1932. If we don't do it now, we can never again champion the cause of those rights for which our party came into being in 1860.

Ms. NORTON. Thank you very much. I'm pleased to see how empower America would score it. I want you to know that it was important, because people sought the guidance and the leadership of the leadership conference on the statehood vote.

Mr. KEMP. Absolutely.

Ms. NORTON. And they didn't know whether this was a civil rights vote or not, and when they learned that the leadership conference scored it as a civil rights vote, there were lots of people who then began to study the bill and understand why it was such. That's why I wanted to get that on the record.

Jack Kemp is a personal phenomenon. I just want to say a few things to Jack and then ask him a question. The Speaker, you will recall, indicated that he expressed some hope that, if we move toward this bill, the District of Columbia would do something to indicate that it wasn't thinking of taxing away what the Federal Government was making available.

So I do want to say for the record here that, in response to my introduction of this bill and before it adjourned for the summer, the District of Columbia City Council has passed a bill that has frozen property, sales, and income taxes in the District of Columbia right now, as a response to my bill.

My bill is getting its first hearing today. I do think that that says something about how even the news of this bill can have an effect on the city.

Mr. KEMP. Right.

Ms. NORTON. Someone has estimated that 50,000 people who now live in the District of Columbia would begin paying District income taxes the moment this bill passed, that there are so many staffers and others who claim other jurisdictions and pay taxes elsewhere who would be inclined to change their residence.

I appreciate what the Speaker said about the uniformity clause, and there will be testimony on that. I'm always amazed to hear about the uniformity clause. Nobody raised the uniformity clause when the District of Columbia is paying, as I speak, taxes second per capita in the United States without any State representation. Where is the uniformity there?

Mr. KEMP. Yes; right.

Ms. NORTON. Where were those constitutional objections? Where is the uniformity clause when four territories send a delegate to Congress and pay no Federal income taxes? Where are the constitutional experts on the uniformity clause on that matter?

Mr. KEMP. Hear, hear. That's right.

Ms. NORTON. I dare anybody to come forward and say this bill is unconstitutional unless they are prepared to say that there ought to be constitutional relief for the people I represent right now, because they pay more Federal income taxes than most people who represent people in the United States. That is the one that has some nerve.

But one thing that you hear my people say is, "No taxation without representation." How come we pay more than this man's people pay? How come we pay more than the chairman's people pay? Come on. We want to talk fairness and constitutionality? Don't open that one up. That one really gets me. I'm pleased that the Speaker took that one on.

What about enterprise zones which have different tax rates from other parts of States? Is that unconstitutional? Why didn't you tell Jack Kemp, when he was pressing, that that was unconstitutional, and that he shouldn't even consider trying to get that through?

Instead, he got it through, and now, he's got the Democratic President of the United States, who put the same bill through last year. It must have been unconstitutional. I want all those people to run into court right now, because they've got vehicles to test that on, and mine isn't even enacted yet.

Mr. Lieberman said that there were things in this bill for other cities. I can think of three cities in his State—New Haven, where he and I know because we were in law school there; Bridgeport; Hartford. I don't pretend that this bill and all of its elements is replicable everywhere those cities have States, and we know the differences.

Mr. KEMP. Right.

Ms. NORTON. But I do believe that we have tried every other kind of urban policy except some kind of citywide favorable treatment for cities. If you could get people to live in Detroit and Bridgeport, you probably wouldn't have to tax those people who live in wealthier parts of the State in order to send money back to keep Bridgeport and Detroit alive and up and running.

Most Americans don't know that the average city gets upward of 75 percent of what it takes to keep them running from State aid and the Federal Government.

Mr. KEMP. That's right.

Ms. NORTON. These cities aren't supporting themselves by any stretch of the imagination. We need to learn, though, what tax policy will do, and so we have to start somewhere. One thing would be a break in State income taxes right now. You can try that right now. But look at this broad bill and see what elements of it prove out, and then, for God's sake, take it quick to New York and to Newark and to Chicago.

Mr. KEMP. Sure.

Ms. NORTON. Finally, I want to ask one question of Mr. Kemp.

Mr. KEMP. Jack.

Ms. NORTON. Or, to his friends, Jack.

Mr. KEMP. My father is Mr. Kemp. I'm Jack. You may meet him some day, and I want you to call him Mister, but I'm Jack.

Ms. NORTON. OK. Enterprise zones began as an idea in Jack Kemp's head which he relentlessly pressed. He mentioned here, first it was seen as a Republican idea.

Mr. KEMP. That's right.

Ms. NORTON. People on my side of the aisle said, "Who ever heard of that?" When the Federal Government didn't immediately do something about it, what you had is that every State and every city tried to pass their own enterprise zones.

Mr. KEMP. That's right.

Ms. NORTON. There have been difficulties because the enterprise zones are limited. It's harder to get business to move back to a part of the city where only low-income people live.

I would like to know how you achieved bipartisan support in the form of stone-cold Democrats like Charlie Rangel for your bill when it was initially seen as a partisan political bill.

Mr. KEMP. Well, I appreciate the question. I love your passion, and I associate myself with your eloquence and your remarks and say one more time for the record that this is not partisan. It's not a new idea. It's as old as Hebrew scripture. This is what Joseph told Pharaoh to do to get 7 fat years. Excuse my allusion to the Bible.

But Rangel and Garcia and Kemp joined together in the late seventies to introduce the Enterprise Zone bill, predicated, as I told you, on the industrialization of Puerto Rico idea of using tax incentives to create an industrial economy in a Third World country, i.e., Puerto Rico.

We crossed the aisle; we shook hands; and I said to Rangel, Gray, and Garcia, "Why don't we do it in Harlem? Why don't we do it in south central L.A.? Why don't we do it in Chi Town, and why not do it in Buffalo, NY?"—which I represented in the 1970's and 1980's. So it was not my idea. I stole it.

Eleanor, I have stolen every—if I have had any good ideas, I've taken them from other people. I got this from Luis Munoz Marin and Bobby Kennedy. I got the Kemp-Roth tax rate reduction from John F. Kennedy, who got it from Calvin Coolidge, who got it from—I don't know—Abraham Lincoln. There are no new ideas. They're all old ideas—A. And B, I would just say, it's interesting—and Wade, you remember this—Mayor Bradley testified on behalf of enterprise zones.

Mr. HENDERSON. Sure.

Mr. KEMP. Mayor Rendell of Philly testified on behalf of it. Giuliani testified on behalf of it. David Dinkins testified on behalf of it. If you gave it to the cities of the country, you would have every mayor—Republican, Democrat, black, white, Hispanic, and whatever. They would be here testifying on behalf of this, from Minnesota to California.

So don't worry about partisanship. We can call it the Eleanor Holmes Norton Memorial—excuse me, not Memorial. [Laughter.]

You could be memorialized before you even go to your eternal reward. It is not partisan.

I'll close with my favorite Bobby Kennedy statement. He said, "To fight poverty without private enterprise is to fight a war without your army." The army to combat poverty in America is not the government alone, albeit it has a role in providing a safety net. The army of private enterprise to create more jobs in America is the tax system.

I want to say to my friend in the chair, I'm looking forward to coming to Minnesota to campaign with him, because I know, in his heart of hearts, he's going to end up being a champion of this great legislation by a great woman from the District of Columbia.

Did you know, by the way, Mr. Chairman, the question was asked by the chairman, Tom Davis, about the so-called \$200,000. I want everybody to know, there are only 4,000 people in the city left who earn \$200,000 or more.

Mr. HENDERSON. That's right.

Mr. KEMP. Now, what are we going to do? Keep the tax system as is and chase them all to Florida? Did you all see what Juwan Howard did? He didn't sign with the Bullets; he signed with—who did he sign with? Some Florida team. Who was it?

Mr. GUTKNECHT [presiding]. Miami. Miami Heat.

Mr. KEMP. The Heat.

Mr. GUTKNECHT. That's right.

Mr. KEMP. They don't even tax income in Florida. So he saved—I don't know what his salary was, but he had a \$19 million contract, and he moved to Florida because the tax on his income in this city would have taken over \$1 million a year for the rest of his career.

Now, what are we going to do, Mr. Chairman, when we don't have anybody to pay taxes in this city? That's what we're doing. We're trying to hurt the rich, and it's not hurting the rich. They move to Montgomery County and Florida. It hurts the poor and keeps them from getting rich, because you cannot get rich, Mr. Leader of the Chamber of Commerce of Fairfax County, on wages.

You've got to get rich by earning, saving, investing, and starting your version of the American dream, and if we snuff it out in the District of Columbia, it's going to be a terrible burden on this Congress and this White House that has already said, "Drop dead, D.C." I'm going to give Bill Clinton a chance to resurrect his image after Leon Panetta almost destroyed it.

Ms. NORTON. Give him a chance.

Mr. KEMP. I'll give him one more chance.

Mr. GUTKNECHT. I want to thank the people who are testifying here and Eleanor. This is really—I'm surprised. I talked to you, Jack, just briefly.

Mr. KEMP. Yeah, Gil.

Mr. GUTKNECHT. To tell you that I had received a number of calls in my office on Monday. I did not see what Mr. Panetta had said on the Sunday morning talk shows. I would just say that I'm delighted that this hearing is getting more of the facts on the table, because I do believe facts are stubborn things.

Mr. KEMP. Bless your heart.

Mr. GUTKNECHT. And I do believe that we need to talk a little bit about our special relationship that the people of the United States have with Washington, DC and with Puerto Rico and with Guam and with the Northern Marianas Islands. I think there are an awful lot of Americans who do not understand the special relationships we have with those particular districts and territories.

Mr. KEMP. Good for you.

Mr. GUTKNECHT. Mr. Henderson.

Mr. HENDERSON. Mr. Chairman, can I make just one observation? That is, if ever there was an example of justice deferred is justice denied, it is in the circumstance of District residents who are denied their constitutional rights to citizenship here in the United States. That's why the Leadership Conference on Civil Rights considered the statehood issue so important in achieving constitutional rights for the District.

The Clinton administration supported statehood, and we appreciated their support because it was an indication of their recognition of the inherent constitutional right that was at issue. It seems to me that, if you look at the current fiscal circumstance of the city, it is hard to dispute the observation that statehood is, at best, at this point, a dream that will be deferred for a period.

For that reason, if for no other, looking for creative solutions that provide a bridge between the current circumstance and what the city must ultimately become in order to achieve those constitutional rights is an important step. So to say that you support statehood, but then don't take the extra step to say, "How do you address the current situation," it seems to me, is a hollow commitment.

What we're asking individuals to do is to examine once again the important role that the tax structure plays in creating a healthy and harmonious atmosphere that allows the city to experience growth that attracts the diversity of citizenry that will be necessary to create the political foundation to achieve these constitutional rights.

That's why the Leadership Conference considers this bill a civil rights bill, not a tax policy bill, because it ultimately goes to the foundation of the constitutional deprivation that D.C. citizens now experience.

Mr. GUTKNECHT. I certainly don't disagree with anything that has been said here, but I want to go back to what the Speaker said, that we have to have a better vision for this city, for our Capital, than what we see now. My grandma used to say, "If you always do what you've always done, you'll always get what you've always got."

Mr. HENDERSON. That's right.

Mr. GUTKNECHT. And just doing more of what we've been doing is not getting us in the right direction. And so the interesting thing

about this concept is it's beginning to say, "Wait a second. We have to take a new look. We have to encourage people to invest and save for themselves." So I think this is an idea—maybe it's not a new idea. Maybe it is an old idea. But maybe it's an idea whose time has finally come.

Mr. HENDERSON. Perhaps so.

Mr. GUTKNECHT. And so I'm delighted that you're here. I was very happy to see the Speaker take an active role. I'm certain we're all going to take some flak about this, but I think we've got to take this story back to our districts and explain the special relationship we have.

As a former State legislator, I do understand that we are like the State legislature for the District of Columbia. In some respects, I almost wish that weren't the way it is. But that's the way it is for now, and I do agree that the whole concept of statehood is something that may happen down the road. It may not.

But whether it happens or not, we do have a special responsibility, not only to the people who call Washington, DC, home but, I think, to all Americans. I think when my constituents come to Washington, DC, I think they want to be proud of this city.

Mr. KEMP. Yes.

Mr. HENDERSON. Absolutely.

Mr. GUTKNECHT. And if we continue to just pour money at it. But one of the concerns that I have, there are really two sides to the equation.

Mr. HENDERSON. Of course.

Mr. GUTKNECHT. This is not just about reducing taxes. It seems to me that may be a very important component. But, on the other hand, I think we have to acknowledge that more and more money is not the answer, either, because if you take this city and break it down, it's not that we're not spending enough money.

Mr. KEMP. Could I just interject a thought, Mr. Chairman—because I appreciate very much your attitude and that of Tom Davis as a lifelong member of the Lincoln wing of the Republican party. I really do. It is the Good Shepherd model to take into concern the weakest part of your family, and this is our family.

Now, having said that, I drove up Pennsylvania Avenue from my office at Empower America at 18th and I. I went by the World Bank. It pays no Federal tax, no property tax, no income tax. They may pay some sales tax. But if you stop and think, as Eleanor has pointed out, close to 45 percent of all the property in the District of Columbia is off the tax roles.

Newt pointed to the Smithsonian. I would point to Fannie Mae. You could point to the SEC, that you and I, Eleanor, helped—was it the SEC that we worked together on—to the World Bank, to the embassies, to the Government buildings.

So, in effect, I'm not sure \$660 million from the Federal Government is enough of a payment to make up for the loss of the tax revenues of having so much property off of the tax roles. I'm not sure. Somebody smarter than I should make that designation. But, in my opinion, it should be painfully obvious to anybody of good will who wants to help the Nation's Capital that the city cannot continue to implode.

I wanted to read into the record—I asked Tom to put this in the record—but listen to the starting paragraph of the New York Times last week:

On any given day in the nation's capital of the richest nation in the world, one-third of the 16 water-pumping firetrucks are kept out of service to save money. Police officers dip into their own pockets to buy tires and put gasoline in their squad cars. City clinics periodically stop testing for AIDS because they cannot afford supplies. Local officials dump extra chlorine into the drinking water to battle the elevated levels of bacteria caused by the eroding pipes.

When are we going to act if we cannot act on the a priori self-evident condition that the city cannot survive without an infusion of either Federal funds or a tax-driven, incentive-based, radical, entrepreneurial, democratic, capitalistic idea? Thanks.

Mr. DAVIS [presiding]. I'm going to let you go.

Mr. KEMP. Thanks, Mr. Chairman.

Mr. DAVIS. We appreciate very much your contributions to the dialog.

Mr. HENDERSON. We appreciate it. Thank you.

Mr. DAVIS. I will now call our next panel to testify, which will consist of economist James Prost, Marty Sullivan, Dean James Edwin Kee of George Washington University, and Dr. Steven Fuller of George Mason University. I am grateful to you for being willing to share your expert views with this committee.

As you've seen, it's the policy of this committee that all witnesses be sworn before they can testify. Would you please rise with me and raise your right hand.

[Witnesses sworn.]

Mr. DAVIS. Thank you. Mr. Prost, we'll begin with you. Thank you all for bearing with us. This has been a spirited morning. We are right now having our third motion to adjourn of the day. They can't do another one of the procedures for another hour, so we're OK for an hour. Go ahead.

STATEMENTS OF JAMES L. PROST, PRINCIPAL, BASILE BAUMANN PROST & ASSOCIATES, INC.; MARTIN A. SULLIVAN, TAX ANALYST; JAMES EDWIN KEE, SENIOR ASSOCIATE DEAN, PROFESSOR OF PUBLIC ADMINISTRATION, GEORGE WASHINGTON UNIVERSITY; AND STEVEN S. FULLER, PROFESSOR OF PUBLIC POLICY, GEORGE MASON UNIVERSITY

Mr. PROST. Thank you. My name is James Prost. I am a principal of Basile Baumann Prost & Associates. We are an economic development firm in Annapolis, MD. I am an economic development planner and have over 25 years of experience, primarily in community economic revitalization issues. I have worked for various local jurisdictions—Fairfax County, Syracuse, Montgomery County, as well as Boston, Cleveland, Kansas City, St. Louis—throughout the country.

I am here to testify on some of the critical issues and problems facing the Nation's Capital; describe the process under which I worked and played a small part in helping to formulate the economic development aspects of the act; describe how the act is targeted to address these critical issues; and, address some of the likely results of implementation of the act.

I am not going to spend much time addressing the problems facing the District. I cannot be as eloquent as the previous speakers, and I think we all know the problems that have affected the District, particular the loss of the middle class.

One interesting statistic, in the last 5 years, while the country as a whole had a 2.8-percent increase in the broad middle class, the District had an 11-percent decline in the broad middle class, as people voted with their feet.

My firm had an ongoing contract with the District government to address a variety of economic development issues, and as that evolved over time, we began working on addressing the issues through the formulation of the Economic Recovery Act.

Some of the key issues to be addressed by that were: First, to avoid controversies related to direct Federal transfers to the District government or to increasing the capacity of the District government itself to tax; second, to help formulate an approach which would have broad bipartisan support; and third, to target the middle class. We wanted to stop the flight of the middle class from the District.

Fourth, we also wanted to encourage investment and job creation in the District and, most importantly, change the market perception. Right now, no one wants to go into the District, at least in terms of making their residential decision. How can we change the market perception? How can we get people to live, work, and invest in the District?

Finally, and very importantly, we worked with the Congresswoman to minimize any unintended consequences as a result of the act, such as housing market pressures, tax avoidance, or negative impact on any selected filer types.

In formulating the proposal, there are important elements we need to look at that differentiate this proposal from many standard flat tax approaches.

First, in order to target the middle class, there are large standard exemptions—\$15,000 for a single filer, \$25,000 for a head of household, \$30,000 for married joint filers.

Second, the proposal retains mortgage interest and charitable deductions. We are very much interested in encouraging home ownership, and encouraging District residents to continue in their generosity through charities.

Third, looking specifically at the nature of the residents of the District and how they make their tax payments, where they earn their money and how they make their tax deductions.

We discovered that it would be very beneficial to the lower and middle class to include these deductions. We also made sure we did not tax fringe benefits, again to target to the middle class.

Fourth, we wanted to encourage small business investment and venture capital, so we structured an arrangement whereby District residents would have their capital gains tax eliminated for District-earned capital gains. We wanted to avoid any potential tax avoidance or people trying to take advantage of it, so only dollars earned within the District have the lower tax.

The treatment of capital gains has a second aspect. By taxing capital gains of District residents earned outside the District at the higher, existing tax rate, it again adds to the progressivity of the

tax, and it also encouraged District residents to invest where they live. Finally, have a "hold harmless" clause to make sure that tax reform proposal does not adversely impact any low-income families.

We also urged and we were very delighted to see, corollary action by the District in terms of freezing property tax and local sales taxes to demonstrate that the reduction in Federal taxes would not be compensated by increases in District taxes.

It is very important to look at the results in terms of the progressivity of the act. District filers with adjusted gross incomes under \$15,000 will pay no Federal taxes. Married couples filing jointly, having income under \$30,000, will pay no Federal taxes.

We estimate that filers with incomes between \$15,000 and \$30,000 will have a tax reduction of 79 percent. Those with incomes of \$30,000 to \$50,000 will receive an average tax reduction of 51 percent.

At the higher levels, the amount of tax reduction is significantly lower. Filers with incomes between \$50,000 and \$100,000 receive an average of 41 percent, and those over \$100,000 receive a reduction of about 34 percent. The act is very progressive in the terms of having the largest deductions to the lower income filers.

Another important aspect of the progressivity is the shifting of the taxes from the lower income households to the higher income households. Filers with incomes over \$50,000 now produce 27 percent of the Federal tax collections. Under the Economic Recovery Act, their taxes would only amount to 17 percent, while the tax burden of households over \$100,000 would increase from 60 to 70 percent. It is a very progressive tax. It is definitely a progressive flat tax proposal.

In looking at some of the impacts, the most important is the change in market perception. The act will significantly encourage people to live and invest in the District.

There are, however, other major factors, as have been discussed, in terms of schools and crime and water and infrastructure, that affect the District, so while the act will have a positive impact on the District, it will not adversely impact the surrounding jurisdictions.

We very much concur with the result of a survey of local business leaders who believe that the tax will help attract newcomers to the District while not having an adverse impact on the surrounding suburban market.

There also are many important safeguards that the District already has and that the district is contemplating adopting to eliminate any problems that might happen in terms of housing price pressures as a result of the act. The act is an excellent instrument, a well-targeted instrument for encouraging investment in the District.

As we increase disposable income of District residents, as we create opportunities for investment in capital gains, we see significant development, encouragement of neighborhood revitalization, small and minority business investment, venture capital, a reality of increasing and enhancing the job creation of the District.

This additional job creation in the District, the additional encouragement of investment in the District, will have overall positive re-

gional growth results and create job opportunities for persons residing throughout the region.

We see the act creating a dynamic change in the market perception. We see this will reverse the negative spiral, return the middle-class taxpayers back to the District, provide the resources for the District to address its revenue problems, reduce its social service costs, reinforce the demand for and the ability to have enhanced services within the District.

The act represents an innovative, balanced, and targeted approach to the economic recovery of the District. Thank you.

[The prepared statement of Mr. Prost follows:]

TESTIMONY OF JAMES L. PROST

I am James L. Prost, Principal of Basile Baumann Prost & Associates, Inc. I am an economic development planner with over 25 years of experience in formulating and implementing economic development policies, community revitalization, market analysis and public/private financial feasibility projects. I have worked for public and private entities throughout the metropolitan Washington region (District of Columbia; Fairfax County, Virginia; Montgomery County, Maryland). I have also worked nationally on economic development and revitalization programs for inner-city areas such as Boston, Cleveland, Kansas City and St. Louis. A brief resume is attached at the end of my testimony.

I am testifying with regard to the District of Columbia Economic Recovery Act. The purpose of my testimony is to: (1) describe the critical issues and problems facing our Nation's Capitol; (2) describe the process under which the economic development aspects of the Act were formulated; (3) describe how the Act is targeted to address the critical issues facing the District; and (4) address the likely results of implementation of the Act.

1. Issues/Problems Facing the District

As we all know too well, the District of Columbia is facing an economic crisis. Residents are moving out of the District. This is particularly true of middle-income wage earners. This has resulted in a reduced tax base for the District, an increased tax burden for residents and a higher percentage of the population needing governmental services.

There also has been a lack of employment growth within the District. The number of jobs in the District rose only 2,900 from 1993 and 1994 compared to an increase of 65,000 jobs in the metropolitan suburbs. The District has also experienced a lack of small business investment, and a continued decline in retail sales and small business formation.

From 1980 to 1993 (adjusted for inflation), the proportion of District federal income tax filers with adjusted gross income between \$15,000 and \$30,000 grew 25 percentage points more than in the country as a whole, while the proportion of filers with adjusted gross incomes between \$50,000 and \$100,000 declined by 10 percentage points more than in the country as a whole.

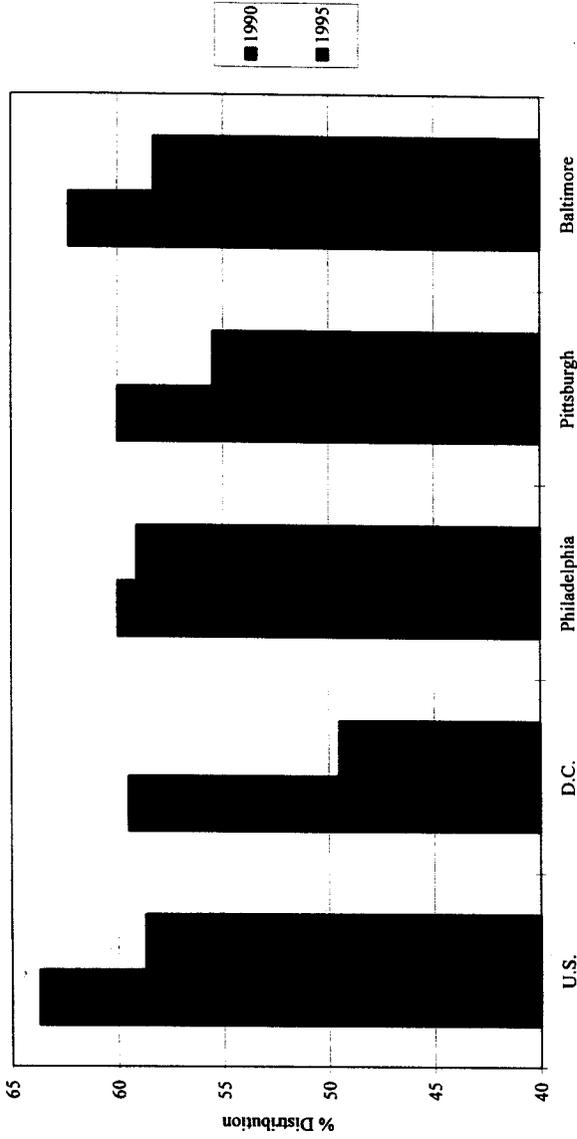
From 1990 to 1995, the District lost 22,500 households. A significant portion of those households are in the broad middle class. As shown in the attached chart, the District experienced a significantly greater loss in broad middle-income households than the nation as a whole or other major northeastern cities (Philadelphia, Pittsburgh, Baltimore).

As shown on the second chart, while the percentage of middle-income households (\$20,000 to \$50,000 Effective Buying Income) increased by 2.8 percent in the country as a whole over the 1990 to 1995 period, the proportion of middle-income households in the District declined by 11.2 percent.

2. Process

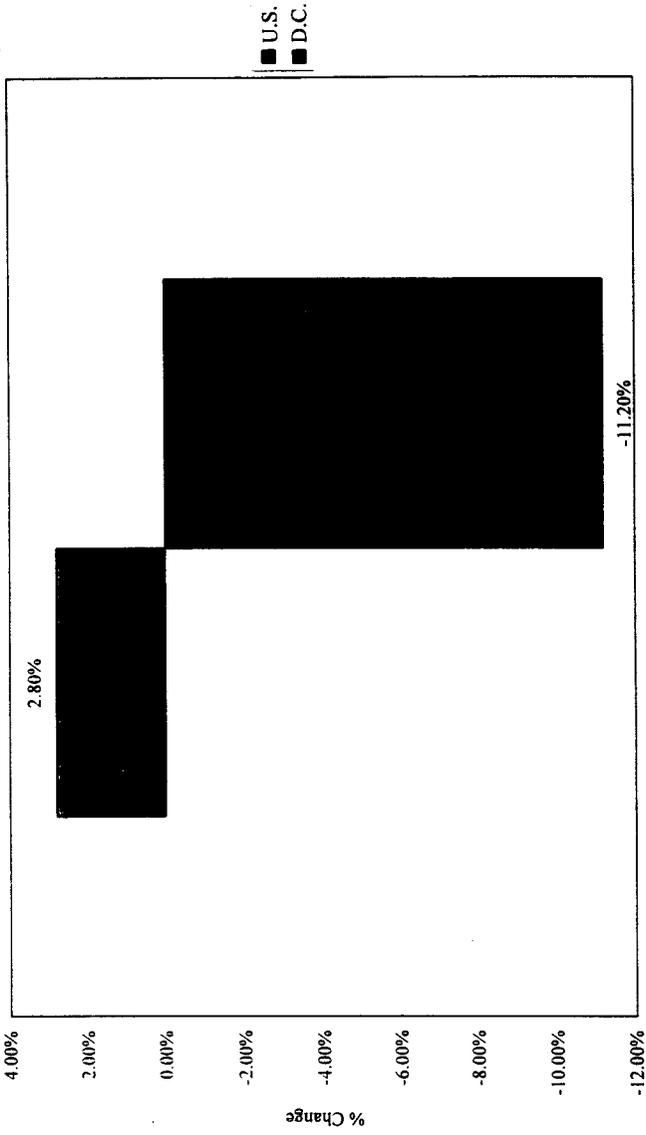
My firm, Basile Baumann Prost & Associates, Inc., had an ongoing task order contract with the District Government, Department of Housing and Community Development to address a variety of economic development issues. As part of this work, we were tasked to

Percentage of Broad Middle Income Households
U.S., District of Columbia, and Selected Cities
1990 and 1995



1/ Sales and Marketing magazine: Effective Buying Income between \$10,000 and \$50,000

Percentage Change in Middle Income Households
U.S. vs. District of Columbia
1990 to 1995



1/ Sales and Marketing magazine: Effective Buying Income between \$20,000 and \$50,000

assist the District Government in formulating economic development issues to address the loss of middle-income households and the lack of economic investment in the District. Over time, this process evolved into evaluating various economic development proposals and tax policies, which ultimately led to the formulation of the District of Columbia Economic Recovery Act.

The objectives of the process were:

- To avoid any controversies related to increased Federal transfers to the District or increasing the District Government's taxing capacity.
- To help formulate an approach which could attract broad bipartisan support.
- To target benefits to the middle-class.
- To help halt the flight of middle-income households from the District.
- To encourage investment and job creation within the District.
- To create a significant change in market perception of the District as a place in which to live, work and invest.
- To minimize any unintended consequences of excessive housing market price pressures; tax avoidance; and negative impacts on selected filer types.

In order to address these issues and target the benefits towards the middle-class, a modified form of flat tax was formulated that makes a major change in market perception with regard to working, living and investing within the District while targeting benefits to the middle-class and avoiding unintended consequences.

Key elements of the Economic Recovery Act which are designed to target benefits toward the middle-class include:

- Relatively large standard exemptions to benefit low- and moderate-income families (\$15,000 for single filers, \$25,000 for head of households and \$30,000 for married joint filers).
- In order to further target benefits to the middle-class, the Act specifically retains mortgage interest and charitable deductions which are most beneficial to the middle-class.
- To further target benefits to the middle-class, the Act does not tax fringe benefits.
- To encourage small business investment and venture capital into the District, capital gain taxes by District residents are eliminated for capital gains earned within the District.

- Capital gains earned outside the District are taxed at the current tax rate. This encourages investment within the District and results in a higher overall tax rate for wealthier filers who have a larger proportion of their income from investments earned outside the District.
- To avoid tax abuse, the lower tax rate applies only to wages and salaries earned in the metropolitan region and investment income earned within the District.
- The Act also includes a “hold harmless” clause which allows residents to file under the existing tax law if it would be to their advantage (this addresses potential impacts on moderate-income filers who may have a very large number of dependents; i.e., head of households or married joint filers with incomes above the threshold tax allowances, but with a large number of dependents).
- Corollary District Council action freezes local property and sales taxes in the District to show that the tax reduction will not be compensated by increases in District taxes and that the District is showing a willingness to “wean” itself away from federal dependency and encourage economic development and growth.

3. Results

The results of the various elements of the Economic Recovery Act are to target the benefits to low- and moderate-income households.

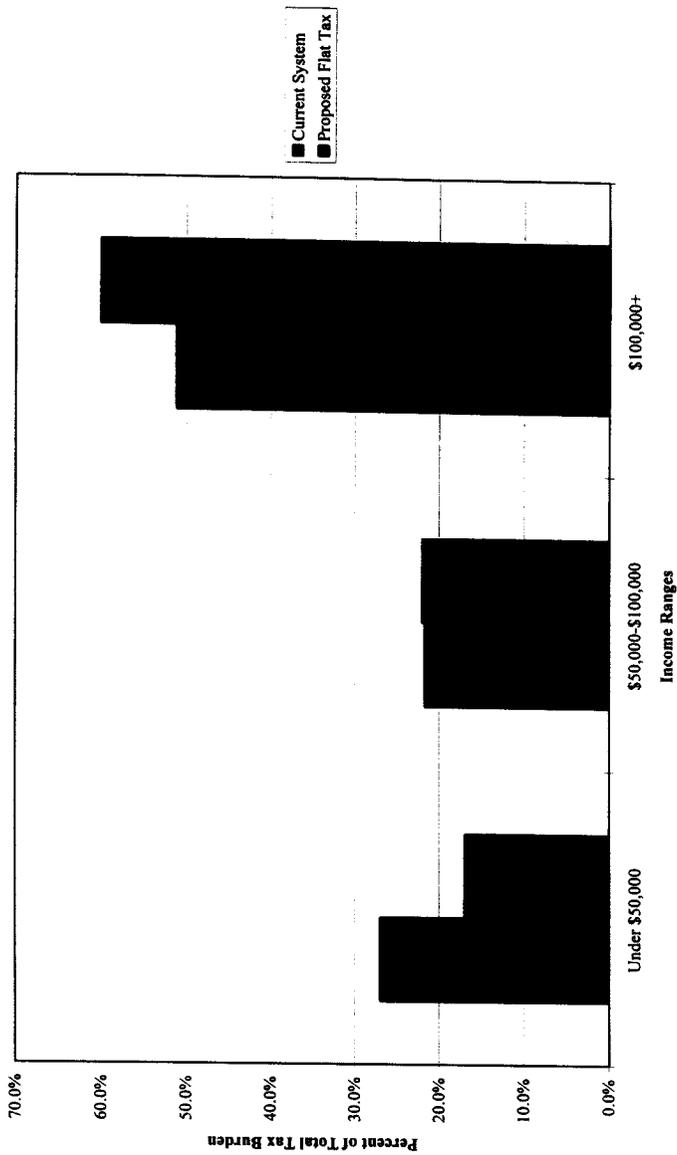
- The District filers with adjusted gross incomes under \$15,000 will have their federal tax liability eliminated completely.

- Those filers with adjusted gross incomes of between \$15,000 and \$30,000 will receive a 79 percent reduction in federal taxes.
- Filers with adjusted gross income between \$30,000 and \$50,000 receive an approximately 51 percent decrease in federal taxes.
- Those filers with adjusted income between \$50,000 and \$100,000 would receive a reduction in tax liability of approximately 41 percent.
- Filers with adjusted gross income over \$100,000 receive a tax benefit of a little over 34 percent.

The implications of relatively large exemptions, the deductibility of mortgage interest and charitable deductions, and the taxing of income earned outside of the District, at the current federal tax rates; has the "progressive" effect of shifting the tax burden away from lower-income filers and towards higher-income filers.

As shown in the attached chart, under the proposed Economic Recovery Act the proportion of federal income tax raised from filers with incomes under \$50,000 would be reduced from 27 to 17 percent of total tax collections. On the other hand, the proportion of tax collections from filers with incomes over \$75,000 increases from 60 to 70 percent. In proportion to their current federal taxes, savings for lowest-income filers are three times that of highest-income filers.

**Comparison: Current System vs. Proposed Flat Tax
Change in Tax Burden by Income Ranges**



We perceive that the adoption of the District of Columbia Economic Recovery Act will have a major positive change in market perception of living and investing within the District. Significant changes in perceived relative attractiveness should encourage major reinvestment within the District creating renewed interest in living in the District and significant job opportunities for District residents.

However, given other factors affecting the residential choice decision (schools, fear of crime, infrastructure, etc.), as well as the reduced level of residential activity within the region, tax reform is unlikely to encourage such large numbers of suburbanites to move back into the District and to create undue housing price pressures. We concur with the results of the survey of business leaders who believe that the tax reform will help attract newcomers to the District, while not having a negative impact on the suburban housing market.

Housing prices in the District already appear to be depressed as a result of current fiscal conditions within the District and concerns about education, security and public services. A portion of the increased after-tax income as a result of tax reform will likely be translated into increased housing values. The impact on housing values will obviously be ameliorated by other factors (e.g., schools, municipal services, security concerns, etc.). A large portion of housing pressures will be impacted by changes in both supply and demand for housing. The capital gains provisions of investment in the District should encourage additional new housing construction, reducing pressure on housing prices. The District Government has also indicated other public policy mechanisms which could be introduced to ameliorate any unanticipated impacts on housing prices.

A variety of factors influence the price of. Empirical studies tend to indicate that physical characteristics (living area, lot size, age, amenities etc.) have the greatest impact on housing values. External factors (which would include tax policies) are less. A 1990 *Land Economics* article by Sanger, Sirmans and Turnbull notes that while much popular press literature discusses the impacts of tax reform on real estate, little empirical work has directly examined the market's response to changes in taxes.

It appears that if a program is successful in attracting middle-income households it would only create modest housing pricing pressures. Other public policy mechanisms should be made available on a standby basis to ameliorate any unanticipated impacts on housing prices.

One such mechanism would be to have the District adopt policies in which a portion of the increment and housing value received upon sale would be "captured" by the District through a special capital gains tax. These capital gains taxes could, in turn, be placed in a "revolving loan pool". With a zeroing out of the federal income tax on capital gains, there is clearly an opportunity to recover a portion of the increased home value that might be generated by tax reform. Ongoing monitoring could be undertaken to document changes in District home prices over time or District versus surrounding jurisdictional change in home prices in order to confirm value created by tax reform.

The incremental increase in home value created by the tax reform could be placed in a special revolving loan pool. The loan pool would, in turn, be utilized to provide zero-interest

second mortgages to aid middle-income families in paying for all or a portion of the incremental value attributed to the Tax Reform Act. Zero-interest loans could be repaid upon sale or refinancing, thus creating a revolving loan fund to address the concern that increases in housing values could "shut out the middle-class".

In essence, the increment in housing value would be utilized to facilitate the middle-class moving into the District. We would suggest that these and other public policy incentives could be initiated to address any anticipated external impacts.

Other mechanisms are already in place in the District, such as the \$30,000 exemption for owner-occupied properties. Similarly, the Senior Citizen Real Property Tax Relief Program allows homeowners over 65, who derive more than 50 percent of their income from pensions, annuities and social security, to receive a reduction of half their property tax liability. The Circuit Breaker Tax Credit allows certain low-income homeowners to deduct a credit from their District income tax liability for property taxes paid. Low-income renters receive the same benefit, with a portion of their rent payments being considered as property taxes.

A major impact of the tax reform will be the encouragement of investment in economic activity within the District. The zeroing out of capital gains tax for District residents' investments within the District, should spur significant entrepreneurial investment, as well as investment in neighborhood business, small retail stores, and the like. The special treatment of capital gains, combined with the increase in the disposable income of District residents, should do much to encourage neighborhood revitalization, small and minority business development and venture capital investments.

The encouragement of venture capital and entrepreneurial investment within the District should also contribute to overall regional growth and development by creating new job opportunities for persons residing throughout the region.

The important element of the District of Columbia Economic Recovery Act is the dynamic change in market perception that would bring people back to the District. The reversal of the current negative spiral and the return of a taxpaying middle-class will help to address the District's current revenue problems, reduce relative social service costs, and reinforce the demand for, and the ability to provide enhanced levels of services. The Economic Recovery Act represents an innovative, balanced, and targeted approach to the recovery of the District by encouraging population growth and economic activity.

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Basile Baumann Prost & Associates, Inc.

JAMES L. PROST, AICP, Principal

Mr. Prost is a founding Principal and co-owner of Basile Baumann Prost & Associates, Inc. He has over 25 years experience in urban economics and real estate development advisory services. He has broad experience in such diverse fields as: market analysis; financial feasibility; economic planning; development programming; growth management; development packaging; project funding; and project implementation and management. His primary areas of specialization include public/private sector development advisory services with a particular emphasis on mixed-use and transportation-related development projects.

Prior to his establishment of Basile Baumann Prost & Associates, Inc. (BBP Associates), he was Corporate Officer and Project Manager for both a multidisciplinary urban economics and development consulting firm (ZHA, Inc.) and a planning and development subsidiary of a large development and design organization (Cannon Group). Mr. Prost was also Principal of his own firm specializing in community development programming and private sector venture development. Earlier in his career, Mr. Prost was a Project Director for a private economic and development consulting firm and has also worked for local and regional development corporations in formulating and implementing real estate projects.

Within BBP Associates, Mr. Prost undertakes and manages numerous development programming and packaging assignments for both the public and private sector. He specializes in transportation-related joint development planning, evaluating the land use and transportation interface for major mixed-use development projects. His current assignments with the firm include a major mixed-use/recreation/entertainment development planning and packaging assignment on the Boardwalk in Atlantic City; formulation of long-range transportation and land use policies for the Research Triangle area; examination of highway improvements as economic development tools for the State of Pennsylvania; evaluations of land use and transportation implications related to new Federal Transportation Legislation; joint development packaging and implementation for a major intermodal transportation center in downtown St. Louis; and multiple development packaging and implementation projects in inner-City portions of Cleveland.

Selected prior transportation/land use joint development experience includes preparing corporate-wide development packaging/private financing and funding programs for the California Department of Transportation, the New York MTA and the New Jersey Transit Corporation. Mr. Prost has also been responsible for the successful completion of a variety of joint development transportation-related projects in such diverse metropolitan areas and locations as: New York; Philadelphia; Baltimore; Buffalo; Cleveland; Columbus; Cincinnati; Washington; Atlanta; Miami; Minneapolis; St. Paul; St. Louis; Houston; Salt Lake; San Francisco; Sacramento; Los Angeles; San Diego; Portland, Honolulu; Ottawa, Canada; and

Basile Baumann Prost & Associates, Inc.

