A Comparative Case Study of Tax Policy Decisions in the District of Columbia, Maryland, and Virginia

by Jason Nicholas Juffras

A.B. in Politics, June 1985, Princeton University
Master in Public Policy, June 1988, Harvard University

A Dissertation submitted to

The Faculty of
The Columbian College of Arts and Sciences
of The George Washington University
in partial fulfillment of the requirements
for the degree of Doctor of Philosophy

May 17, 2015

Dissertation directed by

Joseph J. Cordes
Professor of Economics, Public Policy and Public Administration,
and International Affairs

The Columbian College of Arts and Sciences of The George Washington University certifies that Jason Nicholas Juffras has passed the Final Examination for the degree of Doctor of Philosophy as of February 25, 2015. This is the final and approved form of the dissertation.

A Comparative Case Study of Tax Policy Decisions in
the District of Columbia, Maryland, and Virginia

Jason Nicholas Juffras

Dissertation Research Committee:

Joseph J. Cordes, Professor of Economics, Public Policy and Public Administration, and International Affairs, Dissertation Director

Stuart Kasdin, Assistant Professor of Public Policy and Administration, Committee Member

David Brunori, Research Professor of Public Policy and Public Administration, Committee Member

Dedication

The author dedicates this dissertation to his dear parents, Angelo and Efrosene Juffras, who provided unstinting support and sympathetic ears throughout this endeavor.

Acknowledgments

The author wishes to thank his dissertation director, Professor Joseph J. Cordes, for his consistently thoughtful, insightful advice throughout this project. He also thanks the other dissertation committee members, Research Professor David Brunori and Assistant Professor Stuart Kasdin, for their suggestions and criticisms, and the external examiners, Professor Philip Joyce and Dr. Robert Ebel, for giving generously of their time and expertise.

Abstract of Dissertation

A Comparative Case Study of Tax Policy Decisions
in the District of Columbia, Maryland, and Virginia

This dissertation examines how state policymakers develop, evaluate, and select tax policy options, based on case studies of tax policy decisions in the District of Columbia, Maryland, and Virginia from 2007 to 2010.

States have been the main locus of tax policy change in the U.S. in recent years, varying widely in their choices of which taxes to raise or cut, and whether to adjust tax rates or the tax base. Because public finance and budgeting research has focused largely on appropriations, as well as tax decisions at the federal level, the dissertation seeks to expand the knowledge base about state tax policy formulation. This is a critically important policy area because state tax systems are threatened by the growth of services, the advent of electronic commerce, capital flows that cross state and national borders, and the aging of the population.

Based on a mixed-methods research strategy involving documentary evidence (budget requests, enacted budgets, tax policy bills and laws, fiscal notes and legislative reports, and other written sources), as well as interviews with 10 to 15 key policy participants in each state, the dissertation found that the three states vary widely in their capacity to generate and refine tax policy options, reflecting ideological and institutional differences. Nevertheless, the states were very similar in one respect: each state made only tangential efforts to expand its tax base and curtail tax expenditures during the worst fiscal crisis in decades. This pattern suggests that it will be difficult for states to carry out

the reformers' mantra to broaden tax bases and lower tax rates, a conclusion that is supported by national data.

The case study states also relied heavily on "selective parity" – aligning their tax rates and tax bases with at least some neighboring jurisdictions or comparable states – in making tax policy choices. This practice suggests that states will avoid the gridlock that has marked federal tax policy, because the widespread use of benchmarking provides a rationale for tax increases as well as cuts, while still serving as a moderating factor that pulls states toward regional or national means. States are picking spots on a spectrum of service levels and tax burdens that reflect voter preferences but are also constrained by national and regional norms.

A general hierarchy of taxes constructed from the case studies and also reflected in national data shows that narrowly-targeted levies (such as health facility taxes) and "sin" taxes (such as cigarette taxes) were the most likely to be increased, while broad-based taxes with the strongest revenue performance (such as the personal income tax) were the least likely to be increased. This pattern reinforces the conclusion that states are neglecting the long-term revenue capacity of their tax systems, a finding that is reinforced by a continuous stream of small tax cuts granted in each state, interrupted periodically by larger tax increases – a pattern of "punctuated incrementalism."

Table of Contents

List of Figures

List of Tables

Chapter 1

Introduction

Contents

> Money is, with propriety, considered as the vital principle of the body politic; as that which sustains its life and motion, and enables it to perform its most essential functions.
>
> -- Alexander Hamilton, *The Federalist* No. 30, December 28, 1787

States have been the primary locus of tax policy changes in the United States in recent years. Although federal policymakers struck a deal in the waning hours of 2012 to avert a "fiscal cliff" and permanently extend most of the tax cuts enacted in 2001 and 2003 under President George W. Bush, oft-promised efforts to curtail proliferating tax breaks and reform the corporate tax code have failed to materialize.[1] Local officials rely primarily on the real property tax (Mikesell, 2015: 32; Lee, Johnson, and Joyce, 2013: 152), leaving less room for tax policy change or innovation, and are often constrained by state tax limitations. By contrast, states draw on several major taxes – in particular, the personal income tax, the corporate income tax, and the general sales tax – as well as excise and other taxes. Balanced-budget requirements in 49 states (National Conference

[1] Most recently, federal lawmakers granted another one-year extension to dozens of temporary tax breaks in the final days of 2014 and were unable to agree on measures to stop a trend of "corporate inversions" in which companies merge with a foreign firm and assume an overseas address to avoid U.S. taxation.

of State Legislatures, 2010a: 2-3), as well as the need to finance services and protect credit ratings, lead state officials to adjust tax policies periodically. Different economic, political, and social conditions in the states virtually ensure that there will be considerable diversity in state tax decisions (Mikesell, 2015: 37).

A brief review of state tax actions, based on annual summaries prepared by the National Conference of State Legislatures (NCSL), illustrates this diversity. For example, state tax changes in 2007 were marked by asymmetries: the projected fiscal year (FY) 2008 revenues from personal income tax increases in seven states essentially offset income tax cuts made by 25 states, while sales tax increases in eight states roughly equaled sales tax cuts in 20 states (NCSL, 2008a: 4-5). States also varied in their use of tax levies from year to year. In 2008, states raised business income taxes by a projected $2.3 billion for FY 2009, while cutting personal income taxes by a net $254 million (NCSL, 2009: 3-4). In 2009, facing large budget gaps due to a severe recession, states turned to their two top sources of tax revenue – the personal income tax and the sales tax – for projected increases of $11.4 billion and $7.2 billion, respectively, to help balance FY 2010 budgets (NCSL, 2010b: vii). Meanwhile, states adjusted some smaller taxes: for example, Maryland adopted a 20 percent amusement tax on electronic bingo receipts in 2007, Tennessee applied its privilege tax to professional athletes in 2009, and Alaska cut its tax on cruise ship passengers in 2010.

Several patterns appear amid this diversity. The tendency of state officials to grant modest tax cuts on a steady basis, while imposing larger tax increases less often, is notable. Even in the difficult budget year of 2009, when states imposed the largest net tax increase (in percentage terms) since 1991, seven states cut their personal income taxes, 11 reduced their corporate income taxes, and six trimmed their sales taxes (NCSL, 2010b: vii, 3-5). State officials have taken sporadic, ad-hoc steps to broaden their tax bases, but these efforts have often been paired with (or followed by) new credits, deductions, and exemptions (Cordes and Juffras, 2012: 313-315; NCSL, 2012, 5-12). Tobacco products have been a particularly popular target for state tax increases (NCSL, 2008a: 3-5; NCSL, 2010b, 3-5; Sjoquist, 2015: 77-78), while personal income and sales tax increases have been less frequent and have often been deemed "temporary."[2]

Still, it is not clear why states target certain taxes for increases or decreases, or why states decide to adjust tax rates, the tax base, or both. To increase understanding of state tax policy decisions, this dissertation presents a case study of tax policy formulation in Maryland, Virginia, and the District of Columbia, from 2007 to 2010. The study will examine the following research questions:

1. How were tax policy options developed in the three jurisdictions, and by whom?
2. How were tax policy options evaluated by decision-makers?
3. What factors or criteria determined which tax policy options were enacted?
4. What patterns in the tax policy decisions of the three jurisdictions might also apply to other states and other levels of American government?

For the purposes of this study, a "tax policy decision" involves a statutory change in at least one of the following: (1) a tax rate, (2) a tax base, or (3) the use of tax revenue.[3] Administrative measures, such as efforts to increase tax compliance, are

[2] Examples include California's two-year, across-the-board personal income tax increase, enacted in 2009; the District of Columbia's three-year, 0.25% increase in the sales tax, enacted in 2009; and Arizona's three-year, 1% increase in the sales tax, enacted in 2010.

[3] Although a statutory change in the use of tax revenue might seem like an expenditure issue, the link between a tax and its uses is often integral to decisions on whether to impose a tax and how to structure it.

outside the scope of the study because they seek to implement existing policy more effectively. In addition, fees and fines (which are forms of "non-tax" revenue) are not part of the study because they concern a narrower set of personal transactions, such as paying for an individual service or benefit, or settling a fine for violating the law. Isaac William Martin, Ajay Mehrotra, and Monica Prasad informally describe taxation as "the obligation to contribute money or goods to the state in exchange for nothing in particular." (Martin, Mehrotra, and Prasad, 2009: 3). More formally, taxes can be defined as compulsory payments, usually based on some measure of resources or ability to pay (such as income, consumption, or wealth), that are required to fund the general activities of the government.[4] Taxes are the focus of this study because they finance the collective needs of the citizenry.

<u>Gaps in Research on the Tax Policymaking Process</u>

The power to tax is one of the defining attributes of a sovereign state, and one of the most visible. If taxes are the price we pay for a civilized society, as Justice Oliver Wendell Holmes stated, we have to decide how to divide up the bill. Debate about who should bear the burden of taxation will be ongoing in a democratic society.

Despite the importance of tax policy, significant gaps remain in the research on how tax options are developed, evaluated, and selected. Scholars of public budgeting and finance have studied public expenditure decisions in depth, describing the forces that

---

For example, the motor fuel tax gained widespread acceptance because it is used to build and maintain roads, establishing a link between payers and beneficiaries.

[4] The dividing line between a tax and a fee is not always precise; some revenue sources are essentially hybrids. For example, a charge for a service provided to a specific person is a fee, but it could be characterized as a tax if the amount charged does not bear a close relationship to the cost of serving each individual. See Victor Thuronyi, "Tax," in *The Encyclopedia of Taxation and Tax Policy*, Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle, eds. (Washington, D.C.: Urban Institute Press, 2005), p. 375.

affect decision-making using models of incrementalism (Wildavsky, 1964; Davis, Dempster, and Wildavsky, 1966), punctuated equilibrium (Jones, Baumgartner, and True, 1998), and strategic budgeting (Meyers, 1994). Yet scholars have not devoted as much attention to the revenue side of budget formulation. There is a sizable literature on state tax *adoption* (Hansen, 1983; Berry and Berry, 1992), but that body of work does not examine changes to existing taxes, which occur much more often than tax adoptions.

The most detailed model of tax policy formulation in the United States and other democratic nations was proposed by Walter Hettich and Stanley Winer (1999), who view tax policy as a general equilibrium resulting from economic, political, and administrative factors. Hettich and Winer posit a system of collective choice, based on a "probabilistic" voting model in which political parties adopt positions intended to maximize their votes,[5] and test the model empirically using data from the United States. The politically optimal tax structure, according to Hettich and Winer, minimizes total political costs (in terms of loss of votes) for any given level of revenue collected and equalizes the "marginal political opposition" per dollar of tax revenue among taxable activities and taxpayers. The collective choice that generates this result can also be economically efficient, because voters will choose candidates whom they expect to advance their well-being. Hettich and Winer further posited that officials will select a Pareto-optimal tax policy weighted toward the preferences of voters who are most politically aware and influential, because that will maximize expected votes.

[5] The probabilistic voting model differs from other models of collective choice, such as the median voter model, in assuming that political parties do not know with certainty how voters will cast their ballots. Therefore, a change in a policy position will lead to changes in the probability of support from voters, but does not lead to a total loss of support from a decisive, median voter. The probabilistic model also reflects the reality that voters make their choice based on a host of issues, including but not limited to tax policy.

Hettich and Winer's theory yields powerful and sometimes surprising results. Although many experts argue in favor of broad tax bases with minimal exemptions, deductions, and other adjustments (Feldstein, 2010; Marron, 2011; Marr and Highsmith, 2011), Hettich and Winer view complex tax structures as "politically rational" attempts to win favor with influential groups of voters and thereby minimize opposition to taxation (Hettich and Winer, 1999: 50). Therefore, efforts to close tax "loopholes" are likely to prove futile. Hettich and Winer also found empirical support for the following predictions (Hettich and Winer, 1999: 215-224):

1. Governments will exploit opportunities to lower the effective tax prices of those voters who are most likely to offer political opposition. Reducing opposition is done not only by offering tax preferences but also by (a) shifting tax burdens to higher levels of government that provide offsets or deductions for taxes paid to lower levels of government, and (b) taxing people, goods, and services that move across jurisdictions.

2. Governments will face opposition and political costs that grow at a faster rate as the amount of revenue collected from a tax increases, relative to its base. By the same token, growth in a tax base softens political opposition because the government can collect the same amount of revenue at a lower rate.

3. Both government officials and taxpayers will prefer tax bases and tax systems that yield stable revenue streams to those that are more volatile, in order to minimize the costs of adjusting to fluctuating revenues.

Hettich and Winer reported mixed support for the idea that state tax levels are constrained by tax levels in competing jurisdictions. They found that neighboring states often show opposite rather than converging patterns in their tax levels, but that states tend to adopt similar tax levels as non-contiguous states with a similar socio-economic profile (Hettich and Winer, 1999: 232, 234).

Hettich and Winer's findings are supported by other research and seem consistent with recent patterns in state taxation. Most notably, other scholars agree that public officials seek to blunt political opposition to taxation by spreading the burden among different types of taxes and offering special treatment to influential groups. Irene Rubin (2010) identified three major patterns of revenue politics that arise from conflicting pressures to finance public services while limiting the tax burden. First, when officials determine that additional revenues are necessary, they build public support very carefully and try to frame the increase as unavoidable. Second, officials engage in a "politics of protection" from tax burdens, giving tax cuts and preferences whenever possible to claim credit for shielding taxpayers. Third, the political risks of raising taxes and politicians' preference to chip away at taxes result in a "piecemeal, complicated, inconsistent, and inequitable tax structure that periodically needs overhauling." (Rubin, 2010: 36).

Similarly, Susan Hansen found that state governments show a "strong preference for incremental changes in existing taxes," often making marginal adjustments in rates and imposing "temporary" increases due to political pressures and economic competition with other states (Hansen, 1983: 152). Carol Lewis and W. Bartley Hildreth also view state tax policymaking as largely incremental, because small changes are less likely to arouse public disapproval and vocal opposition (Lewis and Hildreth, 2011: 184). David Brunori contends that, "Political leaders at all levels of government seek to obscure tax burdens by levying taxes that are largely unnoticed by the citizens … By hiding tax burdens, political leaders can create the illusion of paying for public services without the attendant tax burdens." (Brunori, 2011a: 52). In addition, experts agree with Hettich and Winer that state officials try to shift tax burdens to those who live out of state, such as tourists or commuters, or to those who are seen as engaging in socially harmful behavior, such as cigarette smokers and gamblers (Lewis and Hildreth, 2011: 206, Brunori, 2011a).

Although the existing research on tax policy formulation (in general and at the state level) is useful, it needs to be extended and refined. Hettich and Winer's model is admirable for its interdisciplinary approach and its careful empirical testing, but this large-scale, quantitative study does not capture the importance of ideology, information, institutions, and interest groups, which are difficult to represent in quantitative analysis. Hettich and Winer posit the existence of vigorous party competition, clear party platforms, and voters who are fully aware of those platforms – assumptions that are dubious because many elections are uncontested, political parties are weak, and policy positions are imprecise (Weaver and Rockman, 1993; Weaver, 1986; Jacobs and Shapiro, 2000). In the absence of vigorous political competition and a fully-informed public, bureaucracies and interest groups, as well as the rules embodied in constitutions and legislative procedures, may wield greater influence on policy outcomes (Ostrom, 2007; Shepsle, 1989; Riker, 1984). More generally, the research literature does not examine the choice of tax levies in much detail. This dissertation tries to increase understanding of state tax policymaking through a more granular approach that examines the role of ideologies, interests, institutions, and other factors in depth by focusing on several cases.

State tax decisions will be particularly important in upcoming years due to increased strains on state tax systems. Experts agree that the revenue capacity of state tax systems has eroded because they have failed to adapt to economic changes such as the growth in services, the aging of the population, and the advent of electronic commerce (Ebel, Petersen, and Vu, 2012: 8; State Budget Crisis Task Force, 2012a: 46-47; Ebel and Rubin, 2015: 293; Sjoquist, 2015: 70). In addition, state tax revenues have become less stable and more sensitive to economic conditions due to the greater importance of volatile income sources such as capital gains (State Budget Crisis Task Force, 2012a: 50-52; Mattoon and McGranahan, 2012: 146-147; Pattison and Willoughby, 2015: 8). Nor is the precarious fiscal position of state governments merely a short-term problem. State financial obligations are rising faster than states' ability to meet them, largely because of unfunded pension costs, long-term infrastructure needs, and steadily rising health-care costs (State Budget Crisis Task Force, 2014: 10-11). As noted by Robert Ward (2012: 933), states risk damage to the social safety net, loss of physical infrastructure, higher costs for taxpayers, and increased debt if they do not address the looming challenges of fiscal sustainability. This dissertation will examine the tax policy choices of three states in depth in order to illuminate a policy field of ongoing, critical importance.

Seven Propositions about State Tax Policy Formulation

To focus the study and provide a starting point for inquiry, I offer seven propositions about state tax policymaking, based on a review of the research as well as recent state tax policy decisions. It would be difficult, if not impossible, to examine a complex subject without some ideas about how the process works and what the critical variables are (Creswell, 2014:66; Merriam, 2009: 64-66). As stated by Robert Yin, "(T)he complete research design embodies a 'theory' of what is being studied … the simple goal is to have a sufficient blueprint for your study, and this requires theoretical propositions …" (Yin, 2003: 29). Gary King, Robert Keohane, and Sidney Verba note that, "Without a theoretical model, we cannot decide which potential explanatory variables should be included in our analysis." (King, Keohane, and Verba, 1994: 174). The theoretical propositions that inform this study are listed in Table 1.1 (see next page).

In contrast to Hettich and Winer's model, the seven propositions do not assume that the policy positions of elected officials and candidates, and the preferences of voters, are fully developed or understood. The reasoning behind the propositions, which are organized by stages of the policy process, is discussed below in more detail.

Table 1.1
Seven Propositions about State Tax Policy Formulation

Agenda-Setting and Development of Alternatives
1. State tax policy undergoes cycles of change and stability, due to the selective attention of officials and periodic changes in "problem streams" and "political streams" that elevate or lower the position of taxes on the policy agenda.
2. In the absence of a major external shift such as an economic crisis or a change in partisan control, state officials will tend to perform a limited search for tax policy options, focusing on modest adjustments to current taxes rather than more sweeping revisions.
Evaluation and Selection of Tax Policy Options
3. State officials emphasize political acceptability in evaluating tax policy options, at the expense of normative principles such as revenue capacity, efficiency, and equity.
4. State tax policy debates have an important symbolic dimension that has a powerful influence on the options that are selected.
5. State tax policy operates at two largely distinct levels. The "macropolitical" level, which affects a large percentage of the population and generates more publicity, focuses on major parameters of tax policy such as tax rates and is more responsive to public opinion. The "micropolitical" level, which involves smaller numbers of people and generates less publicity, focuses on narrower provisions and is more responsive to interest group pressure.
State Tax Policy Outcomes
6. The desire of state officials to claim credit for tax benefits, while deferring or disguising tax burdens, leads to asymmetries in state tax policies. Modest tax cuts are offered on an almost continuous basis, while tax increases are clustered in times of economic distress.
7. The pendulum swings of state tax policy and the political bias toward providing tax benefits leave long-term economic and demographic changes that threaten state tax systems unaddressed.

Agenda-Setting and Development of Alternatives

1. State tax policy will undergo cycles of change and stability, due to the selective attention of officials and periodic changes in "problem streams" and "political streams" that elevate or lower the position of taxes on the policy agenda.

This proposition draws on John Kingdon's model of policy formulation, which emphasizes the way that policymakers ration their time and attention to issues that rise on the policy agenda due to changes in "problem streams" (such as recessions and budget deficits) and "political streams" (new administrations, shifts in public opinion), creating the opportunity for policy change (Kingdon, 1995).

The case study states reflect this pattern of stasis interrupted by change. The District of Columbia's Tax Parity Act of 1999, which sought to make D.C. tax rates more comparable to those of its neighbors, shaped D.C. tax policy for the next decade by phasing in personal income and real property tax cuts. In 2004, Virginia lawmakers approved the most significant tax changes in the commonwealth in almost 20 years, increasing sales, cigarette, and recordation taxes. In 2007, Maryland lawmakers enacted approved a broad package of sales, personal income, corporate income, and excise tax increases after the election of a Democratic governor ended a period of divided government.

2. In the absence of a major external shift such as an economic crisis or a change in partisan control, state officials will tend to perform a limited search for tax policy options, focusing on modest adjustments to current taxes rather than more sweeping revisions.

As argued by Lewis and Hildreth (2011), Hansen (1983), and others, state tax policymaking tends to be incremental, involving adjustments to existing taxes rather than major revisions or overhauls. Adoption or repeal of a major tax, which represents the most clear-cut form of state tax innovation, has not occurred for decades.[6] More sweeping reforms, such as a value-added tax imposed at each stage of the production process, have not been seriously considered (Lee, Johnson, and Joyce, 2013: 170). The incremental pattern is likely to persist unless there is a major change in the economic or political climate.

Evaluation and Selection of Tax Policy Options

3. State officials emphasize political acceptability in evaluating tax policy options, at the expense of normative principles such as revenue capacity, efficiency, and equity.

[6] For example, the most recent adoption of a broad-based personal income tax occurred in Connecticut in 1991, and the most recent adoption of a general sales tax place took place in Vermont in 1969.

Although political concerns are intrinsic to policy debates in a democracy, so are broader concerns about a policy's impact on social well-being. The political pressures that shape state tax policy are not only strong, but also exert more influence than normative standards of good tax policy – revenue capacity, economic efficiency, equity, ease of administration, and transparency – that are widely accepted by public finance experts (Lee, Johnson, and Joyce, 2013: 133-139; Mikesell, 2003: 300-318). In a study of 19 state tax reform commissions, Carolyn Bourdeaux found that the recommendations, which often reflected public finance principles of sound tax policy, were rarely adopted unless the commissions proposed cutting taxes (Bourdeaux, 2010: 7-12).[7]

4. State tax policy debates have an important symbolic dimension that has a powerful influence on the options that are selected.

Elected officials often lack clear information about voter preferences, just as voters lack clear information about politicians' positions (Jacobs and Shapiro, 2000). In fact, voters may have conflicting views on taxation, because people like the services that taxes buy but dislike paying the bill (Block, 2009: 68). As a result, public officials and interest groups can frame public views on taxation by crafting symbols and images that evoke support (Campbell, 2009; Jacobs and Shapiro, 2000; Baumgartner and Jones, 1993; Sheffrin, 2013: 20-26; 160). A main example concerns successful efforts to curtail estate taxes using the image of a "death tax" that threatens family businesses and harms people at a time of tragedy (Sheffrin, 2013: 142-160; Slemrod and Bakija, 2008: 291-292, Burman, 2002). In the District of Columbia, a proposal to expand sales taxation of services was crippled after it was dubbed a "yoga tax," spurring angry protests by health and fitness enthusiasts (Stewart and Craig, 2010).[8]

5. State tax policy operates at two largely distinct levels. The "macropolitical" level, which affects a large percentage of the population and generates more publicity, focuses on major parameters of tax policy such as tax rates and is more responsive to public opinion. The "micropolitical" level, which involves smaller numbers of people and generates less publicity, focuses on narrower provisions and is more responsive to interest-group pressure.

Hettich and Winer point out that elected officials face powerful incentives to lower opposition to taxes by reducing tax burdens for influential groups. These policies are often carried out in less visible aspects of the tax policy process, such as technical provisions of omnibus bills, which involve only small numbers of people with specialized knowledge. To use terms defined by Emmette Redford (1969: 83-84), state tax policy has a public or "macropolitical" face in which "the community at large and the leaders of

[7] For example, Bourdeaux concluded that many of the reform commissions proposed broadening the tax base and lowering the rates, considering vertical equity, diversifying the tax base, modernizing tax systems to reflect the 21st-century economy, and promoting economic competitiveness. See Carolyn Bourdeaux, "A Review of State Tax Reform Efforts," Fiscal Research Center Report No., 216, Andrew Young School of Policy Studies, Georgia State University (November 2010), pp. 7-12.

[8] In 2014, D.C. policymakers extended the sales tax to health clubs and several other services.

the government as a whole are brought into the discussion and determination of policy" (Redford, 1969: 83), and a hidden, "micropolitical" face in which "individuals, companies, and communities seek benefits from the larger polity for themselves." (Redford, 1969: 83). An example of micropolitics in tax policy, in which the Virginia legislature enacted a sales tax exemption for purchases of computer equipment by America Online, has been mirrored countless times in other states (Brunori, 2011a: 23).

State Tax Policy Outcomes

6. The desire of state officials to deliver and claim credit for tax benefits, while delaying or disguising tax burdens, leads to asymmetries in state tax policies. Modest tax cuts are offered on an almost continuous basis, while tax increases are clustered in times of economic distress.

State tax policymaking seems to reflect uneven swings between tax cuts and tax increases that undermine the long-term stability of the tax system. State tax increases are more likely to be temporary, or to affect smaller parts of the tax base, such as excise taxes on cigarettes and taxes on health care providers. The estimated total increase in state tobacco and health-care taxes exceeded the estimated total increase in state personal income and general sales taxes in 2007, 2008, and 2010 (NCSL, 2008a: 3; NCSL, 2009: 3; NCSL, 2010b, 3; NCSL, 2011a: 3), even though the latter generate almost two-thirds of total state tax receipts (U.S. Bureau of the Census, 2012a: 2).

7. The pendulum swings of state tax policy and the political bias toward providing tax benefits leave long-term economic and demographic changes that threaten state tax systems unaddressed.

Because politicians often use taxes as distributional tools, the capacity of state tax systems to provide adequate revenue while promoting economic efficiency and equity is depleted. There is also growing evidence of a mismatch between the tax system and a changing economy. State sales and corporate tax bases continue to shrink as percentages of personal income and corporate income, respectively (Fox, 2012: 409; Brunori, 2012: 337). More generally, state tax systems have changed little in recent decades in response to the growth of the service economy, the advent of Internet sales, the expansion of multistate and multinational businesses, and greater mobility of capital (Lav, 2012: 871-872; B. Hamilton, 2012: 491-492).

Research Design

The case study method is used for this dissertation because its strengths align with the purposes of the study. Robert Yin contends that case studies are particularly appropriate when (1) what, how, or why questions are being posed, (2) when the researcher has no control over events, and (3) when the study concerns a current or recent phenomenon with a practical context (Yin, 2003: 5-9). This dissertation meets all of these criteria: it attempts to address how tax policies are developed, refined, and evaluated, and why certain options are selected. The study is also concerned with recent tax policy decisions in the practical context of the American states.

In addition, case studies are also a powerful tool for researchers who are trying to understand complex phenomena in depth. Tax policy research, such as that of Hettich and Winer, often detects general patterns or central tendencies from large data sets, but cannot explore the causal mechanisms that underlie the patterns. This study takes a different approach in attempting to explain the dynamics of specific tax policy decisions. Tax policy formulation is complicated and often controversial, with many participants within and outside the government battling over who will pay the costs of the state. By focusing on several cases, the study will be better able to explore the steps in the tax policymaking process – setting the agenda, developing and evaluating options, and choosing from those options – at a more molecular level, while examining the political, economic, and social factors that influence these choices.

As stated earlier, the case study focuses on tax policy formulation in Maryland, Virginia, and the District of Columbia from 2007-2010. Although D.C. is not a state, the D.C. government performs state functions, as well as county and city functions. Moreover, D.C.'s tax system, which includes levies typically imposed by states (personal income tax, corporate income tax, general sales tax, cigarette and other excise taxes), is much more similar to that of other state governments than it is to a local tax system. Including this hybrid jurisdiction in the case study increases the range of settings covered, as discussed below in more detail. For the sake of brevity, D.C. will be referred to as a state even though it is a unique state-local combination.

The three jurisdictions capture a significant amount of variation among states and should therefore generate important insights into tax policy formulation. This variation, described below, should be particularly useful in exploring how political ideology, partisan control of government institutions, and changes in administration affect the development, evaluation, and selection of tax policy alternatives.

D.C. is in some respects one of the most politically liberal states, delivering more than 90 percent of its vote to President Obama in 2008 and 2012, by far the highest percentage in the nation each time. Democrats have held 11 seats on the 13-member D.C. Council since 1998,[9] and the D.C. mayor has been a Democrat since congress granted home rule to the District in the mid-1970s.

Maryland is also a solidly liberal, Democratic state, granting 62 percent of its votes to President Obama in 2008 and again in 2012. Maryland governor Martin O'Malley, who served from 2007 to 2015, is a Democrat, and both houses of the state legislature have been under Democratic control for decades. Nevertheless, Maryland adds an important variable to the analysis: the change in partisan control that occurred when O'Malley ousted Republican Robert Ehrlich offers an example of how a change in administration and the ideological differences between chief executives affect tax policy.

By contrast, Virginia is relatively conservative. Even though President Obama eked out narrow victories in Virginia (53 percent of the vote in 2008 and 51 percent in 2012), he was the first Democratic presidential candidate to carry Virginia since 1964.

[9] A political party cannot hold more than 11 seats on the D.C. Council, because the District's Home Rule Act limits a party to two of the Council's four at-large seats.

Republicans held both the lieutenant governor's office and the attorney general's office from 2007-2015, and have controlled the House of Delegates since 2000. Virginia also adds another institutional dynamic to the case study: that of divided government. Democratic Governor Tim Kaine shared power with a legislature under Republican control until 2008, when Democrats won a majority in the Virginia Senate. Partisan control of the governor's office followed a pattern opposite to Maryland: Republican Robert McDonnell succeeded Kaine (who could not run again) in January 2010.

The three states also differ in their economic and social characteristics, which could affect decisions about the distribution of the tax burden and provisions to promote equity. Although each state has a household income above the national median, D.C.'s poverty rate exceeds the national average while Maryland and Virginia have below-average poverty rates (U.S. Bureau of the Census, 2012b). As of the 2010 Census, D.C. remained (barely) a majority-black jurisdiction, whereas Maryland and Virginia both had white majorities (U.S. Bureau of the Census, 2012b). D.C. is entirely urban, whereas Maryland and Virginia each has urban, suburban, and rural areas.

In addition to a large federal government sector, D.C. has a particularly large service sector, very little manufacturing, and no agriculture (Government of the District of Columbia, 2007a: 18-19, 137-138; U.S. Bureau of the Census, 2012c), suggesting that expanding the sales tax base to cover services could be a salient issue in D.C. In addition, as a prime tourist destination and the center of a large metropolitan area, D.C. enjoys opportunities to "export" its tax burden to visitors and others who live out of state, even though Congress has barred the District from taxing income earned within its borders by non-residents.[10] Maryland and Virginia both have more diverse economic bases, reflecting strength in the government, business and professional services, and health and education sectors, as well as manufacturing and agricultural sectors that are shrinking but still remain important (Board of Revenue Estimates, 2006: 5-20; Commonwealth of Virginia, 2006: A-7; Secretary of Finance, 2006).

Finally, the three states vary in their tax systems. Maryland and Virginia rely mainly on the personal income and sales taxes for tax revenue, but Virginia is particularly dependent on the personal income tax, which generated 54 percent of the state's tax revenue in FY 2006, the last fiscal year before the start of the case study period, compared to only 22 percent for the general sales tax.[11] Maryland's tax system is more balanced: the personal income tax generated 45 percent of state tax revenue and the sales tax provided 25 percent in FY 2006.[12] D.C. has the most diversified tax system of the three states, generating significant amounts of tax revenue from the personal income tax (27 percent), real property tax (26 percent), and sales tax (20 percent) in FY 2006.[13]

Of course, any three states cannot adequately reflect the diversity of the United States. The states chosen for this study lack geographical diversity; all have percentages of foreign-born residents that are near or below the national median; and all have higher

---

[10] This prohibition was part of the D.C. Home Rule Act approved by Congress in 1973.

[11] Author's calculations using data provided in provided in Comptroller of Virginia, *A Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006* (December 2006), p. 44.

[12] Author's calculation using data from Maryland Board of Revenue Estimates, *Report on Estimated Maryland Revenues: Fiscal Years Ending June 30, 2007 and June 30, 2008*, p. 22, and Comptroller of Maryland, *Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2006*, p. 134. The sales tax figure excludes excise taxes such as those on cigarettes and alcohol.

[13] Author's calculation using data from Government of the District of Columbia, *FY 2008 Proposed Budget and Financial Plan: Moving Forward Faster,* Volume 1, Executive Summary (March 23, 2007), pp. 3-10, 4-14 – 4-15. The sales tax figure excludes excise taxes such as those on cigarettes and alcohol.

shares of college-educated adults than the nation as a whole (U.S. Bureau of the Census, 2012b). In addition, the three states are not subject to the tax and expenditure limitations or supermajority requirements that constrain tax policy decisions in many states. Still, the case study states differ on enough key dimensions that they seem likely, collectively, to generate insights into the tax policymaking process. In addition, D.C., Maryland, and Virginia officials monitor one another's tax policies as an aspect of economic competitiveness and may also consider similar policy proposals as ideas diffuse through newspaper articles, television reports, and other media (Walker, 1969; Berry and Berry, 2007). Therefore, the study should provide an opportunity to assess the impact of economic development concerns and diffusion effects on tax policy.

The time frame of 2007 to 2010 spans the severe recession that officially began in December 2007 and ended in June 2009, as well as a year-and-a-half of slow economic recovery that followed the recession. This period includes the pivotal year of 2009, when net state tax increases reached their highest level (relative to total state tax receipts) since 1991, as noted earlier (NCSL, 2010b: vii, 3-5). Still, tax policy debates and enactments during this period involved both tax cuts and tax increases. Mirroring a national pattern, elected officials in each of the case study states advocated tax cuts as a way to spur growth, and others targeted certain taxes or taxpayers for relief in order to ease the pain of overall tax increases. Therefore, tax policy deliberations in D.C., Maryland, and Virginia from 2007 to 2010 provide a window on a wide range of tax policy decisions.

The case study involves multiple methods of gathering and generating data. Written records that document the budget process and its tax policy outcomes – budget proposals and justifications, legislative hearing records and committee reports, and adopted budgets – serve as primary sources. These documents are central to the analysis not only because they record the official actions in each state, but also they often provide the perspectives of key participants. In addition, the analysis includes reports, speeches, press releases, and other documents that further describe the opinions and motivations of public officials, interest groups, and other participants in tax policy deliberations. Finally, the case study draws on semi-structured interviews with 10 to 15 key participants in tax policy decisions in each state to help explain, elaborate, and interpret the policymaking process. Because written documents may conceal or omit as much as they explain, the case study combines document analysis with in-person interviews to obtain direct accounts of the tax formulation process and to probe participants' roles, motivations, behaviors, and choices in greater depth.

The use of multiple methods and data sources is intended not only to provide a fuller picture of tax policy decision-making in the three states, but also to reduce any bias or inaccuracy that could result from relying on one method. In addition, the use of multiple methods, and in particular the interviews with key participants, are designed to temper any bias that might result from the author's role as a D.C. government employee. I worked for the D.C. government throughout the 2007-2010 study period, and since April 2009 I have served as a fiscal analyst performing tax policy research for the District of Columbia's chief financial officer. Learning about the views of key participants in the tax policymaking process through personal interviews helped ensure that my analysis and conclusions are fair and accurate.

Organization of the Dissertation

Chapter 1 discussed the purpose and design of the dissertation. Chapter 2, "Literature Review," reviews relevant scholarship from the fields of public finance and budgeting, public administration, and political science. Chapter 3, "Research Design," discusses the case study methodology and the research strategy in greater detail.

Chapters 4, 5, and 6 present the case studies, describing and analyzing key tax policy decisions in D.C., Maryland, and Virginia, respectively, from 2007 to 2010. Chapter 7 concludes by comparing the cases and synthesizing the findings.

Chapter 2

Literature Review

Contents

> There is no art which one government sooner learns of, than that of draining money from the pockets of the people.
>
> -- Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776

Kings, prime ministers, presidents, and other heads of state have long been creative in finding ways to tax the people, as Adam Smith observed more than 200 years ago. As governments in Europe melded feudal territories into modern nation-states, they introduced taxes on land ownership, rents, stocks, imports, legal documents, and commodities such as tea, sugar, salt, spirits, and tobacco. In the 18th and 19th centuries, sales or consumption taxes became more important in many industrializing nations, as did taxes on personal and corporate income.

From the earliest development of tax systems, decisions about whom to tax and how to tax were infused with politics. Smith noted that, "In the disorderly state of

Europe during the prevalence of feudal government, the sovereign was obliged to content himself with taxing those who were too weak to refuse to pay taxes. The great lords, though willing to assist him upon particular emergencies, refused to subject themselves to any constant tax, and he was not strong enough to force them …" (Smith, 1776: 1080). Philosopher John Stuart Mill recognized the importance of what behavioral economists call the salience of taxation, stating that, "An Englishman dislikes, not so much the payment as the act of paying. He dislikes seeing the face of the tax collector, and being subject to his peremptory demands. Perhaps, too, the money which he is required to pay directly out of his pocket is the only taxation which he is quite sure that he pays at all." (Mill, 1848: 788). These observations echo in American tax policy today, as discussed later in this chapter.

Many of the economic and social welfare principles that are prominent in contemporary tax policy also have a long history. Smith offered four maxims of taxation: (1) citizens should pay taxes in proportion to their "respective abilities," (2) tax bills should be clear, certain, and not arbitrary, (3) taxes should be levied at the time, or in the manner, in which it is most convenient for people to pay, and (4) taxes should be designed to minimize administrative and economic costs (Smith, 1776: 1043-1045). Highlighting the tradeoff between equity and efficiency, Mill called for progressive taxation that would exempt necessities and proportionately tax income above a minimum standard (Mill, 1848: 737), while warning that very high tax rates would "lay a tax on industry and economy" and "impose a penalty on people for having worked harder and saved more than their neighbors." (Mill, 1848: 739). Many early scholars of public finance, including Swedish economist Knut Wicksell (1896: 97) as well as Smith and

Mill, supported "sumptuary" taxation on luxuries and products such as alcohol and tobacco in order to discourage people from wasting resources or, in the case of alcohol, falling into drunkenness and dissipation.

Although the political and economic dimensions of taxation have long been subjects of study and debate, these two strands of the tax policy process have rarely been integrated. Adam Smith recognized that governments are innovative in devising taxes, but more than two centuries later the process by which tax proposals are generated, evaluated, refined and selected is not well-understood. This knowledge gap is especially wide for tax policymaking in the American states, which impose a broad array of taxes – income taxes, sales taxes, excise taxes, and estate taxes, to name a few – and face federal constitutional limits only on their ability to tax imports and exports. To inform this study of tax policy formulation in the District of Columbia, Maryland, and Virginia, this chapter reviews relevant works from the public finance literature and the policy formulation literature.

The literature review provides a valuable foundation for this dissertation, but also identifies parts of the research base that need to be strengthened. As discussed below, the public finance literature has focused more on the expenditure side of the budget process than the tax side; in addition, experts in public finance have explored federal taxation in greater detail than state taxation.[14] The policy formulation literature, which tries to explain how public officials define and select problems for governmental attention and then develop and evaluate ways of addressing the problems, has not addressed tax policy

[14] There is also an extensive body of research on local property taxation, reflecting the property tax's role as the mainstay of local government taxation in the United States and the property tax "revolt" that started in California in the late 1970s.

in a systematic manner.[15] This chapter attempts to identify insights from these disparate bodies of research that may help explain state tax policy formulation and guide the case studies. The chapter also reviews theoretical and empirical work on federal budgeting, because findings from public finance work on federal spending and tax policy may also be relevant to state tax policy decisions.

Development of Modern Budget and Tax Systems in the United States

Modern budget systems and institutions in the United States had just begun to develop as the 20th century dawned. Centralized, executive budgeting, in which a president, governor, mayor, or city manager presents a set of accounts detailing proposed expenditures and revenues for an entire government, was first implemented by Ohio in 1910 and was adopted by the federal government in 1921. Except in times of war, tariffs and excise taxes proved sufficient to finance the federal government, while state and local governments relied primarily on the property tax (Carter, Gartner, Haines, Olmstead, Sutch, and Wright, 2006; Campbell, 2009: 50).

As the government expanded to fight two world wars, mitigate the severe downturns and disruptions of an industrializing economy, and regulate a more complex, densely-populated society, federal and state governments tapped new sources of tax revenue to finance their operations. The federal government adopted a corporate income tax in 1909, a personal income tax in 1913, and an inheritance tax in 1916. Meanwhile, states began instituting personal income, corporate income, and sales taxes in order to

[15] For example, Helen Ingram, Anne Schneider, and Peter deLeon listed 49 published studies on the role of social construction in policy design, but none dealt with budget or tax policy. See Helen Ingram, Anne Schneider, and Peter deLeon, "Social Construction and Policy Design," in *Theories of the Policy Process*, Paul Sabatier, ed., Second Edition (Boulder, CO: Westview Press, 2007), pp. 114-117.

support growing expenditures on transportation, public education, social welfare, and public health programs. Early in the 20th century, tax policy in the United States was largely aimed at keeping the government afloat financially, as the need to fund a growing government reeling from war and depression overshadowed concerns about the economic and social impacts of taxation as well as the relative merits of different tax levies. The growth of modern tax systems would set the stage for more intense battles about the fairness, efficiency, feasibility, and transparency of various taxes in later years.

By 1940, most elements of current state tax systems were in place (Mikesell, 2015: 42). As property values plummeted during the Great Depression, the real property tax could no longer serve as the primary source of state and local tax revenue. States ceded most property tax revenue to local governments; by 1940, the property tax provided only 5 percent of total state tax revenue (Sharkansky, 1969: 171; Mikesell, 2015: 39). States developed new revenue sources to meet their growing obligations for services such as education and aid to localities. By 1940, 31 states had adopted a personal income tax and a corporate income tax (the states adopting each tax were not identical), although the tax rates and revenue yields were often modest because the federal government already drew on those sources (Twentieth Century Fund, 1937: 13, 41; Sharkansky, 1969: 169-171). After Mississippi imposed the first general sales tax in 1932, drawing on a revenue source that the federal government did not tap,[16] 23 other states followed suit by the end of the 1930s (Twentieth Century Fund, 1937: 45-46). In addition, gasoline taxes spread to every state between 1919 and 1929, reflecting growing purchases of automobiles and the use of gas tax revenues to finance roads and highways.

[16] The federal government imposed several excise taxes (selective sales taxes), but not a general sales tax.

By 1940, every state except Nevada taxed assets transferred at death (Twentieth Century Fund, 1937: 23). A majority of states also imposed excise taxes on cigarettes (27 states) and alcohol (30 states) by the end of the 1930s (Advisory Commission on Intergovernmental Relations, 1995: 32-33).

Total state tax revenue climbed from $301 million in 1913 to $3.3 billion in 1940 (nominal dollars), more than a ten-fold increase (Carter, Gartner, Haines, Olmstead, Sutch, and Wright, 2006: 5-52). Despite the rapid growth of state budgets and the diversification of state tax systems, public finance experts did not focus on the design of tax policy or the variation among state taxes. Instead, scholars and reformers emphasized the mechanics of budgeting: how to classify, monitor, and report public spending and revenues in order to enforce spending limits, promote accountability, and prevent corruption. Budgeting was seen as a tool of public administration, and more specifically a means of control, rather than a way of making policy (Schick, 1966: 246-250).

The formulation of budgets as a means of public policymaking, rather than only a tool of public administration, emerged as a subject of academic study in the United States in 1940 when V.O. Key published his seminal work, "The Lack of a Budgetary Theory," in *The American Political Science Review*. Key challenged scholars and practitioners to examine how budgeting could enhance social welfare, but focused almost exclusively on public spending, identifying "the allocation of expenditures among different purposes so as to achieve the greatest return" as "the most significant aspect of public budgeting." (Key, 1940: 1137). Key viewed government revenues largely as a resource constraint requiring difficult tradeoffs among objects of expenditure. The formulation of tax policy, both in its descriptive and normative aspects, remained largely unexplored by scholars.

More than 70 years later, tax policy formulation remains an underdeveloped field of study, particularly at the state level.

Advances in Organizational Theory: Bounded Rationality and Incrementalism

The 1940s and 1950s witnessed important developments in the study of bureaucracy and organization theory, which in turn influenced the nascent field of policy studies. The growing clout of behavioralist thinkers led to new theories of interaction and decision-making within organizations emphasizing limited rationality and reliance on established routines formed by experience. An important result of this framework for organizational behavior was the budgetary theory of incrementalism.

Simon's "Satisficing Man." Herbert Simon's *Administrative Behavior*, published in 1945, discarded the assumptions of perfect information and optimizing behavior held by classical economists[17] and instead proposed a more limited form of individual and organizational rationality ("bounded rationality"). In contrast to "Economic Man," who understands the relevant aspects of a problem or situation, analyzes all possible courses of action and their likely outcomes, holds a stable set of preferences, and chooses the option most likely to fulfill his preferences, Simon's decision-maker is a "Satisficing Man" with limited capacities. Facing pervasive uncertainty about options and their consequences, as well as limits on time and cognitive ability, Satisficing Man examines problems and alternatives sequentially, rather than simultaneously, and relies on habitual, routinized responses based on experience rather than searching broadly for an ideal solution. Satisficing Man's limited ability to cope with a complex external environment

[17] James E. Anderson provides a good summary of these assumptions in "Theories of Decision-Making," in *Public Policymaking*, Fifth Edition (Boston: Houghton-Mifflin Company, 2003), pp. 121-122.

explains why he will generally choose the first option that meets a threshold of adequacy (satisficing) to respond to a given problem (Simon, 1945).

According to Simon, organizations play a critical role in helping people cope with limited rationality. Members of an organization can specialize and coordinate their efforts, enabling the collective to draw on more information and knowledge, and entrusting decisions to people with relevant expertise. Simon further contended that organizational hierarchy aids decision-making because managers set goals, make assignments, and establish plans that simplify the choices people make within the organization. Even so, organizational decision-making remains an exercise in satisficing because organizations cannot fully overcome the limitations of their members. By formalizing roles and procedures, organizations define ways of responding to specific situations, resulting in "programmed decision making" that restricts the study of the problem and the search for solutions. When an organization faces novel or particularly complicated challenges, it will search for new information and options in deciding how to respond, but will generally follow predictable, routine patterns in conducting the search and will not be able to adjust instantly to new circumstances (Simon, 1945).

Simon's concept of satisficing through limited, routinized analysis has been reflected in the thinking of many other scholars (as discussed later in this chapter) and has been supported by empirical research on individual and organizational decision-making (Tversky and Kahneman, 1982; Jones, 1999). Simon's work underlines the need for this study to examine how options are developed and decisions are made within the organizations involved in state tax policymaking – in particular, governor's budget and policy offices, treasury or finance departments, and legislative tax committees – and the extent to which they use standard operating procedures and routinized search mechanisms to cope with bounded rationality.

Lindblom's "Branch Method." In "The Science of 'Muddling Through,'" published in 1959, Charles Lindblom extended and refined Simon's attack on the "rational-comprehensive model," which Lindblom informally termed the "root method." Lindblom echoed Simon in arguing that analysis is inevitably limited; important options, values and outcomes are neglected or omitted due to cognitive and resource limits. In addition, Lindblom rejected the view that public officials set goals and then choose the best ways to reach them, because citizens and the policymakers who represent them often have vague or conflicting goals. Instead, the choice of ends and means is often fused in policy making, or even reversed, because the relative importance of various goals may only become clear when specific options are discussed. Lacking clear goals, unlimited resources, or perfect information, officials can only make "successive limited comparisons" based on modest deviations from current policy, which Lindblom called the "branch method." (Lindblom, 1959: 79-81).

Whereas Simon focused on decision-making within a hierarchical organization such as a government bureaucracy, Lindblom emphasized decision-making in a pluralist society. He argued that the branch method is particularly apposite to democratic systems where power is shared and influence is channeled by rules and institutions, making sweeping, synoptic changes unlikely. Moreover, Lindblom posited that the combined actions of diverse individuals and groups acting incrementally can resemble a synoptic approach through a division of labor in which each cause or interest has its own advocate. Incremental policy changes, in Lindblom's view, also promote social cohesion by enabling society to address problems through modest steps that build consensus and avoid severe harm to particular groups.

Lindblom argued that the branch method characterizes government decision-making on expenditures and taxation (Lindblom, 1961:306). Using the choice between social welfare and defense expenditures as an example, Lindblom contended that the abstract nature of the root method would inevitably fail to provide a basis for making the necessary tradeoffs (Lindblom, 1961: 325-326). Unfortunately, Lindblom did not specify how the branch method would apply to taxation, but his important observation that means-ends rationality may often be absent in public policy debates will be explored in the case studies. Public finance experts broadly agree on criteria that can be used to evaluate a tax system, including revenue capacity, efficiency, equity, transparency, and ease of administration (Lee, Johnson, and Joyce, 2013: 133-139; Mikesell, 2003: 300-318). If Lindblom is correct, policymakers do not use these norms to guide policy development and selection; instead, they determine their goals by weighing specific adjustments of current policies.

In addition, Lindblom makes the important point, which will also inform the case studies, that a wide-ranging or "comprehensive" policy proposal may in fact represent the combination of many incremental efforts. This is particularly relevant for a system of government with separated powers that requires bargaining and compromise on many issues. With numerous participants in the tax policy process (and other policy areas), a single blueprint relating policies to tax policy goals is unlikely. If Simon teaches that decision-making routines within organizations are important, Lindblom reminds us that the interactions – bargaining, cooperating, competing – of satisficing men (and women) who make up those organizations shape public policy, often in incremental steps.