Taipei, Republic of China. He has also conducted national studies of transportation and land use and economic development impact for both the Federal Highway Administration and Urban Mass Transit Administration.

Mr. Prost has directed numerous highway impact evaluations focusing on the impact on existing residential and non-residential land uses, as well as impact on future development opportunities. His previous experience includes evaluations of both urban and rural highway systems. Mr. Prost has been responsible for highway impact evaluations in Vermont, Massachusetts, New York, Pennsylvania, Maryland, Virginia, North Carolina, Florida, Ohio, Michigan and California. He has evaluated development impacts along commercial corridors including the Beaver Valley Expressway (Pennsylvania), the Orange Blossom Trail (Florida) and the Route 1 corridor (Virginia, Maryland, Connecticut and Massachusetts). He has evaluated development needs as it relates to new interstate highway/joint development for Interstate I-670 (Ohio), I-83 (Pennsylvania/Maryland), I-64 (Virginia), I-10 (California). He also has conducted statewide evaluations of highway impacts for the California and Michigan Departments of Transportation.

Mr. Prost's non-transit-related mixed-use development project experience includes successful planning, implementation and funding program for improvements to the Cleveland waterfront; a new balanced residential waterfront community in Atlantic City; financing and funding programs for a new baseball stadium in Richmond, Virginia; mixed-use downtown development projects (office, retail, audience-support facilities) in Dayton, Ohio; waterfront development planning and implementation along the Miami River in Miami, Florida; and numerous other mixed-use development projects involving feasibility evaluation, planning, financing and implementation usually involving major public and private sector investments.

Other successful projects include: downtown office and commercial development; revitalization and growth management programs; land use and master plan development; new towns and large-scale real estate projects; waterfront development projects; shopping centers; industrial parks, and special-use projects (university office parks, planned unit developments, audience-support facilities, health spas, specialty retail, mini warehouses, etc.).

Mr. Prost has moved beyond traditional market/economic analysis to successfully undertake and complete a wide variety of public/private sector assignments with a specialization in financial programming and project implementation. His experience includes documenting costs and revenues for: bond financing; special assessment districts; tax-increment financing; syndication; private sector loans; foundation gifts, and public sector loans and grants. Mr. Prost has successfully aided in the predevelopment packaging and implementation of a wide variety of assignments for the public and private sector in retail, commercial, residential and audience-support implementation programming. He has also served as an expert witness concerning planning, zoning, market demands and development programming in eight separate states.

Basile Baumann Prost & Associates, Inc.

Mr. Prost has completed the Master of Regional Planning Program at Cornell University with an emphasis on urban planning and development and has a Bachelors in Arts Degree in Government and Economics from Northeastern University. He is a charter member of the American Institute of Certified Planners where he serves as Chairman of the Private Practice Division. He is also a Certified Review Appraiser and has held membership and leadership positions in numerous professional organizations including the American Planning Association, Transportation Research Board, The American Public Transit Association, The Transportation Research Forum, the National Council for Urban Economic Development, the National Association of Housing and Redevelopment Officials and the Urban Land Institute.

Projects he has successfully completed in Atlantic City, Baltimore, Cleveland, Shreveport and Denver have won national awards from the American Planning Association, the Department of Housing and Community Development, the Council for Urban Economic Development, National Association of Housing and Redevelopment Officials, the National Association of Home Builders and the Urban Land Institute. Mr. Prost is listed in both Who's Who in Finance and Industry and Who's Who in Leading American Executives. He has lectured extensively, delivered papers before various university groups and professional associations and has published articles in numerous professional journals.

Mr. DAVIS. Thank you very much. We will hear now from Mr. Sullivan. Thank you.

Mr. SULLIVAN. Good afternoon, Mr. Chairman and members of the committee. My name is Martin Sullivan. I'm an economist with Tax Analysts of Arlington, VA, and I'm also currently an adjunct scholar at the American Enterprise Institute. It's an honor for me to appear before you today, and I hope my comments will be genuinely helpful.

Mr. Chairman, there's no doubt that the District of Columbia is a city in economic distress. It has a poverty rate of 26 percent, higher than any of the 50 States. At 67 percent, the District of Columbia has the highest rate of out-of-wedlock births of any of the 50 States.

People are moving out of the city in droves. In the short 5-year span between 1990 and 1994, 71,000 District residents moved out to other States—nearly 11 percent of the population in 5 years. With these types of numbers, it's absolutely clear that the District of Columbia needs an economic development program, and it needs one quick.

It is also clear that H.R. 3244, the District of Columbia Economic Recovery Act, would provide a lot of help to the District of Columbia. There's no doubt about this.

The reason is simple. You're spending \$500 million—at least. The revenue cost of this could even be higher. There's a little bit of uncertainty about that. But this is a very large tax break for a very small area.

The \$500 million of annual tax benefits works out, on average, to over \$1,000 for every man, woman, and child in the city. That compares with the less than \$100 of tax benefits for every citizen of the United States currently embodied in the budget resolution going through Congress.

This legislation is not like anything we've ever seen before. It's not like empowerment zones that were enacted in 1993. Each of those empowerment zones that were enacted in 1993—there were six of them in urban areas—were much smaller than the District of Columbia, and the benefits were much more targeted.

Under DCERA, individuals who are residents of the District of Columbia would pay a maximum tax of 15 percent. This is not a replacement of the current income tax, it is an alternative tax. I like to say it is not a flat tax, but a "max tax"—if we're going to do sound bites today.

Under DCERA, most D.C. taxpayers would have a substantial reduction in their Federal income tax liabilities. Low-income taxpayers that receive a refund under the earned income tax credit would experience no change. A single individual, living and working in the District with \$25,000 of adjusted gross income, would save \$1,300, a 47-percent tax cut. A family of four with \$40,000 would save about \$1,900. A family of four with \$80,000 of income would save \$3,700.

Now, when it comes to high-income families, it's a little more difficult to tell. Generally, they would do very well under this bill, but not always. Under current law, a family of four with \$200,000 of adjusted gross income would pay approximately \$38,000 of tax.

If—and this is a big if—all of that income is District source, that same family would pay about \$22,000 of tax and save 39 percent. But it's most likely that most high-income taxpayers have a lot of non-District source income, so their tax cut would not be as large.

But you should be very aware that some very high-income District residents will pay no income tax under this because they receive their income in the form of capital gains.

How will this affect the economy? The foregone conclusion of this hearing is that there's going to be migration into the city. We don't know that. There's no economic models that predict that. It's based on good commonsense notions. I believe in common sense a lot more than economic models, but let's not assume anything. We don't know how this bill is going to affect the economy.

But let's talk a little bit about what factors might affect people's migration. Obviously, if the District of Columbia raises its taxes and offsets this, nobody is going to migrate. If property values go up and rents go up, including commercial rents, people are not going to migrate back into the city.

Also, another very important factor I ask this committee to take into serious consideration is that the Federal Government doesn't take back these benefits—that is, enact them for 3 years and then get tired of them.

If there's not certainty, nobody is going to move in, so the Federal Government has to make a commitment to hold these tax breaks for 5, 10, 15 years. It's not something you can just change your mind about every year. We don't know how much migration there is going to be.

We also don't know how the money is going to be spent once the money comes into people's pockets. There's two ways this bill is going to affect the D.C. economy. First, it's going to put \$500 million in middle-income and high-income taxpayers' pockets. Second—and this is the uncertain effect—it's going to create immigration into the city.

Let me give you two scenarios about what could possibly happen. First, there is a \$500 million tax cut. Middle- and upper-income taxpayers take that money and go on Caribbean vacations. Nothing happens to the District economy except you've given people some time in the sun. There's no jobs created, no extra tax revenue for the District.

Let me give you another scenario.

Ms. NORTON. Are these residents who pay D.C. income taxes that you're talking about?

Mr. SULLIVAN. Yes.

Ms. NORTON. So no extra income if they pay D.C. incomes taxes?

Mr. SULLIVAN. No. I'm thinking of an extreme case. I'm trying to do the worst-case and the best-case scenario. The worst-case scenario would be, there's a \$500 million tax cut for the District of Columbia. People fill out their tax returns; they have extra money; they go on vacation to the Caribbean. That's one extreme scenario where there is no impact on the D.C. economy. No jobs are created, because all of the money flows directly out of the District.

Ms. NORTON. I just want to establish, the person you are talking about lives in the District, and she is paying property taxes and income taxes to the District.

Mr. SULLIVAN. Yes. Absolutely.

Ms. NORTON. So that is money to the D.C. economy.

Mr. SULLIVAN. No change from the current.

Ms. NORTON. Well, I mean, it's according to whether the person lives here, would have moved out, or is moving in.

Mr. SULLIVAN. Right.

Ms. NORTON. It's another one of those undynamic models.

Mr. DAVIS. He's giving different scenarios at this point.

Mr. SULLIVAN. Yes. I'm just assuming, in this extreme case, there's no immigration.

Now, in the other case, which I think you'll like a little bit better, assume that there's 10-percent immigration into the city. Assume that people took this money and didn't go to Pentagon City, but stayed downtown and spent the money. Well, then we could see a very large increase in the D.C. economy, perhaps even 50,000 jobs created.

I'm saying that these two ends of the spectrum are all possible, and we don't know. I'm going to make a guess and a prediction about what could happen, using some middle-of-the-road assumptions. I think if there is no immigration into the city, you're going to create about 5,000 jobs. I think if you increase the population of the city by about 10 percent, you create 29,000 jobs.

At what price do those jobs come? In the best-case scenario, the cost to the Federal Government is \$17,000 per job; in the worst-case scenario, it's \$100,000 per job. The question, is this bill cost-effective? I think there's a lot of uncertainty on that.

Let me just make a few closing comments. The DCERA is no tax simplification. It means more tax forms for District residents, more IRS agents, and more tax lawyers. When you put this much tax to use into a situation, there is a lot of ways to evade and avoid taxes, and we're going to see some unsightly tax schemes as a result of this. Don't fool yourself about that.

The other thing is that one of the most difficult parts of tax administration is establishing residence, especially when taxpayers have two homes. So people will be spending 183 days in the District, or claiming to be spending 180 days in the District, in order to get very substantial tax breaks.

Finally, let me just make one comment about whether this is an experimental flat tax, where the District of Columbia would be a laboratory for a national flat tax. I have to strongly disagree with this notion.

First of all, this bill is nothing like the Armey flat tax. This bill retains the corporation tax; it retains the estate and gift tax; it retains the mortgage and charitable contributions, all of those that the Armey bill would get rid of.

Second, the DCERA is an enormous tax cut. If we ever enacted a tax cut on a national level, we could never have a tax cut of that proportion. We would be talking about \$200 billion a year.

Finally—and I don't think this is a subject of controversy—the economics of local tax incentives are entirely different than the economics of national tax incentives. The main juice from this bill is the tax cut that you're giving citizens and the immigration that you're creating into the city.

Those are not the type of effects that you can expect on a national scale. So by no means, even if DCERA succeeds in entirely rejuvenating the D.C. economy, will that mean that a similar tax plan would work on a national level.

Just in conclusion, DCERA provides a massive injection of cash into the D.C. economy. It will create jobs, but the amount of additional employment induced by DCERA is highly uncertain.

The incentives provided by DCERA are poorly targeted in two senses. They are not cost-effective in creating jobs, and a lot of the benefits accrue to high-income D.C. residents who are in the least need of economic assistance. If tax incentives are going to be used to promote economic development in the District of Columbia, we can design something better than DCERA at a lower revenue cost.

Thank you very much for this opportunity to share my views.

[The prepared statement of Mr. Sullivan follows.]

Testimony of
Dr. Martin A. Sullivan
of
Tax Analysts, Arlington, Virginia
on
H.R. 3244
The District of Columbia Economic Recovery Tax Act

Before the District Oversight Subcommittee
of the Committee on Government Reform and Oversight
House of Representatives
Congress of the United States
104th Congress

July 31, 1996

Good Morning, Mr. Chairman and Members of the Committee. My name is Martin Sullivan. I am an economist with Tax Analysts of Arlington, Virginia. Tax Analysts is a nonprofit organization devoted to policy analysis of tax issues, and is probably best known as the publisher of *Tax Notes* magazine. I am also currently an Adjunct Scholar with the American Enterprise Institute. Previously, I have worked as an economist with the Office of Tax Analysis of the U.S. Department of Treasury and as an economist with Joint Committee on Taxation. It is honor for me to appear before you today, and I hope my comments will be helpful.

1. Introduction

The District of Columbia is a city in economic and social turmoil. Its unemployment rate is two full percentage points higher than the national unemployment rate. Its poverty rate of 26 percent is higher than any of the 50 states. DC has the highest murder rate of any of the 50 states. And, at 67 percent, DC has the highest rate of out-of-wedlock births of any of the 50 states.

People are moving out of the District in droves. Despite its high birth rate, the District of Columbia's population has declined dramatically over the last 25 years. In 1970, the District had a population of 757 thousand. By 1994, its population had declined to 570 thousand. In the short 5-year span between 1990 and 1994, 71,000 District residents moved out of District to other states--nearly 11 percent of the DC population! With these types of numbers, it is clear that the District of Columbia needs help.

It is also clear that HR 3244, the District of Columbia Economic Recovery Act (DCERA) would provide a lot of help to the District. DCERA's annual injection of more than \$500 million into the DC economy would provide a substantial economic stimulus to the District. This is a big tax break for small area. The District of Columbia is a city of less than 63 square miles. Total disposable income of District residents is about \$17 billion, less than one-third of one percent of total personal income in the nation. Its

570 thousand resident pay about \$1.8 billion of individual tax payments to the federal government.

I estimate that DCERA's price tag exceeds \$500 million annually. This works out to an average of *well over \$1,000* in benefits for every man, woman, and child in the District. In contrast, the \$130 billion of tax cuts over six years included in the current budget resolution work out to *less than \$100* for each resident of the United States.

2. How the Tax Works

Overview

DCERA is not like anything in the current Internal Revenue Code. Perhaps what comes closest are the provisions enacted in 1993 to provide tax benefits to economically distressed areas called "empowerment zones." But each of the six designated urban empowerment zones is much smaller than the District of Columbia in terms of both size and population, and the tax benefits provided are more narrowly targeted.

It should also be noted, despite press reports to the contrary, DCERA is not really anything like the Flat Tax proposed by Mr. Forbes or Mr. Army.

Under DCERA, individuals who are residents of the District of Columbia would pay a maximum federal income tax rate of 15 percent on their income from sources in the District of Columbia. Capital gains from the sale of property in the District would not be subject to any federal income tax. Income of DC residents from sources outside of the District would still be subject to tax as under current law.

It is important to recognize that under DCERA the new 15 percent tax would not be a *replacement* for the current income tax but an *alternative* tax. District residents would still need to compute their regular tax liability if they opt to remain under the current tax. Moreover, District residents would still need compute their regular tax liability if they have any significant non-District source income (e.g., \$500 of dividend income). The good news for DC residents is that because taxpayers have the choice between current law and the new tax, nobody will pay more tax under the bill.

The bad news is that many taxpayers would have to calculate the new 15-percent tax in addition to the calculations required under current law. For this reason--and others I shall discuss later-- DCERA is *not* tax simplification. DCERA would significantly *increase* the complexity of the Internal Revenue Code for DC residents as well as *increase* the administrative burden of the Internal Revenue Service.

What is DC source income?

Most of the statutory language of HR 3244 is devoted to defining what types of income are distinct-source income that qualify for the 15 percent rate. In a nutshell, DC sources of income are: (1) wages and compensation earned in the DC-Baltimore area; (2) retirement income; (3) interest less than \$400 unless generated from DC businesses and other DC sources; (4) dividends less than \$400 unless from a DC corporation; (5) rental income from property in DC; (6) sole proprietorship and partnership income to the extent this income is considered to be generated in DC.

Who is a DC Resident?

In order to be considered a resident of DC for purposes of this statute, the individual must (1) reside in the District at least one half of the days of the year and (2) file a DC income tax return for that same year.

Major Differences from Current Law

There are three major differences between current law and the calculation of the proposed 15-percent maximum tax on DC sources income:

(1) *Larger exemption amounts.* For middle income taxpayers, the major benefit of DCERA is the large exemption amounts. Under DCERA, single taxpayers would be able to exempt the first \$15,000 of District source from tax. This compares very favorably with the \$6,200 of combined standard deduction and personal exemption available under current law (for 1995). Under DCERA, married couples are allowed to exempt the first \$30,000 of District source income. This compares favorably with the \$11,650 combined standard deduction and personal exemptions available to couples without children under current law. (For married couples with two children, the comparable figure is \$16,650.) Exemption amounts, standard deductions, and personal exemption under current law and under DCERA are summarized in Table 1.

Table 1.
Relief from Federal Income Tax on First Dollars of Income
Under Current Law and Under DCERA

Feature	Regular Federal Income Tax	Alternative Maximum Tax Calculation Under DCERA (for DC income of DC residents)
Overall Exemption Amount	-	\$15,000 individual filer, \$30,000 married
Personal Exemptions	\$2,500 per family member	-
Standard Deduction	\$3,700 single filer, \$6650 married	-

(2) *Treatment of itemized deductions.* Under current law, the major itemized deductions for individuals are the deductions for mortgage interest, state and local taxes, charitable contributions, and medical expenses. These would all still be available to DC residents under DCERA to the extent taxpayers choose to itemize their deductions against non-District source income or if they opt not to be taxed under the new system. With regard to itemized deductions, the bad news for taxpayer is that under the alternative maximum tax, only deductions for mortgage interest and charitable contributions would be allowed. The good news is that all taxpayers not just itemizers as under current law) would be eligible for these deductions. All taxpayers may deduct the large exemption amounts as well as the deduction for mortgage interest and charitable contributions. The treatment of itemized deductions under current law and DCERA is summarized in Table 2.

Table 2.
Treatment of Itemized Deductions Under Current Law and Under DCERA

Feature	Regular Federal Income Tax	Alternative Maximum Tax Calculation Under DCERA (for DC Income of DC residents)
Charitable and Mortgage Interest Deductions	Available only to itemizers	Available to All Taxpayers
Other Itemized Deductions (i.e., Other Than Mortgage Interest and Charitable Contributions)	Available only to itemizers	Not Available

(3) *Tax Rates.* As shown in the Table 1 below, under current law taxable income is taxed at rates of 15, 28, 31, 36, and 39.6 percent. Under the alternative maximum tax, the only tax rate is 15 percent. The rate structure under the current income tax is summarized in Table 3.

Table 3. Tax Brackets Under Current Law (1995 Levels)
(Dollar Amounts Refer to Taxable Income)

Current Law Tax Rate	Single	Married Filing Jointly	Married Filing Separately	Head of Household
15%	\$0 - \$23,350	\$0 - \$39,000	\$0 - \$19,500	\$0 - \$31,250
28%	\$23,350 - \$56,550	\$39,000 - \$94,250	\$19,500 - \$47,125	\$31,250 - \$80,750
31%	\$56,550 - \$117,950	\$94,250 - \$143,600	\$47,125 - \$71,800	\$80,750 - \$130,800
36%	\$117,950 - \$256,500	\$143,600 - \$256,500	\$71,800 - \$128,250	\$130,800 - \$256,500
39.6	Over \$256,500	Over \$256,500	Over \$128,250	Over \$256,500

Examples of How DCERA Works

Under DCERA, most DC taxpayers would have a substantial reduction in their federal income tax liabilities. At worst, DC residents would have no change in their tax liabilities.

Low-income taxpayers that pay no income tax or receive a refund of income tax due to the earned income tax credit (EITC) would experience no change. Moderate-income taxpayers would enjoy the substantial benefits because the generous exemption amount allowed under DCERA would shelter all or a significant portion of their income from tax. For example, under current law a single individual living and working in the District with \$25,000 of adjusted gross income would pay about \$2,800 of income tax (in 1997). Under DCERA, that same individual would pay about \$1500 of federal income tax. This is a reduction in federal income tax liability of approximately \$1,300--a tax cut of 47 percent. (Table 4, Case 1)

Table 4
Four Examples of Impact on Federal Income Tax Liabilities of
H.R. 3244, The District of Columbia Economic Recovery Tax Act

	Case 1 Single	Case 2 Family of Four	Case 3 Family of Four	Case 4 Family of Four
Current Law:				
Adjusted Gross Income	\$25,000	\$40,000	\$80,000	\$200,000
Personal Exemption Amounts	\$2,650	\$10,600	\$10,600	\$9,116
Standard Deduction	\$3,900	\$6,950	\$0	\$0
Itemized Deductions -- Mortgage	\$0	\$0	\$10,000	\$16,000
Itemized Deductions -- Charitable	\$0	\$0	\$1,000	\$5,000
Itemized Deductions -- Other	\$0	\$0	\$5,000	\$20,000
Taxable Income	\$18,450	\$22,450	\$53,400	\$152,237
Tax	\$2,768	\$3,368	\$9,578	\$38,123
Proposed DC 15% Max Tax:				
Adjusted Gross DC Income	\$25,000	\$40,000	\$80,000	\$200,000
Exemption Amount	\$15,000	\$30,000	\$30,000	\$30,000
Mortgage Interest Deduction	\$0	\$0	\$10,000	\$16,000
Charitable Contribution Deduction	\$300	\$500	\$1,000	\$5,000
Taxable Income	\$9,700	\$9,500	\$39,000	\$149,000
Tax	\$1,455	\$1,425	\$5,850	\$22,350
Difference:				
Reduction in Tax -- Dollars	\$1,313	\$1,943	\$3,728	\$15,773
Reduction in Tax -- %	47%	58%	39%	39%

Notes: Estimates are for 1997 where personal exemptions, standard deductions, personal exemption phaseouts, and standard deduction phaseouts are assumed to be 6 percent larger than 1995 levels. All four examples assume no capital gain income and that all adjusted gross income is District source income. To the extent taxpayer has positive net capital gains, advantages of H.R. 3244 will generally be greater for high income taxpayers than indicated in the table. To the extent adjusted gross income is not District source income, advantages of H.R. 3244 will be less. Because exemptions are not indexed to inflation in H.R. 3244, advantages of H.R. 3244 relative to current law will become less over time.

Moderate- and middle-income families would do particularly well. Under current law, a family of four would have a standard deduction and personal exemptions equal to almost \$18,000. But under DCERA a standard exemption amount of \$30,000 would be available plus any deductions for charitable contributions and mortgage deductions. A typical family that would pay about \$3,400 (in 1997) under current law would pay about \$1,400 under DCERA. This is a reduction in federal income tax liability of approximately \$1,900--a tax cut of 58 percent. (Table 4, Case 2)

Upper middle-income families significantly benefit--as long as their income is primarily District source income. For example, a family of four with adjusted gross income of \$80,000 would pay about \$9,600 of federal income tax under current law in 1997. Under DCERA this family would pay about \$5,900. This is a reduction in federal income tax liability of approximately \$3,700--a tax cut of 39 percent. (Table 4, Case 3)

High-income families also could do very well under DCERA, but not always. Under current law, a family of four with \$200,000 of adjusted gross income would pay approximately \$38,000 of federal income tax. If all adjusted income is District source, this same family would pay about \$22,000 in federal income tax. This is a reduction in federal income tax liability of approximately \$16,000--a tax cut of 39 percent. (Table 4, Case 4) It is likely that most high-income taxpayers would not receive such large tax benefits because a lot of their income is not District source income--because they are partners at firm's with a substantial fraction of their business outside the District or because a large part of their income is from dividends and interest not from District businesses. In some cases, however, a wealthy individual could be even better off than the 39% percent tax cut indicated in Table 1. Because they are exempt from tax, capital gains from District sources (i.e., sale of real estate) could result in larger tax advantages.

In summary, the impacts on tax liabilities under DCERA are varied and depend on individual circumstances. One cannot simply say: "It just helps the wealthy." It's a bit more complicated than that: It has no impact on the poor. It has substantial benefits on the middle class. And its impact on upper incomes are also generally favorably--but the amount of benefit for high income taxpayers varies considerably depending on individual circumstances.

In addition, the differential impact of DCERA on different income classes depends not only on these direct impacts of the tax but also on the overall stimulus DCERA provides to the DC economy. The magnitude of the economic stimulus is uncertain, but the more there is-- in particular, the more jobs that are created--the more the benefits of DCERA will provide benefits to all income classes.

3. Impact of the New Alternative Tax on the DC Economy

Because of the sheer size of the tax cut being proposed, there can little doubt that the proposed new tax will have a large positive impact on the DC economy. The tougher question is by how much will the DC economy expand. It must be stressed at the outset that any predictions--including my own--of DCERA's economic impact are highly uncertain. Economic models are simply not that well developed to yield accurate predictions. And a lot non-economic factors play a major role in assessing the prospects for economic development.

Even if economics cannot be used for prediction, economics can be useful in assessing the efficacy of DCERA. Here are six critical issues that deserve careful consideration:

(1) *How long can taxpayers count on benefits being in place?* Businesses and families are more likely to move into the District if they have some assurances that tax benefits will be not be repealed in the near future. Under current law, empowerment zone status expires after ten years after the zone is first created. In H.R. 3244, there is no scheduled expiration date for the available tax benefits. Does this mean that Congress really intends for this to be a permanent provision? What kind of implicit or explicit assurances can be made that DCERA will not be repealed in the near future? Those businesses and individuals making important economic decisions would need answers to their questions about the longevity of tax breaks for D.C.

(2) *Will the District government offset the benefits of H.R. 3244 by raising DC taxes?* The potential for DCERA to increase business formation and encourage migration into the District will be reduced if federal tax cuts are offset by increases in the District of Columbia own taxes. There is nothing in H.R. 3244 to prevent or discourage the District of Columbia from increasing its income taxes, sales taxes, property taxes, or fees its charges for services at any time in the future.

(3) *Will the benefits of DCERA be translated into higher land values?* One likely impact of DCERA is an increase in real estate prices. This is good for the current owners. But higher prices of land in the District will partially offset the incentive for businesses and families to move into the District. Rent control laws may partially mitigate this effect. But rent control will not have any impact on the cost of owner-occupied housing and commercial real estate.

(4) *How much will DCERA impact net migration into the city?* This is the real wild card in estimating the economic effects of DCERA. As described in more detail below, the amount of migration into the District induced by DCERA is a critical factor in ascertaining DCERA potential to help the District economy. But DCERA impact on the District's population is uncertain. I know of no studies that have estimated this, nor would I rely on it if such a study existed. Because decisions to move in and out of the District involve a lot more than financial issues, it will be difficult for economists to estimate migration due to tax changes.

It is clear from the examples above that the economic incentives provided by DCERA to move into the District are large, particularly if these incentives can be guaranteed for a significant period of time and if DC taxes and DC rents do not substantially increase in response to the tax. In the examples above, a family of four with \$40,000 of income gets an annual tax break of \$1,900 for living in the District. A family of four with \$80,000 of income gets an annual tax break of \$3,700 for living in the District. Whether this is enough to motivate somebody to move into (or not move out of) the District is a more a matter of opinion than economic analysis. Quantifiable tax benefits must be weighed against largely unquantifiable factors such as differences in public education, crime, and the quality of municipal services.

(5) *Business formation and jobs--cost of capital effect.* DCERA provides tax relief for the profits and interest paid by District businesses to the extent these profits and interest are paid to District residents. There are several reasons to expect that there probably would not be a major increase in businesses and jobs due to reductions in the cost of capital for DC businesses owned by DC residents. First of all, DCERA leaves the federal corporation tax fully in tack. Second, large businesses usually have diverse ownership. It is unlikely that a business would favor investment in the District over

another location because 5, 10, or even 25 percent of its owners resided in the District. With regard to small businesses owned by District residences, it is worth noting that most small, sole proprietorships already pay little or no income tax. Because of generally low profits and the great uncertainty about succeeding at all, it seems unlikely that small businesses owned by DC residents will significantly expand their operations in the District because of a reduction in their own individual taxes.

(6) Business formation and jobs--increased demand from greater disposable income and an influx of new residents. Any increase in disposable income in the District as a result of DCERA will likely expand the demand for District goods and services and increase employment in District. There are two principal ways that DCERA would increase disposable income in the District. First, there is the direct benefit of tax cuts. Second, there is additional disposable income that any influx of new residents bring with them into the city. To the extent these increases in disposable income are used to purchase goods produced and services provided in the District, there would be an expansion of District business and employment.

If the increase in disposable is all spent on services performed in the District and on goods produced in the District, there would be a significant expansion of employment. If, however, increases in disposable income induced by DCERA are used to purchase goods and services outside of the District, there would not be much increased employment.

Some examples can be instructive. At one extreme, suppose that DCERA results in a \$500 million tax cut but does not induce any new immigration and all the money is spent on Caribbean vacations. All that DCERA has done in that case has made middle and upper income DC residents happier by buying them some time in the sun. There is no impact on the DC economy in terms of employment, new businesses, and new investment.

At the other extreme, suppose that in addition to the \$500 million in disposable income injected directly into the economy by tax cuts, there is a net increase in the District population of 10 percent as a result of DCERA. Now also assume suppose that 60 percent of that disposable income is spent on goods and services actually produced in the District. (e.g., restaurants, medical services, auto services) This would have an enormous effect on the DC economy. Under these very optimistic assumptions, total income could increase by \$5.8 billion and total employment would increase by more than 65,000 jobs.

The Appendix at the back of this document describes the details of this and similar calculations. Using a middle-of-the-road assumption about the amount of income recirculated into the DC economy yields estimates of increased DC employment between about 5,000 jobs (with no net migration into the city) and 29,000 (with a net immigration into the city equal to 10 percent of the DC population. If these estimates are correct, the revenue cost per job is between \$17,000 (with migration increasing DC population by 10 percent) to \$100,000 (with no migration). It should also be noted that not all of these new jobs in the District would be filled by District residents.

4. Regional Fairness

Besides raising issues of fairness with regard to rich and poor, the proposed legislation also raises issues of regional fairness. Why should one region of the country get a tax break and not all the rest? Of course, the same question could be asked of the provisions in the current Internal Revenue Code that provide tax breaks to empowerment zones. But in terms of fairness special tax status could be more

problematic for D.C. than it is for empowerment zones. As noted the District's poverty rate is 23 percent--higher than any of the 50 states. But empowerment zones have even higher poverty rates.¹ If the District of Columbia--or even any part of the District deserves unique tax status, why were six other urban areas chosen as empowerment zones by the Department of Housing and Urban Development?

For all of its poverty and unemployment, some of the District's economic statistics are startling. The average real per capita growth rate of personal income grew at an average annual rate of 2.3 percent over the 1980-94 period. (For the United States as a whole, the comparable growth rate was only 1.4 percent.) The District of Columbia also has higher average per capita income than any of the 50 states. Furthermore, out of the 3,100 counties for which the Commerce Department publishes data on per capita income, only 38 had higher per capita incomes higher than the District. In other words, the District of Columbia has higher per capita income than 98.5 percent of the counties in the United States.

These data clearly indicate that not all of DC is in economic distress. The picture that emerges from the data is that the District of Columbia is a city of rich and poor, and the rich are doing quite well. Taxpayers around the country might question the fairness of tax benefits to DC residents--particularly if a significant portion of the benefits flow to DC residents who are not in any way suffering economic distress.

5. Administrative and Compliance Issues

DCERA is not tax simplification. Tax computations may be simplified for some middle income taxpayers if all of their income is from District sources and these taxpayers have fewer itemized deductions than under current law. But for many District residents tax compliance will be substantially complicated.

If they have both District and non-District source income, District residents will be required to compute their tax under both the new rules for the 15-percent tax as well as current rules for calculating regular tax liability.

And the new rules are not always so simple. Wage income is only DC source if it is earned for services provided in the DC-Baltimore metropolitan area. (A safe harbor rule allows that if 80 percent of income is earned for services performed on the DC area than 100 percent of that wage income is considered District source.) But a traveling salesperson or consultant might have to keep a log of time spent in and out of the DC metropolitan area.

Interest and dividend income from DC sources must be so designated by the payors. When a company operates both inside and outside the District, the percentage of dividends or interest that are DC source is equal to the DC percentage shown on that company's DC tax return. This percentage must then reported to recipient of the dividends or interest. This creates an additional compliance burden for businesses operating in the District.

Perhaps the biggest compliance issue of DCERA is establishing residency in the District. In general, residency is extremely difficult for states to monitor--particularly if an individual has a home in two jurisdictions. Because no part of the District is far from Maryland or Virginia, high-income residents in the suburbs near the District might

¹ Each census tract in an empowerment zone must have a poverty rate of at least 20 percent. At least 90 percent of the zones's census tracts must have a poverty rate of at least 25 percent. And at least 50 percent of the zones census tracts must have a poverty rate of 35 percent.

be tempted to claim that they resided in the District for 183 days in order to receive tens of thousands of dollars of tax relief.

Because of the 183-day residency requirement, moving companies will receive brisk business at the end of June and early July. Those moving out of the District will have large incentives to stay past July 1. Similarly, incoming residents will rush to move in before June 30.

The zero rate for capital gains on District assets could create enormous incentives for unproductive tax-motivated behavior. For example, suppose a resident of Virginia were to sell some property in the District with a capital gain of \$5 million. By moving into the District for 183 days that individual could save \$1 million in taxes.

Others with large holdings of DC assets will find it advantageous to use the "rhythm method" of realizing gains and losses rather than having business considerations dictate the timing of sales. For example, suppose a real estate developer were to realize a million of gains and a million of losses on DC property every year. By instead realizing \$2 million of gain in even number years and \$2 million of losses in odd years, the developer could save about \$500,000 in taxes in each two year period--just by shifting the timing of gains and losses.

It is interesting to note that the revenue cost of DCERA is comparable to the total revenue collected by the District of Columbia from its individual income tax. From the standpoint of tax simplicity, before enacting DCERA Congress should give serious consideration to requiring DC to repeal its own income tax and funding the shortfall to the DC government with an increased federal payment. Under this alternative, DC residents would only need to do one income tax calculation (i.e., federal income taxes) instead of the three that would be required under DCERA (regular federal income tax, the new alternative tax, and DC income taxes).

6. An Experimental Flat Tax?

Some have suggested that in addition to fostering the economic development, the enactment of DCERA would serve as a sort of experiment for a flat tax on a national scale. I strongly disagree with this notion. There are three main reasons:

(1) *Statutory differences.* Although DCERA has a single rate like the Arney flat tax, and DCERA has large exemption amounts like the Arney flat tax, there are many significant differences between the two proposals: (a) DCERA retains the regular income tax and adds an alternative 15% maximum tax; the flat tax eliminates the current individual income tax and *replaces* it with a 17% wage tax; (b) DCERA retains the corporation tax and the estate and gift tax; the Arney flat tax eliminates those two taxes; (c) DCERA retains the mortgage and charitable contributions deduction; the Arney Flat Tax does not. Unlike the Arney Flat tax, there are no losers under DCERA. In particular, DCERA retains the earned income tax credit for low income recipients. The differences between DCERA and the Arney flat tax are listed in Table 5.

Table 5. Comparison of DCERA and Arney Flat Tax

A. Similarities	
DCERA	Arney Flat Tax
Single Rate	Single Rate
Large Standard Exemption Amount	Large Standard Exemption Amount

B. Differences	
DCERA	Flat Tax
Does Not Repeal Corporation Tax	Repeals Corporation Income Tax
Does Not Repeal Individual Income Tax-- Instead Puts a Cap on Individual Tax	Repeal Individual Corporate Tax
Only Income From DC Capital Gains Exempt, Other Income from DC Investment Subject to Single Low Rate	All Income from Investments Exempt
Deduction for Mortgage Interest and Charitable Contributions Remain	All Itemized Deductions Repealed

(2) *Budgetary differences.* DCERA is an enormous tax cut. It cuts individual income taxes for District residents on average by about one-third. To enact a flat tax with a tax cut on a similar scale would require an annual tax cut of about \$200 billion annually.

(3) *Economic differences.* The economics of local tax incentives are very different from the economics of national tax incentives. As described above, the major benefits of a local tax incentive such as DCERA come mostly at the expense of other regions who either (a) become responsible for larger national debt or pay higher taxes or (b) lose population, businesses, and jobs to the tax-advantaged district. A national flat tax could not depend on these effects.

In brief, it is easier for local tax incentives to create economic growth than national incentives because of the large opportunity for local incentives to induce shifting from one region to another. Even if DCERA (or some similar plan) succeeds in significantly increasing economic growth and employment in the District by no means does it follow that the same tax plan would succeed on a national level.

7. Conclusion

DCERA provides a massive injection of cash into the D.C. economy. It will create jobs. But the amount of additional employment induced by DCERA is highly uncertain. The incentives provided by DCERA are poorly targeted in two senses: (1) they are not cost effective in creating jobs and (2) a lot of the benefits accrue to high-income DC residents who are in least need of economic assistance.

DCERA is not tax simplification. It substantially complicates tax compliance for DC resident and tax administration for the IRS. It replete opportunities for tax attorneys to devise new tax avoidance techniques.

Finally, enactment of DCERA should not be considered a small-scale experiment for a national flat tax. It is much, much harder to generate economic growth from tax cuts in an entire nation than in a small local economy.

If tax incentives are going to be used to promote economic development in the District of Columbia, we can do better than DCERA. And--if desired--we can devise tax incentives that are more targeted to promoting employment of low- and middle-income District residents.

One possible alternative would be to provide a tax credit of \$1 for each hour of employment of a DC resident by a DC business. This credit would offset the negative effects on employment of the recently increased minimum wage. A \$2 per-hour credit could be provided for new workers that are undergoing training.

Appendix

A Model for Calculating Effects of DCERA

Assumptions:

- Revenue Cost of DCERA = \$500 billion.
- Population of DC = 570,000.
- Effect of DCERA on DC Population = Increase Between 0 and 10 percent.
- Average per capita income of DC resident = \$32,000.
- Percentage of Personal Income of DC Residents Spent on DC Goods Produced and Services Performed in DC = between 20 and 60 percent (= b)
- This results in a multiplier effect $(b/(1-b))$ between 0.25 and 1.50.
- Capital income share of total income = 0.25.
- Average compensation for job in DC = \$40,000.

Example: Calculate the effect of DCERA on DC income and employment assuming 2.5% population increase and 40 percent of increased income is spent on goods produced in DC or services performed in DC.

Step 1. Estimate Direct Effect of Increase on Disposable Income from Tax Cut. Equals revenue cost of approximately **\$500 million**.

Step 2. Estimate Increase in Disposable Income Due to Increase in Population. A 2.5 percent population increase means an increase in population of approximately 14,250 people. If their average per capita personal income is \$32,000, then this population shift increases total DC personal income by approximately **\$456 million**.

Step 3. Sum of Additional DC Income From Tax and Migration Effect. \$500 million plus \$456 million is **\$956 million**.

Step 4. Compute Multiplier Effect. This \$956 million in additional income is assumed to increase demand for goods produced in DC or services performed in DC by 40 percent, or \$382 million. Then 40 percent of this \$382 million, or \$153 million, is spent in DC. Then 40 percent of \$153 million is spent in DC, and so on. In the end, a total of **\$637 million** of income (in addition to the \$956 million above) is induced by increased demand for goods and services

Step 5. Compute Total Impact on DC Income. Direct tax effect of tax cut (\$500 million) plus migration effect (\$456 million) plus multiplier effect (\$637 million) equal the total increase on DC income (**\$1,593 million**) from enactment of DCERA.

Step 6. Effect on Employment. From Step 4 estimated additional demand for DC goods and services in \$637 million. Three-quarters of this, \$478 million, will be needed to pay the salaries of the employees providing those goods and services. If the average salary paid for each of these new jobs is \$40,000, this means that **11,950 new jobs** will be created.

As stressed in the body of this document, effects on DC income and employment are highly sensitive to how increased income is spent and how much net migration into the District is induced by DCERA. The tables on the following page present estimates of DCERA on District income and employment under various assumptions.

Table A-1.
Effects on Total Income of District of Columbia Residents of DCERA
Under various Assumptions About Impact on Population
And Percentage of Income Spent on DC Goods and Services
(in Millions of Dollars)

		% Population Increase				
		0.0%	2.5%	5.0%	7.5%	10.0%
% of Income Spent on DC Good & Services	0%	\$500	\$956	\$1,412	\$1,868	\$2,324
	20%	\$625	\$1,195	\$1,765	\$2,335	\$2,905
	40%	\$833	\$1,593	\$2,353	\$3,113	\$3,873
	60%	\$1,250	\$2,390	\$3,530	\$4,670	\$5,810

Table A-2.
Effects on Total Employment in the District of Columbia of DCERA
Under various Assumptions About Impact on Population
And Percentage of Income Spent on DC Goods and Services
(in Millions of Dollars)

		% Population Increase				
		0.0%	2.5%	5.0%	7.5%	10.0%
% of Income Spent on DC Good & Services	0%	0	0	0	0	0
	20%	2,344	4,481	6,619	8,756	10,894
	40%	5,250	11,950	17,650	23,350	29,050
	60%	14,063	26,888	39,713	52,538	65,363

Mr. DAVIS. Thank you very much, Mr. Sullivan. I'm going to have questions but we have another vote. I thought we were through with votes, but they found another way to delay the proceedings on an exhibit. Somebody made a motion to put an exhibit on the floor.