Incremental Theory of Budgeting. Aaron Wildavsky (1964) built on the work of both Simon and Lindblom in developing an "incremental" theory of federal budgeting. Wildavsky placed budgeting in the context of bounded rationality, noting that officials face an extremely complex task in allocating funds to dozens of agencies, hundreds of programs, and thousands of line items. In dealing with this complexity, policymakers are hampered not only by limited time and cognitive capacity, but also by "the imposing problem of making comparisons among different programs that have different values for different people." (Wildavsky, 1964: 10). As a result, public officials "do not try for the best of all possible worlds," but instead seek to "satisfice." (Wildavsky, 1964: 12-13). Wildavsky argued that budgeting involves piecemeal adjustments rather than optimizing behavior because sweeping change involves too many unknowns, prior commitments must be respected, and past experience informs current decisions. Nevertheless, Wildavsky explicitly excluded revenues from his study (Wildavsky, 1964: vi-vii); like Key, he seemed to view revenues as a resource constraint rather than a matter of policy debate in their own right.[18]

Ira Sharkansky, a leading scholar of state government in the 1960s, contended that state budgeting was even more incremental than federal budgeting, but his elaboration of the theory also focused almost exclusively on appropriations (Sharkansky, 1969). He argued that both "underpowered governors" (who were often subject to single-term limits

[18] This view is reflected in Wildavsky's statement that, "Since funds are limited and have to be divided in one way or another, the budget becomes a mechanism for making choices among alternative expenditures." (Wildavsky, 1964: 2).

and had to share executive power with other elected officials such as attorneys general and treasurers) and "amateurish" state legislatures (which suffered from frequent turnover, low pay, and meager staff assistance) lacked the capacity to review agency budget requests carefully and therefore made only marginal changes to previous budgets (Sharkansky, 1969: 83-84, 111-112, 142-143). Sharkansky offered little evidence to support his description of state tax policy as incremental, except for the apparent "reluctance of tax officials to consider seriously the proposals that they overhaul the entire tax code." (Sharkansky, 1969: 202).

Sharkansky's analysis is not only outdated,[19] but overly simplistic. During the 1960s, state tax policy continued to involve major shifts: 11 states implemented a personal income tax; nine states instituted a corporate income tax, and 10 states imposed a general sales tax (Advisory Commission on Intergovernmental Relations, 1995: 32). Only during the 1970s did state tax adoptions slow down markedly, giving state tax policy a more incremental pace. In 1983, Susan Hansen found that incrementalism "offers a useful description of current tax practices," (Hansen, 1983: 146) but she pointed out that the development of state tax systems was far from incremental.

Experts writing more recently have echoed Hansen's description of state tax policymaking as largely incremental (Brunori, 2011a: 48-49; Lewis and Hildreth, 2011: 184, 211; Mikesell, 2015: 44-47). In some respects, this should not be surprising: if spending patterns change only at the margins, then only incremental changes in the taxes that finance expenditures should be needed. Still, the patterns of tax policy decisions

[19] State governments have changed significantly since Sharkansky's time. For example, Virginia is now the only state that bars a governor from serving two consecutive terms, and governors have four-year terms in every state except New Hampshire and Vermont. Legislatures have expanded their budget and policy staffs and are less dependent on the executive branch for information and analysis.

may differ than those of expenditure policy. First, some of the fragmenting forces in the appropriations process – annual allocations for hundreds of programs and line items, decisions made by multiple appropriations committees or sub-committees – are not present in tax policy, which does not have to be reviewed every year and is usually under the purview of a single committee in a legislative chamber. Second, tax policy changes may follow a different pattern from spending policy changes if officials cut spending to reflect projected revenues, or use fees, debt, or accounting techniques to keep the budget balanced (or seemingly in balance). Third, particular taxes usually do not have well-defined constituencies pushing for a "fair share" in the same way that spending programs, such as farm subsidies or scientific research, are backed by groups with strong common interests. Due to these differences, a contemporary analysis of incrementalism as it pertains to tax policy is needed, and will be a focus of inquiry in this dissertation.

The incremental theory of budgeting also came under attack from critics who assailed its lack of precision and predictive power (Bailey and O'Connor, 1975; Wanat, 1974; Gist, 1974). Ironically, Wildavsky wrote *The Politics of the Budgetary Process* at the dawn of President Lyndon Johnson's Great Society – a massive expansion of social welfare programs launched as part of a "war" on poverty. Wildavsky and colleagues had to concede the existence of "shift points" when budget patterns diverge due to changes in administration or political party control, economic or diplomatic crises, and other external factors (Davis, Dempster, and Wildavsky, 1966: 542). Fortunately, scholars would develop more detailed theories of policy formulation that would explain how incremental change is sometimes interrupted by sharp shifts.

Theories of Policy Formulation: Combining Incrementalism and Major Change

John Kingdon proposed one of the most influential frameworks of public policy development in *Agendas, Alternatives, and Public Policies* (first published in 1984), challenging the "textbook" model that outlined the stages of the policy process (agenda setting, policy formulation, implementation, and evaluation) in a mechanical, linear way (Sabatier, 2007a: 6-7). Focusing on the initial stages of setting the agenda and specifying alternatives, Kingdon set forth a "multiple-streams" framework to explain how some issues capture public attention and rise on the government agenda. One of his major contributions was to show how policies can change in a non-incremental manner once they are joined to problems that are high priorities for policymakers and the public. In other words, public policy is highly fluid, sometimes lurching from point to point rather than staying at equilibrium.

Kingdon posed the question, "What makes an idea's time come?" and more specifically asked, "What makes people in and around government attend, at any given time, to some subjects, and not to others?" (Kingdon, 1995: 1). Drawing on case studies of federal health and transportation policy based on almost 250 interviews, Kingdon found that the alignment of three factors – problems, policies, and politics – can vault a policy idea onto the public agenda for serious debate. Kingdon described these factors as "process streams" that permeate the activities of government (Kingdon, 1995: 85-87). At some critical junctures when the three streams are joined, the most significant policy changes may occur, according to Kingdon. The joining is most likely to occur when "policy windows" – opportunities to frame an issue and advance a proposal – open due to compelling problems (such as an economic downturn, natural disaster, or outbreak of disease) or changes in the political stream (such as changes in national mood or a change in administration) (Kingdon, 1995: 165-170).

According to Kingdon, elected officials and their senior appointees play the greatest role in shaping the governmental agenda, whereas civil servants and non-governmental actors have more impact on the policy alternatives that are considered. Nevertheless, he contended that, "Public policy is not one single actor's brainchild," (Kingdon, 1995: 71) particularly in light of the fragmentation of power in American government. "Thus the key to understanding policy change is not where the idea came from but what made it take hold and grow." (Kingdon, 1995: 72).

The multiple-streams framework rejects the idea of rational, synoptic policy analysis, but also challenges the incrementalist approach that emerged in opposition to the rational model. Like Simon, Lindblom, and Wildavsky, Kingdon concluded that limits on time, attention, and information-processing capacity prevent comprehensive analysis, and that policymakers must often gloss over differences in goals (to the extent they have clear goals) in order to agree on policy (Kingdon, 1995: 77-79). At the same time, Kingdon argued that incrementalism was overstated, pointing to issues in his case studies that "took off" very rapidly after being dormant for some time. He found that changes in the policy agenda are sharp and substantial, whereas the generation of alternatives is incremental (Kingdon, 1995: 79-83).

An important aspect of Kingdon's agenda-setting model is that problems are not objective; rather, they are ambiguous and not fully understood. As a result, there is an ongoing battle among different groups to present information strategically to capture the attention of top officials and convince them that certain conditions represent problems requiring a governmental response (Zahariadis, 2007). Values play a role in problem definition, as do images, symbols, and comparisons that highlight particular aspects of an issue or condition (Kingdon, 1995: 109-111). Because policymakers' time and attention are finite, competition to get items on the public agenda is intense and involves a range of strategies ranging from presenting facts to using institutional power and position. Many issues "take off" and become topics of serious debate as media attention increases and a "contagion" effect leads more people to take note of an issue that is gaining prominence.

Policy proposals swirl around in what Kingdon termed a "policy primeval soup" (Kingdon, 1995: 116-117). Communities of policy specialists, such as legislative staff members, think-tank researchers and academics, and policy analysts from government agencies and private groups focus on particular policy areas and generate proposals that circulate through the policy community. A particularly important figure is Kingdon's "policy entrepreneur," someone who relentlessly promotes certain ideas or positions, and often plays a decisive role in connecting policies to problems and building the political support needed to enact a particular solution (Kingdon, 1995: 122-124, 127-131). A policy entrepreneur can be found inside or outside the government, but his or her defining characteristic is a willingness to invest time, energy, reputation, or money to move an issue forward (an example would be Ralph Nader and his advocacy on auto safety and other consumer protection issues).

Most of the ideas that are mixed into Kingdon's policy primeval soup are "recombinations" – repackaging existing ideas and proposals – rather than "mutations," or wholly new ideas (Kingdon, 1995: 124-125). Kingdon posited that technical feasibility, value acceptability, and resource constraints will help determine if a policy proposal survives (Kingdon, 1995: 131-138). This process of natural selection generates a short list of ideas, and policy specialists may eventually coalesce around a particular idea through a bandwagon or tipping effect (Kingdon, 1995: 139-142).

According to Kingdon, the policy windows that open when the problem, politics, and policy streams are joined can quickly snap shut. Policymakers may believe they have addressed the problem; they may move on to other issues if there is no agreement on a solution; or they may shift their attention to new issues and problems (Kingdon, 1995: 168-171). The process is not linear or rational; even if decision makers believe a problem is pressing, they may not act on it unless a well-vetted solution is attached to it because other ways of spending their time may seem more productive.

The multiple-streams framework provides an explanation for the coexistence of gradual evolution and pronounced change in public policy. As an issue like taxation moves up or down the policy agenda due to changes in the problem or politics stream, incremental policy changes may alternate with major policy changes. In that respect, Kingdon's framework seems consistent with general patterns in tax policy at the federal, state, and local levels: modest or minimal changes are periodically interrupted by major shifts such as President Reagan's tax cuts in 1981, the federal Tax Reform Act of 1986, or the D.C. Tax Parity Act of 1999.

Kingdon's multiple-streams framework has been criticized for having "no explicit hypotheses" and being "so fluid in its structure and operationalization that falsification is difficult." (Sabatier, 2007b: 327). In particular, the concept of a "policy window" is vague and almost impossible to verify or test. Yet the framework can still be used as a lens for this study, particularly for the agenda-setting and policy development processes in the case-study states, because it is built on detailed analysis of 23 case studies (Parsons, 1995: 192; Zahariadis, 2007: 79-80),[20] and was later applied by Kingdon to tax policy – specifically, President Reagan's package of budget and tax cuts in 1981 as well as the Tax Reform Act of 1986 (Kingdon, 1995: 210-217).

The multiple-streams framework has a number of important implications for this dissertation. First, the case studies should seek to understand and explain the place of taxes on the policy agenda in each state, and how changes in the problem or political streams affected the attention devoted to tax policy during the 2007-2010 period. Second, the case studies should explore the nature of the tax policy "community" – the political appointees, civil servants, researchers, and interest-group members – in each state, and how they interact to develop and refine tax policy alternatives. A related task is to see if any "policy entrepreneurs" can be identified, and to assess their role in connecting policies to problems and building political support for a solution.

Frank Baumgartner and Bryan Jones developed a model of "punctuated equilibrium" that also sees policy outcomes as characterized by relatively long periods of stability interspersed with bursts of more rapid change. Baumgartner and Jones' account of policy development is largely consistent with Kingdon's, but focuses more on the behavior of individuals and the specialized policy communities they form, rather than a "macro-level" governmental agenda and the actions of the most powerful officials. The punctuated equilibrium framework was applied to federal budgeting by Jones, Baumgartner, and True (1998), who found that it explained patterns in federal budget authority from 1947 to 1995, but this empirical test did not involve tax policy.

[20] However, Zahariadis (2007: 80) notes that almost all of the empirical work concerned national policies.

According to Baumgartner and Jones, policy subsystems comprised of specialists who care deeply about an issue are often created and destroyed in American politics. When the subsystems are strong, they may be able to ensure a conservative, incremental approach to policymaking, serving in effect as a "policy monopoly" (Baumgartner and Jones, 1993: 4). Such monopolies have two important characteristics: (1) a definable institutional structure for policymaking, which limits access to the policy process, and (2) a powerful supporting idea, such as patriotism or fairness, associated with the institution (Baumgartner and Jones, 1993: 5). Baumgartner and Jones argued that, "Behind a wall of institutional arrangements designed with their help, and with a public or official image also created by their own efforts, some policy experts enjoy tremendous freedom of action, seldom being called upon to justify their actions in terms of broad public accountability." (Baumgartner and Jones, 1993: 6). A policy monopoly, particularly when it is supported by people of considerable wealth or professional distinction, can prevent some alternatives from being considered by public officials – a phenomenon that Peter Bachrach and Morton Baratz (1962) termed "non-decision-making." However, the generation of new ideas makes many policy monopolies unstable in the long run, which is why periods of considerable stability may be punctuated by periods of volatile change.

Baumgartner and Jones posited that the destruction of a policy monopoly is almost always associated with a change in intensities of interest, which can arise from a new understanding of an issue or policy (Baumgartner and Jones, 1993: 6). If the prevailing images associated with an issue are shattered or even blurred, the policy monopoly sustained by those images often weakens or collapses, and new participants may enter the debate. As the scope of people involved in the issue widens, the policy dispute may draw more attention from what Jones called the "macropolitical institutions," (Jones, 1994: 26) such as chief executives and legislatures, and a policy shift or reversal may occur if they intervene in the subsystem. According to Baumgartner and Jones, policy change is also likely to involve institutional change that provides continued access and control to the newly-emergent or dominant forces. Ideas and images are important in eroding a policy monopoly and triggering policy change, and institutions help protect and preserve that change, potentially ushering in a new monopoly that promotes stability.

Institutions can also help spark change when advocates succeed in "venue shifting" – moving an issue onto the agenda of another government institution (including a different level or branch of government, or type of agency such as an independent regulatory body) that is more receptive to their views[21] (Baumgartner and Jones, 1993: 31-35). For example, legislation to control farm runoff will probably fare much better if it is considered by an environment committee rather than an agriculture committee. Reorganizing institutions and reassigning duties can also promote venue-shifting and a change in the policy agenda. As other scholars have noted, control over structure and procedure can determine who participates in policy deliberations, what alternatives are considered, and whose consent is required (Shepsle, 1989).

Consistent with the multiple-streams framework, Baumgartner and Jones view the definition of issues and the promotion of policy images as a strategic, if not manipulative, process.[22] Policy images are always a mixture of empirical information and emotional

---

[21] A powerful example of venue shifting stems from the civil rights movement, which won many important victories by involving the federal courts, and then the president and congress, in decisions that had previously been controlled by the states.

[22] Baumgartner and Jones define a "policy image" as "how a policy is understood and discussed" (Baumgartner and Jones, 1993: 25).

appeals, according to Baumgartner and Jones (1993: 26). Because issues are complex, ambiguous, and constantly evolving, and people's preferences are multi-faceted,[23] political leaders and policy entrepreneurs can advance their ideas by highlighting preferences that are more likely to evoke support, rather than attempting the more difficult task of changing people's preferences (Jones, 1994: 8-9). Those trying to mobilize broad groups attempt to focus attention on highly emotional symbols or easily understood themes, while those who seek to restrict the debate and preserve a policy monopoly convey the issues in more arcane and complicated ways that will discourage participation (Baumgartner and Jones, 1993: 30).

The cumulative impact of the ongoing but sporadic creation and destruction of policy monopolies may be that a competitive and pluralistic political system is much less conservative than it may appear. Echoing Kingdon, Jones argued that agenda-setting is by its very nature episodic or punctuated because it involves selecting problems and alternatives for priority attention, thus diverging from routine business (Jones, 1994: 18). In this way, the setting of the high-level policy agenda creates the conditions for abrupt policy shifts to occur. Because time and attention are limited – in contrast to information, which may be abundant and ambiguous – the agenda items selected, options considered, and policy decisions made will be strongly influenced by those who can best distill information so that it is useful to lawmakers (Jones, 1994: 23). In essence, the job of the policy entrepreneur is to frame an issue in order to win the attention and support of key decision-makers.

[23] As examples of multi-dimensional preferences, Jones points out that people want both to consume and to save, and that they want more public services and lower taxes (Jones, 1994: 13).

The punctuated equilibrium framework may overstate the importance of policy monopolies; other scholars have pointed out that policy communities may be fluid, fragmented, conflictual, or cooperative, rather than dominated by a particular group (Heclo, 1978; Adam and Kriesi, 2007; Sabatier and Weible, 2007). Still, the punctuated equilibrium framework calls attention to aspects of the policymaking process that merit serious consideration in this study, particularly the role of ideas and images in gaining access to the policy agenda and the role of institutions in channeling or restricting access.

Policy Selection: How Alternatives Are Evaluated in the Political Process

The multiple streams and punctuated equilibrium frameworks are particularly useful in understanding how the policy agenda is set and how alternatives are developed, but offer less insight about how options are chosen. Once a policy window opens, what factors influence whether lawmakers will devise a solution and the form it will take?

One of the earliest models of policy selection was developed by Theodore Lowi (1964), who identified three major categories of public policy: distribution, regulation, and redistribution. Lowi contended that each of these policy types, which he referred to as "real arenas of power" (Lowi, 1964: 689), is marked by a distinctive political structure, process, participants, and group dynamics. Tax policy fits in the redistribution category, because taxes transfer resources among broad classes of people.[24] Due to the salience and major impact of redistributive policies, Lowi posited that they will entail bargaining among large "peak" associations, conflict among elite and non-elite groups, and relatively stable coalitions.

[24] Lowi stated that, "The fact that our income tax is in reality only mildly redistributive does not alter the fact of the aims and the stakes involved in income tax policies." See Theodore Lowi, "American Business, Public Policy, Case Studies, and Political Theory," *World Politics* 16 (1964): 691.

Nevertheless, tax policy might sometimes fall in Lowi's "distributive" category, which involves "highly individualized" benefits (Lowi, 1964) so small in scope that they require no obvious redistribution of resources – patronage, in effect. Tax policy is replete with examples of such narrowly-targeted provisions, such as companies that receive tax exemptions or abatements for locating or remaining in a state (Brunori, 2011a: 22-24, 32-33). Tax policy involves both what Emmette Redford described as "micropolitics," in which "individuals, companies, and communities seek benefits from the larger polity for themselves," as well as "macropolitics," in which "the community at large and the leaders of the government as a whole are brought into the discussion and determination of policy." (Redford, 1969: 83). Even if a micropolitical benefit must be approved by a legislature, only a small number of people participate in or even know about the decision, which might be buried in a few lines of a massive bill.

Other scholars critiqued Lowi's approach as oversimplified and lacking predictive power (Greenberg, Miller, Mohr, and Vladeck, 1977; Steinberger, 1980). James Q. Wilson argued that some policies cannot fit into Lowi's framework, that the expected impacts of a policy change over time, and that some policies (such as urban renewal) have distributive, regulatory, and redistributive elements (Wilson, 1974: 328-329).

Wilson revamped Lowi's framework by treating new policies as a separate case, because the public's understanding of a new policy is not settled, and identifying the incidence and concentration of benefits and costs as a key factor in determining policy choices. Wilson devised a two-by-two matrix, summarized in Table 2.1 (see next page), to explain how benefits and costs (projected or actual) affect the political dynamics of a policy debate.

Table 2.1
James Q. Wilson's Theory of Policy Change and Development

	Distributed Benefits	**Concentrated Benefits**
Distributed Costs	I Program tends to expand and become institutionalized. Examples: Social Security, public education, national defense.	II Program is stable or expands because intense support overwhelms diffuse opposition. Examples: farm subsidies, veterans' benefits.
Concentrated Costs	III Program is difficult to enact and subject to challenge once established. Examples: antitrust policy, auto safety programs.	IV Program is subject to ongoing conflict and possible reversals because both sides are highly motivated. Examples: labor-management issues; trade policy.

Source: James Q. Wilson, *Political Organizations* (New York: Basic Books, 1974), pp. 327-337.

Policies that both confer benefits and spread costs over a large number of people (quadrant I in Table 2.1), Wilson contended, will tend to become easily institutionalized and expand without significant effort by proponents. As with Social Security, benefits may increase steadily over time as officials receive positive feedback from the public and seek the political advantage of aiding a large pool of beneficiaries. Policies that focus benefits while spreading costs (quadrant II) will grow and maintain support, according to Wilson, by attracting intense support from beneficiaries and little opposition from anyone else. Farm subsidies and veterans' benefits reflect this pattern, benefiting from the support of government agencies established to administer the programs, as well as strong advocacy groups that lobby for the programs.

By contrast, policies that spread benefits broadly while concentrating costs on a small group (quadrant III) are likely to arouse strong opposition from those adversely affected, and may only win enactment after a focusing event (such as an environmental disaster) activates a new, broad-based constituency that favors change. Clean air, clean water, and auto safety policies fall into this category. Finally, policies that concentrate both benefits and costs (quadrant IV) are likely to trigger ongoing political conflict because people on both sides of the issue are strongly affected. Labor-management issues represent a policy field marked by protracted struggle between powerful interests.

Wilson's typology is consistent with many aspects of tax policymaking. Tax benefits with large constituencies, such as the home mortgage interest deduction or the sales and property tax exemptions for non-profit organizations, which are almost universally offered by states and localities, would seem to fall into quadrant I. Politicians seek to maintain and expand these benefits because they are widely spread and enjoy popular support. Tax incentives for certain industries or businesses, as well as tax preferences for senior citizens, would fit into quadrant II: they receive strong support from the smaller groups that benefit while arousing little opposition because the costs are dispersed. Many policies to broaden the tax base (such as proposals to tax legal, medical, or other services) would fall into quadrant III because the benefits are diffused and the costs are concentrated. Finally, an earmarked tax, such as a tax on alcoholic beverages that is used to fund for addiction programs, might fall into quadrant IV because it could be marked by ongoing battles about whether the benefits of the programs being funded exceed the costs to those who pay the tax.

Wilson's typology also reflects some weaknesses. Most importantly, the terms "distributed" and "concentrated" are not defined. In addition, at some point politicians' impulse to distribute benefits will generate costs that cannot be sustained; diffused costs eventually reach a level that will mobilize powerful opposition. Even if benefit-cost incidence reflects an important dynamic in policy formation, there are many ways that benefits and costs can be distributed to pursue political goals. Politicians may wish to spread benefits widely, but that does not explain why they choose (for example) an across-the-board personal income tax cut or general sales tax cut as the mechanism.

Because the incidence (and fairness) of a benefit or cost is partly a matter of interpretation, the concept of "social construction" of target populations, developed by Anne Schneider and Helen Ingram, seems like a useful supplement to Wilson's typology. Schneider and Ingram contended that the design of public policy is affected not only by the size and concentration of the benefits and burdens to be distributed, but also by depictions of target populations that are "normative and evaluative, portraying groups in positive or negative terms through symbolic language, metaphors, and stories." (Schneider and Ingram, 1993: 334). According to Schneider and Ingram, policymakers typically view target groups (such as senior citizens, homeowners, or welfare recipients) in positive or negative terms, and allocate benefits and burdens to reflect and maintain those images. Therefore, social constructions of target groups are important attributes of political discourse and policy design (Schneider and Ingram, 1993: 345).

Schneider and Ingram offered a typology of policy formation to explain their theory of social construction. As shown in Table 2.2 (see next page), this typology has four quadrants, with the social construction (positive or negative) of a group depicted on one axis and the group's political power (high or low) on the other axis.

"Advantaged" groups, such as small businesses, homeowners, and the elderly (quadrant I), enjoy considerable political power and a positive social construction – these

Table 2.2
Anne Schneider and Helen Ingram's Theory of Social Construction

	Positive Image	**Negative Image**
High Political Power	I "Advantaged" Groups in this category are more likely to receive benefits, such as tax credits and deductions. Examples: small business owners, homeowners, the elderly.	II "Contenders" Groups in this category are likely to receive benefits because of their political power, but the benefits may be hidden due to negative images of the target groups. Examples: labor unions, rich donors, the religious right.
Low Political Power	III "Dependents" Groups in this category are seen as deserving but benefits may be symbolic because the groups lack political power. Examples: mothers, children, persons with intellectual disabilities.	IV "Deviants" Groups in this category are regarded as harmful and tend to absorb a disproportionate share of burdens and sanctions. Examples: criminals, illegal immigrants.

Source: Anne Schneider and Helen Ingram, "Social Construction of Target Populations: Implications for Politics and Policy," *American Political Science Review*, June 1993, 87(2): 334-347.

are the pillars of society. The advantaged are more likely to receive benefits and to be treated with respect through flexible policies that involve them in designing and modifying the program (Schneider and Ingram, 1993: 338-339). "Contender" groups shown in quadrant II, such as labor unions, the wealthy, and conservative activists, have substantial political resources but are often regarded as selfish and socially harmful. Contenders are likely to receive benefits due to their political power, but the benefits are more likely to be hidden in the details of legislation or otherwise difficult to identify because the groups are controversial or polarizing (Ingram, Schneider, and deLeon, 2007: 102).

"Dependent" groups shown in quadrant III, such as mothers, children, and the developmentally disabled, have little political power but a positive social construction because they are seen as deserving. Because dependent groups lack political resources, they may receive benefits that are meager or symbolic (Schneider and Ingram, 1993: 339). Finally, "deviant" groups shown in quadrant IV, such as felons and illegal immigrants, lack political power and serve as society's scapegoats. Deviants are easy, if not valuable, targets for burdens imposed by policymakers (Ingram, Schneider, and deLeon, 2007: 103).

The four categories described above do not serve as rigid boundaries, because social constructions can be strongly contested and may evolve[25] (Schneider and Ingram, 1993: 336). Policymakers may also sub-divide target groups, perhaps by deeming part of a group (such as children of illegal immigrants) to be worthy while focusing disapproval and sanctions on another part of the group (such as criminal aliens). Nevertheless, Ingram, Schneider, and de Leon argue that, "The allocation of benefits primarily to the advantaged, burdens to deviants, hidden benefits and empty burdens to contenders, and inadequate and demeaning help to dependents is a pattern found across many policy areas." (Ingram, Schneider, and deLeon, 2007: 104). According to this view, public officials, especially elected officials, respond to and reinforce social constructions of target groups to gain public support and approval. In doing so, officials may exaggerate the positive and negative traits of social groups in order to align themselves with those who are powerful and well-respected (Ingram, Schneider, and deLeon, 2007: 107-108).

[25] For instance, there are often competing images of poor people in political discourse: sometimes the poor are characterized as unfortunate people who fell on hard times through no fault of their own, and at other times they are characterized as lazy or irresponsible people who have caused their own plight.

Social construction theory seems like a useful tool for understanding state tax policymaking, because the perceived worth of target groups is a salient factor in tax policy debates. State tax preferences reflect not only the political calculus of concentrated benefits and diffused costs, but also the positive social constructions of frequent beneficiaries, such as the elderly and military veterans.[26] As Ingram, Schneider, and deLeon would predict, tax benefits afforded to groups with less virtuous images, such as real estate developers or political donors, are often buried in complex budget or tax legislation (Brunori, 2011a: 22-23). Although cigarette taxes are defended as a way to reduce the harms of smoking, the sharp nationwide increase in cigarette taxation in recent years may also reflect a growing view that smoking is deviant (Brunori, 2011b). At any rate, the power of images such as the "death tax" that threatens the family farmer, or the hard-working secretary who pays a higher marginal tax rate than billionaire Warren Buffett, suggests that social construction is a powerful factor in tax policy debates.

Policy Formulation and the Study Propositions

The preceding review of the public policy formulation literature informs many of the seven study propositions set forth in Chapter 1 (see p. 10). The first two propositions, regarding agenda-setting and development of policy alternatives, are as follows:

1. State tax policy undergoes cycles of change and stability, due to the selective attention of officials and periodic changes in "problem streams" and "political streams" that elevate or lower the position of taxes on the policy agenda.

[26] Among the 43 states and the District of Columbia that levy a personal income tax, 31 exempt all Social Security income from taxation, going beyond federal policy which provides a full exemption only for lower-income senior citizens. Similarly, 29 states are more generous than the federal government in the tax exemptions provided to members of the armed forces; in fact, 10 states exempt all military pay from taxation. See Wisconsin Legislative Fiscal Bureau, "Individual Income Tax Provisions in the States," Informational Paper 4 (Madison, WI: Wisconsin Legislative Fiscal Bureau, 2013), pp. 3-5.

2. In the absence of a major external shift such as an economic crisis or a change in partisan control, state officials will tend to perform a limited search for tax policy options, focusing on modest adjustments to current taxes rather than more sweeping revisions.

These propositions are based largely on the multiple streams and punctuated equilibrium models, which accommodate both incrementalism and significant change by focusing on the episodic nature of agenda change at the senior levels of government. As noted in Chapter 1, tax policy in the case study states seems to reflect this pattern of minor adjustments interrupted by major change.

The next three propositions, dealing with the evaluation and selection of tax policy options, are as follows:

3. State officials emphasize political acceptability in evaluating tax policy options, at the expense of normative principles such as revenue capacity, efficiency, and equity.

4. State tax policy debates have an important symbolic dimension that has a powerful influence on the options that are selected.

5. State tax policy operates at two largely distinct levels: the "macropolitical" level, which affects a relatively large percentage of the population and generates more publicity, and the "micropolitical level," which involves smaller numbers of people and generates less publicity.

These propositions are largely informed by Simon's notion of bounded rationality and its implications for government decision-making as outlined by Lindblom, Kingdon, and Baumgartner and Jones. Facing pervasive uncertainty about the nature of problems and possible solutions, public officials representing different ideologies, constituencies, and branches of government are hard-pressed to agree on normative goals of public finance, such as revenue capacity, efficiency, and equity, or how to put them into practice. In a competitive political environment where people often hold strongly diverging opinions, policy agreement is often possible only at a superficial level and conflicting views are often papered over rather than resolved (Majone, 1989). Thus, public officials must cobble together policies that meet a test of political acceptability.

The role of symbols and images is important in framing the evaluation of a policy from a political standpoint, as emphasized not only in the social construction framework but also in the multiple streams and punctuated equilibrium frameworks. As public officials with limited time, attention, and capacity to resolve issues face an overflow of ambiguous information about problems and possible solutions, powerful symbols help focus the attention of officials and citizens, while evoking aspects of a policy choice that make it understandable and galvanize support. Research has shown that carefully-crafted images have played a major role in sparking opposition to federal and state estate taxes, which have been cast as a "death tax" that puts family assets at risk at a time of tragedy, even though less than .1 percent of all deaths will result in estate taxation (Sheffrin, 2013: 142-160). These emotive appeals affect the whole range of tax policy issues.

Redford's concepts of macropolitics and micropolitics also help distinguish how tax policy issues are considered when they command the attention of top political leaders and a large segment of the population (the issues rank high on the "policy agenda") and when the issues are known only to specialists and affect small numbers of people (the issues are far from the policy agenda). If public officials' attention is constantly shifting, then the micropolitical system may determine policy outcomes when high-level focus and attention are lacking. As Redford contended, the intense interests of the few may override the diffuse interests of the many in this case, because the few are the only ones participating in the decision-making process (Redford, 1969: 21-22). David Brunori explicitly linked micropolitics to state tax policy, stating that, "(M)uch tax policy is developed and implemented behind closed doors at both the legislative and executive levels of government … Typically, a person, corporation, or industry will lobby a legislator for a particular tax benefit … In many cases, the legislator will then attempt to hide the true beneficiary by burying the proposed change in legislation that appears generally applicable." (Brunori, 2011a, 22-23). As Clarence Stone (1980) argued, micropolitics affects who benefits from public policy, because those with greater economic resources, political connections, and social standing are likely to dominate an arena that depends on highly specialized knowledge and access.

These propositions, as well as the sixth and seventh propositions, also draw on findings from the public finance literature. The next section of this chapter returns to a discussion of that literature.

Public Finance and Tax Policy

Economic Theory and Tax Policy. Several theoretical advances in the second half of the twentieth century contained important insights for tax policy formulation. In "A Pure Theory of Local Expenditures," Charles Tiebout (1956) contended that citizen mobility forces sub-national governments to engage in competition similar to that found in a market. To attract and retain residents, Tiebout posited, state and local governments will develop distinctive packages of services and taxes that reflect different preferences among the populace. If individuals are fully mobile and fully informed about spending and revenue patterns in different jurisdictions, citizens can pick the community that best meets their preferences for services and tax levels. State and local governments do not need to mirror one another's service or tax levels, in Tiebout's view, but the competition caused by citizen mobility will impel governments to minimize the cost of producing a given package of services. Mobility replaces the usual market test of willingness to pay and "reveals the consumer-voter's demand for public goods." (Tiebout, 1956: 420). Tiebout's perspective on competition among sub-national governments is important because it challenges the notion that competition should lead states to match their neighbors' services or tax rates. Rather, differentiation is a likely result of competition.

In "An Economic Approach to Federalism", Wallace Oates (1972) identified a key reason why sub-national tax systems should be less progressive than federal tax systems. Oates examined the comparative advantage of different levels of government in a federal system with respect to three main functions: allocation (efficient use of resources), stabilization (maintaining high levels of employment with price stability), and distribution (equity). He contended that a central government is more suited to fulfill the stabilization and distribution functions. The uncoordinated activities of numerous sub-national governments would hinder stabilization, and a state or local government with a generous distribution policy would attract poorer people while wealthier people needed to finance the benefits departed. "The scope for redistributive programs is thus limited to some extent by the potential mobility of residents, which tends to be greater the smaller the jurisdiction under consideration," Oates stated. "This suggests that … a policy of income redistribution has a much greater promise of success if carried out on a national level." (Oates, 1972: 8).

Oates contended that sub-national governments play a critical role in allocation, providing public services that span their geographical boundaries. In that respect, Oates' theory is consistent with Tiebout's: the role of state and local governments is to tailor public goods to the preferences of the community in the most efficient manner. Whether and how states differentiate their tax policies to meet the preferences of their residents, as Tiebout and Oates would predict, is a question that the case studies may illuminate.

Public Finance and the Politics of Taxation. Public finance experts also focused on the politics of taxation. Writing after a wave of state tax cuts proposed by newly-elected Republican governors in 1995, Steven Gold cautioned that this trend was part of a larger cyclical pattern, adding that state legislatures had trimmed or rejected most of the proposals for large tax cuts (Gold, 1996). Noting that state and local tax revenue per $100 of personal income was almost unchanged from 1970, Gold decomposed the different parts of the policy cycle. He pointed out that state taxes increased during the recession years of 1971, 1975, 1983, and 1991, and that tax increases were also more common in odd-numbered years, when very few states hold elections. By contrast, states tended to reduce taxes a few years after a recession: net tax cuts occurred in 1978, 1979, 1985, 1994, and 1995. Gold identified a "pendulum effect" in which states cut taxes in order to offset increases that occurred several years before (Gold, 1996: 18).

David Brunori argues that a politics of "antitaxation" has pervaded tax policy debates at all levels of American government since the late 1970s, when Proposition 13 in California triggered a "tax revolt." (Brunori, 2011a: 3-4, 44-45). To meet the demand for services while avoiding the wrath of anti-tax sentiment, Brunori posits that state officials turn to less visible sources of revenue (such as excise taxes, gaming revenue, user fees, and asset sales) while trying to "export" as much of the tax burden to out-of-state individuals and firms as possible (Brunori, 2011a, 51-53).

Carol Lewis and W. Bartley Hildreth (2011) also contend that state officials frame tax policy strategically to assuage anti-tax sentiment. Lewis and Hildreth view incrementalism – "making small and politically acceptable changes in existing taxes instead of grand changes" (Lewis and Hildreth, 2011: 184) – as a way to avoid voter ire, and further pointed out that using many different taxes and fees allows policymakers to spread burdens and reduce the visibility of taxation (Lewis and Hildreth, 2011: 188). In addition, Lewis and Hildreth note that public officials will often dedicate tax revenue to a popular program or clearly-needed project in order to gain support for tax increases from a skeptical public (Lewis and Hildreth, 2011: 188). Irene Rubin echoes similar themes, arguing that policymakers who believe tax increases are necessary must design the tax package and build support strategically, while taking credit for tax reductions and exemptions (what Rubin called a "politics of protection") in more favorable times (Rubin, 2010: 36). The strategies officials may use to make tax increases palatable include earmarking, making the tax increase temporary, or raising a number of taxes by small amounts, "so that no one group is seriously hurt and citizens feel that the burdens are being widely and equitably shared." (Rubin, 2010: 42-43).

Scholarship on "cutback management" – defined by Charles Levine as "managing organizational change toward lower levels of resource consumption and organizational activity" (Levine, 1979: 180) – places tax increases in a larger framework of budget-balancing measures that is consistent with the findings of Brunori, Lewis and Hildreth, and Rubin, as discussed above. In a review of fiscal retrenchment strategies used following the recession of 2001-2002, Michael Dougherty and Kenneth Klase found that states acted first to curb spending through less controversial measures such as travel and hiring freezes, across-the-board cuts, transfers from special funds and use of reserve funds, and delays of new initiatives – actions that would largely avoid reducing benefits

(Dougherty and Klase, 2009: 612-615). Only as fiscal problems continued and the initial stopgap strategies were exhausted did policymakers turn to more painful measures such as deeper, targeted spending cuts and tax increases, reflecting strong anti-tax sentiment. In a case study of eight states, Dougherty and Klase noted that states made changes "at the margins of the tax and revenue process," such as delaying planned tax cuts or decoupling from federal income tax provisions, but were reluctant to increase broad-based taxes (Dougherty and Klase, 2009: 612-615). Similar patterns were found by other researchers who studied state cutback strategies during the same period (Finegold, Schardin, and Steinbach, 2003; Holahan, Coughlin, Bovbjerg, Hill, Ormond, and Zuckerman, 2004; Boyd, 2008), as well as by the National Conference of State Legislatures for the 1988 to 2010 period (NCSL, 2011b: 4). The cutback management findings are consistent with the view that policymakers seek to minimize, delay, and obscure tax burdens while distributing tax relief as often as possible.

Christopher Howard (2009) traced one of the most important results of the anti-tax movement, showing how politicians from both parties use tax expenditures (targeted tax relief measures that are often used to promote certain activities, such as home buying, or to provide financial assistance) to make social policy while easing tax burdens.[27] Howard noted that tax expenditures are a useful tool for elected officials because they are aimed largely at middle- and upper-class voters, who pay the most in taxes and are most likely to vote (Howard, 2009: 94). Moreover, tax expenditures are particularly valuable when political control of government is divided and partisan divisions are sharp,

[27] Tax expenditures are defined by the Congressional Budget and Impoundment Control Act of 1974 (section 3(3)) as "those revenue losses attributable to provisions of the … tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

providing a rare area of potential agreement for politicians from different parts of the ideological spectrum (Howard, 2009: 96-99).

Statistical Analysis of Tax Policy. Several scholars also conducted statistical analyses of factors that affect state tax policy. Frances Stokes Berry and William D. Berry (1992) conducted a detailed study of factors that affect state tax adoption (initial enactment of a tax), which might also suggest factors that influence state tax policy changes. The Berrys found support for a "political opportunity" explanation of state tax adoptions: distance from the next election, existence of a fiscal crisis, and adoption of a tax in a neighboring state all allowed politicians to shield themselves from the political costs of supporting a new tax. This finding was consistent for different tax instruments and different periods during the 20th century. Contradicting prior work by Susan Hansen (1983), the Berrys did not find empirical support for the hypothesis that unified governments, in which the executive branch and both houses of the state legislature are controlled by the same party, are more likely to adopt a tax than divided governments.[28]

The Berrys observed that a strict distinction between economic and political factors is probably counterproductive (Berry and Berry, 1992: 736-737). Instead, they found that the chances of tax adoption were greatest when political and economic conditions converged (a result consistent with Kingdon's idea of "policy windows"). Indeed, the effects of election proximity, fiscal health, and neighboring-state adoptions on the probability of a state adopting a tax were multiplicative: an extreme value on one variable amplified the impact of the other variables on the chances of adoption.

[28] In trying to explain the difference in findings, the Berrys pointed out that they used more statistical controls than Hansen, who relied primarily on bivariate analysis. They also noted that unified governments are not likely to adopt new taxes if the party in power is conservative. See Berry and Berry, 1992: 735-736.

Moreover, if one of these variables showed an extreme value not conducive to adoption, the probability of tax adoption dropped sharply even if the other two variables were highly favorable to adoption (Berry and Berry, 1992: 737).

The most detailed model of tax policy formulation in the United States and other democratic nations was proposed by Walter Hettich and Stanley Winer (1999), who view tax policy as a general equilibrium resulting from economic, political, and administrative factors. Particularly notable about this model is that Hettich and Winer included detailed assumptions about voter behavior and its effects on the political process, while treating taxes as a system of tax bases, rate structures, and special provisions that are interrelated.

Hettich and Winer set forth a system of collective choice, based on a "probabilistic" voting model in which political parties adopt positions intended to maximize their votes,[29] which was tested empirically using data from the United States. The politically optimal tax structure, according to Hettich and Winer, minimizes total political costs (in terms of loss of votes) for any given level of revenue collected and equalizes the "marginal political opposition" per dollar of tax revenue among taxable activities and taxpayers. The collective choice that generates this result can also be economically efficient, because voters will choose candidates whom they expect will advance their well-being. Hettich and Winer further posited that officials will select a Pareto-optimal tax policy weighted toward the preferences of voters who are most politically aware and influential, because that will maximize expected votes.

---

[29] The probabilistic voting model differs from other models of collective choice, such as the median voter model, in assuming that political parties do not know with certainty how voters will cast their ballots. Therefore, a change in a policy position will lead to changes in the probability of support from voters, but does not lead to a total loss of support from a decisive, median voter. The probabilistic model also reflects the reality that voters make their choice based on a host of issues, including but not limited to tax policy.

Hettich and Winer's theory yields powerful and sometimes surprising results. Although many experts argue in favor of broad tax bases with minimal exemptions, deductions, and other adjustments (Feldstein, 2010; Marron, 2011; Marr and Highsmith, 2011), Hettich and Winer view complex tax structures as "politically rational" attempts to win favor with influential groups of voters and thereby minimize opposition to taxation (Hettich and Winer, 1999: 49). Therefore, efforts to close tax "loopholes" are likely to prove futile. Hettich and Winer also found empirical support for the following predictions (Hettich and Winer, 1999: 215-224):

4. Governments will exploit opportunities to lower the effective tax prices of voters who are most likely to offer political opposition. Reducing opposition is done not only by offering tax preferences but also by (a) shifting tax burdens to higher levels of government that provide offsets or deductions for taxes paid to lower levels of government, and (b) taxing people, goods, and services that move across jurisdictions.

5. Governments will face opposition and political costs that grow at a faster rate as the amount of revenue collected from a tax increases, relative to its base. By the same token, growth in a tax base softens political opposition because the government can collect the same amount of revenue at a lower rate.

6. Both government officials and taxpayers will prefer tax bases and tax systems that yield stable revenue streams to those that are more volatile, in order to minimize the costs of adjusting to fluctuating revenues.

The combined effect of public officials' desire to dampen opposition to taxes, shift the burden of taxes outside the jurisdiction, and rely on growing tax bases is a pattern of "spreading the tax as widely as possible," which mutes the issue of taxation because "the costs of organizing opposition are more difficult to overcome if many taxpayers are affected to a small degree than if payments are concentrated among a few." (Hettich and Winer, 1999: 35). The driving force is for the government to adjust tax rates "until the marginal political cost … or reduction in expected votes, of raising an additional dollar … is equalized across taxpayers." (Hettich and Winer, 1999: 46).

Hettich and Winer reported mixed support for the idea that state tax levels are constrained by tax levels in competing jurisdictions. They found that neighboring states often showed opposite rather than converging patterns in their tax levels (consistent with Tiebout's theory), but that states tended to adopt similar tax levels as non-contiguous states with a similar socio-economic profile (Hettich and Winer, 1999: 232, 234).

Hettich and Winer's model also suffers from some flaws. In particular, Hettich and Winer ignored the evidence for bounded rationality, stating that, "Tax structure, including special provisions, represents an equilibrium result of the political process where all components have been rationally chosen by governments engaged in the struggle to remain in office." (Hettich and Winer, 1999: 58). Hettich and Winer also posited the existence of vigorous party competition, clear party platforms, and voters who are fully aware of those platforms – assumptions that are dubious because many elections are uncontested, political parties are weak, and policy positions are imprecise (Weaver and Rockman, 1993; Weaver, 1986; Jacobs and Shapiro, 2000).

In the absence of vigorous political competition and a fully-informed public, bureaucracies and interest groups, as well as the rules set by constitutional provisions and legislative procedures, may wield greater influence on policy outcomes (Ostrom, 2007; Shepsle, 1989; Riker, 1984). As William Riker has argued, the choice process itself is very dynamic; all of the options are not developed and considered at once, and they change over time. Therefore, the public officials and private actors who can structure the choice, using institutional roles, legislative procedures, or skillful strategy, can strongly influence the policy outcome (Riker, 1984). Hettich and Winer's large-scale, quantitative study does not capture these important variables pertaining to ideology, information, institutions, and interest groups, which are difficult to represent in quantitative analysis.[30]

Public Finance and the Study Propositions

This review of the public finance literature further informs many of the study propositions that were set forth in chapter 1 and refines the ideas developed in reviewing the policy formulation literature. With regard to agenda-setting and the development of policy alternatives, Gold, Brunori, Lewis and Hildreth, and Rubin saw incremental patterns in state tax policy but did not rule out the possibility of more pronounced shifts. In discussing the cycles of state tax policy, Gold pointed out that many proposals for major change (such as large tax cuts proposed by state governors) are often scaled back in our system of separated powers: state legislatures forced the governors to compromise. In their study of state tax adoptions, Berry and Berry pointed out that non-incremental shifts are possible when a number of political and economic forces (timing of elections, fiscal crises) are aligned, reflecting a widespread view among scholars that major changes in tax policy can take place in periodic bursts (proposition #1).

The public finance literature also offers strong support to proposition #3: that state officials emphasize political acceptability in evaluating tax policy options, rather than normative principles such as revenue capacity, efficiency, and equity that are widely accepted by public finance experts (Lee, Johnson, and Joyce, 2013: 133-139; Mikesell,

[30] In fact, Hettich and Winer downplayed the importance of ideology in positing that the platforms of political parties will converge as they seek to maximize expected votes. Although Hettich and Winer recognized the importance of institutions in creating and preserving policy equilibria, they acknowledged that their statistical analysis did not account for the role of institutions (Hettich and Winer, 1999: 234).

2003: 300-318). In particular, Hettich and Winer assailed the idea that politicians might try to promote economic efficiency and horizontal equity by broadening the tax base and repealing tax preferences, because this approach contradicts the political imperative to reduce taxes for influential groups in order to suppress anti-tax sentiment. Hettich and Winer's argument seems persuasive in light of the dozens of special tax breaks that pervade state tax codes, despite regular calls for reform (Rubin, 2010: 57-64; Cordes and Juffras, 2012: 313-315). More generally, experts in public finance emphasize the tendency of policymakers to spread tax burdens widely, to rely on taxes that are less visible or salient, and to shift tax burdens out of state.

The public finance literature also highlights the cyclical nature of state tax policy, emphasized in propositions #6 and #7. As Gold noted, state officials tend to approve tax cuts when the economy is strong and surpluses are growing, and to impose tax increases when the economy is sputtering and deficits are looming. Nevertheless, there is an imbalance to these cycles or pendulum swings. Reflecting politicians' desire to distribute benefits and to avoid or postpone pain, tax increases are often temporary and are crafted to spread costs rather than to generate sufficient revenue for the long term. Tax cuts seem to be awarded almost continuously, except in times of severe fiscal distress, while tax increases seem like stopgaps rather than more enduring changes to the tax system.

As state officials focus on the short-term swings of the economy and the opportunities to distribute benefits through the tax code to assuage anti-tax sentiment, they may be failing to adjust tax systems to reflect long-term changes in the economy and society. "While state taxes have remained essentially unchanged," David Brunori noted, "the economy has moved from a manufacturing base to one dominated by services and intellectual property … State tax structures are incapable of dealing with economic swings." (Brunori, 2011a: 2). If tax policy is designed to dampen political conflict by emphasizing benefits and hiding costs, then officials may find it difficult to align tax burdens with parts of the economic base that are large or growing. There is growing evidence of such a mismatch. For example, state sales and corporate tax bases continue to shrink as percentages of personal income and corporate income (Fox, 2012: 409; Brunori, 2012: 337; Ebel and Rubin, 2015: 294; Sjoquist, 2015: 67-72).

In summary, there is a rich body of academic research from public administration, political science, and economics that offers insight about tax policy formulation, but this literature has not treated state tax policymaking in a detailed, systematic fashion. The case studies presented in this dissertation will test seven propositions that emerge from this literature in an effort to build a stronger knowledge base about how tax policies are developed, evaluated, and selected at the state level. Chapter 3 describes the study's research design before the D.C., Maryland, and Virginia case studies are presented, respectively, in chapters 4, 5, and 6.

Chapter 3

Research Design

Contents

> There are no simple answers and there is no simple finite set of causes for anything that happens in an organization.
>
> -- Karl Weick, *The Social Psychology of Organizing*

This dissertation explores the formulation of tax policy in the American states, tracing the development, evaluation, and selection of tax changes that are enacted into law. This inquiry was motivated by an intellectual puzzle: what explains the *content* of state tax policy decisions? State officials may choose from a number of levies (personal income, corporate income, general sales, excise, and other taxes), which they can adjust by increasing or decreasing rates, or by expanding or narrowing the base. Policymakers can also establish new levies, such as a value-added tax imposed at every step of the production process. How and why do state officials select particular items from this broad array of tax options? For example, why might officials raise personal income taxes on wealthy individuals, rather than expanding the sales tax base to include professional services provided by doctors, lawyers, and engineers? Why would officials offer firms a credit for hiring new employees rather than cutting corporate tax rates?

To illuminate state tax policy choices, this dissertation presents a case study of tax policymaking in the District of Columbia, Maryland, and Virginia, from 2007 to 2010. This chapter summarizes the research design, including the research orientation, case study methodology and sample selection, and strategies for data collection and analysis, that will be used to answer the following research questions:

5. How were tax policy options developed in the three jurisdictions, and by whom?
6. How were tax policy options evaluated by decision-makers?
7. What factors or criteria determined which tax policy options were enacted?
8. What patterns in the tax policy decisions of the three jurisdictions might also apply to other states and other levels of American government?

As stated in the introduction, a "tax policy decision" is defined in this study as a statutory change in one or more of the following: (1) a tax rate, (2) a tax base, or (3) the use of tax revenue. Administrative measures, such as efforts to increase tax compliance, are beyond the scope of the study because they serve to implement existing policy more effectively. Taxes can be defined as compulsory payments, usually based on some measure of resources or ability to pay, that fund the general activities of the government. Taxes are the focus of this study because they finance the collective needs of the citizenry. Table 3.1 (see next page) delineates the scope of the dissertation.

Table 3.1
Scope of the Dissertation

The scope includes:	**The scope *does not* include:**
Taxes, defined as compulsory payments, usually based on a measure of resources or ability to pay (such as income, consumption, or wealth), that finance general activities of the government.	Non-tax revenue, such as fees or fines that can be charged to a particular person, household, or organization to pay for a discrete service or benefit, or to impose a penalty for violating the law.
Tax policy in the American states. Although the case study focuses on three states (D.C, Maryland, and Virginia), it seeks to identify patterns and findings that might apply to other states. In addition, the study will suggest avenues for further research on federal and local tax policy in the U.S. if appropriate.	Tax policy in nations other than the United States. Federal structure, as well as the powers of provinces, cantons, and other sub-national levels of government, is so different in other nations that findings from American states would not apply to those polities.
Statutory action to change tax rates, the tax base, or the use of tax revenues.	Statutory or administrative actions to improve or increase the collection of taxes in accordance with existing law.

Research Orientation: A Qualitative Approach

This dissertation mainly employs a qualitative research strategy to answer the four research questions. Although qualitative research is often associated with spoken or written words and open-ended analysis, the defining attributes of qualitative research are more complex (Creswell, 2014: 4; Mason, 2002). Qualitative research has three distinctive characteristics: (1) it is grounded in a philosophical position that is at least partly "interpretive," reflecting a concern with how the processes being studied are interpreted, understood, and experienced by participants, (2) it is based on methods of data generation that are both flexible and sensitive to the social context in which the data are produced, and (3) it is based on methods of analysis, explanation, and persuasion that emphasize understandings of complexity, detail, and context in an attempt to portray a process or phenomenon holistically (Mason, 2002: 3-4). A qualitative research strategy is appropriate for this study, because it provides a way to explore the tax policy outcomes (the end result) as well as the motivations, reasoning, and strategies of those involved in the decisions (the path to the end result). By contrast, a quantitative research strategy that identifies central tendencies or patterns among a large number of instances is less able to delve beneath surface patterns, trends, and correlations to probe how and why those patterns emerge, and how they develop over time. In presenting a case study of budgeting practices in 15 states, Edward J. Clynch and Thomas P. Lauth observed that:

> Aggregate data studies tend to mask the important institutional and contextual differences among states in the ways they allocate available resources among competing agencies, programs, and constituencies. Sometimes, aggregate data conclusions bear little resemblance to individual state conditions or practices. (Clynch and Lauth, 2006: 1)

Andrew Bennett and Colin Elman offer a useful distinction between (1) research that examines "effects of causes," which typically relies on quantitative methods to infer systematically how much a cause contributes, on average, to an outcome within a particular population, and (2) research that examines "causes of effects," which usually relies on qualitative methods to investigate how causes interact in a case or several cases to produce an outcome, rather than the average effect of a cause (Bennett and Elman, 2006: 456-458). Because this dissertation is concerned with the step-by-step development of state tax policy – the anatomy of tax policy decisions, if you will – a qualitative approach aimed at identifying causes of effects is appropriate.

Bennett and Elman also point out that "small-n," qualitative research methods are particularly well-suited for subjects characterized by strong "path dependence," in which initial choices constrain the future choices of individuals or groups (Bennett and Elman, 2006: 463-465). The critical choices that set the future path are difficult to identify without an intensive study of a particular case or cases. State tax policy is marked by path dependence; for example, states that were early adopters of particular levies such as the personal income tax or the general sales tax continued to rely disproportionately on those taxes (Hansen, 1983: 160). Path dependence in state tax policy stems from the relative degree of acceptance that often attaches to existing taxes, as well as the efficiency of using tax collection systems that are already in place. A qualitative research strategy is well-suited to understanding the paths leading to state tax policy outcomes.

Case Study Methodology

The type of qualitative research employed in this dissertation is the case study, which can be defined as "a method for learning about a complex instance, based on a comprehensive understanding of that instance obtained by extensive description and analysis of that instance taken as a whole and in context." (Newcomer, 2008). Other definitions of case study emphasize the real-life context of the inquiry and the difficulty of separating the subject being studied from its economic, political, and social context (Yin, 2003: 13). A case study takes a "micro" approach, attempting to gain in-depth knowledge of a phenomenon – its origins, mechanics, and impacts – in a practical setting.

The case study method was chosen because its strengths align with the purposes of the dissertation. Robert Yin contends that case studies are particularly appropriate when (1) what, how, or why questions are being posed, (2) the researcher has no control over events, and (3) the study concerns a current or recent phenomenon with a practical context (Yin, 2003: 5-9). This dissertation meets all of these criteria. It seeks to address how tax policies are developed, refined, and evaluated, and why certain options are selected. The study is also concerned with recent tax policy decisions in the practical context of the American states. The case-study method is particularly suited for this dissertation because it provides the focus necessary to examine the complexities of state tax policy formulation and the economic, political, and social forces that affect it.

The study uses multiple cases (D.C., Maryland, and Virginia) in order to examine state tax policy formulation in different contexts. The multiple-case format was chosen to study tax policy in a range of settings that reflect some of the economic, political, and demographic diversity of the states. Although D.C. is not a state, the D.C. government performs state functions, as well as county and city functions.[31] Moreover, D.C.'s tax system, which includes levies typically imposed by states (personal income tax, corporate income tax, general sales tax, excise taxes) is more similar to most state tax systems than to a prototypical local tax system. Including this hybrid jurisdiction in the case study increases the diversity of settings covered, as discussed below, which should offer useful contrasts and additional evidence to inform the conclusions. For the sake of brevity, D.C. will be referred to as a state even though it is a unique state-local combination.

Because the three states do not comprise a representative, statistically-valid sample of the 50 states and the District of Columbia, case study findings cannot be generalized to that universe. Instead, this study aims for analytic or theoretical generalization: "the development of a theory that not only makes sense of the particular persons or situations studied, but also shows how the same process, in different situations, can lead to different results." (Maxwell, 1992: 293). Jennifer Mason describes theoretical generalization as using a "detailed and holistic explanation of one setting, or

[31] This is why many federal government geographical classifications, such as those of the U.S. Census Bureau, refer to the 50 states and the District of Columbia (and Puerto Rico, in some cases).

set of processes, to frame relevant questions about others." (Mason, 2002: 196). Differences among the three states provide a strong base for theoretical generalization about state tax policy formulation.

<u>The Case-Study States: District of Columbia, Maryland, and Virginia</u>

Walter Hettich and Stanley Winer view tax systems as the product of political, economic, and administrative influences (Hettich and Winer, 1999: 239), but social or demographic factors such as age and family structure may also play a major role. Senior citizens, for example, rely more on savings, investment, and pension income than working-age adults, who gain more of their income from salary and wages (Sjoquist, Wallace, and Winters, 2007: 15-16). These differences affect not only the political dynamics of taxation but also the size of the relevant tax bases. As outlined below, the three case-study states were selected purposely to capture broad variation in the political, economic, and administrative factors identified by Hettich and Winer, as well as the social forces that also affect tax policy decisions.

Political Variation. The political differences among D.C., Maryland, and Virginia should be particularly useful in exploring how political ideology, partisan control of government institutions, and changes in administration affect the development, evaluation, and selection of tax policy alternatives. Located in the mid-Atlantic, Maryland marks the southernmost point of the politically liberal Northeast, while Virginia stands at the northern tip of the politically conservative South.[32]

[32] A January 13, 2013, feature in *The Washington Post Magazine* stated that, "Perhaps it started during the Civil War, when they took opposite sides. For whatever reason, Maryland and Virginia have a rivalry as deep and as long as the Potomac River." One difference cited in the article is that, "Virginia taxes cars; Maryland taxes, well, everything." See Michael S. Rosenwald and Tom Jackman, "The Great Divide," *Washington Post Magazine*, January 13, 2013, pp. 5-10.

Surrounded by Maryland and Virginia, D.C. is in some respects one of the most politically liberal states. President Obama captured more than 90 percent of the D.C. vote both in 2008 and 2012, by far the highest percentage in the nation, and Democrats have held 11 of 13 seats on the D.C. Council since 1998. The D.C. Mayor has been a Democrat since Congress granted home rule to the District in the mid-1970s.

Maryland is also a solidly liberal, Democratic state, granting 62 percent of its votes to President Obama in 2008 and again in 2012. Democrat Martin O'Malley served as governor from January 2007 to January 2015, and both houses of the state legislature had Democratic majorities of more than two-thirds throughout the 2007-2010 period.[33] Nevertheless, Maryland adds an important variable to the analysis: the change in partisan control of the executive branch that occurred when O'Malley ousted Republican Robert Ehrlich offers an example of how a change in administration and the ideological differences between chief executives affect tax policy.

By contrast, Virginia is a moderate-to-conservative state. Even though President Obama eked out narrow victories in the commonwealth in 2008 and 2012, he was the first Democratic presidential candidate to win Virginia since 1964. Analysts have begun to describe Virginia as a "purple" state – up for grabs between "red" Republicans and "blue" Democrats. Reflecting this newly competitive political environment, Virginia was marked by shifting patterns of divided government from 2007 to 2010. Through the end of 2007, Democratic governor Tim Kaine faced a General Assembly with Republican majorities in both chambers; in 2008, Democrats took control of the Virginia Senate but remained a minority in the House. Republican Robert McDonnell succeeded Kaine (who

[33] Throughout the 2007-2010 period, the Maryland Senate was comprised of 33 Democrats and 14 Republicans, and the Maryland House of Delegates was comprised of 104 Democrats and 37 Republicans.

was term-limited) as governor in 2010 while control of the legislature remained split. The multiple permutations of divided government in Virginia from 2007 to 2010 add another institutional dynamic to the case study, as contrasted with unified government in Maryland and the District of Columbia.

Economic Variation. The three states also differ in their economic bases, which could affect decisions about the distribution of the tax burden. D.C. has a particularly large service sector (including the government sector), very little manufacturing, and no agriculture (U.S. Bureau of the Census, 2012c), suggesting that expanding the sales tax base to cover services could be a major issue in the District. In addition, as a prime tourist destination and the hub of a large metropolitan area, D.C. enjoys opportunities to "export" its tax burden to tourists and others who live out of state, even though Congress has barred the District from taxing income earned within its borders by non-residents.[34] The large percentage of tax-exempt federal and diplomatic property in D.C., due to its role as the nation's capital, also narrows the District's real property tax base,[35] potentially increasing the government's reliance on income and sales taxes while reinforcing the incentive to shift the burden to non-residents.[36]

Maryland also has a relatively large service sector, with particular strength in educational services, health care, and social assistance. In addition, Maryland has a relatively high percentage of government workers, although not as high as in D.C. (U.S.

[34] This prohibition was included in the D.C. Home Rule Act approved by Congress in 1973.

[35] U.S. Supreme Court decisions dating back to *McCulloch v. Maryland* in 1819 ruled that the federal government is immune from taxation by state and local governments. Embassies and related property used for diplomatic purposes are also exempt from state and local taxation as a principle of international law.

[36] One way to shift the burden to non-residents would be to rely on personal income taxes that qualify for an itemized deduction on the federal personal income tax, generating a federal subsidy for the D.C. tax.

Bureau of the Census, 2012c). Maryland has a growing biotechnology industry near the National Institutes of Health in the D.C. suburbs, as well as declining farming communities in the western part of the state – a mix of new and traditional sectors that may vie for special provisions to reduce their tax burdens.

Virginia's economic profile resembles that of Maryland, with a relatively large employment base in educational services, health care, and social assistance (U.S. Bureau of the Census, 2012c). Still, Virginia is distinctive for its government contracting sector in Northern Virginia, including many firms involved in defense and homeland security work, as well for shipbuilding, cargo transfer and storage, and manufacturing near the port and military bases of Hampton Roads. Declining textile and tobacco industries of southside Virginia have also been an ongoing concern for state officials, raising questions about whether lawmakers should protect industries in the southern part of the state. On the other hand, prosperous Northern Virginia accounted for one-third of all jobs in the state and more than half of new jobs in FY 2006 (Department of Taxation, 2006: 2-5), making the ongoing growth of high-wage and high-tech jobs in that region a major issue.

Social Variation. Social and demographic differences among the three states could shed light on the way that equity considerations influence tax policy decisions. Although each state has a household income above the national median, D.C.'s poverty rate exceeds the national average (U.S. Bureau of the Census, 2012b) and unemployment rates in the District have historically been above the national average. As a result, debates about the progressivity and the distribution of tax burdens might be particularly salient in D.C. Maryland and Virginia, by contrast, have below-average poverty rates (U.S. Bureau of the Census, 2012b). As of the 2010 Census, D.C. remained (barely) a majority-black jurisdiction, whereas Maryland and Virginia both had white majorities (U.S. Bureau of the Census, 2012b). D.C. is entirely urban, whereas Maryland and Virginia each has urban, suburban, and rural areas. These demographic differences may affect the tax policy process as different groups strive to minimize their burden of taxation by securing credits, deductions, and exemptions.

Administrative Variation. Hettich and Winer (1999) contend that the ideal tax system, from the perspective of an elected official, would generate a tax bill tailored to each individual's preferences for government services and his or her sensitivity to taxation. Such a system would minimize the loss in political support that results from taxation, but is not feasible because of its complexity. As a result, officials group economic activities into tax bases and assign individuals and entities to tax brackets in order to operate the tax system at a reasonable cost while still calibrating tax burdens to the extent possible (Hettich and Winer, 1999: 50-53). As noted earlier, the current tax system may affect state tax policy decisions because mechanisms to identify relevant transactions and collect taxes (such as employer withholding of wages and salaries and vendor collection of the sales tax) are in place and can be readily adapted. Moreover, individuals who benefit from existing provisions of the tax code are highly motivated to protect those benefits.

The case-study states display variation in how they group taxpayers and set their tax liability. Maryland and Virginia rely mainly on the personal income and sales taxes for tax revenue, but Virginia is particularly reliant on the personal income tax, which generated 54 percent of the state's tax revenue in FY 2006, the last fiscal year before the start of the case study period, compared to only 22 percent for the general sales tax.[37] Maryland's tax system is more balanced: the personal income tax generated 45 percent of state tax revenue and the sales tax provided 25 percent in FY 2006.[38] D.C. has the most diversified tax system of the three states, generating significant amounts of tax revenue from the personal income tax (27 percent), real property tax (26 percent), and sales tax (20 percent) in FY 2006.[39]

At the beginning of the study period (January 2007), there were important structural differences in the personal income taxes of the three states. Although each state had a progressive personal income tax, the top rate was much higher in D.C. (8.7%) than in Maryland (4.75%) or Virginia (5.75%). Nevertheless, Maryland counties had the authority to add a personal income tax of up to 3.2 percent, bringing the combined state-local rate as high as 7.95% (Virginia localities do not impose a personal income tax). As of January 2007, the top tax rate also started at a higher income level in D.C. ($40,001) than in Maryland ($3,001) or Virginia ($17,001).

Interstate competition seemed more acute with respect to the general sales tax; both Maryland and Virginia had 5 percent rates as of January 2007.[40] The District of Columbia had the highest general sales tax rate, 5.75 percent. Unlike D.C. and Maryland,

---

[37] Author's calculations using data provided in provided in Comptroller of Virginia, *A Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006* (December 2006), p. 44.

[38] Author's calculation using data from Maryland Board of Revenue Estimates, *Report on Estimated Maryland Revenues: Fiscal Years Ending June 30, 2007 and June 30, 2008*, p. 22, and Comptroller of Maryland, *Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2006*, p. 134. The sales tax figure excludes excise taxes such as those on cigarettes and alcohol.

[39] Author's calculation using data from Government of the District of Columbia, *FY 2008 Proposed Budget and Financial Plan: Moving Forward Faster,* Volume 1, Executive Summary (March 23, 2007), pp. 3-10, 4-14 – 4-15. The sales tax figure excludes excise taxes such as those on cigarettes and alcohol.

[40] State law in Virginia allocates 4 percent to the state and 1 percent to the local government where the purchase was made.

Virginia also taxed groceries, charging a 2.5 percent rate. There was a wider spread in corporate income tax rates among the three states as of January 2007: D.C. had the highest rate (9.975 percent), followed by Maryland (7 percent), and Virginia (6 percent).

Limitations. Any three jurisdictions cannot adequately reflect the diversity of the United States. First, these eastern states lack geographic diversity, despite straddling the northeast and southeast. In addition, each state has a percentage of foreign-born residents that is near or below the national mean; a percentage of senior citizens slightly below the national mean; and a higher share of college-educated adults than the nation as a whole (U.S. Bureau of the Census, 2012b). Moreover, the three states are not subject to the tax and expenditure limitations or supermajority requirements that constrain tax policy decisions in many states. Still, the case study states differ on enough key dimensions that they seem likely, as a group, to generate insights into the tax policy process. The lack of geographic diversity is also in some ways an asset. As neighboring states, D.C., Maryland, and Virginia provide a test case of the ways that competitiveness concerns, as well as policy imitation and diffusion, affect tax policy.

Time Frame. The time frame of 2007 to 2010 spans the severe recession that officially began in December 2007 and ended in June 2009, as well as a year-and-a-half of slow economic recovery after the recession. The 2007-2010 period was chosen in part because it includes the most recent peak of tax policy activity in the states, which occurred in 2009. NCSL reported that in 2009, 25 states made significant tax policy changes, defined as statutory changes that increase or decrease tax collections by at least 1 percent, and that the net tax increase of 3.7 percent represented the largest total increase since 1991 (NCSL, 2010b: vii).[41] The time frame of 2007-2010 offers an opportunity to examine tax policy choices before, during, and after this recent peak of tax policy change.

Although closing budget deficits through spending cuts and tax increases became a focus of policy debate nationwide during the economic downturn, some officials in Maryland and Virginia continued to advocate tax cuts as a way to spur growth, and many tax proposals in each state targeted some taxes or taxpayers for reductions in order to ease the pain of overall tax increases. Therefore, tax policy deliberations in D.C., Maryland, and Virginia from 2007 to 2010 provide a window on a wide range of tax policy decisions, in times of economic growth and decline.

Data Collection

Use of Multiple Methods. The dissertation employed a two-part data collection strategy, drawing first on documentary evidence to establish the official record of tax policy decisions as well as the stated motivations and rationales of key participants in each state. The study was further informed by semi-structured interviews with 10 to 15 key individuals who were closely involved in tax policy debates in each state.[42] The interviews provided a way to probe, verify, and extend public records and narratives of tax policy formulation in each state, and to explore the perceptions, behaviors, and decisions of influential participants in greater depth.

[41] The net change of 3.7 percent has not been exceeded in subsequent years.

[42] "Semi-structured" means that the interviewer has pre-written questions, but sometimes departs from the prepared questions or follows up on them to seek more detail. Therefore, the structure has flexibility that enables the interviewer to pursue important points, as well as unexpected topics, in greater depth.

Documentary Evidence. In any year, a state legislature may consider dozens or hundreds of tax policy bills. Even though many of these bills do not receive serious consideration or undergo a public hearing, most state governments enact statutory changes to tax rates, tax bases, or tax uses every year. These laws range from major changes affecting large numbers of taxpayers to arcane, technical provisions designed for a single person or business. To avoid getting lost in minutiae and to illuminate critical aspects of the tax policy process, this study must focus on bills that were particularly important or pivotal in each state during the 2007-2010 period.

The task of identifying the key tax policy changes in each state started with a review of the annual operating budget: the annual budget request of the chief executive, and the enacted budget approved by the legislature and signed by the chief executive for each of the fiscal years (2008, 2009, 2010, and 2011) that correspond to the 2007-2010 period.[43] Although Virginia approves a biennial budget, policymakers amend the budget in the second year of the biennium, so there is still an annual budget process. The budget is an appropriate starting point for a study of state tax policy decisions because major tax policy changes are often proposed as part of the budget, or as companion legislation to the budget, to ensure that the changes comply with balanced-budget requirements.

The second step in determining the critical tax policy choices was to examine government documents and data bases that describe the tax legislation introduced, considered, and enacted in each state. In Maryland and Virginia, non-partisan legislative service agencies highlight the major tax bills and enactments from each legislative

[43] In Maryland and Virginia, fiscal years begin on July 1st of the preceding calendar year (i.e., fiscal year 2008 began on July 1, 2007), whereas in D.C., fiscal years begin on October 1st of the preceding calendar year (i.e., fiscal year 2008 began on October 1, 2007). Therefore, fiscal years 2008-2011 correspond to the 2007-2010 time frame of this study.

session while also summarizing other tax policy measures that were considered or enacted. The Maryland Comptroller and the Virginia Department of Taxation also publish detailed annual summaries of statutory changes to state tax policy. A key factor in identifying major tax policy bills or amendments was the projected fiscal impact. In addition, some bills that had close votes were also examined because they would spotlight a range of views and competing (or conflicting) priorities that officials weigh in making tax policy decisions.

To understand the rationale for major tax policy proposals, as well as arguments against them, I examined chief executives' budget messages, revenue sections of the budget documents, budget amendments, public hearing testimony, and legislative reports. To provide additional context for understanding the budget documents and legislative reports, the analysis also included speeches, press releases, and blogs by key participants in tax policymaking in each state. Speeches that outline major policy initiatives include the mayor's State of the District address in D.C., the governor's State of the State address in Maryland, and the governor's State of the Commonwealth address in Virginia (all of which are annual events). In addition, the Virginia case study was informed by the governor's biennial presentations to the legislature's "money committees,"[44] which present the governor's budget, as well as the Secretary of Finance's annual briefings of the money committees, which review key economic data and budget forecasts.

Legislative records served as another critical source of documentary evidence. The D.C. Council, Maryland General Assembly, and Virginia General Assembly all maintain online legislative databases that that provide details about each bill, including

[44] The money committees are the Senate Finance, House Appropriations, and House Finance committees.

the text of a bill as introduced, amended, and enacted; sponsorship and voting data; fiscal notes; and legislative history. Online records of public testimony on D.C. tax legislation were particularly useful in detailing the views of executive branch officials, interest groups, and residents, while fiscal notes available in all three states provided non-partisan analyses of the revenue, economic, and administrative impacts of tax bills.[45]

External sources were also used to sharpen the analysis of tax policy actions in the study states. News articles (primarily from *The Washington Post*, *The Baltimore Sun*, and *Richmond Times-Dispatch)* as well as political blogs provided important perspectives on major tax policy issues in each state. Finally, each case study drew on a wide range of statistical, policy, and research reports that provided context on the budget and tax system in each state. These sources, including comprehensive annual financial reports for each state prepared by external auditors as well as economic reports, revenue histories and forecasts, and tax expenditure budgets, helped clarify the tax policy proposals and debates. The documents included reports by government agencies, expert panels, and non-governmental sources (such as interest groups and academics) on particular taxes, long-range financial plans and trends, and the distribution of the tax burden.

Personal Interviews. As noted earlier, the purpose of the in-person interviews was to verify, elaborate, and refine the picture of the tax policymaking process in each state that emerged from the documentary evidence. The bills, amendments, and statutes that affect tax policy provide an objective record of the tax policymaking process and its outcomes, while speeches, press releases, legislative reports, testimony, and other written

[45] Although Maryland and Virginia did not provide online access to public hearing records, the author obtained copies of public hearing testimony for many tax policy bills through the Maryland Department of Legislative Services and the Library of Virginia.

materials help explain why particular choices were made. Nevertheless, the documentary record cannot adequately explain the perceptions, motives, incentives, and strategies that influenced the behavior of key participants. In particular, official records reflect the perspectives of those who prepare the records, and often focus on policy outcomes rather than the steps leading to the outcomes. Official documents may seek to present policymakers in an overly favorable light, downplay disagreements, and omit details that are politically sensitive or known only by a few. Moreover, official records, news articles, and other public documents may conflict with one another. The in-person interviews are intended to alleviate these problems not only by probing the descriptions of the tax policy process in the documentary record, but also by capturing additional details that are not available through public records and documents. The goal is to use multiple methods of data collection – often referred to as "triangulation" – to develop case studies of tax policy formulation that are more detailed, accurate, and balanced.

As noted in the introduction, the use of multiple methods, and in particular the interviews with key participants, were also designed to reduce any bias that might result from my role as a D.C. government employee. I worked for the D.C. government throughout the 2007-2010 study period, and since April 2009 I have served as a fiscal analyst performing tax policy research for the D.C. chief financial officer.[46] In addition to developing views about the D.C. tax policy process from my work experience, I have also learned about tax policy decisions in Maryland and Virginia – D.C.'s neighboring states and economic competitors – from my professional experience. Probing the views

[46] I also worked as a staff member on several D.C. Council committees from 1997-2001, and 2002-2007, and then as the director of performance measurement for the D.C. Auditor from 2007 to 2009.

and actions of key participants in the tax policy process in the three states through semi-structured interviews helped to ensure that my analysis and conclusions were informed and challenged by multiple perspectives, reducing any bias.

Although differences in institutions, the distribution of power and duties, and the composition of interest groups in D.C., Maryland, and Virginia prevent an exact correspondence of interview subjects, I sought interviews with individuals holding similar positions in each state. Based on the documentary record, I set a guideline of 10 to 12 interviews in each jurisdiction, comprised of four executive branch officials, four to six legislative branch officials, and two private-sector participants (advocacy, interest, or research groups) to reflect the range of key policymakers and non-governmental actors in the tax policy process.[47] This guideline was used to facilitate comparisons across the states but provided the flexibility needed to reflect varying patterns of influence in each jurisdiction. The interview strategy was executed successfully: at least 10 individuals closely involved in the tax policy process were interviewed in each state, including senior policy, budget, and finance officials from both the executive and legislative branches as well as several representatives of private research or advocacy groups.

Table 3.2 (see next page) lists the individuals who were interviewed. A point about the interviewees merits explanation: throughout the dissertation, I use the titles that individuals held during the case study period, rather than the title they hold presently. For example, Muriel Bowser, who is now Mayor of the District of Columbia, is referred to as "Councilmember Muriel Bowser" because that was her title from 2007 to 2010.

[47] Specifically, the reason for using a range of four to six interviews with legislative branch officials is that the Maryland and Virginia legislatures are bicameral, unlike the D.C. Council which is unicameral. Therefore, more interviews (six) might be needed in Maryland and Virginia than in D.C. (four interviews).

Table 3.2
Individuals Interviewed in the District of Columbia, Maryland, and Virginia

Sector	Individuals Interviewed in Each State
Executive Branch	Budget and Finance Departments DC – Natwar Gandhi, Chief Financial Officer DC – Fitzroy Lee, Chief Economist and Deputy Chief Financial Officer MD – David Roose, Director, Bureau of Revenue Estimation VA – Jody Wagner, Secretary of Finance (2006-2008) VA – Richard Brown, Secretary of Finance (2008-) VA – John Layman, Chief Economist, Department of Taxation Governor/Mayor's Office DC – Will Singer, Mayor's Budget Director MD – Joseph Bryce, Governor's Chief Legislative Officer VA – Brian Shepard, Director, Governor's Office of Policy VA – Wayne Turnage, Governor's Chief of Staff VA – Barbara Reese, Deputy Policy Director
Legislative Branch	Tax Committee DC – Councilmember Jack Evans, Chairman, Finance and Revenue Committee MD – Senator Ulysses Currie, Chairman, Budget and Taxation Committee MD – Delegate Sheila Hixson, Chairman, Ways and Means Committee VA – Senator Charles Colgan, Chairman, Finance Committee Other Legislators DC – Council Chairman Vincent Gray and Councilmembers David Catania, Mary Cheh, and Phil Mendelson MD – Senator Richard Madaleno Legislative Staff DC – Ruth Werner, Legislative Analyst, Committee on Finance and Revenue MD – John Favazza, Co-Chief of Staff to House Speaker Michael Busch MD – Warren Deschenaux, Director of Policy Analysis, Department of Legislative Services MD – Ryan Bishop, Department of Legislative Services VA – Betsey Daley, Staff Director, Senate Finance Committee VA – Becky Covey, Legislative Analyst, Senate Finance Committee VA – Robert Vaughn, Staff Director, House Appropriations Committee
Non-Governmental	DC – Ed Lazere, Director, D.C. Fiscal Policy Institute MD – Neil Bergsman, Director, Maryland Budget and Tax Policy Institute MD – Jay Hancock, columnist, *Baltimore Sun* VA – Michael Cassidy, President, Commonwealth Institute for Fiscal Analysis VA – Sara Okos, Policy Director, Commonwealth Institute for Fiscal Analysis VA – Robert Chase, President, Northern Virginia Transportation Alliance

Personal interviews present the researcher with challenges in gathering relevant, accurate, and sufficient evidence, just as documentary material does. Interviews can only capture a small slice of someone's experience. Moreover, interview subjects may portray themselves in an overly favorable light, interpret others' motives and actions without direct knowledge, or provide selective information – similar to problems that arise with documentary evidence. In addition, interview subjects are susceptible to a distinctive shortcoming: their memories may fade. At the same time, the interviewer may fail to understand points made by the interview subject, or may interpret his or her statements in a way that reflects his or her own biases or experiences. As stated by one expert, "Accounts of participants' meanings are never a matter of direct access, but are always *constructed* by the researcher(s) on the basis of participants' accounts and other evidence." (Maxwell, 1992: 290, emphasis in the original). Therefore, a mixed-methods research strategy relying on documentary evidence and personal interviews must try to address the weaknesses of both approaches.

Data Analysis

In this mixed-method studying relying largely on qualitative data,[48] it was not feasible to set fixed rules for data analysis. Judgment was inevitably required to weigh the competing claims made in written records and personal interviews by participants in the tax policy process in D.C., Maryland, and Virginia. Still, there are several guidelines that informed the data analysis, based on the strategy of using interviews to confirm, refine, and extend the information available through documentary evidence. The aim was

[48] The case studies include descriptive statistics (such as the number of percentage of tax policy bills that increased taxes, decreased taxes, or left tax liability unchanged) as well as fairly simple quantitative measures such as the estimated annual change in the tax burden due to statutory changes.

not only to verify information through consistent accounts by multiple sources of information (documents or people), but also to search for corroborating evidence from individuals or documents associated with different institutions or points of view. For example, an interview with a legislator that supports an account in a governor's press release would provide stronger supporting evidence than an interview with the governor's budget director. The greatest weight was given to the following types of evidence:

- Descriptions and explanations found in multiple documentary sources that were confirmed in one or more interviews without any conflicting accounts;
- Descriptions and explanations found in multiple documentary sources that were confirmed in one or more interviews with someone in a different sector, branch, or political party;
- Accounts from more than one interview that were confirmed by at least one documentary source without any conflicting accounts; and
- Accounts from more than one interview that were confirmed by documentary evidence produced by someone in a different sector, branch, or political party.

A pattern-matching approach (also called the "constant comparative method") was used to assess whether the evidence developed from the documentary record and personal interviews supported, refuted, or modified the seven propositions about the formulation of state tax policies set forth in Chapter 1 (see p. 10). Pattern-matching involves comparing data from the interviews and documentary sources to determine similarities and differences, aggregating qualitative data into various themes, and then comparing the themes from each case in the study to the predicted pattern set forth at the outset of the study (Creswell, 2014: 196; Yin, 2003, 119; Merriam, 2009: 30-31, 175-183). The goal was not only to test the propositions, but also to identify patterns in state tax policy formulation that were overlooked or not fully recognized. The patterns can be arranged in relationships in order to build a theory or theories.

<u>Research Limitations and Threats to Validity</u>

Facing limits on time and other resources, researchers must always seek to enhance the validity of their data collection and analysis while recognizing the uncertainties and threats to validity that remain. For the purposes of this study, the most important types of validity are measurement validity (also known as "construct validity") and reliability. Because the study is qualitative and exploratory in nature and does not involve large, statistically-representative samples, other major forms of validity – internal validity, external validity, and statistical conclusion validity – are not relevant. Instead of establishing causal relationships (internal validity) that can be generalized to other states (external validity) using statistically valid procedures (statistical conclusion validity), this dissertation aims at theoretical generalization: to develop theoretical propositions that might apply to other settings and would serve as the basis for additional research and analysis.[49] In essence, this study is an exercise in model-building, attempting to identify factors that affect tax policy outcomes in the states.

Measurement validity refers to the researcher's ability to define key concepts precisely and accurately, and to apply the definitions ("constructs") consistently

[49] John Creswell explains why external validity, or generalizability, is usually not relevant in qualitative research, stating that, "In fact, the value of qualitative research lies in the particular description and themes developed in the context of a specific site. Particularity rather than generalizability is a hallmark of good qualitative research." See John Creswell, *Research Design: Qualitative, Quantitative, and Mixed Methods Approaches*, 4th Edition (Thousand Oaks, CA: 2014), pp. 203-204.

throughout the data collection and analysis.[50] The most important construct for this study – its main focus – is a state "tax policy decision." To promote measurement validity, this concept was given a clear definition: a statutory change in a tax rate, the tax base, or the use of tax revenue. The definition establishes some boundaries for the study; for example, an income tax rate increase falls within the scope of the study whereas a tax amnesty does not. Nevertheless, perfect clarity in defining important concepts and attributes is unattainable. For example, there is no universally accepted definition of a "tax," and even if one were available it would have to be applied to complex situations using judgment. To enhance measurement validity while addressing such challenges, this study aims to make definitional issues transparent and to explain how and why particular concepts were used, using the research literature to inform those decisions.

Reliability refers to the consistency of data collection, or the extent to which a measure produces the same, accurate result when different people use it to record or describe the same condition or event (Hoover and Donovan, 2008: 24; King, Keohane, and Verba, 1994: 25).[51] Enhancing reliability may be a challenge in this study for a number of reasons. First, this is an individual research project; there are no co-investigators who can provide a reliability check by weighing the same evidence. Second, both the subject matter (factors that influence tax policy choices) and the data sources (written records, oral interviews) lack standardized scales of measurement and

---

[50] Gary King, Robert O. Keohane, and Sidney Verba offer a very succinct definition of measurement validity: "measuring what we think we are measuring." See Gary King, Robert O. Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton, NJ: Princeton University Press, 1994), p. 25.

[51] Reliability reflects the quality of the measurement instrument and the way it is used. For example, a breathalyzer has to be properly calibrated to measure blood alcohol content, but it must also be used by trained individuals who know how to record and interpret the results.

are subject to interpretation. Indeed, the methods of data collection are intended to probe the motivations, strategies, and perceptions of key participants in the tax policy process, which are difficult to measure precisely. To increase reliability, I took the following steps (some of which have been discussed earlier):

- reviewed similar documents about the tax policy process in each state (such as executive budget proposals, legislative finance committee reports, and official revenue forecasts);
- interviewed individuals in similar positions of authority in each state;
- posed identical questions to multiple interviewees in order to probe specific issues in a uniform manner;
- entered interview notes into a case study database within 24 hours of conducting an interview in order to enhance accuracy; and
- shared a case study protocol with all interview subjects so they would have the same information about the purpose and scope of the study.

Nevertheless, the measurement validity and reliability of the data collection and analysis is fundamentally based on the overall research design. The use of multiple methods – analysis of documentary evidence and in-person interviews – provides numerous opportunities to test and refine the key concepts that underlie this study and the evidence gathered about the tax policy process in each state. The case studies that follow in chapters 4-6 will seek to make transparent the data that were gathered, the way the data were analyzed, and how conclusions were drawn from the evidence so that the findings are accurate, insightful, and defensible.

Chapter 4

District of Columbia Case Study

Contents

> "And we will do all of these things without raising taxes."
>
> -- D.C. Mayor Adrian Fenty, State of the District Address, March 21, 2007

Summary

Tax policy decisions in the District of Columbia from 2007 to 2010 generally followed a pattern consistent with the seven propositions set forth in Chapter 1 (see p. 10). Tax policymaking in D.C. was marked by a short-term focus and an ad-hoc approach to generating and evaluating tax policy options in response to immediate political and economic pressures. D.C. lawmakers were highly sensitive to the tax burden on residents and concerned about competitiveness with neighboring Maryland and Virginia, but they often neglected the long-term revenue capacity, equity, and efficiency of the tax system.

D.C. policymakers generally conducted a limited search for tax policy options, drawing on policy tools they had used before and making modest adjustments to tax rates and the tax base. Political acceptability often predominated in D.C. tax policy decisions, outweighing normative concerns related to efficiency, equity, revenue capacity, and administrative feasibility. The case study revealed a powerful undercurrent of "micropolitics" – much stronger than in Maryland or Virginia – as D.C. lawmakers approved a steady stream of tax relief measures for single properties and businesses that were almost invisible on an individual basis but entailed significant costs as a whole. While D.C. policymakers proposed, debated, and approved tax relief measures for individuals and groups almost continuously, tax increases became most salient during the depths of the recession in 2009, suggesting a tendency to neglect the long-term revenue capacity of the D.C. tax system in favor of periodic patches.

The case study also points to a larger problem that spans the D.C. tax policymaking process: the breakdown or lack of what legislative specialists call "regular order" – the rules that govern an orderly, deliberative policymaking process (L. Hamilton, 2012). Regular order reflects the formal stages of the legislative process: introduction of legislation and referral to a committee; public hearings; committee analysis, amendment, and approval; floor debate, amendment, and approval; and (in a bicameral legislature) conference committee reconciliation of different versions. Many of the most important tax policy decisions in D.C. during the case study period bypassed the standard process and were often crafted on the "floor" of the D.C. Council – in its Committee of the Whole – without public hearings or analysis of economic, distributional, or administrative impacts. Because the standard process provides a buffer against immediate political pressures and permits a wider range of public input, D.C.'s lack of regular order in its tax policy process meant that it was more susceptible to political and interest-group influence and weakly grounded in principles of sound tax policy, such as revenue capacity, efficiency, equity, and feasibility.

The D.C. case study also exposes flaws in the propositions, as well as important factors that were omitted. In terms of *agenda-setting and developing alternatives*, the case study suggests that cycles of change and stasis may be less distinct than policy formulation theory would predict. Because taxes provide the largest share of state revenue (U.S. Bureau of the Census, 2014: 2) and budgets are formulated or revised annually, tax policy receives ongoing attention from policymakers and changes may be incremental, moderate, or major. In terms of *evaluating and selecting tax policy options*, the case study highlights the critical role of parity – identifying a comparable tax policy within the state or in a neighboring state – to justify a change in tax rates or the tax base. D.C. lawmakers' concern about parity was especially acute in light of the District's status as a small jurisdiction (in population and size) adjacent to prosperous localities in Maryland and Virginia that compete with the District for jobs and residents.

Modest Change in Tax Burdens. As shown in Table 4.1 (see next page), the size of tax policy changes in D.C. from 2007 to 2010 was modest. Only in 2009 did the net change in tax burden reach the 1 percent threshold for significant change described in Chapter 3.[52] Enacted during the depths of the "Great Recession," the 2009 tax increase

[52] This standard is used not only by the National Conference of State Legislatures in its annual reports on state tax actions, but also by the Nelson A. Rockefeller Institute of Government at the State University of New York at Albany. See Nicholas W. Jenny, "State Fiscal Brief: 2004 Tax and Budget Review" (November 2004), No. 71, p. 2.

was moderate in light of a 16 percent drop in projected revenues for FY 2010.[53] Tax policymaking in the District of Columbia during this period was marked by only small rate changes for the major taxes: (1) a reduction in the property tax rate for owner-occupied homes from $0.88 to $0.85 per $100 of assessed value,[54] (2) a reduction in the commercial property tax rate from $1.85 to $1.65 per $100 on the first $3 million of assessed value, and (3) a three-year, 0.25 percent increase in the general sales tax.

Table 4.1
Impact on District of Columbia Tax Burden from Statutory Changes, 2007-2010
(dollars in 000s)

Year	**Projected Change in Tax Revenues for Next Fiscal Year**	**% Change in Tax Revenues for Next Fiscal Year**
2007	-$30,360	-0.6%
2008	$3,869	0.1%
2009	$48,632	1.0%
2010	$17,913	0.4%

Note: The annual change represents the projected revenue impact of statutory changes in tax policy in the upcoming fiscal year, divided by the budgeted amount of tax revenue in the current fiscal year.

Source: Author's calculations using data from annual District of Columbia budget documents and fiscal impact statements prepared by the Office of the Chief Financial Officer, available at www.cfo.dc.gov.

The D.C. case study highlights the limits of both incremental and punctuated models of change in tax policymaking. Even though the magnitude of annual change in the D.C. tax burden was usually small during the case study period, the increase still

[53] Author's calculation using data from letters from D.C. Chief Financial Officer Natwar Gandhi to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia," dated September 24, 2008, December 19, 2008, February 25, 2009, and June 22, 2009.

[54] This reduction took effect automatically in FY 2008, because lawmakers had enacted a "calculated rate" that was set at a level intended to prevent residential property tax revenues from exceeding a fixed amount.

jumped from 0.1 percent in 2008 to 1.0 percent in 2009. In particular, the D.C. case study suggests that a leading model of agenda-setting and policy development, John Kingdon's multiple-streams framework (Kingdon, 1995), lacks explanatory power for tax policymaking. The massive budget shortfall that D.C. officials faced in 2009 (the largest in almost 15 years) serves as a classic example of a "policy window" that facilitates major change in Kingdon's framework – in this case, an opportunity for those who supported tax increases to protect public services from severe cuts. Nonetheless, D.C. lawmakers who sought to raise taxes on the wealthy as an alternative to program cuts failed in that effort and settled for a more modest (and regressive) package of sales, gas, and cigarette tax increases. This outcome can be explained using Kingdon's framework, because proponents failed to join the "problem stream" (the budget deficit) with the "politics stream" and the "policy stream" (a politically viable solution), but that outcome was not inevitable and the decisive factors seem apparent only in retrospect. A similar pattern was apparent in Virginia (see Chapter 6), where tax policies were unchanged after a large shortfall in transportation funding opened a policy window for tax increases. As discussed below in more detail, one must examine the roles of political leadership, institutional design, and interest group pressures to understand why some policy windows lead to major change while others do not.

Narrow Range of Tax Policy Options. The range of tax policy options considered in D.C. was narrow both in absolute and relative terms. D.C. policymakers did not propose any increases in real property tax or business income tax rates from 2007 to 2010 (unlike their neighbors in Maryland, who raised the corporate income tax), and a proposal to add a new top personal income tax rate was much simpler than the changes to the personal income tax in Maryland. Tax-cut proposals in D.C. were more diverse, but lawmakers also resorted to familiar tools – particularly caps on the annual growth of property taxes and calculated property tax rates tied to revenue targets – they had relied on in the past, even after the calculated rate unexpectedly created a shortfall in the District's FY 2008 budget. Moreover, there were no proposals in D.C. for more sweeping change that would raise some taxes and cut others, or substitute one levy for another, to improve the equity, efficiency, or reliability of the tax system.

Ideology and Institutions as Mediating Factors. The largely incremental change in D.C. tax policy during the study period was mediated by the ideological views of officials in key leadership positions as well as the structure and capacity of public institutions. Positions taken by D.C. Mayor Adrian Fenty, who had pledged not to raise taxes during his campaign for mayor, and D.C. Council Finance and Revenue Committee Chairman Jack Evans, who was generally unwilling to approve tax increase bills in his committee, deterred tax increase proposals.[55] D.C. Council Chairman Vincent Gray, who supported a tax increase as part of a budget-balancing package in 2009, served as a moderating force. Because tax increase proposals would not emerge from the mayor's office or the council's finance committee, Mr. Gray's Committee of the Whole (which has purview over the budget) became the venue where the 2009 tax package was crafted (tax-cut legislation was also fashioned in the Committee of the Whole in 2007). Institutional procedures and privileges, in addition to political ideology, influenced tax policy decisions in D.C., as Chairman Gray was able to use his authority to present a revised version of the annual budget bill to the council to shape tax policy decisions.

[55] In one of the interviews conducted for the dissertation, D.C. Councilmember David Catania observed that, "Bills to raise revenue find a swift end in the Finance and Revenue Committee."

Both the mayor and council were hampered by a lack of staff support on tax policy, which is administered by an independent chief financial officer (CFO) in the District. Whereas both houses of the Maryland and Virginia legislature receive policy advice and analysis from a non-partisan legislative services office, the two legislative staff members who work for the D.C. Council's Committee on Finance and Revenue report to the committee chairman rather than the entire council. The mayor and council relied heavily on tax policy options and analyses developed by the CFO and the D.C. Fiscal Policy Institute (a non-profit research and advocacy group) in a tax policy process that was described in the personal interviews as "ad-hoc," "reactive," and "piecemeal."

The most notable example of this reliance on outside assistance stems from the tax package that the council crafted during two weeks in July 2009, choosing from a list of 22 options prepared by the CFO's Office of Revenue Analysis (some of the options had also been proposed by DCFPI). Almost all (18) of the options had not been the subject of legislation or public hearings held by the council, leaving legislators in a position of evaluating the options without detailed review and reflecting the council's departure from regular order in which bills are introduced, subject to hearings and analysis by a tax committee, and brought to the legislature for consideration and vote.

Irregular and Cursory Review Process. Table 4.2 (see next page) contrasts the review process for four major provisions in the council's 2009 tax package with the review of similar legislation in Maryland. Reflecting the lack of regular order, only one of the four provisions in D.C. was introduced as legislation and subject to public hearings prior to enactment, whereas in Maryland, bills were introduced and public hearings were held on each proposal in multiple years even though only two of the four provisions were

Table 4.2
Review of Four Tax Policy Proposals in the District of Columbia and Maryland, 2007-2010

Tax Policy Proposal	**District of Columbia**	**Maryland**
Sales Tax Increase		
Legislation Introduced?	No	2004, 2007 (regular and special sessions)
Public Hearings Held?	No	2004, 2007 (regular and special sessions)
Outcome	Tax raised from 5.75% to 6% in 2009	Tax raised from 5% to 6% in 2007
Cigarette Tax Increase		
Legislation Introduced?	2008	2006, 2007 (regular and special sessions)
Public Hearings Held?	2008	2006, 2007 (regular and special sessions)
Outcome	Tax raised from \$1 per-pack to \$2 in 2008 and to \$2.50 in 2009	Tax raised from \$1 per-pack to \$2 in 2007
Motor Fuel Tax Increase		
Legislation Introduced?	No	2007 (regular and special sessions), 2009, 2010
Public Hearings Held?	No	2007 (regular and special sessions), 2009, 2010
Outcome	Tax raised from \$0.20 per gallon to \$0.235 in 2008	No action
Combined Reporting of Corporate Income		
Legislation Introduced?	No	2003-2007, 2009-2010 (each year)
Public Hearings Held?	No	2003-2007, 2009-2010 (each year)
Outcome	Enacted in 2009, effective in tax year 2011	No action – referred to study commission

Source: D.C. Council Legislative Information Management System, found at www.dccouncil.us, and Maryland General Assembly's legislative data base, found at www.mgaleg.maryland.gov.

enacted from 2007 to 2010. Options and analyses put forth by the CFO and DCFPI were often requested or considered toward the end of the budget or legislative process, limiting the time available to analyze them. By failing to develop tax options internally and instead relying on outside sources, D.C. lawmakers were less prepared to make tax policy decisions, which is one reason why many major decisions were made in the Committee of the Whole right before final votes on budget or tax legislation.

A particularly striking example of the cursory review given to tax policy changes in D.C. involves combined reporting of corporate income, which was part of the council's 2009 tax package and is regarded as a primary way to prevent tax avoidance by hindering firms from shifting income among their subsidiaries. In Maryland, combined reporting bills were introduced and subject to public hearings in the General Assembly for at least four years before being included in Governor Martin O'Malley's 2007 tax reform plan. The extended process gave business groups the opportunity to convince the legislature not to adopt combined reporting.[56] By contrast, legislation mandating combined reporting was not introduced in D.C. and public hearings were never held; rather, during the two weeks of budget discussions in the summer of 2009, councilmembers selected combined reporting from the CFO's list of revenue options to help balance the budget. Because combined reporting emerged as an issue so quickly in D.C. and went to an immediate vote as part of an omnibus tax package, business groups did not have time to offer input on the proposal or mount any opposition. More generally, Maryland's tax policy process was more deliberative and transparent because a wider range of options was considered over a longer period of time, whereas in D.C., policymakers chose from a smaller range of options subject to less public scrutiny.

[56] Maryland lawmakers referred the issue of combined reporting to a study commission in 2007.

Political Pressures Often Predominant. Although it is difficult – perhaps artificial – to separate political motivations for tax policy decisions from policy or normative factors, political acceptability predominated in a number of major tax policy outcomes in D.C. during the 2007-2010 period. The most notable examples of this pattern are as follows:

- In 2008, an amendment attached to a nuisance property bill doubled the tax on vacant and abandoned properties (which was already more than five times the rate on owner-occupied homes). Although the council displayed sensitivity to serious public concern about abandoned, deteriorating properties, the public record and interviews revealed no discussion of risks involved in doubling the tax, especially for vacant properties in decent condition. The desire to "crack down" on vacant property owners without exploring all of the ramifications would lead the council to overhaul the vacant property tax again in 2009 and 2010 in response to new problems created by the council's actions.

- In 2009, the council approved a proposal by Mayor Fenty to end the District's two annual sales tax holidays on clothing. Interviewees consistently stated that the holidays (the only tax expenditure repealed in D.C. during the study period) were repealed not due to concerns about their cost or effectiveness, but rather because their sponsor and main champion had lost her re-election bid the prior year. There was no discussion of extensive research finding that sales tax holidays shift, rather than increase, economic activity while allowing retailers to boost prices.

- In 2009, the package of sales, cigarette, and gas tax increases crafted by the council was designed largely to shift as much of the burden to commuters and tourists. The likely regressive impact of the tax package – a regular topic of debate when sales and excise taxes are increased – was not discussed.[57]

Importance of Benchmarking in Selecting Tax Policy Options. Nevertheless, political and normative concerns were inseparable aspects of D.C. policymakers' strong concern about tax competitiveness, particularly with Maryland. As shown in Table 4.3 (see next page), most of the major tax increases enacted in D.C. from 2007 to 2010 – a

---

[57] General sales taxes are usually considered regressive because lower-income households spend more of their income on consumption; in addition, higher-income households may spend a greater percentage of their consumption on non-taxable services. Moreover, cigarette consumption is higher among low-income groups. See Robert D. Lee, Jr., Ronald W. Johnson, and Philip G. Joyce, *Public Budgeting Systems* (Burlington, MA: Jones and Bartlett Learning, 2013), Ninth Edition, pp. 165-174.

cigarette tax increase to $2 per pack (2008), the sales tax increase to 6 percent (2009), and the gasoline tax increase to 23.5¢ per gallon (2009) – were explicitly matched to higher rates imposed in Maryland. D.C. lawmakers stated in interviews that attaining parity with Maryland offered a policy rationale (or at least a defense) for tax increases – namely, that D.C. would be unlikely to lose businesses, jobs, or residents – as well as evidence that the higher rates would not be intolerable or trigger a severe political backlash. In essence, the large tax increase enacted in Maryland in 2007 (discussed in chapter 5) shaped the smaller tax increase enacted in D.C. in 2009 by giving D.C. policymakers room to raise rates while still staking a claim to competitive tax rates. This is one of many instances from the case studies in which parity was highly selective – D.C. lawmakers avoided mentioning that the tax increases would lift the District's sales, cigarette, and gasoline tax rates even higher above those charged in Virginia.

Table 4.3
Parity Measures Used to Justify D.C. Tax Increases, 2007-2010

Tax Increase	**Parity Standard**
Cigarette tax increase from $1 to $2 per pack (2008)	Maryland cigarette tax ($2 per pack)
Insurance premiums tax increase from 1.7% to 2% for accident and health insurers (2008)	Maryland insurance premiums tax (2%)
Economic interests tax increase from 2.2% to 2.9% (2008)	D.C. deed taxes (2.9% on transactions of $400,000 or more)
Sales tax increase from 5.75% to 6% (2009)	Maryland sales tax (6%)
Motor fuel tax increase from $0.20 to $0.235 per gallon (2009)	Maryland motor fuel tax ($0.235 per gallon)
Insurance premiums tax increase from 1.7% to 2% for life and property insurers (2010)	Maryland insurance premiums tax (2%) and D.C. insurance premiums tax for accident and health insurers (2%)

Parity between D.C. taxes was also used as a standard to justify tax increases. After lawmakers raised the insurance premiums tax on accident and health insurers from 1.7 to 2 percent in 2008 to finance an expansion of health insurance, Mayor Fenty's 2010 proposal to raise the rate for life and property insurance to 2 percent was enacted without opposition. Similarly, the mayor's 2008 proposal to raise the economic interests tax was approved without dissent because it was designed to match the maximum combined rate for the District's deed taxes (and because the tax is relatively obscure). The economic interests tax (imposed when a company holding a certain amount of property is sold) and the deed taxes (imposed when a single property is sold) fulfill similar purposes, so equalizing the rates seemed both logical and fair.