So I'm going to have to go vote; I'll be back in 10 minutes. So, if you can just bear with us, I'm going to recess the meeting subject to the call of the Chair, but it shouldn't be more than 10 minutes.

[Recess.]

Mr. DAVIS. The meeting will come back to order until the next vote. Mr. Kee, thank you for bearing with us.

Mr. KEE. Thank you, Mr. Chairman. I'm delighted to be here. My name is James Kee, and I'm a professor of public administration and senior associate dean of the School of Business and Public Management at George Washington University.

Last year, when Jack Kemp began to talk about major tax reductions for D.C. residents, a group of business leaders from the District asked George Washington University to study Jack Kemp's proposals and to analyze their possible effects, both on the city and on the region.

I headed up that study for a team of professors from the public administration, economics, and political science faculties at G.W. So one of the things we did was review the academic literature to see if we could find out whether such proposals really did work.

There have been a number of empirical studies, and while the evidence is mixed, I think the preponderance of evidence suggests that a major tax reduction in a large enough geographical area will have a significant positive effect on economic development in that area if it is coupled with other efforts by the locality to spur economic development.

I think this is an important point because, clearly, the proposal of Delegate Norton is not a panacea and has to be accompanied by concerted efforts by the District government to get its own in-house economic development shop in order, to make it easier for people to invest in the District.

But the academic evidence, is that yes, a large, targeted tax relief will have a positive economic impact on the District.

The second question relates to one that Congresswoman Morella asked this morning, concerning a possible in-flow of residents from suburban counties to the District. Here, again, the literature on this suggests that, in fact, such in-flow is not likely to happen. In other words, if a family is already located in a suburban county, that family is not likely to relocate back to the District because of the tax reduction.

Where it will have some impact is on people moving into the metropolitan area, since they have a choice on where they're going to live. At the margin, lower taxes would have a positive impact on their locational decision.

But of course, as others have said, quality of housing, quality of schools, the crime issue are certainly equally important along with the taxes in terms of determining where someone is going to locate.

So I think that the fear of the suburban districts that there might be a big out-migration from those suburban counties into the District is probably not well-founded, at least according to the existing academic literature.

The third issue we looked at was cost, and as you might remember, the Kemp proposal included complete elimination of the income tax and capital gain tax in return for an elimination of the payment, until the net cost actually was about the same as we're talking in the Norton proposal—about \$700 million.

Obviously, that is a significant cost to the Treasury, but the issue here is the one that Delegate Norton and others have raised so eloquently. What is the Federal Government's responsibility to the Capital? The Capital needs an enormous infusion of economic development activity, as well as better management at the District level, if we're going to make the Capital the kind of capital that we all want it to be in terms of the Capital of the United States.

So I think that the obligation is there. The question is whether there is a better way to spend the \$700 million. I think simply putting money into the District is not the answer, even though fiscal needs such as the infrastructure of the city and the schools have to be dealt with.

I firmly believe that the private sector must play a strong role in developing the economy of the District and that this type of tax proposal, particularly the reduction in capital gains for those who invest in the District, can be a spur to economic activity, particularly for those businesses that already exist in the District and are looking either to expand in the District or to move outside of the District. This could tip the balance in terms of those expansion opportunities.

Two more issues I would like to briefly touch on. First, a progressive flat tax is not an oxymoron. I think that the proposal, as James Prost has outlined, is, in fact, a rather progressive one, with the very large standard deductions that it envisions.

So most of the tax relief, percentwise, does go to lower- and middle-income individuals. In terms of sheer dollars, of course, the upper-income taxpayers would receive the biggest break. But I think if you look at it as a percent of income, the proposal is a progressive tax proposal and should be viewed that way.

Finally, when we did our study last year, we did notice one anomaly that I think deserves some further study. We didn't have an opportunity to do that yet. But in looking at the cost of the proposal, we looked at IRS Statistics of Incomes for the District of Columbia, as well as the District's own statistics on that filings.

We found that there was about a 10,000-filer difference between those who filed Federal income taxes in the District and those who filed city income taxes in the District. In other words, there were less filers who filed city income taxes, about 10,000 fewer, and most of these were at the higher income levels.

Now, even allowing for possible differences in the Tax Code which might suggest that there would be some fewer filers in the District than the Federal Government, it suggests to me the possibility that there is a great deal of untaxed income which is declared for Federal income tax purposes, but is not declared for District income tax purposes.

One of the things I would hope you would look at, perhaps as part of this bill, is something that the IRS Code now allows: it allows the Federal Government to collect the State's taxes. I think there's one State that does this now.

Instead of the current tax structure and bureaucracy that exists in the District, the IRS could actually piggyback the District's income taxes on top of the Federal income taxes, collect the whole amount, and then remit the District taxes back to the District. It would cut out a whole enforcement group at the District level.

Mr. DAVIS. Does the IRS collect taxes now for any State?

Mr. KEE. At least it did for one State, one of the Northeastern States. I'm not sure whether it does now.

Mr. DAVIS. If you could get back to us.

Mr. KEE. But they're allowed to do so under the Code currently, and, particularly because of this anomaly in the tax filing, I thought it's something that the committee might want to look at as part of this proposal. It would relieve a cost that the District now has, the collection of a separate city income tax, and I think compliance would be considerably higher if the IRS was collecting the city income tax.

Mr. DAVIS. Now we will hear from our last member of the panel, Dr. Steve Fuller, with George Mason University, in the 11th Congressional District. Steve, thank you very much for being here.

Mr. FULLER. Thank you, Mr. Chairman. I'm pleased to be here with you. I have prepared a paper. I'm going to sort of cut that short to save time, and that's available.

It would be easy to come here today and endorse this proposal. Being for lower taxes is a popular position. In a recent survey that I conducted of Washington area business leaders just earlier this month, almost 70 percent of the respondents said that they supported the flat tax proposal for the District.

I, however, do not support this bill, not because I am against the flat tax concept or even the bill in general terms, but because I do not think it will achieve the objectives for which it is being proposed. It is not the correct solution for the District of Columbia's economic development problems.

There's no disputing that the District of Columbia is experiencing significant economic and fiscal problems. The District's continuing population decline and the erosion of its job base provide a clear measure of the severity of these problems. There is no disputing those.

However, the Federal income tax was not responsible for the loss of population or jobs in the District. While reducing the Federal tax burden on District residents may encourage some selective population growth and some investment, the conditions that have contributed to the District's economic problems will not have been ameliorated by the reduction of the Federal tax burden on the District's residents, and these problems will continue to negatively impact the District. These problems may very well be sufficiently negative so as to completely offset the competitive tax advantage this bill would create.

What do we know about residential location decisions? The literature is fairly clear about the factors that are important to choice of jurisdiction in which to reside.

The factors found to be the primary determinants of residential location include proximity to place of work; quality of public facilities and services; community reputation and image; economic considerations such as cost of housing, including local taxes, property

values, cost of living; housing conditions; neighborhood amenities; access to services; shopping and cultural activities; and familiarity with the jurisdiction—that friends had lived there in the past.

It isn't that taxes are unimportant in residential choice. Rather, it is that other factors are more important. These nontax factors are what have made the District of Columbia less attractive for residential location. Unfortunately, this bill does not address these critical deficiencies, and lowering the Federal income tax rate will not even indirectly improve the quality of life in the District's neighborhoods.

The provisions of the bill do little for the business climate in the District. Businesses select locations based on market conditions, operating costs, availability and quality of labor, quality of transportation, and institutional factors. Taxes are not unimportant, but these other factors are substantially more important.

If this bill proposed reductions in business taxes, that would at least provide a direct benefit to District-based businesses. Lowering the capital gains tax could result in an in-flow of capital to the District, but capital without business development opportunities is idle capital.

At present, there is no indication that I know of that the District has a capital scarcity; rather, the District has a scarcity of attractive investment opportunities. This bill does not foster the building of new markets, the strengthening of existing markets, or the reduction of business operating costs. This is what is directly required to directly expand the District's business base and to create new and expanded enterprise.

What are the likely outcomes if this bill was enacted? Some higher-income households will be retained where otherwise they might have moved out of the District had the flat tax not been enacted.

But the District will not attract a significant number of new residents from the suburbs. The reasons that these households are in the suburbs have more to do with schools, housing type, amenities, location of churches, clubs, jobs and friends, than with taxes.

The savings from the proposed flat tax may not prove to be very significant when compared to the added costs of relocation, higher District local tax rates, and the extra costs of living in the District—higher insurance rates, possible need to rely on private schools.

It is possible that the District could increase its capture rate of newcomers to the Washington region, but probably not significantly, as other location factors remain the primary determinants of residential choice.

However, if the District was successful in substantially increasing its capture rate of newcomers to the region and maybe even attracting current suburban residents to relocate to the District, then there would be a negative price effect on the suburban housing market.

The more successful the District was in attracting new residents, the greater would be the negative impact on the suburban residential market. Lower residential demand in the suburbs has to result in lower prices and weaker housing market conditions.

This is not the only potential cost of this bill if it were enacted. Increased housing demand in the District would result in displace-

ment of lower income households and contribute to housing price inflation. There are other likely social costs, as well.

This bill will not result in the District's economic recovery. In my opinion, this is the wrong answer to the right question—maybe not the wrong answer, but an incomplete answer—better term.

The District of Columbia has substantial economic development potential, and it is clearly in need of help to achieve its potentials, but this bill does little to directly address the District's economic development constraints, and these must be resolved before the District's economy can grow and develop.

I am convinced that a more comprehensive approach that directly addresses these developmental problems would prove successful in revitalizing the District's economy. Thank you.

Mr. DAVIS. Thank you very much. Let me start with a fundamental question. It goes back to what the Joint Committee on Taxation will testify to later and I asked Mr. Kemp earlier. Is this a zero sum game, or do you think that H.R. 3244 would create new economic activity, or does it just shift it from one area to another?

I think that's a fundamental question for whether this works for the region, whether it works for the District, whether it works for the suburbs, and I will ask any of you who feel so moved to try to answer. We'll start with you, Mr. Prost.

Mr. PROST. I would like to respond to that. I think the important aspect of the act the way it's structured is the treatment of capital gains, what this does for someone who resides in the District. It encourages you to invest in the District.

If I buy my General Motors stock or my Microsoft stock, and I'm a resident of the District, I move into the District, I'll continue to pay my capital gains under the old Federal tax rate. Matter of fact, my capital gains tax will be higher than my ordinary income tax earning money working and living in the District. It will encourage me to transfer my investments into the District.

I think it's clear, particularly with the 4,300 higher-income filers who have significant income from capital gains, that they will redirect their investments into the District. The redirection of this investment into the District from the Nation as a whole—not just the region, but from the Nation as a whole—will create economic growth, both in the District and in the surrounding region.

Mr. DAVIS. But let me ask you just to followup on that. The kind of capital gains—if you were making capital gains free in the city, for example—is that idle capital? It's reinvested in the city, but does that create jobs, or does that just create new investment in buildings?

Mr. PROST. All right. I want that capital gains to earn money somehow, so I am going to invest it in something that is going to have a return, and I think that part of it will be invested in real estate; part of it can be invested in new entrepreneurial opportunities.

The advantages inuring to me to invest it in the District, the nature of that investment, I think, will be a variety of small businesses initially, because we've increased disposable income. The first natural investment to me would be small business. Take advantage of that disposable income. That will create jobs, and it will create additional wealth, both in the District and the region.

Mr. DAVIS. So even a company that's thinking of going public, a small company rising, would find an advantage being in the District for its owners, at least, to move that capital in there.

Mr. PROST. Correct.

Mr. KEE. I would echo those comments. In addition, I think that we need to look at the positive impact it would have on the region as a whole. I think that new jobs created in the District also create jobs in the suburbs. The suburbs have done very well because of their location next to the District of Columbia, and certainly the economic growth in the counties surrounding the District has been very much related to the Federal Government and other activities.

Of course, now there's a great deal of diversification going on. However, the location next to the District of Columbia has been very positive for the economic climate of the surrounding counties. I think we're about in a situation where it's now becoming a negative, where the core is crumbling.

I think if you revitalized the core, it helps both the core, in terms of new jobs, as well as provides positive spill-over benefits to the suburban counties.

Mr. DAVIS. Dr. Kee, there is no question that it's hurting the region right now. It's not beginning to; it has for some time. We've known this as we were doing our advertising in Fairfax and looking at our market surveys. This region 20 years ago was one of the hot places in the country to do business. We're not on any of the lists now.

The capital has gone south. It has gone to North Carolina or Atlanta or Texas or somewhere else. This city is a drag on the region, and that's why it's important that we work together and recognize our destinies are intertwined and not necessarily adverse, as so often happens in these kinds of things.

From a technology point of view, the technology that is taking over in the Virginia suburbs, where you have over 1,250 companies at last count, and probably another 100 since we last counted. In Maryland, you get a lot of biotechnology and high technology companies. The city has got practically none.

And yet some of the entrepreneurs who can really locate anywhere in the this country, they tend to locate where there's a lot of human capital that can do the work, whether it's the Silicon Valley or route 28 or Research Triangle or northern Virginia in the Washington suburbs. They could locate in the city. There's no reason they couldn't, if they're thinking of going public.

Does this work? Let me ask Dr. Fuller. You—rightly, I think—have some skepticism about this whole thing. Can this work in that manner?

Mr. FULLER. Well, let me echo what Jed Kee said. Anything that generates jobs in the District and income in the District will benefit the suburbs and grow the economy faster. My hesitation is that I don't think, in the short term—in a 5-year timeframe, for example—that this will actually enlarge the total economy of the region and that, in the short term, it will be a zero sum game.

There will be some redistribution, possibly—and likely—to the benefit of the District. It will be robbing Peter to pay Paul. The suburbs may be able to afford this.

Mr. DAVIS. Depending on what increment we're talking about, sure.

Mr. FULLER. I think the total population of the Washington area 5 years from now, with this bill, will be the same without it. It's just where the newcomers—and we do get population moving here. We're adding 50,000 people to the region in various forms, mainly from natural growth, but we do get in-migration, net in-migration, and the District will get some of that with this bill, as opposed to those people going to the suburbs.

I don't think it's going to be large numbers, because most of the jobs are in the suburbs. It's hard to generate new jobs in the District unless there's more market capacity in the District. It isn't just investment capital that generates jobs. There has to be a reason. There has to be work to be done.

If this is a 15-year commitment or a 20-year commitment, the region will be bigger with it than without, but it's a very long-term commitment before the benefits begin to accrue and we can look back and say this was a good thing.

Mr. DAVIS. Any other comment on that?

Mr. SULLIVAN. I would just like to add that this is really, the way I view it—I think it's of overall benefit to the entire area. But it is sort of a zero sum game, where we're taking more from the rest of the country to contribute to the D.C. area.

The main economic benefit here is not a supply side tax cut, but a demand side tax cut, by putting more money in people's pockets, which they'll spend in the District and in the outlying areas.

Mr. DAVIS. Is there any other kind of targeted cut that you think you could get more bang for the buck, so to speak, that would have an entrepreneurial value of attracting business in there that may not be as steep as the across-the-board flat tax here? Dr. Fuller, can you think of anything?

Mr. FULLER. Well, I wouldn't restrict your question to taxes or to cuts. If the right number is \$700 million. I think that's probably large. I don't think the impact is that great. But if we have \$700 million to work with in the District, I think we could make an enormous difference by attacking the problems that have made the District less competitive.

The District has just enormous growth potential. People want to live in the District. It's the Nation's Capital. It has lots of amenities and lots of reasons to be here and to locate businesses here. There are impediments to that.

Mr. DAVIS. Right.

Mr. FULLER. Remove the impediments, and the growth occurs naturally.

Mr. DAVIS. Well, that was my earlier question to the Speaker. You may or may not have been here.

Mr. FULLER. I was.

Mr. DAVIS. For that amount, is this the wisest allocation, short-term, long-term, even 1 year? Let's say the number is \$700 million. We don't know what it is. But just assume it is.

Mr. FULLER. Oh, I don't think so. If this is the first step in a big program, then go for it. It's a great step.

Mr. DAVIS. But for that amount you could basically redo the water pipes. You could add transportation. You could do some in-

formation technology. There's a lot of things you could do for that money just in 1 year.

Mr. FULLER. That's right.

Mr. DAVIS. Just to bring the city up to where they need to be to be able to do other things from a service level. Is that the idea?

Mr. FULLER. I would agree with that.

Mr. DAVIS. That's what we need to do. In taking a look at the resources, it doesn't mean you can't do the taxing.

But it's very clear that the educational limitations that the city offers right now—I mean in Fairfax, which has the same tax structure, across the way, housing values differ because of what neighborhood schools they go to. It's a sad fact, but it's very true. So there's no reason to think the city would be immune from that same kind of thing.

Mr. PROST. I would just like to add a couple of comments. We'll hear from later panelists, that there is no one magic panacea alone, we will hear from the D.C. Chamber of Commerce on the corollary actions that the District will be doing to take advantage of this bill.

We talk about brick sidewalk solutions. You can give the District all the money you want to brick the sidewalks and to help the infrastructure, but if there isn't more income and there isn't a viable residential population, it's all going to go to naught. So you really have to have combined resources to encourage people both to live and invest in the District.

The interesting thing about this tax—and obviously there are targeted investments that could be done—but we want to do two things. We want to target investment and jobs, both in the District and the region, and we also want to help shore up the bleeding that the District has in terms of its residential population.

Mr. DAVIS. The demographic shifts, yes.

Mr. PROST. This is an excellent combination of addressing both the investment issue, with the investment tax credit part of the act, as well as the reduction in overall income tax which addresses the residential problem, as well.

Mr. DAVIS. I think the silver lining in this whole thing, and with Ms. Norton's bill, is the focus, once again, on adding something of value to the city, whether it's tax cuts, whether it's additional aid of some kind, we must, in focusing that, shine that light on there.

This is how we can best help the city. There can be some honest disagreements over how to do that, but for the people who don't like this plan, you've got to ask yourself, what is your answer? Because by doing more of the same, we know where that ends up at this point.

Let me yield now to my friend from the District, Ms. Norton.

Ms. NORTON. Thank you, Mr. Chairman. I want to thank all the witnesses, because I've found all of your testimony to be very helpful, very useful, and it may even have inspired some changes that I will be making as a result of these hearings in my own bill.

I want to say to the chairman that I think he focuses on the right question. This is not an academic exercise, ladies and gentlemen. It really isn't. I am an academic, I should say, because I continue to be a tenured professor of law at the Georgetown University Law School, which will be starting classes next month.

But, in a real sense, the chairman's question is the question before the House. If not this, what? And therefore, my questions are going to be aimed truly at trying to draw out suggestions for alternatives or additions to my bill, because I don't have time to wait to see whether the schools will improve and that will draw them.

Name me a big city in the United States whose schools are improving. Name me a big city in the United States where living conditions are improving. So I've got urban problems, plus a city going out of existence.

I think of the chairman's notion, that is the right question to ask. Of course he, better than I, knows the answer, because he said, "Well, you know, what alternative uses can be made of this money?"

We now have a water crisis. Can you see it now? Suppose the Congress said—let's not take \$700 million; let's take half of that—"Here's \$300 million right now to fix the water pipes." I can see them now, running back from Fairfax with their glasses in their hands, because the water pipes have been fixed. We've got to ask ourselves what would have any effect on people's decisions.

I appreciate what most of you have testified. I think what I hypothesize would also be the truth, would also be the case, and that is, you're more likely to have an effect on people who are here than on people in the suburbs returning. That certainly is my goal, stop the hemorrhaging, because otherwise we won't have anything to talk about.

Mr. Sullivan, I found your testimony particularly interesting and helpful, because you say, "What would be the most cost-effective thing to do?" Well, you know, you ought to ask yourself, in the context of living on this planet at this time in this Congress, if you really want to be helpful to the District of Columbia, because that's what I have to do every day when I go on the House floor. That's what I have to do every day when I come to the Congress.

You say in your testimony, "If tax incentives are going to be used . . . we can do better than DCERA." I note that this is the shortest part of your testimony, Mr. Sullivan, that all of this is what comes before, and here comes the suggestion for an alternative. It really takes up one short paragraph.

It says, "One possible alternative would be to provide a tax credit"—I like this idea—"of \$1 for each hour of employment of a D.C. resident by a D.C. business. This credit would offset the negative effects on employment of the recently increased minimum wage. A \$2 per-hour credit would be provided for new workers that are undergoing training."

I like that idea very much, and I think it would have nothing to do with the decision of people living here to stay or leave. It would have an effect on employers, and I welcome that effect in a city that has one of the most business-unfriendly climates in the United States.

But in sitting down and writing this bill, Mr. Sullivan, Mr. Fuller, Mr. Kee, and Mr. Prost, I did not say, "I think a tax cut might be a good idea." I asked myself the more pointed question, "What is my problem?" My problem is I'm losing taxpayers. If I continue to lose them, there will be no more District of Columbia. What will get back taxpayers?

Mr. Sullivan is right. We don't have a clue as to whether this will work. But I do have this clue, Mr. Sullivan. What you suggest will not work. This will not keep one taxpayer in the District of Columbia.

So I challenge each of you to help me. This does not help me. I love it. I will put in a bill to that effect—because people put in bills all the time that won't pass, but they're good, and people need to know. This will not help me. Do you have any other ideas, Mr. Sullivan, for—and I quote—incentives that “can do better than DCERA”? That's what I'm asking for at this point.

Mr. SULLIVAN. Ms. Norton, I grew up in Jersey City, NJ, so I know a little bit about the real world. I think, when I looked at the data, 26-percent poverty rate in the District of Columbia—and in certain areas, the concentrations are much higher than that.

Maybe I was trying to be a little too polite in my testimony. I don't think we should rely on trickle-down economics to solve the District's problems. Let me just be blunt. We want to keep wealthy people in the District. The District has an incredible disparity between rich and poor. Let's talk about it.

You drive up Connecticut Avenue, Wisconsin Avenue, you have some of the wealthiest people in the country. You drive in the other direction, you have some of the least fortunate people in the country. By giving the rich of the District a tax cut, it will help the District, but it's a very indirect benefit.

Ms. NORTON. Do you consider the people who will get 50 percent of their tax relieved to be wealthy?

Mr. SULLIVAN. No.

Ms. NORTON. Why do you focus only on the wealthy, as if the tax cut were geared toward the wealthy, when those who get an 80-percent cut are at the bottom end?

I believe that my bill might have the unintended effect, given how steeply progressive it is, of drawing in or keeping more people between \$20,000 and \$50,000 than in getting more people between \$50,000 and above, which is where I have the deficit. So why do you talk only about the people who have been most loyal because they don't use services, the people at the upper end?

Mr. SULLIVAN. I appreciate your frank question. What I was focusing on was the poverty rate, and I thought the best way to reduce the District's poverty rate was to increase employment.

With that simple premise, after working years on empowerment zones and on flat taxes, and based on meetings with Republicans and Democrats, the tax proposal that is most often used to increase employment is a wage credit, because it directly increases jobs.

The hope there would be that, by increasing employment, we need not keep the wealthy who are already in the District here, but we would create more wealth by bringing the people who most need the help out of poverty and into the middle class. So not by drawing the middle class in from the suburbs, but by creating a middle class from people who are currently not doing that well.

Ms. NORTON. This is a very helpful answer, because it certainly makes me understand that we're talking about apples and oranges. I endorse that, and I think it is very important. When you consider that 83 percent of the residents of the District of Columbia make

under \$50,000, and 65 percent make under \$30,000, adding an increment to their pay is most helpful.

It does not address the problem of the DCERA. As I drew the people in week after week, I kept saying, "Your eye is not on the ball—you've forgotten the principle." The principle is, I'm trying to draw middle-income people here. Now, there is other legislation I need to put in, but this bill is to draw middle-income and others to the District.

I just want to indicate that I think it is a novel idea, so novel that I would like to consider writing a piece of legislation, but—you said it yourself—it's aimed at doing something about the 28-percent poverty rate. That was not the aim of the DCERA, as important an aim as it is. I appreciate it, though, because you've given me a good idea for a bill.

I would like to ask Mr. Kee a question, because he raises my interest when he talks about out-migration. Mr. Kee, in your view—let me preface this by saying what I notice anecdotally. Some of it is happening in Virginia; more of it is happening in Prince Georges County. The hidden out-migration is not the most obvious.

If you look at the \$50,000 range, that's where we've had the most loss—\$40,000–\$50,000—those true middle people trying to get just a little higher. But if you want to know where the silent out-migration is, it is in working-class and struggling people—people who wear uniforms to work, people who work every day.

Those are the people whom I believe—and this is anecdotally, and I'm asking your opinion on this matter—the neighboring State of Maryland and, to some extent, Virginia, will get more of these people, it would seem, who are foreign language-speaking. You tend to go where other people who speak your language are. So they're having the same effect.

For lower income Washingtonians, what I see being created in Maryland is a replica of the District of Columbia, which in the District is called ward 9. There are many people on welfare who leave the District. Maryland has good services for poor people. Particularly, there are many people who work every day, but are in lower income brackets, that are leaving the District.

The anecdote that is most familiar to me really has to do with the time since I've been in Congress. That is when, particularly, black people see you in the street or see you up here, and they recognize you, they come up to you and say, "Ms. Norton," and we would always talk about the District. And the people wave to you in your car.

But I have noticed a change. The people who come up to me with good working-class jobs here, I ask every last one of them now, just as I did when I came to Congress, "Are you one of mine?" And, you know, they're not one of mine. They really do say "I live in Maryland" a lot.

And on the streets, when they wave to me, I now know they're waving to me because they saw me on television, not because I'm their Congresswoman. And they come up to me in the department stores and everywhere else, just because they know who you are, not because you are their Congresswoman.

What I'm asking you is, what effect is the financial crisis of the District of Columbia having on the out-migration of poor people and working-class people, perhaps to those counties?

Mr. KEE. Well, I think it's obvious that it has had a big effect, along with, generally, the quality of life, the quality of the schools. I guess the question also would be, will the change in taxes in the District alone bring those families back?

I don't think it will. I think once having made the decision to relocate from the District to Montgomery or Prince Georges County, it's not likely that a change in taxes alone is going to bring those constituents back to you. I just don't think that's going to happen.

Ms. NORTON. They are part of the kind of balanced population I was trying to get. What you say is interesting, because I think that in terms of the tax break, when you consider housing costs and how hard it is to make any movement if you are working-poor today, that I probably lost those people forever and, if anything, I probably have less of a change of a balanced, across-the-board kind of population I'm looking for. I'm sorry. Please continue.

Mr. KEE. Well, I wish I could say I thought that they would come back in droves, but I don't think that's likely. Certainly, at least the studies that have been done in this area have indicated that you're not likely to see that movement back—again, because of relocation costs; you get family friends in a particular area.

But I do think it will help stem the out-flow, and I think that's one of the things you're trying to do with this bill is stop the hemorrhaging. I think it will help do that. But in order to get the sort of positive economic development spin on the bill, I think it will require much more than just the tax bill itself.

I know we've got other people that can address some of the sort of dysfunctional issues with the D.C. economic development problem, but clearly the District has to completely reform its economic development approach if it's going to take advantage of the reduction in capital gains and other tax reductions that you're proposing.

Ms. NORTON. Thank you. Dr. Fuller, you know, I suppose, as an academic who relies on evidence, my first inclination was to say to you, "Listen to your own survey and listen to your own business people." Frankly, if 67 percent of the business people that you survey are saying that they think the tax break would be useful, that's interesting evidence that needs to be probed more deeply. Perhaps you can tell us more about that survey.

Mr. FULLER. Well, I think if you ask any businessman if lower taxes are good, that most of them will say yes.

Ms. NORTON. In a jurisdiction where they do not live and which would become more competitive with them, perhaps?

Mr. FULLER. I did a survey for the D.C. Tax Revision Commission 20 years ago of residents moving into Washington—into the District and into the suburbs. Interestingly, they had pretty much the same answers of why they picked where they moved, and the least cited factor was taxes. The most cited was proximity to place of employment.

Ms. NORTON. Yes; but that's not my question, because I agree with that. My question is why do people who consider the economic effects of tax relief say that this would be a good thing to happen, not whether they would move.

Mr. FULLER. Well, I think you find very broad support in the business community, regardless of jurisdiction, for anything that will help the District revitalize, because it is recognized—perhaps not proven in fact, but I think probably could be—that a healthy central city is good for the regional economy. I think the debate comes, is how do you accomplish that?

Job growth—if there's jobs in the District, the residential base of the District will be stronger. In the last 5 years, the District has lost more jobs than residents. I just went and looked up the data for the last 5 years on employment change in the District.

Ms. NORTON. You say if there's job growth, residency will—would you repeat that?

Mr. FULLER. If you add jobs, the attractiveness of the community as a place to live will improve. It's not the only thing, but if you continue to hemorrhage jobs, as the District is—and they're not just government jobs; 40 percent of them are private sector jobs.

Ms. NORTON. I yield to the chairman for a moment.

Mr. DAVIS. Excuse me. Dr. Fuller, I think it's very insightful and an important point. My observation has been that a lot of jobs, though, are moving to the suburbs because that's where the people are.

Ms. NORTON. Yes.

Mr. DAVIS. Now, is that because, in the high-technology industries and the knowledge-base industries, that's where a lot of your educational base is. Am I missing something?

Mr. FULLER. That would be true of those jobs that are population-based, such as retail jobs. They go where the market is. Jobs that are not population-based, that are not services of the residential community, go where the cost of operation is lower.

Ms. NORTON. Such as?

Mr. FULLER. Such as the high-technology companies.

Mr. DAVIS. Like professional services companies, and we've got a lot of them in northern Virginia—1,250 at last count. There are very few in the District.

Mr. FULLER. Such as Peat Marwick, such as business services. They are going out there because their employees are out there. They are going out there because the cost to operate their business there is considerably less. Some of those costs are imposed by local governments.

Mr. DAVIS. The regulatory environment has something to do with that, too.

Mr. FULLER. Very much so. Transportation costs. You know, there are momentums that are moving economic activity away from the District. Some can't be counteracted; some could be. The District hasn't done a good job in building off of its competitive position in this region, and I think there's something to be done. None of these solve all of the problems.

Ms. NORTON. I understand we may be in a chicken-and-egg situation, but I really do want to note for the record what business people tell me and what the literature certainly reveals, that one of the great driving forces for where business locates is the quality of the work force and of the residential base.

Bearing in mind that we could have a chicken-and-egg problem, if you're going to work on anything in the District of Columbia—

where you can't even get a class today if you tried for the Police Department or for the Fire Department—I think you would first try to get some folks here that people would hire.

You would have a better chance doing that than you would have saying, “Come here and we might try to find you some folks to hire,” because if you came here now, I think you would find folks to hire, and I think they would come from Tom’s district. We’re glad to provide more jobs for them. As it is now, in the District of Columbia, 85 percent of the jobs provided in this city are going to the suburbs.

So that’s what has driven me to say, “I think I have a better chance getting business if I’m able to show the kind of diverse work force that this city had when I was growing up as a kid here.

One more thing to Dr. Fuller, because I have a question for Mr. Prost.

Mr. DAVIS. We have two more panels.

Ms. NORTON. Yes. I will finish shortly.

You are certainly right, and I want to endorse your notion that taxes were not responsible for the job loss. You’re absolutely right—it was a whole set of urban conditions and the way in which the District, itself, has operated.

But Dr. Fuller, I think you got to watch out for the logic here. Tax was not responsible for the loss, but that does not show the converse, that taxes cannot stimulate some behavior toward the District. You know, that’s really like saying what is also true, that the low scores of kids from low-income neighborhoods on the SAT did not come because you didn’t require a 700 or whatever on the SAT.

But I’ll tell you this much. Requiring a 700 or whatever it now is on the SAT has had an effect on boys who now want to go to college and play ball. I just ask everybody to approach this bill the way I do.

I haven’t told my residents, who are enthusiastic in every class and in every color and every kind. I say, “Wait a minute. Nobody knows anything about what this bill will do. We don’t have a clue, because nothing even remotely like this has been tried. And don’t think that the District is going to turn around and there’s going to be a lot of money in your pocket.”

What I do think this bill will do is make people stop before they leap, and they’re leaping now across the District line. That’s about all I think it will do initially. I do think that, over time, with the Control Board in place, with the city trying to improve, there is—and I’m using your words—“we need more market capacity in the District of Columbia.” That means residents.

I do think there’s a certain kind of market that you could begin with, of people making first-time decisions about where to go, such as single people, such as married couples who don’t have children.

I would hypothesize conservatively, as I think you’ve tried to do, what would happen, although where you end up is that nothing would happen. I’m tempted to put you into the Speaker’s category of “Do nothing and something good will happen.” I am forced to do something.

But I am most intrigued—and I simply have to say this for the record—I’m most intrigued with the part of your testimony that

says—God help me, as I sit here, seeing everybody sit and doing nothing about the District—that this bill would provide the perfect excuse. We have passed ground-breaking legislation for the District. Let's wait to see what it does. They're waiting for Godot right now.

So, as opposed to waiting when nothing has happened and waiting after something happens, I'm going to choose to tell them to make something happen and then wait, because the District is going down, and they're waiting just as much.

Nobody is moving here. You see some passion on the part of two or three leaders, but there is a great danger that all that you have said and all that has been said today will make its way into somebody's history of what happened to the District at a moment when there was time to do something.

There will be those who said that they didn't do anything because people said, "If you do something, then they'll say you did something, so don't do anything. Something will happen." Or who says, "Look, you could do something else with that \$700 million," when everybody who sits in this city knows that the Congress would not, in fact, vote \$700 million. In fact, the Congress has just finished cutting the Federal payment for the 12th time in 12 years.

Let me say to Mr. Prost, could you take on a harder question?
Mr. PROST. OK.

Ms. NORTON. How likely is it that, given urban and other special problems that the District has, that housing costs will rise out of control, and we will have the opposite problem from that that Dr. Fuller sees and that others on the panel see, that there will be such an abundance of riches that the economy will run away with itself and nobody will be able to afford to live here—it will be like Hong Kong?

Mr. PROST. Well, first of all, I would just like to observe a kind of a truism that if all the economists of the world were put end to end, there wouldn't be a conclusion. It really is necessary, however, in the words of the commercial, to do something, to "do it."

We perceive that the major impact of this act in terms of the housing market is to change the market perception, and perception is reality. As everyone on this panel has stated and as the literature has stated, there are hundreds of decisions that go into making a home purchase decision and whether to move—the size of the house, the location of the job. I perceive that it will enhance the housing market.

Other factors tend to ameliorate the impact. In any event, there are tools that the District already has in place in terms of senior citizen tax credits, in terms of other mechanisms the District has in place to address the housing price problem. There are other tools that can be put in place, and we would like to see corollary tools put in place that can address the housing problem.

We have worked on suggestions that there could be a special capital gains tax created, that if someone does wind up getting a wind-fall profit and selling a home in the District, that that could be utilized to create a revolving loan fund which could be available for lower income, moderate-income people to purchase homes in the District.

So there are ways, mechanisms by which we can capture the value that would be created to help target middle-income residential development. They're very simple tools. They're tools that have been used in Canada, for example, and in England, that can take a portion of this value capture and create the funds to help support the middle-income households who we're targeting.

Ms. NORTON. It's interesting. I'm having people look at what some in Fairfax County and Prince Georges County want to get rid of, the TRIM legislation, because it might be more suitable as standby legislation here if we were ever so fortunate as to have the thing turn around just that much on us.

Mr. Chairman, one more question, because this has also arisen.

Mr. DAVIS. The 5 minutes are almost up. [Laughter.]

Ms. NORTON. Suppose the only thing we were able to get in this bill, Mr. Prost, was the part of my bill that deals with investment and job creation—capital gains, the 15-percent rate on investment—and no income tax relief. What result there for the viability of the city?

Mr. PROST. Well, I guess the analogy earlier, it's half a loaf, so it does encourage investment in the District, which is beneficial. We're discovering that investment in the District, if it creates a job, for every 100 jobs it creates, it creates 85 jobs in the suburbs, 15 jobs in the District. So it has a very marginal impact.

It doesn't encourage me to come in and move as a resident or to decide not to move out as an existing District resident. It doesn't change the whole residential equation. It encourages some investment, but doesn't address the residential problem, which is the real hemorrhaging.

Ms. NORTON. Thank you very much. Thank you, Mr. Chairman.

Mr. DAVIS. Thank you. Mr. Gutknecht.

Mr. GUTKNECHT. Mr. Chairman, I really don't have any questions. I do want to thank the panel for coming. I'm sorry I didn't get a chance to hear all of the testimony. I understand that there are some differences of opinion about this.

Mr. DAVIS. When you get four economists together, what do you expect? You're going to always get differences.

Mr. GUTKNECHT. But let me just say, though, for the record, that I think maybe that's one of the issues that intrigues me, and that is, maybe we ought to just try it and see what happens and find out if taxes, and particularly taxes on investment, whether they really do or do not have consequences.

My instincts tell me that they do. This may be a good place to prove or disprove that theory. I think, as scientists, you would probably all agree that, if we look back in 5 or 10 years and say it was an abysmal failure, we could all say it was an abysmal failure. But we might just find out that it actually works.

So that may be the biggest argument in favor of at least giving this a go, because if it will work here, then maybe it will work in Detroit and Chicago and a lot of our other inner cities.

So I don't really have any questions—that's a comment—but I do appreciate the testimony, and I do appreciate the fact that this is an issue that needs some serious discussion by serious people. I don't think we're going to move on this probably in the next week or two, but I do think it's something that deserves some real care-

ful study by economists and other folks around the country. So thank you very much for being with us.

Mr. DAVIS. Thank you all very much. We'll hear our next panel, then—Tom Ripy, an attorney with the Congressional Research Service, accompanied by Marie Morris, also an attorney with CRS; Mr. Ken Kies, the chief of staff for the Joint Committee on Taxation; and Mr. James Atwood, a partner in the prestigious firm of Covington & Burling.

As you know, it's the policy of this committee that all witnesses be sworn before they can testify. If you would rise with me and raise your right hand.

[Witnesses sworn.]

Mr. DAVIS. Thank you. You may be seated. The subcommittee will carefully review any written statements you care to submit. Try to keep your oral testimony to 5 minutes. I'll ask Mr. Ripy for his statement, and then Mr. Kies, and then Mr. Atwood. Tom, thank you for being with us, and thanks for bearing with us.

STATEMENTS OF THOMAS B. RIPPY, LEGISLATIVE ATTORNEY, CONGRESSIONAL RESEARCH SERVICE; KENNETH J. KIES, CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION, U.S. CONGRESS; AND JAMES R. ATWOOD, COVINGTON & BURLING

Mr. RIPPY. Mr. Chairman, members of the subcommittee, my name is Thomas B. Ripy. I am an attorney with the American Law Division of the Congressional Research Service. I'm appearing today at the request of the subcommittee to discuss constitutional issues which might arise under a proposal to grant special Federal income tax treatment to District of Columbia residents.

Appearing with me today is Marie B. Morris, an attorney with the American Law Division who specializes in tax law. She has dealt with these issues in other contexts and will be available to assist in responding to any questions you may have.

In keeping with the role of the Congressional Research Service, we will not be advocating a policy position, but attempting in a nonpartisan and objective manner to identify and summarize potential legal issues, relevant constitutional provisions, and cases interpreting and applying those provisions.

In October 1995, we prepared a memorandum addressing constitutional issues raised by an earlier proposal providing special tax benefits to District residents, H.R. 748. We did so in response to a specific request from a client for such a review of the law. Subsequently, the client agreed to permit us to circulate the contents of that memorandum to others making similar inquiries.

Recent inquiries from clients raised similar questions with regard to H.R. 3244. Because we received several inquiries of this nature and H.R. 3244 was substantively different, we prepared a revision of the earlier memorandum in general distribution form that was tailored to the new proposal.

A copy of that memorandum is attached for incorporation into our written testimony. It provides a more detailed examination of relevant law than we shall undertake in this statement.

A review of the relevant constitutional provisions in case law suggests that the most important questions to be examined are whether and how the requirement of article I, section 8, clause 1,

of the Constitution, that all "Duties, Imposts and Excises, shall be uniform throughout the United States" applies to the flat tax proposal contained in H.R. 3244, the District of Columbia Economic Recovery Act.

Case law suggests the following. If the reasoning of Chief Justice Marshall in *Loughborough v. Blake*, an 1820 Supreme Court decision, is followed, it seems likely that the District of Columbia would be treated as part of the United States and like another State for purposes of the Federal taxing power and the application of its constitutional limitations.