The parity argument worked both ways; for example, D.C. policymakers pointed to much lower commercial property tax rates in neighboring Maryland and Virginia to justify efforts to reduce D.C.'s commercial property tax. Nevertheless, the parity standard seemed even more important in giving officials a rationale for the distasteful (and politically risky) step of raising taxes.

Reliance on Peripheral Levies. In order to minimize the political costs of taxation by making tax increases less visible, D.C. lawmakers imposed disproportionate increases on small, peripheral levies during the case study period – consistent with the theory of Hettich and Winer (1999), as well as the findings of Brunori (2011a) and Lewis and Hildreth (2011). As shown in Table 4.4 (see next page), two minor taxes – cigarette taxes and health care provider taxes (assessments on nursing homes, hospitals, and intermediate care facilities) – rose an estimated 107 percent due to tax policy changes from 2007 to 2010. In fact, the projected increase in cigarette taxes ($22.7 million) over

Table 4.4
Projected Annual Change in Selected D.C. Taxes from Statutory Changes, 2007-2010
(dollars in 000s)

Tax	**FY 2007 Baseline Revenue**	**Net Change In Annual Revenue** (Projected)	**% Change in Revenue** (Projected)
5 Largest Percentage Increases			
Health Care Provider	$11,000	$11,803	107.3%
Cigarette	$21,234	$22,715	107.0%
Insurance Premiums	$56,500	$20,309	35.9%
Economic Interests	$52,111	$13,100	25.1%
Motor Fuel	$26,844	$3,500	13.0%
3 Largest Tax Revenue Sources			
Real Property	$1,367,163	-$86,000	-6.3%
Personal Income	$1,210,306	-$22,399	-1.9%
General Sales	$955,085	$20,280	2.1%

Note: The projected net change in annual revenue reflects the sum of the first-year impacts of statutory changes made during the 2007-2010 period.

Source: Author's calculations using data from annual District of Columbia budget documents and fiscal impact statements prepared by the Office of the Chief Financial Officer, available at www.cfo.dc.gov.

the four-year period was greater than that for the general sales tax ($20.3 million), even though the FY 2007 base for the general sales tax was more than 40 times as large as that of the cigarette tax. The three other taxes that were raised by more than 10 percent due to tax policy changes from 2007 to 2010 – the insurance premiums tax (35.9 percent increase), the economic interests tax (25.1 percent), and the motor fuel tax (13 percent) also had small bases, generating 1 percent or less of D.C.'s total tax revenues in FY 2006.[58] By contrast, the District's three largest levies saw only slight increases or

[58] Author's calculations using data from Government of the District of Columbia, *FY 2008 Proposed Budget and Financial Plan: Moving Forward Faster*, Vol. 1, Executive Summary (March 23, 2007), pp. 4-14 – 4-16.

reductions from 2007 to 2010: the general sales tax was increased by 2.1 percent, while the personal income tax was cut 1.9 percent and the real property tax was reduced 6.3 percent.[59] (Note: Although the figures cited in this paragraph are *projected* revenue changes from tax policy actions rather than *actual* revenue changes, which are impossible to specify precisely, the projected changes are relevant because they reflect the information available to policymakers when they made their decisions).

Hierarchy of Taxes. Table 4.5 (see next page) depicts a hierarchy of D.C. taxes reflecting the willingness of D.C. lawmakers to increase each tax during the study period; the ordering (which reflects a general pattern rather than a fixed ranking) is based on the author's judgment as described below. Cigarette taxes, which were raised 150 percent (from $1 per-pack to $2.50 per pack) from September 30, 2008 to October 1, 2009, rank first, followed by other "sin" or sumptuary taxes.[60] Not only did D.C. officials double the tax on blighted properties, but they also imposed a 5-cent excise tax on plastic and paper carryout bags (regarded as creating a negative externality by polluting the waterways). Reflecting the popularity of sumptuary taxes, the bag tax was approved unanimously by the council, as were the vacant property and cigarette tax increases.

Higher health facility assessments and insurance premiums taxes also met little resistance in D.C. during the study period. Lawmakers could justify the health facility tax increases (enacting a hospital bed tax and increasing the assessment on intermediate

[59] These are the author's calculations using data from District of Columbia budget documents and fiscal impact statements prepared by the Office of the Chief Financial Officer, available at www.cfo.dc.gov.

[60] Table 4.5 refers to a 107.3 percent increase in tobacco tax revenues from 2007 to 2010. The 150 percent statistic cited refers to the change in the unit tax, rather than the estimated change in revenue. The latter figure is lower because consumption drops as the tax rate rises.

Table 4.5
A General Hierarchy of Taxes in the District of Columbia, 2007-2010
(ranked from most likely to be increased to least likely)

Tax or Taxes	**Rationale for Increasing Tax and Evidence of Its Ranking**
Cigarette	Public health concerns and negative views of smokers and tobacco industry generated support for the tax increases. Tax was increased by 150% from 2008 to 2009.
Other "Sin" Taxes	Concern about negative externalities bolstered support for the taxes. Tax on blighted property was doubled between 2007 and 2009 and bag tax was established in 2009 without any dissenting votes.
Health Provider	Opportunity to claim federal matching funds and increase reimbursement rates made taxes a potential "win-win." Hospital bed tax was established and assessment on intermediate care facilities was increased in 2010.
Insurance Premiums	Tax on a narrow industry segment with some negative connotations generated less opposition than other tax increases. Tax on HMOs and other health insurers was raised in 2008, and tax on life and property insurers was raised in 2010.
Sales and Excise	Taxes were more "exportable" to out-of-state workers and tourists. Sales tax and motor fuel tax were increased in 2009.
Business Franchise	Taxes were seen as a way to gain tax revenues from non-residents who conduct business in D.C., but concern about competitiveness and District's high rates created opposition to raising rates. Business tax rates were unchanged from 2007-2010, but combined reporting of corporate income was mandated to close loopholes.
Personal Income	Some argued that wealthy residents could afford to pay more income tax, particularly in a time of growing income inequality. Income tax rates remained constant during this period.
Real Property	Some argued that D.C.'s residential property tax rates were lower than those in neighboring jurisdictions, but soaring assessments created pressure to cut taxes. Real property tax rates for owner-occupied homes and commercial property dropped during this period and many individual abatements were approved.

care facilities for people with intellectual disabilities in 2010) by pointing to the increase in federal Medicaid matching funds that would result, dampening any opposition.[61]

The insurance premiums tax, a relatively narrow tax levied on an industry with some negative connotations, was increased in steps: on HMOs and other health insurers

[61] Facilities with small operating margins or low numbers of residents receiving Medicaid opposed the tax increases.

in 2008 and on life and property insurers in 2010. Next are sales and excise taxes, which were raised in 2009 as a way to export as much of the tax burden as possible to non-residents. At the bottom of the hierarchy are the two largest broad-based taxes, the personal income tax and real property tax, which are the most visible to D.C. residents.[62]

Effects on Revenue Capacity. By focusing tax burdens on the periphery of the tax system and cutting the most broad-based taxes, D.C. policymakers inadvertently undermined the long-term revenue capacity of the tax system. Like other sin taxes, the cigarette tax has a relatively low elasticity (percentage change in revenue compared to percentage change in the tax rate) because of long-term declines in consumption resulting not only from higher taxes but also changing societal attitudes toward smoking (Lav, 2002). In the District of Columbia, the revenue elasticity of the cigarette tax may be particularly low because of options for cross-border purchasing in Virginia, where cigarette taxes are much lower.[63] After D.C. lawmakers raised the cigarette tax from $2 per pack to $2.50 in 2009 (exceeding Maryland's $2 rate), cigarette tax revenues fell $12 million short (26 percent) of the forecast for FY 2010,[64] a gap that the CFO attributed to a shift in sales to Virginia and Maryland (Chief Financial Officer, 2010a: 2-3).

The revenue performance of the tax on vacant and blighted property was also particularly poor after the rate increases imposed from 2007 to 2009: while tax liability

---

[62] As many researchers point out, the sales tax is less salient because it is paid in very small amounts with each retail purchase. By contrast, the real property tax is directly billed twice a year and the personal income tax requires the filing of an annual return which is often quite complex.

[63] Virginia's cigarette tax has been 30¢ per-pack since 2005, much lower than D.C.'s tax, which was raised from $1 per-pack in 2008 to $2.50 per-pack by the end of 2009. Local governments in Northern Virginia also impose their own cigarette taxes, which ranged from 20¢ to 80¢ per-pack during the case study period.

[64] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge*, Vol. 1, Executive Summary (September 2009), pp. 4-17, 4-20, and Government of the District of Columbia, *FY 2012 Proposed Budget and Financial Plan: One City Rising to the Challenge*, Vol. 1, Executive Summary (August 2011), p. 4-6.

for such properties more than quintupled, from $15.7 million to $85.6 million, tax receipts only doubled, from $11.7 million to $22.8 million, as more property owners challenged their tax bills and the collection rate dropped (Office of Revenue Analysis, 2009a). Motor fuel tax revenues also grow slowly as cars become more fuel-efficient (Fox, 2013: 32), while insurance premium taxes may grow at steady rates because people tend to purchase a base amount of insurance that remains relatively constant. By contrast, the personal income tax, which tends to have a high elasticity due to its progressive rate structure (Cordes and Juffras, 2012: 305; U.S. Government Accountability Office, 2010: 26-27), and the real property tax, which is characterized by very steady revenue performance (Bell, 2012: 274-275; U.S. Government Accountability Office, 2014: 9), were subject to net reductions during the study period.

Importance of "Social Construction" of Target Groups. The tax policy choices made in the District of Columbia during the study period expose flaws in James Q. Wilson's model of policy change and development (discussed in chapter 2, pp. 43-46), which emphasizes the magnitude and concentration of costs and benefits as determinants of policy outcomes (Wilson, 1974). Although Wilson's model would predict that taxes with highly focused costs would be difficult to maintain or increase, the largest percentage increases in D.C. taxes during this period affected narrow groups (smokers, vacant property owners) or industries (insurance, health care facilities). Anne Schneider and Helen Ingram's "social construction" framework (also discussed in chapter 2, pp. 46-49), which posits that policy outcomes reflect normative or evaluative depictions of target groups, as well as the size and concentration of the benefits and burdens to be distributed (Schneider and Ingram, 1993), is more consistent with tax policy choices in D.C. during the study period. The political and social standing of the target group, emphasized by Schneider and Ingram, helps explain why a highly concentrated tax burden was chosen in specific cases, as well as why particular groups were targeted for tax reductions. Table 4.6 classifies selected D.C. tax policy changes using the social construction framework.

Table 4.6
Social Construction Theory Applied to D.C. Tax Policy Decisions, 2007-2010

	Positive Image	**Negative Image**
High Political Power	I "Advantaged" Groups in this category are more likely to receive benefits because they are viewed as contributors to society. Examples: small businesses targeted for commercial property tax relief (2007-2008); high-tech firms retaining 5-year business tax exemption (2010).	II "Contenders" Groups in this category are likely to receive hidden benefits because of their political power but negative image. These groups may absorb burdens, but they may be hard to enforce. Examples: commercial property owners who received tax relief defined as "small business tax relief" (2007-2008); real estate developers who received tax abatements inserted into annual budget bills (2008-2010)
Low Political Power	III "Dependents" Groups in this category are seen as deserving but benefits may be symbolic because the groups lack political power. Example: bill granting property tax refund to Shirley's Place, which serves the homeless, was enacted but never funded (2010).	IV "Deviants" Groups in this category are regarded as harmful and tend to absorb a disproportionate share of burdens. Examples: 150 percent increase in tax on cigarette smokers (2008-2009) and doubling of tax on blighted property owners (2007-2009).

As Schneider and Ingram would predict, "advantaged" groups with positive images as contributors to society were most likely to receive tax benefits, while "deviant" groups regarded as harmful absorbed major tax increases. "Contenders" with negative images but considerable political power in terms of membership or resources, and "dependents" with positive images but little political influence fell in the middle.

The largest single net tax cut approved by D.C. policymakers during the study period – a package of commercial real and personal property tax cuts – was reflexively and almost universally described by officials as "small business tax relief" vital to iconic local businesses such as Ben's Chili Bowl and Blues Alley.[65] Council Chairman Vincent Gray expressed a prevailing view of small businesses as valued contributors to society when he described them as "the backbone of the District economy."[66] Although smaller businesses might claim a disproportionate share of the benefits, the business property tax cuts were available to all businesses.

Conversely, the two taxes which D.C. policymakers increased by 100 percent or more from 2007 to 2010 targeted two pariah groups: smokers and blighted property owners. Lawmakers doubled the tax on blighted properties not only to address concern about their harmful effects on neighborhoods, but also because punishing the owners – derided in public statements by councilmembers as "slumlords" and "faceless corporations" from out-of-state – was politically valuable to legislators besieged by

[65] Opened in 1958, Ben's Chili Bowl is a landmark restaurant on U Street N.W., formerly known as the District's "Black Broadway." Opened in 1965, Blues Alley is a popular jazz nightclub in Georgetown.

[66] This statement was made in a written response to questions from the author.

complaints about the properties.[67] The negative image of vacant property owners spurred policymakers to enact a 100 percent tax increase without analyzing the possible unintended consequences. The 150 percent increase in the cigarette tax did not spark the same level of rhetorical outrage, but was described in interviews as an easy step politically due to the negative image of smokers and the tobacco industry in D.C.

A Vibrant Micropolitical Process. At the same time that D.C. policymakers crafted general tax policies for individuals and businesses, they engaged in an almost entirely separate process of distributing tax benefits to individual properties or organizations, or properties owned by a single organization. This "micropolitical" process of distributing discrete tax benefits continued throughout the study period, even as the economy sank into the worst recession in 70 years, and was much more prominent in D.C. than in Maryland or Virginia.[68] Table 4.7 (see next page) shows that D.C. policymakers enacted 47 of these highly-targeted tax relief measures from 2007 to 2010, at an estimated total first-year cost of $9.2 million. Support for these tax bills was overwhelming: the combined vote on the measures was 157 to 2 in committee[69] and 577 to 11 on the final vote in the council.

The micropolitical tax process was supported by a procedural device, known as the "subject-to-appropriations" clause, crafted by D.C. officials to enact legislation that was not consistent with the District's four-year financial plan and budget. Thus, D.C.

---

[67] In an interview, Councilmember Jack Evans, chairman of the Committee on Finance and Revenue, noted that legislators competed to "show that I'm tougher than you are" in sanctioning vacant property owners.

[68] One reason (but not the only reason) for the vibrant micropolitical process in D.C. is that the District imposes a real property tax, which is mostly a local tax in Maryland and entirely a local tax in Virginia.

[69] The relevant committee was the Committee on Finance and Revenue, except for one bill that was referred to the Committee on Economic Development.

Table 4.7
Micropolitical Tax Relief Measures Enacted in the District of Columbia, 2007-2010
(dollars in 000s)

Year	Bills Enacted	Bills Unfunded	1st-Year Fiscal Impact	Committee Vote (Aggregate)	Council Vote (Aggregate)
2007	3	2	-$262	13-0	32-2
2008	17	12	-$4,801	54-0	212-2
2009	6	2	-$230	21-0	74-0
2010	21	17	-$3,923	69-2	259-7
Total	**47**	**32**	**-$9,216**	**157-2**	**577-11**

Sources: Author's calculations using data from fiscal impact statements prepared by the Office of the Chief Financial Officer, found at www.cfo.dc.gov, and the D.C. Council Legislative Information Management System, found at www.dccouncil.us.

lawmakers could approve bills without financing them. As shown in Table 4.7, more than two-thirds (32 of 47) of the tax relief bills enacted in D.C. for specific properties or organizations from 2007 to 2010 included a subject-to-appropriations clause. D.C. policymakers used the clause to offer a steady stream of benefits to individuals and groups in all eight wards of the District without having to explicitly confront the costs or weigh the merits of the tax relief bills against other priorities. Although lawmakers still had to identify financing before the tax relief could be provided, the enactment of the bills gave them a priority claim on additional resources and almost all were later funded even as agency budgets were cut significantly from 2008 to 2010.

The $9.2 million total first-year cost of these micropolitical tax benefits appears modest, but would have been sufficient to fund 90 additional teachers or police officers.[70] Moreover, most of the tax reductions applied to multi-year periods and in several cases,

[70] This calculation is based on the reasonable assumption that the annual salary, benefits, and overhead for each teacher or police officer would be approximately $92,000.

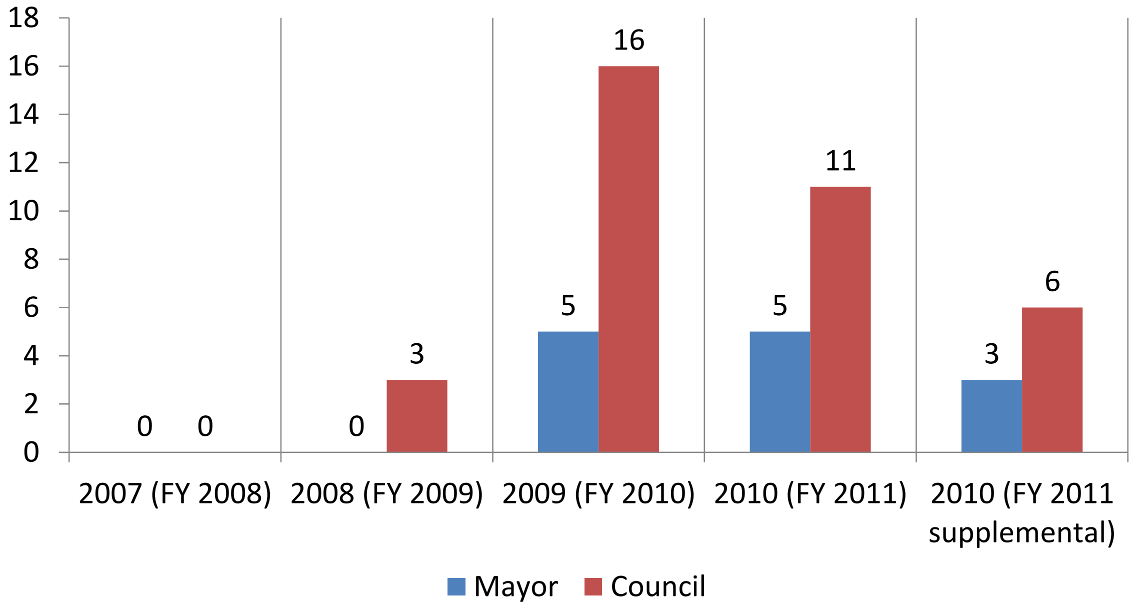
large costs were pushed to the out-years.[71] As a result, D.C. policymakers' willingness to grant discrete tax benefits risked long-term damage to the revenue capacity (and equity) of the tax system.

Individually-targeted tax relief provisions also became part of the District's annual budget bills. Many of the tax relief measures that were enacted with a subject-to-appropriations clause were funded during the annual budget process, as were new tax relief provisions targeted at specific properties or organizations. Figure 4.1 (see next page) shows the number of micropolitical tax benefits proposed by Mayor Fenty in each budget, as well as the number enacted by the council. Although the mayor and council both engaged in the practice of targeting tax relief to particular properties or entities, the council greatly widened its scope each year, reflecting legislators' interest in promoting projects in their wards and the tangible results they could highlight.

The pivotal year of 2009, when D.C. policymakers had to close a $800 million budget gap in the FY 2010 budget and then revise the budget when projected revenues dropped by another $150 million, shows the priority D.C. officials placed on distributing tax benefits to specific beneficiaries. The council more than tripled (from 5 to 16) the number of parcel-specific tax breaks that Mayor Fenty proposed in the FY 2010 budget, and all of those items were untouched when the new $150 million gap was eliminated. In addition to the sales, cigarette, and gas tax increases approved as part of the budget revision, D.C. lawmakers froze the homestead deduction (real property tax), and the personal exemption and standard deduction (personal income tax) – tax benefits available

[71] An example is D.C. Law 18-257, the "Redevelopment of the Center Leg Freeway (Interstate 395) Act of 2010," which disposed of D.C. air rights to allow construction of a mixed-use development. The act placed the District at a risk of a $12 million loss in property tax revenue outside of the financial plan. See Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Center Leg Freeway (Interstate 395) PILOT and Air Rights Disposition Act of 2010,'" dated June 21, 2010.

Figure 4.1
Micropolitical Tax Relief Measures Proposed by Mayor Fenty
and Enacted by the D.C. Council in the Budget, 2007-2010



<u>Note</u>: The FY 2011 supplemental budget included three *additional* tax relief measures proposed by Mayor Fenty and six *additional* tax relief measures enacted by the council. The 11 tax relief measures approved by the council in the initial FY 2011 budget remained intact.

<u>Sources</u>: Annual District of Columbia budget requests to the D.C. Council and the U.S. Congress.

to thousands of residents – while preserving all of the tax cuts for specific properties.[72] The practice of regularly allocating tax benefits to specific properties and groups displays the classic elements of "micropolitics" outlined by Emmette Redford (see Chapter 2, pp. 43, 51-52): intense interest by potential beneficiaries and little attention from anyone else, costs that seem negligible individually but are significant as a whole, and a policy of mutual non-interference among policymakers who secure political benefits from participating in the process (Redford, 1969: 83-84). In addition, the ongoing distribution

[72] For example, 96,705 homeowners qualified for the $67,500 homestead deduction (which reduces the taxable value of owner-occupied housing by that amount) in tax year 2009. See Government of the District of Columbia, *District of Columbia Data Book: Revenue and Economy*, October 2010, p. 38.

of micropolitical tax benefits reflects policymakers' willingness to make the tax system more complex by creating special tax rates for individual taxpayers, consistent with Hettich and Winer's theory that tax simplification efforts are likely to prove futile.

In 2010, four tax relief measures that sparked controversy due to concerns that they would benefit large businesses showed that such measures could be defeated only in very rare conditions. All but one of these bills – a measure to provide a tax exemption to businesses operating in federally-owned Union Station – were approved after concessions were offered to dampen the opposition.[73] The Union Station bill, which was the only tax relief measure approved by the Committee on Finance and Revenue from 2007 to 2010 which was not enacted, failed because the following elements were present: (1) a property owner, the federal government, with negative associations, (2) businesses that lacked local roots and political influence, (3) the implausibility of employment gains at stores already operating in a fixed space, and (4) an effort to disguise costs of the legislation by shifting them beyond the four-year financial plan. Without this unusual confluence of negative factors, highly-targeted tax relief measures were almost certain to win enactment following approval by the Committee on Finance and Revenue, reflecting how D.C. policymakers used the subject-to-appropriations clause and omnibus budget bills to facilitate enactment of dozens of tax bills benefiting individual claimants. .

Short-Term Instability and Long-Term Stasis. At the end of 2010, the D.C. tax system had changed little from the start of the study period in January 2007, in spite of the intervening turmoil in the economy. Personal and business income tax rates were

[73] The other measures were Bill 18-476, the "High Technology Commercial Real Estate Database and Service Providers Tax Abatement Act," Bill 18-431, the "OTO Hotel at Constitution Square Economic Development Act of 2010," and Bill 18-969, the "Adams Morgan Hotel Real Property Tax Abatement Act of 2010." Bill 18-969 was enacted as part of an FY 2011 supplemental budget bill.

unchanged, and the 0.25 percent increase in the general sales tax rate was scheduled to expire on October 1, 2011. Commercial property tax rates had dropped slightly due to adoption of the two-tier rate, reflecting a trend toward greater differentiation in property tax rates also seen in the new tax category for "blighted" property; owner-occupied (residential) property tax rates had also dropped slightly due to a "calculated rate" in effect in 2007.[74] Apart from mandating combined reporting of corporate income, policymakers made few changes to broaden the tax base. Expansions of the sales tax base to cover sugar-sweetened beverages and medical marijuana and excise tax bases (the bag tax) were very narrow. The most significant changes to the D.C. tax system, as noted earlier, were concentrated on the periphery of the tax system.

Although the D.C. tax system looked much the same in December 2010 as it did in January 2007, there was also much instability in between. D.C. policymakers were forced to quickly reverse several key tax policy decisions after a rapid response to public pressures was not accompanied by sufficient analysis of the problem and possible solutions. In 2008, a calculated tax rate for the first $3 million in assessed value of commercial property had to be replaced only months after enactment with a fixed rate because the calculated rate (which depended on changes in estimated revenues) would have reduced the tax rate by more than 50 percent and caused a budget deficit. The vacant property tax was subject to major overhauls in 2008, 2009, and 2010, as policymakers rushed to crack down on nuisance properties by doubling the tax rate in 2008; limited the higher tax to "blighted" properties and exempted properties that were

[74] Specifically, the real property tax rate for residential property dropped from $0.88 per $100 of assessed value to $0.85 of assessed value on October 1, 2007, due to a calculated rate designed to keep revenue within a target level.

well-maintained in 2009; and imposed punitive rates both for vacant properties ($5 per $100 of assessed value) and blighted properties ($10 per $100 of assessed value) in 2010. The rapid shifts in response to changing political pressures had serious consequences for property owners who could face sharply different property tax rates (ranging from $0.85 to $10 per $100 of assessed value) within a span of two years, and reflected weaknesses in the way that tax policy options were developed and evaluated.

The lack of major change in the D.C. tax system during the case study period also underscores the lack of attention to its long-term capacity. As the District's narrow tax base – constrained by the large tracts of tax-exempt federal property as well as a ban on the District's ability to tax non-resident income earned in D.C. – remained under pressure from national trends such as the growth in non-taxable services and e-commerce (Fox, 2012: 410), D.C. policymakers were patching tax policy to balance the budget rather than strengthening its efficiency, equity, and ability to generate revenue in future decades. By maintaining a tax policy process that allowed for rapid enactment of legislation designed to meet immediate political, economic, and fiscal pressures – and to circumvent fiscal impact requirements – D.C. lawmakers followed a short-term horizon that obscured the long-term health and fairness of the tax system.

Background

District of Columbia government officials had reason to feel proud when they released the fiscal year (FY) 2006 comprehensive annual financial report – the yearly audit of the District's financial records – in February 2007. The District had amassed a \$325 million general fund surplus, representing a 10th consecutive balanced budget, while receiving an unqualified, or "clean" opinion, on the accuracy of its books from an external auditor (Chief Financial Officer, 2007a: 1). The District's bond ratings had climbed from "junk" status in the mid-1990s, when a soaring budget deficit led congress and the president to appoint a five-member control board to oversee D.C. finances, to investment-grade in 2007 (Chief Financial Officer, 2007a: 8). The District had improved its financial position by almost \$2 billion during the previous decade, turning an accumulated deficit of \$518 million at the end of FY 1996 into a fund balance of \$1.435 billion at the end of FY 2006 (Chief Financial Officer, 2007a: 1).

D.C.'s chief financial officer (CFO), Dr. Natwar Gandhi, also sounded some cautionary notes, pointing to the volatility of the District's tax revenues, a growing debt burden, unmet infrastructure needs, and a "structural imbalance" between expenditures and revenues caused by severe limitations on the tax base (Chief Financial Officer, 2007a: 2, 4, 12-13). D.C. officials are barred by federal Home Rule Act from taxing income earned in the District by non-residents, which was estimated at two-thirds of total income (Chief Financial Officer, 2007a: 13). The District's largest employer, the federal government, is exempt from taxation. Land owned by the federal government and foreign embassies also contributes to a high percentage of tax-exempt real property, which equaled 38 percent of total property value in the District in 2006 (Government of the District of Columbia, 2007b: 136).

Still, D.C.'s economic and fiscal condition appeared stable, if not strong, at the start of the case study period. In March 2007, following several years of sharp growth in revenue from a booming real estate market and elevated federal defense and homeland security spending, CFO Gandhi projected "no major disruptions and steady growth in employment, wages, and income." (Government of the District of Columbia, 2007c: 4-1). After falling for decades, the District's population had inched up by 9,000 residents from 2000 to 2006, leading Gandhi to conclude that housing construction and renovation, along with strides in city services and amenities, were attracting more people to D.C. and lifting resident employment (Government of the District of Columbia, 2007c: 4-13).

Change and Stability in D.C. Government. Optimism also marked the January 2, 2007, inauguration of Adrian Fenty as D.C.'s fifth mayor since congress granted the District home rule in 1973. A member of the D.C. Council since 2001, the 36-year-old Fenty was the first mayoral candidate to win every precinct in the Democratic primary (Montgomery and Silverman, 2006), which was tantamount to election in a heavily Democratic jurisdiction and a strong mandate from voters long divided by race and economic class.[75] Despite a populist reputation, Fenty was the only mayoral candidate who pledged not to raise taxes, stating that he would fund any new initiatives through offsetting savings (Montgomery, 2006). Will Singer, who served as Mayor Fenty's budget director from 2007 to 2009, described the no-tax pledge as a way for Fenty to

[75] Fenty won the race by 26 percentage points, capturing 57 percent of the Democratic primary vote, compared to 31 percent for the second-place finisher, Council Chairman Linda Cropp,

change the view that he was "maybe hostile to business," adding that, "There was a bit of reverse engineering to figure out what he meant" by this promise. Several other individuals interviewed for the dissertation interpreted Mayor Fenty's no-tax pledge as applying only to the rates of the three major taxes – income, property, and sales – and the mayor did in fact propose some minor tax increases during his time in office.

The 13-member D.C. Council, comprised of 11 Democrats, one Republican, and one independent, would also have new leadership as Ward 7 Councilmember Vincent Gray became council chairman. The council would include five freshman lawmakers, reflecting further turnover in the District's leadership.

Amid the change in elected leadership, CFO Gandhi served as a source of stability in a position he had held since 2000. Dr. Gandhi's reappointment was announced by Fenty while he was still mayor-elect, and the council unanimously confirmed the appointment in March 2007. The federal Financial Responsibility and Management Assistance Act of 1995 (which also created the control board) established the CFO as an independent steward of the District's finances and entrusted him with broad powers and duties. The CFO prepares the mayor's budget and must certify that it is balanced; executes the budget; develops binding revenue estimates; conducts all financial transactions; collects all taxes and fees; determines whether legislation complies with the District's financial plan and budget; maintains systems of accounting and internal control; and oversees the government's borrowing, cash management, and investments.

Another source of continuity in D.C. tax policy was Councilmember Jack Evans, who continued as chairman of the council's tax-writing panel, the Committee on Finance and Revenue, a post he had held since 1999. A staunch advocate of lower taxes, Evans was a co-author of D.C.'s Tax Parity Act of 1999, which gradually reduced the personal income and real property taxes in order to make the District's rates more competitive with Maryland, Virginia, and local governments in the Washington region.

Institutional Structure of the D.C. Government. The mayor and council face unique constraints in governing the District of Columbia. Article 1, Section 8, Clause 17 of the Constitution gives the U.S. Congress the right "(t)o exercise exclusive Legislation in all cases whatsoever, over such District … as may … become the Seat of the Government of the United States …" The District of Columbia Home Rule Act (Public Law 93-198), enacted in 1973, allows D.C. residents to exercise self-government under parameters set by congress pursuant to its constitutional authority over the District.

The mayor serves as chief executive for a four-year term. Although the mayor did not share executive power with other elected officials before 2015, [76] the CFO served as a check on the mayor's authority through his control over the District's finances, as described earlier. The CFO is appointed by the mayor to a five-year term and can be removed only for cause with the concurrence of two-thirds of the council.

The council is comprised of eight members who represent geographical wards, four at-large members, and a chairman elected at-large who is the presiding officer. Councilmembers serve four-year terms. The council lacks an appropriations or budget committee similar to the Finance and Revenue Committee. Instead, the budget is debated and approved in a Committee of the Whole (comprised of all members, as the name suggests, and led by the council chairman), after receiving recommendations from standing committees such as finance and revenue, health, and economic development.

[76] In 2014, D.C. voters elected an attorney general (who took office in January 2015) for the first time.

The mayor proposes an annual "Budget Request Act" that includes the operating budget for the next fiscal year, a four-year financial plan, and a six-year capital improvement plan. After the council reviews and approves the Budget Request Act with any changes it deems necessary, the Act goes to the mayor for signature (the mayor can veto the budget or particular line items, and the council can override a veto by a two-thirds vote). The CFO must certify that the budget is balanced over a four-year period. Once D.C. officials have finalized the Budget Request Act, it is transmitted to congress and approved as a federal appropriations act that must be signed by the president. The council also approves a companion piece of local legislation, the annual "Budget Support Act," that makes changes to the D.C. Code that are needed to implement the budget.[77] Like other acts of the council, the Budget Support Act does not become permanent D.C. law until it is approved by the council in two votes conducted at least two weeks apart, signed by the mayor, and sent to congress for a 30-day review period[78] (the council can also enact emergency legislation for 90 days without congressional review).

The District faces a number of restrictions on its power to tax. Like other jurisdictions, the District cannot tax the property of the federal government, other states, or foreign embassies. As noted earlier, the D.C. government is barred from taxing the personal income of any individual who is not a D.C. resident.[79]

---

[77] For example, if an agency needed to change program eligibility requirements or restructure a program in order to meet budget targets, the relevant statutory changes would be included in the Budget Support Act.

[78] The review period is defined not as 30 calendar days, but rather as 30 weekdays (excluding holidays) in which either house of congress is in session. Thus, the 30-day review often spans two months or more. The review is "passive" – if congress does not act during the 30-day period, the legislation takes effect.

[79] See section 602(5) of the District of Columbia Home Rule Act, found in § 1-206.02(a)(5) of the D.C. Official Code.

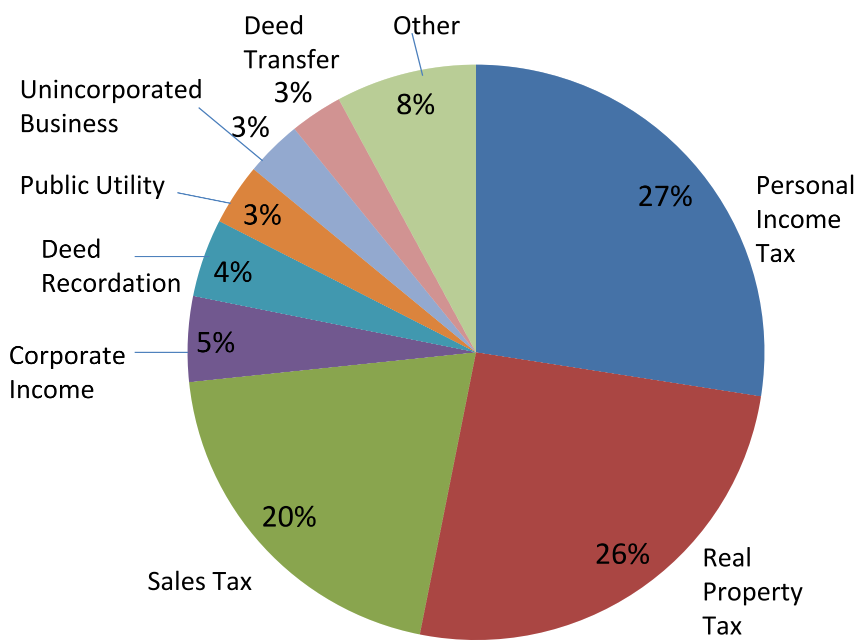
Another important restraint on the D.C. government stems from the control board act of 1995 (P.L. 104-8). Although the control board – a five-member board appointed by the president – ceased operations at the end of FY 2001 after the District balanced its budget for four consecutive years and regained access to municipal credit markets, the board can be reinstated if the D.C. government needs to requisition money from the U.S. Treasury; lacks sufficient reserves to pay debt service; defaults on loans, bonds, or other borrowings; fails to make payroll; has a cash deficit at the end of any quarter; or fails to make pension and benefit payments. These events would trigger a new "control period," during which the board must approve the District's budget, contracts, borrowings, and legislation. The prospect of the control board's return and the attendant loss of local autonomy provide an ongoing incentive for fiscal prudence by D.C. officials.

A Diversified Tax System. Because it performs state, county, and city functions, D.C. collects taxes typically levied by states (personal income tax, corporate income tax, general sales tax, excise taxes) and localities (real property tax, personal property tax, deed taxes). During FY 2006 (October 1, 2005 – September 30, 2006), immediately prior to the case study period, the District collected $4.49 billion in tax revenue, or 63 percent of total revenue.[80] The rest of the District's revenue flowed from federal grants and payments ($1.77 billion), earmarked fees and fines ($375 million), general-purpose fees and fines ($362 million), the lottery ($74 million), and private grants ($21 million) (Government of the District of Columbia, 2007c: 3-10, 4-14 – 4-15).

[80] Author's calculation using data from Government of the District of Columbia, *FY 2008 Proposed Budget and Financial Plan: Meeting the Challenge,* Volume 1, Executive Summary (March 23, 2007), pp. 3-10, 4-14 – 4-15.

The District's tax system can be seen as a three-legged stool, resting on the personal income tax ($1.23 billion in FY 2006 revenue, or 27 percent of total tax revenue), the real property tax ($1.15 billion in FY 2006 revenue, or 26 percent), and the general sales tax ($909 million in FY 2006 revenue, or 20 percent),[81] as depicted in Figure 4.2. The District also generates smaller amounts of revenue from taxes on corporations, unincorporated businesses, public utilities, business personal property, deeds, cigarettes, alcoholic beverages, motor fuel, motor vehicles, and estates.

Figure 4.2
D.C. Tax Revenue by Source, FY 2006



Source: Author's calculations using data from Government of the District of Columbia, *FY 2008 Proposed Budget and Financial Plan: Moving Forward Faster*, Vol. 1, Executive Summary (March 23, 2007), pp. 3-10, 4-14 – 4-15.

---

[81] Author's calculations using data from Government of the District of Columbia, *FY 2008 Proposed Budget and Financial Plan: Moving Forward Faster*, Volume 1, Executive Summary (March 23, 2007), pp. 3-10, 4-14 – 4-15.

Table 4.8 (beginning on the next page) describes the taxes levied by the D.C. government as of early 2007, along with their rates and actual revenue for FY 2006.

The D.C. tax system in 2007 was marked by a complex rate structure that reflected policymakers' efforts to dampen political opposition by reducing the rates paid by influential groups, as predicted by Hettich and Winer (1999). For example, the District divided real property into three classes (residential, commercial, and vacant), marked by wide disparities in the applicable tax rate ($0.88 per $100 in assessed value for residential properties, $1.85 per $100 for commercial properties, and $5.00 per $100 for vacant and abandoned properties). The District's sales tax is highly unusual for its five-tier structure. In 2007, the District charged a 5.75 percent general rate, as well as 9 percent for alcohol sold for off-premises consumption; 10 percent for restaurant meals, alcohol sold for on-premises consumption, and rental vehicles; 12 percent for parking motor vehicles; and 14.5 percent for hotel rooms. Generally, higher tax rates are imposed on those who are seen as engaging in harmful activities (vacant property owners) or those who are more likely to live out of state (commercial property owners, commuters who dine out and park at commercial lots, tourists who stay at hotels), while the lower rates are targeted at residents who vote in local elections. As stated by John Bowman, a consultant to the 1996-1998 D.C. Tax Revision Commission, "Individuals vote, businesses do not, so classification favors residential property over business property." (Bowman, 1998: 133).

In D.C., the tendency for policymakers to shift tax burdens onto those with less political influence and those who live out of state has been reinforced by efforts to compensate for the federal ban on the District's ability to tax income earned within its

Table 4.8
District of Columbia Taxes at the Start of the Case Study Period (2007)

Tax and FY 2006 Actual Revenue (000s)	**Rates**
<u>Property Taxes</u>	
Real Property ($1,153,795) – residential and business property is taxable, unless expressly exempted. Properties owned by the federal government, foreign countries, churches, and non-profit school, hospital, and charitable organizations are among those exempt. A homestead exemption of $60,000 applies to owner-occupied residential real property.	Class I (residential): $0.88 per $100 of assessed value Class II (commercial): $1.85 per $100 of assessed value Class III (unimproved or vacant): $5.00 per $100 of assessed value
Personal Property ($65,514) – all tangible business property, except inventory, is taxable. A $50,000 exemption is in place.	$3.40 per $100 of assessed value
<u>Sales and Excise Taxes</u>	
General Sales ($908,884) – sales of tangible property and selected services are taxable. Groceries, prescription drugs, non-prescription drugs, and residential utility sales are among the exempt items.	General: 5.75% Liquor sold for off-premises consumption: 9% Restaurant meals, liquor sold for on-premises consumption, and rental vehicles: 10% Parking of motor vehicles in commercial lots: 12% Hotel accommodations: 14.5%
Motor Vehicle ($42,563) – every issuance of title for a motor vehicle or trailer is taxable	3,499 lbs. or less: 6% of fair market value 3,500 to 4,999 lbs.: 7% 5,000 or more lbs.: 8%
Motor Fuel ($24,960) – gasoline, diesel, and other fuels used by motor vehicles are taxable. The revenue is dedicated to the D.C. Highway Trust Fund.	$0.20 per gallon
Cigarettes ($22,293)	$1.00 per pack of 20

Table 4.8 (p. 2)
District of Columbia Taxes at the Start of the Case Study Period (2007)

Tax and FY 2006 Actual Revenue (000s)	**Rates**
Sales and Excise Taxes (cont.) Alcoholic Beverage ($5,070)	 Beer: $2.79 per 31-gallon barrel Wine ≤ 14% alcohol: $0.30 per gallon Wine >14% alcohol: $0.40 per gallon Champagne/sparkling wine: $0.45 per gallon Spirits: $1.50 per gallon
Income Taxes Personal Income ($1,233,602) – taxable income is based on federal adjusted gross income and then modified for D.C. deductions, exemptions, credits, and add-backs. Corporate Franchise ($215,283) – net income of all corporations with nexus in D.C. is taxable. Minimum tax is $100. Unincorporated Business ($142,598) – net income of firms with gross receipts over $12,000 is taxable, subject to (1) a 30% salary allowance for owners, (2) a $5,000 exemption, and (3) a total exemption for businesses that earn more than 80% of gross income from personal services. Minimum tax is $100.	 $0 to $10,000 in taxable income: 4.0% $10,001 to $40,000 in taxable income: $400 + 6.0% of amount over $10,000. $40,001 or more in taxable income: $2,200 + 8.5% of amount over $40,000. 9.975% of taxable income 9.975% of taxable income
Gross Receipts Taxes (charged in lieu of other business taxes) Public Utility ($155,157) – Gas and electric companies are taxed on the amount of energy used. Local telephone companies are taxed on gross receipts. The commercial rate is always 10 percent higher than the residential rate, with the revenue raised from the surcharge dedicated to the ballpark fund.	 Gas: $.0707 per therm, + 10% for commercial users. Electric: $.007 per kilowatt-hour, + 10% for commercial users. Telephone: 10% of gross receipts for residential users and 11% for commercial users.

Table 4.8 (p. 3)
District of Columbia Taxes at the Start of the Case Study Period (2007)

Tax and FY 2006 Actual Revenue (000s)	**Rates**
Gross Receipts Taxes (cont.)	
Toll Telecommunications ($56,611) – gross receipts of firms providing long-distance and wireless telephone service in the District of Columbia are taxable.	residential: 10% commercial: 11% (extra 1% dedicated to ballpark fund)
Insurance Premiums ($51,495) – tax is based on gross insurance premiums from policies issued in the District, less premiums received for reinsurance assumed, returned premiums, and dividends paid to policyholders.	1.7% of policy and membership fees, plus net premium receipts
Ballpark ($15,952) – tax on business gross receipts above $5 million annually helps finance the debt on bonds issued to build the Washington Nationals baseball stadium.	tax is $5,500 for gross receipts of $5 million to $8 million; $10,800 for gross receipts of $8,000,001 to $12 million; $14,000 for gross receipts of $12,000,001 million to $16 million; and $16,500 for gross receipts above $16 million.
Healthcare Provider ($9,107) – gross receipts of nursing homes are taxable.	6.0%
Other Taxes	
Deed Recordation ($197,528) – the recording of all deeds to real estate is taxable, based on the value of the consideration given for the property.	1.1% for residential properties valued at less than $400,000; 1.45% for all other properties.
Deed Transfer ($132,615) – the transfer of property is taxable at the time a deed is recorded, based on the value of consideration given for the property.	1.1% for residential properties valued at less than $400,000; 1.45% for all other properties.
Economic Interest ($30,274) – the tax is triggered when 80% or more of the assets of an entity being sold consist of real property located in the District, or more than 50% of the controlling interest of a corporation is being transferred.	2.2% of the consideration or fair market value.

Source: Government of the District of Columbia, *FY 2008 Proposed Budget and Financial Plan: Moving Forward Faster*, Vol. 1, Executive Summary, March 23, 2007, pp. 4-14 – 4-15, 4-20 – 4-36, 4-50 – 4-52.

borders by non-residents. This issue is particularly salient because the District, as the employment center of the Washington metropolitan area, provides services to a large daytime population of commuters and tourists (Office of the Chief Financial Officer, 2007a).[82] The high commercial property tax rate, more than double the rate imposed on residents, represents one way to extract more revenue from non-residents (D.C. Tax Revision Commission, 1998: 35-36). The unincorporated business franchise tax, which targets income that would be subject to the personal income tax at the federal level, offers another means for the District to generate revenue from non-residents who are exempt from the D.C. personal income tax (Cordes and Watson, 1998: 383, 391). The District's relatively high utility taxes (11 percent) on non-residential properties not only raise revenue from out-of-state sources, but also allow the District to gain revenue from the federal government, the largest holder of tax-exempt property in the District (D.C. Tax Revision Commission, 1998: 35). The ways that D.C. politicians calibrate tax burdens and shift them to non-residents are strongly influenced by the goal of compensating for the revenue loss caused by the ban on taxing non-resident income and the large amount of tax-exempt property in the District.

[82] Although the District holds only 11 percent of the region's population, it is the location of 23 percent of the region's jobs. See Office of the Chief Financial Officer, *Economic Report of the District of Columbia: A Fiscal Perspective, 2007*, p. 9, available at www.cfo.dc.gov.

Tax Policy Decisions in 2007

Tax policymaking in the District of Columbia followed an incremental path during 2007. Elected officials continued a pattern of enacting targeted tax cuts that started in 2002 when a booming real estate market began fueling rapid revenue growth, but in 2007 D.C. officials shifted their focus from the residential real property tax to a more balanced approach including commercial property tax relief as well as income tax measures designed to help low- and moderate-income households. Institutional position and leadership were influential in shaping D.C. tax policy decisions in 2007, as the Committee on Finance and Revenue failed to define clear priorities for tax relief and the major choices were made in the Committee of the Whole. Council Chairman Vincent Gray crafted the final tax package, including proposals advocated by the D.C. Fiscal Policy Institute (DCFPI), a non-profit research and advocacy group focused on policies that affect low- and moderate-income residents.[83] In an environment in which tax policy priorities were fluid, DCFPI played a critical role in generating options and providing the analyses needed to choose among them.

As is usually the case, the most important tax measures in 2007 were incorporated into the District's annual operating budget, thereby ensuring that they were consistent with a balanced budget certified by the CFO. A number of other tax measures of varying scope and importance were considered outside the budget process.

Fiscal Year 2008 Budget Process. In March 2007, Mayor Fenty proposed an FY 2008 operating budget of $8.3 billion, representing a $520 million increase (6.7 percent)

---

[83] DCFPI's mission is described in more detail on its Internet site, www.dcfpi.org. DCFPI is part of a national network, the State Priorities Partnership Project, which is coordinated by the Center on Budget and Policy Priorities and includes the Maryland Center on Economic Policy (formerly the Maryland Budget and Tax Policy Institute) and Virginia's Commonwealth Institute for Fiscal Analysis.

from the FY 2007 operating budget (Chief Financial Officer, 2007b: 5). Mayor Fenty touted his budget as "fiscally conservative … with targeted investments, a number of programmatic innovations, and no taxes added to the (chief financial officer's) baseline revenues" (Mayor Adrian Fenty, 2007: 7). He did not propose any tax cuts.

The District's budget was feeling the strain of program expansions and tax cuts approved during the boom years of FY 2002 to FY 2006. Lawmakers had earmarked \$100 million in sales tax revenue, beginning in FY 2007, to rebuild and renovate dilapidated public schools. In addition, officials had completed a series of tax reductions mandated by the Tax Parity Act of 1999, while enacting a 10 percent cap on annual increases in the taxable value of owner-occupied homes and doubling a real property homestead exemption from \$30,000 to \$60,000. The estimated FY 2008 revenue loss due to the Tax Parity Act was \$117 million, while the estimated FY 2008 revenue loss from property tax relief measures approved since FY 2004 was \$124.2 million (Government of the District of Columbia, 2007c: 4-19). In addition, the District faced higher costs in FY 2008 for a larger police force (\$49.6 million), general pay raises (\$62.2 million), retiree health benefits (\$106.2 million), the health care safety net program (\$53.0 million), and Medicaid (\$51.4 million) (Chief Financial Officer, 2007c).

Nevertheless, legislators continued to propose additional tax relief in the two-year legislative session (Council Period 17) that began in January 2007, reflecting the strong political imperative to reduce tax burdens. Real property tax relief remained high on the policy agenda due to sharp growth in property values. From FY 2001 and FY 2005, the total assessed value of residential real property in the District soared by 151 percent (from \$24.7 billion to \$61.9 billion), and the total assessed value of commercial real property grew by 82 percent (from $20.6 billion to $37.4 billion), raising property tax bills (Office of the Chief Financial Officer, 2007a: 93). "We tend to be very reactive with regard to tax policy," observed Phil Mendelson, who served as an at-large councilmember from 1999 until he became council chairman in 2012. Complaints about rising assessments, he noted, led policymakers to say, "Oh, we gotta deal with that tax." Still, the council was responding to a serious concern that property tax bills were growing faster than people's ability to pay.

To address the real property tax burden, policymakers considered a tool they had used repeatedly in the past five years – caps on growth in taxable assessments for residential property – and explored capping commercial property assessments, which had no such restriction. In 2002, D.C. officials approved the first cap (25 percent) on annual growth in the taxable value of an owner-occupied home. As discontent about rising property taxes persisted, the council lowered the cap to 12 percent in 2004 and 10 percent in 2005. Although capping the annual growth in taxable values for commercial property owners ultimately proved unaffordable, D.C. officials would constrain commercial property tax revenue in 2007 using another tool they had applied to residential property taxes: a "calculated tax rate" that is adjusted in order to keep total revenues within a target level. The calculated tax rate had the advantage (at least in political terms) of being self-funding: if the CFO certified that revenue from a tax was on a path to exceed budget estimates, the tax rate would then be lowered by an amount projected to offset the surplus. No program cuts or tax increases would be needed to finance the tax cut.

Councilmember Evans, the finance committee chairman, indicated his priorities by holding the first tax policy hearing of 2007 on three bills: (1) Bill 17-19, which would reduce the maximum annual growth in taxable value of owner-occupied homes from 10 percent to 5 percent, (2) Bill 17-20, which would cap annual growth in the taxable value of commercial and non-owner-occupied residential properties at 10 percent, and (3) Bill 17-37, which would "re-couple," or align, the District's estate tax threshold with the federal estate tax, thereby raising the $1 million threshold for estate tax liability to $2 million in FY 2008 and $3.5 million in FY 2009 and subsequent years.[84]

Versions of Bills 17-19, 17-20, and 17-37 had been considered in prior council periods. As the FY 2008 budget process unfolded, it seemed that D.C. legislators were checking off items on a running list of tax relief options. In an interview, Fenty budget director Will Singer observed that commercial property tax relief rose on the agenda in 2007 because "it seemed like the biggest outlier" compared to surrounding jurisdictions after D.C. policymakers lowered residential property tax rates (D.C.'s commercial property tax rate was more than twice as high as that of Alexandria City and Arlington and Fairfax Counties in Virginia, and roughly 70 percent higher than that of Montgomery and Prince George's Counties in Maryland).[85] D.C. interviewees repeatedly cited the plight of beloved, longtime small businesses such as Ben's Chili Bowl and Lee's Flower Shop, which faced spiraling property taxes in revitalized neighborhoods, as a major source of concern about the commercial property tax burden.

Although developments in the "problem stream" boosted commercial property tax relief onto the governmental agenda, D.C. officials faced difficulty in joining a policy

---

[84] The "recoupling" envisioned in Bill 17-37 would only last through 2009, because federal law at that time provided that the estate tax would expire in 2010 and then in 2011 revert to the rules that were in effect in 2001. To avoid repealing the District's estate tax in 2010, Bill 17-37 would maintain a $3.5 million estate tax threshold in 2010 and subsequent years – a path that did *not* conform to federal policy.

[85] See Government of the District of Columbia, *Tax Rates and Tax Burdens: Washington Metropolitan Area, 2006* (November 2007), p. 35.

solution to the problem. Affordability emerged as an obstacle to a commercial property tax cap. CFO Gandhi estimated that Bill 17-20 (the 10 percent cap on commercial and non-owner-occupied residential properties) would result in a revenue loss of $228.9 million in FY 2007 and $1.2 billion from FY 2007 to 2010 (Office of the Chief Financial Officer, 2007b). OCFO officials dealt another blow to Bill 17-20 by stating it "would channel most of the benefits to large commercial buildings," often owned by limited liability corporations, large corporations and associations, real estate investment trusts, and large investors (Ebel and Newman, 2007: 1-2), rather than small businesses. The OCFO analysis forced legislators to abandon the commercial property tax cap.[86]

DCFPI served as the main proponent of an alternative approach to tax relief in 2007, calling for more progressive tax relief measures instead of the property tax cap and estate tax bills. Specifically, DCFPI urged D.C. lawmakers to consider the following types of personal income tax relief: (1) raising the standard deduction and personal exemptions to match federal levels, (2) increasing a credit for child-care expenses, and (3) updating a credit for low-income homeowners and renters whose housing costs exceed a certain percentage of income. In a pattern that continued throughout the study period, DCFPI was a main source of tax policy options and analyses for D.C. officials, along with the CFO's Office of Revenue Analysis. In effect, DCFPI executive director Ed Lazere and his staff served as "policy entrepreneurs" who helped join problems and policies in the political process.

[86] In reporting on a revised version of Bill 17-20, the Committee on Finance and Revenue stated that the 10 percent cap was put aside because, "(T)he fiscal impact of the legislation … proved too great an obstacle." See Council of the District of Columbia, Committee on Finance and Revenue, "Report on Bill 17-20, the 'Small Business Commercial Property Tax Relief Act of 2007," dated December 6, 2007.

DCFPI contended that broad-based tax reductions, such as the tax caps, were not warranted because taxes on D.C. families had fallen to the lowest in the region. DCFPI also highlighted findings that the D.C. tax system was regressive, with households in the top 1 percent of the income scale paying the lowest percentage in taxes, and argued that renters should be included in new tax relief measures (D.C. Fiscal Policy Institute, 2007). Although DCFPI's views gained little traction in the Committee on Finance and Revenue, they influenced the final tax package enacted by the council by providing distributional analyses that were otherwise lacking in the tax policy debate.

The Committee on Finance and Revenue voted on May 4, 2007, to recommend adoption of three tax relief measures: (1) the 5 percent cap on annual residential real property tax increases for owner-occupants, (2) estate tax recoupling, and (3) a business tax exemption for community development entities receiving federal new market tax credits (the last item was technical and applied to a very small number of firms). Chairman Evans also expressed his desire to provide commercial property tax relief, but noted that he was still working with the OCFO to target the relief to small businesses.[87]

The finance committee action was far from definitive. Because the committee had not identified offsetting revenue increases or spending cuts (or both) that would be needed to enact the bills, the committee's vote was subject to the "proviso that funds will need to be identified at the Committee of the Whole to fund this proposal." (Committee on Finance and Revenue, 2007a: 28-29). Moreover, Mr. Evans repeatedly stated that the panel was only offering recommendations to the council chairman, noting that, "We are all going to sit down next Wednesday and Thursday and look at these recommendations

[87] One of the problems Chairman Evans pointed out was the difficulty of targeting relief to small businesses that did not own their space, but were absorbing higher property tax costs from their landlords.

plus anything else that anyone wants to bring to the table, and decide what we're going to do." (Office of Cable Television, 2007a).

In response, committee members blurred the panel's priorities instead of clarifying them. Councilmember Jim Graham added language to the committee budget report stating that the 5 percent property tax cap should be "considered as one option with other pressing tax relief measures, including tax relief for historic small businesses" (Committee on Finance and Revenue, 2007a: 33), while Councilmember Kwame Brown voiced support for the estate tax re-coupling as long as it did not preempt other items that "should be in the basket" of tax options (Office of Cable Television, 2007a). The committee also stated that it "remains interested in further exploring" the idea of increasing and indexing the personal exemption and standard deduction (Committee on Finance and Revenue, 2007a: 15). By expressing general support for many types of tax relief, the committee failed to provide strong policy direction. In an interview discussing the tax policy options that were considered at the time, Mr. Evans reiterated that, "I thought all those ideas were good."

Although the committee displayed acute sensitivity to the complaints lodged by residents about D.C. taxes – the real property tax in particular – it did not build the case for the policy responses it favored. In advocating a 5 percent cap on annual residential property tax increases, Chairman Evans argued that very few homeowners enjoy the 10 percent annual increases in income needed to keep pace with a 10 percent tax cap, adding that, "This is the (issue) I hear the most about." (Office of Cable Television, 2007a). Mr. Evans also contended that the estate tax threshold should be raised to protect those whose estates were rising above the $1 million tax threshold due to rising home values

(Committee on Finance and Revenue, 2007a: 32-33), but there were no data estimating the extent of this phenomenon or the effects of the estate tax on outmigration. Moreover, the committee did not set forth the reasons for supporting the 5 percent residential property tax cap and the estate tax recoupling instead of other options, such as an increase in the property tax circuit-breaker for low-income households.

The absence of a strong consensus in the Finance and Revenue Committee or detailed analysis of the policy options gave Chairman Gray the latitude to frame the council's tax policy choices as the venue for decision-making shifted to the entire body. Mr. Gray's opening to craft a solution grew when Dr. Gandhi raised the District's revenue estimate in early May by $19.2 million for FY 2007 and $61.4 million for FY 2008 (Chief Financial Officer, 2007d).

Chairman Gray proposed setting aside $35.4 million of the additional FY 2008 revenue for tax relief. In a revised version of the FY 2008 Budget Support Act circulated hours before the May 15, 2007, budget vote (Stewart, 2007), Mr. Gray introduced a new tax relief package with three main elements: (1) raising the standard deduction and personal exemption (personal income tax) and indexing both provisions for inflation, (2) increasing the homestead deduction (real property tax) and indexing it for inflation, and (3) reserving money for small business property tax relief (the details of which would be fleshed out in subsequent legislation).[88] In a written response to questions, Mr. Gray explained his proposal as follows: "The bills that the Finance Committee put forth were passed without funding … As a proponent of fair and equitable tax policy, I put forward

[88] The chairman also adopted the Finance and Revenue Committee's recommendation to exclude community investment income for businesses receiving new market tax credits, but this technical change was the only finance committee proposal that was included.

those tax relief items which I felt would have the most value citywide and that we could afford to enact. Increasing and indexing the standard deduction, personal exemption, and homestead deduction are things that would impact every household in some way."

The interviews indicate that Mr. Gray used his position to shift the council's 2007 tax policy decisions in a more progressive direction consistent with his views. One interviewee described Mr. Evans as "a bit of a Republican when it comes to taxes," adding that Chairman Gray, who had a career in human services prior to representing Ward 7 (the District's second-poorest ward)[89] on the council, "choked at copying Republicans on the estate tax." Mr. Gray's tax package balanced a number of competing interests, including residential property tax relief and commercial property tax relief, with income tax provisions that would benefit a large share of taxpayers. In presenting the plan to the Committee of the Whole, Chairman Gray repeatedly described it as "progressive," adding that it would benefit "every person in every ward of the city." (Office of Cable Television, 2007b). Mr. Gray emphasized that the personal exemption and standard deduction provide disproportionate benefits to low- and middle-income families, while also helping renters (who are much less likely to itemize their deductions) and large families (who can claim a personal exemption for each member).

The council approved Chairman Gray's tax package with a minor change,[90] and Mayor Fenty signed the tax relief package into law as part of the FY 2008 BSA.

---

[89] As of the 2000 Census (the most recent data available at that time), Ward 8 had the highest poverty rate in the city (36.0 percent), followed by Ward 7 at 24.9 percent. See Peter A. Tatian, G. Thomas Kingsley, Margery Austin Turner, Jennifer Comey, and Randy Rosso, *State of Washington, D.C.'s Neighborhoods* (Washington, D.C.: The Urban Institute, 2008), pp. 154-155.

[90] Chairman Gray had proposed increasing the personal exemption from $1,500 to $1,850. The council adopted an amendment by Councilmember Marion Barry that increased the personal exemption only to $1,675 in order to shift funds to the rent supplement program.

Reflecting on the smooth passage of the chairman's tax plan, Councilmember Mary Cheh stated in an interview that, "Vince Gray from early on was able to use the aura and gravitas of his position to convince the members to vote his way. I think he was really effective." Mr. Gray's tax proposals moved forward because they were politically astute, spreading benefits broadly, and advanced a widely-shared goal of targeting low- and middle-income residents who had not benefited from tax relief measures in recent years.

While Chairman Gray had skillfully balanced political interests in crafting the tax plan, he also benefited from DCFPI's analysis and its advocacy for more progressive tax relief measures. Between the Committee on Finance and Revenue vote and the council's budget vote, DCFPI issued another report arguing that soaring real property tax bills were largely a myth and estimating that nearly half of D.C. homeowners would pay lower property tax bills in 2008 than in 2005 due to the tax relief measures already enacted (Lazere, 2007: 3). In particular, DCFPI projected that the 5 percent cap on the annual increase in taxable assessments for owner-occupied homes would deliver 53 percent of the benefits to owners of homes worth $750,000 or more, who comprised only 21 percent of homeowners (Lazere, 2007: 3). Several interviewees noted that these arguments were effective in undermining support for the 5 percent cap. DCFPI also posited that very few estates exceeded the existing tax threshold of $1 million, and cited research showing that the tax has little effect on mobility patterns among the elderly (Lazere, 2007: 1-2, 5-6). Proponents of the 5 percent property tax cap and the estate tax recoupling did not produce analyses to challenge DCFPI's findings, reflecting the importance of information and policy entrepreneurship as well as institutional position (the role of the council chairman) in shaping the council's tax policy decisions in 2007.

More generally, the 2007 tax package represents a prime example of incremental change, as policymakers made small moves to alleviate a variety of perceived problems. The size of the total tax relief package was modest, as the projected revenue loss in FY 2008 equaled 0.6 percent of total tax revenue.[91] Legislators took a first step on commercial property tax relief by setting aside $11.1 million annually for that purpose, but this was a fraction of the $200 million in annual relief sought by Councilmember Evans in his 10 percent tax cap proposal. DCFPI achieved some major goals by helping defeat the 5 percent property tax cap and the estate tax cut, while advocating successfully for increases in the standard deduction and personal exemption to help low- and moderate-income families. Even so, the standard deduction and personal exemption would remain well below the levels DCFPI recommended and the proposal to expand the property tax circuit-breaker for low-income households was not adopted. Table 4.9 (see next page) summarizes the FY 2008 tax relief package.

The council's tax policy deliberations during the FY 2008 budget process lend support to several of the propositions set forth in Chapter 1. First, D.C. officials performed a fairly narrow search for tax policy options (proposition #2), turning first to policy tools, such as tax caps and calculated rates – that had been used in the recent past in an ongoing effort to reduce taxes, particularly the real property tax. Tax increases and base-broadening measures were not considered, nor were more complex proposals that would have increased some taxes and reduced others in an attempt to increase the fairness, efficiency, or revenue capacity of the tax system.

---

[91] Author's calculation using data from Government of the District of Columbia, *FY 2008 Proposed Budget and Financial Plan: Moving Forward Faster*, Vol. 1, Executive Summary (June 2007), pp. 4-17, 4-19, and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2008 Budget Support Act of 2007,' June 5, 2007, pp. 8-10.

Table 4.9
District of Columbia Fiscal Year 2008 Tax Relief Package

Provision	Projected Fiscal Impact
Increase standard deduction from $1,250 to $2,000 (single filers) and from $2,500 to $4,000 (joint filers), and index for inflation	-$10.9 million, FY 2008 -$47.9 million, FY 2008-11
Increase personal exemption from $1,500 to $1,675, and index for inflation	-$5.2 million, FY 2008 -$22.8 million, FY 2008-11
Increase homestead exemption from $60,000 to $64,000, and index for inflation	-$2.9 million, FY 2008 -$18.0 million, FY 2008-11
Provide small business commercial property tax relief – details to be worked out in subsequent legislation	-$11.1 million, FY 2008 -$44.3 million, FY 2008-11
Exclude income from low-income community investments from taxable income of unincorporated businesses that receive new market tax credits	-$35,000, FY 2008 -$140,000, FY 2008-11

Sources: Council of the District of Columbia, Committee of the Whole, "Report on Bill 17-148, the 'Fiscal Year 2008 Budget Support Act of 2007,'" May 15, 2007, pp. 2-3, 29-30; and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2008 Budget Support Act of 2007,'" June 5, 2007, pp. 1, 7-10.

Second, D.C. officials emphasized political acceptability in evaluating tax policy options, rather than normative principles such as revenue capacity, economic efficiency, and equity (proposition #3). By presenting a menu of tax relief options, Finance and Revenue Committee members allied themselves with a wide range of important interests (homeowners, businesses, senior citizens) without making distinctions among them based on tax policy principles (and in the case of commercial property tax relief, the policy was to be developed later). Although Chairman Gray revamped the council's tax relief package to make it more progressive, the only distributional analysis performed during the 2007 budget process was done by DCFPI (on the progressivity of the tax system and the 5 percent cap for owner-occupied homes), reflecting D.C. policymakers' dependence on external analyses.

The set-aside for commercial property tax relief illustrates the importance of symbolic framing in influencing tax policy outcomes (proposition #4). As noted earlier, commercial property owners, often viewed as out-of-state business interests, were taxed at rates more than twice as high as residential property owners, who are seen as likely voters. After several years in which D.C. officials focused on residential property tax relief, commercial property tax relief gained support in 2007 through its association with small, neighborhood businesses. In its FY 2008 budget report, the Committee on Finance and Revenue highlighted "rising property taxes impacting businesses of long standing, such as Blues Alley, Ben's Chili Bowl, the Warehouse Theatre, Colonel Brooks' Tavern, and many others." (Committee on Finance and Revenue, 2007a: 14). Committee chairman Jack Evans warned of a possible "malling of the city" if small businesses were driven out of business by soaring property taxes (Office of Cable Television, 2007c).

In addition, the council's tax policy decisions during the FY 2008 budget process highlight the impact of institutional powers and procedures. Legislative rules allowing the council chairman to present a new version of the budget support act (known as an "amendment in the nature of a substitute") on the morning of the vote gave Chairman Gray considerable leverage over the outcome. Not only did his proposal start with an inherent advantage – it would have to be revised or deleted by a majority vote – but the lack of a notice requirement left potential opponents little time to organize. This example shows the limits of a "rational model" of policymaking, in which officials try to identify the best means of reaching goals that reflect their collective preferences. In this case, lawmakers' preferences were fluid and institutional procedures molded those preferences into a policy choice – what Shepsle (1989) termed a "structure-induced equilibrium." Moreover, the 2007 tax-cut package reflects the importance of "venue-shifting," which enabled advocates of more progressive tax policy to prevail in the more favorable forum of the Committee of the Whole.

Commercial Property Tax Relief for Small Businesses. After enacting the FY 2008 budget, policymakers had to devise commercial property tax relief legislation that had been funded in the budget. After another public hearing in October 2007, Chairman Gray and Councilmember Evans revised the commercial property tax cap bill (Bill 17-20) to include (1) a lower tax rate on the first $3 million of assessed value of a commercial property, contingent on commercial property tax revenues exceeding projected levels, and (2) an increase in the personal property tax exemption from $50,000 to $225,000. The legislation moved quickly through the council, receiving final approval on a 12-1 vote in January 2008, and was signed by Mayor Fenty.[92]

By instituting a calculated rate for the first $3 million in commercial property value, legislators made commercial real property tax relief "costless" in terms of the enacted budget. As of September 2008, any increase in projected commercial property tax revenue for FY 2009, compared to a baseline estimate from December 2007 ($1.12 billion) would be redirected to commercial property owners through a lower tax on the first $3 million in property value. For FY 2010 and subsequent years, aggregate growth in commercial property tax revenue would be capped at 10 percent by calculating a rate reduction sufficient to keep revenue under that limit (if necessary), and the tax rate on the

[92] Even though final passage was on January 8, 2008, Bill 17-20 is treated as a tax policy decision of 2007 because the key provisions had been determined in 2007. Except for the addition of a reporting requirement, Bill 17-20 was unchanged during the final vote in January 2008.

first $3 million of assessed value could not increase. Chairman Gray and Councilmember Evans both stated in response to questions that affordability was a main advantage of the calculated rate. Dr. Fitzroy Lee, who helped prepare fiscal impact statements on tax legislation as the CFO's director of revenue estimation, also noted that the calculated rate "was designed to have no fiscal impact." The increase in the personal property tax exemption would be funded by the $11.1 million set-aside in the FY 2008 budget.

Although the commercial property tax relief responded to the pleas made in public hearings by trade associations and small business owners, the council's policy solution was not grounded in an analysis of the tax burden or its impacts. The Committee on Finance and Revenue report on the legislation did not explain why the two policy tools were chosen, and no data were presented on how many businesses would benefit from the higher personal property tax exemption or the lower rate on the first $3 million in commercial property value, which was chosen to reflect the worth of property a small business might own. "It was something (Chairman Gray and I) could agree on," Councilmember Evans stated in explaining why the calculated rate was chosen. Councilmember Mendelson expressed the view that, "There was really no analysis over who actually benefits … We think we're providing relief to the Mom and Pop … if a small business is a tenant, is it passed through to them? We really don't do the analysis."

In the absence of detailed policy or economic analysis, the positive image of small businesses and warnings about their plight continued to serve as the driving force for commercial property tax relief. The finance committee report on Bill 17-20 underlined the image of small businesses as steadfast, deeply-rooted contributors to the community, stating that:

> As the District's economy has seen dramatic growth, the tax burden faced by our neighborhood businesses has increased along with it. So much so, that some of the City's 22,000 small businesses have had to close their doors in search of new locations, often in Maryland and Virginia where tax rates are lower. This has put our small businesses, many of which are institutions in our city, at risk of disappearing from our neighborhoods.
>
> These small business owners stayed with the District during a period of time when the District faced severe financial and societal problems. Communities want to keep small, local businesses as an integral part of the fabric of their neighborhoods … (Committee on Finance and Revenue, 2007b: 1-2).

The main notes of caution about Bill 17-20 came from DCFPI, which faulted the legislation for making commercial property tax relief the first priority if extra tax revenue materialized. DCFPI also pointed out that the notion of surplus revenue was artificial because it was not based on actual collections but rather on whether new revenue estimates exceeded prior estimates. In a comment that would prove prescient, DCFPI noted that revenues from different taxes often move in opposite directions, so that unexpected gains in commercial property tax revenue might be needed to offset shortfalls from other sources (D.C. Fiscal Policy Institute, 2008). More generally, the use of the calculated rate could undermine the long-term revenue capacity of the tax system: although rates would be cut when revenues were on a path to exceed estimates, they would not be increased when revenues were falling short of estimates.

Other Tax Legislation Considered in 2007. By the end of 2007, four other tax policy bills were approved by the council and signed by the mayor. As summarized in Appendix 4.1 at the end of the chapter, these bills were narrow in scope: three dealt with single properties, while the fourth clarified the scope of a personal income tax deduction.

By providing real property tax relief for single parcels, two of the bills were projected to result in a total of almost $1.5 million in forgone revenue from FY 2008 to FY 2011.[93]

The real property tax relief bills reflected an ongoing practice of D.C. lawmakers to approve tax relief (and other) measures subject to "the inclusion of its fiscal effect in an approved budget and financial plan," also known as the "subject-to-appropriations" clause. D.C. officials devised this language (the practice was later codified in federal law) [94] to enact legislation that the CFO deemed inconsistent with the approved budget. Legislation enacted with a subject-to-appropriations clause entered a statutory gray zone, becoming law but not being immediately implemented. In the words of Councilmember Phil Mendelson, the subject-to-appropriations clause served as "a technique we have discovered to pass stuff and not pay for it," allowing lawmakers to claim credit for delivering benefits while deferring the less pleasant decisions about offsetting the costs.

The process of approving tax relief with financing to be determined later reflects policymakers' desire to deliver benefits to specific, identifiable neighborhood projects. Bill 17-143, introduced by finance committee chairman Evans, provided tax forgiveness and an exemption to a house museum (Heurich House) in Mr. Evans' ward that did not meet the standard for tax-exempt museums.[95] Bill 17-180, introduced by Chairman Gray at the request of Mayor Fenty, granted a tax exemption and abatement to a rental housing

[93] See Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Heurich House Foundation Real Property Tax Exemption and Real Property Tax Relief Act of 2007,'" dated June 14, 2007, and Office of the Chief Financial Officer, "Fiscal Impact Statement: "Georgia Commons Real Property Tax Exemption and Abatement Act of 2007,'" dated April 3, 2007, available at www.cfo.dc.gov.

[94] See section 204 of P.L. 109-356, the "2005 District of Columbia Omnibus Authorization Act," effective October 16, 2006. The language was then added to the D.C. Official Code as § 1-301.47a.

[95] This standard requires that a museum is open to the public free of charge for at least two days per week. The Heurich House exemption is one of the few tax relief measures with a subject-to-appropriations clause that was never funded.

and retail project (Georgia Commons). Both bills were approved by the council unanimously even though they were unfunded. "When there's no cost attached to it, councilmembers don't put much thought into it – it's an easy vote," stated DCFPI executive director Ed Lazere.

More generally, the tax relief measures for Heurich House and Georgia Commons reflect the importance of the "micropolitical" aspect of tax policymaking discussed in proposition #5. While addressing issues of broad concern such as commercial property tax rates, the mayor and council were also willing to calibrate tax rates to meet the demands or needs of particular groups and property owners. Any costs from these efforts would be so small and widely dispersed that they would not generate any opposition while the tax reductions would be very salient to the recipients.

In an interview, Councilmember Evans stated that, "We've had great success with these development projects," adding that, "There's no common thread to these bills … We do it on a case-by-case basis." Although the tax relief measures may have been worthy by promoting ends such as affordable housing, D.C. officials sidestepped the question of whether tax relief represented the best use of scarce resources by approving the bills without financing them – just as they did when they held out the prospect of lower commercial property taxes if surplus revenues materialized. In both cases, D.C. lawmakers put tax benefits on a path to enactment without having to confront their costs. At the same time, by creating an ongoing queue of unfunded tax relief measures, D.C. policymakers created a slow but persistent strain on the long-term revenue capacity of the tax system (proposition # 7).

Tax Policy Decisions in 2008

The dynamics of tax policymaking in the District of Columbia changed markedly during 2008, as a worsening economy ushered in a period of austerity. The main focus of attention was revising the commercial property tax relief bill that had just been enacted in January 2008, because it was projected to trigger a cut of more than 50 percent in the tax rate on the first $3 million of assessed value – an unexpected result. To balance the FY 2009 budget and finance an expansion of health insurance, D.C. officials also approved a range of modest tax increases, doubling "sin taxes" on cigarettes and vacant properties on unanimous votes. Similarly, D.C. lawmakers restricted the other tax increases approved in 2008 to peripheral parts of the tax base without politically potent constituencies: the insurance premiums tax and the economic interests tax. Because the Committee on Finance and Revenue would not consider tax increases, the venue for tax increases once again shifted – to the Committee on Health and the Committee of the Whole.

Due to the slumping economy, the CFO reduced the FY 2009 revenue estimate by a total of $355.7 million, or almost 7 percent of baseline revenue,[96] in the quarterly estimates released in 2008. Nevertheless, a $62.5 million drop in the revenue forecast issued in February 2008 was due not to the economy but rather to the calculated commercial property tax rate. Because projected commercial property tax revenues were on a path to exceed the original FY 2009 estimate by $95.7 million,[97] an offsetting cut of that amount was required (Chief Financial Officer, 2008a: 1-2). Putting the cut into

[96] This figure reflects the author's calculation of the total drop in projected FY 2009 revenue during 2008, compared to a December 2007 baseline of estimated revenue. The calculation uses data from CFO revenue certifications dated February 27, 2008, May 7, 2008, September 24, 2008, and December 19, 2008.

[97] One reason why commercial property tax revenue remained strong is that the FY 2009 tax liability was based on assessments conducted in 2007, before the market fell.

effect would require reducing the tax rate on the first $3 million in assessed value by more than half, from $1.85 per $100 to $0.91 per $100 (Office of the Chief Financial Officer, 2008a: 35). The mandated reduction in commercial property taxes would exceed the growth in other D.C. revenues, creating the budget gap and reflecting the unintended consequences of funding tax relief from "surplus" revenues.

Vacant Property Tax Legislation. Although the D.C. government's major tax policy debates in 2008 once again took place during the budget process, one of the tax decisions reflected in the budget – a tax increase on vacant or abandoned real property – unfolded suddenly in the fall of 2007. Legislation to improve the regulation of vacant properties was amended to increase the tax rate on vacant properties (residential and commercial) from $5 per $100 of assessed value to $10. Both the process by which the tax change occurred and the result (the doubling of a tax rate) were unusual.

Bill 17-86, the "Nuisance Properties Abatement Reform and Real Property Classification Amendment Act of 2007," was intended to coordinate and streamline the procedures to identify and penalize vacant and abandoned properties. The legislation was referred sequentially to the Committee on Finance and Revenue (which had jurisdiction over tax administration) and the Committee on Public Services and Consumer Affairs (which had jurisdiction over vacant property regulation).

When the Committee on Public Services and Consumer Affairs voted on the legislation in September 2007, it approved with little discussion and no dissenting votes an amendment by Councilmember Kwame Brown to double the vacant property tax rate (Committee on Public Services and Consumer Affairs, 2007: 16-17). "It was one of those on-the-spot things where you say, 'OK,'" Councilmember Mary Cheh, the committee chairperson, stated in an interview. “My whole thing was to make (vacant property owners) put it back into productive use and to make it as painful as possible.” The unusual action to raise a tax in a committee without jurisdiction over taxes resulted in a re-referral of the legislation to both committees, which again approved the legislation with the $10 vacant property tax rate. Bill 17-86 received final, unanimous approval from the council in July 2008, with no objection to the tax increase.

The smooth path to enactment for the vacant property tax increase is also reflected in the legislative history, which indicates that drawbacks or unintended consequences were not considered. Beyond citing the CFO’s fiscal impact estimate, the legislative reports of both committees did not discuss any economic impacts or implementation issues, such as the possible difficulty of financing property renovations in a slowing housing market (Committee on Finance and Revenue, 2007c; Committee on Public Services and Consumer Affairs, 2008). The lack of attention to possible drawbacks is surprising because the $10 tax rate would be more than 10 times the rate on residential property ($0.85 per $100 of assessed value) and more than five times the top rate on commercial property ($1.85 per $100 of assessed value above $3 million).

Overall, the unanimous approval of the vacant property tax increase reflected the intensity of political pressure to reduce the number of abandoned and blighted properties, as well as the pariah status of the property owners. In effect, D.C.’s vacant property tax serves as a “sin tax” intended to punish people viewed as engaging in harmful behavior. The limited discussion of the tax increase reflects the political imperative to crack down on vacant property owners – and to be seen as cracking down – without a clear sense of how the desired result would be attained. Councilmember Evans, the finance committee chairman, stated in an interview that the widespread view that vacant properties are "destabilizing" set off a competition among councilmembers to "show that I'm tougher than you are" on the issue. Councilmember Kwame Brown, the sponsor of the higher tax rate, contended during a committee meeting that, "If you don't hit them in the pocketbooks, they are just not going to respond." (Committee on Public Services and Consumer Affairs, 2008: 12). Councilmember Jim Graham expressed the prevailing view of the vacant property tax as a deterrent to harmful behavior by irresponsible outsiders when he stated during committee debate that:

> Vacant properties attract crime, vagrancy, and compose an immediate threat to the public. They contribute to blight in communities. Often these properties are owned by individuals or faceless corporations that do not even reside in the District and feel no incentive to repair or maintain the property. In fact, vacant properties are a downer for neighborhoods. They depress neighborhoods and depress the morale. (Office of Cable Television, 2008a)

Several individuals interviewed for the dissertation observed that politically popular ideas can move through the council very quickly because of its unicameral structure, its dominance by one political party, and a tradition of deference to committee chairpersons. But a more precise conclusion may be that sin taxes – taxes to punish behavior regarded as harmful – can be enacted very easily, especially when a legislature lacks a non-partisan policy analysis or research office (similar to the Department of Legislative Services in Maryland or the Division of Legislative Services in Virginia) that can highlight relevant economic and administrative issues that should be considered. None of the councilmembers had even introduced a bill to increase the vacant property tax rate. As an amendment offered with no advance notice, the vacant property tax increase gathered support with very little deliberation. Vacant property owners in the District exemplify the "deviants" described in Schneider and Ingram's social construction theory (outlined in Chapter 2) who are portrayed as harmful, if not alien, and are targeted for a disproportionate share of societal burdens – in this case, a punitive level of taxation.

Although a sin tax may be relatively easy to enact – particularly if the sinners are small in number and lack defenders – the tax usually fares poorly in terms of revenue generation because the taxable activity declines. Prior efforts to reduce the number of vacant properties had resulted in a "steadily decreasing value of assessed tax liability on Class 3 properties over the (FY 2003 to FY 2007) period." (Office of the Chief Financial Officer, 2007c: 2). Most taxes grow over time with the economy, but the CFO forecast that the revenue yield from doubling the vacant property tax would be 14 percent lower in FY 2012 ($6.83 million) than in FY 2009 ($7.97 million) (Office of the Chief Financial Officer, 2008a: 15). As described later in this chapter, the revenue gain fell short of these projections within a year.

Fiscal Year 2009 Budget Process. As noted earlier, the slowing economy and the unexpected effect of the calculated commercial property tax rate constrained Mayor Fenty as he prepared the FY 2009 budget. The CFO had forecast general-fund revenue growth of 5.7 percent for FY 2009, a substantial drop from the double-digit increases recorded in most recent years (Government of the District of Columbia, 2008: 4-2). In response, Mayor Fenty proposed an FY 2009 operating budget of $8.67 billion, an increase of $273.6 million, or 3.3 percent, from FY 2008, but much of the increase stemmed from growth in federal grants (Chief Financial Officer, 2008b: 3). Reflecting the growing fiscal pressures, the local funds share of the budget (representing unrestricted revenue generated by D.C. taxes, fees, and fines) would grow by only $37.1 million (0.7 percent), to $5.66 billion (Chief Financial Officer, 2008b: 2).

The mayor's budget included a net tax cut of $12.3 million in FY 2009 and $59.3 million for the FY 2009-2012 period.[98] Most importantly, the mayor proposed replacing the calculated commercial property tax rate with fixed rates of $1.70 per $100 in assessed value for properties valued at $3 million or less and $1.84 per $100 for all other properties.[99] This action would replace the impending $95.7 million cut in commercial property taxes due to the calculated rate with a cut of $15.0 million in FY 2009 (Office of the Chief Financial Officer, 2008a: 35-38). Because the calculated rate had not been implemented and the new FY 2009 commercial property tax rate had not been finalized, the mayor's proposal is treated here as a modest cut from the $1.85 fixed rate, rather than an increase from the calculated rate that was slated to go into effect.

In addition, Mayor Fenty's FY 2009 budget included the $10 vacant property tax rate, which was still before the council at that point. The vacant property tax increase was projected to increase revenue by $8.0 million in FY 2009 and by $29.6 million from FY 2009 to FY 2012 (Government of the District of Columbia, 2008: 4-20). The mayor also proposed increasing the District's earned income tax credit for low-income working parents from 35 percent to 40 percent of the federal EITC. In several interviews, DCFPI was credited with persuading the mayor to propose the EITC expansion in order to balance commercial property tax relief with tax relief for low-income families, reflecting

---

[98] Author's calculation using data from Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2009 Budget Support Act of 2008,'" dated March 28, 2008, pp. 14-15, 34-38.

[99] Under the mayor's plan, commercial properties valued at more than $3 million would *not* enjoy the lower rate on the first $3 million in value.

how Wildavsky's notion of "fair shares" (Wildavsky, 1964: 16-18) applies to tax benefits as well as spending in an incremental budget process that balances the needs of different groups (similar to 2007, when the council raised the standard deduction and personal exemption to balance commercial tax relief). The EITC increase, which the mayor hailed as "effectively eliminating income taxes for families making $25,000 a year or less," (Mayor Adrian Fenty, 2008) was projected to reduce tax revenues by $5.3 million in FY 2009 and by $23.1 million from FY 2009-2012 (Government of the District of Columbia, 2008: 4-20). Table 4.10 details the tax policy changes in the mayor's FY 2009 budget.

Table 4.10
Mayor Fenty's Proposed Tax Policy Changes in the FY 2009 Budget

Provision	**Projected Fiscal Impact**
Set commercial property tax rate at $1.70 per $100 of assessed value for commercial properties valued at $3 million or less and at $1.84 per $100 for commercial properties valued at more than $3 million.	-$15.0 million, FY 2009 -$65.8 million, FY 2009-2012
Double vacant property tax rate from $5 to $10 for each $100 in assessed value, retroactive to 10/1/08.	$8.0 million, FY 2009 $29.6 million, FY 2009-2012
End dedication of a portion of deed tax revenue to the Comprehensive Housing Strategy Fund.	None
Increase the local Earned Income Tax Credit (EITC) from 35% to 40% of the federal EITC	-$5.3 million, FY 2009 -$23.1 million, FY 2009-FY 2012

Sources: Government of the District of Columbia, *FY 2009 Proposed Budget and Financial Plan: Getting the Job Done*, Vol. 1, Executive Summary, March 20, 2008, pp. 4-20, 4-45, and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2009 Budget Support Act of 2008'," March 28, 2008, pp. 14-15, 34-38.

After the CFO reduced the District's FY 2009 revenue estimate by $35.4 million less than a week before the council's vote on the budget, legislators had even less latitude to oppose the mayor's commercial property tax plan even though they faulted it (Stewart, 2008). The council also approved the mayor's request to increase the local EITC. Legislators added $5.2 million for commercial property tax relief by making other budget cuts, allowing them to set the commercial property tax rate at $1.65 per $100 for the first $3 million in assessed value and $1.85 per $100 for assessed value above $3 million.[100]

The council added several new tax policy measures to the FY 2009 Budget Support Act (see Table 4.11 on the next page). Most notably, the council folded an initiative to expand access to health insurance into the FY 2009 budget, which included several tax increases to fund the program ("Healthy DC") and bolster the general fund. Councilmember David Catania and eight colleagues sponsored Bill 17-700, the "Healthy DC Act," to provide universal health care in the District, backed by a requirement for all adults to obtain and maintain health insurance. As introduced, the legislation would have dedicated revenue from three tax sources to subsidize health insurance for lower-income, uninsured residents: (1) a new 2 percent tax on premiums paid to health maintenance organizations (HMOs), (2) a premium tax increase on CareFirst, chartered by the U.S. Congress as a charitable, non-profit health insurer, and (3) a premium tax increase on other health insurers. HMOs would no longer be subject to the District's business franchise taxes, which yielded less revenue from HMOs than the proposed insurance premium tax. In addition, Bill 17-700 would double the District's cigarette tax from $1 per pack to $2, but this revenue would continue to be deposited in the general fund.[101]

[100] Unlike the mayor's proposal, commercial properties with assessed value of more than $3 million would qualify for the lower rate on the first $3 million in assessed value.

[101] Even though the cigarette tax revenue was not earmarked, it was intended to increase general fund revenues by a sufficient amount to allow the D.C. government to increase Medicaid reimbursement rates.

Table 4.11
Tax Policy Items Added to the FY 2009 Budget by the D.C. Council

Provision	Projected Fiscal Impact
General Fund Revenue	
Increase insurance premiums tax on health insurers from 1.7% to 2%.	$2.0 million, FY 2009 $7.9 million, FY 2009-12
Impose HMO premiums tax of 2% and allocate 25% of revenue to general fund.	$2.5 million, FY 2009 $12.4 million, FY 2009-12
Exempt HMOs from business franchise tax.	-$3.0 million, FY 2009 -$12.1 million, FY 2009-12
Double cigarette tax from $1/pack to $2/pack.	$12.5 million, FY 2009 $48.3 million, FY 2009-12
Increase economic interests tax from 2.2% to 2.9%.	$8.0 million, FY 2009 $18.1 million, FY 2009-12
Decouple from federal accelerated depreciation rules.	None
Decouple from federal domestic production deduction.	$3.4 million, FY 2009 $18.5 million, FY 2009-12
Increase allowable deductions for college savings plans.	-$299,000, FY 2009 -$1.5 million, FY 2009-12
Provide property tax abatement for Constitution Square.	-$500,000, FY 2009 -$7.0 million, FY 2009-12
Provide property tax exemption for Golden Rule Plaza.	None
Exempt Verizon Center from deed recordation tax.	None
Healthy D.C. Fund Revenue	
Increase CareFirst premium tax from 1.7% to 2%	$1.1 million, FY 2009 $4.5 million, FY 2009-12
Impose HMO premiums tax of 2% and allocate 75% of revenue to Healthy D.C.	$7.4 million, FY 2009 $37.1 million, FY 2009-12

Sources: Government of the District of Columbia, *FY 2009 Proposed Budget and Financial Plan: Getting the Job Done*, Vol. 1, June 3, 2008, pp. 4-20 – 4-21, and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2009 Budget Support Act of 2008'," June 3, 2008.

Note: Although decoupling from federal accelerated depreciation rules was projected to save $27 billion from FY 2009 to 2012, the CFO's revenue estimates had assumed a decision to decouple. That is why the fiscal impact in of this provision in Table 4.11 is listed as "none."

In an interview, Councilmember Catania explained his rationale for the tax proposal by stating that, "I didn't have jurisdiction over general taxes. So I looked for ways that I could raise money within the purview of my committee." In fact, the bill was referred to the Committee of the Whole because of its cross-cutting nature (covering health care, insurance, and taxation), but Chairman Gray and other councilmembers stated in interviews that they deferred to Mr. Catania and his Committee on Health on the design and financing of Healthy DC. Councilmember Catania also noted that CareFirst had been criticized for stockpiling reserves that many argued should be used to provide care for the indigent.[102] Raising the insurance premiums tax on CareFirst, therefore, was "a way to obtain indirectly what we couldn't obtain directly," Mr. Catania stated. "This was a way to cover some of the people who lacked insurance."

During the public hearing on Bill 17-700, Councilmember Catania used comparisons with other states to justify the proposed tax increases and stated his intent to reduce smoking by doubling the cigarette tax. He noted that the 2 percent insurance premiums tax on health and accident insurers would be "consistent with Maryland," which also imposed a 2 percent rate, and also argued that D.C.'s $1 per pack tax on cigarettes, which ranked 26th in the nation, was too low for a progressive state. Mr. Catania described the cigarette tax increase as "an intentional punitive tax … aimed at discouraging smoking among our young people." His colleagues echoed the view of smoking as a harmful activity that should be discouraged through higher taxation (Office of Cable Television, 2008b).

[102] In particular, the D.C. Appleseed Center for Law and Justice argued in a 2008 report that CareFirst "has not been meeting the described charitable obligation to citizens of the National Capital Area … It is clear that it could and should do much more to carry out that mission." See D.C. Appleseed Center, *CareFirst: Meeting Its Charitable Obligation to Citizens of the National Capital Area* (2008), pp. I-1 – I-2. In June 2008, the District's attorney general filed suit against CareFirst to seek a higher level of charitable care.

Full implementation of Healthy DC proved unfeasible, largely because revenues began to drop. Therefore, Chairman Gray proposed dividing the extra tax revenue was divided between the D.C. general fund and Healthy DC, which did not require all adults to obtain health insurance as enacted. “That was an issue of just trying to cover budget holes,” Councilmember Catania stated in explaining the transfer of Healthy D.C. revenue to the general fund. To expand health care coverage for people with incomes between 200 and 400 percent of the federal poverty standard, the FY 2009 Budget Support Act dedicated 75 percent of HMO tax revenues ($7.4 million in FY 2009) and all of the increased revenue from taxing CareFirst at a 2 percent tax rate ($1.1 million in FY 2009) to Healthy DC. The rest of the revenue, including 25 percent of HMO tax revenue ($2.5 million in FY 2009), the increased revenue from taxing health insurers at the 2.0 percent tax rate ($2.0 million in FY 2009), and the increased revenue from the cigarette tax increase ($12.5 million in FY 2009) would flow into the general fund[103] (Office of the Chief Financial Officer, 2008b: 38-42, Appendix A).

The enactment of Healthy DC reflects several underlying political dynamics. First, the earmarking of revenue to meet a high-priority public goal (expanding access to health care) defused opposition to the tax increases that were proposed to cover the uninsured. Second, tax increases may tend to “stick” once they have gained some level of public acceptance – in this extreme case, 62 percent of the revenues were shifted from Healthy DC to the general fund even before they were enacted.[104] Finally, the groups targeted for tax increases – insurance companies and smokers – had unfavorable public

[103] The general fund would also suffer a loss of $3.0 million in FY 2009 due to the exemption of HMOs from the business franchise tax.

[104] Author’s calculation using data from Office of the Chief Financial Officer, “Fiscal Impact Statement: ‘Fiscal Year 2009 Budget Support Act of 2008’,” dated June 3, 2008, pp. 38-42.

images. Councilmember Catania noted that the cigarette tax increase met with little opposition because smoking was considered harmful. "The cigarette industry knew that it didn't have a chance to battle those tax increases here," he stated. Councilmember Jack Evans observed that the other Healthy DC taxes were acceptable "because of who they were being raised on." (health insurers). By raising the cigarette tax from $1 to $2 per pack, D.C. lawmakers doubled a second "sin tax" in the FY 2009 budget bill.

The choice of financing provisions for Healthy DC was strongly consistent with the social construction framework developed by Anne Schneider and Helen Ingram, outlined in Chapter 2. Schneider and Ingram classified the targets of government policy into four groups – the "advantaged," "contenders," "dependents," and "deviants" – who are allocated benefits or burdens based not only on their political power but also on widely-shared perceptions of the groups' social value. In the context of Healthy DC, HMOs and other insurers closely match Schneider and Ingram's definition of contenders: groups with considerable resources (financial and political) that are hampered by images of greed or excessive power.[105] In D.C., CareFirst had been under attack for excessive executive compensation, hoarding reserves, and neglecting charitable care. Cigarette smokers, by contrast, fall more squarely into the deviant group, as reflected in the public hearing statements described earlier. Based on the policymaker interviews, it seems that the earmarking of insurance premium tax revenues for Healthy DC pre-empted effective opposition by the insurance industry,[106] whereas for the cigarette tax increase earmarking

[105] One dimension of insurers' political power is their campaign contributions. A review of the District's campaign finance data base (found at www.ocf.dc.gov) shows that CareFirst made at least 44 contributions to principal campaign committees in the District of Columbia since 2002, while Aetna made at least 11.

[106] During the public hearing on Bill 17-700, insurance industry representatives argued that broader-based taxes should be used to fund Healthy DC, but their arguments did not gain any traction.

was not necessary due to the unfavorable image of smokers and tobacco companies. Dr. Lee, the CFO's director of revenue estimation, stated in an interview that, "Sin taxes are always much easier to do. The cigarette tax has been the low-hanging fruit, not just for the District."

Overall, the tax provisions included in the FY 2009 Budget Support Act generated little controversy. The final version entailed a net tax increase projected at $13.6 million in FY 2009, or 0.3 percent of total tax revenue.[107] The doubling of the cigarette tax represented the largest tax increase in the FY 2009 budget ($12.5 million), while the HMO insurance premiums tax ($9.9 million) and the little-known economic interests tax ($8.0 million) took second and third place, respectively. D.C. officials had an equity rationale for increasing the economic interests tax, which serves as a substitute for the deed tax when shares of an entity owning real property in the District changes hands (rather than property alone changing hands): raising the economic interests tax from 2.2 percent to 2.9 percent would make the tax equal to the deed taxes on property worth $400,000 or more (Stewart and Nakamura, 2008).[108] In fact, Chairman Gray used the internal equity argument to describe the change not as a tax increase but as the closing of a loophole (Office of Cable Television, 2008c).

Another striking pattern was that none of the tax increases in the District's FY 2009 budget was crafted by the council's finance committee. Largely because

[107] Table 4.1, on p. 4 of this chapter, states that the total change in the tax burden due to statutory changes in 2008 was 0.1 percent, rather than 0.3 percent; the difference is due to tax policy changes made outside the budget process, which reduced the total to 0.1 percent.

[108] Specifically, the economic interests tax is triggered when (1) 80 percent or more of the assets of an entity consist of real property located in D.C., or (2) more than 50 percent of the gross receipts of an entity are derived from ownership or disposition of real property in D.C.

Councilmember Evans, the committee chairman, was strongly against tax increases, they were fashioned in the Committee of the Whole, including the tax provisions related to Healthy DC. The need to craft tax increases outside of the tax-writing committee mitigated against broad-based tax increases using the major sources of tax revenue (income, sales, and property taxes) and favored the use of narrower taxes, such as the insurance premiums tax, that were linked to the services being funded.

Other Tax Legislation Enacted in 2008. During 2008, the council enacted 19 tax policy laws as stand-alone legislation (one reason why the number of laws was higher than in 2007, when four were enacted, was that many bills received public hearings in 2007 and were then voted on in 2008). The most striking pattern is that 17 of the 19 tax policy laws involved abatements, exemptions, or earmarks for particular organizations or properties. The beneficiaries of tax relief were diverse, serving purposes such as affordable housing, civic education, economic development, health care, military housing, public radio, and social services. Appendix 4.2 at the end of the chapter summarizes the 19 tax policy measures enacted separately in 2008.

Most (12 of 17) of the laws providing tax relief to a particular organization or property laws were enacted with a subject-to-appropriations clause, leaving them in the legislative limbo where policies have been approved but cannot take effect until they are funded. Although councilmembers expressed qualms about the subject-to-appropriations mechanism in the interviews, there was little actual resistance to the practice: 11 of the 12 bills passed unanimously and the other bill passed on an 11-1 vote. "When there's no cost attached to it, councilmembers don't put that much thought into it," DCFPI executive director Ed Lazere observed in an interview. "It's an easy vote."

More generally, policymakers' willingness to approve unfunded tax relief bills during the start of an economic downturn indicates the importance of tax policy as a tool to distribute benefits to identifiable groups and specific projects. Councilmember Cheh said in an interview that councilmembers will usually support tax exemptions in one another's wards. "We all don't want to jump on the other person's thing," Ms. Cheh stated, noting as an example that colleagues supported her bill providing a tax exemption for the Tregaron Conservancy in her ward. By adopting a policy of mutual non-interference, policymakers limit public awareness and scrutiny of the tax breaks granted to specific properties and organizations through the micropolitical process, while retaining influence over proposals that are particularly important to them or their districts.

In interviews, several councilmembers divided the parcel-specific tax relief bills into two categories: (1) bills to help property owners, such as churches, that would normally be tax-exempt but failed to file the proper paperwork to claim the exemption, and (2) bills to support economic development projects. With regard to the second category, Councilmember Mendelson asked, "Who's always pushing these? The developers. Who's always profiting from this? The developers." Mr. Mendelson contended that councilmembers lack sufficient information to weigh the economic development claims but don't want to stand in the way of the benefits that are promised. Because the costs are so diffused, it is also difficult for skeptics – within or outside the government – to organize a coalition against any of the narrowly-targeted tax relief bills.

The reflexive support for distributing discrete tax benefits – and the likely futility of mounting any opposition – is shown by the votes on the 17 tax relief laws enacted in 2008 for specific organizations or parcels. The combined vote in the Committee on

Finance and Revenue was 54 in favor and none against, and the total vote in the council on final passage was 212 in favor and two against.[109] Mayor Fenty introduced six of the bills and six councilmembers introduced or co-introduced the other bills, which reduced taxes for organizations or properties in six of the District's eight wards.

The D.C. government's tax policy choices in 2008 once again lend support to many of the propositions outlined in Chapter 1. D.C. lawmakers continued to perform a fairly narrow search for tax policy options (proposition #2), focusing on taxes related to health and insurance that could be earmarked to expand access to health care in the District. Political approval was the overriding factor in the doubling of the vacant property tax (proposition #3), which was approved unanimously without any estimate of its impact on the number of vacant properties or discussion of unintended consequences such as a higher rate of foreclosures. The images used in the vacant property tax debate – particularly the depiction of vacant property owners as faceless, out-of-town slumlords – also were a powerful source of support for a tax increase that was attached to a regulatory affairs bill with no advance notice (proposition #4). The profusion of tax relief measures crafted for a single organization or property (17 such bills were enacted in 2008), most (12) of which had not been funded, reflects the important "micropolitical" tax policy process in D.C., which allocates discrete benefits to identifiable groups (proposition #5) and delivers political benefits to elected officials while the costs are barely noticeable.

---

[109] Author's calculation using data from the D.C. Council's Legislative Information Management System, available at www.dccouncil.us.

Tax Policy Decisions in 2009

Tax policy deliberations in the District of Columbia during 2009 were framed by the ongoing severe recession and the continued drops in revenue that ensued. After projected FY 2010 revenues fell by $952.3 million in one year (from June 2008 to June 2009), an astounding 16.3 percent drop, [110] the council enacted an FY 2010 budget that included a modest set of tax increases to help close the large budget gap. The tax package included a three-year increase in the general sales tax rate from 5.75 percent to 6 percent, marking the first rate increase in more than a decade for one of the District's three major taxes (personal income, real property, and sales),[111] but the tax increases were mostly incremental and spread among a number of levies in order to be less visible. The council's tax choices were based firmly on political acceptability, as they were designed to shift burdens to non-residents to the greatest extent possible. The regressive nature of the tax package – which included gas and cigarette tax increases as well as the sales tax increase – was not discussed, reflecting the primacy of political concerns over normative concerns about efficiency, equity, or revenue capacity.[112]

Growth in real property tax revenue, which had offset some of the decline in other revenue sources, ended as lower assessments from calendar year 2008 were reflected in

---

[110] Author's calculation based on letters from Chief Financial Officer Natwar Gandhi to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia, dated September 24, 2008, December 19, 2008, February 25, 2009, and June 22, 2009.