The cases intimate that, despite the Pollock decisions treating an earlier income tax as, at least in part, as a direct tax, such taxes will be treated as indirect taxes subject to the uniformity requirement that we quoted above.

According to the Supreme Court in its most recent pronouncement of the application of the limitation contained in the uniformity clause in *United States v. Ptasynski*, 1983, the uniformity clause "does not prohibit" Congress "from considering geographically isolated problems. * * * But where Congress does choose to frame a tax in geographic terms," the Court said, "we will examine the classification closely to see if there is actual geographic discrimination."

After the Supreme Court reviewed the circumstances surrounding the enactment of the Windfall Profits Tax, it concluded that the congressional decision to exempt Alaskan North Slope oil was supported by substantial neutral factors which made the cost of exploration and drilling in this geographically defined area substantially higher than elsewhere in the United States.

These neutral factors, including "severe weather conditions, remoteness, sensitive environmental and geological characteristics," and the resultant high exploration and drilling costs would justify the special treatment.

The Supreme Court's review of the legislative history in the Windfall Profits Tax case was an integral element in its decisional process. One lesson that could be drawn from the approach utilized by the Court in *Ptasynski* is that developing a legislative record evidencing a rational decision predicated on neutral factors might lend significant support to the argument in support of the constitutionality of any tax benefit granted to a geographically defined class.

In sum, a proposal, such as the one under consideration, which bestows a tax benefit based on the geographic residency of the taxpayer inevitably raises constitutional questions involving the application of the uniformity clause. If neutral factors can be found to justify the geographical classification, it may pass constitutional scrutiny. If not, it may fail.

[The prepared statement of Mr. Ripy follows:]

**TESTIMONY OF THOMAS B. RIPPY, LEGISLATIVE ATTORNEY,
CONGRESSIONAL RESEARCH SERVICE
BEFORE THE HOUSE DISTRICT OVERSIGHT SUBCOMMITTEE
HEARINGS ON H.R. 3244
JULY 31, 1996**

Mr. Chairman, members of the Subcommittee, my name is Thomas B. Ripy. I am an attorney with the American Law Division of the Congressional Research Service. I am appearing today at the request of the Subcommittee to discuss constitutional issues which might arise under a proposal to grant special federal income tax treatment to District of Columbia residents. Appearing with me today is Marie B. Morris. Ms. Morris is an attorney with the American Law Division who specializes in tax law. She has dealt with these issues in other contexts and will be available to assist in responding to any questions you may have. In keeping with the role of the Congressional Research Service, we will not be advocating a policy position but, in a nonpartisan and objective manner, attempt to identify and summarize potential legal issues, relevant constitutional provisions, and cases interpreting and applying those provisions.

In October of 1995 we prepared a memorandum addressing Constitutional issues raised by an earlier proposal providing special tax benefits to District residents (H.R. 748, 104th Congress). We did so in response to a specific request for such review of the law. Subsequently, the client agreed to permit us to circulate the contents of that memorandum to others making similar inquiries. Recent inquiries from clients raised similar questions with regard to H.R. 3244. Because we received several inquiries of this nature and H.R. 3244 was substantively different, we prepared a revision of the earlier memorandum in general distribution form tailored to the new proposal. A copy of that memorandum is attached for incorporation into our written testimony. It provides a more detailed examination of relevant law than we shall undertake in this statement.

A review of the relevant constitutional provisions and case law suggests that the most important questions to be examined are whether and how the requirement of Article I, § 8, cl. 1 that "all Duties, Imposts, and Excises shall be uniform throughout the United States" applies to the "flat tax" proposal contained in H.R. 3244, "District of Columbia Economic Recovery Act".

Case law suggests the following: 1) If the reasoning of Chief Justice Marshall in *Loughborough v. Blake*, 18 U.S. 317 (1820), is followed, it seems likely that the District of Columbia would be treated as a State (part of the United States) for purposes of the federal taxing power and the application of its constitutional limitations. 2) The cases intimate that, despite the *Pollock* decisions treating an earlier income tax as, at least in part, a direct tax, such taxes will be treated as indirect taxes subject to the uniformity requirement quoted above. See, e.g., *Brushaber v. Union Pacific R. Co.*, 240 U.S. 1, 18-19 (1916) and *Stanton v. Baltic Mining Co.* 240 U.S. 103, 112-113 (1916). 3) According to the Supreme Court in its most recent pronouncement on the application of this limitation in *United States v. Ptasynski*, 462 U.S. 74 (1983), the uniformity clause "does not prohibit" Congress "from considering geographically isolated problems. ... But where Congress does choose to frame a tax in geographic terms, we will examine the classification closely to see if

there is actual geographic discrimination." *Id.* at 84-85. 4) After reviewing the circumstances the Court concluded that the congressional decision to exempt Alaskan North Slope oil from the Windfall Profits Tax was supported by substantial neutral factors which made the cost of exploration and drilling in the geographically defined area substantially higher than elsewhere in the United States. These neutral factors, including "severe weather conditions, remoteness, sensitive environmental and geological characteristics", and the resultant high exploration and drilling costs would justify its special treatment. *Id.* at 78-79, 85-86.

The Supreme Court's review of the legislative history of the Windfall Profits Tax (*Id.* at 76-80) was an integral element in its decisional process. One lesson that could be drawn from the approach utilized by the Court in *Ptasynski* is that developing a legislative record evidencing a rational decision predicated on neutral factors might lend significant support to the argument in support of the constitutionality of any tax benefit granted to a geographically defined class.

In sum, a proposal, such as the one under consideration, which bestows a tax benefit based on the geographic residency of the taxpayer inevitably raises constitutional questions involving the application of the uniformity clause. If neutral factors can be found to justify the geographical classification it may pass constitutional scrutiny. If not, it may fall.

Mr. GUTKNECHT [presiding]. Thank you, Mr. Ripy. Mr. Kies.

Mr. KIES. Thank you, Mr. Chairman. My name is Ken Kies. I'm the chief of staff of the Joint Committee on Taxation. I'm accompanied today by Barbara Angus, who is senior business tax counsel with the joint committee.

It's my pleasure to present the testimony of the joint committee at this hearing concerning H.R. 3244, the District of Columbia Economic Recovery Act. We've provided written testimony to the committee, and I'll just briefly summarize it.

The bill before the committee would contain several key features. First, individual taxpayers who reside in the District of Columbia for at least 183 days a year and who file D.C. income tax returns would be subject to Federal income tax on their District source income at a flat rate of 15 percent.

In computing this tax on District source income, District taxpayers would be entitled to an exemption amount which would be \$30,000 for taxpayers filing joint returns and \$15,000 for single taxpayers. In addition, deductions for qualified residence interest and charitable contributions would be allowed.

Special rules would apply in determining District source income—for example, compensation income with respect to services performed in the Washington-Baltimore metropolitan area would be treated as District source income. A portion of interest and dividend income would be treated as District source income based on the percentage of the payor's income that is from District sources.

District taxpayers would pay no Federal income tax on capital gains from dispositions of tangible property located in the District. District taxpayers generally would be subject to Federal income tax on their non-District source income at their average Federal income tax rate. District taxpayers would pay the lower of the tax calculated under the bill or under current law.

My written testimony contains three simple examples of how the provisions in the bill would apply to hypothetical taxpayers.

The bill would be effective for taxable years ending after date of enactment. Thus, if the bill were enacted before January 1, 1997, the changes would apply to the 1996 tax year.

My testimony discusses several issues with respect to the legislation. First, concerning compliance and administration, the proposed modified flat tax would raise a number of compliance and administrative issues. For example, tax filing would be somewhat more complex for many District residents, since they would have to complete at least two returns to calculate their Federal income tax liability.

In addition, District businesses that pay interest or dividends would need to report the District percentage of such amounts to recipients.

Only District residents would be eligible to compute their tax liability under the modified flat tax schedule provided in the bill. From a compliance standpoint, it would be difficult, perhaps, for the IRS to determine if an individual satisfies the 183-day residency test. This issue is particularly critical because of the likelihood that higher-income taxpayers might establish nominal residences in the District, while maintaining a primary residence in a neighboring jurisdiction, to take advantage of the lower tax rate.

The prior witnesses discussed some of the constitutional issues associated with the legislation. We would underscore the importance of explaining the basis for a geographical classification if the Congress were going to proceed in this manner so as hopefully to avoid uniformity clause objections. Our testimony contains a more detailed discussion of that issue.

Concerning the revenue effect of this legislation, the staff of the joint committee estimates that the bill would reduce Federal budget receipts by \$12.8 billion for the fiscal years 1996 through 2006. Assuming that the bill is enacted before January 1, 1997, decreases in Federal income tax liability would be \$675 million for calendar year 1996, when few behavioral effects would be expected, and would increase to \$1.8 billion in calendar year 2006, by which time it is expected significant behavioral responses will have occurred. This estimate assumes that certain technical changes would be made to the bill to prevent the creation of significant unintended consequences.

The District has experienced an accelerating out-migration of population in the past decade. The Joint Committee staff anticipates that the bill would result in a reduction in the rate of decline in the population in the District. The staff also anticipates that some out-migrating middle-income residents would be replaced by higher-income residents. The staff further assumes that there will be a substantial number of higher-income taxpayers in the District metropolitan area who would establish second residences in the District to take advantage of the provisions in the bill.

The net effect of these changes in population movements would be a stabilization of existing population and a substantial relocation of high-income residents from metropolitan suburbs to the District. These changes in residential location would be accompanied by a relocation of some businesses that tend to locate nearer their customers and a rise in property value and economic activity in the District.

While these relocations would improve the economy and income and property tax bases of the District, they would cause a contraction in the economies and tax bases of neighboring suburbs. For this reason, the revenue estimate does not assume any net increase in national income as a result of this proposal.

Particularly in the later years of the budget window, the joint committee staff also projects there would be some relocation of certain types of businesses from other regions of the country to the District. Businesses most likely to relocate from other regions would come from various service industries such as certain financial services and advertising. Wages and salaries are typically a large fraction of costs in these businesses, and services can be performed at a distance from potential clients. Like the relocation of residents within the metropolitan area, this relocation is not assumed to result in a net increase in national income.

That concludes our oral testimony. We would be happy to answer any questions that you might have, Mr. Chairman.

[The prepared statement of Mr. Kies follows:]

I. INTRODUCTION

This document¹ represents the written testimony of the Joint Committee on Taxation at the hearing held on July 31, 1996, by the Subcommittee on the District of Columbia of the House Committee on Government Reform and Oversight concerning H.R. 3244, the "District of Columbia Economic Recovery Act."

This testimony first describes the bill as introduced by Delegate Eleanor Holmes Norton on April 15, 1996, and discusses certain issues raised by the bill. These include compliance and administrative issues, residency issues, technical issues, and federalism and other issues. Finally, it discusses the revenue analysis of H.R. 3244 prepared by the staff of the Joint Committee on Taxation, and reviews certain behavioral and other assumptions underlying the revenue estimate.

¹ This document may be cited as follows: Joint Committee on Taxation, *Written Testimony of the Staff of the Joint Committee on Taxation Regarding H.R. 3244, the "District of Columbia Economic Recovery Act"* (JCX-45-96), July 31, 1996.

**II. DESCRIPTION OF H.R. 3244,
THE "DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT"**

Summary of the key features of H.R. 3244

- Individual taxpayers who reside in the District of Columbia (the "District") for at least 183 days a year would be subject to Federal income tax on their District source income at a rate of no greater than 15 percent.
- District taxpayers would be entitled to an exemption amount of \$30,000 for taxpayers filing joint returns and surviving spouses, \$25,000 for heads of household, and \$15,000 for single taxpayers and for married taxpayers filing separate returns. In addition, these taxpayers would be entitled to claim a charitable deduction and a deduction for qualified residence interest.
- District taxpayers would pay no tax on their District source capital gain income.
- District taxpayers would pay the lower of the tax calculated under the bill or under present law. Thus, for example, low income taxpayers would continue to receive the earned income tax credit under the present Federal income tax system.

Description of the bill

H.R. 3244, the "District of Columbia Economic Recovery Act," would allow individuals who reside in the District of Columbia for at least half the taxable year to calculate their Federal income tax liability according to a modified flat tax schedule. These taxpayers would then be liable for the lesser of the modified flat tax or their regular Federal income tax (plus alternative minimum tax, if applicable) after credits. In general, District taxpayers would be subject to tax at a rate not in excess of 15 percent on their District source income and at present-law Federal tax rates for their non-District source income.

To qualify for the modified flat tax, a taxpayer must use as a residence a place of abode in the District of Columbia (and must be physically present at the abode) for at least 183 days in the taxable year. The taxpayer must also file a District of Columbia income tax return for the taxable year.

To calculate the modified flat tax liability, the individual must determine his or her District source income and non-District source income. The tax liability is the sum of pieces calculated separately with respect to income from the two sources. The individual would be liable for a 15-percent tax on District source income in excess of the exemption amount (which would be \$30,000 for taxpayers filing joint returns and surviving spouses, \$25,000 for heads of household, and \$15,000 for single taxpayers and married taxpayers filing separate returns). On non-District source income, the individual would be liable for tax at a rate equal to the ratio of the sum of the individual's regular tax liability and alternative minimum tax liability to the

individual's taxable income, where this ratio is calculated with respect to the regular Federal income tax. The exemption amount does not apply to the non-District source income.

Under the modified flat tax, none of the present-law individual credits, such as the earned income credit or the dependent care credit, apply to either District source or non-District source income tax liability calculations. A taxpayer does not lose entirely the ability to claim these credits, since the credits would be available to the extent allowed under present law if the taxpayer elects to pay Federal income tax under present law rather than under the modified flat tax.

The bill defines District source income as adjusted gross income ("AGI") less (1) net capital gain determined by taking into account only the gains and losses sourced in the District of Columbia, (2) the deduction for charitable contributions (regardless of the location of the donee), (3) the deduction for qualified residence interest (regardless of the location of the residence), and (4) gross income from sources outside the District of Columbia reduced (but not below zero) by adjustments to AGI allocable to such income. The effect of this formula is to provide (1) that capital gains from District of Columbia sources receive a zero percent marginal tax rate, (2) that District taxpayers are entitled to deductions for charitable contributions and qualified residence interest against their District source income, and (3) that income from non-District sources is subject to tax under the regular Federal tax system.

Thus, the first step in calculating tax liability under the bill is for the individual to calculate his or her Federal income tax liability under present-law rules. This step is required to obtain the tax rate to be applied to non-District source income. It also serves as an upper limit for determining ultimate Federal income tax liability -- the individual would choose to pay the modified flat tax only if that liability is less than the liability under the present-law calculation. That is, under H.R. 3244, a District of Columbia resident can never have a larger tax liability than under present law. Once the Federal return is completed, the individual then allocates his or her income to District and non-District sources and applies the modified flat tax rules to District source income and the average tax rate to non-District source income, as described above. Examples of the calculation of the modified flat tax liability are provided at the end of this section.

Sourcing rules

Personal service income--Employee compensation (other than retirement income) and net income from self-employment would be sourced where the individual performs such services. Services performed in the Washington/Baltimore Consolidated Metropolitan Statistical Area or in St. Mary's County, Maryland, would be considered to have been performed in the District of Columbia. If at least 80 percent of the individual's hours of wage and self-employment service during the taxable year are performed (or are considered to have been performed) in the District of Columbia, then all such hours of service would be treated as performed in the District of Columbia.

Interest--For interest paid during a calendar year by a business that was required to file (and did file) a District of Columbia franchise tax return for the business's taxable year ending with or within the prior calendar year, the interest recipient would treat the District of Columbia percentage of such interest (as shown on the franchise tax return) as District-sourced if the business provides the percentage in a statement to the recipient on or before January 31 following the year of payment. For new businesses (that would not have been required to file a franchise tax return for the prior calendar year), all interest paid during the calendar year by the business would be District-sourced if the business is required to file (and does file) a District of Columbia franchise tax return for the business's taxable year ending during such calendar year.

For interest paid by a debtor who was required to file (and did file) a District of Columbia income tax return for the debtor's taxable year ending during the prior calendar year and who was not required to file a District of Columbia franchise tax return, all such interest would be District-sourced.

For all other interest received or accrued during the individual taxpayer's taxable year, the first \$400 per return would be treated as District source income and the rest would be non-District-sourced.

Dividends--For dividends paid during a calendar year by a corporation that was required to file (and did file) a District of Columbia franchise tax return for the corporation's taxable year ending during the prior calendar year, the dividend recipient would treat the District of Columbia percentage of such dividends (as shown on the franchise tax return) as District-sourced if the corporation provides the percentage in a statement to the recipient on or before January 31 following the year of payment.

For all other dividends received or accrued during the individual taxpayer's taxable year, the individual would treat the first \$400 per return as District-sourced and the rest would be non-District-sourced.

Dispositions of tangible property--Income, gain, or loss from the disposition of tangible property would be sourced to the property's location at the time of the disposition.

Dispositions of intangible property--Income, gain, or loss from the disposition of the property would be District-sourced to the extent any portion of the most recent income attributable to such property received or accrued before such disposition was from District of Columbia sources. Otherwise, income, gain, or loss from the disposition of the intangible property would be non-District-sourced.

Rents--Rents from property would be sourced to the property's location.

Royalties--Royalties would be non-District-sourced.

Income from sole proprietorships--Income from a business that is a sole proprietorship

(other than income included in the individual's net income from self-employment) generally would be treated as non-District-sourced. If, however, the individual is required to file (and does file) a District of Columbia franchise tax return with respect to a sole proprietorship for the taxable year, then the District of Columbia percentage of such income would be District-sourced.

Income from partnerships--Income from a business that is a partnership (other than income included in any partner's net income from self-employment) generally would be treated as non-District-sourced. If, however, the partnership was required to file (and did file) a District of Columbia franchise tax return for the partnership's taxable year ending with or within the individual's taxable year, then the District of Columbia percentage of the individual's distributive share of such income would be District-sourced. For partnerships not required to file a District franchise tax return for the partnership's taxable year ending with or within the individual's taxable year, the portion of the individual's distributive share of income that the individual would otherwise treat as District-sourced (under the sourcing rules) would be District-sourced.

Retirement income--Individuals would treat retirement income (generally as defined in 4 U.S.C. 114(b)(1)) as District-sourced.

Income in respect of a decedent and income from an estate--Such income would be sourced at the place where the decedent was domiciled at the time of death.

Income from a trust--Individuals would treat income from a trust (other than retirement income) as from the same sources as the trust income to which it is attributable.

Other income--Any income not otherwise specified would be treated as District-sourced. Thus, for example, S corporation income would be District-sourced.

For purposes of the sourcing rules for interest, dividends, sole proprietorship income and partnership income, the "District of Columbia percentage" of such income would be determined by dividing the net income taxable in the District of Columbia (as shown on the original franchise tax return for the relevant taxpayer's taxable year) by the total net income from all sources (as shown on such franchise tax return).

Effective date

The bill would be effective for taxable years ending after the date of enactment. Thus, if the bill were enacted before January 1, 1997, the changes would apply to tax year 1996.

Examples

The following examples illustrate the operation of certain provisions of H.R. 3244.

Example #1

Assume a married couple filing a joint return residing in the District of Columbia in 1996 has wage income of \$100,000, interest income of \$5,000, and dividend income of \$5,000. Also assume that the wages were earned by employment in the Washington metropolitan area and \$1,000 of the interest income is "District source" interest income, but that none of the dividend income is District-sourced. Further assume that the couple pays \$8,500 in District income taxes, but has no other expenditures that can be claimed as itemized deductions. Under the regular Federal tax system, the couple's AGI would be \$110,000 (wages plus interest plus dividends). The couple would itemize deductions of \$8,500 as this exceeds the value of the standard deduction for married taxpayers filing a joint return and, after claiming two personal exemptions (\$2,550 per exemption for 1996), the couple would have a taxable income of \$96,400 and a Federal income tax liability of \$21,779.

Under the bill, the couple could elect to source all of its wage income to the District of Columbia. The couple also could claim as District source \$1,400 of interest income (\$1,000 of reported "District source" interest plus \$400 of other interest) and \$400 of dividend income. The couple's total District source income would be \$101,800 (wages plus District source interest and dividends). The couple's non-District source income would be \$8,200 (the remaining interest and dividend income).

Under the bill, the couple would compute its total Federal tax liability as follows. The couple could claim a \$30,000 standard deduction against total District source income of \$101,800 yielding a net District source taxable income of \$71,800. The \$71,800 is then taxed at a flat 15-percent rate creating a tax liability from District source income of \$10,770. The couple also would compute tax on its \$8,200 of non-District source income. The rate of tax applicable to non-District source income is determined as the ratio (rounded to the nearest whole percent) of the couple's regular Federal income tax liability (\$21,779) to the couple's regular Federal taxable income (\$96,400). In this example, that ratio is 23 percent. This rate of tax applied to the couple's non-District source income produces a liability of \$1,886 (0.23 times \$8,200) on non-District source income. The couple's total Federal tax liability under the bill would be \$12,656 (\$10,770 plus \$1,886).

Example #2

Assume a single individual residing in the District of Columbia in 1996 has wage income of \$50,000 and capital gain income from the sale of real property located in the District of Columbia of \$10,000. Also assume that the wages were earned by employment in the Washington metropolitan area. Further assume that the individual has mortgage interest expense of \$5,000, makes \$1,000 of charitable contributions, and has \$1,000 of other expenses that may be claimed as itemized deductions under present law. The individual's AGI would be \$60,000 (wages plus capital gain). The individual would choose to itemize deductions of \$7,000 (mortgage interest, charitable contributions and other deductions) as this exceeds the value of the standard deduction for single taxpayers. The individual's taxable income would be \$50,450

(AGI less itemized deductions less one personal exemption (\$2,550)). The individual's tax liability would be \$11,006.

Under the bill, the individual could elect to source all of his or her wage income to the District of Columbia. Because the individual's capital gain is from the sale of District of Columbia property it would not be included in District source income, nor would it be non-District source income. Thus, the individual has no non-District source income.

Under the bill, the individual would compute his or her total Federal tax liability as follows. The individual could claim a \$15,000 standard deduction against total District source income. The individual could also claim his or her \$5,000 of mortgage interest expense and \$1,000 of charitable contributions against total District source income. The individual's taxable District source income is \$29,000 (\$50,000 minus \$15,000 minus \$5,000 minus \$1,000). The \$29,000 is then taxed at a flat 15-percent rate creating a tax liability from District source income of \$4,350. Because the individual has no non-District source income, his or her total Federal tax liability would be \$4,350.

Example #3

Assume a married couple filing a joint return residing in the District of Columbia in 1996 has wage income of \$20,000. Also assume that the wages were earned by employment in the Washington metropolitan area. Further assume that couple has two dependent children and claims the standard deduction (\$6,700 for 1996). The couple's AGI would be \$20,000 and after claiming the standard deduction and four personal exemptions (\$2,550 per exemption for 1996) the couple would have a taxable income of \$3,100 and a Federal income tax liability of \$465. The couple would also be eligible for an earned income credit of \$1,789, which would eliminate their tax liability and result in a refund of \$1,324.

Under the bill, the couple could elect to source all of their wage income to the District of Columbia. The couple's total District source income would be \$20,000. The couple's modified flat tax liability would be zero, since the couple could claim a \$30,000 standard deduction against total District source income to yield a net District source taxable income of zero. The couple would have no non-District source income.

Because the modified flat tax liability of zero is greater than the Federal income tax liability after credits (a \$1,324 refund), the couple would not choose to pay the modified flat tax and would receive a \$1,324 refund under present-law rules.

III. DISCUSSION OF ISSUES

A. Compliance and Administrative Issues

The proposed modified flat tax under H.R. 3244 could raise a number of compliance and administrative issues. Tax filing may be more complex for many District of Columbia residents, since they would have to complete at least two returns to calculate their Federal income tax liability in addition to their District of Columbia income tax return. For Federal income tax purposes, District of Columbia residents would first fill out their Federal income tax return as under present law to obtain the tax rate to be applied to non-District-source income. Once the Federal income tax return is completed, the taxpayer would turn to the modified flat tax return, segregating income by its source and performing separate tax calculations for District-source and non-District-source income. This second step must be done to determine whether the modified flat tax would reduce the individual's Federal tax liability.

The modified flat tax could also make the current tax withholding system more complex for District of Columbia-resident taxpayers. The withholding system is geared to the current Federal income tax liability; altering it to reflect the modified flat tax could complicate it. In order to obtain the benefits of any reduction in tax liability under the modified flat tax throughout the year, rather than in a lump sum at the time the return is filed, a taxpayer would have to modify either his or her withholding or estimated tax payments. Calculating the appropriate reduction in either withholding or estimated tax payments could be complicated for individual taxpayers. For example, taxpayers would need to go through the exercise of allocating their income to District and non-District sources and projecting what their average Federal income tax rate will be (in order to apply that rate to non-District-source income). Requiring employers of District of Columbia-resident taxpayers to modify wage withholding could also be complex or burdensome for those employers. For example, employers would have to adjust their computer programs that currently compute wage withholding to take into account of the different rules applicable only to District residents.

The modified flat tax would allow individuals a deduction for charitable contributions in the calculation of District-source income, regardless of whether the individual claimed itemized deductions on the Federal income tax return. Thus, all District of Columbia residents would have to maintain records on charitable contributions if they intended to claim them on their modified flat tax return.

Because District of Columbia residents would need to allocate their capital income to District and non-District sources in the modified flat tax calculation, all businesses who file District of Columbia franchise tax returns and pay interest, dividends, or distributive shares of income would need to report the District of Columbia percentage of those payments to the payees. The calculation of the District of Columbia percentage would be straightforward (the ratio of net income taxable in the District to the business's total net income from all sources), but the information returns provided to individuals would represent an added burden. In addition, the businesses may have an incentive to allocate income to the District of Columbia in order to

increase their District of Columbia percentage. The business would have to balance the benefit in Federal individual income tax reduction for its shareholders, creditors, and owners against any increased District of Columbia franchise tax liability. These incentives to reallocate income are similar to those that some businesses face under current Internal Revenue Code section 482, relating to domestic and foreign sources of income.

B. Residency Issues

Only District of Columbia residents are eligible to compute their tax liability under the modified flat tax schedule provided in H.R. 3244. Under the bill, an individual is treated as a "resident" of the District of Columbia for a taxable year if the individual satisfies the following two tests: (1) the individual uses a residence in the District of Columbia as a place of abode (and was physically present at such place) for at least 183 days of such taxable year, and (2) the individual files a District of Columbia income tax return for such taxable year.

To satisfy the residency requirement, individuals could either establish their sole residence in the District of Columbia or establish a second residence in the District of Columbia while maintaining a primary residence elsewhere (e.g., Virginia or Maryland). In the former case, the individual likely would relocate from some other jurisdiction, causing a reduction in that jurisdiction's tax base. A similar reduction might also occur in the second case, although it is possible for an individual to be a "resident" of two different jurisdictions for tax purposes. For example, an individual who is domiciled in Maryland on the last day of the taxable year is considered a "resident" for Maryland tax purposes. The same individual could have lived in the District of Columbia for 183 days during the same taxable year and have filed a District of Columbia tax return; thus, the individual would also be a resident of the District of Columbia under the bill.

Because, under H.R. 3244, an individual's Federal income tax liability depends on satisfying the tests for District of Columbia residency, it is particularly important to be able to enforce such requirements. From a compliance standpoint, it would be difficult, if not impossible, for the Internal Revenue Service to determine if an individual satisfies the 183-day residency test, although it would be fairly straightforward to ascertain whether an individual filed a District of Columbia income tax return. The issue is particularly critical because of the likelihood that higher-income taxpayers would establish nominal second residences in the District, while maintaining a primary residence in a neighboring jurisdiction, to take advantage of the lower Federal tax rate.

C. Technical Issues

The statutory language of H.R. 3244 presents several technical issues. Among the more significant issues are those relating to the treatment of S corporations and personal service corporations.

For Federal income tax purposes, a corporation generally is subject to tax at the corporate

tax rates on its income as the income is earned and the corporation's shareholders are subject to tax at the individual tax rates when the income is distributed to them as dividends. An exception to this dual-level system of taxation is provided for qualified small business corporations that elect to be treated as S corporations. The income of an S corporation is taxed to the individual shareholders of the corporation as the income is earned; distributions of such income are not subject to tax. Thus, for Federal income tax purposes, S corporations and their shareholders are provided treatment that is similar to that provided to partnerships and their partners or sole proprietorships and their owners. H.R. 3244 provides explicit rules for the treatment of partnerships and sole proprietorships, but not S corporations. It would seem appropriate that the partnership rules of H.R. 3244 apply to S corporations.

For Federal income tax purposes, a personal service corporation ("PSC") generally is a corporation, the principal activity of which is the performance of personal services by owner-employees of the corporation. Because a PSC may be viewed as an "alter ego" of its owners, various provisions of the Internal Revenue Code deny certain tax benefits to PSCs. For example, Section 269A of the Internal Revenue Code allows the Secretary of the Treasury to reallocate items of income, deduction, credits, exclusions and other allowances between a PSC and its employee-owners where the principal purpose of the formation or use of the PSC is the avoidance or evasion of Federal income tax. H.R. 3244 provides different treatment for different types of income (e.g., all royalties would be treated as non-District sourced). It would seem appropriate that the bill provide that these allocation rules could not be avoided by use of a PSC or other similar device.

D. Federalism and Other Issues

Definition of Federal tax base

The provisions of H.R. 3244 would operate in such a manner that the District of Columbia would be making determinations as to the Federal tax base. Under the bill, the proportion of interest and dividend income that is treated as District source, and therefore subject to the modified flat tax, would be based on the percentage of the payor's income that is reported on its District of Columbia franchise tax return. Thus, decisions by the District of Columbia regarding the parameters of its franchise tax would determine the characterization of amounts for purposes of the Federal income tax base. While present law contains exemptions and deductions (e.g., the State and local income tax deduction) that are determined by local law, the Federal government generally has not ceded to State or local jurisdictions fundamental determinations with respect to the Federal tax base.

Application of the Uniformity Clause

The provision of special tax treatment to residents of the District of Columbia as contemplated in H.R. 3244 raises a potential constitutional issue. Because H.R. 3244 provides preferential tax treatment based on a geographic classification, it would be subject to potential challenge as a violation of the requirements of the Uniformity Clause of the United States

Constitution.

Pursuant to the Constitution, Congress has broad powers to impose taxes. However, the power to tax is not without limits. In particular, the Uniformity Clause requires that taxes "be uniform throughout the United States."² The Uniformity Clause operates to prevent the Congress from exercising the power to tax with the purpose of providing undue preferences for one region of the country over other regions.³

The requirement of uniformity in taxes extends not only to the States, but also to the District of Columbia. In considering the application to the District of Columbia of Congress' power to tax and the limiting requirement of uniformity, the Supreme Court noted that "the [D]istrict of Columbia . . . is not less within the United States, than Maryland or Pennsylvania...."⁴ The Supreme Court revisited this issue in *Downes v. Bidwell*, 182 U.S. 244 (1901), a case involving the question of the application of the revenue clauses of the Constitution to the territories of the United States. In *Downes*, the Court cited with approval the earlier determination in *Loughborough* that the power to tax and the related requirement of uniformity are applicable to the District of Columbia, noting that such result is consistent with the fact that the District of Columbia had been part of the States of Virginia and Maryland: "[i]ndeed, it would have been a fanciful construction to hold that territory which had been once part of the United States ceased to be such by being ceded directly to the Federal government."⁵

In contrast to its application to the District of Columbia, the Uniformity Clause is not necessarily applicable to the U.S. territories. In the case of the territories, its application depends upon the status of the particular territory. The Supreme Court in *Downes* concluded that the Uniformity Clause is not applicable to those territories that are not explicitly incorporated into the United States.⁶ On this basis, the Court held that the Uniformity Clause did not bar the imposition of duties on imports from Puerto Rico.⁷ Because the Uniformity Clause is not applicable to the Commonwealth of Puerto Rico, the special tax provisions of present law for residents of, and corporations doing business in, Puerto Rico do not give rise to issues under the

² Article I, section 8, clause 1.

³ Although there historically has been some debate over the application of the Uniformity Clause in the case of income taxes, there is now a consensus that income taxes are within the scope of the Uniformity Clause. See *Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1 (1916).

⁴ *Loughborough v. Blake*, 18 U.S. 317, 319 (1820).

⁵ *Downes* at 261.

⁶ *Downes* at 286-7.

⁷ *Downes* at 287.

Uniformity Clause.

The Uniformity Clause does not require that a tax must have an equal or proportionate effect in every State and the District of Columbia. Rather, the Supreme Court has stated that "a tax is uniform when it operates with the same force and effect in every place where the subject of it is found."⁸ Thus, the imposition of a tax on tobacco, for example, is not forbidden under the Uniformity Clause, notwithstanding the fact that tobacco is grown in some States but not in others. On the other hand, a tax that applies only to tobacco grown in a particular State would raise a potential issue under the Uniformity Clause.

Explicit geographic distinctions in Federal tax statutes are not necessarily invalid under the Uniformity Clause. In United States v. Ptasynski, the Supreme Court first considered the issue of whether the Uniformity Clause represents a *per se* prohibition on Congress defining the subject of a tax in geographic terms. In a unanimous opinion, the Court concluded that the Uniformity Clause does not prohibit Congress from fashioning legislation to address "geographically isolated problems."⁹ If a tax provision is framed in geographic terms, the Court "will examine the classification closely to see if there is actual geographic discrimination."¹⁰

In Ptasynski, the Court considered whether the exemption from the crude oil windfall profits tax for certain Alaskan oil violated the Uniformity Clause. The Court concluded that the special treatment for Alaskan oil was justified based on neutral factors, citing the disproportionate costs and difficulties involved in oil extraction in the particular region.¹¹ The Court noted that there was no evidence that Congress intended to grant an undue preference to Alaska.¹² The exemption at issue applied not to all oil produced in Alaska, but only to a relatively small percentage of such oil; moreover, the exemption was not limited to Alaska, but applied also to oil produced in certain offshore territorial waters. In this regard, the Court stated that

[t]he exemption thus is not drawn on state political lines.

⁸ United States v. Ptasynski, 462 U.S. 74, 82 (1983) (quoting Head Money Cases, 112 U.S. 580, 594 (1884)).

⁹ Ptasynski at 83-84.

¹⁰ Ptasynski at 85. In this regard, a commentator has suggested that "[b]y 'actual geographic discrimination,' the Court apparently had in mind a situation in which the geographic distinctions were intended simply to benefit one state or region at the expense of others (or to harm one state or region to the benefit of others), rather than to address 'geographically isolated problems.'" Zelenak, "Are Rifle Shot Transition Rules and Other Ad Hoc Tax Legislation Constitutional?," 44 *Tax Law Review* 563 (1989).

¹¹ Ptasynski at 85.

¹² Ptasynski at 85-86.

Rather it reflects Congress' considered judgment that unique climatic and geographic conditions require that oil produced from this exempt area be treated as a separate class of oil.¹³

Like the windfall profits tax exemption at issue in *Ptasynski*, the preferential tax treatment that would be provided to residents of the District of Columbia under H.R. 3244 is couched in geographic terms. Accordingly, the provisions would be subject to scrutiny under the Uniformity Clause. The Uniformity Clause analysis with respect to H.R. 3244 would turn on whether the provision of special tax treatment to District of Columbia residents could be justified on the basis of neutral factors. Because of the few judicial decisions in this area, the actual level of scrutiny a court would apply is not clear.¹⁴ Indeed, it should be noted that no Federal tax statute has been invalidated under the Uniformity Clause.

Unlike the exemption that was approved by the Supreme Court in *Ptasynski*, the preferences provided in H.R. 3244 are drawn precisely on political boundaries. H.R. 3244 would provide preferential tax treatment to all residents of the District of Columbia with respect to income from sources within the District of Columbia. The applicability of this special tax treatment would be based solely on a taxpayer's place of residence, without regard to the taxpayer's economic circumstances or income level. Individuals who are not resident in the District of Columbia, and income from sources outside the District of Columbia, would not be eligible for the lower rate of Federal income tax. On its face, such special tax treatment could be viewed as the kind of preference for one jurisdiction over another at which the Uniformity Clause is aimed. The fact that the classification under H.R. 3244 is defined by a political boundary may heighten a court's scrutiny of whether the geographic classification serves as an appropriate proxy for a neutral, nongeographic classification.

The special tax treatment provided under H.R. 3244 can also be contrasted with the present-law provisions providing tax benefits for areas designated as empowerment zones or enterprise communities which were enacted in 1993 and which have not been challenged under the Uniformity Clause. In order to be eligible to be selected as an empowerment zone or enterprise community, an area must meet specified criteria, which include poverty, unemployment and economic distress, and must be nominated by a State or local government. Unlike the special tax treatment of H.R. 3244, which applies exclusively to the District of Columbia, the special tax treatment applicable to empowerment zones and enterprise communities potentially was available to any area that met the specified criteria (subject to a limit on the number of areas that could be designated following a competitive application process). Moreover, unlike the special tax treatment provided in H.R. 3244 for all residents of the District of Columbia with respect to District-source income, the tax benefits provided to

¹³ *Ptasynski* at 78.

¹⁴ For a discussion of the level of scrutiny to be applied in light of the decision in *Ptasynski*, see Zelenak, *supra*, at 590-591.

empowerment zones and enterprise communities are specifically targeted at employment and investment within such zones or communities. A credit is provided for certain wages paid to an empowerment zone resident employed within the zone (even if the employer may not otherwise have a presence in the zone), more generous expensing allowances are permitted for certain business property used in an empowerment zone, and a special category of tax-exempt financing is available for use to finance certain business property within an empowerment zone or enterprise community. Although the tax benefits of the empowerment zone/enterprise community provisions are provided only to certain geographic areas, the eligible areas are defined in terms of economic factors and the tax benefits provided are closely targeted at addressing such economic factors.

The special tax treatment provided in H.R. 3244 is defined in purely geographic terms. As such, the provisions would be subject to scrutiny by a court in determining whether the tax preferences provided are consistent with the requirements of the Uniformity Clause. However, because a case involving tax preferences drawn precisely on political boundaries would be a case of first impression for the courts, the level of scrutiny and the degree of deference that would be applied is unclear. In anticipation of a Uniformity Clause challenge, a clear record would have to be made that Congress determined that the preferential tax treatment provided to residents of the District of Columbia under H.R. 3244 is necessary to address specific unique circumstances existing with respect to the District of Columbia that justify such preferential treatment. The stronger and more detailed the record is on these issues, the more likely a court is to give deference to the judgment of Congress in enacting legislation providing preferential tax treatment for residents of the District of Columbia.

IV. REVENUE ANALYSIS

The staff of the Joint Committee on Taxation estimates that H.R. 3244 would reduce fiscal year Federal budget receipts by \$12.8 billion for fiscal years 1996 through 2006. Assuming that the date of enactment occurs before January 1, 1997, decreases in Federal income tax liability begin at \$675 million for calendar year 1996, when few behavioral effects are expected, and increase to \$1.8 billion in calendar year 2006, by which time it is expected significant behavioral responses will have occurred. These figures may be compared to projected 1997 Federal tax receipts from District of Columbia residents under present law of approximately \$1.70 billion, which is slightly less than the District of Columbia individual income tax liability of \$1.73 billion reported by the Internal Revenue Service for 1994.

The District of Columbia has experienced an accelerating out-migration of population in the past decade. Between 1980 and 1990, the District's population declined by 31,000; between 1990 and 1994, it declined by another 37,000. Comparable figures for Maryland and Virginia show an increase in population of 1.4 million from 1980 to 1990, and increase of 600,000 from 1990 to 1994. Similarly, between 1987 and 1992, the number of Federal individual income tax returns filed from the District of Columbia dropped by six percent. Between 1992 and 1994, District of Columbia returns dropped another eight percent. By contrast, the number of Federal individual income tax returns filed from Maryland and Virginia increased by seven percent from 1987 to 1992, and by one percent from 1992 to 1994.

The Joint Committee staff anticipates that H.R. 3244 would result in a reduction in the rate of decline in population in the District of Columbia. The staff also anticipates that some out-migrating middle-income residents would be replaced by higher-income residents. The net effect of these changes in population movements would be a stabilization of existing population, and a substantial relocation of high-income residents from the metropolitan suburbs to the District of Columbia. These changes in residential location would be accompanied by a relocation of some businesses that tend to locate near their customers, and a rise in property values and economic activity in the District of Columbia.

While these relocations would improve the economy and income and property tax bases of the District of Columbia, they would cause a contraction in the economies and tax bases of surrounding suburbs. The revenue estimate does not assume any net increase in national income as a result of this proposal.