[111] The class 3 real property tax rate (vacant and abandoned property) was raised in 2008, but the main real property tax rates applicable to residential and commercial property – covering the vast majority of property owners – had not been raised for more than a decade.

[112] General sales taxes are usually considered regressive because lower-income households spend more of their income on consumption; in addition, higher-income households may spend a greater percentage of their consumption on non-taxable services. Moreover, cigarette consumption is higher among low-income groups. See Robert D. Lee, Jr., Ronald W. Johnson, and Philip G. Joyce, *Public Budgeting Systems* (Sudbury, MA: Jones and Bartlett Publishers, 2008), 8th edition, pp. 109-122.

FY 2010 revenue projections. As unemployment rose and the housing market continued to sputter, the CFO concluded in February 2009 that a "deep recession" would last through much of FY 2010. That month, Dr. Gandhi lowered the FY 2010 revenue estimate by $346.3 million (Chief Financial Officer, 2009a). Still, the economy had not hit bottom in what turned out to be the longest and deepest recession since the Great Depression, and in June 2009 the CFO reduced the FY 2010 revenue estimate by another $150.2 million (Chief Financial Officer, 2009b).

FY 2010 Budget Process: Part 1. The District's FY 2010 process was the longest and most arduous in recent memory. After lawmakers finished the budget in May, they had to reopen it in June after the downward revision of the revenue estimates, adding to the spending cuts and revenue increases that had already been made.

The mayor requested an FY 2010 operating budget of $8.92 billion, reflecting an increase of $289.7 million (3.4 percent) from the FY 2009 budget, but an infusion of federal funding through the American Reinvestment and Recovery Act masked reductions in own-source funding and averted even more severe austerity measures. The District's local-funds budget (representing unrestricted revenue from D.C. taxes, fees, and fines) would shrink by $220.2 million (3.9 percent), from $5.60 billion in FY 2009 to $5.38 billion in FY 2010, under the mayor's plan (Chief Financial Officer, 2009c: 3).

To balance the budget, the mayor limited most agencies to their FY 2009 funding levels while proposing a broad array of fee increases as well as measures to broaden the tax base. The mayor did not seek any tax rate increases and the estimated net tax increase was modest, totaling $24.5 million in FY 2010 (only 3 percent of the projected $800 million budget gap for FY 2010) and \$110.6 million from FY 2010-13.[113] In fact, only one of the tax proposals – closing the "Delaware holding company" loophole in the corporate income tax[114] – was projected to generate more than \$10 million in revenue during any of the next four years, reflecting the marginal nature of the mayor's tax proposals (Government of the District of Columbia, 2009: 4-19 – 4-20). Explaining why he did not seek tax rate increases in spite of an \$800 million budget gap, Mayor Fenty stated in testimony to the council that:

> As the District's finances have stabilized over the past decade, the District has made tremendous progress in making its tax structure more competitive with the rest of the D.C. metropolitan region. The proposed budget protects those hard-earned gains, by leaving tax rates where they stand. (Mayor Adrian Fenty, 2009: 2).

The mayor's FY 2010 budget also included several tax reductions, which are reflected in the net tax increase cited above. The mayor sought to fund four tax abatements that had been enacted subject to appropriations, while also granting a real property tax abatement to the Pew Charitable Trusts. These items entailed an estimated revenue loss of \$1.6 million in FY 2010 and \$24.1 million from FY 2010-13.[115] In addition, the mayor proposed conforming the D.C. personal income tax to two federal income tax changes: increasing the earned income tax credit for larger families and

---

[113] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge*, Vol. 1, Executive Summary (March 25, 2009), pp. 4-19 – 4-20.

[114] The "Delaware holding company" loophole reflected a business practice of making payments for intangible assets such as trademarks or patents to subsidiaries in other states, thereby shifting income to states that do not tax the income of the subsidiaries and netting a deduction from D.C. corporate income. These deductions would be disallowed under the mayor's budget plan.

[115] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge*, Vol. 1, Executive Summary (March 25, 2009), p. 4-19.

excluding a larger amount of unemployment benefits. These policies would reduce revenue by $2.9 million in FY 2010 and by $8.6 million from FY 2010-13 (Government of the District of Columbia, 2009: 4-20). Table 4.12 outlines the tax policy changes in the mayor's FY 2010 budget.

Table 4.12
Mayor Fenty's Proposed Tax Policy Changes in the FY 2010 Budget

Provision	**Projected Fiscal Impact**
Eliminate annual "sales tax holidays."	$1.3 million, FY 2010 $5.6 million, FY 2010-13
Replace dedicated sales tax funding of school modernization with bond financing	No fiscal impact
Close "Delaware holding company" loophole in business tax.	$10.0 million, FY 2010 $46.4 million, FY 2010-13
Apply economic interests tax to sale of cooperative housing units.	$5.1 million, FY 2010 $22.9 million, FY 2010-13
Freeze homestead deduction (real property tax).	$2.1 million, FY 2010 $8.8 million, FY 2010-13
Freeze standard deduction (personal income tax).	$2.3 million, FY 2010 $17.1 million, FY 2010-13
Freeze personal exemption (personal income tax).	$2.9 million, FY 2010 $22.2 million, FY 2010-13
Set 40% floor on taxable real property assessments	$5.2 million, FY 2010 $20.3 million, FY 2010-13
Fund Georgia Commons real property tax abatements.	-$100,000, FY 2010 -$1.1 million, FY 2010-13
Fund Southwest Waterfront bond financing act	none, FY 2010 -$12.0 million, FY 2010-13
Fund National Public Radio real property tax abatements	-$190,000, FY 2010 -$3.0 million, FY 2010-13
Fund Urban Institute real property tax abatements	-$200,000, FY 2010 -$3.3 million, FY 2010-13
Provide real property tax abatements to Pew Charitable Trusts	-$1.1 million, FY 2010 -$4.7 million, FY 2010-13
Conform to federal change in EITC benefits	-$1.8 million, FY 2010 -$3.5 million, FY 2010-13
Conform to federal change in exclusion of unemployment insurance benefits	-$1.0 million, FY 2010 -$5.1 million, FY 2010-13

Sources: Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge,* Vol. 1, Executive Summary, March 20, 2009, pp. 4-19-4-20, 4-42-4-46, and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2010 Budget Support Act of 2009'," March 25, 2009, pp. 16-17, 48-51, 53-57.

By trimming tax expenditures and broadening the base of smaller levies, the mayor could increase tax revenues in a less noticeable way and limit political opposition. The mayor's FY 2010 budget chipped away at exemptions or deductions for the major taxes by calling for a freeze on the homestead deduction (real property tax), freezes on the personal exemption and standard deduction (personal income tax), and the elimination of sales tax holidays (general sales tax). The mayor's proposal for a 40 percent floor on the taxable value of residential real property effectively capped the value of the numerous forms of real property tax relief (assessment increase cap, homestead deduction, senior citizen credit) offered by the D.C. government, but this cap was not very stringent. More than 60 percent of the total increase in tax revenue from FY 2010-13 would arise from the corporate income tax (closing the Delaware holding company loophole) and the economic interests tax (which would be applied to the sale of cooperative housing), even though the two taxes accounted for only 5 percent of total D.C. tax revenue in FY 2009. [116]

Mayoral budget director Will Singer noted in an interview that the mayor's FY 2010 budget did not increase tax rates and that the measures "were all arguably not tax increases" because they could be seen as fairness measures or preserving the status quo. The CFO's director of revenue estimation, Fitzroy Lee, observed that the deduction and exemption freezes are "almost invisible" because, "People don't have it in hand yet … You're not saying, 'I'm going to reduce your homestead exemption … The bird wasn't in the hand yet.'"

[116] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge*, Vol. 1, Executive Summary (March 25, 2009), pp. 4-17 – 4-23.

The successful proposal to repeal the sales tax holidays illustrates the idiosyncratic nature of D.C. tax policymaking at this time and how modest changes were patched together to increase revenue. Sponsored by Councilmember Carol Schwartz and enacted in 2004, the sales tax holidays allowed tax-free purchases of clothing, shoes, and accessories costing $100 or less per item for nine days in August and 10 days after Thanksgiving in November. The repeal occurred not due to any policy argument but rather because Mrs. Schwartz had lost her November 2008 re-election bid. In fact, there was no subject of more emphatic agreement in the D.C. interviews. "She was the only advocate," Committee on Finance and Revenue Chairman Jack Evans stated, and the sales tax holiday was vulnerable "as soon as Carol lost her seat." The sales tax holiday was "entirely motivated by Carol Schwartz," echoed Councilmember Phil Mendelson, and had been enacted because, "No one wanted to fight her on it."

The repeal of the sales tax holidays only after the defeat of its main advocate reflects how unwilling or unable D.C. officials were to scrutinize, curtail, or eliminate tax expenditures. Although DCFPI called for ending the sales tax holidays and Fenty budget aide Will Singer expressed skepticism about their effectiveness (the second holiday began after Thanksgiving when people flock to stores for holiday shopping, making incentives superfluous) public documents and the policymaker interviews did not reveal any discussion of research finding that sales tax holidays change the timing of purchases and allow retailers to maintain higher prices (Hawkins and Mikesell, 2001; New York State Department of Taxation and Finance, 1997; Harper, Hawkins, Martin, and Sjolander, 2003). This example – representing the only tax expenditure that D.C. lawmakers repealed during the 2007-2010 period – illustrates how the D.C. tax policy process was influenced by personal relationships rather than more objective analysis of policies and their economic and social impacts. That a change of one seat in a 13-member legislature (the council's lone Republican) made the sales tax holidays vulnerable to repeal shows how tax policy departs from a rational choice model and how tax benefits can persist even when there is little consensus that they are valuable.

Mayor Fenty relied much more heavily on fines and fees than on taxes to generate revenue in the FY 2010 budget. In fact, the non-tax revenues proposed by the mayor to balance the budget ($77.6 million in FY 2010 and $314.5 million from FY 10-13) were approximately three times as large as the tax revenue increases.[117] The largest source of additional non-tax revenues was enhanced automated traffic enforcement,[118] and the mayor also sought significant revenue increases from parking meter fees, a proposed new streetlight maintenance fee that would be added to residents' utility bills, and an increase in 911 fees. The mayor also planned to collect $20 million in FY 2010 from a tax amnesty (Government of the District of Columbia, 2009: 4-19 – 4-20).

In its initial action on the FY 2010 budget, the council made only slight changes to the mayor's tax proposals. Several legislators stated in interviews that the large budget deficit left them with few alternatives,[119] but by using extra revenue from litter and parking enforcement measures as well as a $20 million cut to the summer youth

---

[117] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge*, Vol. 1, Executive Summary (March 25, 2009), pp. 4-19 – 4-20.

[118] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge*, Vol. 1, Executive Summary (March 25, 2009), pp. 4-19 – 4-20.

[119] In a written response to questions, Council Chairman Gray stated that the council accepted Mayor Fenty's tax proposals in 2009 "because the revenue picture was bleak and finding better options to replace these … increases was difficult."

employment program, they scaled back various program cuts and revenue increases.[120] The council limited the freeze of the homestead deduction to FY 2010, and entirely eliminated the freezes on the personal exemption and standard deduction. The reason for preserving the inflation adjustments was that they are most valuable to low-income families (Committee on Finance and Revenue, 2009: 37-38). The council did not add any provisions to increase tax revenue at this point.

What was most remarkable about the council's tax policy changes in the first round of the FY 2010 budget process was the decision to finance an additional nine laws granting tax relief to particular properties or neighborhoods (which had been approved with subject-to-appropriations clauses), as well as three new abatements for particular properties (the council denied the mayor's request to grant a new tax abatement to the Pew Charitable Trusts). Thus, the mayor's proposal to finance tax relief for five parcels was more than tripled by the council to encompass 16 parcels. The total cost for parcel-specific tax relief almost doubled during the four-year financial plan, from $24.1 million as proposed by the mayor to $41.5 million as approved by the council.[121]

Although the mayor and council both participated in the yearly distribution of tax benefits to identifiable recipients, the council appeared more willing to grant such tax relief, perhaps reflecting the constituency pressures on members representing eight geographic wards. The importance to legislators of narrowly-targeted tax relief measures as a policy and political tool is reflected in the sponsorship of the measures. Among the

---

[120] The council also deleted the streetlight maintenance fee and the increase in E-911 fees proposed by the mayor, which had aroused strong opposition.

[121] Author's calculations using data from Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2010 Budget Support Act of 2009,'' March 25, 2009, and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2010 Budget Support Act of 2009,'" June 2, 2009.

12 such tax relief items added to the FY 2010 Budget Support Act by the council, 10 had been authored by a ward councilmember and one had been introduced by Mayor Fenty (the last item had not been introduced as a separate bill). Six of the eight ward councilmembers sponsored at least one of the highly-targeted tax relief measures included in the council's version of the FY 2010 Budget Support Act.[122]

The combined effect of the council's property-specific tax reductions and its restoration of cost-of-living adjustments for the homestead deduction, personal exemption, and standard deduction was to reduce by more than half the total revenue generated by tax increases during the four-year (FY 2010-13) financial plan. By trimming the net tax increase to $16.9 million in FY 2010 and $47.2 million from FY 2010-13,[123] the council limited tax increases to a paltry 2 percent of the $800 million in gap-closing measures needed to balance the FY 2010 budget.

FY 2010 Budget Process: Part 2. In June 2009, D.C. policymakers had to revise the FY 2010 budget after the CFO projected sharp revenue declines both for FY 2009 (a $190 million reduction) and FY 2010 (a $150 million reduction). Because FY 2009 was nearly over, tax policy changes (which require some lead time for the tax office, employers, and businesses to make required changes to forms, computer systems, and

---

[122] These data are derived from the council's Legislative Information Management System, found at www.dccouncil.us. Specifically, Ward 1 Councilmember Jim Graham (two items), Ward 2 Councilmember Jack Evans (one item), Ward 3 Councilmember Mary Cheh (1 item), Ward 5 Councilmember Harry Thomas, Jr. (3 items), Ward 6 Councilmember Tommy Wells (1 item), and Ward 7 Councilmember Yvette Alexander (2 items) all had sponsored parcel-specific or (in one case) neighborhood-specific tax relief measures that were included in the FY 2010 Budget Support Act.

[123] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge*, Vol. 1, Executive Summary (March 25, 2009), pp. 4-19 – 4-20, and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2010 Budget Support Act of 2009,'" June 2, 2009, pp. 90-94, 96-105.

withholding schedules) would be of little use in closing the gap; instead, tax policy options were most relevant to FY 2010 budget deliberations.

Mayor Fenty avoided tax increases in the revised budgets he submitted to the council on July 16, 2009, and increased the FY 2010 budget gap to $212.5 million by proposing to withdraw $125 million from the District's rainy-day fund in FY 2009 (federal law requires the District to repay withdrawals from the fund in equal amounts over two years).[124] The mayor proposed resolving the FY 2010 budget gap using (1) $110 million in additional program cuts, (2) $57 million from converting dedicated taxes and earmarked non-tax revenues to general fund revenue, (3) $36 million in federal stimulus funds, (4) $6 million from asset sales, and (5) $4 million from the District's accumulated, unreserved fund balance (Office of the City Administrator, 2009: 3).

In order to deliver a revised FY 2010 budget to Congress, the council had only two weeks to review the mayor's proposal. During a public briefing on the revised budget,[125] Chairman Gray outlined an alternative approach that was embraced by the council, using excess funds from earmarked accounts to balance the FY 2009 budget instead of borrowing from the rainy-day fund (thereby avoiding the need to replenish the fund in FY 2010 and FY 2011) and using both spending cuts and revenue increases to close the $150 million budget gap in FY 2010 (Council Chairman Vincent Gray, 2009).

Several legislators who believed that programs for low-income residents had borne the brunt of budget reductions preferred to raise taxes to offset some of the new proposed cuts, but they were hamstrung by the short time frame and a lack of well-vetted

[124] See D.C. Official Code § 1-204.50a.

[125] Public hearings at the D.C. Council have a public notice requirement. Because that requirement could not be met in this compressed time frame, the meeting had to be called a "public briefing" instead.

options. Councilmember Jim Graham had filed a bill to impose a new top tax rate of 8.9 percent on annual income above $500,000, but there were no co-sponsors and the bill had not received a public hearing.[126] Mr. Graham's bill was very rudimentary: it simply added a new top tax bracket without changing any of the other tax brackets, and served as a revenue source rather than a considered approach to progressive taxation.[127] During the public briefing, there was cursory discussion of an income tax increase, a gas tax increase, and a tax on snack foods (Neibauer, 2009a), but the latter two options had not been discussed in years or been introduced as legislation.

In the absence of tax revenue options developed internally, councilmembers then met to review 22 options covering all of the major taxes, as well as eight non-tax revenue options, prepared by the CFO's Office of Revenue Analysis (ORA) (Craig, 2009a). The options included rate increases for the general sales tax, real property tax, parking tax, cigarette tax, alcohol tax, and gasoline tax, as well as measures to broaden the sales tax base and increase the minimum tax on businesses (Office of Revenue Analysis, 2009b). ORA estimated the revenue impact of each option but did not make recommendations. Several items on the ORA list had been proposed by DCFPI in a July 2009 issue brief (D.C. Fiscal Policy Institute, 2009: 5-7).[128] The council was starting mostly with a blank slate in reviewing the options: only four of the 22 had been introduced as legislation (three were part of Mayor Fenty's FY 2010 Budget Support Act and had not been

[126] This was Bill 18-243, the "Equitable Income Tax Amendment Act of 2009."

[127] In fact, the bill was so hastily drafted that, as originally introduced, it would have inadvertently provided a large tax cut to those with more than $500,000 in annual income.

[128] The DCFPI options included a cigarette tax increase, higher minimum business income tax, expansion of the sales tax base, and repeal of the income tax deduction for interest on out-of-state municipal bonds.

adopted by the council) and only three had been the subject of public hearings (once again, these were items from the mayor's FY 2010 Budget Support Act).[129] One individual closely involved in D.C. tax policy making described the council's ability to develop and evaluate tax policy options as "very poor. They get some idea, maybe from Ed Lazere, and they say, 'Let's do it.' It is always basically reactive." At the same time, legislators willing to support tax increases were hamstrung because finance committee chairman Evans opposed them. Councilmember David Catania noted that, "Bills to raise revenue will find a swift end in the Finance and Revenue Committee." For a tax increase to proceed, Mr. Catania added, "These measures find their way in sideways."

Two days before voting on the revised budget, councilmembers agreed on a budget blueprint containing a modest package of tax increases, reflecting the view that the budget should not be balanced through spending cuts alone, particularly for programs serving people in need (Craig, 2009b). The main elements of the tax package were (1) the three-year increase in the general sales tax from 5.75 to 6 percent, (2) an increase in the cigarette tax from $2 to $2.50 per pack, and (3) an increase in the motor fuel excise tax from 20¢ to 23.5¢ per gallon (although motor fuel taxes were dedicated to the highway trust fund, the new revenue from the rate hike would flow into the general fund).

The legislative record on the revised FY 2010 budget is sparse, because council committees did not hold additional hearings or "mark up" the budget.[130] Thus, there were no legislative reports documenting and explaining the council's decisions. Nevertheless, news articles and the personal interviews confirm that two main principles guided the tax

[129] This statement is based upon Office of Revenue Analysis, "Revenue Options, 2010-2013," dated July 28, 2009, and a review of the council's Legislative Information Management System.

[130] "Mark up" refers to a committee process of reviewing and revising proposed budget items or legislation.

package: (1) mirroring tax rates in Maryland, which had raised its sales tax rate to 6 percent in 2008 and had imposed a 23.5¢ per gallon gasoline tax since 1992 (Neibauer, 2009a; Craig, 2009a), and (2) shifting as much of the burden of higher taxes to commuters and tourists through consumption taxes (Craig, 2009b). "The analysis is never deep," stated Councilmember Phil Mendelson. "It's obvious that non-residents pay the sales tax and that they don't pay the property tax … The gas tax goes to the top of the list because it matches Maryland." Councilmember Mary Cheh noted that the tax increases selected "were perceived to be less painful," adding that the District's high-tax reputation is associated with the personal income tax and that real property taxes are high because property in D.C. is so expensive. As a result, increasing sales and excise taxes seemed more bearable than raising income or property taxes. In a written response to questions, Chairman Gray stated that he had chosen the options that would be "most palatable to members and the public given our financial situation."

As suggested by the comments cited above, analysis of economic, social, and administrative impacts did not play a key role in shaping the council's package of tax increases in 2009. Although the three taxes selected for rate increases – general sales, cigarette, and gasoline taxes – are all regarded by economists as regressive because consumption accounts for a larger share of income for less-affluent households, there was no evidence from written documents or the interviews that the regressive nature of sales and excise taxes was discussed during deliberations on the revised FY 2010 budget. "What gets lost in this is the progressivity issue," stated Councilmember Mendelson. In addition, the council agreed to a mayoral proposal that it had initially rejected, freezing the value of the personal exemption, standard deduction, and homestead deduction for four years. These steps not only served as back-door income and property tax increases, but would also be regressive because the fixed value of the deduction or exemption represents a larger share of income for those with lower incomes.

Institutional position also played a role in shaping the Council's tax package. Chairman Gray drafted the package based on the council's public briefing and subsequent discussions, placing the onus on other members to persuade a majority to make any changes to his plan. "Once the chairman puts something in," Councilmember Evans stated, "you have to find money to take it out … people just kind of go along." Councilmember Mendelson echoed that view, saying, "Vince presents the package and it's hard to unwind it."

The council's revised FY 2010 budget contained two other tax revenue increases with low visibility. First, the council increased the tax on small cigars to match the higher tax rate for cigarettes. Second, the council approved a major change in corporate taxation advocated by liberal groups such as the Center on Budget and Policy Priorities and the Institute on Taxation and Economic Policy: mandating combined reporting of business income for multi-state corporations and their subsidiaries. Combined reporting treats a parent company and its affiliates as a single entity to block firms from shifting profits to subsidiaries incorporated in states with low or no corporate income tax.[131] The policy change did not arouse strong interest or opposition because it would not take effect until tax year 2011 (nevertheless, projected revenues from combined reporting were needed to balance the budget in the last two years of the District's four-year financial

[131] Income is usually shifted through inter-company transfers such as licensing, royalty, and rent payments.

plan).[132] The personal interviews suggest that lawmakers found combined reporting appealing because it would help close the budget gap but did not have immediate, obvious drawbacks. DCFPI executive director Ed Lazere posited that combined reporting was adopted because the OCFO offered it as an option (giving it some credibility) and business groups had no time to object. Another individual closely involved in D.C. tax policymaking stated more bluntly that, "Had we not had the need for the money, the council would have buckled. They didn't know where to go for $22 million" that combined reporting was projected to generate in FY 2012.

Finally, the council included a significant tax reduction in the revised FY 2010 budget, rolling back the vacant property tax increase it had approved a year earlier. Not only were owners protesting the doubling of the tax rate amid a severe recession and credit crunch that made it difficult to put vacant property to use (Committee on Finance and Revenue, 2009: 15; O'Connell, 2009; Neibauer, 2009b), but many properties that were not eyesores – such as homes left unoccupied by members of the Foreign Service, or by elderly residents who were sick or hospitalized – were charged the higher rate.[133] Moreover, the tax was faring poorly in generating revenue because the higher tax led many owners to contest their property tax liability. More than 70 percent of vacant properties had been granted exceptions by the Department of Consumer and Regulatory Affairs, returning the properties to the much lower residential or commercial tax rates (Office of the Chief Financial Officer, 2009a: 5). On the final vote on the FY 2010

[132] The CFO projected that combined reporting would generate $22.6 million in FY 2012 and $19.4 million in FY 2013. See Office of the Chief Financial Officer, "Fiscal Impact Statement: Fiscal Year 2010 Budget Support Act of 2009' and 'Fiscal Year 2010 Budget Support Emergency Act of 2009," September 22, 2009, p. 122.

[133] Another factor mentioned in the personal interviews was that the Department of Consumer and Regulatory Affairs stepped up enforcement, identifying more vacant properties subject to the higher rate.

Budget Support Act, the council adopted an amendment to retain the $10 tax only for properties that were deemed "blighted," based on the view that the $10 rate was spurring derelict owners to improve their properties. Vacant properties that were not blighted would be taxed at the regular rates for residential or commercial property.

The council's retreat from its unanimous decision the previous year to double the vacant property tax reflects a weakness of its tax policy making process and its strong susceptibility to changing political pressures. As noted earlier, the measure to double the vacant property tax had not been introduced as stand-alone legislation and the proposal's economic effects and possible unintended consequences were not examined in depth. In response to concern about the harmful effects of vacant properties, the council doubled the tax with almost no opposition; a year later, following complaints from property owners whose taxes had soared, the council backpedaled – a process that DCFPI analyst Elissa Silverman termed "legislative ping-pong." (Silverman, 2009). Elected officials must weigh and respond to political pressures and citizen complaints, but the magnitude and speed of the changes in the vacant property tax were remarkable, revealing instability in policy preferences as different aspects of the issue became salient. Notably, the amendment to delete the higher tax rate for vacant property in 2009 was moved by the same legislator (Councilmember Kwame Brown) who had proposed the $10 rate in 2008. Speaking on his amendment in 2009, he stated that, "The idea was not to tax them because they can't sell their house, right? … I don't want to hurt good people for the sake of catching two or three bad people," even though he and his colleagues had sidestepped similar concerns a year earlier (Office of Cable Television, 2009a).

Councilmembers did not consider another revenue-raising option for the revised FY 2010 budget – reducing the number or value of parcel-specific tax abatements that were approved in the first round of the budget process. The 16 parcel-specific items were left intact, reducing projected revenue by $4.0 million in FY 2010 and $41.5 million from FY 2010-2013. Deleting all of the property-specific tax abatements would have allowed the council to forego some tax increases, such as the freeze on the personal exemption and the standard deduction,[134] but legislators opted to preserve tax benefits for specific, identifiable projects at the expense of more general, widely-dispersed benefits.

The revised FY 2010 budget, including the tax package, was unanimously approved by the council and signed into law by Mayor Fenty, who noted that the tax increases were not "draconian." (Craig and Stewart, 2009).[135] Table 4.13 (see next page) outlines the tax measures included in the revised budget and their projected revenue impacts. Compared to the size of the budget gap, the tax increases enacted by D.C policymakers were modest. The net tax increase amounted to $45.1 million, or 0.9 percent of total tax revenue in FY 2010,[136] just below the 1 percent threshold for a "significant" tax increase.[137]

---

[134] Other adjustments would have been needed for lawmakers to restore the inflation adjustments for the personal exemption and standard deduction, because the first-year cost of the targeted tax relief ($4.1 million) was lower than the first-year cost of restoring the adjustments ($5.2 million). Still, reducing or forgoing the parcel-specific tax benefits would have allowed officials to limit general tax increases.

[135] The mayor's budget director, Will Singer, stated in an interview that the mayor's pledge not to raise taxes meant that he would not propose any tax increases. Thus, the mayor could claim to have fulfilled his pledge even though he signed the 2009 tax increases into law.

[136] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge,* Vol. 1, Executive Summary, September 28, 2009, pp. 4-17 – 4-21, 4-43 – 4-52.

[137] Table 4.1, on p. 4 of this chapter, states that the total change in the tax burden due to statutory changes in 2009 was 1 percent, rather than 0.9 percent; the difference is due to tax policy changes made outside the budget in 2009, which boosted the total to 1 percent.

Table 4.13
Tax Policy Changes in the District of Columbia's FY 2010 Budget

Provision	Projected Fiscal Impact
Eliminate annual "sales tax holidays."	$1.3 million, FY 2010 $5.6 million, FY 2010-13
Replace dedicated sales tax funding of school modernization with bond financing.	No fiscal impact
Set 40% floor on taxable real property assessments.	$5.2 million, FY 2010 $20.3 million, FY 2010-13
Close "Delaware holding company" loophole in business tax.	$10.0 million, FY 2010 $46.4 million, FY 2010-13
Apply economic interests tax to sale of cooperative housing units.	$5.1 million, FY 2010 $22.9 million, FY 2010-13
Reclassify vacant properties as Class I or Class II properties except for properties deemed "blighted"	-$12.8 million, FY 2010 -$48.2 million, FY 2010-13
Conform to federal change in EITC benefits.	-$1.8 million, FY 2010 -$3.5 million, FY 2010-13
Conform to federal change in exclusion of unemployment insurance benefits.	-$1.0 million, FY 2010 -$5.1 million, FY 2010-13
Freeze homestead deduction, FY 2011-13	$4.0 million, FY 2010 $15.9 million, FY 2010-13
Freeze standard deduction, FY 2010-13	$2.3 million, FY 2010 $16.0 million, FY 2010-13
Freeze personal exemption, FY 2010-13	$2.9 million, FY 2010 $20.7 million, FY 2010-13
Mandate combined reporting of corporate income	$0, FY 2010 $42.0 million, FY 2010-13
Raise general sales tax to 6.0%, FY 2010-12	$20.5 million, FY 2010 $64.1 million, FY 2010-13
Increase gasoline tax to 23.5¢ per gallon	$3.5 million, FY 2010 $14.5 million, FY 2010-13
Increase cigarette tax to $2.50 per pack	$9.7 million, FY 2010 $37.4 million, FY 2010-13
Increase little cigar tax to equivalent of $2.50 per pack	$515,000, FY 2010 $2.0 million, FY 2010-13
Impose 5% deed transfer tax surcharge on retail service stations	$2.7 million, FY 2010 $2.7 million, FY 2010-13
Provide real property tax abatements to 16 parcels of land	-$4.0 million, FY 2010 -$41.5 million, FY 2010-13

Sources: Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge,* Vol. 1, Executive Summary, September 28, 2009, pp. 4-19 – 4-21, 4-43 – 4-52, and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2010 Budget Support Act of 2009' and 'Fiscal Year 2010 Budget Support Emergency Act of 2009'," September 22, 2009, pp. 105-124.

Other Tax Legislation Considered in 2009. During 2009, the council enacted eight tax policy bills as stand-alone legislation, which are summarized in Appendix 4.3 at the end of the chapter. Following the pattern of prior years, the council again focused on tax measures for specific parcels: six of the eight bills applied to particular plots of land. Among the six parcel-specific tax laws that were enacted, four provided tax exemptions or abatements and two dedicated tax revenues to support specific projects (a waterfront park and a convention center hotel). Once again, highly-targeted tax relief measures sailed through the council: the six parcel-specific tax laws were approved by the Committee on Finance and Revenue on a combined vote of 21 to 0, and by the council on a combined vote of 74 to 0.[138] Two of the parcel-specific tax relief measures enacted by the council in 2009 included a subject-to-appropriations clause, maintaining the pipeline of special tax measures that would need financing in future actions of the council.

Only one tax policy bill enacted in 2009 would increase revenue. Bill 18-150, the "Anacostia River Cleanup and Protection Act of 2009," would ban non-recyclable carryout bags provided by stores selling food or drink and impose a 5-cent excise tax on recyclable bags.[139] The revenue from the tax would be deposited into a special fund to clean up the Anacostia River, which had been deemed "impaired" by the U.S. Environmental Protection Agency, triggering a requirement for the District to reduce pollution throughout the river's watershed (Committee on Government Operations and the Environment, 2009: 3-4). In seeking to discourage a harmful behavior – discarded

[138] Author's calculation using data from the D.C. Council's Legislative Information Management System, available at www.dccouncil.us.

[139] The 5¢ charge was often described as a "fee," but it is more properly viewed as a tax because it is levied on private market activity rather than charged for a specific public good or service. The retailer providing a recyclable carryout bag would retain one cent of the fee in order to offset any administrative burden.

plastic bags were found to account for almost 50 percent of the trash in the Anacostia's tributaries (Committee on Government Operations and the Environment, 2009: 3) – the "bag tax" represents another "sin tax," even though it was not targeted at a narrow, pariah group such as smokers or vacant property owners. Despite some opposition from residents who believed that the bag tax would increase costs for low-income families and "Mom-and-Pop" stores, the earmarking of revenue for the Anacostia River generated support for the bill,[140] which was approved unanimously by the council.[141]

The tax policy decisions made by D.C. officials in 2009 generally support the propositions set forth at the outset of the study, but also reveal some inconsistencies or omissions. The severe recession and the sharp drop in revenues moved tax policy higher on the agenda as D.C. policymakers sought to close a budget shortfall of almost $1 billion; in Kingdon's terminology, the large budget gap opened a "policy window" for tax increases. But even when facing the largest budget gap since the mid-1990s (when the control board was created to oversee D.C. finances), D.C. lawmakers made only modest changes in tax policy, amounting to 1 percent increase in the total tax burden in FY 2010 (a 0.9 percent increase in the Budget Support Act and a 0.1 percent increase from non-budget bills, such as the "bag tax"). The overall change was not more sweeping because supporters of a tax increase had not developed a plausible solution and the political stream was largely blocked due to the opposition of the mayor and finance committee

[140] During the debate on Bill 18-150, Councilmembers Harry Thomas, Jr., and Jim Graham voiced concern about the tax's impact on low-income residents, but stated that they would vote yes to support cleaning up the Anacostia River. Mr. Thomas stated that, "The underlying issue is we must protect our environment, we must protect our waterways …" Mr. Graham stated that, "I think that the objectives involved are so great and so important … I want to be part of this." See Office of Cable Television, "The Council of the District of Columbia, 'Tenth Legislative Meeting,' June 2, 2009," available at www.oct.dc.gov.

[141] The revenue performance of the bag tax fell below predictions. Because bag use dropped faster than expected, the tax yielded only $2 million in its first year, rather than $3.5 million as projected. See Alex Baca, "Bag Tax Raises Only $2 Million, But So What?" *Washington City Paper*, January 5, 2011.

chairman. More than a year into a serious downturn, legislators who believed that the budget deficit should not be resolved only through spending cuts had introduced only one bill to increase taxes (Councilmember Graham's income tax bill), reflecting their failure to join problem, policy, and political streams. This example, and the D.C. case study more generally, suggest that tax policy changes follow a more gradual, continuous path than Kingdon's multiple-streams or Baumgartner and Jones' punctuated-equilibrium framework would predict (proposition #1). Because taxes are such a salient issue and are usually discussed during the annual budget process, tax policy may always be on or near the government agenda and a punctuated-equilibrium model may not be apposite.

The D.C. case study also highlights the important role of analytic and institutional capacity in the process of agenda-setting and developing policy alternatives. Both the mayor and council were hampered by a lack of staff support on tax matters, which are administered by the independent CFO in the District. Whereas both houses of the Maryland and Virginia legislature receive policy advice and analysis from a non-partisan legislative services office, the two legislative staff members who work for the D.C. Council's Committee on Finance and Revenue report to the committee chairman rather than the entire council.[142] As a result, the mayor and council relied on outside sources – particularly the CFO's Office of Revenue Analysis and the D.C. Fiscal Policy Institute – to develop and assess tax policy options (tax increase options in particular) when the need arose, but did not develop alternatives internally and refine them over time. The tax increases of 2009 were conceived outside of the finance committee, in a compressed time

[142] The council also had a budget office with a director and five analysts and in late 2008 established an Office of Policy Analysis (OPA) to assist councilmembers with research and analysis. Comprised of a director and four professional staff members, OPA's most important work on tax issues involved a study of the real property tax appeals process.

frame and without public hearings,[143] leaving legislators in a position of assessing the options without detailed review and reflecting the lack of an orderly tax policy process.

D.C. tax policy choices in 2009 support the view (proposition #3) that public officials emphasize political acceptability in evaluating tax options, at the expense of normative principles such as revenue capacity, efficiency, and equity. Consistent with Hettich and Winer's hypothesis that public officials will try to minimize political opposition by spreading tax burdens widely, Mayor Fenty's modest proposals to increase tax revenue involved smaller levies like the corporate income and economic interest taxes and were designed to be less visible by freezing exemptions and deductions rather than increasing tax rates. As noted earlier, the primary principle underlying the sales, cigarette, and gas tax increases selected by the council in 2009 was to blunt political opposition by shifting as much of the tax burden to non-residents, a longstanding strategy for D.C. officials given the District's role as a hub for tourism and regional employment. The equity concerns that figured strongly in Maryland's decision to increase sales and excise taxes in 2007 were absent from D.C. policymakers' deliberations in 2009.

The repeal of the sales tax holidays, which succeeded by all accounts only because their sponsor and main supporter had lost her re-election bid, provided the most extreme example of how political calculations overshadowed policy arguments in shaping D.C. tax policy outcomes. The extensive body of policy analysis and research on sales tax holidays, much of which suggested that the holidays largely shift purchases and provide a windfall to retailers, was not a factor in the repeal decision.

[143] Although the council did hold a "public briefing," it did not cover any specific tax policy changes that were part of a bill or proposal released prior to the briefing.

The choice of poorly-vetted tax increases based primarily on political concerns had negative consequences for tax policymaking in D.C. The doubling of the vacant property tax, fueled by outrage about community effects, was approved unanimously in 2008 but largely undone in 2009, when the $10 tax rate was limited to "blighted" properties – again on a unanimous vote. By hastily revising the vacant property tax without carefully examining the ramifications, D.C. lawmakers failed to design a fair, consistent, policy that would deter neighborhood blight without harming owners who had valid reasons for not using their properties and maintained them adequately.

D.C. tax policy decisions in 2009 also provide a stark example of the importance of a micropolitical process in which lawmakers distribute tax benefits to finely-targeted, identifiable constituencies, reaping political benefits with those groups while attracting little notice from anyone else. As the budget crisis peaked, legislators more than tripled the number of parcel-specific tax breaks included in the FY 2010 Budget Support Act and then left the 16 tax breaks untouched when they had to close an additional $150 million budget gap. While cutting agencies and programs across the government and raising taxes, D.C. lawmakers treated concentrated tax benefits for the few as inviolate.

Tax Policy Decisions in 2010

Tax policy proposals in the District of Columbia were narrower in scope and less controversial in 2010, partly because policymakers had spent some of their political capital by increasing taxes in 2009. In addition, 2010 was a major election year in D.C., with contests for mayor, council chairman, and six council seats. In March, Chairman Gray decided to challenge Mayor Fenty in the Democratic primary, which is tantamount to election in heavily Democratic D.C. The mayoral contest (which Gray won with 54 percent of the vote in September) seemed to reinforce cautious attitudes on tax policy on the part of both men during the FY 2011 budget cycle (Craig, 2010a).

Although the national recession officially ended in June 2009, the District endured additional reductions in revenue during the slow recovery that unfolded in 2010. Projected revenues for FY 2011 dropped by $153.4 million between September 2009 and February 2010 (Chief Financial Officer, 2009d, 2009e, and 2010a). Stock market gains and rising federal government employment began to lift personal income tax collections, but the District's real property tax receipts continued to fall, reflecting property assessments made in 2008. Declining cigarette tax revenues, apparently triggered by a shift in cigarette purchases to Maryland and Virginia after D.C. raised its cigarette tax to $2.50 per pack (the highest in the region), also added to the projected revenue loss (Chief Financial Officer, 2010a), underscoring the weak revenue capacity of the tax.[144]

The CFO's revenue forecast held steady until the fall, after D.C. officials had approved the FY 2011 budget. In late September 2010, Dr. Gandhi lowered the FY 2011

[144] Specifically, estimated cigarette tax revenue had been lowered by $15.4 million for FY 2010 and $15.2 million for FY 2011, representing reductions of approximately one-third. See Chief Financial Officer Natwar M. Gandhi, letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman, Council of the District of Columbia, dated February 24, 2010.

revenue estimate by $99.8 million, reflecting a continued drop in assessed property values, particularly for commercial property, as well as a fall-off in sales tax collections (Chief Financial Officer, 2010b). Before the end of 2010, the mayor and council had to close an additional gap of $188.4 million in the FY 2011 budget, reflecting not only the drop in projected revenue, but also cost increases and a mistaken assumption that congress would appropriate additional Medicaid stimulus funds.

FY 2011 Budget Process: Part 1. The mayor proposed an FY 2011 operating budget of $8.9 billion, representing a decrease of $466.6 million (5.0 percent) from the FY 2010 operating budget, largely due to the loss of $211.6 million in federal stimulus funds as well as a projected $334.9 million drop in federal (non-stimulus) operating grants. The District's local-funds budget (representing unrestricted revenue generated by D.C. taxes, fees, and fines) would grow from $5.21 billion in FY 2010 to $5.27 billion in FY 2011 (increasing by $60.7 million, or 1.2 percent), under the mayor's budget (Chief Financial Officer, 2010c: 5).

Although the mayor proposed policy changes to increase revenues by $93.7 million in FY 2011 and $423.6 million from FY 2011 to 2014, more than half of the new revenue would come from non-tax revenues.[145] In particular, the mayor sought to generate $112.1 million over four years by increasing traffic fines (Government of the District of Columbia, 2010: 4-22 – 4-23).

[145] Specifically, non-tax revenues were projected to generate $57.9 million in FY 2011 and $230 million from FY 2011 to 2014. These are the author's calculations using data from Government of the District of Columbia, *FY 2011 Proposed Budget and Financial Plan: Maximizing Efficiency*, Vol. 1, Executive Summary, April 1, 2010, pp. 4-21 – 4-23.

The proposed tax increases in the mayor's budget were not only modest, estimated to raise $35.8 million in FY 2011 and $193.6 million from FY 2011 to 2014,[146] but were also skewed toward earmarked taxes as well as taxes on insurance premiums and health care facilities (see Table 4.14 on the next page). A new 1 percent tax on hospitals' net patient revenue would account for roughly two-thirds of the tax increase ($25.3 million in FY 2011 and $126.7 million from FY 2011-14), with the revenue deposited in a new Hospital Fund that would support Medicaid services (Office of the Chief Financial Officer, 2010a: 46-47). Applying the 2 percent HMO insurance premiums tax to receipts from low- income health programs (such as Medicaid) would generate $8.6 million in FY 2011 and $45.1 million from FY 2011-14 for the Healthy DC Fund (Office of the Chief Financial Officer, 2010a: 47-48). These dedicated taxes would account for roughly 90 percent of the tax increases in Mayor Fenty's FY 2011 budget.[147]

The largest source of new tax revenue that would flow into the District's general fund (non-dedicated tax revenue) in Mayor Fenty's FY 2011 budget was an increase in the premiums tax on life and property insurance from 1.7 percent to 2 percent (thereby matching the 2 percent rate already imposed on accident and health insurance). The increase in the insurance premiums tax (which Mayor Fenty termed an "assessment equalization" rather than a tax increase)[148] was expected to generate $1.2 million in FY

[146] Author's calculations using data from Government of the District of Columbia, *FY 2011 Proposed Budget and Financial Plan: Maximizing Efficiency*, Vol. 1, Executive Summary, April 1, 2010, pp. 4-21 – 4-23.

[147] Author's calculations using data from Government of the District of Columbia, *FY 2011 Proposed Budget and Financial Plan: Maximizing Efficiency*, Vol. 1, Executive Summary, April 1, 2010, pp. 4-22 – 4-23. Specifically, the dedicated taxes would generate an estimated $33.9 million in FY 2011 and $171.8 million from FY 2011 to FY 2014.

[148] See Title II-N of Bill 18-731, the "Fiscal Year 2011 Budget Support Act of 2010," introduced on April 12, 2010, by Chairman Gray at the request of Mayor Fenty.

Table 4.14
Tax Policy Changes Proposed by Mayor Fenty in the FY 2011 Budget

Provision	Projected Fiscal Impact
General Fund Revenue	
Raise business franchise tax on new high-tech companies in certain areas from 0 to 6%.	$1.3 million, FY 2011 $7.4 million, FY 2011-14
Reduce D.C. earned income tax credit from 40% to 39% of federal credit	$1.0 million, FY 2011 $4.4 million, FY 2011-14
Increase insurance premiums tax for life and property insurers from 1.7% to 2%	$1.2 million, FY 2011 $15.4 million, FY 2011-14
Fund tax abatements for Heights on Georgia Avenue project	-$52,000, FY 2011 -$447,000, FY 2011-14
Fund tax abatements for Studio Theater artist housing	-$27,000, FY 2011 -$101,000, FY 2011-14
Fund tax abatements for First Congregational United Church of Christ	-$317,000, FY 2011 -$951,000, FY 2011-14
Fund tax abatements for Park Place at Petworth project	-$696,000, FY 2011 -$2.0 million, FY 2011-14
Fund tax abatements for Kelsey Gardens redevelopment for two-year period	-$2,000, FY 2011 -$4,000, FY 2011-14
Provide tax abatements for non-profits locating in designated areas	-$500,000, FY 2011 -$2.0 million, FY 2011-14
Dedicated Tax Revenues	
Impose 1.0% assessment on net hospital patient revenue (Hospital Fund)	$25.3 million, FY 2011 $126.7 million, FY 2011-14
Apply 2% premiums tax on HMOs to receipts from Medicaid and other low-income programs (Healthy D.C. Fund)	$8.6 million, FY 2011 $45.1 million, FY 2011-14

Source: Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2011 Budget Support Act of 2010,'' April 20, 2010, pp. 29, 46-48, 61-69.

2011 and $15.4 million from FY 2011 to FY 2014 (Office of the Chief Financial Officer, 2010a: 29). In addition, Mayor Fenty proposed curtailing two tax expenditures. First, he sought to require newly-certified high-technology firms in designated zones to pay a 6 percent business income tax, rather than no tax as allowed under current law (the 6 percent rate would still be lower than the regular 9.975 percent rate). This change, which had been advocated by DCFPI, would increase revenue by $1.3 million in FY 2011 and $7.4 million from FY 2011-14 (Office of the Chief Financial Officer, 2010a: 65-66). Second, the mayor proposed reducing D.C.'s earned income tax credit from 40 percent to 39 percent of the federal EITC, which would generate $1.0 million in FY 2011 and $4.4 million from FY 2011-14 (Office of the Chief Financial Officer, 2010a: 66).

Finally, the mayor proposed funding tax relief for five properties or developments that had been enacted with a subject-to-appropriations clause, as well as real property tax abatements to non-profits located in "emerging commercial areas." The tax relief included in the mayor's budget was relatively low-cost, with a projected revenue loss of $1.1 million in FY 2011 and $3.5 million from FY 2011-2014.[149]

The mayor's FY 2011 budget once again aimed tax increases at the periphery of the D.C. tax system. In an interview, Councilmember Mary Cheh contended that the proposed hospital assessment and insurance premium tax increases reflected the mayor's inclination to tax "things that were hidden from public view or attention." Because they are unlikely to generate community meetings and protests from constituents, Ms. Cheh added, "These are easy taxes, so to speak." Deputy Chief Financial Officer Fitzroy Lee also noted the role of precedent in paving the way for these tax increases, suggesting that the prior increase in the insurance premiums tax on HMOs meant that "this would work too" for other types of insurance companies. Dr. Lee also pointed out that a hospital

[149] Author's calculations using data from Government of the District of Columbia, *FY 2011 Proposed Budget and Financial Plan: Maximizing Efficiency*, Vol. 1, Executive Summary, April 1, 2010, p. 4-21.

assessment would also generate a larger federal Medicaid match for the District by increasing local spending on hospital care. "It was kind of a win-win," Dr. Lee stated. "The narrower you make tax policy, the more you can get away with."

Because the insurance premium tax increases (both the rate increase for life and property insurers and the inclusion of receipts from low-income programs) were narrowly targeted and most of the revenues would mostly be earmarked to support the Healthy DC program, the council approved the measures with little debate. The insurance premium tax increase was defensible to legislators not only because it met the standard of internal equity (the tax rate on health insurers) but also because it would match the 2 percent tax imposed by Maryland on insurance premiums. In justifying the increase, Committee on Public Services and Consumer Affairs Chairperson Muriel Bowser stated that:

> This subtitle is needed to establish insurance premiums tax rates in the District that are commensurate with the premium tax rates charged by Maryland and Virginia. The District's 1.7 percent tax rate is significantly lower than Maryland's rate of 2 percent, and Virginia's rate of 2.25 percent. The new rate will keep the District competitive with its neighbors without leaving revenue on the table during these difficult budget times. (Office of Cable Television, 2010a).

The council reduced the 1 percent tax on hospitals' net patient revenue to a $1,500 assessment on each licensed bed in response to opposition from hospitals facing thin operating margins. The revised proposal was estimated to generate $6.3 million in FY 2011 and $25.2 million from FY 2011 to 2014 (Office of the Chief Financial Officer, 2010b: 57-58), roughly one-fourth of the amount estimated for the mayor's proposal (Office of the Chief Financial Officer, 2010a: 46-47). The revenue would still be deposited into a Hospital Fund and used to finance Medicaid services. The council also increased an assessment on intermediate care facilities for the mentally retarded (ICF-MRs) from 1.5 percent of gross revenue to 5.5 percent, which would be earmarked to improve the quality of care for people with intellectual disabilities. The higher tax on ICF-MRs was projected to generate \$3.4 million in FY 2011 and \$13.6 million from FY 2011 to 2014 (Office of the Chief Financial Officer, 2010b: 59-60). Even though the hospital assessment was reduced, health facility assessments still remained a preferred option for D.C. policymakers to raise tax revenue.

By contrast, the mayor's efforts to trim two tax expenditures – the local EITC and business tax incentives for high-technology companies – were rebuffed by the council, as the original sponsor of each provision (Councilmembers Jack Evans and David Catania, respectively) reduced appropriations to keep the tax benefits intact. Although the Finance and Revenue Committee explained the decision to protect the EITC by stating that it is "one of the best programs to encourage and assist working families in the District" (Committee on Finance and Revenue, 2010a: 32), the committee did not offer a rationale for retaining the business tax exemption for high-tech companies.[150] In particular, the committee did not address an analysis by DCFPI, which found that high-technology jobs had grown more slowly than other jobs in the District and had not kept pace with high-tech jobs in surrounding jurisdictions since tax incentives for high-tech firms were enacted in 2000 (Du and Lazere, 2008).[151] Although the tax exemption for

[150] In discussing the mayor's proposal to curtail the high-technology tax incentives, the committee's budget report only stated that, "The Committee recommends rejection of this proposed subtitle." See Committee on Finance and Revenue, "Final Report and Recommendations of the Committee on Finance and Revenue on the Fiscal Year 2011 Budget Request and Budget Support Act for Agencies Under Its Purview," May 13, 2010, p. 32.

[151] During the committee's fiscal year 2011 budget markup, Councilmember Catania contended that the incentives had been used "very successfully in the city to lure 48 companies to the city." See Office of

high-tech companies was preserved, the outcome reinforces the lesson from the sales tax holiday debate: the presence or absence of an influential sponsor, rather than an analysis of benefits and costs, was decisive in determining the outcome.

The council added several other tax policy changes to the FY 2011 budget, but the amendments were marginal. In the absence of a clear consensus about the relative merits of protecting programs, rebuilding the fund balance, and limiting new taxes and fees, councilmembers considered a favorite tax policy tool – sin taxes – while trimming several fees and restoring some program cuts proposed by the mayor.