In addition, the Joint Committee staff assumes that there will be a substantial number of higher-income taxpayers in the District of Columbia metropolitan area who would establish (or claim to establish) second residences in the District of Columbia and change their official place of residence to the District of Columbia for the purpose of taking advantage of the provisions of H.R. 3244. This activity would result in an additional increase in the individual income tax base for the District of Columbia, and a decrease in the income tax bases of surrounding jurisdictions, without resulting in any additional changes in economic activity in the District of Columbia. As discussed in Part III.B., above, it would be very difficult for the Internal Revenue Service to

determine exactly how much residential time a given taxpayer spends in the District of Columbia.

Particularly in the later years of the budget window, the Joint Committee staff also projects that there would be some relocation of certain types of businesses from other regions of the country to the District of Columbia. Businesses most likely to relocate from other regions would come from various service industries, such as certain financial services and advertising. Wages and salaries are typically a large fraction of costs in these businesses, and the services can be performed at a distance from potential clients. Like the relocation of residents within the metropolitan area, this relocation is not assumed to result in a net increase in national income.

The Joint Committee estimate assumes that certain changes will be made in the legislation to prevent the creation of certain significant unintended consequences in the form of tax loopholes. For example, the estimate assumes that treatment of S corporation income will be parallel to treatment of partnership income. It further assumes that the statute will be modified to clarify the status of income earned by personal service corporations and related taxpayers to ensure that royalty and other income cannot be recharacterized as labor compensation, and that taxpayers who, in fact, are not performing most of their services in the District of Columbia metropolitan area cannot claim that they are.

Although the revenue estimate does not assume that there is a net change in national income as a result of this tax proposal, it is possible that dramatically lower marginal tax rates could result in an increase in labor supply, which could lead to an increase in national income. This effect would be most likely to occur among higher-income people. However, in order for the increased labor supply to result in increased income, there must be sufficient demand for labor to take advantage of increased labor availability. The relatively high District of Columbia unemployment rate of eight percent raises the possibility that such absorption would be relatively slow, and net economic growth effects would be modest, particularly in the short run.

H.R. 3244 also provides tax relief for income from capital located in the District of Columbia, but only to District of Columbia residents. Employment and business activity in the District of Columbia is concentrated in non-capital intensive industries, primarily because the District of Columbia does not have adequate land and other natural resources to make it an attractive location for manufacturing. Therefore, this proposal is not expected to produce a large increase in net investment. However, there may be some additional investment, which would result in some growth in the District of Columbia's economy in the later years of the budget window.

The staff of the Joint Committee on Taxation is currently engaged in a study of the feasibility of including these macroeconomic effects in its revenue estimates. However, it is likely that any net economic growth and increased tax revenues resulting from the tax incentives would be quite small relative to the relocation effects of this proposal. The location-based nature of this proposal creates opportunities both for intensified economic development within the favored location in lieu of some other location, and for changes in tax liability due to

recharacterizations of place of residence. Therefore, increases in taxable income in the District of Columbia resulting from these behavioral responses would not be expected to be replicated in a nationwide application of this proposal.

V. ESTIMATED REVENUE EFFECTS OF H.R. 3244,
THE "DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT"

Fiscal Years 1997 - 2008

(Billions of Dollars)

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	1997-01	1997-03	1997-06
H.R. 3244, the "District of Columbia Economic Recovery Act".....	Yes DOE	-1.1	-0.9	-1.0	-1.1	-1.2	-1.3	-1.4	-1.5	-1.6	-1.8	-5.3	-8.0	-12.8

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.
Estimate is very preliminary and subject to change pending additional data.

Legend for "Effective" column: DOE = date of enactment
Yes = taxable years ending after

Mr. GUTKNECHT. Thank you, Mr. Kies. Mr. Atwood.

Mr. ATWOOD. Thank you, Mr. Chairman. I am James Atwood with the law firm of Covington & Burling here in Washington. I am appearing on behalf of the D.C. Appleseed Center for Law and Justice, and with me is Joshua Weiner, the executive director of D.C. Appleseed.

I should mention at the outset that D.C. Appleseed has not presently taken any position on the merits of the bill. It is still under review. But they did ask me to address the constitutionality of the statute to ensure that the Congress could consider this bill on the merits and not because of possibly misperceived constitutional problems.

In my judgment, the DCERA would pass constitutional muster under the uniformity clause. My paper goes into this in great detail, but I will just hit the highlights, if I may.

I think there are two reasons why this bill would be ruled constitutional by the courts. First, I think there is a serious question whether the uniformity clause would apply at all to a personal income tax. The uniformity clause only applies to indirect taxes. It does not apply to direct taxes.

If you asked 100 people on the street—indeed, even if you asked 100 lawyers—whether the income tax was direct or indirect, I am sure everybody would say it is about as direct as you can be.

Now, there is a lot of historical baggage behind these terms, so it isn't quite as simple as that. For many years, the courts strained very hard to narrow the category of direct taxes and to broaden the category of indirect taxes, because of the requirement at the time that direct taxes be apportioned.

That was perceived to be a very serious problem, so, to avoid that problem, Congress and the courts reached an informal agreement, if you will, that they were going to read the category of direct taxes narrowly.

I think now that the 16th amendment has eliminated that odd pressure, that if the courts were to take a fresh look at the issue, there is a very good chance the income tax would be viewed as direct and, therefore, not subject to the uniformity clause.

But let us assume the uniformity clause does apply. As Mr. Ripy, in particular, has indicated, the uniformity clause is not absolute. It is not *per se*. The Supreme Court has said that if a tax statute is defined in geographic terms, the courts will take a close look at it, but they are not going to consider it *per se* unlawful.

The Court will address whether or not there are sufficient neutral factors to sustain the judgment Congress has made in drawing a geographic region; the Court will look to see whether the statute was motivated by an effort to discriminate against a geographic region; and the Court, in assessing these factors, will give deference to Congress.

That is a very important point, and the courts have indicated that judgments that Congress reaches on these issues are important to the courts. I think that level of deference would be particularly strong when Congress is addressing the District of Columbia.

Obviously, the U.S. Federal Government and Congress, in particular, have particularly important constitutional responsibilities, powers, and authority with respect to the District of Columbia, so

I think that would be a substantial factor in the courts' giving deference to Congress' judgment.

And then, finally, the courts will look at whether or not the geographic designation is creating a problem that the uniformity clause was intended to prevent. I think this is very important. The reason there is a uniformity clause in the Constitution was a concern by the Framers that politically powerful States would use their voting power in Congress to gain an unfair advantage against politically less powerful States that had less voting representation.

Well, the present situation could not be further from that fact, obviously. This would not be a situation where Congresswoman Norton would be using her zero votes to impose a favorable tax provision against the rest of the Congress of the United States.

So this is really exactly the opposite of the problem that the uniformity clause was designed to address. And then, most importantly again, these neutral factors will be weighed and the issue of discrimination will be weighed.

Sitting through the hearings today, it is clear that there are many important, unique characteristics of the District's financial crisis that are neutral, that are not animated by discrimination or animus, that could be marshaled to justify treating a local problem in a special way because of the unique circumstances applicable to the District.

I think both Mr. Ripy and Mr. Kies make an important point, that Congress should build a record to explain to the court why it is doing this, why this is not negative discrimination, to explain the neutral factors carefully. For example, some of the preamble language that was used by Congress in creating the Control Board identifies some of the important reasons why that legislative action was taken.

Similar preamble language would probably assist here, and in hearings such as this it would set the legislative record clear. It would give courts the comfort in realizing Congress had addressed this issue, a very serious issue, in a responsible way. With that record created, in my judgment, the courts would sustain this legislation.

[The prepared statement of Mr. Atwood follows:]

Mr. Chairman, and members of the Subcommittee:

I have been asked to address the constitutionality of H.R.3244, which proposes an alternative federal income tax regime for residents of the District of Columbia. Questions have been raised whether such special tax provisions would be consistent with the Uniformity Clause of the United States Constitution (art. I, § 8, cl. 1) and the equal protection component of the Fifth Amendment. In my judgment, H.R.3244 is constitutional and would be found so by the courts.

I am appearing today on behalf of the D.C. Appleseed Center for Law and Justice. The D.C. Appleseed Center is a public interest organization founded in 1994 that seeks to involve lawyers and other professionals in addressing the unique problems of the District of Columbia in a systemic fashion. Among other things, the Center has recently issued reports making specific recommendations concerning the annual federal payment to the District and the District's unfunded pension liability.

In that connection, I must emphasize that D.C. Appleseed has taken no position on whether H.R.3244 should be enacted. The Center is presenting this testimony on the constitutionality of the bill at the request of the Subcommittee.

I. The Uniformity Clause

Because H.R. 3244 would provide a special tax regime available only to District of Columbia residents, the question has been raised whether the Uniformity Clause would preclude this proposal. I believe the answer is no, for two reasons. First, there is legitimate question whether the Uniformity Clause applies to the federal income tax for individuals. Second, even assuming the Clause does apply, the special circumstances and objectives of H.R.3244 are such that, in my judgment, the courts would conclude that the bill is not an unjust preference in contravention of Uniformity Clause requirements. I address these two arguments in turn.

A. Does the Uniformity Clause Apply?

Broadly speaking, the Constitution authorized the federal government to lay and collect two different categories of taxes: direct and indirect.^{1/} The distinction is important, because indirect taxes -- referred to in the Constitution as "duties," "imposts," and "excises" -- are subject to

^{1/} The basic taxing provision of the Constitution is in article I, section 8, clause 1: "The Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises" The phrase "indirect taxes" has been used to describe "duties, imposts, and excises," and the term "direct taxes" to describe the remaining tax measures. E.g., Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, 617-18 (1895) ("the Constitution divided Federal taxation into two great classes, the class of direct taxes, and the class of duties, imposts, and excises," the latter group being "indirect" taxes); The License Tax Cases, 72 U.S. (5 Wall.) 462, 471 (1866) (distinguishing between "direct" and "indirect" taxes).

the requirement of geographic uniformity across the United States,^{2/} whereas direct taxes are not. In fact, the Constitution proscribed that direct taxes should not be uniform, in the sense that they had to be apportioned among the states on the basis of population, rather than on the basis of wealth, income, or some other criteria.^{3/}

The important point for present purposes is that the constitutional requirement of geographic uniformity applies only to taxes that are "indirect" in the constitutional sense. So, we need to ask whether the federal income tax on individuals is a "direct tax" or "indirect tax." Unfortunately, there is no clear answer to this question, particularly when viewed from the standpoint of the Framers of the Constitution. We do know that, within the direct-tax category, the Framers intended to include capitation or poll taxes^{4/} and property taxes on real estate.^{5/} Indirect taxes, denominated in the Consti-

^{2/} Art. I, § 8, cl. 1 ("all Duties, Imposts and Excises shall be uniform throughout the United States"). See, e.g., The License Tax Cases, 72 U.S. at 471 ("Congress cannot tax exports, and it must impose direct taxes by the rule of apportionment, and **indirect taxes by the rule of uniformity.**") (emphasis added).

^{3/} See art. I, § 2, cl. 3 ("direct Taxes shall be apportioned among the several States); art. I, § 9, cl. 4 ("No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census . . .").

^{4/} See art. I, § 9, cl. 4.

^{5/} See The Federalist No. 21, at 143 (Alexander Hamilton) (Clinton Rossiter ed. 1961) (direct taxes "principally relate to land and buildings").

(continued...)

tution as "duties," "imposts," and "excises," clearly included taxes on articles of consumption.^{5/} But it was not at all clear where a tax on income would fall between these points on the spectrum.^{2/}

^{5/} (...continued)

In an early case, three justices of the Supreme Court suggested that only capitation and land taxes were direct. Hylton v. United States, 3 U.S. (3 Dall.) 171, 175 (Chase, J.), 177 (Paterson, J.), 183 (Iredell, J.) (1796). A leading scholar described this suggestion as an "unnecessarily broad conclusion" and having an "elusive" basis: "[T]he opinions fall short of convincing the modern reader that contemporary understanding limited the term [direct taxes] to land and poll taxes." David Currie, The Constitution in the Supreme Court: 1789-1801, 48 U. Chi. L. Rev. 819, 855-56 (1981).

^{5/} See The Federalist No. 21, at 142 (indirect taxes were "taxes on articles of consumption"), No. 36 at 219 (indirect taxes are "duties and excises on articles of consumption"). See also Pollock v. Farmers' Loan & Trust, 158 U.S. at 624 (indirect taxes are "duties and excises on articles of consumption"); Hylton v. United States, 3 U.S. at 174 (Chase, J.) ("a tax on expense is an indirect tax").

^{2/} See Sidney Ratner, Taxation and Democracy in America 18-19 (1980):

"The framers of the Constitution and those who ratified it did not clearly and exhaustively define the term 'direct taxes.' All that can now be definitely established is that at that time import and export duties were generally considered indirect taxes, and that land and poll taxes were considered direct taxes. Since taxes on personal and corporate income, gifts, inheritances, and excess profits were not in existence in 1787, it is impossible to state dogmatically what the founders and the ratifiers of the Constitution would have thought of these taxes."

The debates at the 1787 Constitutional Convention are of little help. Only one passage speaks specifically to the meaning of direct taxes, and it is not enlightening: "Mr King asked what was the precise meaning of direct taxation? No one answd." 2 Max Farrand, The Records of the Federal Convention of 1787 350 (rev. ed. 1966).

Early Supreme Court decisions did, however, read the category of "direct taxes" narrowly and indeed treated some forms of income tax to be a "duty" or "excise" and thus to be an "indirect" tax.^{2/} Unquestionably, this was driven in part by practical considerations and in part by the Court's deference to the judgments of Congress. The apportionment process required of direct taxes was regarded as exceedingly cumbersome, and yet the revenue needs of the federal government had to be satisfied. This was particularly so with the advent of the Civil War, when Congress was compelled to raise unprecedented sums to finance the war effort. Both Congress and the courts were thus constrained to read the category of "direct taxes" narrowly and "indirect taxes" broadly. Finding no clear definition of the term "direct taxes" in the Constitution, the Supreme Court was willing to defer to "the practical construction of the Constitution by Congress"^{2/} by cate-

^{2/} See Flint v. Stone Tracy Co., 220 U.S. 107 (1911) (corporate tax on the privilege of doing business in corporate form and measured by income is an excise rather than direct tax); Springer v. United States, 102 U.S. 586 (1881) (tax on gains and profits from business is an excise or duty and not a direct tax); Pacific Ins. Co. v. Soule, 74 U.S. (7 Wall.) 433 (1869) (tax on insurance company's receipts for premiums and assessments an indirect excise or duty).

^{2/} Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533, 544 (1869) (concluding that a 10% tax on banknotes was not a "direct tax").

gorizing a wide variety of taxes as "indirect" and thus not subject to the apportionment requirement.^{10/}

In 1895, however, the Supreme Court in Pollock v. Farmers' Loan & Trust adopted a more aggressive view and held that, to the extent that the source of income was real or personal property, an income tax was a direct tax and thus was invalid unless apportioned.^{11/} The Court relied on the fact that income taxes had long been treated as "direct" under English law and in other European jurisdictions.^{12/} While

^{10/} Indeed, this deference dates back to the first decision that addressed the direct/indirect tax distinction, Hylton v. United States, 3 U.S. (3 Dall.) 171 (1796). That case involved a challenge to a federal tax on carriages, a tax that was -- like the later Civil War levies -- mandated by defense considerations. See Pollock v. Farmers' Loan & Trust, 158 U.S. at 623-24. Justice Chase, in concluding that the carriage tax was indirect and thus not subject to the apportionment requirement, wrote: "The deliberate decision of the national legislature (who did not consider a tax on carriages a direct tax, but thought it was within the description of a duty) would determine me, if the case was doubtful, to receive the construction of the legislature." 3 U.S. at 173. See also Knowlton v. Moore, 178 U.S. 41, 88 (1900) ("Congress has the power to choose the objects of direct taxation").

^{11/} Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, on rehearing, 158 U.S. 601 (1895).

^{12/} "In England, we do not understand that an income tax has ever been regarded as other than a direct tax. In Dowell's History of Taxation and Taxes in England, admitted to be the leading authority, the evolution of taxation in that country is given, and an income tax is invariably classified as a direct tax. 3 Dowell, (1884,) 103, 126. The author refers to the grant of a fifteenth and tenth and a graduated income tax in 1435, and to many subsequent comparatively ancient statutes as income tax laws. 1 Dowell, 121. It is objected that the taxes imposed by these acts were not, scientifically speaking, income tax until Pitt's of 1799. Nevertheless, the

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not concluding that an income tax in its entirety was direct, the Court struck down the 1894 federal income tax because at least substantial elements of it taxed income from real and personal property and thus were direct in nature.

The Pollock decision placed considerable pressure on Congress, which felt the need to raise revenues measured by income but wished to avoid the requirement of apportionment. Congress was successful in this regard in Flint v. Stone Tracy Co.,^{12/} where it denominated as an "excise tax" a tax on the privilege of entities to do business in corporate form, with the amount of the tax measured by the corporation's income. Observing that a privilege-to-do-business tax was traditionally categorized as an "excise," the Court accepted Congress'

^{12/} (...continued)

income taxes levied by these modern acts, Pitt's, Addington's, Petty's, Peel's, and by existing laws, are all classified as direct taxes; and, so far as the income tax we are considering is concerned, that view is concurred in by the cyclopaedists, the lexicographers, and the political economists, and generally by the classification of European governments wherever an income tax obtains."

158 U.S. at 630-31.

Among the "political economists" of the era who appeared to regard an income tax as direct was Adam Smith. His Wealth of Nations (1776), quoted by Justice Paterson in Hylton v. United States, 3 U.S. at 180, describes "taxing people in proportion to their revenue" as direct taxation, as opposed to "endeavors to tax [revenue] indirectly, by their taxing their expense." As one scholar has noted: "Under Smith's definition, . . . a tax on income is precisely what is meant by a direct tax." Currie, supra note 5, at 860.

^{13/} 220 U.S. 107 (1911).

judgment that this was not a direct tax, albeit one measured by income.^{14/}

As a broader and more lasting response to Pollock, however, the 16th Amendment was ratified 1913. It expressly gave Congress the "power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States." Thus, even if and to the extent an income tax was "direct," it was no longer subject to the apportionment requirement. However, one cannot fairly read the 16th Amendment as ratification of the view that income taxes are inherently "direct" and -- therefore -- not subject to the Uniformity Clause applicable to indirect taxes. The Supreme Court addressed this point in Brushaber v. Union Pacific Railroad,^{15/} which involved a corporate income tax enacted shortly before the 16th Amendment was ratified. In upholding the tax, the Court read Pollock as holding that an income tax was "direct" only to the extent income was derived from property, whereas income otherwise derived could be taxed as an "excise." Accordingly, the Court stated that the income tax in question there was subject to the Uniformity Clause, but it then rejected the Uniformity Clause claims on the

^{14/} Id. at 147-52.

^{15/} 240 U.S. 1 (1915).

merits because they were not in any way based on a lack of geographic uniformity.^{16/}

There are more recent cases which, although not addressing squarely the direct/indirect categorization of income taxes under the Constitution, may give new vitality to the argument that income taxes are direct. This June, in United States v. IBM,^{17/} the Supreme Court revisited the terms "taxes," "imposts," and "duties" as used in the Constitution in the Export Clause (applicable to the federal government)^{18/} and in the Import/Export Clause (applicable to the States).^{19/} Reviewing the constitutional history surrounding those terms, the Court concluded that imposts and duties were a distinctly narrower class of revenue measures than the broader category of "taxes."^{20/} The class of indirect taxes includes "excises" as well as imposts and duties, but IBM is perhaps a step in the direction of the Court's reexamination of the distinction between direct and indirect taxes as written into the Constitution. In this regard, the historical evidence that income taxes were traditionally regarded as

^{16/} 240 U.S. at 24.

^{17/} United States v. International Business Machines, Inc., 116 S. Ct. 1973 (1996).

^{18/} Art. I, § 9, c. 5.

^{19/} Art. I, § 10, cl. 2.

^{20/} 116 S. Ct. at 1802-03.

direct under English and continental law (note 12 supra) could take on added significance.

Finally, recent non-constitutional decisions should be mentioned. The Supreme Court in United States v. Wells Fargo Bank^{21/} described the federal income tax as a "direct tax" when applied to interest on a financial obligation, as contrasted to an indirect tax such as "an excise tax, which is levied upon the use or transfer of property even though it might be measured by the property's value."^{22/} This was in the context of determining the proper scope of a statutory tax exemption that applied to the financial obligation. And in Zenith Radio Corp. v. United States,^{23/} in addressing countervailing-duty rights under GATT, the Court listed income taxes as an example of "direct taxes," as contrasted to a sales levy on a manufacturer's products (an "indirect tax").^{24/}

* * * *

^{21/} 485 U.S. 351 (1988).

^{22/} Id. at 355.

^{23/} 437 U.S. 443 (1978).

^{24/} For lower court decisions that have referred to the income tax as "direct," see United States v. Collins, 920 F.2d 619, 629 (10th Cir. 1990), cert. denied, 500 U.S. 920 (1991) (16th Amendment "authorizes a direct nonapportioned tax"); In re Becraft, 885 F.2d 547, 548 (9th Cir. 1989) ("For over 75 years, the Supreme Court and the lower federal courts have both implicitly and explicitly recognized the Sixteenth Amendment's authorization of a non-apportioned direct income tax . . .").

Where does this line of cases leave us? One could well conclude that income taxes are of a mixed variety -- that they are direct insofar as income is derived from property but indirect insofar as income is derived from earnings from a business, from a profession, or from the fruits of one's labor. If so, the Uniformity Clause would apply to the federal income tax to the extent of such non-property income.

On the other hand, the cases supporting the "indirect tax" categorization either principally or exclusively involved corporate taxes, where the label of an "excise tax" on the privilege to doing business has long support. Also, in these cases the Supreme Court was deferring to the judgment of Congress that the tax in question was indirect and did not require apportionment. One might well see a like element of deference if Congress were to conclude that a personal income tax was more in the nature of a direct than indirect tax.

I would conclude, then, that there is a legitimate basis to argue that the federal income tax as applied to individuals is a direct tax, not just in the normal sense but in the constitutional sense as well. If the Supreme Court were to address this issue from the standpoint of intent of the original Framers, and not in a context comparable to the Civil War-era cases where a contrary ruling would invalidate a crucial wartime revenue measure, there is a good prospect that the Court would conclude that personal income taxes are rather closer to a direct tax than to a "duty," "impost," or "ex-

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cise." Indeed, the Court would likely give deference to Congress on this categorization. The 16th Amendment eliminated one force that strongly drove the courts to read "direct taxes" narrowly and "indirect taxes" broadly, and so one should not assume that -- if the issue were looked at anew -- income taxes would be found to be indirect in nature and thus subject to the requirements of the Uniformity Clause.

B. If It Were Applicable, Would the Uniformity Clause Invalidate H.R.3244?

Even if the Uniformity Clause were applicable to the federal personal income tax, I believe the courts would conclude that H.R.3244 was not in violation of that clause. The Uniformity Clause is not absolute in its scope, and the Supreme Court has accorded to Congress a reasonable degree of respect and deference in its development of tax measures having varying geographical impacts. Added to this is Congress's unique authority with respect to District of Columbia affairs and -- most importantly -- the unique financial circumstances that face the District today.

1. The purpose of the Uniformity Clause

The fundamental purpose of the Uniformity Clause is to prevent politically powerful States, through their representatives in Congress, from using the federal taxing power to benefit themselves at the expense of politically weaker States. See United States v. Ptasynski, 462 U.S. 74, 81 (1983); 1 Joseph Story, Commentaries on the Constitution of

the United States § 957 (T. Cooley ed. 1873). The Clause thus requires "geographical uniformity,"^{25/} meaning that a tax satisfies the requirements of the Clause "when it operates with the same force and effect in every place where the subject of it is found."^{26/} Significantly, the clause does not require Congress to devise taxes that "fall[] equally or proportionately" on all states; nor does it prohibit Congress from defining the subjects of taxes "by drawing distinctions between similar classes [of taxpayers]."^{27/} As the Supreme Court in Ptasynski explained: "[T]he Framers did not intend to restrict Congress' ability to define the class of objects to be taxed. They intended only that the tax apply wherever the classification is found."^{28/}

Where a proposed tax does not involve a geographically-defined class of taxpayers, the requirements of the Uniformity Clause are easily satisfied. But even where Congress defines the subject of a tax according to geographic criteria (as in H.R.3244), such a tax is not necessarily unconstitutional. The leading modern Supreme Court case interpreting the Uniformity Clause is Ptasynski, which involved a challenge to an exemption from the Crude Oil Windfall

^{25/} Knowlton v. Moore, 178 U.S. 41, 108 (1900).

^{26/} Head Money Cases, 112 U.S. 580, 594 (1884).

^{27/} Ptasynski, 462 U.S. at 82.

^{28/} Id.

Profit Tax Act of 1980 for oil produced in northern Alaska. In unanimously upholding the exemption, the Court expressly stated that the Uniformity Clause does not "prohibit all geographically defined classifications," and "gives Congress wide latitude in deciding what to tax and does not prohibit it from considering geographically isolated problems." 462 U.S. at 84.^{29/}

2. The test for permissible geographical classifications

The test established by the Court in Ptasynski to distinguish permissible from impermissible geographical classifications requires courts to "examine . . . closely" any tax framed in geographic terms in order to determine whether "there is actual geographic discrimination." 462 U.S. at 85. So long as the geographic classification is based on "neutral factors" (id.) and there is no evidence that Congress intended to grant one state an "undue preference" at the expense of another (id. at 86, emphasis added), the classification will be upheld. In Ptasynski, for example, the Court upheld the Alaskan oil exemption to the windfall profits tax on the grounds that north Alaska's uniquely difficult climatic conditions justified separate treatment for Alaskan oil,

^{29/} As the Court noted, the tax exemption in Ptasynski was not drawn precisely in terms of a state boundary, because only part of Alaska production was exempted and some offshore non-Alaska oil was also included. 462 U.S. at 77-78. Unquestionably, however, the principal purpose of the exemption was to benefit "Alaskan oil," which was defined in specific geographic terms. Id. at 77.

concluding that Congress's reasons for benefitting Alaska (i.e., to prevent the windfall profits tax from discouraging the exploration and development of domestic oil in regions with extreme climatic conditions) did not "offend the purpose of the Clause." Id. at 85-86.

Underlying the Court's reasoning in Ptasynski is the basic principle that the Uniformity Clause does not prohibit federal taxes that merely have a disparate impact among different states and regions of the country. See Augusta Towing Co. v. United States, 5 Cl. Ct. 160, 166 (1984) ("disparate impacts of the tax on different parts of the country . . . do not vitiate uniformity in the constitutional sense"). Rather, the clause prohibits intentional discrimination by Congress for the benefit of one State at the expense of another. See Apache Bend Apartments, Ltd. v. United States, 702 F. Supp. 1285, 1296 (N.D. Tex. 1988) (explaining the reasoning in Ptasynski to be that "an indirect tax could affect citizens of different states differently, so long as the purpose of the indirect tax was not to favor the citizens of one state over the citizens of another state"), aff'd in part and rev'd in part on other grounds, 987 F.2d 1174 (5th Cir. 1993) (en banc). The Court's discussion in Ptasynski of "neutral factors" and of the absence of any congressional "inten[t] to grant Alaska an undue preference" (462 U.S. at 86, emphasis added) clearly supports such a reading.

The central question, then, is: What constitutes an "undue" preference? While the Supreme Court has not offered a complete answer, the Ptasynski Court made two things clear: First, in defining classes of taxpayers for purposes of the Uniformity Clause, Congress may consider local issues and isolated problems. 462 U.S. at 83-84 (explaining that the Uniformity Clause "does not deny Congress power to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems" (quoting Regional Rail Reorganization Act Cases, 419 U.S. 102, 159 (1974)^{20/}). And, second, where Congress has determined on the basis of "neutral factors" that geographically-defined classes of taxpayers merit "separate treatment" (id. at 85), Congress's judgment is entitled to

^{20/} The Regional Rail Reorganization Act Cases involved challenges to a congressional plan, the Regional Rail Reorganization Act of 1973, to reorganize eight major railroads in the northeast and midwest regions of the country in response to a national transportation crisis triggered when the eight railroads entered into bankruptcy proceedings. The Act was challenged, inter alia, on the grounds that it violated the uniformity requirement of the Bankruptcy Clause of the Constitution. See Art. I, § 8, cl. 4 (providing that Congress shall have the power to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States"). In upholding the constitutionality of the Act, the Supreme Court agreed with the lower court's interpretation that the clause "was not intended 'to hobble Congress by forcing it into nationwide enactments to deal with conditions calling for remedy only in certain regions.'" 419 U.S. at 159. Although the Regional Rail Reorganization Act Cases arose under the Bankruptcy Clause and not the Uniformity Clause, the Court in Ptasynski explained that it "look[s] to the interpretation of one Clause in determining the meaning of the other." 462 U.S. at 83 n.13.

judicial deference. "Where, as here, Congress has exercised its considered judgment with respect to an enormously complex problem, we are reluctant to disturb its determination." Id. at 86.^{21/}

3. H.R.3244 under the Uniformity Clause

Because H.R.3244 creates an alternate federal income tax scheme applicable only to residents of the District of Columbia, it will require "close examination" under Ptasynski for conformity with the Uniformity Clause. In order to survive this constitutional scrutiny, the bill's special classification of District taxpayers (1) must be based upon "neutral factors," and (2) must not be motivated by Congress's desire to grant the District an "undue preference" vis-a-vis the other states. The court's analysis of the sufficiency of Congress's rationale for adopting the classification at issue will be influenced by reasonable deference to the views of Congress. Based on these criteria, I believe the bill will pass constitutional muster.

First, it is clear that H.R.3244 is entirely outside the core evil that the Uniformity Clause was designed to

^{21/} For other indications of the deference that would be accorded Congress under the Uniformity Clause, see Augusta Towing Co., 5 Cl. Ct. at 169 (interpreting "close examination" as form of equal protection-style "rational-basis" review); Nelson Lund, Comment, The Uniformity Clause, 51 U. Chi. L. Rev. 1193, 1194 (1984) ("The opinion in [Ptasynski] . . . suggests that only the most patently discriminatory taxes will even be examined for violations of the Uniformity Clause; furthermore, such examinations are apparently to be conducted in a manner that is extremely deferential toward Congress.").

prevent: the imposition by politically powerful States of discriminatory taxes upon the politically weak. Far from having excessive political power, the District of Columbia has no voting representation whatever in Congress. H.R.3244 would be an example of the States using their votes to help a disenfranchised jurisdiction, not to secure a financial advantage for themselves.

Second, H.R.3244 is not motivated by Congress's desire to discriminate in an invidious manner against the other states, or to advantage the District at the expense of Maryland and Virginia. It addresses a national problem -- the financial crisis of the seat of the Nation's government -- and it addresses that crisis by offering tax incentives to residents to continue to live in, and invest in, the District. See 142 Cong. Rec. H3391 (daily ed. April 16, 1996) (statement of Congresswoman Norton). Even if the bill could have a marginally disadvantageous impact upon the surrounding states (because some individuals currently residing in those states might relocate to the District), such incidental effects will not be held to violate the Uniformity Clause where there is no evidence that Congress intends to benefit the District "for reasons that would offend the purpose of the Clause." See Prasynski, 462 U.S. at 85-86.^{32/}

^{32/} Indeed, Congress may conclude that H.R.3244 would actually benefit the surrounding Maryland and Virginia areas, given that their economic prosperity is closely tied to that of the
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In the judicial evaluation of these considerations, a central question will be whether there are sufficient "neutral factors" to justify the special favorable tax treatment the bill grants the District, especially given that many other cities also suffer from economic problems. Here, Congresswoman Norton points to two key facts about the District: First, it is not a part of any State. Consequently, the District is "the only city that pays for State, county, and municipal functions" and "the only city with no State to recycle income from wealthier areas." 142 Cong. Rec. H3240 (daily ed. April 15, 1996) (statement of Del. Norton). Second, Congress is constitutionally entrusted with providing for the welfare of the District's residents. See U.S. Const. art. I, § 8, cl. 17 (granting Congress exclusive authority to legislate for District); see also United States v. Cohen, 733 F.2d 128, 138 (D.C. Cir. 1984) ("[Congress's] responsibility for the general welfare of the citizenry in that location is especially grave because it is not shared.").

At the time it established the District of Columbia Financial Responsibility and Management Assistance Authori-

^{22/} (...continued)

District. As Congress found in enacting the District of Columbia Financial Responsibility Act of 1995, "[t]he failure to improve the financial situation of the District government will adversely affect the long-term economic health of the entire National Capital Region." Pub. L. No. 104-8, § 2(a)-(8), 109 Stat. 97, 98.

ty,^{33/} Congress made a series of findings that demonstrate the unique status of the District of Columbia and the significance of its financial difficulties from the standpoint of the national interest. Congress found, inter alia, that the District's financial and management problems

"have already adversely affected the long-term economic health of the District of Columbia by causing the migration of residents and businesses out of the District of Columbia and the failure of new residents and businesses to move to the District of Columbia. [Indeed, the] efficient operation of the Federal Government may be adversely affected by the current problems of the District of Columbia not only through the services the District government provides directly to the Federal Government but through services provided indirectly such as street and traffic flow maintenance, public safety, and services affecting tourism."

District of Columbia Financial Responsibility Act of 1995,
Pub. L. No. 104-8, § 2(a), 109 Stat. 97, 98.

These congressional findings illustrate the gravity of the financial situation in the District and the importance of the District's economic health to that of the National Capital Region and the federal government. They also indicate that aspects of the financial crisis in the District as found by Congress -- for example the migration of residents and businesses out of the District -- will be directly addressed by H.R.3244. The importance of the economic health of the District to the overall functioning of the federal government, coupled with the unique status of the District as a city

^{33/} Public Law 104-8, supra.

carrying out municipal, county, and State functions, provides a strong rationale for differential tax treatment of District residents.

The unique political status of the District and its special constitutional relationship to Congress are characteristics shared by no other city. See District of Columbia v. Carter, 409 U.S. 418, 432 (1973) ("[T]he District is truly sui generis in our governmental structure."). Moreover, as a direct result of these characteristics, the District must confront its economic problems without the assistance of any State. H.R.3244 would be a step in addressing the District's uniquely unfavorable local conditions and in recognizing its unique importance to the federal government. Finally, because the fundamental purpose of the Uniformity Clause is to prevent an abuse of power by powerful States through the votes of their congressional representatives, it would be particularly anomalous for a court to invoke the Uniformity Clause against legislation favorable to the District, given its lack of any voting representation in Congress.

Thus, I do not believe it likely that a court, applying a reasonable standard of review and taking into account Congress's explicit constitutional responsibility for the welfare of the District, would hold H.R.3244's favorable tax treatment for District residents to be in violation of the Uniformity Clause.

II. Equal Protection Principles

Finally, I comment briefly on whether H.R.3244 raises any problems under the equal protection component of the Due Process Clause. Given my view that the bill is permissible under the Uniformity Clause (assuming that that clause were found applicable to the federal income tax), the discussion of equal protection can be brief.

Generally, where a statutory classification does not employ a suspect category or interfere with the exercise of a fundamental right, it will be upheld so long as it "bear[s] a rational relation to a legitimate governmental purpose." Regan v. Taxation With Representation, 461 U.S. 540, 547 (1983). In practice, under the rationality standard, courts are extremely deferential to congressional decisionmaking. This is particularly true where tax classifications are involved. As the Supreme Court explained in Regan: "Legislatures have especially broad latitude in creating classifications and distinctions in tax statutes." Id. The Court continued:

"[I]n taxation, even more than in other fields, legislatures possess the greatest freedom of classification. . . . [T]he presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it."

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Id. at 547-48 (quoting Madden v. Kentucky, 309 U.S. 83, 87-88 (1940) (footnotes omitted)).^{34/}

Since H.R.3244 does not employ a suspect classification or interfere with the exercise of a fundamental right, it will be subject to equal protection scrutiny under the rationality standard discussed in Regan. Given the highly deferential nature of this standard and the substantial justifications for the bill as discussed in the prior section of this testimony, I believe it clear that a reviewing court would uphold the constitutionality of the bill under the equal protection component of the Fifth Amendment.

* * * *

This concludes my testimony. I would be happy to try to answer any questions.

^{34/} In Regan, the Court upheld the denial of federal tax-exempt status to a public interest group engaged in substantial lobbying activities, even though a veterans' organization also engaged in substantial lobbying activities had been granted such status, on the grounds that it was not irrational for Congress to decide to subsidize one group but not the other. Id. at 550-51. See also McGowan v. Maryland, 366 U.S. 420, 427 (1961) (upholding special state "blue laws" exemption for retailers in one county, on grounds that "territorial uniformity is not a constitutional prerequisite"); Augusta Towing Co. v. United States, 5 Cl. Ct. 160, 164 (1984).

Mr. GUTKNECHT. Thank you, Mr. Atwood. Ms. Morris.

Ms. MORRIS. I have no statement.

Mr. GUTKNECHT. With that, we'll go to questions. I would go first to the delegate from the District, Ms. Norton.

Ms. NORTON. Thank you, Mr. Chairman. I want to thank all the witnesses for this testimony. It's very thoughtful, and for me it's very important. I recognize that constitutional matters—particularly matters that may seem arcane here, because this matter doesn't come up very often—may not interest the average citizen, but it certainly interests me.

I want to thank each of you, because I think each of you has given very fair testimony. I may not agree with it all, but I think it is fine and analytical testimony.

I guess I ought to note what you already know, and that is that Congress doesn't pay much attention to constitutional issues when it passes legislation. Members jump up and down and say something is unconstitutional, and they say, "So? Well, the courts will tell us." But I certainly am interested in getting a piece of constitutional legislation.

I want to ask about one section of the constitution and how it fits in with this, but first I would like to ask Mr. Kies whether his estimates of the cost of the bill comport with the CBO estimates, or where his estimates come from.

Mr. KIES. Ms. Norton, the CBO does not do revenue estimates of tax legislation. Only the Joint Committee on Taxation does. So it's our responsibility to estimate tax legislation.

Ms. NORTON. And the Congress then abides by your estimate the way it would, in other legislation, the CBO.

Mr. KIES. That's correct. Under the Budget Act, the CBO has responsibility for estimating spending proposals, and we estimate all revenue changes.

Ms. NORTON. Now, let me move into the constitutional issue. Some of it may have been implied. I'm not sure I saw the section, as I read hastily through Mr. Atwood's testimony.

But the District, when it comes forward, as it often does, to complain about invidious treatment—no State to help it out; no vote, which people in the District regard as a death-defying principle—it's the last thing you would expect in this country. No commuter tax. There are a whole set of disabilities that no other jurisdiction would ever be subject to.

And then, what we are told always is, "Well, sorry. Under Article I, Section 8, Clause 17, the plenary power of the Congress we can do anything we want to."

I suspect that if Congress tried under the plenary power to—there are things probably bad enough. These things we've gotten used to. We have a whole set of citizens who can't have the same rights everybody else has, and instead of hanging our heads and trying to correct it, we've grown used to it, and that doesn't mean anything to us any more.

But I suspect that there are things we could do to the District that even the courts wouldn't accept that the plenary power would allow. Reversing that now, given almost 200 years of allowing invidious discrimination—and I use that word advisedly—invidious discrimination against the District that is not practiced against the

territories or any other citizens of the United States, would not this broad clause also provide some basis to say that the Constitution would allow the Congress to relieve the District of some of its tax liability, given its responsibilities and given—well, let me stop there.

I would like each of you to try that question on. In other words, I'm addressing now the specific section of the Constitution which is the one most often quoted, article I, section 8, clause 17, which says no more than, "Hey, it's our District. We can do anything we want to in it," is essentially what it says. I guess starting with Mr. Atwood, going to Mr. Kies and Mr. Ripy.

Mr. ATWOOD. I have no doubt that that would be an important factor in the court's deciding that, in an analysis of the uniformity clause, they ought to give special difference to congressional action that would be favorable to the District of Columbia. That clause would be most directly applicable if Congress were legislating with respect to the D.C. tax, but here, of course, you would be legislating with respect to the Federal tax.

I do not think the D.C. provision would trump the uniformity clause, but I think, in the balance of factors and the weight that would be given to congressional judgments, the fact that this is the Nation's Capital, that Congress has a special responsibility, would be very important in the court's analysis under the uniformity clause.

Ms. NORTON. I want to get the part, the plenary power—are you saying that, with respect to Federal legislation, the plenary power means that the District has to be treated like everybody else and that the plenary power really goes only to internal District matters?

Mr. ATWOOD. The uniformity clause, which applies to Federal taxation, is what I'm focusing on. I think that would be the key constitutional issues, whether there's an infringement of the uniformity clause.

In my judgment, the plenary power that Congress has over District affairs does not trump the uniformity clause. You still have to deal with the uniformity clause on the merits.

Ms. NORTON. And so, if Congress were to excuse District residents from the draft, that wouldn't be possible. I'm not going now to the uniformity clause, I'm trying to analogize out to solely Federal responsibilities.

Mr. ATWOOD. I guess I would have to think about that a little bit before giving a definitive answer. What may be different about that example as compared to what we're dealing with here is that you have another specific constitutional provision that is saying the laws shall be uniform through the United States. For these purposes, I think the District is part of the United States.

Ms. NORTON. What about the 13th, 14th, and 15th amendments? Let's leave out 13. How about the 14th and 15th amendments, Federal amendments relating to behavior in the District, as well as in the States? I mean we don't have voting rights here.

Mr. ATWOOD. Yes.

Ms. NORTON. If you have the same thing to happen across the river in Virginia, I take it it would be unconstitutional. Why isn't it unconstitutional here?

Mr. ATWOOD. Congresswoman Norton, I am not competent to justify or prepared to justify the voting issue in the District of Columbia. That, I'll admit, is not an area of my expertise.

Ms. NORTON. I'm really going by analogy, too. I have no idea what the answer is, but I'm starting with your premise that this distinction between Federal mandates on the country, which the District also would be counted, and plenary power, which goes only to internal District affairs. I cite the 14th and 15th amendments, because that obviously applies to everybody, including the District.

Mr. ATWOOD. Well, those are directed primarily to the States and not to Federal legislation.

Ms. NORTON. But under *Brown v. Board of Education*, the District was treated as a State, and separate but equal was found unconstitutional through the fifth amendment, seeming to imply that at least the Supreme Court doesn't see a distinction between the District and the States as to Federal rights, as your uniformity clause analysis would seem to see.

Mr. ATWOOD. Well, under the uniformity clause, the Supreme Court has said that the District of Columbia is to be treated as a State for those purposes, and thus Congress should not rely on that justification.

Ms. NORTON. And under the 14th amendment, they said so in the *Brown* series of cases.

Mr. ATWOOD. I'm afraid you're outside my area of expertise, ma'am. I'll have to defer to you on that. I'm sorry.

Ms. NORTON. Thank you very much, Mr. Atwood. Mr. Kies, would you tackle the same question about the article I, section 8, clause 17?

Mr. KIES. I think, Ms. Norton, the issue on the uniformity clause really boils down to three basic issues. The first is whether or not the District of Columbia is subject to the uniformity clause.

The Supreme Court has clearly said it is on a number of occasions. That's in contrast to what they've said, for example, about some of the unincorporated possessions—for example, Puerto Rico—that were never previously incorporated into the United States.

The District was part of the United States, and it was carved out of Maryland and Virginia. The Supreme Court has ruled that it was not removed from the United States. So the uniformity clause pretty clearly applies to the District of Columbia. That's the first threshold question.

I think the second question is one that Mr. Atwood referred to, which is whether or not an income tax is itself subject to the uniformity clause on the basis of whether it's a direct or an indirect tax. I think that is an issue that's open for debate.

When, several years ago, there was issue about whether or not Puerto Rico should come into the United States, an issue that was looked at was whether or not continuing so-called section 936 treatment—the special treatment accorded possessions corporations—could have been continued after incorporation of the island of Puerto Rico as a State into the Union.

Some people took the position that if section 936 had continued after incorporation, that would have violated the uniformity clause, because it would have accorded certain activities in Puerto Rico

special tax benefits that would not have been accorded to businesses doing business elsewhere in the United States.

That issue has never been directly addressed, because Puerto Rico has not been incorporated into the United States, but at least some people believe that simply giving tax preferences to a geographic region without some justification would raise the uniformity clause questions.

I think the third and final threshold issue for this legislation is whether the circumstances of the District of Columbia do justify a geographic discrimination. I think you're right that the Congress frequently proceeds with legislation without specifically addressing whether there is or isn't a constitutional issue.

In the final analysis, I think if this legislation were enacted, one would have to contemplate that, at some point, the courts would take a look, and when they did, the issue that they would have to address is whether or not the geographic classification justifies special treatment, assuming they have concluded that this tax is one that is subject to the uniformity clause.

There has been other experience in the Tax Code where, for example, enterprise zones are created based upon a geographic classification. But those are the kind of issues I think they would have address here.

Ms. NORTON. Mr. Kies, I'm not sure I got how you think the plenary power clause should be read with the uniformity clause.

Mr. KIES. Ms. Norton, I'm not sure it's relevant to the issue of the uniformity clause. I think the uniformity clause is independent of it.

Ms. NORTON. Yes, well, it clearly is independent of it, but generally, the court reads related sections of the Constitution together when making a judgment. I was just asking for your opinion, if you have any, on how the court would read these two together, especially in light of the fact that the court has allowed the Congress to do virtually anything it wanted to do to or for the District under article I, section 8, clause 17.

Mr. KIES. And I think our initial view—and I'll say we have devoted a fair amount of time to preparing for this hearing—but our initial view is that it would not be significantly relevant to how they would apply the uniformity clause.

Ms. NORTON. You may be right, but I have to tell you that I think our court would be put in a very tough position to say that "We will apply the uniformity clause, regardless of anything else in the Constitution, to do negative things to you, but when it comes to helping you keep from going down the drain, we're going to bring the uniformity clause out of the Constitution and wave it in your dying face."

Mr. Ripy.

Mr. RIPPY. When I looked at this proposal originally, I looked at it in terms of an exercise of the national taxing power and not as an exercise of the power of Congress as, in effect, the super city council of the District of Columbia. So I haven't really given a lot of thought to the question that you raised.

My initial reaction is that one of the special factors that might be considered when you are attempting to analyze the constitutionality of a proposal that gives special benefits to the residents

of the District of Columbia, that one of the special factors that you might urge is that there is a different political relationship between the District and the National Government than there is between the National Government and other cities and local governments.

Now, I don't have a crystal ball, so I can't tell you how the courts would react to that, but I think, certainly, it's an argument that someone would consider making.

Ms. NORTON. Thank you. Thank each of you for those answers. Mr. Chairman.

Mr. GUTKNECHT. Ms. Collins.

Ms. COLLINS. Thank you, Mr. Chairman. I would like to congratulate the ranking minority member, Congresswoman Norton, for crafting this viable solution to a critical situation. Her quick action and concern should be commended, and I wholeheartedly support proposal H.R. 3244 because I feel that this legislation is the only solution in providing relief to this economically distressed city.

I feel that this legislation does exactly what it should do, and that is provide a means to attract and keep middle-class residents in the District, since these are the very people who are leaving this city in droves and creating a gaping financial hole in the city's economy.

I realize the arguments against this legislation, the primary one being that other cash-strapped cities would not be privy to such a special benefit as a tax relief proposal. To those naysayers, I must say that I represent one of those cash-strapped cities—Detroit, MI—and I strongly feel that the Nation's Capital should set the tone for the entire country.

I feel that Congress should be aware of this fact and do whatever needs to be done to uphold the District of Columbia and restore it to the city it once was.

I would like to, first of all, apologize for missing most of the other panelists. I have read some of their testimony, but, as you know, we had a long string of votes at one time, and I do have other meetings to go to, so I won't stay.

But I don't think that the ranking member has to worry about the constitutionality of this proposed legislation. This is the Nation's Capital, and, as you say, it has not been treated uniformly in the Constitution or legislatively, as any other State or city has in the Nation. So I don't think that argument will hold water.

What I am very pleased with is the bipartisanship of the support of this proposal. I hope that we have enough time to really work on the Members and the President to support this.

Our cities are dying across the Nation. Our middle class have really abandoned the cities, and this could be a gleam of light down the tunnel for us—not saying that all cities should have the same remedy, but at least you're offering a remedy, something to stop that flow. So I thank you all for your testimony, and I'm sorry I won't be able to stay for the rest.

Mr. GUTKNECHT. Thank you, Ms. Collins. To be honest, I really don't have any questions. I think most of the questions that I had have been asked by Delegate Norton. I want to thank you for coming, though. I think your testimony was all very valuable.

I think we're going to have to wrestle with this for a while and determine what the real consequences may or may not be and

whether it's constitutional or not. Ultimately, though, I would have to agree with Delegate Norton. Ultimately, I think Congress may make this decision one way or the other, regardless of whether or not it's constitutional. We'll allow the courts to decide that. We should decide whether or not we think it's good policy.

But again, I will dismiss this panel, and thank you very much for joining us today.

I would now like to call up Ms. Diane Duff of the Greater Washington Board of Trade; Mr. Hollister Cantus, representing the Fairfax County Chamber of Commerce; Mr. Kwasi Holman, executive vice president of the District of Columbia Chamber of Commerce; and Mr. Timothy Coughlin, president of the Riggs National Corp.

Before you sit down, I'm going to make you stand back up. As you may know, it's the policy of this subcommittee, as well as the full committee, to swear all witnesses.

[Witnesses sworn.]

Mr. GUTKNECHT. Please let the record reflect that the witnesses answered in the affirmative.

I should mention to all of the people testifying that we have had votes. There are a number of other meetings going on. So please, I apologize that we don't have the attendance I would like to have. As a matter of fact, I have another meeting to go to at 3, and so I hope the Chair will be back.

We have reviewed your written statements, and there is staff here who will brief the Members about your testimony, so we do appreciate your taking time out of your busy schedules to be with us.

I believe the order that we have listed here is first Ms. Duff.

STATEMENTS OF DIANE DUFF, STAFF DIRECTOR FOR FEDERAL AFFAIRS, GREATER WASHINGTON BOARD OF TRADE; H. HOLLISTER CANTUS, DIRECTOR, LEGISLATIVE AFFAIRS, FAIRFAX COUNTY CHAMBER OF COMMERCE; KWASI HOLMAN, EXECUTIVE VICE PRESIDENT, D.C. CHAMBER OF COMMERCE; AND TIMOTHY C. COUGHLIN, PRESIDENT, RIGGS NATIONAL CORP.

Ms. DUFF. Thank you, Mr. Chairman and members of the subcommittee, for the opportunity to testify before you today. My name is Diane Duff, and I am the staff director for Federal affairs for the Greater Washington Board of Trade, which is the regional chamber of commerce, representing more than 1,000 businesses located in suburban Maryland, northern Virginia, and the District of Columbia.

I would like to thank the subcommittee for holding hearings today on the D.C. Economic Recovery Act, which the board of trade strongly supports as a first step toward resolving the Federal city's financial crisis.

The concept behind this bill is one of the most positive developments to gain attention on Capital Hill that I have seen in many years. This bill recognizes that the unique nature of the District of Columbia as a Federal city prevents it from singlehandedly overcoming the urban problems that have eroded large cities all over this country.

It cannot be viewed as a cure-all, in our opinion, but it should be the precursor for developing a more realistic and viable relationship between the city of Washington and the Federal Government.

For the last few years, there has been much debate about how to resolve the District of Columbia's financial crisis. The recession in the late 1980's and early 1990's exposed the deficiencies of the District government and marked the beginning of a spiraling financial crisis that resulted in the deterioration of services and increasing flight of businesses and the middle class. As services got worse, the middle class left the city faster.

There is no question this vicious cycle will continue until we can figure out how to stabilize the District's financial problems. This bill offers the catalyst needed to stop the exodus of the District of Columbia's middle class tax base.

Although many people agree that the tax incentives provided by this legislation will not likely attract middle-class families back into the District in the short run, they will provide a strong incentive for many current residents to stay. This legislation could have a far more dramatic impact on the District's economy, in our opinion, if the capital gains provision included in the Senate's companion legislation were included.

By providing incentives to outside investors, the District of Columbia would realize much greater benefits through increased economic activity and the resulting creation of new jobs, which is a badly needed prerequisite for the renewal of this city.

In addition, it would allow residents and businesses in the surrounding regional jurisdictions to participate in the financial recovery of the heart of the region. In either case, while it remains unclear what the exact economic outcome would be, it's certain that this bill would increase disposable income of current residents.

So, if you accept that any of the increased income will be spent in the District of Columbia, then you will also agree that increased spending equals increased sales and property tax revenues, and this positive economic activity begins to make discussions about lowering local taxes or shifting resources to improve basic city services, such as public safety, more viable.

Until now, the debate at both the local and Federal levels has focused primarily on whether the answer to the city's problems is increasing its revenues or cutting the budget. But neither one of these approaches deals with the immediate issue of stopping the drastic erosion of the District's tax base.

In a best-case scenario, the local government would cut its taxes and improve the services that taxpayers expect. However, while cutting local taxes now would improve the long-term outlook by itself, it would most likely result in a short-term budget shortfall that would likely exacerbate problems with core service delivery.

This does not mean that these things should not be done. The board of trade is actively working with the D.C. Council, the Mayor, and the control board, to develop and implement personnel and procurement reforms that will allow for savings that can be used to improve services.

We are also advocating tax reforms that would make the District competitive with the surrounding jurisdictions. But these proposals

for long-term, systemic change will not provide the short-term solution for stabilizing the dwindling tax base.

Nonetheless, I must emphasize that the board of trade views this proposal as only a first step. The complexities of the District's financial relationship to the Federal Government must be addressed in order to achieve long-term fiscal stability in the Nation's Capital.

There are a number of larger issues that require cooperation and leadership from the Federal Government if they are to be resolved, such as the estimated \$5 billion unfunded pension liability and other traditionally State functions such as the Medicaid Program, which currently represents a significant portion of the budget.

If these costly issues are left unresolved, the District of Columbia will never be able to achieve long-term fiscal stability regardless of whether this bill is implemented.

I would like to close my remarks with some brief observations about the unique characteristics of Washington, DC. As all of you know, Washington has operated for the last 20 years as a city with State functions, yet independent of State financial support, only minimal Federal support, and no alternative revenue-generating authorities.

It has been responsible for providing State functions to its residents, ranging from corrections to Medicaid, and these functions account for more than a third of the annual budget. It has attempted to provide these functions within a budget where more than half the money comes from local taxes, as opposed to other cities that receive on average 75 percent of their budgets from State and Federal Governments.

Other national capitals, such as London, Paris, Rome, and Tokyo, are generously subsidized by their respective national governments, and in each case, these capitals are a source of national pride. Despite the similarity of its problems, Washington, DC, is unlike New York, Detroit, Boston, or any other urban area in the United States. It is the Nation's Capital.

If any of us ever expect it to become a source of national pride, then we must all begin to recognize it as our own, as a part of our national fabric, and treat it accordingly.

Thank you again for this opportunity to testify today.

[The prepared statement of Mr. Fazakerley follows:]



Board of Trade Building
1129 20th Street, N.W.
Washington, D.C. 20036
202-857-5900
FAX: 202-223-2648

**STATEMENT BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA**

July 31, 1996

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to testify before you today. My name is Greg Fazakerley, and I am Chairman and CEO of Development Resources Inc. I am here today on behalf of the Greater Washington Board of Trade, the regional chamber of commerce that represents more than 1,000 businesses located in suburban Maryland, Northern Virginia and the District of Columbia.

I would like to thank the Subcommittee for holding hearings today on H.R. 3244, the District of Columbia Economic Recovery Act, which the Board of Trade strongly supports as a first step toward resolving the federal city's financial crisis. I believe the concept behind H.R. 3244 is one of the most positive developments to gain attention on Capitol Hill that I have seen in many years. This bill recognizes that the unique nature of the District of Columbia as a federal city prevents it from single-handedly overcoming the urban problems that have eroded large cities all over this country. It cannot be viewed as a cure-all; but it should be the precursor for developing a more realistic and viable relationship between the City of Washington and the federal government.

For the last few years, there has been much debate here on Capitol Hill and throughout Greater Washington about how to resolve the District of Columbia's financial crisis. The recession in the late '80s and early '90s exposed the deficiencies of the District government and marked the beginning of a spiraling financial crisis that resulted in the deterioration of services and increasing flight of businesses and the middle class. As services got worse, the middle class left the city faster. This vicious cycle will continue until we can figure out how to stabilize the District's financial problems. H.R. 3244 offers the catalyst needed to stop the exodus of the District of Columbia's middle class tax base.

Although many people agree that the tax incentives provided by this legislation will not likely attract middle class families back into the District in the short-run, they will provide a strong incentive for many current residents to stay. This legislation could have a far more dramatic impact on the District's economy if the capital gains provision included

in the Senate's companion legislation were included. By providing incentives to outside investors, the District of Columbia would realize a much greater benefit through increased economic activity and the resulting creation of new jobs—a badly needed prerequisite for the renewal of this city. In addition, it would allow residents and businesses in the surrounding regional jurisdictions to participate in the financial recovery of the heart of the region.

While it remains unclear what the exact economic outcome would be under the Economic Recovery Act, it is certain that this bill would increase disposable income of current residents. Basic economic principles tell us that increased disposable income inevitably causes a ripple effect, especially for retailers, real estate companies and lending industries. Increased spending equals increased sales and property tax revenues, and this positive economic activity begins to make discussions about lowering local taxes or shifting resources to improve basic city services, such as public safety, more viable.

Until now, the debate at both the local and federal levels has focused primarily on whether the answer to the City's problems is increasing its revenues or cutting the budget. But neither one of these approaches deals with the immediate issue of stopping the drastic erosion of the District's tax base. In a best case scenario, the local government would cut its taxes and improve the services that taxpayers expect. However, while cutting local taxes now would improve the long-term outlook by itself, it would most likely result in a short-term budget shortfall that would likely exacerbate problems with core service delivery.

This does not mean that these things should not be done. The Board of Trade is actively working with the DC Council, the Mayor and the control board to develop and implement personnel and procurement reforms that will allow for savings that can be used to improve services. We are also advocating tax reforms that would make the District competitive with the surrounding jurisdictions. But these proposals for long-term, systemic change will not provide the short-term solution for stabilizing the dwindling tax base. H.R. 3244 would take that first step.

Nonetheless, I must emphasize that the Board of Trade views this proposal as only a first step. The complexities of the District's financial relationship to the federal government must be addressed in order to achieve long-term fiscal stability in the Nation's Capital. There are a number of larger issues that require cooperation and leadership from the federal government if they are to be resolved, such as the estimated \$5 billion unfunded pension liability and other traditionally state functions such as: the Medicaid program, which currently represents a significant portion of the city's annual budget; and the Lorton correctional facility, which, at a minimum, is in desperate need of capital improvements. If these costly issues are left unresolved, the District of Columbia never will be able to achieve long-term fiscal stability, regardless of whether H.R. 3244 is implemented.

I'd like to close my remarks with some brief observations about the unique characteristics of Washington, DC, that allow this city to warrant special federal attention. As all of you know, Washington has operated for the last 20 years as a city with state functions, yet independent of state financial support, only minimal federal support and no alternative revenue-generating authorities. It has been responsible for providing state functions to its residents, ranging from corrections to Medicaid, and these functions account for more than 1/3 of the annual budget. Further, it has attempted to provide these functions within a budget where more than half of the money comes from local taxes, as opposed to other cities that receive on average 75% of their budgets from state and federal governments.

Other national capitals—such as London, Paris, Rome and Tokyo—are generously subsidized by their respective national governments, and in each case, these capitals are a source of national pride. Despite the similarity of its problems, Washington, DC, is unlike New York, Detroit, Boston, or any other urban area in the United States—it is the Nation's Capital. If any of us ever expect it to become a source of national pride, then we all must begin to recognize it as our own—as a part of our national fabric—and treat it accordingly.

Thank you again for the opportunity to testify today and to reiterate the Board of Trade's strong support for H.R. 3244 as a positive first step toward making the Nation's Capital something of which we can all be proud. I will be happy to answer any questions you may have.

Mr. DAVIS [presiding]. Thank you very much. Holly, at long last. Mr. CANTUS. Thank you, Mr. Chairman.

Mr. DAVIS. We actually have more votes. I'm going to try to get as much as we can through. We have two votes in a row. So go ahead.

Mr. CANTUS. In the interest of time, if I can submit my statement for the record, I'll just talk extemporaneously.

Mr. DAVIS. Sure. The whole statement is in the record.

Mr. CANTUS. So that Ms. Norton and other Members are aware, I'm Hollister Cantus. I'm senior vice president for Federal, State, and local government relations for ICF Kaiser, headquartered in Fairfax, and I'm representing the Fairfax County Chamber of Commerce today, with its 2,000 member companies, all of whom are neighbors of the District of Columbia.

There is a lot to be said about this bill that is supported by our chamber. The good news is that Ms. Norton has offered this bill at this time, and the chairman has called these hearings at this time. The bad news is, we haven't had time to get a vote on our board, so we're bureaucratically blocked from taking a position.

I can say we do not oppose this bill. I can say that, in concept, we support the goals of the bill and the direction it's going. Our concern, if you will, Mr. Chairman, is that the proposal may not go far enough. I'm personally concerned that this could be a Venus flytrap for the flat tax.

If Members are to look at this proposal, this bill, as the only solution for the District of Columbia, then the District's fate is still in jeopardy. Excess taxes—Federal taxes—did not cause the problems in the District, and I don't think resolving that issue is going to be the solution for the District.

The crisis in the District is now. This bill addresses tomorrow. There is no time for trickle-down. The problems of the District are today. Today's problems are water, sewer, roads, bridges, schools, safety, and health. Nothing in this proposal affects those problem areas immediately.

The quality of life is what has driven the people who have been discussed by previous witnesses out of the city, and it's going to be the return of quality of life that brings them back.

That is not to say that this bill doesn't help. This bill will help, but on a longer term. It will address the problems of tomorrow, like restoring the economy, restoring jobs, bringing new business, new bakeries, to the District. It will renew the tax by bringing people back in, bringing the families back into the District to live.

The District does need tax relief. Business needs tax relief. But the District also needs cash. Ms. Norton was looking for solutions today. The solution is cash. There are bridges just south of this city that are about to fall into the river. There's a water treatment plant which, if it isn't fixed, may make it possible to walk across the river.

There's a water system which, if it isn't fixed, may make Blue Plains unnecessary, because there won't be anything to flow in that direction. This city is in extremis, and the problem must be solved by cash.

When Jack Kemp said that perhaps the Federal payment isn't big enough, I think he has put his finger right on it. We have ex-

pected the city to live in a manner similar to the other urban areas of the country, and perhaps even better, but we haven't paid for it. That's the real problem. That's today's problem.

Tomorrow's problem may be solved by tax relief provisions and the regulatory relief provisions that ought to go with it so it doesn't take the new businesses that want to come to town a year to get the permits in order to do business; because it's a year after that before they pay their first year's taxes.

So that's in essence our comments, our views from the other side of the Potomac. I would tell you, Mr. Chairman, that, on the surface, we do not see any negative impact to our economy in the largest district south of you.

We believe that, as a "rising suburb"—to use someone else's phrase this morning—we will benefit when the District moves up, and we look forward to that. There may be some minor perturbations. We can live with those.

[The prepared statement of Mr. Cantus follows:]

Good morning, Mr. Chairman and Members of the Committee. I am Hollister Cantus, Senior Vice President for Federal, State and Local Government Relations for ICF Kaiser International, one of the nation's largest environmental consulting, engineering and construction services companies which is headquartered in Fairfax, Virginia. I am appearing here today in my capacity as the member of the Executive Committee of the Board of Directors responsible for Legislative Affairs for the Fairfax County Chamber of Commerce; the largest chamber of commerce in the Metropolitan Washington area. As such, I am representing the Chamber's more than 2,000 member companies; over 80 percent of which are small and emerging businesses.

We appreciate the opportunity to be heard on the proposed District of Columbia Economic Recovery Act (DCERA) introduced by Delegate Eleanor Holmes Norton. Let me begin by commending Ms. Norton for her commitment to the search for positive solutions to the challenges facing the District. Her dedication, persistence and zeal are unmatched and greatly appreciated beyond the borders of the District of Columbia.

The Fairfax County Chamber of Commerce is here today to give testimony as to its support for efforts to limit, stop and reverse the negative fallout which arises from a prolonged failure to revive the economic and fiscal health of the District of Columbia. We believe that prompt, thoughtful and innovative proposals to assist the District in its bid to reverse the unfortunate decline in population and business with the resulting loss of local tax revenues are essential to the

residents of Washington and its immediate neighbors to the north and south as well as to the taxpayers of the nation at large.

With those parameters on the extent and scope of our support, I must admit that the Chamber has not had time to fully analyze or evaluate the specifics of DCERA on the District or our region as a whole. Our Board of Directors has informally acknowledged that the issue is worthy of detailed exploration as part of the larger effort to ensure economic prosperity for the District. Until such analyses are completed, we cannot present specific recommendations or solutions. However, we do believe that we can contribute to the deliberations by adding a perspective from across the Potomac. Such a perspective of Washington is necessarily broader than the view from inside the District.

We understand that the economic health of the District of Columbia is important to the economic health of Fairfax County and our Chamber's member companies. As other business leaders can confirm, Fairfax County's ability to attract and retain companies in our community is impacted by the tangible and intangible relationship that exists among the region's political jurisdictions. Our proximity to the District is often a key selling point in our efforts to market our community to business executives from around the world. The District's health and welfare are a crucial component of our region's competitive posture.

Unfortunately, our perspective suggests that the proposed legislation, while well-intended, may

miss the objective the sponsor and her neighbors all desire: the economic revitalization of the District of Columbia. We believe that objective is better found through broad-based relief and incentivization of business rather than personal relief for a small segment of the population.

Excessive federal income taxes are not the cause nor is federal income tax relief the solution for the District's problems. In the unique economic environment of Washington, it is not at all clear that personal tax savings would be reinvested inside the District of Columbia. Reduction of income taxes are unlikely to make any significant impact on reversing population declines which reportedly have exceeded the rate of the previous decade in just the past five years. We believe that personal income tax relief will have a negligible impact on bringing new business, new jobs, and new residents to Washington to provide the total tax base sufficient to fund a quality school system, support an effective security system (police, fire and emergency response agencies); resolve water, sewer and transportation infrastructure problems and provide the other elemental services that make a community attractive as a place in which to reside and to conduct business.

This view is supported by the fact that many District residents have moved to the suburbs where, as in Prince George's County, Maryland, for instance, the overall tax burden is higher than the District's. Clearly the income tax burden is not the major cause for the population emigration.

Furthermore, the loss to the national Treasury of an estimated \$750 million to \$1 billion might cause a political vacuum where Members of Congress from other jurisdictions might, with some justification, determine that the void should be filled by the residents nearest to the problem.

We would hope, Mr. Chairman, that, if this proposal is adopted, judgements along those lines would not be made prematurely, before the results of a modified flat-tax experiment could be measured.

Nevertheless, the intent behind this legislation is still worthy. If there are areas where tax relief might be used as a means of promoting overall economic recovery, then those areas deserve serious investigation. Proposals relating to the establishment of so-called enterprise zones, reduction or elimination of capital gains taxes, exemption from rigid minimum wage standards, and the whole panoply of growth-inducing economic incentives could be implemented in the District and could serve as both the testing ground and the model for the economic recovery of other urban areas. In that context, federal investment is consistent with our national, regional and local goals and would be justified by what we learn from those efforts.

In addition, were the Congress to adopt a pro-growth recovery plan for the District, it might well include accelerated investment in the District's water, sewer and transportation infrastructures. District facilities which are in disrepair and can be legitimately described as in extremis (such as the Blue Plains Water Treatment plant and the Woodrow Wilson Bridge) could be funded for accelerated repair, modernization or replacement. The jobs -- from design through construction to continuous operation -- would not only resolve many of the health and safety and related quality of life problems which are the root cause of urban flight but would enhance the District's revenue base to help restore the government to solvency...or at least move in that direction.

Mr. Chairman, this is by no means intended to be a complete list of the actions we believe will help resolve the District's very real and present problems. They are, however, representative of alternatives to the proposed legislation which we believe would match up favorably in a cost-benefit analysis against the modified flat-tax proposal. We cannot say the tax proposal won't work -- as a matter of fact, on a national scale, it might be very effective -- but our view is that there are other proposals which in this unique place and at this particular time would have a greater, quicker, and more focussed beneficial impact.

The Fairfax Chamber of Commerce believes that the District of Columbia's economic recovery is important to the point of being essential to the economic well-being of our region. We believe it is essential to the national prestige since the Capitol City retains its position as symbolic of the American way of life. What we do here, collectively as neighbors and in concert with our Governments provides an opportunity to project to the world the ability of our system to overcome incredible human, fiscal and economic problems.

Mr. Chairman, we stand ready to assist in that effort and would be pleased to answer any questions you may have at this time or as the effort progresses.

Mr. DAVIS. Thank you very much.

Kwasi, we've got two votes quickly, and then nothing for an hour. If you could indulge us, we'll go over to vote and recess for about 10 minutes.

Mr. HOLMAN. Certainly.

Mr. DAVIS. Then we'll take some questions. We'll have a good exchange. So thank you both. We're going to recess the meeting for about 10 minutes.

[Recess.]

Mr. DAVIS. We will reconvene the meeting. Kwasi Holman, we'll let you speak next. Thank you for your patience. Tim, you, too—all of you. Go ahead.

Mr. HOLMAN. All right. Thank you, Mr. Chairman, Congresswoman Norton. I will just say two types of things, because many of the issues have already been discussed. I wanted to just make the observation that there are two kinds of people in this world, the talkers and the doers, and certainly, in the minds of our members, the nearly 900 members of the D.C. Chamber of Commerce, this committee represents some of the doers.

This is certainly a critical element of the District's recovery, as were the actions that led up to the MCI Center and the Convention Center, and we applaud the committee for taking those kinds of actions.

I wanted to react to the second issue that looks at this bill in terms of being the panacea for the District's problems. I don't think that there is any single solution to the District's problems—not to its economic problems, its political or social problems, but certainly this is the linchpin of real long-term, sustained economic recovery for the District of Columbia.

When I think about the number, literally the hundreds of calls we get every day at the chamber of commerce from individuals looking to relocate into this region, and when they hear about this bill, it certainly is a positive indicator.

I won't say that other factors, like schools and proximity to jobs, aren't important, but certainly this is a very important signal, even without its being passed. So this is a very important sign that something positive is being even considered for the District of Columbia.

And so we applaud you in that regard, and we also think that there are a number of activities that are going on that may not have gotten as much publicity, but certainly form a part of the solution based on what you're considering today.

Certainly, as Congresswoman Norton pointed out, the actions of the D.C. Council to even consider, much less agree to it, a tax freeze over a period of time is unprecedented in my 20 years of looking at these issues, and that's certainly something that's important.

What has also happened is, through organizations like the chamber, like the Greater Washington Board of Trade, and about 13 other business organizations, we have been working in partnership with the District government. We know what the issues are. They're issues that cause businesses to relocate, such as taxes, but also such as the cost of doing business.

Right now, we have young interns that are supported by members of the business community, in the Department of Consumer and Regulatory Affairs, changing their permit system from one that's on card files to one that's automated. We're making significant progress there.

We are looking at other factors that affect business relocation, such as workers compensation. We're working in a joint task force with a number of organizations of the Department of Employment Services and labor unions to look at that.

Likewise, if you identify any major impediment, such as the city's being organized to really retain businesses, there has been no real focus there. So we have formed a partnership with the D.C. government to address how we market the city and to go out to those companies that are still here, tell them that they're wanted, try to address their issues, and make sure that they stay here long enough for the kind of benefits that will inure, not just to their employees, but to them as companies, to kick in.

So I think this is the single brightest light that has been pointed at this problem. Everybody can tell you what's wrong with the District. We think that it's really admirable that something is being done that will get at some of the root causes.

We have had the privilege of working with the Congresswoman over the past year on this. Our board unanimously supports it, and we will look forward to working with you during its implementation as we try to work with you to resolve some of the District's other problems. We know that we'll be successful, because we don't believe in just identifying what's wrong; we want to be a constructive part of that solution.

Thank you for the opportunity to testify.

[The prepared statement of Mr. Holman follows:]

Good morning, Congressman Davis and members of the House District Oversight Subcommittee. My name is Kwasi Holman and I am the Executive Vice President of the DC Chamber of Commerce. I am here today to voice the strong and unanimous support of the DC Chamber of Commerce for H.R. 3244, the District of Columbia Economic Recovery Act, introduced by Eleanor Holmes Norton. The DC Chamber of Commerce believes that H.R. 3244 offers a unique solution to our financially challenging situation.

Mr. Chairman, it is a gross understatement to say that the District of Columbia needs to recapture and expand its revenue base. However, to accomplish this daunting task, it is not going to be easy. In the first five years of this decade, the city has lost more taxpayers than during the whole of the 1980s. While the District of Columbia has suffered from the same urban flight pattern that has been experienced by other urban cores, the District of Columbia is structurally different, we are special. We are not Detroit or New York or Philadelphia. We are the nation's capital. Unlike other cities, we have no state governments to supplement locally-raised revenues. In addition to expense reductions which we think are necessary and positive, for our long term survival we must look at the revenue side as well. Just as the District is landlocked, we are also "taxlocked." We cannot assess a commuter tax on the million plus commuters who work in Washington every day and we cannot and should not raise our local taxes any higher.

We are structurally challenged by the restrictions of the Home Rule Charter granted to the District of Columbia by Congress. So desperate for home rule, we took a bad deal twenty years ago. It is true, we have not made matters better for ourselves. However, it is also true that the District of Columbia labors under a \$5 billion unfunded federal pension liability passed on to it by Congress. The federal payment paid to the District of Columbia does not approximate the financial burden that the District carries as the nation's capital. The middle class taxpayers that continue to live here are shouldering the federal as well as District burden. It is clear that something has to be done sooner than later.

For business, what does DCERA mean? In terms of the benefit to realtors and lending officials, the effect should be immediate. For small businesses from dry cleaners to drug stores to grocers, the effect should be equally positive on their bottom line as the population begins to grow and there are more trips to the corner store. This comes at a time when retail sales by D.C. businesses continue their downward slide.

In terms of business as a whole, it is difficult to predict the effect of passage of DCERA. It is clear that tax cuts alone will not attract business but it will help to stem the exodus while we begin to implement changes in how the DC government does business. The DC Chamber is participating in several initiatives which will soon come on-line. Most exciting is the public-private initiative to totally automate the permit processing system to provide true one-stop service through state-of-the-art technology and a

computerized database of all properties in the District of Columbia. This system will address complaints about excessive processing times, interference incompetence and inconsistency that contribute to business decisions to not remain or expand in the city. We are also in the process of drafting legislation and soliciting support for revisions in the city's workers compensation program that will achieve comparability with these programs in our neighboring jurisdictions.

The DC Chamber has been working with Congresswoman Norton for one year on this endeavor. The DC Chamber of Commerce believes that Congresswoman Norton's bill is the most creative and substantive idea that has been developed. We appreciate this opportunity to speak before you on this critical piece in an overall strategy that is geared toward achieving financial stability for the nation's capital and its residents and its businesses.

Mr. DAVIS. Kwasi, thank you very much. Last, but not least, Tim Coughlin from Riggs Bank. Tim, thanks for staying with us.

Mr. COUGHLIN. Thank you, Mr. Chairman. It's a pleasure, a true pleasure, to appear before you, and also before you, Eleanor Holmes Norton, my Congresswoman.

My name is Tim Coughlin. I am president of Riggs National Corp. I am also chairman of the Tax Committee of D.C. 2000. Our committee has helped Eleanor Holmes Norton prepare this piece of legislation.

I also serve on an advisory committee to the Control Board. This advisory committee was formed by the Board of Trade, the Federal City Council, and the D.C. Chamber of Commerce. I am also serving on an advisory committee to the Brookings Institute, which is preparing a study on District revenues.

Now, I have three important perspectives for supporting this bill. First, I am president of the oldest and largest banking company headquartered in the Nation's Capital. Second, I am a resident of the District of Columbia, where I have lived with my wife and four children for more than 12 years. But most importantly, I am an American citizen who loves his country and who cares about his Capital.

Across the Nation there are many false impressions about the District of Columbia which I would like to use this testimony as an opportunity to correct. While I realize that members of this subcommittee are well familiar with the true facts that I am about to enumerate, I ask for your indulgence so the record may be set straight and so that a factual basis may be set for my comments on Delegate Eleanor Holmes Norton's bill to implement a progressive flat tax for the District of Columbia.

Now, I have often heard it said that the District of Columbia is just like any other large city in the United States, but such a statement could not be further from the truth, especially when it comes to taxes.

The first and most important difference to recognize is that the District cannot charge income taxes on the vast majority of those who work within its borders. Not only is the Nation's Capital prohibited from charging income taxes on Members of Congress and the White House and their staffs, it cannot charge taxes on the incomes of the two-thirds of its working population who live outside the District in Virginia and Maryland.

Is the rest of the country aware that the District is denied the very same nonresident income tax that is the right of every other local government in the United States? Do the citizens of the United States realize that their Nation's Capital is short-changed an estimated \$1.4 billion of income tax revenue by not having the same nonresident income tax rights as every other jurisdiction?

The second most important difference to recognize is that the Federal Government owns a far greater percentage of real estate in the District of Columbia than in other major cities across the country. Does the Nation realize that 57 percent of the land in the District of Columbia is not subject to local real estate taxes, mostly because it is owned by the Federal Government and foreign embassies which pay no real estate tax?

Moreover, the Federal Government and foreign embassies don't even pay sales tax on the goods and services they purchase within the Nation's Capital. Even the \$660 million annual Federal payment to the District does not fully compensate the Nation's Capital for these lost taxes due to Federal and foreign government exemptions.

Perhaps the most egregious difference between the Nation's Capital and other major cities across the country is the tax which the District of Columbia must impose upon its residents to pay for the unfunded pension liability incurred by the Federal Government for District employees that were part of the Federal work force before home rule.

Does the rest of America realize that it costs the District of Columbia \$230 million a year to service the \$3.3 billion pension liability which was the Federal Government's responsibility but which it never funded?

I could go on and on and on, but the simple facts I have already cited demonstrate that the District of Columbia is not just like anyplace else. The Nation's Capital is denied taxation rights that no other jurisdiction in the entire United States is denied. It is subject to Federal and foreign tax exemption to a degree that no other city in the country is exposed, and it has been imposed upon with the burden of a huge unfunded pension liability incurred by the Federal Government.

Now, in addition to recognizing the fundamental taxation differences between the Nation's Capital and the other major cities across the United States, it is also important to recognize the significant difference in the control of expenses that has been established in the District of Columbia as a result of the District of Columbia Financial Responsibility and Management Assistance Act of 1995.

The favorable reception by Congress to the District's 1997 budget demonstrates that the Control Board established by this act is effective with respect to District expenses. Now is the time for Congress to address the issue of taxation within the District upon which the future of our Nation's Capital is at stake.

Over the last 25 years, the District of Columbia has lost 200,000 citizens with its population decreasing from 750,000 to 550,000. At an accelerating rate, District residents are leaving for the lower taxes and better services of Virginia and Maryland, and who can blame them?

In the Nation's Capital, there is even a question as to whether or not the water is safe to drink. Those who can afford to leave do so, and as they do, the District's tax base continues to shrink. The only way to prevent further deterioration in the District of Columbia is to make it a sufficiently attractive place to live, such that its residents will choose to remain rather than to move away.

Some say that jobs in the District of Columbia are important, and they are, but they are not as important as working residents. I am always amazed by the fact that the District of Columbia has 670,000 jobs, as compared to just 550,000 residents. We have more jobs here than we have people living here, but the problem is that most people who work here don't live here.

From my own experience, the operations center at Riggs Bank is a good example of this phenomenon. A year ago, we chose to move our operations center with its 600 employees from downtown Washington, DC, to Prince Georges County. We moved for significantly lower real estate taxes and because most of our work force had already preceded us in leaving the District.

Actually, at the time we moved, only 15 percent of our operations work force still resided in the District of Columbia, and the vast majority of our employees welcomed our move to Prince Georges County, where more of them already lived than anywhere else in the Washington metropolitan area.

In order to save the District of Columbia from further exodus, we need to give District residents a reason to stay, especially members of the middle class who are living and working to make their communities better in each of the District's wards.

That's exactly what Delegate Eleanor Holmes Norton's District of Columbia Economic Recovery Act does. It provides a progressive flat tax that will encourage wage earners to remain residents in the District, and it provides District businesses with a capital gains tax incentive for economic growth.

Now, just as there are many misconceptions about the District of Columbia, so are there many misconceptions about Delegate Norton's tax bill. One erroneous claim is that it will create a tax haven for the rich. The Norton proposal only provides a Federal flat tax to District residents and only for their income derived locally from within the Washington metropolitan area. Income from outside the metropolitan area would not benefit from Delegate Norton's progressive flat tax proposal.

Moreover, local District income taxes would continue to be the highest in the metropolitan area. District residents subject to any benefits from the progressive flat tax would have to cope with the many problems of the District exacerbated by many years of neglect and decay. This is hardly a formula for a tax haven to be sought after by the rich.

Those who fear Delegate Norton's bill goes too far also raise concerns that property values and rents will soar in the District making it unaffordable for many who already live here. In my opinion, this is a needless concern.