Before council committees began voting on the FY 2011 budget, advocacy groups seeking to restore funding for social services programs suffered a stinging defeat in a largely symbolic skirmish. The Fair Budget Coalition, a group of non-profit human service providers and advocates, led the effort to protect social services funding. After *The Washington Post* reported that the council would consider a list of revenue increases proposed by the coalition, including expanding the sales tax to cover services such as "pet grooming, club memberships, and theater tickets" (Craig, 2010b), gym owners flooded councilmembers with thousands of angry e-mails about the so-called "yoga tax." Chairman Gray and Councilmember Evans reassured residents that a sales tax expansion was not being considered, and there is no evidence that the proposal had gained support among legislators (Council Chairman Vincent Gray, 2010).[152] Still, the rapid mobilization of business owners and consumers who might be affected by the proposal

Cable Television, "The Council of the District of Columbia, Committee on Finance & Revenue, Mark-Up, Thursday, May 13, 2010, Jack Evans, Chairperson," available at www.oct.dc.gov.

[152] Although the *Post* article identified legislators who favored a tax increase on the wealthy and a soda tax, it did not name any sponsors or supporters of a sales tax expansion. In an interview, Councilmember Mary Cheh stated, "That was a whole lot of bull. We weren't considering those taxes, ever."

showed the power of manipulating symbols effectively. The image of taxing a healthful and wholesome activity such as yoga blocked the sales tax expansion from consideration, even though the proposal also targeted more mundane services such as carpet cleaning, chimney cleaning, packing and crating, and taxidermy.[153]

Rather than increase the rate or base of a major tax – particularly by taxing a healthful activity such as gym membership – the council approved three tax increases at the margins of the property and sales tax bases. First, the council revived the tax on vacant property, which had been repealed only months before. As described earlier, the vacant property tax had taken a number of abrupt turns. The Council doubled the vacant property tax from 5$ per $100 of assessed value to $10 in 2008, before limiting the $10 tax to "blighted" property in 2009. At that point, property that was vacant but not blighted reverted to the regular tax rates for residential or commercial property. In 2010, the council restored the $5 tax rate for vacant property while keeping the $10 rate for blighted property, marking the third major policy change on this issue in three years. Councilmember Muriel Bowser, who sponsored the amendment restoring the vacant property tax, contended that, "Vacant properties harm neighborhoods and must not be treated the same as occupied properties," adding that exemptions for "vacant property owners acting in good faith" would ensure the fairness of the tax (Committee on Public Services and Consumer Affairs, 2010: 70).

A decade after D.C. policymakers collapsed five real property tax categories into two (residential and commercial), enacting a major recommendation of the 1996-98 Tax Revision Commission, officials had largely reversed this simplification effort. The

[153] In 2014, the council approved an expansion of the sales tax to cover a variety of services including fitness club memberships, but this effort succeeded because it was part of a larger tax-cut package.

property tax system now contained four classifications: residential, commercial, vacant, and blighted (in addition, the commercial rate had two tiers). In returning to a more stratified property tax system reflecting political influence and social standing (especially the pariah status of vacant and blighted property owners), D.C. lawmakers behaved in a way consistent with Hettich and Winer's model. In 1998, the Tax Revision Commission concluded there was "no evidence" that the higher tax rate provided an incentive to develop or renovate vacant properties while noting "severe problems of administration and compliance" with the tax (D.C. Tax Revision Commission, 1998: 60-61), but 10 years later, D.C. officials continued to rework a punitive tax that was difficult to apply fairly given the diverse and frequently changing conditions of vacant property owners.

The second battle over a tax designed to curb a negative externality involved a one-cent-per-ounce excise tax on sugar-sweetened drinks proposed by Councilmember Cheh to finance a bill (the "Healthy Schools Act") she had sponsored to improve school health and nutrition programs.[154] The Act, which received final approval from the council in May 2010, included a subject-to-appropriations clause because projected costs had not been offset (Office of the Chief Financial Officer, 2010c). In an interview, Ms. Cheh described the tax (dubbed the "soda tax" even though it applied to other beverages) as a way to reinforce the Healthy Schools Act by discouraging consumption of high-calorie drinks with little nutritional value. Distributors, grocery stores, and restaurants formed the "No D.C. Beverage Tax Coalition" to fight the proposal and mounted a media campaign portraying the tax as an added cost to "hard-working, low- and middle-income families, elderly residents, and those living on fixed incomes," a threat to stores that

[154] The Act established local nutritional standards for school meals, offered monetary incentives for schools to meet nutritional and food quality standards, and set health and physical education standards for schools.

would lose business to Maryland and Virginia, and the latest intrusion of an overbearing, bloated government (No D.C. Beverage Tax Coalition, 2010).

The excise tax ultimately failed because the retailers opposing the tax were stronger in number and resources, and also presented a more favorable social image, than the cigarette smokers and vacant property owners who had seen their tax rates doubled by the council in the past two years. In contrasting the large cigarette tax increases to the unsuccessful excise tax on soda, DCFPI executive director Ed Lazere observed that the beverage industry is very powerful and "not as demonized" as the tobacco industry. Although soda and other sugar-sweetened beverages comprise a small portion of consumer expenditures, they are purchased by large numbers of people whom opponents were able to mobilize against the tax by exploiting powerful symbols.

Councilmember Evans opposed the tax, stating that it should not be allowed to bypass his committee (Ms. Cheh had not introduced the soda tax as a separate bill). In an interview, Mr. Evans described the tax as another way of "nickling and diming" residents who had already absorbed a range of fine and fee increases. Ms. Cheh and other interviewees cited a ploy by Councilmember Harry Thomas, Jr., as helping to cement opposition to the excise tax. A former coach of youth athletics, Mr. Thomas brought bottles of Gatorade and other sports drinks into a council meeting to highlight some of the products would be taxed and argued that the tax would make sports and recreation more expensive – turning the health argument for the tax on its head.

The issue of parity also played a role in the soda tax debate, as councilmembers were unwilling to impose a higher tax than other jurisdictions even on a very narrow type of consumption. In a written response to questions, Chairman Gray stated that, "This one-cent per-ounce tax would have placed an unprecedented tax on these products and would have placed us completely out of sync with other jurisdictions." Instead, Mr. Gray proposed applying the 6 percent general sales tax to soft drinks, which he argued would keep the District in line with Maryland and Virginia (both states applied the sales tax to beverages, although in Virginia they were taxed at the 2.5 percent rate charged on food). The compromise, which was enacted as part of the FY 2011 budget, also met the standard of internal equity: soda and other beverages would be taxed at the same rate as most other types of consumption. By generating $7.9 million in FY 2011 and $33.1 million from FY 2011 to 2014 (Office of the Chief Financial Officer, 2010b: 102-103), the general sales tax on soda was sufficient to fund the Healthy Schools Act. The soda tax offered another example of a tax increase coming "sideways" through the council; there were no public hearings on the tax, which was negotiated in the Committee of the Whole.

The other change to the sales tax base was less controversial: the council voted to apply the 6 percent sales tax to medical marijuana, which had been legalized in the District. The revenue, which was projected at $27,000 in FY 2011 and $401,000 from FY 2011-2014, would be deposited in the Healthy DC Fund (Office of the Chief Financial Officer, 2010b: 98-99).

Groups seeking to restore funds for social-service programs tried to rally support for an amendment offered by Councilmember Graham to create a new top personal income tax rate of 8.9 percent starting at an income level of $350,000. Mr. Graham paired the tax increase with funding increases for human services programs,[155] but his amendment failed in an 8 to 5 vote. Councilmember Evans argued that the tax increase

[155] These programs were rapid re-housing, grandparent caregiver subsidies, emergency rental assistance, interim disability assistance, homeless services, rent supplements, and the Office on Latino Affairs.

would only encourage overspending and reduce the District's appeal as a place to live. Chairman Gray also opposed the amendment, stating in a written response to questions that, "(I)n general I do not support increasing any category of taxes to restore a specific cut to an agency's budget or services," and that, "(M)ore discussion needed to take place both with members and the public." As discussed in Chapter 5 (Maryland case study), broad-based tax increases are difficult to advance without strong support from the chief executive and legislative leadership.

Even as councilmembers struggled to increase social-service funding, they continued a pattern of previous years by more than doubling (from five to 11) the number of property-specific tax abatements proposed by the mayor in the FY 2011 budget. The council granted tax relief to the five properties proposed by the mayor, as well as his request to establish a tax abatement program for non-profits locating in designated areas, while approving tax relief for six more parcels.

Overall, the tax measures included by the council in the FY 2011 budget amounted to a modest change, with a projected net revenue increase of $27.7 million in FY 2011 (0.5 percent of total tax revenues) and $133.0 million from FY 2011 to 2014.[156] Approximately two-thirds of the revenue ($18.3 million in FY 2011 and $84.3 million from FY 2011-14) would flow into earmarked funds.[157] Table 4.15 (see next page) summarizes the tax policy changes made by the council in the FY 2011 budget.

---

[156] Table 4.1, on p. 4 of this chapter, states that the total change in the tax burden due to statutory changes in 2010 was 0.4 percent, rather than 0.5 percent; the difference is due to tax policy changes made outside the budget process in 2010, which reduced the total to 0.4 percent.

[157] Author's calculations using data from Government of the District of Columbia, *FY 2011 Proposed Budget and Financial Plan: Maximizing Efficiency*, Vol. 1, Executive Summary (July 1, 2010), pp. 4-17 – 4-19.

Table 4.15
Tax Policy Changes Made by the D.C. Council in the FY 2011 Budget

Provision	Projected Fiscal Impact
General Fund Revenues	
Restore 5% tax on vacant real property	$3.2 million, FY 2011 $12.6 million, FY 2011-14
Apply 6% sales tax to soft drinks	$7.9 million, FY 2011 $33.1 million, FY 2011-14
Finance tax abatements for Affordable Housing Opportunities rental project	-$112,000, FY 2011 -$213,000, FY 2011-14
Finance tax abatements for Jubilee Housing project	-$52,000, FY 2011 -$242,000, FY 2011-14
Finance tax abatements for Campbell Heights project	-$150,000, FY 2011 -$645,000, FY 2011-14
Finance tax abatements for International House of Pancakes	-$50,000, FY 2011 -$50,000, FY 2011-14
Finance tax abatements for King Towers residential housing project	-$83,000, FY 2011 -$248,000, FY 2011-14
Provide real property tax abatement to Pew Charitable Trusts	-$805,000, FY 2011 -$3.2 million, FY 2011-14
Dedicated Tax Revenues	
Impose a $1,500 assessment on each licensed hospital bed (Hospital Fund)	$6.3 million, FY 2011 $25.2 million, FY 2011-14
Increase the assessment on intermediate care facilities from 1.5% of gross revenue to 5.5% (Stevie Sellows Quality Improvement Fund)	$3.4 million, FY 2011 $13.6 million, FY 2010-13
Apply 6.0% sales tax to medical marijuana (Healthy DC and Health Care Expansion Fund)	$27,000, FY 2011 $401,000, FY 2011-14

Source: Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2011 Budget Support Act of 2010," July 1, 2010, pp. 22-23, 57-60, 74-75, 98-99.

FY 2011 Budget Process: Part 2. Facing a projected $188.4 million budget gap in his final months as chief executive, Mayor Fenty continued to rely on spending cuts (which totaled $161.2 million) to close the gap in his November 2010 revised budget (Mayor Adrian Fenty, 2010: 2; McDonald, 2010: 2). Although the mayor's revised budget for FY 2011 also included $27.4 million in "revenue initiatives," they mostly involved transfers from special-purpose funds (which use revenues from fines, fees, and reimbursements) and dedicated taxes to the unrestricted part of the general fund, rather than tax increases (Mayor Adrian Fenty, 2010: 2-3; McDonald, 2010: 2-3). The sole tax increase proposed by the mayor was a $500 increase in the hospital bed tax that had been set at $1,500 in the original FY 2011 budget. The increase would generate $2.1 million for the Hospital Fund in FY 2011 and $8.4 million from FY 2011-2014 (Office of the Chief Financial Officer, 2010d: 11-12). In addition, Mayor Fenty proposed financing two tax relief measures that had been enacted with subject-to-appropriations clauses[158] as well as a new tax relief measure.[159] All three of these subsidies were targeted at particular properties or developments. The total cost of the tax relief measures was minor: $261,000 in FY 2011 and $1.1 million from FY 2011-14.[160]

Consistent with prior patterns, legislators doubled the number of parcel-specific tax relief measures in the supplemental budget from three to six. The council approved the three tax relief measures proposed by the mayor and as well as tax relief for an International House of Pancakes restaurant, the Central Union Mission, and a luxury hotel to be built in the Adams Morgan neighborhood. Although tax relief for the Adams

---

[158] These measures were Bill 18-828, the "Kenilworth Avenue Northeast Redevelopment Project Real Property Limited Tax Abatement Assistance Act of 2010," and Bill 18-628, the "2323 Pennsylvania Avenue Southeast Redevelopment Project Real Property Limited Tax Abatement Assistance Act of 2010."

[159] The new tax relief provision involved a tax exemption for an affordable housing development located at 4427 Hayes Street, N.E. The total value of the exemption would be capped at $140,000.

[160] Author's calculation using data from Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Fiscal Year 2011 Supplemental Budget Support Act of 2010," November 24, 2010, pp. 15-19.

Morgan hotel would result in a 20-year revenue loss of $46 million, the council was able to add this provision to the budget because the costs would not begin accruing until after the four-year period covered by the District's financial plan (Office of the Chief Financial Officer, 2010e). This provision, which originated as stand-alone legislation before being included in the budget, is discussed below in greater detail. The council also approved the mayor's request to increase the hospital assessment to $2,000 per licensed bed, while once again rejecting proposals to restore social services funding by raising personal income tax rates for high-income households.[161] Table 4.16 (see next page) summarizes the tax policy changes enacted in the FY 2011 supplemental budget.

Other Tax Legislation Considered in 2010. In 2010, the council enacted 30 tax policy bills. Accentuating a pattern from previous years, the council approved 20 bills providing tax relief for specific parcels of land, as well as one measure providing tax relief to a specific company (CoStar). Almost all (17) of the parcel-specific tax relief measures were enacted with a subject-to-appropriations clause, maintaining the pipeline of special tax measures enacted without financing. Only one stand-alone piece of tax legislation enacted in 2010 (Bill 18-655, the "Payment of Full Hotel Taxes by Online Vendors Clarification Act") had the potential to increase revenues by requiring online travel agencies (OTAs) to pay hotel tax based on the retail price paid by the hotel guest, rather than the wholesale price that OTAs paid to the hotel, but this outcome was in doubt due to the high likelihood of litigation (Office of the Chief Financial Officer, 2010f).

[161] There were two amendments, both of which failed on 8-5 votes. One amendment would have imposed an 8.9 percent tax on incomes of $200,000 or more and a 9.4 percent tax on incomes of $1 million or more, while the other amendment would have imposed an 8.75 percent tax on incomes of $75,000 or more, a 9.0 percent tax on incomes of $150,000 or more, and a 9.5 percent tax on incomes of $500,000 or more.

Table 4.16
Tax Policy Changes in the District's FY 2011 Supplemental Budget

Provision	**Projected Fiscal Impact**
General Fund Revenue	
Shift parking tax revenue from D.C. Department of Transportation to WMATA operating subsidy	No fiscal impact
Finance tax abatements for 800 Kenilworth Avenue Northeast Redevelopment Project	-$134,000, FY 2011 -$585,000, FY 2011-14
Finance tax abatements for 2323 Pennsylvania Avenue Southeast Redevelopment Project	-$88,000, FY 2011 -$371,000, FY 2011-14
Provide five-year real property tax exemption to 4427 Hayes Street, N.E.	-$39,000, FY 2011 -$140,000, FY 2010-13
Provide real property tax forgiveness to IHOP Restaurant	-$50,000, FY 2011 -$50,000, FY 2011-14
Provide real property and deed transfer tax forgiveness to Central Union Mission	-$508,000, FY 2011 -$508,000, FY 2011-14
Provide 20-year real property tax exemption for Adams Morgan hotel	No fiscal impact
Dedicated Tax Revenue	
Increase assessment per licensed hospital bed from $1,500 to $2,000 (Hospital Fund)	$2.1 million, FY 2011 $8.4 million, FY 2011-14

Sources: Office of the Chief Financial Officer, "Revised Fiscal Impact Statement: 'Fiscal Year 2011 Supplemental Budget Support Act of 2010," December 21, 2010, pp. 12-13, 16-22; Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Central Union Mission Real Property Tax Exemption and Equitable Tax Relief Act of 2010, November 18, 2010; and Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Adams Morgan Hotel Real Property Tax Abatement Act of 2010, October 6, 2010.

Note: The real property tax exemption for the Adams Morgan hotel was deemed to have no fiscal impact only because the estimated $46 million cost would begin in FY 2015, outside the four-year financial plan.

Once again, the tax relief measures for specific organizations or properties passed on lopsided votes. The combined vote on the 21 bills was 69 to 2 in the Committee on Finance and Revenue, and 259 to 7 on final reading in the council. Appendix 4.4 at the end of this chapter summarizes the stand-alone tax policy bills enacted in 2010.

Nevertheless, several bills providing subsidies to for-profit businesses tested the limits of the council's willingness to offer tax incentives, even though proponents of tax relief prevailed in three of the four cases. The first contentious battle over business tax relief concerned the mayor's efforts to persuade CoStar, one of the largest providers of commercial real estate information and marketing services, to move its headquarters from Maryland to the District. In the fall of 2009, Mayor Fenty transmitted legislation to the council (Bill 18-476) to grant a $7 million tax abatement over 10 years to property that would be leased by CoStar.[162] Pointing to the District's 11.1 percent unemployment rate and the prospect that CoStar's D.C. workforce could reach 1,000 employees within 10 years, the administration argued that the bill would increase income and sales tax revenue while supporting local firms that would receive at least 20 percent of CoStar's business to design and build out its space (Siegel, 2009).

The Committee on Finance and Revenue unanimously approved Bill 18-476, along with seven other bills, with no discussion in a six-minute meeting (Office of Cable Television, 2009b). After DCFPI questioned the case for the tax incentives in a series of policy briefs, the debate on the bill began in earnest when the council considered the bill. DCFPI pointed out that the District's office vacancy rate was the second-lowest in the nation, and much lower than that in the D.C. suburbs. DCFPI also argued that CoStar was a thriving business and would receive a tax break simply for moving employees into the District, with no requirement to increase D.C. resident employment (Lazere, 2009).[163]

[162] The bill used generic language to authorize tax abatements for "high technology commercial real estate database and service providers," but it was designed solely for CoStar.

[163] Another concern was that CoStar would not contribute corporate income tax revenues for five years because it would qualify for an exemption under the District's tax incentives for high-tech firms.

This critique, which highlighted the incongruity of granting a tax break to a prosperous firm during the midst of a fiscal crisis (Lazere, 2009), became more potent politically when nearly 30 D.C. small businesses and non-profits, including neighborhood anchors such as Politics and Prose bookstore and Busboys and Poets restaurant, signed a letter urging the council to reject the tax break.[164]

The opposition from well-respected local interests almost defeated the CoStar legislation, which was approved by the council on an initial vote of 7 to 5. Prior to the final vote in January 2010, Councilmember Kwame Brown, chairman of the Committee on Economic Development, proposed amendments that smoothed the way to enactment. Most importantly, CoStar could not claim an abatement until the D.C. Department of Employment Services certified that the company had increased the number of D.C. residents employed by at least 100, a level that CoStar would have to maintain. In addition, the local business set-aside for design, build-out, and property improvements was increased from 20 percent to 35 percent and the 10-year cap on the abatements was reduced from $7 million to $6.185 million. Bill 18-476 was approved on a final vote of 8 to 4 and became law. Several interviewees stated that the job requirements as well as the relocation of a business from Maryland – which had both substantive and symbolic value – were decisive in the bill's approval. In addition, the desire of D.C. officials to diversify an economy depending on the federal government and related businesses made the recruitment of CoStar particularly appealing.

[164] The group wrote that, "It does not make sense to take a portion of D.C.'s most valuable real estate off the tax rolls for 10 years or to target economic development resources on large businesses in downtown D.C., rather than on small businesses and other parts of the city." See D.C. Fiscal Policy Institute, "Sign-On Letter to Oppose Business Tax Breaks," dated December 9, 2009, available at www.dcfpi.org.

Shortly thereafter, the council considered Bill 18-431, the "OTO Hotel at Constitution Square Economic Development Act of 2010," which would provide a new hotel in the North of Massachusetts Avenue (NOMA) neighborhood with a real property tax abatement from FY 2020 to FY 2029, and a sales tax exemption for construction materials used in the project. This subsidy would follow a $7 million real property tax abatement for the Constitution Square project (of which the OTO Hotel was a part) that was enacted in 2008.[165] At a public hearing on Bill 18-431, an OCFO official stated that (1) the subsidy was large, equaling 24 percent of total project cost, (2) other hotels in NOMA had not received government subsidies, and (3) the bill would therefore give the OTO Hotel a competitive advantage over other hotels (Ross, 2009: 3-4). The projected revenue loss for FY 2010-13 (from the sales tax exemption) was estimated at $1.1 million, with a $15.7 million revenue loss for the real property tax exemption from FY 2020 to FY 2029 (Office of the Chief Financial Officer, 2010g). DCFPI echoed the OCFO's concerns about the bill, noting that it would benefit wealthy individuals such as billionaire Wayne Huizenga, an investor in OTO Development (Reed and Silverman, 2010). Despite the criticisms, the Committee on Finance and Revenue approved Bill 18-431 on a 3-0 vote, with one abstention. After Bill 18-431 was amended to cap the total tax abatement at $8.1 million (approximately 13 percent of the project cost), the council approved the legislation on a final vote of 12 to 1, and it was signed by Mayor Fenty.

Another hotel tax relief bill narrowly escaped defeat at the end of 2010, facing more opposition because the subsidies were targeted at a luxury hotel and entailed a particularly large cost. Bill 18-969, the "Adams Morgan Hotel Real Property Tax

[165] This legislation was D.C. Law 17-126, the "Constitution Square Economic Development Act of 2008."

Abatement Act of 2010," would grant a 15-year real property tax exemption to a five-star hotel planned on the site of a former church. Although the bill would result in a large revenue loss, the legislation could move forward because the cost would not occur during the FY 2011-14 financial plan (Office of the Chief Financial Officer, 2010e). The developer contended that the hotel would yield nearly $7 million in annual revenue "from a property that currently generates zero," while creating more than 1,500 construction jobs and 500 permanent jobs and serving as "a magnet for economic growth and stabilization in the broader Adams-Morgan corridor." (Friedman, 2010).

A price tag initially estimated at $61.3 million led the Committee on Finance and Revenue to table Bill 18-969 in a 3 to 2 vote in December 2010, but four days later the panel reconsidered and approved the measure unanimously after making two changes. First, committee chairman Evans capped the tax abatement at $46 million, stating that a $61 million package was "never the request of the hotel at all." (Committee on Finance and Revenue, 2010b: 7). Second, Councilmember Kwame Brown added language requiring the project to meet local hiring and contracting requirements.[166] The quick turnaround was remarkable: Councilmember Michael Brown, who had moved to table the bill at the prior meeting, now described the hotel as a "great economic development project." (Office of Cable Television, 2010b). With too little time remaining in Council Period 18 to gain approval on two required votes, proponents attached the legislation to the pending FY 2011 supplemental budget bill, prevailing on a 9 to 3 vote.

[166] The requirements were mandated by two programs: the First Source program and the Certified Business Enterprise (CBE) program. First Source requires government-assisted projects with subsidies of $300,000 or more to target D.C. residents for 51 percent of new hires. The CBE program sets and enforces targets for the share of D.C. government contracting dollars spent on local, small, and disadvantaged businesses.

The council declined to adopt one costly tax break aimed at a particular property: federally-owned Union Station. The Finance and Revenue Committee had proposed amending the FY 2011 Budget Support Act to allow commercial properties operating in Union Station to make a payment in lieu of taxes (PILOT) instead of the District's possessory interest tax, which applies to government-owned properties that are used for non-governmental purposes.[167] Although Chairman Gray did not include the provision in the budget bill, Councilmembers Evans and Tommy Wells then sought to enact the stand-alone version of the legislation (Bill 18-220, the "Union Station Redevelopment Corporation Payment in Lieu of Taxes Act of 2010").

Like the tax relief for CoStar, the OTO hotel, and the Adams Morgan hotel, the tax break for Union Station sparked opposition largely because it would have helped for-profit businesses without local roots. The Union Station tax subsidies also resembled the Adams Morgan hotel subsidies in shifting revenue losses outside the four-year financial plan, exploiting a loophole in the District's fiscal impact rules but also creating resentment. Nevertheless, the Union Station bill appears to have failed while tax relief bills for CoStar, the OTO hotel, and the Adams Morgan hotel passed, because the Union Station measure violated a cherished principle for D.C. officials: that the District was entitled to relief from the large revenue losses caused by tax-exempt federal property. Because of that belief, it would seem hypocritical for D.C. officials to grant a tax exemption to commercial properties in Union Station. Moreover, the Union Station bill would help businesses that were already operating in the District of Columbia, whereas CoStar, the OTO hotel, and the Adams Morgan hotel would be new enterprises in D.C.

[167] The tax on government-owned property used for non-exempt purposes, known as the "possessory interest tax," is charged to the lessee and calculated by applying the residential or commercial property tax rate to the assessed value of the parcel. See D.C. Official Code § 47-1005.01.

As introduced, Bill 18-220 called for the Union Station Redevelopment Corporation, the landlord for the businesses operating in Union Station, to make annual PILOTs of $253,000, retroactive to FY 2008, with annual inflation adjustments starting in FY 2010. Because the annual PILOT was lower than the projected possessory interest tax, and would also grow more slowly, the CFO projected that the legislation would result in a revenue loss of $14.9 million through FY 2013 as well as an additional loss of $35.3 million in the following decade (Office of the Chief Financial Officer, 2009b).

To allow Bill 18-220 to proceed without violating the District's fiscal impact rules, Mr. Evans revamped the bill so that the PILOTs would be made up front, avoiding any revenue loss during the FY 2011-14 financial plan. At the end of FY 2015, the PILOTs would cease and the Union Station commercial properties would not make any payments to the District (Committee on Finance and Revenue, 2010c: 4-5). The finance committee approved the revised bill on a 3-0 vote in July 2010, but opposition generated by DCFPI led Councilmember Evans to table the bill at the full council. DCFPI pointed out in a YouTube video called "Desperate Properties" that the bill would benefit national chains such as McDonald's, Godiva Chocolatier, and Victoria's Secret – businesses of little concern to D.C. lawmakers – and noted that, "If the bill were passed, the Starbucks in Union Station would not pay commercial property tax, while Sidamo Coffee & Tea a few blocks away on H Street NE would." (D.C. Fiscal Policy Institute, 2010). Although Mr. Evans filed a notice of intent to move the bill on an emergency basis (which would require a two-thirds vote) during the last meeting of Council Period 18, he withdrew the measure, apparently at the request of Chairman Gray (Neibauer, 2010).

If the Union Station legislation reflects the limits on the council's willingness to provide tax relief to individual properties, businesses, and organizations, then those boundaries are very wide. From 2007 to 2010, the Adams Morgan hotel legislation was the only tax relief measure that was defeated in the Committee on Finance and Revenue (a defeat that was reversed) and the Union Station legislation was the only tax relief measure approved by the committee that was not approved by the council and signed into law. Even when highly-targeted tax relief measures, such as those offered to Costar and the Adams Morgan hotel, faced resistance because they would benefit large, prosperous, or national businesses, concessions in the form of cost reductions, job targets, or contracting opportunities were able to stem the opposition. The failure of the Union Station legislation appears to reflect the confluence of four damaging factors: (1) a property owner, the federal government, with negative associations, (2) businesses that lacked neighborhood roots and political influence, (3) the implausibility of job gains at businesses that were already operating in a fixed space, and (4) the effort to disguise the costs of the legislation by shifting them to later years (the latter was cited as a factor in interviews with Chairman Gray and Councilmember Mendelson). The compound effect of these negative attributes blocked the way to enactment in what was otherwise a steady flow of tax abatements for single claimants. Without this alignment of negative factors, tax abatements for identifiable beneficiaries enjoyed a strong likelihood of enactment.

What was also notable about the four tax relief measures discussed above is that concerns about their cost, effectiveness, and fairness were usually debated only after they were raised by DCFPI. For the CoStar and OTO Hotel tax incentives, subsidy reductions or stricter requirements for local hiring and contracting were added only during the debate at the full council, and in the case of the Adams Morgan hotel, a lower cost cap was added by the finance committee on Finance and Revenue when it reconsidered the bill after initially rejecting it. The Union Station legislation was one of nine measures approved by the committee, with no discussion, in a meeting that took less than four minutes, without addressing any of DCFPI's criticisms (Office of Cable Television, 2010c). It seems that the committee could have better designed and examined these tax incentives through more extensive discussions of the impacts, costs, and accountability requirements of each bill, instead of amending the bills later in the legislative process to address flaws pointed out by critics and to salvage the legislation.

As in prior years, D.C. tax policy decisions in 2010 generally supported the seven propositions set forth in Chapter 1 (see p. 10). D.C. policymakers conducted a limited search for tax policy options, focusing tax increases on smaller, peripheral taxes such as the insurance premiums tax and health facility taxes, while avoiding income, sales, and property tax increases (and continuing to chip away at the real property tax base through a steady stream of exemptions). Rather than broaden the sales tax base to cover more services, the council made more tangential changes by applying the sales tax to soda and medical marijuana. The lack of attention to the long-term health and stability of the tax system is exemplified by the enactment of 21 tax policy bills providing abatements, credits, or exemptions to 20 parcels of land and one company, 17 of which were not funded. Even as D.C. lawmakers approved an FY 2011 budget revision intended to close a $188 million budget gap, they enacted a 15-year tax exemption for a luxury hotel, estimated to cost $46 million in forgone revenue through FY 2029, reflecting the appeal of tangible economic development projects over much more distant, less visible costs.

Appendix 4.1
D.C. Tax Policy Measures Approved in 2007: Stand-Alone Legislation

Legislation	Projected Fiscal Impact
Bill 17-117, "Verizon Center Sales Tax Revenue Bond Approval Act." Authorizes issuance of revenue bonds to finance upgrades to Verizon Center and increases tax on sales at Verizon Center to 10% to repay the bonds.	No fiscal impact Annual sales tax collections would cover cost of debt service on the bonds.
Bill 17-140, "Quality Teacher Incentive Clarification Act." Clarifies that charter school teachers may deduct classroom and professional development expenses from the personal income tax, and that teachers may not deduct any items that were already deducted from federal income tax.	No fiscal impact
Bill 17-143, "Heurich House Foundation Real Property Tax Exemption and Real Property Tax Relief Act." Provides real property tax exemption, personal property tax exemption, and real property tax forgiveness to historic house museum.	-$225,000, FY 2008 -$616,000, FY 2008-FY 11 Approved with "subject to appropriations" clause because revenue loss was not offset.
Bill 17-180, "Georgia Commons Real Property Tax Exemption and Abatement Act." Provides real property tax exemption and abatement to mixed-use residential and retail project.	-$37,000, FY 2008 -$852,000, FY 2008-11 Approved with "subject to appropriations" clause because revenue loss was not offset.

Sources: Council of the District of Columbia's Legislative Information Management System, available at www.dccouncil.us, and fiscal impact statements prepared by the Office of the Chief Financial Officer, available at www.cfo.dc.gov.

Appendix 4.2
D.C. Tax Policy Measures Approved in 2008: Stand-Alone Legislation

Legislation	Projected Fiscal Impact
Bill 17-71, "Low Income Homeownership Cooperative Housing Association Reclarification Act." Implements 10% assessment increase cap for certain low-income housing in tax year 2007.	-$5.6 million, FY 2008 -$22.9 million, FY 2008-11 Approved "subject to appropriations."
Bill 17-86, "Nuisance Properties Abatement Reform and Real Property Classification Amendment Act." Doubles vacant property tax from $5 to $10 per $100 in assessed value.	$8.0 million, FY 2009 $29.6 million, FY 2009-2012
Bill 17-292, "Arthur Capper/Carrollsburg Public Improvements Revenue Bonds Approval Amendment Act." Amends terms of revenue bonds and payments in lieu of taxes, and exempts parcels from real property tax on improvements.	No fiscal impact because properties were previously tax-exempt.
Bill 17-342, "Tregaron Conservancy Tax Exemption and Relief Act." Provides real property and deed tax exemptions for parcels acquired by Tregaron.	-$393,000 in FY 2008 -$982,000, FY 2008-11 Approved "subject to appropriations."
Bill 17-344, "Constitution Square Economic Development Act." Provides real property tax exemption as well as sales tax exemption for construction materials used in project.	$0, FY 2008 -$7.0 million, FY 2008-11 Approved "subject to appropriations."
Bill 17-374, "So Others Might Eat Property Tax Exemption Act." Exempts properties owned and controlled by SOME from real property tax.	-$217,000 in FY 2008 -$826,000, FY 2008-11 Approved "subject to appropriations."
Bill 17-461, "Rhode Island Avenue Metro Plaza Revenue Bonds Approval Act." Provides real property tax exemption and sales tax exemption for construction materials used in project.	-$2.0 million in FY 2008 Approved "subject to appropriations."
Bill 17-464, "East of the River Hospital Revitalization Tax Exemption Amendment Act." Exempts property at Greater Southeast Hospital from real property and deed taxes.	No fiscal impact. Property had not been taxable previously.
Bill 17-587, "St. Martin's Apartments Tax Exemption Act." Provides real property tax exemption as well as sales tax exemption for construction materials used in project.	-$418,000, FY 2009 -$801,000, FY 2009-12 Approved "subject to appropriations."

Appendix 4.2 (p. 2)
D.C. Tax Policy Measures Approved in 2008: Stand-Alone Legislation

Bill 17-591, "Southwest Waterfront Bond Financing Act of 2008." Diverts sales tax revenue from project area to repay debt issued to finance project; firms will close during construction phase.	none in FY 2009 -$12 million, FY 2009-12 Approved "subject to appropriations."
Bill 17-666, "National Public Radio Real Property Tax Exemption Act." Limits annual increases in real property tax on NPR's current headquarters, and freezes tax on NPR's new headquarters.	-$387,000, FY 2009 -$5.1 million, FY 2009-12 Approved "subject to appropriations."
Bill 17-730, "Gateway Market Center and Residences Real Property Tax Exemption Act." Freezes real property tax and allows sales tax exemption for construction materials used.	-$250,000, FY 2009 -$353,000, FY 2009-12 Approved "subject to appropriations."
Bill 17-731, "Bolling Air Force Base Military Housing Real Property Tax Exemption and Equitable Real Property Tax Relief Act." Allows exemption from real property and deed taxes.	No fiscal impact because property had never been taxable.
Bill 17-774, "New Convention Center Hotel Technical Amendments Act." Exempts new convention center hotel from deed taxes.	-$3.7 million, FY 2009 -$3.7 million, FY 2009-12
Bill 17-794, "Asbury United Methodist Church Equitable Real Property Tax Relief Act." Waives real property taxes, interest, and penalties.	-$15,000, FY 2009 Approved "subject to appropriations."
Bill 17-800, "City Market at O Street Tax Increment Financing Act of 2008." Allows sales and property taxes generated from designated TIF area to repay bonds financing mixed-use project.	none in FY 2009 -$3 to -$5 million, FY 2009-12 Approved "subject to appropriations."
Bill 17-809, "Close-Up Foundation Sales Tax Exemption Act." Provides sales tax exemption for purchases made by Foundation.	No fiscal impact because Close-Up never paid sales tax. The legislation blocked an administrative decision to end exemption.
Bill 17-855, "Eckington One Residential Project Economic Development Act." Provides 10-year real property tax abatement.	none in FY 2009 -$75,000, FY 2009-12 Approved "subject to appropriations."
Bill 17-917, "Walker Jones/Northwest One Unity Health Center Tax Abatement Act." Provides clinic with real property tax abatement for leased space.	none in FY 2009 -$755,000, FY 2009-12 Approved "subject to appropriations."

Source: Fiscal impact statements prepared by the Office of the Chief Financial Officer, available at www.cfo.dc.gov.

Appendix 4.3
D.C. Tax Policy Measures Approved in 2009: Stand-Alone Legislation

Legislation	**Projected Fiscal Impact**
Bill 18-21, "Processing Sales Tax Clarification Act." Clarifies that the sales tax exemption for utilities directly used in manufacturing or processing tangible personal property for sale includes natural or artificial gas or electricity directly used in a restaurant.	No fiscal impact
Bill 18-99, "National Law Enforcement Museum Sales and Use Tax Credit Act." Authorizes a 20-year credit against sales and use taxes for the National Law Enforcement Museum.	No fiscal impact Because the project is new, the forgone sales tax revenue was not assumed in the District's revenue estimates.
Bill 18-150, "Anacostia River Clean Up and Protection Act of 2009. Imposes 5¢ fee on use of carryout bags provided by stores selling food or drink and dedicates revenues for cleanup of Anacostia River.	\$3.6 million, FY 2010 \$9.5 million, FY 2010-13
Bill 18-204, "Studio Theatre Housing Property Tax Exemption and Equitable Tax Relief Act." Provides a real property tax exemption, as well as real property and deed recordation tax forgiveness for artist housing.	-\$225,000, FY 2010 -\$298,000 FY 2010-13 Approved "subject to appropriations."
Bill 18-211, "KIPP DC Douglass Property Tax Exemption Act." Provides real property and possessory interest tax exemptions, as well as deed tax exemptions, as long as property is owned by KIPP DC or a subsidiary and used as a public charter school.	No fiscal impact. Property was already tax-exempt. The legislation preserves the exemption if the school is transferred to a subsidiary in order to obtain federal new market tax credits.
Bill 18-222, "Kelsey Gardens Development Project Real Property Limited Tax Abatement Assistance Act." Freezes real property taxes for housing development.	-\$5,000, FY 2010 -\$472,000, FY 2010-13 Approved "subject to appropriations."
Bill 18-299, "Waterfront Park at the Yards Act." Funds public park and other amenities by creating a special assessment district and dedicating sales tax revenues from parcels adjacent to the park.	No fiscal impact. Sales tax revenues would come from sites that were formerly undeveloped land owned by the federal government.
Bill 18-310, "New Convention Center Hotel Amendment Act." Finances new convention center hotel through lease payments from developer, tax-increment bonds, convention center bonds, and additional funds from convention center authority.	No fiscal impact. Pledged funds are sufficient to finance the convention center hotel.

Source: Fiscal impact statements prepared by the Office of the Chief Financial Officer, available at www.cfo.dc.gov.

Appendix 4.4
D.C. Tax Policy Measures Approved in 2010: Stand-Alone Legislation

Legislation	Projected Fiscal Impact
Bill 18-44, "Neighborhood Supermarket Tax Relief Clarification Act." Extends real property tax relief to supermarkets that lease space in certain neighborhoods.	No fiscal impact
Bill 18-45, "Heights on Georgia Avenue Tax Exemption Act." Provides real property tax abatements to mixed-use development.	-$12,000, FY 2010 -$372,000, FY 2010-13 Approved "subject to appropriations."
Bill 18-198, "Allen Chapel A.M.E. Senior Residential Rental Project Property Tax Exemption and Equitable Real Property Tax Relief Act." Provides real property tax exemption and forgiveness for vacant property.	-$128,000 FY 2011 -$327,000, FY 2011-14 Approved "subject to appropriations."
Bill 18-231, "Park Place at Petworth, Highland Park, and Highland Park Phase II Economic Development Act." Grants real property tax exemption for mixed-use project.	-$620,000, FY 2010 -$2.3 million, FY 2010-13 Approved "subject to appropriations."
Bill 18-281, "Affordable Housing Opportunities Residential Rental Project Tax Exemption and Equitable Real Property Tax Relief Act." Provides real property tax exemption and forgiveness for affordable housing developments.	-$66,000, FY 2010 -$384,000, FY 2010-13 Approved "subject to appropriations."
Bill 18-431, "OTO Hotel at Constitution Square Economic Development Act." Grants real property tax exemption and sales tax exemption for materials used in constructing hotel.	-$572,000, FY 2010 -$3.7 million, FY 2010-13 Approved "subject to appropriations."
Bill 18-432, "Third and H Streets, N.E., Economic Development Act." Grants real property tax abatement, sales tax exemption for construction materials, and deed tax exemptions for mixed-use project.	-$685,000, FY 2010 -$5.0 million, FY 2010-13 Approved "subject to appropriations."
Bill 18-456, "Jubilee Housing Residential Rental Project Real Property Tax Relief Act." Provides real property tax exemption for affordable housing project.	-$52,000, FY 2010 -$224,000, FY 2010-13 Approved "subject to appropriations."
Bill 18-476, "High Technology Commercial Real Estate Database and Service Providers Tax Abatement Act." Provides real property tax abatement for property leased and occupied by Costar, if firm meets job-creation and other requirements.	$0, FY 2010 -$2.1 million, FY 2010-13

Appendix 4.4
D.C. Tax Policy Measures Approved in 2010: Stand-Alone Legislation (p. 2)

Bill 18-490, "Campbell Heights Residential Project Real Property Tax Exemption Act." Provides real property tax exemption for affordable housing project.	-$36,000, FY 2010 -$508,000, FY 2010-13 Approved "subject to appropriations."
Bill 18-505, "Wayne Place Senior Living Limited Partnership Real Property Tax Exemption Act." Grants 10-year real property tax exemption for senior citizen housing.	-$58,000, FY 2011 -$238,000, FY 2011-14 Approved "subject to appropriations."
Bill 18-520, "Shirley's Place Equitable Real Property Tax Relief Act." Forgives real property tax for day center for homeless families and families in crisis.	-$7,000, FY 2010 -$7,000, FY 2010-13 Approved "subject to appropriations."
Bill 18-558, "Samuel J. Simmons NCBA Estates No. 1 Limited Partnership Real Property Tax Exemption and Equitable Real Property Tax Relief Act." Provides real property tax exemption for senior citizen housing.	-$138,000, FY 2011 -$588,000, FY 2011-14 Approved "subject to appropriations."
Bill 18-602, "Land Acquisition for Housing Development Opportunities Program Act." Exempts properties leased under Land Acquisition Program from the possessory interest tax, and refunds tax payments.	-$1.3 million, FY 2011 -$2.0 million, FY 2011-14 Approved "subject to appropriations."
Bill 18-619, "UNCF Tax Abatement and Relocation to the District Assistance Act." Provides 10-year real property tax abatement to United Negro College Fund.	$0, FY 2011 -$612,000, FY 2011-14 Approved "subject to appropriations."
Bill 18-628, "2323 Pennsylvania Avenue Southeast Redevelopment Project Real Property Limited Tax Abatement Assistance Act." Provides 10-year real property tax freeze for mixed-use development.	-$88,000, FY 2011 -$371,000, FY 2011-14 Approved "subject to appropriations."
Bill 18-655, "Payment of Full Hotel Taxes by Online Vendors Clarification Act." Requires a room re-marketer to pay hotel tax on the amount paid by guest, rather than the amount the remarketer paid the hotel.	No fiscal impact The prospect of litigation meant that a revenue increase was uncertain.
Bill 18-658, "Job Growth Incentive Act." Authorizes business tax credits for firms that create at least 10 new jobs, pass a "but-for" test, and meet other requirements.	$0, FY 2010 -$1.3 million, FY 2010-13 Approved "subject to appropriations."
Bill 18-669, "SOME, Inc., Technical Amendments Act." Maintains real property tax exemptions as long as properties comply with federal low-income housing tax credit rules.	No fiscal impact

Appendix 4.4
D.C. Tax Policy Measures Approved in 2010: Stand-Alone Legislation (p. 3)

Bill 18-707, "Processing Sales Tax Clarification Act." Provides sales tax exemption for utilities used in producing goods for sale in a restaurant.	-$6.5 million, FY 2011 -$17.3 million, FY 2011-14 Approved "subject to appropriations."
Bill 18-726, "Computation of Gross Income Clarification Act." Makes technical changes regarding exclusions from gross income.	No fiscal impact
Bill 18-749, "King Towers Residential Housing Real Property Tax Exemption Act." Provides real property tax abatement so long as owner complies with terms of federal low-income housing tax credit program.	-$28,000, FY 2010 -$193,000, FY 2010-13 Approved "subject to appropriations."
Bill 18-776, "Thirteenth Church of Christ Real Property Tax Relief and Exemption Act." Provides real property tax exemption and forgiveness for vacant land.	-$454,000, FY 2011 -$454,000, FY 2011-14 Approved "subject to appropriations."
Bill 18-806, "Redevelopment of the Center Leg Freeway (Interstate 395) Act." Authorizes tax exemption and payments in lieu of taxes for developer.	No fiscal impact during financial plan. Revenue losses to the District would not begin until after FY 2014.
Bill 18-828, "800 Kenilworth Avenue Northeast Redevelopment Project Real Property Limited Tax Abatement Assistance Act." Provides real property tax exemption for affordable rental housing complex.	-$134,000, FY 2011 -$585,000, FY 2011-14 Approved "subject to appropriations."
Bill 18-899, "Ballpark Fee Clarification Act." Rebates the ballpark fee to firms that pass through at least 80% of their income to a 501(c)(3) non-profit.	-$50,000, FY 2011 -$50,000, FY 2011-14
Bill 18-970, "H Street, N.E., Retail Priority Area Incentive Act of 2010." Directs tax increment from H Street, N.E., Retail Priority Area into special fund.	No fiscal impact. Use of tax increment financing for area had been previously approved.
Bill 18-1004, "Perry Street Affordable Housing Tax Exemption and Relief Act." Provides real property tax exemption and refund, as well as deed tax refund.	-$104,000, FY 2011 -$104,000, FY 2011-14 Approved "subject to appropriations."
Bill 18-1041, "M Street, N.E., Real Property Tax Abatement Act." Provides 10-year real property tax abatement for mixed-use development.	No fiscal impact during financial plan. Revenue losses begin in FY 2015, outside of the financial plan period.
Bill 18-1076, "West End Parcels Development Omnibus Act." Diverts deed taxes from mixed-use parcels to maintenance fund for library and fire station.	No fiscal impact

Source: Fiscal impact statements prepared by the Office of the Chief Financial Officer, available at www.cfo.dc.gov.

Chapter 5

Maryland Case Study

Contents

> Restoring fiscal responsibility to our state will not be easy. It will require sacrifice and honesty in facing Maryland's challenges. And it will require that we begin – this year – on the structural reforms needed to deal with our structural deficit.
>
> -- Maryland Governor Martin O'Malley, January 18, 2007, press conference on the fiscal year 2008 budget

Summary

The Maryland case study is distinctive because in a 2007 special session of the General Assembly, Governor Martin O'Malley and legislators enacted one of the largest state tax increases in recent years, boosting tax revenues by an estimated $1.3 billion, or 9.3 percent, in the first year of implementation (fiscal year 2009).[168] The 2007 tax

---

[168] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session,"

increase represented an effort to solve Maryland's "structural deficit," a long-term imbalance between spending and revenues resulting from personal income tax cuts approved in 1997, a more generous education funding formula (the "Bridge to Excellence," or "Thornton" plan) enacted in 2002, and other program commitments. By raising the personal income tax on high-income residents; increasing the sales, corporate income, vehicle excise, and cigarette taxes; and authorizing a gross receipts tax on slot-machine facilities, Maryland's 2007 tax package represented the most significant change in the state's tax policy in 40 years, when the state first adopted a graduated personal income tax and aligned its personal and corporate income taxes with federal income tax rules.

This sharp increase in Maryland taxes was possible only due to unusually favorable political circumstances: the return to unified Democratic control of the governor's office and General Assembly in 2007; executive leadership by newly-elected Governor Martin O'Malley; large (more than 2 to 1) margins held by Democrats in both houses of the legislature; and the length of time (three years) until the next statewide elections. Given the narrow margins by which several bills in the 2007 tax package were approved in the General Assembly,[169] it seems almost certain that the package could not have passed without this favorable alignment of political factors.

November 30, 2007, pp. 2, 4, and Department of Budget and Management, *Maryland Budget Highlights: FY 2008* (January 2008, Appendix B.

[169] The 2007 tax package was comprised of five bills. In the Senate, three bills (SB 2, SB 3, and HB 5) passed by only one or two votes more than the required 24-member majority. In the House, one bill (SB 3) received the bare majority (71 votes) needed for passage while SB 4, a constitutional amendment requiring a three-fifths majority, received one more vote than needed for passage. The voting data are available from the Maryland General Assembly's Internet site, www.mgaleg.maryland.gov.

In part because it depended on such a fortuitous set of circumstances, the Maryland tax increase of 2007 reflects how difficult it is for American state governments to enact large tax increases and illustrates the constraints on tax reforms intended to strengthen long-term revenue capacity and make the tax system more progressive. Even before the recession began, the Maryland tax package was not projected to eliminate the state's structural imbalance. In addition, the tax package relied heavily on regressive sales and other consumption taxes despite the governor's effort to shield low- and moderate-income residents from tax increases.

The Maryland experience suggests that large state tax increases may follow a pattern of punctuated equilibrium – serving as rare interruptions in a pattern of stasis or gradual tax-cutting – due to the difficulty of overcoming pervasive anti-tax sentiment in American politics. Even in one of the most liberal states in the country, Maryland's 2007 tax increase was preceded and accompanied by program cuts needed to establish credibility that a tax hike would not lead to wasteful spending. When annual budget gaps of $2 billion or more (almost 15 percent of the state's general-fund budget) returned in fiscal years 2009 through 2011 due to the "Great Recession" that began late in 2007, Maryland policymakers approved only minuscule tax increases. [170] As the Maryland case study shows, a major tax increase requires elected officials to expend a large amount of political capital, which takes time to replenish. In an interview, John Favazza, who served as co-chief of staff to Maryland House Speaker Michael Busch, stated that, "In terms of the (2007-2010 term), we had done the tax thing. We weren't going to go back." As shown in Table 5.1 (see next page), the large tax increase of 2007 was followed by a

[170] In his 2010 State of the State Address, Governor O'Malley stated that his FY 2011 budget would bring total spending cuts to $5.6 billion during his first term. See Office of the Governor, "Governor Martin O'Malley Outlines FY11 Budget, Closes $2 Billion Deficit and Protects Key Priorities," January 19, 2010.

modest tax cut in 2008 (as lawmakers repealed the extension of the sales tax to computer services) and almost no change in tax burdens in 2009 and 2010.

Table 5.1
Impact on Maryland Tax Burden from Statutory Changes, 2007-2010
(dollars in 000s)

Legislative Session	Projected Change in Tax Revenues for Next Fiscal Year	% Change in Tax Revenues for Next Fiscal Year
2007 Regular	$25,371	0.2%
2007 Special	$1,310,000	9.3%
2008 Regular	-$57,355	-0.4%
2009 Regular	-$8,503	-0.1%
2010 Regular	-$14,939	-0.1%

Note: The annual change represents the projected revenue impact of statutory changes in tax policy in the upcoming fiscal year, divided by the budgeted amount of tax revenue in the current fiscal year.

Sources: "Fiscal and Policy Notes" prepared by the Department of Legislative Services, available at www.mgaleg.maryland.gov, and annual *Maryland Budget Highlights* prepared by the Department of Budget and Management, available at www.dbm.maryland.gov.