Under the Norton proposal, a family of four earning \$40,000 annually, would save \$2,500 in Federal income taxes. While this might give a family already living in the District reason to stay, it is unlikely to give a family in the suburbs enjoying its neighborhood and local government services, especially education, reason to move.

The greatest risk to the District is that nothing will be done to make it attractive to residents. In that case, the District is in a death spiral. Residents will continue to leave for lower taxes and better services. The District will be forced to look to a shrinking tax base for its revenues which will only mean further reduction in services and higher taxes for those who remain, thus accelerating migration from the District even more.

No matter what else is done, if the District is not provided with a means to stabilize its own local tax base, its only means of sur-

vival is an ever continuing and increasing bailout from the Federal Government.

In closing, I would like to report the summary of McKinsey & Co., Inc. and the Urban Institute in their October 1994 report to the Federal City Council, "Assessing the District of Columbia's Financial Future." And I quote:

Two-thirds of the District's financial problem is on the revenue side. While the District shares with other cities the loss of tax-paying residents, it is unlike any other city in that the financial effects of this loss hit the District immediately, and there is no dampening mechanism such as the nonresident income tax or state transfer payment to cushion the blow.

In my opinion, the blow that McKinsey & Co. and the Urban Institute are referring to is fatal without the enactment of enlightened legislation such as the District of Columbia Economic Recovery Act which Delegate Norton has proposed.

I have worked closely with Delegate Norton in assisting her to create this bill, and I am convinced that it is in the best interests, not just for the Nation's Capital itself, but for our entire country. Failure to provide the District of Columbia with a means to stabilize its tax base and begin growing again will only cost the Federal Government more in the end to clean up the mess that is now being created.

No amount of cost savings in the District of Columbia will be able to keep up with the District's shrinking tax base as its citizens leave, and they will leave absent a change in tax policy. The past 25 years have made that obvious.

However, there is a tax solution, namely the District of Columbia Economic Recovery Act. Overnight, it would establish economic stability, and the District would become perceived as a reasonable place to live. Is that asking too much for the capital of the free world?

Thank you.

[The prepared statement of Mr. Coughlin follows:]

TIMOTHY C. COUGHLIN, PRESIDENT
RIGGS NATIONAL CORPORATION
DISTRICT OF COLUMBIA ECONOMIC RECOVERY ACT TESTIMONY
DISTRICT OF COLUMBIA OVERSIGHT SUBCOMMITTEE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
HOUSE OF REPRESENTATIVES
CONGRESS OF THE UNITED STATES
JULY 31, 1996

Chairman Davis, Delegate Norton and other representatives of the District of Columbia Oversight Subcommittee, I appreciate the opportunity to appear before you today and testify on behalf of the District of Columbia Economic Recovery Act.

I have three important perspectives for supporting this bill. First, I am President of Riggs National Corporation, the oldest and largest banking company headquartered in the nation's capital. Second, I am a resident of the District of Columbia where I have lived with my wife and four children for more than twelve years. But most importantly, I am an American citizen who loves his country and cares about its capital.

Across the nation there are many false impressions about the District of Columbia which I would like to use this testimony opportunity to correct. While I realize that members of this subcommittee are well familiar with the true facts that I am about to

enumerate, I ask for your indulgence so that the record may be set straight and so that a factual basis may be set for my comments on Delegate Eleanor Holmes Norton's bill to implement a federal "progressive flat tax" for the District of Columbia.

I have often heard it said that the District of Columbia is just like any other large city in the United States, but such a statement could not be further from the truth, especially when it comes to taxes.

The first and most important difference to recognize is that the District cannot charge income taxes on the vast majority of those who work within its borders. Not only is the nation's capital prohibited from charging income taxes on members of Congress and the White House and their staffs, it cannot charge taxes on the incomes of the two-thirds of its working population who live outside the District in Virginia and Maryland. Is the rest of the country aware that the District is denied the very same non-resident income tax that is the right of every other local government in the United States? Do the citizens of the United States realize that their nation's capital is short-changed an estimated \$1.4 billion of income tax revenue by not having the same non-resident income taxation rights as every other jurisdiction?

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Perhaps the most egregious difference between the nation's capital and other major cities across the country is the tax which the District of Columbia must impose upon its residents to pay for the unfunded pension liability incurred by the federal government for District employees that were part of the federal work force before home rule. Does the rest of America realize that it costs the District of Columbia \$230 million a year to service the \$3.3 billion pension liability which was the federal government's responsibility but which it never funded?

I could go on and on and on, but the simple facts I have already cited demonstrate that

the District of Columbia is not like any place else. The nation's capital is denied taxation rights that no other jurisdiction in the entire United States is denied; it is subject to federal and foreign government tax exemption to a degree that no other city in the country is exposed; and it has been imposed upon with the burden of a huge unfunded pension liability incurred by the federal government.

In addition to recognizing the fundamental taxation differences between the nation's capital and other major cities across the United States, it is also important to recognize the significant difference in the control of expenses that has been established in the District of Columbia as a result of the District of Columbia Financial Responsibility and Management Assistance Act of 1995. The favorable reception by Congress to the District's 1997 budget demonstrates that the "control board" established by this act is effective with respect to District expenses. Now it is time for Congress to address the issue of taxation within the District upon which the future of our nation's capital is at stake.

Over the last twenty-five years, the District of Columbia has lost 200,000 citizens with its population decreasing from 750,000 to 550,000. At an accelerating rate, District residents are leaving for the lower taxes and better services of Virginia and Maryland,

and who can blame them? In the nation's capital, there is even a question as to whether or not the water is safe to drink. Those who can afford to leave do so, and as they do, the District's tax base continues to shrink. The only way to prevent further deterioration in the District of Columbia is to make it a sufficiently attractive place to live such that its residents will choose to remain rather than to move away.

Some say that jobs in the District of Columbia are important, and they are, but they are not as important as working residents. I am always amazed by the fact that the District of Columbia has 670,000 jobs as compared to 550,000 residents. We have more jobs here than we have people living here, but the problem is that most people who work here don't live here.

From my own experience, the operations center at Riggs Bank is a good example of this phenomena. A year ago we chose to move our operations center with its 600 employees from downtown Washington to Prince George's County. We moved for significantly lower real estate taxes and because most of our work force had already preceded us in leaving the District. Actually, at the time we moved, only 15% of our operations work force still resided in the District of Columbia, and the vast majority of our employees welcomed our move to Prince George's County where more of them

already lived than anywhere else in the Washington metropolitan area.

In order to save the District of Columbia from further exodus, we need to give District residents a reason to stay, especially members of the middle class who are living and working to make their communities better in each of the District's wards. That's exactly what Delegate Eleanor Holmes Norton's District of Columbia Economic Recovery Act does. It provides a progressive flat tax that will encourage wage earners to remain residents of the District, and it provides District businesses with a capital gains tax incentive for economic growth.

Just as there are many misconceptions about the District of Columbia, so are there many misconceptions about Delegate Norton's tax bill. One erroneous claim is that it will create a tax haven for the rich. The Norton proposal only provides a federal flat tax to District residents and only for their income derived locally from within the Washington metropolitan area. Income from outside of the metropolitan area would not benefit from Delegate Norton's progressive flat tax proposal. Moreover, local District income taxes would continue to be the highest in the metropolitan area. District residents subject to any benefits from the progressive flat tax would have to cope with the many problems of the District exasperated by many years of neglect and

decay. This is hardly a formula for a tax haven to be sought after by the rich.

Those who fear Delegate Norton's bill goes too far also raise concerns that property values and rents will soar in the District making it unaffordable for many who already live here. In my opinion, this is a needless concern. Under the Norton proposal, a family of four earning \$40,000 annually would save \$2,500 in federal income taxes. While this might give a family already living in the District reason to stay, it is unlikely to give a family in the suburbs enjoying its neighborhood and local government services, especially education, reason to move.

The greatest risk to the District is that nothing will be done to make it attractive to residents. In that case, the District is in a death spiral. Residents will continue to leave for lower taxes and better services. The District will be forced to look to a shrinking tax base for its revenues which will only mean further reduction in services and higher taxes for those who remain, thus accelerating migration from the District even more. No matter what else is done, if the District is not provided with a means to stabilize its own local tax base, its only means of survival is an ever continuing and increasing bailout from the federal government.

In closing, I would like to report the summary of McKinsey & Co., Inc. and the Urban Institute in their October 1994 report to the federal city council, "Assessing the District of Columbia's Financial Future."

Two-thirds of the District's financial problem is on the revenue side.

While the District shares with other cities the loss of tax paying residents, it is unlike any other city in that the financial effects of this loss hit the District immediately, and there is no dampening mechanism (e.g., non-resident tax, state transfer payment) to cushion the blow.

In my opinion, the blow that McKinsey & Co. and the Urban Institute are referring to is fatal without the enactment of enlightened legislation such as the District of Columbia Economic Recovery Act which Delegate Norton has proposed. I have worked closely with Delegate Norton in assisting her to create this bill, and I am convinced that it is in the best interest not just for the nation's capital itself, but for our entire country. Failure to provide the District of Columbia with a means to stabilize its tax base and begin growing again will only cost the federal government more in the end to clean up the mess that is now being created. No amount of cost savings in the District of Columbia will be able to keep up with the District's shrinking tax base as its

citizens leave, and they will leave absent a change in tax policy. The past twenty-five years have made that obvious.

However, there is a tax solution, namely the District of Columbia Economic Recovery Act. Overnight, it would establish economic stability, and the District would become perceived as a reasonable place to live. Is that asking too much for the capital of the free world?

Mr. DAVIS. Tim, thank you very much. I want to thank all of you very much.

Let me start the questioning and try to get a regional perspective on this. Do you think that H.R. 3244 is going to, as the Joint Committee on Taxation says, basically be zero sum game raiding of revenue from the suburbs into the city, or do you think this is going to be a proposition that grows the regional base? Holly, let me start with you.

Mr. CANTUS. Well, Mr. Chairman, as I said, we haven't done a detailed analysis as some organizations have, but I think an intuitive answer is going to be accurate in this case. And the answer is no, it's not a zero sum game, any more than OMB's economic projections are a zero sum game.

In fact, if our core city, if you will—and I have no problem calling it that, even though I'm from a different State—if our core city improves its economy, it's going to help our economy.

As I said in my statement, very frequently we will use the geographical proximity of the District and the tangible and intangible relationships we have with the District as a major selling point for convincing new businesses to come, not from the District but from other places, into Fairfax County.

Therefore, in any situation where the District economy becomes more attractive, it has got to help the economy of the entire region.

Mr. DAVIS. Diane, do you have any perspective?

Ms. DUFF. Sure.

Mr. DAVIS. The board of trade represents the whole region, correct?

Ms. DUFF. That's correct. The board of trade has been very consistent in advocating a healthy core for the growth of the entire region. Through our State of Potomac activities, which have brought the various jurisdictions together, we keep seeing how job growth in one area tends to promote the entire region.

So there are plenty of statistics out there that support the fact that if you grow jobs and resident income here in the District of Columbia, it's certainly going to support the region's economy. So we do not believe that it is a zero sum game.

Mr. DAVIS. Kwasi, let me ask you. The D.C. Chamber, are you working with the executive and the Council, now? Not just to computerize records, but to try to reform rules and regulations to make the city more business-friendly? I mean taxes help.

Mr. HOLMAN. Yes.

Mr. DAVIS. But can't the city do more on its own?

Mr. HOLMAN. Absolutely.

Mr. DAVIS. That, coupled with taxes, maybe can bring a greater synergy than just acting in a regular forum.

Mr. HOLMAN. Sure. What we're doing right now, as I said, we're working with, for example, the Department of Employment Services and the unions on workers compensation. We've looked at unemployment compensation.

We are looking, with the Department of Consumer and Regulatory Affairs, not just at the permitting process, but working with other organizations, we're looking at the whole regulatory process and trying to keep that in line with what at least surrounding ju-

risdictions do in terms of the level of regulation, as well as the time it takes to get permits processed.

So that is certainly part of what I believe the Mayor is looking for when he talks about creating this super business regulatory agency.

A lot of the reforms that we're doing will benefit other areas of the Government. For example, if we get a common property base and a common business base, a lot of the anomalies that were referenced earlier about people who pay Federal taxes and don't pay D.C. taxes won't necessarily happen anymore, because there will be a common data base within the Government.

Right now, there are separate data bases within a number of agencies that really impede things, not just tax collection, but just pure efficiency, that drive businesses crazy. So I think that we are going to stay on this track, because this is where the gold is for our members.

Mr. DAVIS. Do you have any timing on that?

Mr. HOLMAN. We're estimating right now that we should have the first improvements to the permitting process concluded by the end of August. We're going to work like heck to make that happen, but we're fairly confident that we can at least get that phase done.

Ultimately, what they need is what some of the other jurisdictions have, which is a geographic information service that will link up every bit of information from the subterranean level up to the sky in terms of what's there, what the permitting is, and so forth, but that's a \$2 million proposition, and I think we'll build toward that. But certainly, we think we're making progress.

Mr. DAVIS. Tim, let me say, Riggs has had a longstanding commitment to the city. The Pennsylvania Avenue closure probably hasn't helped your downtown office too much, but we admire you all for sticking with it.

What effects do you think this would have on businesses moving into the city, people moving in? Any anecdotal tales, if you don't have anything solid? Economists seem to disagree over what the effect would be. I suspect the variables of education and crime and those things that are still going to, to the extent you can fix them, along with taxes, hasten the synergy and the effectiveness of what we do. Nevertheless, I just wonder if you have a perspective on that.

Mr. COUGHLIN. Well, I do. I guess I would first just like to address the zero sum game argument. I find that to be the most ridiculous statement. I have a graduate economics degree, so I can talk economics, as well as business.

To talk zero sum game is to deny economic history, because, when you think about it, if you talk a zero sum game, you're saying there's no economic growth. If there's no economic growth, what has happened in this country? What has happened to this area? We've achieved incredible growth, and what Eleanor Holmes Norton's bill does is provide an incentive for that growth to resume in the District, which I think is terribly important.

In terms of the business of Riggs, what we see is an attractiveness to the Washington area which has a drawback, and that drawback is the District. I think that if we could have the Dis-

strict participate in the growth, that we would have net growth throughout the entire region. I think it's just as simple as that.

Mr. DAVIS. Thank you very much. Ms. Norton.

Ms. NORTON. Thank you, Mr. Chairman. In light of the hour, I would like simply to pose one question to the four witnesses. First, I want to thank them for their testimony, and especially so because we've had lots of speculation about what will happen and what will not happen.

In light of the lack of data in the literature, I have to say to you, the most compelling testimony for me comes from you, because you have lived with the problems of the city and the region and observed at close hand and had to pay the price for those problems, so that your testimony was particularly important to receive here today. I found it very helpful and very enlightening.

To the two regional witnesses, Ms. Duff and Mr. Cantus, you have broken a stereotype here today that exists all over this city, and that is that the region would reflexively oppose tax relief for District residents.

I hope I will be carrying the message to the neighborhoods for those who don't get it, what was said here, because you reinforce the notion this is one region and that those who do business in the region understand that better than most.

When Dr. Fuller brings forward 67 percent of the businesses saying you need tax relief in the District and says, "Well, you know, they're always for tax relief," I can only say to you that I know that the business people are not always for tax relief and that they are very selective in where they think tax relief should go and they consider their own circumstances and consider whether they would be competitive or noncompetitive.

So I just want to say for the record that you've performed an important service here today simply in explicating not only your reasons but in light of your own experience.

You also helped me to understand the notion of "Which comes first, the chicken or the egg? The residents or the businesses?" and it seems pretty clear that business people would not look first and say, "Let me just go there before there are some folks there who can do the jobs." You've helped me in that regard, since we were kind of chasing our tails in that way, too.

Perhaps you can help me, finally, in the question I would like to pose to each of you. There has been talk, "Well, maybe we can do the enterprise zone type parts of the Norton bill." That, of course, would mean perhaps some tax relief for businesses. Do you think that would do the job?

Mr. COUGHLIN. May I take that question on first? Because I think that the example that I cited in terms of our operations center is illustrative.

We live in a metropolitan area where transportation is very easy throughout the jurisdictions. Someone can choose to work in one area, in one jurisdiction, and live in another area. It's absolutely no problem. That's why, when we moved to Prince Georges County, only 15 percent of our operations work force resided in the city, and we actually followed them out into the suburbs.

I think if you create business opportunity, even if you create additional jobs in the District, if you do not make this a capital which

is an attractive place to live, it's very easy to live outside, and you are still going to have the same fundamental problem of shrinking tax base that you have now.

I would just also like to comment, if I could, going back to the chairman's earlier question about whether it's a zero sum game or economic growth. Riggs is fortunate to do business with most of the Embassies in town, and, as a result of that, I often go overseas. I'm constantly amazed when I see the amount of business activity that is going on in every nation's capital of the world except this one.

In every nation that I can think of, the capital of each of those nations is the center of business activity, and here it is not. I think that one of the most important things that we have to recognize is that Washington, DC, is not well perceived.

The best thing that I can think of in connection with this proposed bill by Delegate Norton is that you would have an immediate perception that Washington is a place receptive to doing business which welcomes the residents and is a good place to live.

The effect of that on the entire Washington area would be enormous, because when people think of Washington—we're talking regionally—they don't really think of just, "Well, you've got the District with its borders, and then you've got Virginia, and you've got Maryland."

When they think of Washington, they think of the entire Washington area, and if you have a weak link, one as weak as the Nation's Capital is, in the center of that area, it is going to adversely affect business opportunity for everyone.

On the other hand, if you could create a growing and thriving District through enlightened legislation, it would be like a magnet for business opportunity for the entire area, and would increase the growth not only in the District, but in the entire metropolitan area, as well.

Mr. HOLMAN. I would just say that without affecting the residents and the desire to stay in the city, you're going to continue to have the kind of weak tax base that you have, and businesses will have to chip and, and they may leave because of that.

But where are the customers for the business? Where are the customers for the small neighborhood grocery stores and dry cleaners? Where are the customers for the Bell Atlantics and the other utilities? Without residents, any city is just buildings, and that's not what we need.

That's why we've worked very carefully with the Congresswoman on this bill, because we know that it addresses the critical issues that will affect the long-term viability of the city. And so we would hope that the bill wouldn't be divided in that way.

Mr. CANTUS. Ms. Norton, I would agree that I would not want to see the bill divided, but only because I don't believe even the total bill is the total solution. Let me just give you one anecdotal example—that's redundant. Let me give you one example.

In one of my previous incarnations, I was an associate administrator of NASA after Challenger. We had to decide where to move the ill-fated space station office.

We did excruciating studies, as NASA is wont to do, in extreme detail, with no hypothetical new residents for the area, but for people who knew they were coming to Washington, period. The ques-

tion was whether they were coming to Maryland, to the District, or to Virginia. Where were we going to put that office?

We did excessively long, I thought—as a Virginian, I thought it was a long and unnecessary study. On the other hand, what we found was that these thousand or so engineers and scientists and their families did not really ask about the tax burden.

It was one of their questions, of course. And they were coming from Texas, and some from Alabama, where the tax burden was not very high. But the tax burden was not question one. Question one was education; question two was quality of life; question three was safety.

Those were the elements on which they made their decision and on which the agency made the decision, and, I'm happy to say, Mr. Chairman, that it went into your district—or just next door, close enough.

Mr. DAVIS. It went into Fairfax County, though; right?

Mr. CANTUS. Fairfax County. Right. So I am rather a cynic on how much this burden of taxes is chasing residents out of the District or chasing residents out of anyplace.

In the District in particular, as I mentioned in the statement, an awful lot of folks in that middle-income bracket have moved to Prince Georges, where the total tax burden is even higher than the District.

This wanders a bit away from the answer. My point is, I don't think taxes were the principal reason for chasing people away. I don't think tax relief is the principal reason for bringing them back, but it's a big reason, and it has to be both personal and business-oriented tax relief.

Mr. DAVIS. Thank you.

Ms. DUFF. I would echo the comments of the rest of the panel, but I would add that, as I indicated in my testimony earlier, that I would agree that this bill alone is not going to be the answer to correcting the District's problem.

It's going to take a lot of work on both sides, the Federal and the local level, to address the issues that Mr. Cantus just raised with regard to educational quality, quality of life, safety. But this is a great first step.

This is an important first step, and it's something that is important in terms of the Federal relationship to the Nation's Capital. So I would urge you not to separate those two items the way it was indicated earlier, and take a full first step instead of just half of one.

Mr. DAVIS. Thank you very much.

Ms. NORTON. Mr. Chairman, I won't even try to enlarge upon those answers. I think they were very complete and very useful. Thank you, Mr. Chairman.

Mr. DAVIS. Thank you. Let me just say, Senator Mack very much wanted to testify today, but a scheduling conflict kept him from appearing. His statement is here and will be entered into the record if there is no objection. I want to thank Senator Mack for his interest, and I'm sorry he was unable to be with us today. Thank all of you.

Without objection, I ask unanimous consent that all written statements submitted by witnesses be made part of the record, that

a statement submitted by Montgomery County Executive Doug Duncan be made a part of the record, as well as the letter from Governor Parris Glendening, and that the record be held open for 2 weeks so that written submissions may be introduced as part of the permanent record of these proceedings.

[The information referred to follows:]

STATE OF MARYLAND
OFFICE OF THE GOVERNOR



PARRIS N. GLENDENING
GOVERNOR

ANNAPOLIS OFFICE
STATE HOUSE
100 STATE CIRCLE
ANNAPOLIS, MARYLAND 21401
(410) 974-3801

WASHINGTON OFFICE
SUITE 311
444 NORTH CAPITOL STREET, N.W.
WASHINGTON, D.C. 20001
(202) 638-2215
TDD (410) 333-3088

July 26, 1996

The Honorable Tom Davis
Chairman, House Government Reform and Oversight
Subcommittee on the District of Columbia
B-349A Rayburn House Office Building
Washington DC 20515

Dear Mr. Chairman:

Thank you for inviting me to comment on H.R. 3244, the District of Columbia Economic Recovery Act. Innovative thinking, such as that contained in this legislation, often produces effective solutions. I am concerned, however, that while the District's challenges require fresh ideas, the solutions proposed by this legislation raise several issues which must be addressed before H.R. 3244 moves forward.

As Governor of Maryland, I am deeply concerned about the future of the District of Columbia since its future will have a significant impact on our entire region. Although the District of Columbia is unique in its status as America's capital, its problems are common to those facing many of our nation's cities. While we all agree that the federal government must help resolve the financial challenges facing our nation's capital, I share your reported view that H.R. 3244 may be the wrong solution to the right problem.

From my own experience as Prince George's County Executive and as Governor of a state with urban areas, I understand the challenges facing America's cities. All across our nation, young families are leaving the inner cities for new suburbs. As Judge Otto Kerner warned America 25 years ago when he talked about race relations, we are in danger of having two separate societies: one rich and one poor, one with jobs and one without work, one living in huge homes and the other having huge numbers of homeless.

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In Maryland, we are working hard to encourage revitalization of urban areas through our "Smart Growth" initiative. As part of this initiative, we are modernizing existing schools and renovating existing libraries, fire and police stations. We also implemented a Job Creation Tax Credit which allows businesses that create 60 or more jobs in revitalization areas such as Baltimore and Takoma Park to double the amount of their tax credits. By using resources, ranging from highway funds to school construction projects, we are encouraging residents to live in more urbanized areas instead of developing costly new distant suburbs.

Unfortunately, if this federal tax cut for the District of Columbia becomes law, no matter how hard we in surrounding jurisdictions work to revitalize our urban areas and create jobs, we will never be able to offer as generous a tax cut as this legislation offers to District residents. Clearly, every American has an interest in revitalizing our capital city. This legislation, however, invites the question of whether Congress should use federal income tax law to favor one urban area over another.

Great urban centers of American life from Boston to Los Angeles face similar challenges in dealing with poverty, crime and urban revitalization. Yet this legislation favors one city over all others. I am concerned about using the federal tax code to favor the District of Columbia over Cumberland, Cambridge, Takoma Park or Baltimore in Maryland, or urban areas in other states such as Chicago, New York or Atlanta.

While we are working hard to create jobs and revitalize our communities in Maryland, our work is far from over. Communities that border the District such as Silver Spring and Capital Heights could be hardest hit by this legislation, with no way to compensate for a loss of residents or jobs. Because state income taxes are so much lower than federal rates, even cutting a state rate to zero would not give as much aid to residents of larger cities than is offered to District residents in this bill.

Although carefully targeted tax credits can be used effectively to create jobs, I am also concerned that an across-the-board federal income tax cut will not address the problems of poverty, crumbling schools, or urban violence. Tax cuts are simply not the answer to every problem. A tax cut will not feed a hungry child. A tax cut will not renovate an old schoolhouse. A tax cut will not put more police officers on the streets to fight crime. Surely, basic District services such as police, fire, teachers, and libraries can be improved at considerably less cost than the price tag associated with this proposal.

There is still much work to be done in revitalizing urban America. The problems of

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poverty, violence and urban revitalization demand hard work, tough decisions, and investment by government in basic services. Given the historic relationship between the District of Columbia and the federal government, there is little doubt that the federal government must meet its financial obligations to the citizens of the District. Although fiscal crises demand innovative solutions, the concerns I have raised about H.R. 3244 must be addressed before this legislation moves forward.

Thank you for considering my views in this matter. Please feel free to call me if you have any questions or need additional information.

Sincerely,



Parris N. Glendening
Governor

cc: The Honorable Paul S. Sarbanes
The Honorable Barbara A. Mikulski
The Honorable Steny H. Hoyer
The Honorable Benjamin L. Cardin
The Honorable Constance A. Morella
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The Honorable Robert L. Ehrlich, Jr.
The Honorable Elijah E. Cummings
The Honorable William V. Roth, Jr.
The Honorable Bill Archer
The Honorable Eleanor Holmes Norton

Ms. NORTON. Mr. Chairman, if you'll yield a moment, I move that a certain editorial in favor of the bill be printed in the record.

Mr. DAVIS. Without objection, so ordered.

[The information referred to follow:]

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Tax relief: A Capitol idea

A proposal put forth by D.C. Delegate Eleanor Holmes Norton (D) aimed at reviving the moribund economy of the District of Columbia by sharply reducing federal income taxes for District residents picked up some critically important and much-needed support over the weekend from House Speaker Newt

Gingrich (R-Ga.).

Gingrich, who recently emerged from several months of self-imposed hibernation while he pondered the reasons for a downturn in his party's political fortunes, demonstrated that he is serious about helping the nation's capital address its myriad of economic and social problems.

"We are looking very seriously... at a very dramatic tax change for the city of Washington to literally create an incentive for people to move back into the city," Gingrich declared on ABC's "This Week with David Brinkley" program. "This city has had a hemorrhage for 15 years of people who work for a living. They've moved out to the suburbs, and the result is the city is imploding. To have your national capital implode is a disaster."

Norton, who is proving to be an aggressive and effective champion of her disenfranchised constituents, met last week with Gingrich and Senate Majority Leader Trent Lott (R-Miss.) to discuss her tax cut proposal, which she introduced earlier this year. The plan already has the backing of the number two Republican in the House, Majority Leader Dick Armey (Texas), and Lott said Monday he will become a co-sponsor of the bill.

Both Gingrich and Norton will be meeting with other lawmakers in the coming days to seek more co-

sponsors for her bill, which would lower federal income tax rates for D.C. residents from a current maximum of almost 40 percent for higher-income taxpayers with a flat 15 percent rate for everyone.

Under Norton's bill, D.C. residents also would be exempted from paying capital gains taxes on the sale of investments in the District, while mortgage interest deductions and charitable contributions would remain unchanged. Similar legislation has been introduced in the Senate, which would eliminate capital gains taxes for anyone investing in D.C., regardless of where they live, and would also offer a tax break to first-time homebuyers.

While there are serious questions about how much the proposed D.C. tax cut will cost the U.S. Treasury in lost annual revenues — the best estimate seems to be about \$700 million — the cost of getting the city back on its financial feet is probably less than it would be if it continues on its present path towards bankruptcy.

While Norton views the bill as an emergency measure to slow the flight of middle-class and wealthy District residents to the Maryland and Virginia suburbs to escape high crime rates, substandard schools and poor public services, Gingrich may view it in a slightly different light.

Even though he lives on Capitol Hill, the Speaker probably sees the Norton proposal more as an election year opportunity for showcasing Republican efforts to stimulate economic growth by cutting taxes, than he does strictly as an effort to rescue the District's faltering economy.

Whatever his reasons, we applaud the Speaker's leadership, along with that of Del. Norton, and we hope many more members of both parties in the House and Senate will support this much-needed legislation.

*Trying
to avert
disaster*

Mr. DAVIS. Thank you all again for testifying. These proceedings are closed.

[Whereupon, at 4:10 p.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]



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MEMORANDUM

July 18, 1996

SUBJECT: Constitutional Issues Raised by a Proposal to Limit Application of the Federal Income Tax on District of Columbia Residents (H.R.3244, §2 (104th Congress))

AUTHOR: Thomas B. Ripy

This general distribution memorandum has been prepared in response to several congressional inquiries concerning §2 of H.R.3244 (104th Cong.) and the uniformity clause of the Constitution. Briefly, §2 of H.R.3244 would limit the federal income tax imposed on residents of the District of Columbia. Constitutional considerations raised by such a geographically based tax benefit include:

1) The District of Columbia appears to be treated the same way as any State in the application of the limitations imposed by the body of the original Constitution. In other words, direct taxes have to be apportioned and indirect taxes must satisfy the uniformity requirement. Income taxes may be levied regardless of the source of the income. The latter is permitted under the 16th Amendment, designed to nullify the *Pollock* decisions, discussed below. That amendment would have no effect on the application of an indirect tax limitation.

2) Assuming that the income tax is in whole or part an indirect tax and that the District of Columbia is to be treated as part of the United States for the purposes of the application of the uniformity clause, then a proposed amendment to the Federal income tax providing special limits on the application of the Federal income tax to D.C. residents must satisfy the uniformity requirement tests to pass constitutional muster.

3) Earlier court decisions on the uniformity clauses of the Constitution seemed to impose a barrier against any geographically based distinctions. More recent decisions suggest that geographical descriptions in providing special statutory tax treatment may be accepted, but the courts will examine such schemes closely to see if there is actual geographic discrimination. The uniformity requirement of the Constitution appears to have been interpreted to mean that a tax provision cannot survive if it discriminates geographically between regions of the country. It cannot survive if the only reason for the disparate treatment is geographical. However, if there is some rational,

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geographically neutral basis for the treatment, then it may survive constitutional scrutiny.

For purposes of this analysis, the proposed limitation is treated solely as an exercise of Federal taxing power. In this context, what the Congress could do when acting as a legislature for the District of Columbia is irrelevant. We have done so because the tax involved was not enacted on the basis of the legislative power of Congress over the District of Columbia but pursuant to its taxing power as the national legislature. In that context, the significant constitutional provisions are the following:

I. The Congress shall have the power to lay and collect Taxes, Duties, Imposts and Excises ... but all Duties, Imposts and Excises shall be uniform throughout the United States[.] Article I, Sec. 8, cl. 1.

II. Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union[.] ... The actual Enumeration shall be made within three Years after the first Meeting of the Congress of the United States, and within every subsequent Term of ten Years, in such Manner as they shall by Law direct. Article I, Sec. 2, cl. 3.

III. No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census of Enumeration herein before directed to be taken. Article I, Sec. 9, cl. 4.

IV. The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration. 16th Amendment.

One might anticipate that since the constitutional provision quoted in II above requires apportionment among the "States" there could be no direct tax upon D.C. residents, since D.C. is not a State. Not so, according to the Supreme Court decision in *Loughborough v. Blake*, 5 Wheat.(18 U.S.) 317 (1820). In that case the sole question before the Court was whether the Congress had a right to impose a direct tax on the District of Columbia. The Court said yes. In an opinion by Chief Justice Marshall, the Supreme Court reasoned that:

The 8th section of the 1st article gives to Congress the 'power to lay and collect taxes, duties, imposts and excises' for the purposes thereafter mentioned. This grant is without limitation as to place. It, consequently, extends to all places over which the government extends. If this could be doubted, the doubt is removed by the subsequent words which modify the grant. These words are, 'but all duties, imposts and excises, shall be uniform throughout the United States.' It will not be contended that the modification of the power

extends to places to which the power itself does not extend. *The power then to lay and collect duties, imposts and excises, may be exercised, and must be exercised throughout the United States.* ... The [D]istrict of Columbia ... is not less within the United States, than Maryland or Pennsylvania; and it is not less necessary, on the principles of our [Constitution], that uniformity in the imposition of imposts, duties, and excises should be observed in the one, than in the other. Since, then, the power to lay and collect taxes, which includes direct taxes, is obviously co-extensive with the power to lay and collect duties, imposts and excises, and since the latter extends throughout the United States, it follows, that the power to impose direct taxes extends also extends throughout the United States. [Emphasis added.]¹

In addressing the requirement that direct taxes be apportioned among the "States" based on the enumeration, Chief Justice Marshall says, in substance, that this is a condition, not a limit, on the exercise on the power of Congress when levying a direct tax. In brief, Congress has the power to extend a direct tax to the District if it elects to do so. If it does so, the tax must be apportioned on the basis of the enumeration. In his discussion the Chief Justice adopts a (direct v. indirect) categorization of taxes which resonates in subsequent cases interpreting these provisions. Rejecting the want of elected representation in Congress as a basis for distinguishing the District from the States for the purposes of the application of Federal taxing power, the Chief Justice notes that the stamp act and the duty on tea which were the source of discontent leading to the American Revolution were not direct taxes, but taxes of the type to which the uniformity clause extends and which the Constitution "not only allows, but enjoins the government to extend ... to this district."² Insofar as the apportionment requirement is concerned, he adds: "If it be said that the principle of uniformity, established in the constitution, secures the district from oppression in the imposition of indirect taxes, it is not less true, that the principle of apportionment, also established in the constitution, secures the district from any oppressive exercise of the power to lay and collect direct taxes."³

While at first blush it might seem plausible to argue that there might be a category of taxes which are not direct taxes subject to the apportionment requirement and not "duties, imposts or excises" subject to the uniformity requirement, subsequent judicial decisions appear to treat taxes as direct or

¹18 U.S. 317, 319.

²*Id.* at 324-325.

³*Id.* at 325.

indirect. Those falling within the latter category are subject to the uniformity requirement.⁴

Collectively these judicial decisions suggest that, if the special treatment which would be accorded District of Columbia residents under H.R.3244 (104th Congress) involves "indirect" taxes, the courts would apply the uniformity clause in scrutinizing their constitutionality.⁵ Thus, a significant question which must be addressed is whether the special treatment of District of Columbia residents for income tax purposes, involves exceptions to an "indirect" tax subject to the uniformity clause requirements or exceptions to a "direct" tax.

But for *Pollock v. Farmers' Loan & Trust Co.*⁶ invalidating the 1894 federal income tax law, there would seem little doubt that income taxes are to be treated as "indirect" taxes, subject to the uniformity clause. An examination of judicial decisions preceding and subsequent to *Pollock* suggests that the decision may have been an aberration.

Briefly, the first *Pollock* decision struck down the tax as applied to income from real property and from state and municipal bonds,⁷ and the second invalidated the tax on income from certain personal property, such as stocks and bonds. Taxes on the income from property, real and personal, were viewed as taxes on property itself, thus direct and invalid because not apportioned. While the Supreme Court viewed the tax as applied to earned income as indirect, not subject to the apportionment requirement, and valid standing alone,⁸ it found that Congress would not have enacted those portions had it known that the taxes on income from property and state and local bonds were unconstitutional. Finding those provisions not severable, the entire act was declared invalid.

⁴See, e.g., *United States v. Ptasynski*, 462 U.S. 74 (1983) (crude oil windfall profits tax); *Steward Machine Co. v. Davis*, 301 U.S. 548, 581 (1937) (social security tax); *Brushaber v. Union Pacific R. Co.*, 240 U.S. 1, 12-13; see also, *Knowlton v. Moore*, 178 U.S. 41, 83-110 (1900) and *Nicol v. Ames*, 173 U.S. 509, 515, et. seq., where the Court assumes that if taxes are not "direct" within the meaning of the apportionment clause they are "indirect" and subject to the uniformity clause.

⁵For purposes of the application of the uniformity clause to territories, the Supreme Court appears to distinguish between incorporated and unincorporated territories, applying it to the former but not the latter. Compare, *Downes v. Bidwell*, 182 U.S. 244 (1901) and *Binns v. United States* 194 U.S. 486 (1904).

⁶157 U.S. 429, modified on rehearing, 158 U.S. 601 (1895).

⁷As to the state and municipal bond portion of the opinion, see *South Carolina v. Baker*, 108 S.Ct. 1355, 1362-1368.

⁸158 U.S. at 637.

As early as *Hylton v. United States*⁹, the Supreme Court had said that direct taxes as contemplated by the Constitution were only two, a capitation or poll tax and a tax on land. That view appears to have been accepted until *Pollock*. Applying this rule the Supreme Court had upheld the Civil War income tax in *Springer v. United States*.¹⁰ In the context of these decisions, *Pollock* came as something of a surprise. Subsequent decisions suggest the Court may have had second thoughts about the *Pollock* cases and their rationale.

In the post *Pollock* period distinctions became strained as the Court upheld a variety of taxes as excises, which at first blush seemed potentially doomed. Thus, in *Knowlton v. Moore*¹¹ the Court upheld a progressive inheritance tax; in *Nicol v. Ames*¹² the Court upheld taxes on sales at exchanges or boards of trade; and in *Flint v. Stone Tracy Co.*¹³ the Court upheld a tax on the net income of corporations. These cases indicate that any proposal to treat Federal corporate income taxes or transfer taxes of D.C. businesses or residents in a special manner would be subject to scrutiny under the uniformity clause as indirect taxes.

The adoption of the 16th Amendment eliminated the necessity of strained distinctions between congressionally imposed taxes resulting from the *Pollock* holding. The language and history could have been read as accepting the Court's judgment that certain income taxes are direct, and thus, in the absence of the 16th Amendment, subject to the apportionment requirement as direct taxes. Accepting that idea would have meant that in the post 16th Amendment era, such taxes were not subject to either the apportionment limit or the uniformity requirement. This does not appear to have been the view that the Court adopted. Rather, it seems to have accepted the position that the 16th Amendment simply restored the prevailing view that income taxes were indirect.

Thus, in *Brushaber v. Union Pacific R. Co.*¹⁴ the Supreme Court stated that the 16th Amendment "forbids the application to [income] taxes of the rule applied in the *Pollock Case* by which alone such taxes were removed from the great class of excises, duties, and imposts ... and were placed under the other or

⁹3 U.S. 171 (1796).

¹⁰102 U.S. 586 (1881); *see also*, *Pacific Ins. Co. v. Soule*, 7 Wall. (74 U.S.) 433 (1869); *Veazie v. Bank of Fenno*, 8 Wall. (75 U.S.) 533 (1869); *Scholey v. Rew*, 23 Wall. (90 U.S.) 331 (1875).

¹¹178 U.S. 41 (1900).

¹²173 U.S. 509 (1899).

¹³220 U.S. 107 (1911).

¹⁴240 U.S. 1, 18-19 (1916).

direct class." And in *Stanton v. Baltic Mining Co.*¹⁵ the Court reiterated that "the Sixteenth Amendment conferred no new power of taxation but simply prohibited the previous complete and plenary power of income taxation possessed by Congress from the beginning from being taken out of the category of indirect taxation to which it inherently belonged and being placed in the category of direct taxation subject to apportionment"

In sum, case law seems to indicate that there is a high degree of probability that any congressional enactment providing special favorable treatment to District of Columbia residents under generally applicable Federal income taxes or transfer taxes (estate or gift) will be treated as "indirect tax" preferences and subject to scrutiny under the uniformity clause.

The uniformity demanded by this constitutional provision is geographical not intrinsic and does not preclude classification and progressive rates of taxation. This position has been repeatedly restated and applied by the Supreme Court.¹⁶ Briefly, these cases involved taxes that contained no geographical classifications, but produced results that varied geographically. In sum, it appeared that while Congress was not required to ignore special circumstances, it had to frame distinctions in nongeographic terms. However, in its most recent decision involving the uniformity clause the Court held that Congress, having ascertained a special circumstance that was geographically isolated, could constitutionally frame the exception to the tax statute in express geographic terms.¹⁷ That decision provides a potential basis for arguing that the special treatment, which the proposal would accord District of Columbia residents, might survive scrutiny under the uniformity clause.

The outcome could well turn on whether the Court, having deviated from an apparently settled course of interpretation - not squarely, of course, having never previously addressed the merits of an express geographic tax classification - will, in subsequent decisions, apply the latest precedent narrowly or incorporate its apparently more liberal view of the uniformity clause into those decisions.

The two most important cases prior to *Ptasynski* which address the meaning of the uniformity clause are the *Head Money Cases*¹⁸ and *Knowlton v. Moore*.¹⁹ In the former, a federal law imposed a charge on the carrier of

¹⁵240 U.S. 103, 112-113 (1916).

¹⁶*LaBelle Iron Works v. United States*, 256 U.S. 377 (1921); *Brushaber v. Union Pacific*, 240 U.S. 1 (1916); *Knowlton v. Moore*, 178 U.S. 41 (1900); *Head Money Cases*, 112 U.S. 580 (1884).

¹⁷*United States v. Ptasynski*, 462 U.S. 74 (1983).

¹⁸112 U.S. 580 (1884).

¹⁹178 U.S. 41 (1900).

each alien coming by sea from a foreign port to any American port. The purpose of the charge was to raise funds for administering the immigration laws and for aiding immigrants who found themselves in distress after arrival. Among the challenges to the enactment was the charge that it violated the uniformity clause because it did not apply to aliens arriving over inland borders (from Canada or Mexico) but only to those areas of the country where seaports were located. While the Court upheld the charge as a regulation (fee) under the commerce power, it also discussed why, even considered as a tax, the charge satisfied the uniformity requirement.

The tax is uniform when it operates with the same force and effect in every place where the subject is found. The tax in this case, which, as far as it can be called a tax, is an excise duty on the business of transporting passengers from foreign countries into this, by ocean navigation, is uniform and operates precisely alike in every port of the United States where such passengers can be landed.... [The law does not apply to passengers arriving by railroad or other inland mode of conveyance. But the law applies to all *ports* alike, and evidently gives no preference to one over another, but is uniform in its operation in all ports of the United States. It may be added that the evil to be remedied by this legislation has no existence on our inland borders, and immigration in that quarter needed no such regulation.²⁰

Thus, the Court did not demand "[p]erfect uniformity and perfect equality of taxation."²¹ It was geographic uniformity that was demanded, not some chimerical conception of equality in all respects. "The uniformity here prescribed has reference to the various localities in which the tax is intended to operate.... Is the tax on tobacco void, because in many of the States no tobacco is raised or manufactured? Is the tax on distilled spirits void, because a few States pay three-fourths of the revenue arising from it?"²² It was "substantial uniformity," taking into account differences throughout the country, that was required.²³

Knowlton remains the most thorough consideration of the meaning of the uniformity clause in the pre-*Ptasynski* era, containing a lengthy exposition of the movement in the Continental Congress and the Constitutional Convention for taxing and commerce regulation powers in a national Congress and the safeguards to be attached thereto. From this review, the Court determined that

²⁰Head Money Cases, 112 U.S. at 594-595; emphasis by the Court.

²¹*Id.* at 595.

²²*Id.* at 594.

²³*Id.* at 595.

its conclusion in *Head Money* had been correct, that is, the purpose of the clause was to prevent Congress from favoring one State or region over another.²⁴

In *Knowlton* the statute under attack included an inheritance tax, exempting smaller legacies and taxing larger ones at progressive rates. The Court first addressed and rejected the contention that the tax was invalid as an unapportioned direct tax, and then proceeded to examine the proposition that as an indirect tax it failed to pass the uniformity requirement because it did not operate precisely the same on all individuals or all property.²⁵ This standard, dubbed "intrinsic uniformity" was rejected by the Court in favor of a narrower one of geographic uniformity. The clause "simply requires that whatever plan or method Congress adopts for laying the tax in question, the same plan and the same method must be made operative throughout the United States; that is to say, that wherever a subject is taxed anywhere, the same must be taxed everywhere throughout the United States, and at the same rate."²⁶

The Court gave three reasons for concluding that the uniformity referred to in this clause of the Constitution was simply and solely geographic. First, the language of the clause suggested the more limited meaning. If "uniform" meant "equal and uniform" in the broader sense, that is, taxes must affect every person or all property identically, then nothing would be added by the phrase "throughout the United States" contained in the clause. The phrase does have meaning, however, if the clause is construed as a geographically based requirement, and such an analysis comports with the canon of construction that each word of the Constitution be given effect.²⁷

Second, giving the clause a broad construction would effectively place a wide range of subjects outside the federal taxing power, inasmuch as indirect taxes would rarely affect everyone equally. Few, if any goods and services are produced and consumed equally by everyone. Direct taxes might be more amenable to intrinsic uniformity, but these were subject only to the apportionment requirement. Adoption of the broader construction produced the anomalous result of applying the restraint to taxes where least appropriate and not to taxes where it would have been most appropriate. In contrast, the narrower view, that the limit was solely geographical, avoided the anomaly and harmonized the uniformity and apportionment clauses.²⁸

Third the Court reviewed the history of tax practices in the colonies and England, finding no evidence of any idea of "intrinsic" uniformity with respect

²⁴*Supra*, 178 U.S. 95-106.

²⁵*Id.* at 83-84.

²⁶*Id.* at 84-85.

²⁷*Id.* at 87.

²⁸*Id.* at 87-89.

to indirect taxes.²⁹ In contrast, it found convincing evidence that geographical uniformity was the focus of concern in its review of the history of the Continental Congress and the Constitutional Convention.³⁰

Applying this geographic uniformity standard, the Court found the tax under examination satisfied the uniformity requirement. While admitting that the impact of the tax varied from place to place, the Court denied that this made any difference. "The proposition in substance assumes that the objects taxed by duties, imposts and excises must be found in uniform quantities and conditions in the respective States, other wise the tax levied on them will not be uniform throughout the United States. But what the Constitution commands is the imposition of a tax by the rule of geographical uniformity, not that in order to levy such a tax objects must be selected which exist uniformly in the several States."³¹

Two propositions emerge from these decisions. First, uniformity is satisfied as long as the subjects of a tax are not specifically geographically identified, even though the effects are uneven because of the distribution of the subjects of taxation. So a tax on tobacco or distilled spirits, as the *Head Money Cases* indicate, is valid, even though the taxes collected vary considerably from area to area because tobacco and spirits are not produced equally in all areas of the country. On the other hand, a tax directed solely on "tobacco in the State of Maryland" would be suspect and probably invalid. Second, Congress can take into account special problems or evils in drafting tax law, thus, in the *Head Money Cases* the Court found it permissible to treat aliens entering through seaports as a distinct class even though other aliens entering at inland borders were not subject to a similar charge. Considerable congressional discretion is available within these parameters.

The remaining question is how the clause is to be applied where Congress sees a special problem but expressly defines it in geographic terms. The pre-*Ptasynski* cases suggest such an express geographic classification would run afoul of the uniformity clause. When the issue came before the Court in *United States v. Ptasynski*³², the Court upheld an exemption written in geographic terms. The exemption involved was contained in the Crude Oil Windfall Profit Tax Act of 1980.³³ Briefly, the law imposed an excise tax on domestic crude oil production, under a scheme which utilized a tiered system with varying rates for each tier and exempted certain production from the tax altogether. The classification scheme for the tiered system utilized a variety of nongeographic

²⁹*Id.* at 89-95.

³⁰*Id.* at 95-106.

³¹*Id.* at 108.

³²462 U.S. 74 (1983).

³³ P.L. 96-223, 94 Stat 229.

criteria related to production. The statute did, however, include a class of exempt Alaskan oil³⁴ (most oil produced north of the Arctic circle), and that class was defined in specific geographic terms.³⁵

Suit was brought in the District Court for the District of Wyoming by independent oil producers and royalty owners seeking a refund for taxes paid and contending that the statute violated the uniformity requirement of the Constitution. On a motion for summary judgment, the lower court held the act unconstitutional.³⁶ Relying on the *Head Money Cases* the court concluded that "[d]istinctions based on geography are simply not allowed."³⁷ Finding that the unconstitutional provision could not be severed from the remainder of the act, the District Court held the entire windfall profits tax unconstitutional.³⁸

In a unanimous opinion the Supreme Court reversed the District Court, holding this particular classification satisfied the uniformity clause.³⁹ In his opinion for the Court, Justice Powell reviewed the history of the framing of this provision, finding that it was designed to avoid undue preference of one area over another. Acknowledging that this general purpose does not define the precise scope of the clause, he then turns to judicial decisions interpreting the uniformity clause to provide a framework for analysis of this specific geographical exception. Reviewing the *Head Money Cases* and *Knowlton v. Moore* he concludes that the uniformity clause does not require equality in result nor prohibit drawing of distinctions between similar classes.

Insofar as the use of specific geographic definitions are concerned, Justice Powell notes that in the 1974 decision of the Court in the *Regional Rail*

³⁴ As the Court noted the exemption did not extend to all Alaskan oil but to less than 20% of the total Alaskan production. 462 U.S. at 77.

³⁵ The language of the exemption was expressly geographic:

any crude oil (other than Sadlerochit oil) which is produced-

(1) From a reservoir from which oil has been produced in commercial quantities located north of the Arctic Circle, or

(2) from a well located on the northerly side of the divide of the Alaska-Aleutian Range and at least 75 miles from the nearest point on the Trans-Alaska Pipeline System. 94 Stat. 244.

³⁶ 550 F.Supp. 549 (1982).

³⁷ *Id.* at 553.

³⁸ *Id.* at 554-555.

³⁹ *United States v. Ptasynski*, 462 U.S. 74 (1983).

*Reorganization Act Cases*⁴⁰ the Court upheld a similar challenge to a geographical classification of debtors challenged under the uniformity requirement of the bankruptcy clause.⁴¹ The reorganization statute was designed to address "geographically isolated problems."⁴² The mere fact that it utilized a geographical classification scheme did not render it void. In fact, it "operated uniformly throughout the United States", because it applied to "all railroads under reorganization pursuant to Sec. 77 during the time the Act applies."⁴³ In a subsequent decision, cited in a footnote in *Piasynski*⁴⁴, the Court held a bankruptcy provision addressing one railroad violated the uniformity provision, distinguishing it from the *Regional Rail* cases. "The conclusion is ... inevitable that [the statute] is not a response either to the particular problems of major railroad bankruptcies or to any geographically isolated problem: it is a response to the problems caused by the bankruptcy of one railroad."⁴⁵

Utilizing the principles it discerned from these earlier decisions the *Piasynski* Court proceeded to examine the geographical tax classification scheme in the case before it. In what may in some respects be an overstatement⁴⁶ the Court said:

Where Congress defines the subject of a tax in nongeographic terms, the Uniformity Clause is satisfied. See *Knowlton v. Moore*, 178 U.S., at 106. We cannot say that when Congress uses geographic terms to identify the same subject, the classification is invalidated. The Uniformity Clause gives Congress wide latitude in deciding what to tax and does not prohibit it from considering geographically isolated problems. See *Head Money Cases*, *supra*, at 595. This is the substance of our decision in the *Regional Rail Reorganization Act Cases*, 419 U.S., at 156-161. [footnote omitted] But where Congress does choose to frame a tax in geographic terms, we will examine the classification

⁴⁰419 U.S. 102.

⁴¹ Art. I, Sec. 8, Cl. 4.

⁴²419 U.S. at 159.

⁴³*Id.* at 161.

⁴⁴ 462 U.S. at 85, n.14.

⁴⁵*Railway Labor Executives' Ass'n. v. Gibbons*, 455 U.S. 457, 470 (1982).

⁴⁶ To say, as the Court does in the passage quoted below, that every tax phrased in nongeographic terms would satisfy the uniformity requirement suggests that Congress might constitutionally enact a provision in nongeographic terms, which is in fact drafted to single out a particular area and treat it in a discriminatory fashion.

closely to see if there is actual geographic discrimination. See *id.* at 160-161.⁴⁷

The Court viewed the statutory classification before it as more like the provision upheld in the *Reorganization Act Cases* than the provision struck down in the *Railway Labor Executives' Assn.* case. In reaching that conclusion and upholding the Alaska oil exemption the Court relied heavily on evidence that Congress viewed such oil as unique and for that reason requiring special treatment. "It had before it ample evidence of the disproportionate costs and difficulties - the fragile ecology, the harsh environment, and the remote location - associated with extracting oil from this region. We cannot fault its determination, based on neutral factors, that this oil required special treatment." 462 U.S. at 85.⁴⁸

It is against this judicial backdrop that the tax provisions of H.R. 3244 (104th Cong.) must be evaluated. Is there something unique about the income of District residents that might justify special treatment? Are there special problems unique to these taxpayers, that Congress has identified and is attempting to address? At this point one can only speculate as to what reasons might be offered and what evidence might be shown in support and opposition to such favored treatment of District taxpayers. Presumably the arguments in support will include the District's position as the seat of government, the extra demands placed on District taxpayers as a result, the financial difficulties of the District of Columbia government, the absence of voting representation in Congress for District residents, and the limits imposed on the D.C. tax base because of the presence of substantial federal property in the city. Opponents will argue that there is nothing really unique about D.C. or its residents that justifies this type of special treatment; other local governments are having financial problems, e.g. Bridgeport, Connecticut and Orange County, California; other jurisdictions have large amounts of property excluded from the tax base as federally owned; unlike exempt Alaskan oil, there is no history of special treatment of District taxpayers nor evidence that they face substantially more difficult burdens in earning a living, accumulating wealth, or transferring property. Supporters may urge that disparate treatment is justified by the lack of voting representation in Congress; while adversaries may be expected to maintain that this argument was considered and rejected by the Supreme Court long ago. Proponents will urge the Court to take a broad view of *Ptasynski*; opponents will urge a limited scope, arguing distinctions; and the outcome cannot be predicted with any degree of certainty.

Our examination of the precedents suggests the following: 1) It is probable that the courts would find that the uniformity clause applies to a limitation on

⁴⁷462 U.S. 84-85.

⁴⁸462 U.S. at 85. The Court also noted that Alaskan oil had previously been treated differently by the President and Federal Energy Administration under the price control system in effect prior to the adoption of the tax. 462 U.S. at 75-76 and 85, n.15.

the application of the Federal income tax to District of Columbia residents. 2) It is probable that the courts would view the Federal income tax as an indirect tax to which the uniformity requirement applies. 3) A classification that is framed in geographic terms is suspect but not necessarily constitutionally flawed. 4) The survival of such a geographical classification depends on a non-geographical, non-discriminatory, rational justification for such an exemption. 5) Such a justification for the proposed special treatment of District of Columbia residents can be argued, but its judicial acceptance is uncertain.



OFFICES OF THE COUNTY EXECUTIVE

Douglas M. Duncan
County Executive

**POSITION STATEMENT BY
DOUGLAS M. DUNCAN
COUNTY EXECUTIVE
MONTGOMERY COUNTY, MARYLAND**

**ON H.R. 3244
THE DISTRICT OF COLUMBIA
ECONOMIC RECOVERY ACT**

**BEFORE THE
DISTRICT OVERSIGHT SUBCOMMITTEE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT**

U.S. HOUSE OF REPRESENTATIVES

JULY 31, 1996

Chairman Davis, members of the House District Oversight, Ladies, and Gentlemen. Thank you for the opportunity to share my thoughts concerning H.R. 3244, the District of Columbia Economic Recovery Act. I would like to applaud Congresswoman Norton for proposing such innovative and thought-provoking legislation. It is indicative of the type of forward-thinking leadership that people throughout the metropolitan area have come to respect her for.

I start from the premise that a healthy and vibrant District of Columbia is good for the entire metropolitan region. If the bill is successful in stimulating the economy of the District, it may well generate positive economic spin-offs to the suburban jurisdictions. Importantly, such revitalization would also improve the ability of the District to meet its regional obligations and provide needed stability in areas such as Metro funding and water and sewage infrastructure. Enactment of legislation creating the DC Financial Control Board, as well as this Subcommittee's constructive efforts to assist in the resolution of problems at the Blue Plains wastewater treatment plant, indicate to me that Congress recognizes the importance of making the District financially solvent.

Clearly, there are over-arching economic and tax policy considerations surrounding this proposal. I have not had the benefit of any econometric analysis of the bill and know that the jury is still out on the benefits of a flat tax system - even one implemented on a pilot basis. I also recognize that there are unanswered questions concerning the fiscal impact of the legislation on the U.S. Treasury as well as legal and policy issues related to tax uniformity. Additionally, there may be more measured economic development approaches, such as expanded enterprise zones or targeted block grants, that might be tried first. I am not in a position to know those answers. Consequently, my testimony on the bill should be interpreted as being primarily limited to its probable impact on Montgomery County.

As introduced, the bill would reduce federal taxes in the District by instituting a flat 15% federal income tax rate on DC residents, increasing the standard individual and household deductions, and excluding DC residents from federal capital gains taxes on DC-based investments. Specifically, standard deductions and personal exemptions would increase significantly from \$6,400 to \$15,000 for single filers, \$25,000 for single heads of households, and \$30,000 for married joint filers. As a result of these changes, Congresswoman Norton's office estimates that the nearly 240,000 tax filers in DC would receive an average federal tax reduction of 45%.

While these changes might have a positive effect on the taxpayers of the District of Columbia, I do not believe these changes alone will have a measurable direct impact on Montgomery County. The underlying goal of Congresswoman Norton's bill is to help stabilize the District's tax base by giving taxpayers, especially middle class taxpayers, a financial incentive to remain or become DC residents. While her proposal may convince many current residents to remain in the city, I do not think that reduced federal taxes will attract many new middle class residents to DC.

Position Statement on H.R. 5244
County Executive Douglas M. Duncan

Families, like businesses, are, more often than not, rational economic entities. They review both the benefits and the costs of relocation before they contemplate a move. They consider carefully the jurisdiction's public education system, public services, infrastructure, and taxes before making a decision. We in Montgomery County believe we provide our residents with the type of quality services they are looking for at a reasonable tax rate and do not think they will move, based simply on lower federal taxes, into the District.

Another issue not usually addressed in the discussion of this legislation concerns the changing nature of the Washington area. The distinction between urban and suburban has blurred considerably in this region during the past fifteen years. In my county, the majority of the workforce stays in the county for their jobs. Only 24% of the county's workers actually commute into the District for their employment. With this in mind, few people, who do not already work in DC, are going to seriously think about moving into DC. A doctor living in Silver Spring, a lawyer living in Bethesda, or a software engineer living in Rockville, all of whom have jobs in Montgomery County, are not going to move into the District for lower taxes and longer commutes.

As I have stated, while I do not think this legislation would result in any substantial movement from the suburbs into the District, I do believe the federal tax advantage of having DC residency might drive some people to establish paper residencies in the District. The bill as drafted defines a DC resident as a person living at least 183 days a year in the District. While this may be a sensible definition for the law, I do not believe there are adequate protections to ensure people will meet this standard.

In some background discussions with the Internal Revenue Service, my staff learned that the IRS has no formal mechanism to confirm someone's place of residence for filing purposes, nor has it ever really had to. The reason is simple: no matter where you live within the United States, the federal tax code is the same. People in Maryland, Mississippi, and Montana all are subject to the same federal tax rates. This proposal would change this standard.

If this bill were enacted, the IRS would need to create some way of minimizing the risk that non-DC residents will file fraudulent tax returns. I think you would want them to as a way to prevent the residents of other states from getting around paying their fair share. This issue is especially important for people in my state, as Maryland collects a majority of its tax revenues from personal income taxes. We need assurances that the federal government will work with our tax collectors to vigorously guard against fraud. I would encourage you to look closely at enforcement issues as part of your review of this bill.

Finally, if I may address another issue that has arisen concerning this legislation. In its current form the bill exempts capital gains earned only by DC residents on DC-based investments from federal taxation. Senator Lott has suggested an amendment to this bill exempting all DC-based investments from the federal capital gains tax for any investor, regardless of residence. This type of amendment could have a profound negative impact on my county and the entire greater Washington-Baltimore metro area.

Position Statement on H.R. 3244
County Executive Douglas M. Duncan

Many efforts have been made at all levels of government to encourage new development or revitalization through tax credits. However, I do not think something as broad as Senator Lott's proposal has ever been seriously considered. I would strongly encourage you to carefully weigh the ramifications of his proposal. Not only could it have the unintended consequence of transferring all of the available capital out of businesses elsewhere in this area to investments in the District, it may also prove to be a significant drain on capital resources from all over the country. I do not think it would be good for the country for Congress to potentially direct so much private capital into one jurisdiction, to say nothing of the significant enforcement questions which the IRS would need to address.

In summary, the future of the District of Columbia is of great importance to the people of Montgomery County, of this entire region, and of this country. We in Montgomery County have always been advocates of regionalism. My colleagues and I devote time and energy to building regional solutions to our mutual problems. As a life-long resident of this area, it pains me to see the both real and perceived deterioration of our nation's capital. I know that something substantial and additional needs to be done to help stabilize the District, and I compliment Congresswoman Norton for keeping Congress focused on it.

Is this legislation a magic bullet for the District's problems? I doubt it. Yet, it may stem the flight of the District's middle class to the suburbs - a laudable objective and one critical to maintaining an economically viable city. Further, I do not perceive a substantial revenue loss to Montgomery County will be caused by residents moving to the District as a result of passage of this bill in its current form. In reviewing the bill, I would urge you to establish a solid monitoring process to effectively check residency claims and to reject efforts to broaden the capital gains provision.

Thank you.



 Joint Economic Committee

 U. S. SENATOR
 Connie Mack
 CHAIRMAN

 OPENING
 STATEMENT

July 31, 1996

**OPENING STATEMENT BY SENATOR CONNIE MACK (R-FL),
 CHAIRMAN, JOINT ECONOMIC COMMITTEE:**

Mr. Chairman, as you are well aware, the social, administrative and fiscal problems of our nation's capital are well documented: high crime rates, poor schools, sub-standard health care services, deteriorating infrastructure, and poor delivery of basic public services -- just to name a few. In short, the District of Columbia is facing its greatest economic crisis since it was established in 1790.

This is not the District of Columbia that I remember from my youth. I first visited Washington in 1947, and can still recall the pride and awe that I felt visiting the nation's capital. Back then, Washington DC was a city that inspired the world, not despaired under financial and social mismanagement.

Since 1950, Washington's population has declined by nearly 250,000 residents: in fact, more people have left DC in the first half of *this* decade than in all of the 1980's. Most of the people in this exodus have been middle class families whose taxes funded the city's operations. DC's tax base is declining so rapidly that soon it is doubtful it will have the ability to support itself, notwithstanding even the most dramatic reduction in the size of its government.

By any standard, the District's situation is unique.

Today, in the capital of the richest nation in the world, nearly one-third of its water pumping fire trucks are out of service, its bond rating is junk status, and city contractors don't get paid.

The District is not part of a state that can redistribute funds or assistance from outlying suburbs like other cities can. Therefore, DC pays for items other cities have their states pay for, such as Medicaid, prisons, and a multi-billion dollar pension obligation to its workers that costs more than \$1 billion a year.

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104TH CONGRESS

Two-thirds of Washington's workforce are commuters who don't pay DC taxes, and even 51% of the District's own government workers live outside of the District. On top of that, 43% of the property within its borders is owned by the government, diplomatic missions or non-profit institutions - meaning that these properties cannot be taxed to raise revenue for the city.

The District's per person total debt is the highest of all major cities in the country -- almost twice as high as the second ranking City of New York. However, in taxes, DC ranks number one in per person total taxes, individual and corporate taxes, state and local property taxes and sales taxes.

DC also has the *highest* number of adults under correctional supervision, the *highest* percent of one parent families, the *highest* percent of births to unmarried women, the *highest* infant mortality rate and the *very highest rate in the nation* when it comes to welfare expenditures. So far this year, DC's murder rate has increased by 24% compared with this time last year. While the President of the United States lives safely in the White House, a few miles away people are living in a war zone.

Clearly, DC is like no other city.

Economically, the District's own response to its alarming decline has been a misguided effort toward higher taxes. But higher taxes have only led to even more residents leaving the city in search of lower tax rates, better schools and safer streets.

In order to attract residents back to the District, we must take the blinders off, disregard attempts to ignite partisan class warfare, and fight back the defenders of the status quo to make way for positive change. Mere tinkering, or simply reshuffling the existing tax system is not genuine economic reform, and will not sufficiently turn this city around. We must create a new city structure that allows everyone to benefit from economic growth.

Let me be clear. I believe that DCERA will help this city tremendously by creating growth, opportunity, and greater freedom for its residents. But -- DCERA will *not be* the end-all solution for some of the very serious social problems that this city faces, and will still need to address in conjunction with *any* growth legislation. *However*, by helping to establish a thriving tax base and strong local economy, our legislation can be a major step in the right direction toward addressing many of its social problems as well.

The premise of DCERA is that the best way to help the District is to promote economic growth, and the best way to promote economic growth is to significantly reduce the tax burden on its residents. Economic growth will mean more jobs, more opportunity, greater private sector investment and ultimately a better quality of life in the nation's capital.

Our legislation provides significant tax incentives, including a uniform, maximum 15 percent federal income tax rate for all District residents, an increase in the standard deduction and personal exemption for people making under \$30,000, a \$5,000 first time DC home-buyer credit, and a brown-fields provision to expense environmental clean-up on new purchases of real estate in the District.

We have also included a zero capital gains tax rate on investments made *within* the District to help spur investment, new businesses and more jobs. Our legislation gives all Americans a chance to participate in DC's economic revitalization by extending the zero capital gains rate to anyone wanting to invest and take part in the resuscitation of their capital.

We believe that these incentives will help to stem the flight of the District's residents, and attract *new* residents, *new* business and investment, and more jobs. Lower tax rates will increase people's take home pay, expand the tax base to better fund DC services, and provide greater hope and opportunity for the District's residents.

Restoring Washington's economic health should be the first step toward promoting stronger growth and better opportunities for every city and town in America. Once America sees what economic growth through a lower income tax rate and a zero capital gains tax rate can produce, the rest of the country will demand the same opportunity for more jobs, stronger investment and greater hope for the future.

CRS Report for Congress

Congressional Research Service • The Library of Congress

District of Columbia Economic Recovery Act: H.R. 3244

Gregg A. Easenwein
Specialist in Public Finance
Economics Division

SUMMARY

On April 15, 1996, Delegate Eleanor Holmes Norton introduced H.R. 3244, the District of Columbia Economic Recovery Act. The District of Columbia Economic Recovery Act (DCERA) would establish a new method of calculating federal income taxes for District residents, which in many instances would dramatically lower federal income taxes for these individuals. Proponents hope that this new tax scheme will halt the exodus of middle and upper income households from the District and help re-invigorate the District's economy. The proposal has picked up the support of House Speaker Newt Gingrich and Senate Majority Leader Trent Lott. Others, however, including House Ways and Means Committee Chairman Bill Archer, have expressed reservations about DCERA.

DCERA is characterized as a "flat-rate" tax because of its 15% tax rate. It would also greatly increase the basic tax exemptions compared to their levels under the regular federal income tax. However, as introduced, it is far from a simple plan.

It will require District (DC) taxpayers to separate their income, both earned and unearned, into DC source and non-DC source income. In general, only income the taxpayer earned while working in the metropolitan area or income earned on investments in businesses located in the District proper would qualify as DC source income. DC source income would be taxed at the flat rate of 15% while non-DC source income would be taxed at standard rates. Rules would be required to determine what constitutes DC source income and non-DC source income.

OUTLINE OF INCOME TAX CALCULATIONS UNDER DCERA

Under DCERA, District residents would compute their federal income taxes based on a multi-step process.¹ First, they would compute their federal income tax in the normal manner. That is, they would calculate their federal income

¹ To qualify as a DC resident the taxpayer must reside in the District for at least 183 days and file a DC income tax return.



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tax based on all of the rules currently in effect with respect to income, deductions, exemptions, etc. From this calculation they would derive their "average rate", which is their regular federal income tax liability divided by their regular federal taxable income.

The next step of the process requires District residents to separate their income into DC source income and non-DC source income (the procedures for determining what is DC versus non-DC source income are described below). The income tax on DC source income is calculated by first deducting a basic exemption amount. Basic exemption amounts are \$30,000 for joint returns, \$25,000 for heads-of-households and \$15,000 for single returns. DC source income is further reduced by subtracting net capital gains on District source investments, charitable contributions, and home-mortgage interest. This is DC source taxable income and is taxed at a flat 15% income tax rate.

The federal income tax liability on non-District source income is calculated by multiplying the average tax rate derived in step one against the amount of non-District source income. The final federal income tax liability for DC residents under DCERA is determined by adding the income tax owed on DC source income to the income tax owed on non-DC source income.

To illustrate the procedure for calculating federal income taxes under DCERA consider the case of a married couple who have \$100,000 in income and file a joint income tax return. Assume that their income is composed of \$80,000 of wages and \$20,000 of net capital gains income. While the wage income is all District-source, only \$5,000 of the capital gains income is District-source. Further assume that the couple pays \$15,000 in home mortgage interest, made charitable contributions of \$2,000, and paid \$7,000 in local taxes.

For tax year 1996, their regular federal taxable income would be \$70,900 (\$100,000 income less two personal exemptions, \$5,100, and itemized deductions of \$24,000). Their regular federal income tax liability would be \$14,639. For purposes of DCERA, their average federal income tax rate would be 20.647% and would be rounded up to 21% (\$14,639 federal income tax liability divided by \$70,900 federal taxable income).

Their District source income would equal \$85,000 (\$80,000 in District source wages plus the \$5,000 of District source capital gains income). To calculate their federal income tax on this DC source income they would subtract the basic exemption of \$30,000, their home mortgage interest payments of \$15,000, and their charitable contributions of \$2,000. As a result, their taxable DC source income would equal \$38,000 and at 15%, their income tax would be \$5,700.

Their income tax on their \$15,000 non-DC source income would be \$3,150 (\$15,000 non-DC source income times their 21% "average rate" under regular federal income tax law). Their final federal income tax liability under DCERA would be \$8,850 which is the sum of their income tax on DC source income \$5,700, and their income taxes on non-DC source income, \$3,150.

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DC VERSUS NON-DC SOURCE INCOME

To qualify for the preferential tax treatment under DCERA, income must be derived from District of Columbia sources. With respect to personal service income (wages and other similar compensation), it will be treated as DC source income if the individual performing the services performs at least 80% of the services for which he is compensated within the Washington-Baltimore Consolidated Metropolitan Statistical Area (including St. Mary's County, MD).

Interest and dividend income in amounts totaling less than \$400 would be treated as DC source income regardless of its source. For interest and dividend income in excess of these amounts, it would be considered DC source income only if it was paid by a firm or resident who was required to file an income tax return with the District of Columbia. In these cases, the amount of dividends and interest that would qualify for DCERA tax treatment would be prorated to match the percentage of total income treated as DC source income on the DC return of the firm or resident paying the dividends or interest.

Capital gains income or loss from the disposition of tangible property will be considered DC source income if the property is located in the District of Columbia. Capital gains income or loss from intangible property (stocks, bonds, etc.) would be treated as arising from sources outside the District unless such gain or loss could be shown to be specifically attributable to sources within the District of Columbia. All royalty income would be treated as arising from sources outside of the District of Columbia. On the other hand, all retirement income (including social security payments) would be considered as DC source income for the purposes of DCERA. The percentage of proprietorship and partnership income that can be shown to have been earned in the District would also be considered as DC source income.

ECONOMIC CONSIDERATIONS

It is not clear whether DCERA would achieve its intended goals of reversing the exodus of middle and upper income taxpayers and re-invigorating the District of Columbia's economy. Neither economic theory nor the empirical evidence provide a basis for evaluating the overall effects of DCERA. Critics maintain, however, that the primary reason people are leaving the District is because the quality of life in the District and the quality of District services have deteriorated over time. Lowering federal income taxes will not necessarily change the quality of life or services in the District. Whether the benefits of lower federal income taxes would offset other factors is not determinable at this time.

Although the overall effects are not clear, it is obvious that DCERA will create a much more complex federal income tax system. Individuals and businesses will face an increase in their tax compliance and record keeping requirements. New rules and regulations will be needed to delineate specifically what constitutes DC source and non-DC source income. Detailed guidelines will

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probably also be needed to prevent tax shelter operations from taking advantage of DCERA benefits.

There may also be issues with DCERA from an equity standpoint.³ A basic economic principle is that individuals in the same situations and with the same incomes should pay the same amount of income taxes (horizontal equity issues). Yet under DCERA, District residents with similar situations and incomes could pay vastly different amounts of taxes. For example, consider the case of an author and a teacher who both earn the same amount of income. Because the teacher teaches in a District school he qualifies for the tax benefits of DCERA. On the other hand, the author who receives his income in the form of royalties from the textbooks he has written does not qualify under DCERA and has to pay much higher income taxes. DCERA has the potential to create many horizontal equity problems for District residents.

In addition, DCERA may also create questions with respect to the distribution of the tax burden across the income spectrum (vertical equity issues). Because DCERA creates such a large tax differential in the treatment of income based on its type and source, the progressivity of the federal income tax in the District may be reduced. It is possible, for example, that some District households who do not receive their income in the form or from the source that receives the most preferential treatment under DCERA may end up paying higher federal income taxes than their District neighbors who have larger incomes but receive it in the form that qualifies for preferential treatment.

While DCERA may hold out the possibility of helping the District of Columbia, it also raises complex issues that could benefit from further research and analysis.

³This report does not address the equity issue of providing preferential federal income tax treatment to different geographic areas. For a legal review of the constitutionality of geographic based preferences in the federal income tax see: U.S. Library of Congress. Congressional Research Service. American Law Division. *Constitutional Issues Raised by a Proposal to Exempt District of Columbia Residents from the Federal Income Tax and for Other Purposes (H.R. 748, 104th Congress)*. Legal memorandum, dated October 27, 1995.

The Washington Post

AN INDEPENDENT NEWSPAPER

A Tax Cut to Stabilize D.C.

DC. DEL. Eleanor Holmes Norton's bill to cut federal income taxes for District residents is a thoughtful proposal to stabilize this city's uniquely threatened tax base and demographic core. It is at once imaginative enough to attract bipartisan support in Congress and realistic enough to make a serious difference over time. The District has been losing its middle-class heart to the suburbs. No matter how well Congress, the control board and local leaders do in cleaning up past financial horrors, the prospects for a sturdy tax base are slim to none without some incentive for residents and businesses to stay and for others to come in.

Del. Norton's measure would replace the current federal income tax schedule with a fixed rate of 15 percent. It also would more than double the federal personal exemption. This would eliminate federal income taxes for single residents who make up to \$15,000 a year, for single heads of households who make up to \$25,000 and for married couples filing jointly who make up to \$30,000. Deductions for mortgage interest and charitable contributions would stay in effect, as would the ability to file under the current system if the taxpayer preferred. D.C. residents would pay no capital gains taxes on the sale of investments in local business. The proposal's 15 per-

cent rate would be applied to wages earned by D.C. residents either in the city or suburban jurisdictions, as well as to District-generated dividends and investment income.

It is essential to the success of this plan that the local government not jack up taxes to skim the amounts that would return to residents from a federal tax break. That promise needs more than verbalizing by the mayor and city council. Though it is difficult to calculate exactly how this plan would restructure the population, at the start it could cost the federal Treasury hundreds of millions of dollars a year in lost revenue. But other proposals to put the capital city on a sound footing—federal funds, a tax on suburban commuters' salaries, statehood—carry their own heavy political and financial burdens. And as Ms. Norton and others in Congress have noted, if this tax-incentive proposal helps stabilize the city, other urban areas may have a model to follow.

Del. Norton knows as well as anyone that tax incentives alone won't remake the District of Columbia. Other conditions—start with the public schools and security—must improve if the District hopes to keep and attract a vital base of working families with younger children. But her proposal offers a practical way to help spur the revival the city desperately needs.

TUESDAY, APRIL 16, 1996

A serious plan for what ails the District

D.C. Delegate Eleanor Holmes Norton, who played such an influential role in establishing the District's financial control board last year, has another good idea. Coinciding with the annual tax-payment date, Mrs. Norton yesterday offered a visionary plan — the District of Columbia Recovery Act — that would slash federal income taxes for residents and businesses of the District. The short-term goal is to staunch the middle-class flight from the District, and the long-term hope is to encourage middle- and upper-income families to return or relocate in droves to the nation's capital.

Those are exceedingly tall orders that are virtually certain never to happen unless tangible incentives are provided. Without a return of middle-class families, however, it is equally certain that expanding the District's own tax base and generating local private-sector job creation — two measures indispensable to the long-term fiscal solvency of the national capital — will prove to be pipe dreams. Having the benefit of witnessing firsthand the accelerated flight of more than 50,000 residents since 1990 and understanding the long-term economic devastation such a trend portends for her remaining constituents, Mrs. Norton, whose liberal credentials are impeccable, has offered a plan to overcome the challenge she faces rather than satisfy the class-warfare ideology some of her colleagues embrace.

Mrs. Norton's radical proposal would establish a single federal income tax rate of 15 percent in place of the current brackets that move from 15 percent to 39.6 percent. To introduce progressivity in her plan, which she calls the Progressive Flat Tax, she provides for significantly higher ceilings on (\$3,000 for singles, \$30,000 for married couples filing jointly and \$25,000 for heads of households) to replace the current combined standard deduction and personal exemptions (\$6,400 for singles, \$11,530 for married couples filing jointly and \$8,250 for heads of households). Mortgage-interest and charitable deductions

would remain, as would the option to file under the current system.

Income-tax liabilities for District residents would be reduced across the board. For incomes under \$15,000, federal income taxes would be eliminated; in the \$15,001-\$30,000 range, taxes would decline by an average of nearly 80 percent; for incomes between \$50,001 and \$100,000, the crucial solidly middle-class range, taxes would decline between 44 percent at the low end to 37 percent at the high end. In the District, 65 percent of filers have incomes below \$30,000, and 83 percent have incomes below \$50,000. Only 11.5 percent have incomes between \$50,001 and \$100,000, compared to nearly 20 percent nationally — where, it must be noted, the cost of living is generally much lower. For its long-term solvency, the District clearly needs to attract more middle-class families, the very sort of stable demographic group that is fleeing.

And it needs new and re-invigorated businesses just as badly. To this end, Mrs. Norton's plan would eliminate capital-gains taxes on D.C. investments by D.C. residents and would apply its 15 percent rate against D.C.-generated dividends and income.

Opponent of the oft-pitied conditions of D.C. public education, Mrs. Norton is not so naive as to believe that tax cuts alone will immediately attract hordes of middle-class families with school-aged children. That's a luxury for long-term consideration. Her plan would, however, address the immediate crisis of middle-class flight by providing incentives for people to stay. It would also extend a welcome mat to the region's prosperous households and entrepreneurs, whose payment of local taxes could one day lead to a reduction in those oppressive burdens as well.

The social, economic and budgetary ills afflicting the District, which this page routinely catalogues and laments, are so extreme that nothing short of a major assault from multiple angles is likely to prove effective in the long run. Establishing the control board was an indispensable first step. The Norton plan on taxes would be a worthy successor.

Flat Tax on the Potomac?

The flat tax received a political equivalent mugging by everyone from the elite media to Republican Presidential candidates this winter. But guess who just asked for a flat tax? The Beltway itself. Specifically, Eleanor Holmes Norton, the District of Columbia's Democratic delegate in Congress, has just proposed a dramatic incentive-based tax reform for the nation's capital. Its centerpiece is a flat 15% federal income tax rate.

Ms. Norton's plan has the enthusiastic support of both Mayor Marion Barry and D.C. Council Chairman David Clarke. They point out that the District's population has fallen to 554,000 with the exodus of most of the middle class. Ms. Norton says the District's high taxes "have been a major factor in taxpayer flight." Her message to Congress is clear: "The only way to keep and attract new residents and to rebuild our tax base is to offer a meaningful financial incentive."

Her plan would affect only federal taxes, leaving the District's punitive income tax unchanged. However, District residents would enjoy real savings at the federal level because the plan would exempt the first \$30,000 in income for married couples (shades of Steve Forbes). Charitable and mortgage deductions would be retained, and capital gains taxation would be eliminated on investments in the District that are held by residents. The flat rate would apply to any resident who lives at least half the year in the

District and also pays its income taxes.

Some in Congress will object to D.C. residents getting a tax break while their constituents outside the Beltway have to pay marginal rates that can exceed 40%. Well, then, make it clear that Washington's flat tax would be a proving ground for nationwide tax reform.

Another conventional objection will be that the flat tax envisioned by Ms. Norton would bring in less revenue than the current system. So what? D.C. is already halfway down the drain. In any event, Federal Reserve Board Member Larry Lindsey has argued that economic growth would reduce the revenue loss significantly. The District could also be required to privatize and streamline its bloated government as a condition for having its federal taxes lowered.

We believe, along with Speaker Newt Gingrich and Jack Kemp, that the Norton plan merits consideration. A simple, flat tax would surely encourage a significant return of the middle class to the District. Without their presence, there is no hope. The status quo is bankrupt. When the political writers start sniffing at the details of Ms. Norton's flat tax the way they did with Steve Forbes's proposal, maybe she should ask them what was the last useful idea any of them had for reviving her utterly beleaguered city. Instead of carping, the Norton plan deserves some support.