Evidence Challenges Case Study Propositions. Because Maryland policymakers made the unusual choice of increasing taxes to enhance the long-term revenue capacity of the tax system (rather than increasing taxes to address an immediate fiscal crisis), the Maryland case study challenges some of the seven propositions set forth in Chapter 1 (p. 10). With regard to *setting the agenda and developing alternatives*, Maryland lawmakers introduced and considered a fairly wide range of tax policy bills affecting broad-based taxes (income and sales) as well as excise taxes (alcohol, motor fuel, cigarette). These measures included increases or decreases to tax rates as well as adjustments to the tax base. In *evaluating and selecting tax policy options*, Maryland lawmakers not only took a major political risk in raising income, sales, and excise taxes, but also sought to make the tax system more equitable by making the personal income tax more progressive. As in the District of Columbia, policymakers used parity with neighboring states and national comparisons as a standard for making tax policy decisions (particularly in defending tax increases) even though the comparisons were selective and the concept of parity was somewhat malleable. Political and social welfare objectives were intertwined in Maryland tax policy decisions, so it does not seem fair to say that political acceptability was the predominant consideration for Maryland policymakers.

In terms of *shaping tax policy outcomes*, Maryland officials defied the prevailing national trend by enacting tax increases to attack a long-term structural deficit rather than to respond to an immediate economic and fiscal crisis, but even so the Maryland case reflects the difficulty state lawmakers face in looking beyond short-term concerns. Despite an effort to apply the sales tax to more services in order to enhance the efficiency, equity, and revenue capacity of the Maryland tax system, lawmakers' decision to repeal a tax on computer services in 2008 left the sales tax base unchanged and was not fully offset by other tax increases or spending cuts.

Institutional Capacity. In making tax policy decisions during the case study period, Maryland officials built on solid institutional capacity that helped them identify problems and analyze solutions. The tax increases and spending cuts enacted during the 2007 special session responded to consistent warnings of the state Department of Budget and Management, which forecast a $4 billion structural deficit during the governor's first term (Governor Martin O'Malley, 2007a) and the General Assembly's Department of Legislative Services, which estimated an even larger structural gap of almost $5.8 billion during the same period (Department of Legislative Services, 2006: 9). Acting on these warnings, Governor O'Malley decided to address the budget challenge by calling the special session during his first year in office – a way to put the structural deficit "in the rear-view mirror," in the words of one interviewee, and then focus on other issues. In the terminology of Kingdon's multiple-streams framework, the governor served as the policy entrepreneur who joined the problem and politics streams with a policy solution when he offered his tax plan to resolve the structural deficit prior to the 2007 special session.

Anatomy of Maryland's 2007 Tax Increase. The 2007 tax package reflects the somewhat artificial distinction between incremental and sweeping change. The special session tax package combined several fairly incremental changes – such as 1 percentage-point increases in the sales and vehicle excise tax rates, and a 1.25 percentage-point increase in the corporate income tax – into a large net tax increase that affected most aspects of the Maryland tax system. Table 5.2 (see next page) summarizes the elements of the 2007 tax increase, as proposed by the governor and enacted by the legislature.

Raising most of the major taxes (sales, personal income, corporate income, excise) as part of a large tax increase package made sense from a political standpoint: by spreading and sharing the increased tax burden, policymakers could minimize the opposition from any particular group – as predicted by Hettich and Winer's theory, discussed in Chapter 2 (pp. 58-61). As noted earlier, the 2007 tax package also included several major changes to parts of Maryland's tax system, in addition to incremental changes. First, the personal income tax system became more progressive, with the highest marginal tax rate rising from 4.75 percent to 5.5 percent and the top tax bracket starting at $500,000, rather than $3,000 in taxable income. Second, policymakers

Table 5.2: Maryland's 2007 Special Session Tax Increase, by Type of Tax (dollars in millions)

Tax Policy Changes	Governor (Proposed) Projected Revenue, FY 2008-12	General Assembly (Enacted) Projected Revenue, FY 2008-12
General Sales Tax	**$3,460 (53.8%)**	**$4,234 (63.6%)**
Rate Increase to 6%	$3,290	$3,290
Extend Tax to Certain Services	$247	$895
Tax Holidays	-$77	-$20
Personal Income Tax	**$475 (7.4%)**	**$198 (3.0%)**
Rate Adjustments	$864	$951
Increase Refundable EITC to 25%	-$145	-$160
Double Personal Exemption for Seniors and Blind	-$62	--
$50 Rebate for Low-Income Households	-$182	--
Adjust Personal Exemption According to Income	--	-$592
Corporate Income Tax	**$675 (10.5%)**	**$619 (9.4%)**
Rate Increase	$514	$619
Combined Reporting of Income	$161	--
Other Business Taxes	**$496 (7.7%)**	**$476 (7.3%)**
Video Lottery Terminal (Slots) Tax	$496	$476
Property Taxes	**-$365 (-5.7%)**	**$56 (0.8%)**
Rate Cut of 3¢ per $100 of Assessed Value	-$428	--
Close Controlling-Interest Loophole in Property Transfer Tax	$63	$56
Excise Taxes	**$1,695 (26.3%)**	**$1,014 (15.8%)**
Double Cigarette Tax to $2/Pack	$724	$716
Raise Vehicle Excise Tax to 6%	$701	$701
Allow Trade-In Deduction for Vehicle Excise Tax	--	-$403
Index Motor Fuel Tax	$270	--
Apply 20% Amusement Tax to Electronic Bingo and Tip Jars	--	$23
Projected Revenue Increase, FY 2008-12	**$6,436**	**$6,554**

Sources: Department of Legislative Services, "Fiscal and Policy Note, House Bill 2," October 30, 2007; Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007; and Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly," November 30, 2007.

established a new gross receipts tax on slot-machine gambling. Third, lawmakers doubled the cigarette tax from $1 to $2 per pack, reflecting widespread concern about the health effects of smoking and the relative ease of raising this "sin tax."

Development of Tax Policy Options. The 2007 tax increase package built on years of preparatory work in which officials developed and examined a fairly wide range of tax policy options. In the 2007 regular session of the General Assembly, which served as a "tax policy scrimmage," legislators held hearings on a bill to make the personal income tax more progressive; two bills to increase the sales tax to 6 percent; two bills to expand the sales tax base; two bills to double the cigarette tax; a bill to raise the vehicle excise tax to 6 percent; two bills to increase the motor fuel tax; a bill to establish and tax slot-machine gambling; and a bill to close a loophole in the property transfer tax. In fact, most of these proposals had been introduced and subjected to public hearings in several previous years, reflecting the long-term horizon of tax policy discussions in Maryland and presenting a sharp contrast to D.C.'s short-term focus (see Chapter 4). With the exception of the motor fuel tax increase (which was proposed by the governor but not enacted), these proposals or modified versions of them became part of the tax package enacted during the 2007 special session.

Maryland legislators benefited from strong analytic support in developing and evaluating tax policy alternatives provided by the Department of Legislative Services (DLS), the non-partisan research and policy arm of the General Assembly. DLS prepares a "Fiscal and Policy Note" on every bill which offers in-depth analyses of current law, proposed changes, recent legislation or laws on the same subject, implementation issues, and economic impacts. The fiscal and policy notes on tax legislation also estimate the distributional impacts of major tax changes by income level or geographical area and compare Maryland's tax policies to those of surrounding states. The high-quality staff support provided by DLS helped ensure that tax policy changes were analyzed from a variety of perspectives. Despite some public displeasure over the tax increases, all of the tax policy changes approved during the 2007 special session remained in place except for a hastily-conceived decision to apply the sales tax to computer services, which was not subject to the usual process of public hearings and detailed analysis by DLS.

Roles of Parity and Precedent in Selecting Tax Options. Two factors particularly influenced Maryland lawmakers' evaluation and selection of tax policy options during the case study period: parity with neighboring states and precedent. For the 2007 tax package, Governor O'Malley and the legislature tax rate increases and base-broadening measures that would position Maryland similarly to at least some of its neighbors. This benchmarking was selective but still suggested that Maryland would not be an outlier in its tax policies. In particular, the central role of the sales tax in the 2007 tax package stemmed largely from national and regional comparisons. The governor emphasized that Maryland's sales tax revenues ranked 45th in the nation as a share of personal income and 43rd on a per-capita basis, enabling him to argue that an increase would not be harmful; moreover, raising the rate to 6 percent would leave Maryland on par with Pennsylvania and West Virginia (Governor Martin O'Malley, 2007b). Lawmakers who supported raising the cigarette tax to reduce the health hazards of smoking also used benchmarking to make their case: they pointed out that doubling the tax from $1 to $2 per pack would lift Maryland from the 20th-highest to 4th-highest rate in the nation (House Health and Government Operations Committee, 2007), a ranking that proponents saw as more suitable (D.C. lawmakers used similar arguments to justify their cigarette tax from $1 to $2 per pack in 2008). Benchmarking was also used to defeat some proposals: a major argument against the governor's proposal to require combined reporting of corporate income, which the legislature rejected, was that no surrounding state had adopted it.

In addition, the governor's 2007 tax plan was comprised largely of items that had been previously approved by the House or Senate. The vital role of precedent was also apparent in 2008, when lawmakers repealed the computer services tax. To replace some of the forgone revenue, legislators enacted a three-year personal income tax surcharge on high-income residents, based largely on the experience with an income tax surcharge imposed from 1992 to 1994 that closed a budget gap without causing a major backlash.

By emphasizing both parity and precedent, lawmakers devised tax policies that had met tests of political acceptability in Maryland or other states (or at least were less politically distasteful than the alternatives) while also seeming defensible and fair from a policy standpoint. In particular, comparisons to neighboring states allowed Maryland lawmakers to contend that the policy changes would not harm the state's appeal as a place to live, work, or operate a business. The important roles of parity and precedent also show that officials may structure a politically risky tax increase in as conservative a way as possible, reflecting the difficulty of enacting large tax increases even in liberal states such as Maryland.[171] Tables 5.3 and 5.4 (see next pages) summarize the parity standards and precedents, respectively, which influenced the 2007 tax package, while also highlighting the partial nature of the comparisons that were made.

[171] Although Governor O'Malley won an election rematch in 2010 against his Republican predecessor, Robert Ehrlich, O'Malley's lieutenant governor Anthony Brown was defeated in the 2014 gubernatorial race by Republican Larry Hogan, who assailed tax increases enacted under O'Malley. Hogan's victory reflected the latent power of anti-tax sentiment in Maryland.

Table 5.3
Parity Measures Used to Justify Tax Increases Proposed in 2007 Special Session

Tax Increase	**Parity Standard**
Sales tax increase to 6%	6% rate in Pennsylvania and West Virginia *omits* D.C. (5.75%), Virginia (5%), and Delaware (no sales tax)
Corporate income tax increase to 8% (proposed) and 8.25% (enacted)	9.99% rate in Pennsylvania, 9.975% in D.C., 8.75% in West Virginia, and 8.7% in Delaware *omits* Virginia (6%)
Combined reporting of corporate income (not enacted)	enacted in 21 states, but not in any surrounding states
Gross receipts tax on slot-machine gambling	authorized in Delaware, Pennsylvania, and West Virginia
Cigarette tax increase to $2 per pack	$2 rate would be 4th-highest in nation $1.35 rate in Pennsylvania, $1.15 in Delaware, $1.00 in D.C., $0.55 in West Virginia, and $0.30 in Virginia
Vehicle excise tax increase to 6%	6% - 8% rate in D.C., 6% in Pennsylvania *omits* West Virginia (5%), Delaware (3.25%), and Virginia (3%)
Indexation of motor fuel tax, currently $0.235/gallon (not enacted)	$0.312 rate in Pennsylvania, $0.27 in West Virginia *omits* D.C. ($0.20), Delaware ($0.23), and Virginia ($0.175)
Close controlling-interest loophole in transfer tax	Transfers of controlling interest taxed in D.C., Delaware, Pennsylvania, and Virginia

Sources: Governor Martin O'Malley, "Governor O'Malley Announces Plan to Cut Maryland Property Tax by 3 Cents," September 20, 2007; Governor Martin O'Malley, "Governor O'Malley Announces Plan to Close Corporate Loopholes," September 21, 2007; Governor Martin O'Malley, "Governor O'Malley Announces Plan to Invest in Higher Education and Transportation, September 24, 2007; Department of Legislative Services, "Fiscal and Policy Note: House Bill 2," October 30, 2007, pp. 37, 55-56, 61-62, 66; Department of Legislative Services, "Fiscal and Policy Note: House Bill 3," November 1, 2007, pp. 7-9; House Health and Government Operations Committee, "House Bill 754: Tobacco Tax Fact Sheet," pp. 1-3; Matt Gallagher, Eloise Foster, John Porcari, and Kevin Hughes, testimony on Senate Bill 5/House Bill 5: Transportation Investment Act," before the Senate Budget and Taxation Committee and the House Ways and Means Committee, October 31, 2007, p. 3; Department of Legislative Services, "Fiscal and Policy Note: Senate Bill 5," October 30, 2007, pp. 18-19, 21.

Table 5.4
2007 Special Session Tax Proposals Previously Approved by Maryland House or Senate

Tax Provision	**Previous Action by House or Senate**
More progressive personal income tax structure with new top tax rate for highest-income households	Approved by House in 2004
Sales tax increase to 6%	Approved by House in 2004
Sales tax expansion to property management, tanning, massage, and physical fitness	Approved by House in 2004
EITC increase to 25%	Approved by House in 2004
Gross receipts tax on slot machine gambling –15,000 machines at 5 sites	Approved by Senate in 2005 (15,500 machines at 7 sites) Approved by House in 2005 (9,500 machines at 4 sites)
Increase vehicle excise tax to 6%	Approved by House in 2004
Double cigarette tax to $2 per-pack	Approved by House in 2007
Close controlling-interest loophole in transfer tax	Approved by House in 2002, 2004, 2005, and 2007

Source: Legislative data base of the Maryland General Assembly, found at www.mgaleg.maryland.gov.

Importance of Earmarking. Earmarking tax revenues was also a critical element of the 2007 tax package: 39 percent of the projected revenues (almost $2.6 billion from FY 2008 to 2012) would be dedicated to special funds, a much higher percentage than the share of earmarking (18 percent) of tax revenues in Maryland's FY 2007 budget.[172] The reliance on earmarking helped facilitate enactment of the tax package by highlighting the benefits residents would receive from higher taxes. The Maryland Chamber of

[172] Author's calculation using data from Maryland Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, and Maryland Department of Budget and Management, *FY 2008 Budget Highlights* (January 2007), Appendix B.

Commerce and the Greater Baltimore Committee,[173] for example, supported the vehicle excise tax increase (enacted) and motor fuel tax increase (not enacted) to generate revenue for the Transportation Trust Fund, and both groups called for $200 million more in annual transportation funding than the governor proposed (Maryland Chamber of Commerce, 2007a; Greater Baltimore Committee, 2007a). More than two-thirds of the earmarked tax revenues ($1.8 billion from FY 2008 to 2012) would flow to the Transportation Trust Fund, while the rest of the earmarked revenue would mostly support two new funds: the Education Trust Fund and the Higher Education Investment Fund. When Maryland faced large general-fund deficits during the recession that began in December 2007, many of the earmarking rules were eased to shift revenues to the general fund, suggesting a broader pattern in which lawmakers use earmarks to win approval of tax increases that are later diverted to provide an unrestricted source of funds.

Moderating Role of the Legislature. Although Governor O'Malley played the decisive role in shaping the 2007 tax package by calling the special session and proposing a carefully-balanced package of tax increases, the legislature made important changes to the tax package. The legislature's impact was largely to moderate most aspects of the final bills, scaling back some of the largest tax increases while removing or reducing several "sweeteners" – targeted tax cuts included by the governor. The moderating role of the legislature reflects institutional structure and constraints: the plurality of interests represented in a legislature as well as the number of hurdles that legislation must clear (committee approval, floor votes in each chamber, conference committee) tend to encourage compromise while blurring policy priorities. Thus, the tax package enacted by

[173] The Greater Baltimore Committee, which describes itself as "the region's premier organization of business and civic leaders," addresses issues that affect the competitiveness and quality of life of the Greater Baltimore region. See www.gbc.org.

the General Assembly featured a more modest increase in the top personal income tax rates (a change sought largely by Montgomery County legislators with the highest numbers of wealthy constituents), rejected combined reporting of corporate income (a change sought by large business groups and corporations), left the motor fuel tax unchanged, and diluted the vehicle excise tax increase by allowing a deduction for the value of a trade-in vehicle (a change sought by the Maryland Automobile Dealers Association). The General Assembly recouped some of the forgone revenue by deleting a property tax cut, a sales tax rebate, and an increase in the personal exemption for senior citizens and the blind, reflecting the legislature's tendency to preserve the status quo.

Despite the slightly different roles played by the governor and General Assembly in the special session deliberations, both branches of government sought to balance and spread the pain of higher taxes to make them more tolerable. As shown in Table 5.5 (see next page), the final version of the 2007 tax plan required many groups to pay more while sparing them from a more extreme proposal. In this way, policymakers were able to steer a large tax increase through the legislature while still allowing affected interest groups to claim a victory in preventing an even worse outcome (and allowing policymakers to claim credit for protecting them). In effect, lawmakers sought to calibrate what the political marketplace would bear in terms of higher tax burdens – which meant spreading the burden and, in many cases, moderating initial proposals to make them more palatable.

Computer Services Tax as a Breakdown in the Policy Process. The backlash to the computer services tax enacted in 2007 ironically resulted from a decision that was based almost entirely on a political calculus. To protect Maryland's sales tax base as economic activity shifted from the production of goods to the delivery of services,

Table 5.5
Provisions to Balance or Moderate Tax Burdens in the 2007 Tax Package

Tax Type or Provision	Balancing or Equalizing Measures
Tax Increases	
Personal Income Tax	Proposed top rates of 6 and 6.5 percent are reduced to 5 and 5.5 percent. Lower top rates are slightly offset by phaseout of personal exemption at higher income levels.
Sales Tax	Sales tax increase to 6 percent partly offset for low-income residents by EITC increase to 25%
Corporate Income Tax	Rate increase to 8.25% is balanced by rejection of combined reporting.
Motor Vehicle Taxes	Vehicle excise tax increase to 6% is balanced by rejection of indexation of motor fuel tax Rate increase to 6% partly offset by deduction for trade-in vehicle
Tax Reductions	
Sales Tax	Sales tax rebate is deleted and sales tax holidays delayed to FY 2011
Property Tax	3-cent tax cut is deleted

Governor O'Malley proposed applying the sales tax to property management, health clubs, tanning salons, and massage services – a change that the House had approved in 2004. When the targeted industries mounted vigorous opposition, the Senate Budget and Taxation Committee granted them a reprieve and looked for substitutes from a list of tax-exempt services. In a process similar to a game of musical chairs, legislators floated options that met opposition from a succession of industries and their lobbyists, resulting in a decision by the Senate committee to tax computer services, video arcades, and landscaping. In a hasty decision described by *The Baltimore Sun* as a "bait and switch" (The Baltimore Sun, 2007a), computer services were subjected to the sales tax (the House deleted the taxes on video arcades and landscaping) largely because (1) there was no coordinated political opposition, and (2) legislators wanted another source of business tax revenue to replace the governor's proposal for combined reporting of corporate income. Because computer services had not been included in previous bills to expand the sales tax base, the industry was not organized to fight the proposal. In short, the computer services tax arose from political expediency, cursory analysis, and a need for revenue.

This departure from Maryland's usual process of carefully vetting tax policy options backfired, as computer services firms formed a coalition (the "Tech Council") to fight for repeal of the tax and hired experienced lobbyists to make their case. The arguments that the tax would put Maryland technology firms at a cost disadvantage (none of Maryland's neighbors imposed a similar tax), shift business out of state, and harm the state's ability to generate high-wage jobs in the economy of the future resonated strongly with lawmakers. Although Governor O'Malley, Senate President Miller, and House Speaker Busch initially opposed repeal, each leader changed his position due to intense pressure. The computer services tax was rescinded before it took effect, but the hasty enactment of the tax based on perceived political acceptability had long-term, negative consequences. The forgone revenue was only partly replaced by the three-year income tax surcharge (a 6.25 percent tax rate on residents with taxable income of $1 million or more), a shift of revenues from the Transportation Trust Fund, and additional spending cuts, undermining the effort to resolve the structural deficit and upgrade deteriorating, clogged roads, highways, and bridges. While there was broad agreement that Maryland's sales tax base needed to be expanded to reflect changes in the economy, the failure of the 2007-2008 effort made policymakers reluctant to address the issue in subsequent years.[174]

---

[174] As of this writing in 2015, there had been no change to Maryland's sales tax base after the computer services tax was repealed in 2008.

Theories of Policy Development. The rapid repeal of the computer services tax lends support to James Q. Wilson's framework of policy change and development (see chapter 2, pp. 43-46), which emphasizes the magnitude and concentration of costs and benefits as predictors of policy outcomes. According to Wilson's model, a tax with highly diffused benefits (reducing the structural deficit) and focused costs (affecting one industry, albeit a fairly large one) would be difficult to enact or maintain. When a public hearing on the computer services tax was held in 2008, only the Maryland Budget and Tax Policy Institute and the League of Women Voters spoke in favor of retaining the tax while dozens of business owners and their representatives testified in favor of repeal. As noted by Governor O'Malley's chief legislative officer, Joseph Bryce, "Don't raise the rate, expand to services – everybody says it, but no one does it once it becomes specific."

In addition, Anne Schneider and Helen Ingram's "social construction" framework (see chapter 2, pp. 46-49), which posits that policy outcomes reflect normative or evaluative depictions of target groups, as well as the size and concentration of the benefits and burdens to be distributed, identifies another factor that helps explain the quick reversal on the computer services tax. Advocates of repeal highlighted and reinforced a public image of the technology industry as a source of innovation, economic growth, and high-wage jobs; in other words, owners of computer service firms fall into Schneider and Ingram's category of the "advantaged," who are viewed as deserving tax relief and other benefits because they enhance social welfare. Although lawmakers overlooked the positive associations of the technology industry due to the lack of public input when the tax was first enacted, the repeal campaign that followed made this imagery salient and it became an important factor leading to repeal.

Although the symbolic dimension of the tax policy process influenced the debate on the computer services tax, it was not as decisive as in the District of Columbia debates on the vacant property tax and the “yoga tax” (see chapter 4). The governor’s plan to make the personal income tax more progressive emphasized the need to help “working families,” but the use of images and symbols seemed like standard rhetoric rather than an influential factor in Maryland tax policy decisions from 2007 to 2010. An important reason why is that tax policy debates during this time were generally informed (with the exception of the computer services tax) by public input and detailed policy analysis, shifting the debate away from the symbolic dimension.

Preference for “Sin” and Health Facility Taxes. Maryland policymakers did not focus tax increases on small, peripheral levies to the same extent as D.C. policymakers – indeed, Maryland officials could not do so due to the size of the structural deficit they were trying to close – but they disproportionately emphasized sin taxes on gambling and smoking. As shown in Table 5.6 (see next page), health provider taxes recorded the largest (470 percent) percentage increase in state revenues due to tax policy changes from 2007 to 2010, but gross receipts taxes (which include slot-machine gaming) and tobacco taxes placed second and third, respectively, in percentage increases and also yielded much larger gains in projected tax revenue. Two broad-based taxes, the sales tax and the corporate income tax, were projected to increase by smaller percentages almost exactly equal to the respective rate changes enacted in 2007.

Table 5.6
Largest Projected Annual Change in Selected Maryland Taxes
from Statutory Changes, 2007-2010
(dollars in 000s)

Tax	**FY 2007 Baseline Revenue**	**Net Change In Revenue** (Projected)	**% Change in Revenue** (Projected)
Health Care Provider	$7,026	$33,000	469.7%
Business Gross Receipts (includes slots facilities)	$128,486	$422,000	328.4%
Tobacco	$285,127	$162,000	56.8%
General Sales	$3,485,746	$687,390	19.7%
Corporate Income	$754,605	$137,233	18.2%

Note: The projected revenue change reflects the sum of the revenue effects in the first fiscal year after a tax policy change was enacted, except for business gross receipts, which reflects projected revenues from slot-machine gambling in the fourth fiscal year after enactment due to the delayed implementation of slots.

Source: Author's calculations using data from annual Maryland budget documents published by the Department of Budget and Management and fiscal and policy notes prepared by the Department of Legislative Services, available at www.mgaleg.maryland.gov.

Table 5.7 (next page) depicts a stylized hierarchy of Maryland taxes reflecting the willingness of lawmakers to increase each tax during the study period; the ordering (which reflects a general pattern rather than a fixed ranking) is based on the author's judgment as described below. The health provider tax ranks at the top of the chart because it would generate federal Medicaid matching funds that could then be recycled to providers through higher reimbursements, making it an unusual "win-win;" nevertheless, this tax has a narrow base. The cigarette tax, described by one interviewee as "our favorite sin tax," ranks second. Broader-based taxes – the corporate income, personal income, and real property taxes – stand at the bottom of the hierarchy.

Table 5.7
A General Hierarchy of Taxes in Maryland, 2007-2010
(ranked from most likely to be increased to least likely)

Tax	Rationale for Increasing Tax and Evidence of Its Ranking
Health Provider	Opportunity to claim federal matching funds makes taxes a "win-win." Nursing home assessment was established in 2007 and doubled in 2010 with little opposition.
Cigarette	Public health concerns and negative views of smokers and tobacco industry create support for increases. Tax was doubled in 2007 to $2 per-pack, part of an effort to make Maryland's cigarette tax one of the highest in nation.
Gross Receipts	Authorizing and taxing slot-machine gambling is seen as a way to recover money being spent on gambling in Delaware, Pennsylvania, and West Virginia, and thereby reduce the need for other tax increases. A 67 percent tax on slot machine gambling was enacted in 2007.
Sales	The state sales tax ranked relatively low in national comparisons (45th-highest as % of personal income and 43rd highest on a per-capita basis), as of 2007. The sales tax served as largest revenue source in 2007 tax package.
Corporate Income	Supporters argued that the burden of higher taxes should be shared by individuals and businesses. Although rate was increased, combined reporting of corporate income was not adopted.
Personal Income	Proponents argued that those who had benefited from economic prosperity could afford to pay more. Tax rates were raised for wealthy households and reduced for low- to moderate-income households, particularly by increasing the EITC.
Real Property	There were no proposals to increase this tax during the case study period. Governor O'Malley's proposal to cut the tax in 2007 was not adopted.

Continuous Flow of Targeted Tax Cuts. While the tax package of 2007 and the amendments in 2008 commanded the most public attention and affected almost all Maryland taxpayers, state lawmakers approved several dozen smaller pieces of tax policy legislation during the case study period. As shown in Table 5.8, most of these bills provided small tax cuts that were balanced out by a smaller number of bills that increased taxes. Partly because the property tax in Maryland is primarily a local tax (the state property tax is a small add-on), Maryland's tax policy decisions did not have the strong "micropolitical" focus seen in the District of Columbia, in which individual firms, property owners and small groups receive unique tax benefits that escape public attention due to their narrow scope. Targeted tax cuts were used most often to promote policy objectives related to environmental protection and renewable energy (eight measures enacted during the case study period) and economic development (four measures enacted during the case study period). Military service members and veterans were the demographic group most often targeted for tax relief, benefiting from minor modifications or extensions of existing tax breaks in each of the case study years. These measures enjoyed broad bipartisan support by linking social welfare goals with tax cuts: among the 38 tax-cutting bills enacted in Maryland from 2007 to 2010, 24 were approved unanimously in both houses and 11 were approved unanimously in one house.

Table 5.8
Fiscal Impact of Stand-Alone Tax Policy Measures Enacted in Maryland, 2007-2010
(dollars in 000s)

	2007	**2008**	**2009**	**2010**	**Total**
Bills Projected to Increase Tax Revenues	2	1	1	1	5
Bills Projected to Decrease Tax Revenues	6	15	6	11	38
Bills Projected to Have No Fiscal Impact	1	0	3	2	6
Net Fiscal Impact in Next Fiscal Year	$25,371	$1,735	$8,797	-$31,939	$3,964

Sources: Legislative data base of the Maryland General Assembly and "Fiscal and Policy Notes" prepared by the Department of Legislative Services, found at www.mgaleg.maryland.gov.

Once tax incentives are in place, it is very difficult to uproot them. There was only one attempt to repeal a tax expenditure in Maryland from 2007 to 2010 (the governor's proposal to repeal the tax credit for Maryland-mined coal, which was not enacted),[175] even as annual budget gaps exceeded $2 billion and legislators continued to propose dozens of new tax breaks each year. Thus, tax expenditures represented a subset of tax policymaking in which Maryland officials searched very narrowly for policy options. A similar pattern was apparent in both D.C. and Virginia, where attention focused on only one or two tax expenditures while all others escaped serious scrutiny.

During the case study period, Maryland lawmakers granted 10 extensions of tax credit programs, including four one-year extensions of a credit for firms that hire workers with disabilities. All but one of the extensions was approved unanimously by both houses and the legislative record indicates little evidence that the effectiveness of the credits was reviewed prior to reauthorization, suggesting that tax incentives serve as ways to deliver benefits to constituencies rather than well-tailored means to attain policy goals. Interviewees noted that it is difficult to mobilize opposition to bills that provide targeted tax relief because the benefits of denying the tax break are too diffuse. The only tax-cut bills that were closely contested from 2007 to 2010 involved controversial issues that had sparked interest-group organizing in the past: a bill to provide tax credits to businesses and non-profits supporting private schools (which failed) and two bills to grant domestic partners tax exemptions available to married couples (which passed).[176]

Best-Case Scenario Fails to Address Long-Term Threats to Tax System. Even though Maryland policymakers took the unusual, and difficult, step of raising taxes to

---

[175] Legislators reduced the annual cap on the coal tax credits by 50 percent for four years.

[176] The bills were the "Building Opportunities for All Students and Teachers in Maryland Tax Credit," which was introduced each year in both chambers; SB 597, "Recordation and Transfer Taxes – Exemptions – Domestic Partners" (2008); and SB 785, "Inheritance Tax – Exemption – Domestic Partners" (2009).

ensure that revenues could support long-term spending commitments before a fiscal crisis erupted, the Maryland example highlights the constraints facing state tax systems in light of changes in the economy and society. These are the same challenges other states face: the growing importance of services to the economy, the increasingly free flow of capital across state and national boundaries, and the aging of the population. Even with the rare confluence of favorable political factors described earlier and the motivation to show that Democrats could govern effectively, Maryland lawmakers relaxed their effort to resolve the structural deficit when they repealed the computer tax without replacing all of the forgone revenue. Maryland officials also left an eroding tax base largely unchanged,[177] and approved significant increases in sales and consumption taxes that undermined the goal of a more progressive tax system (over the first five years, 79 percent of estimated new revenues from the 2007 tax package would result from sales or excise taxes).[178] An ambitious attempt to revamp the Maryland tax system to reflect the modern economy and meet the needs of residents well into the future succeeded only partly.

[177] John Mikesell has estimated that Maryland's sales tax base covered only 25.4 percent of state personal income in 2010, below the national median of 34.5 percent in 2010, and down from Maryland's average of 35.3 percent for the 1970 to 2010 period. See John L. Mikesell, "The Disappearing Retail Sales Tax," *State Tax Notes* (63), March 5, 2012, pp. 779-780.

[178] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly," November 30, 2007.

Background

Maryland entered a new phase of Democratic party control in January 2007, when a new governor and members of the General Assembly were sworn in for four-year terms. After frequent battles between Republican governor Robert Ehrlich and a legislature ruled by Democrats during the prior four years, Maryland officials now faced better prospects for reaching consensus on major issues. Democrat Martin O'Malley, the two-term mayor of Baltimore, unseated Ehrlich in the November 2006 elections, claiming 53 percent of the vote. Democrats also strengthened their grip on the General Assembly, maintaining a 33 to 14 advantage over Republicans in the Maryland Senate while picking up six seats in the House of Delegates for a 104 to 37 majority.

Governor O'Malley and the General Assembly would quickly face fiscal challenges. Based on the most recent revenue estimates as well as the expected costs of continuing current services, the Department of Legislative Services in January 2007 projected a budget shortfall of more than $1.4 billion for fiscal year 2008, which would begin on July 1, 2007 (Department of Legislative Services, 2007a: 3). Even though the FY 2007 budget was technically balanced (as is required of all operating budgets in Maryland), that result was attained only by transferring funds from the state's revenue stabilization account and other reserve funds. Ongoing revenues would fall $526 million short of operating costs for FY 2007 (Department of Legislative Services, 2007a: 4). From FY 2008 through FY 2011, expenditures were projected to exceed revenues by as much as $5.8 billion if current policies were continued, a gap that was known as the "structural deficit." (Department of Legislative Services, 2006: 9).

The structural deficit developed largely because lawmakers made long-term spending commitments without providing (and in some cases cutting) the necessary revenues. In 1997, then-Governor Parris Glendening and the General Assembly enacted a 10 percent cut in the personal income tax, which was phased in over five years. In 2002, Governor Glendening and legislators approved the Bridge to Excellence in Public Schools Act, also known as the "Thornton Plan,"[179] which revamped Maryland's school funding formula to channel more state aid to poorer school districts, and those with more poor, limited-English proficient, or special education students.[180] Implementing the Bridge to Excellence law would increase annual funding for state education aid by $1.3 billion between FY 2003 and FY 2008 (Maryland State Department of Education, 2012).

For FY 2008, the General Assembly's Spending Affordability Committee estimated that the $805 million incremental cost of the Bridge to Excellence plan and other statutory mandates for state education aid would exceed projected revenue growth of $580 million for the entire state government (Spending Affordability Committee, 2006: 32, 43). Rising Medicaid expenditures, pension enhancements for teachers and state employees enacted in 2006, and unfunded liabilities for retired workers' health care only added to the fiscal burden. In addition, the governor had pledged to freeze tuition at state colleges and universities, and to increase school construction funding.

Although economic growth had allowed Maryland policymakers to delay addressing the structural deficit, the December 2006 forecast of the Board of Revenue Estimates noted that, "The Maryland economy … has been sluggish over the past several

[179] Dr. Alvin Thornton chaired the Commission on Education Finance, Equity, and Excellence, which issued the recommendations that provided the basis for the Bridge to Excellence in Public Schools Act.

[180] The Bridge to Excellence in Public Schools Act also included accountability measures, allowed school districts more flexibility in using state aid, and mandated full-day kindergarten.

months," signaling the end of a housing boom that had boosted personal income, sales, and estate tax revenue (Board of Revenue Estimates, 2006: i). DLS, the research and analysis arm of the General Assembly, described the fiscal challenge facing Maryland officials in early 2007 as follows:

> By the end of fiscal 2007, nearly all the $1.4 billion general fund cash balance existing at the end of fiscal 2006 will have been utilized to support ongoing spending. After application of the nearly $173 million remaining balance in fiscal 2008, a cash deficit of $413.0 million is estimated. By fiscal 2009, the State will again be facing a cash deficit that is estimated to be approximately $1.6 billion. Given a recent softening of revenues, it appears unlikely that revenue growth will increase at a rate necessary to address these pending fiscal challenges. (Department of Legislative Services, 2006: 5)

It was not clear how Governor O'Malley and the General Assembly would close the budget gap or what role tax policy would play. During the 2006 election, issues such as crime, education, and electricity rates predominated and tax policy was discussed only superficially. To protect himself against charges of being a tax-and-spend liberal,[181] O'Malley assailed his predecessor for raising the state property tax in 2003 and for raising car registration and sewer service fees (Marimow, 2006a; Marimow, 2006b). Although O'Malley did not rule out tax increases, he stated that he would make spending cuts first and adapt his CitiStat accountability program statewide to make the government more efficient (Green, 2006).

State Government Institutions and Budget Roles. Governor O'Malley would exert considerable authority to shape Maryland's budget due to powers conferred on him by

---

[181] Governor Ehrlich had labeled then-Baltimore Mayor O'Malley a "tax and spend" Democrat for raising the city income tax in 2001, increasing water and sewer rates in 2003, and establishing telephone and energy taxes in 2004. See Chris Yakaitis, "Ehrlich Targets O'Malley On Increased Taxes," Capital News Service, October 24, 2006, available at www.newsline.umd.edu.

the state constitution. The governor must submit an annual operating budget request (the "budget bill") to the General Assembly on the third Wednesday in January. With the exceptions of funding for the General Assembly, the courts, and public schools, the legislature may amend the budget only to strike or reduce appropriations; it cannot increase funding levels or transfer money from one line item to another. A guide to Maryland's budget process states that, "The budget process in Maryland is unique in the degree to which the legislature is constrained from increasing or transferring funds within the Executive Branch during consideration of the budget. Lacking the flexibility afforded the U.S. Congress or other state legislatures, the General Assembly may only reduce or restrict funding, operating in an executive-dominated model of budgeting." (Department of Legislative Services, 2010a: 3). The governor may also call a special session of the General Assembly (which cannot exceed 30 days) to consider budget or other matters.

Once the annual budget bill is approved by the Maryland Senate and House of Delegates in identical form, it becomes law immediately; the budget bill is the only bill the governor does not sign or veto. The operating budget proposed by the governor as well as the budget enacted by the General Assembly must be balanced. If statutory changes such as raising revenues, altering funding formulas, or modifying mandates are needed to execute the budget, the governor usually proposes the changes in a Budget Reconciliation and Financing Act (BRFA), which is submitted to the General Assembly along with the budget bill (a BRFA is similar in purpose to a Budget Support Act in the District of Columbia). Legislators can add, strike, or modify provisions, and the governor can veto the BRFA or particular items in the bill. Overriding a veto requires a three-fifths vote of the membership of each house of the General Assembly.

In addition to the governor, three state executive branch officials are elected: the lieutenant governor, attorney general, and comptroller. The Maryland constitution deems the comptroller responsible for the "general superintendence of the fiscal affairs of the state,"[182] which entails collecting taxes, maintaining the general ledger, controlling appropriations, and managing the state government payroll. The comptroller serves on two important state panels, the Board of Public Works (BPW) and the Board of Revenue Estimates (BRE). BPW, comprised of the governor, comptroller, and state treasurer, is powerful because it approves most state contracts, loans, capital allotments, and sales, leases or transfers of real property; the Board also makes spending cuts needed to balance the budget when the legislature is not in session. BRE, comprised of the comptroller, state treasurer, and the head of the Department of Budget and Management, forecasts the state's revenues in the current and next fiscal year, monitors the state economy, and projects the fiscal impact of proposed changes to Maryland tax laws.

In contrast to the executive branch, leadership of the Maryland General Assembly remained stable at the start of 2007. Thomas V. "Mike" Miller served as president of the 47-member Senate, a position he had held since 1987. Miller was not only the longest-serving Senate President in Maryland history, but also had the longest tenure of any state senate leader then in office nationwide (Department of Legislative Services, 2007b). Michael Busch remained speaker of the 141-member House of Delegates, a position he assumed in 2003. The Budget and Taxation Committee considers all budget matters in the Senate, while the Appropriations Committee and the Ways and Means Committee

[182] See Article VI, Section 2 of the Constitution of Maryland.

divide budget duties in the House (the Appropriations Committee reviews expenditures and the Ways and Means Committee oversees taxes).

Between the annual 90-day legislative sessions (the "legislative interim"), legislators meet in committees, task forces, and other forums to study policy issues, oversee the budget, review regulations proposed by state agencies, and draft legislation. The General Assembly receives support from the Department of Legislative Services (DLS), a non-partisan, central staff agency that conducts fiscal and policy analysis, performs audits, drafts legislation, assists standing and other committees, operates the legislative information system, and provides library services.

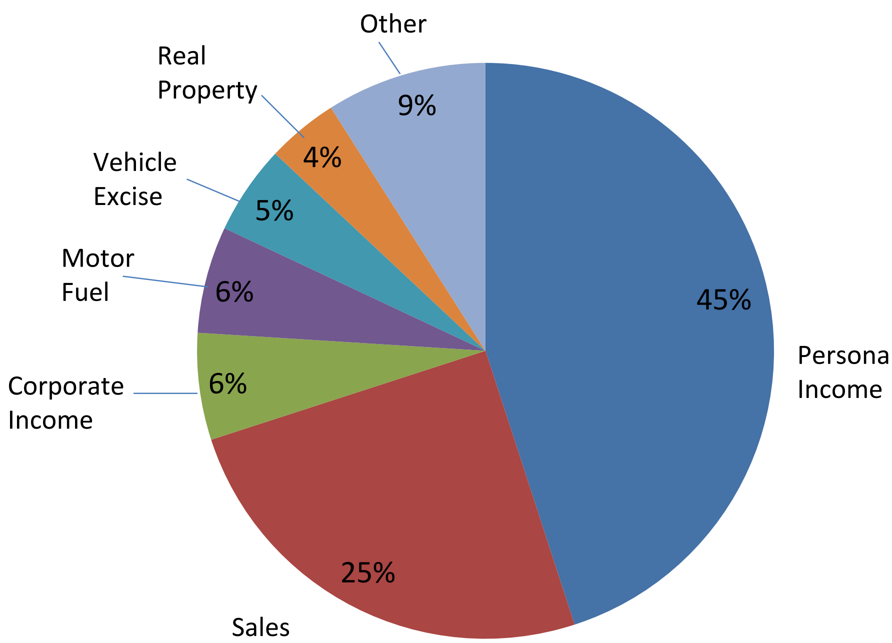
Components of Maryland's Tax System. Maryland's tax system is fairly diversified, although the state relies more on personal income tax revenue than most other states (NCSL, 2008b). In FY 2006, tax revenue totaled $13.7 billion, just more than half of Maryland's $27.1 billion in total revenue. The bulk of the tax revenue ($11.1 billion) flowed into the state's general fund, the main operating fund that can be used flexibly to support government programs. The rest of the tax revenue ($2.5 billion) flowed into special funds, the largest of which is the Transportation Trust Fund. [183]

As depicted in Figure 5.1 (see next page), the personal income tax ($6.2 billion) was the largest source of tax revenue in FY 2006, providing 45 percent of total tax revenue, followed by the general sales tax ($3.4 million, or 25 percent). Maryland received smaller sums of revenue from the corporate income tax ($820 million, or 6 percent); motor vehicle fuel tax ($758 million, or 6 percent); motor vehicle excise tax

[183] Author's calculations using data provided in Comptroller of Maryland, *Comprehensive Annual Financial Report: Fiscal Year Ended June 30, 2006* (November 2006), p. 134, and Maryland Board of Revenue Estimates, *Report on Estimated Maryland Revenues: Fiscal Years Ending June 30, 2007 and June 30, 2008* (December 2006), pp. 22-47.

($719 million, or 5 percent); real property tax ($575 million, or 4 percent); insurance premiums tax ($275 million, or 2 percent); cigarette tax ($272 million, or 2 percent); property transfer tax ($270 million, or 2 percent); and miscellaneous other taxes.

Figure 5.1
Maryland Tax Revenue by Source, FY 2006



Source: Author's calculations using data from Maryland Board of Revenue Estimates, *Report on Estimated Maryland Revenues: Fiscal Years Ending June 30, 2007 and June 30, 2008*, pp. 22-23, and Comptroller of Maryland, *Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2006*, p. 134.

Maryland also has an add-on, or "piggyback" local income tax with rates that ranged in 2007 from 1.25 to 3.2 percent, the maximum local rate (Comptroller of Maryland, 2012). The local income tax revenue is not included in the revenue totals listed above. Maryland localities cannot impose a general sales tax, but some localities are authorized to levy selective sales taxes on utilities, hotel rooms, and parking.

Most revenues from the motor vehicle fuel tax, the motor vehicle excise tax, and motor vehicle fees, as well as a portion (approximately 25 percent) of corporate income tax revenues, were dedicated to the Transportation Trust Fund at the outset of the case study period. In addition, real property tax revenues were used exclusively to pay debt service on the state's general obligation bonds, while the property transfer tax was used to finance the preservation of open space. Maryland law grants the Board of Public Works the authority to set the state's real property tax rate.

As of early 2007, Maryland maintained a tax system that had been designed for a prior era. Maryland's personal income tax rates, which reached a top rate of 4.75 percent at $3,000 of taxable income, had been modified only slightly since a graduated tax system was first adopted in 1967, and the tax brackets had not changed at all (Department of Legislative Services, 2007c: 6-10). Due to income growth and inflation, the graduated income tax structure was now very flat. Maryland's sales tax, instituted when the sale of goods was predominant, generated little revenue from the growing service economy. The only services taxed were cellular telephone and other mobile telecommunications, custom telephone, credit reporting, pay-per-view television, security, and cleaning services.

In an analysis of Maryland's state and local government tax burden released in December 2006, DLS noted that:

> [C]ompared to other states, total state and local government revenues collected in Maryland are generally not high. Maryland ranks eighteenth highest in total State and local government revenues when measured on a per capita income basis and near the lowest, forty-eighth, in revenues collected as a percentage of total personal income of residents. Maryland relies more than most states on taxes and less on nontax sources of revenue when measured both on a per capita basis and a percentage of personal income basis. (Department of Legislative Services, 2006: 27)

Although local taxes are not within the scope of this study, the combined state-local tax burden may affect state officials' decisions to increase or decrease certain taxes.

DLS found that Maryland's combined personal income tax burden was relatively high (3rd-highest in the nation as a percentage of personal income and on a per-capita basis). Maryland's corporate income tax (imposed only at the state level) fell closer to the national average, ranking 31st as a percentage of personal income and 16th on a per-capita basis. Maryland's sales and excise taxes (predominantly levied by the state) were relatively low, ranking 45th in the nation as a percentage of personal income and 43rd on a per-capita basis (Department of Legislative Services, 2006: 29-30).

Table 5.9 (beginning on the next page) shows the taxes levied by the State of Maryland in early 2007, along with their rates and actual revenue for FY 2006 (the most recent actual data available at the start of the study period).

Table 5.9
Maryland State Taxes at the Start of the Case Study Period (2007)

Tax and FY 2006 Actual Revenue (000s)	**Rates**
Personal Income Tax Personal Income ($6,200,194) – taxable income is based on federal adjusted gross income and then modified for Maryland deductions, exemptions, credits, and add-backs.	first $1,000 in taxable income: 2.0% second $1,000 in taxable income: 3.0% third $1,000 in taxable income: 4.0% over $3,000 in taxable income: 4.75% non-resident income: 1.25%
Sales and Excise Taxes General Sales ($3,355,168) – sales of tangible property and selected services are taxable. Groceries, prescription drugs, non-prescription drugs, and residential utility sales are among the exempt items. Rental of Motor Vehicles ($26,527) – tax is imposed on the rental of motor vehicles for 180 days or less. Tobacco ($280,306) – tax is imposed on the sale of cigarettes, cigars, pipe tobacco, chewing tobacco, and snuff at the wholesale level. Alcoholic Beverages ($27,953) – tax is imposed on wholesalers, manufacturers, or brewers of alcoholic beverages.	General: 5.0% Trucks: 8.0% Passenger vehicles: 11.5% $1.00 per pack of 20 cigarettes 15% of wholesale price of cigars, pipe tobacco, chewing tobacco, and snuff Beer: 9¢ per gallon Wine: 40¢ per gallon Distilled Spirits: $1.50 per gallon

Table 5.9 (p. 2)
Maryland State Taxes at the Start of the Case Study Period (2007)

Sales and Excise Taxes (cont.)	
Motor Fuel ($757,900) – gasoline and other fuels used by motor vehicles are taxable. The revenue is dedicated to the Transportation Trust Fund.	23.5¢ per gallon of gasoline 24.25¢ per gallon for special fuels such as diesel and kerosene 7¢ per gallon for aviation fuel
Motor Vehicle Excise ($719,206) – every issuance of title (including re-sale) for a motor vehicle or trailer is taxable.	5.0% of fair market value
Business Taxes	
Corporate Income ($820,031) – tax is based on federal taxable business income and modified for Maryland additions and subtractions, as well as an apportionment factor to compute the amount of income allocated to Maryland.	7.0% of taxable income
Insurance Premium Tax ($274,901) – tax is based on premiums derived from insurance business conducted in Maryland.	2.0% of premiums for authorized insurers, including HMOs 3.0% of premiums for unauthorized insurers
Public Service Company Franchise Tax ($125,154) – tax is imposed on electric utilities, gas utilities, and telephone companies.	electric: .062¢ per kilowatt-hour plus 2.0% tax on cost of distribution gas: .402¢ per therm of natural gas plus 2.0% tax on cost of distribution telephone: 2.0% of gross receipts

Table 5.9 (p. 3)
Maryland State Taxes at the Start of the Case Study Period (2007)

<u>Real Property Tax</u> Real Property ($575,131) – residential and business property is taxable, unless expressly exempted. Blanket exemptions include property owned by the federal government, foreign countries, churches, and non-profit school, hospital, and charitable organizations. Real property is assessed every three years and increases in value are phased in over three years after the appraisal. The revenue is dedicated to debt service on state general obligation bonds.	 11.2 cents per $100 of assessed value
<u>Other Taxes</u> Property Transfer ($269,995) – the transfer of property is taxable at the time a deed is recorded. The revenue is dedicated to land preservation programs. Estate ($171,503) – tax is imposed on the estate of decedents who at the time of death were Maryland residents, or who held an interest in real or personal property located in Maryland. Estates valued at $1 million or less and property that is bequeathed to a surviving spouse are exempt. Inheritance ($50,406) – tax is imposed on the receipt of bequeathed property that is located in Maryland. Estates of $30,000 or less, as well as property passing among family members, are exempt.	 0.5% of consideration paid for real property, except for first-time homebuyers in Maryland who are charged 0.25%. Tax liability is based on the rate schedule formerly used by the federal government to determine the state credit against federal estate tax liability, and is capped at 16% of the amount by which the value of the estate exceeds $1 million. 10.0%

<u>Sources</u>: Maryland Board of Revenue Estimates, *Report on Estimated Maryland Revenues: Fiscal Years Ending June 30, 2007 and June 30, 2008*; Department of Legislative Services, *Tax Guide 2006*; and Comptroller of Maryland, *Consolidated Revenue Report: Fiscal Year 2007*.

Tax Policy Decisions During the 2007 Regular Session

FY 2008 Budget Process. One day after taking the oath of office, Governor O'Malley proposed a $30.0 billion FY 2008 state operating budget that included no major changes in tax policy even as he warned of "annual deficits in the $1 billion range for the foreseeable future." (Department of Budget and Management, 2007).[184] The governor emphasized spending restraint, stating that, "The FY 2008 budget grows by only 2.5% over the current year, a lower rate of growth than in nine of the last 10 budgets." (Department of Budget and Management, 2007). He also pledged to make state government more accountable and efficient by introducing StateStat, a performance tracking system requiring frequent reports on key measures and detailed reviews with top officials to implement program improvements and cost savings.

Despite the governor's claim to fiscal responsibility and transparency, his FY 2008 budget delayed most of the difficult choices facing the state government. The governor proposed large funding increases for high-priority programs, most notably a $680 million, or 15 percent, increase for public education (the largest in the state's history). He also sought a $123 million increase (27 percent) for teacher pensions, a $38 million increase (18 percent) for community colleges, and "full funding" for open space preservation, while setting aside $16 million to freeze undergraduate tuition at state colleges and universities (Department of Budget and Management, 2007: 8-9, 18; Department of Legislative Services, 2007a: 13-14; Governor Martin O'Malley, 2007c). The governor balanced the budget partly by shifting $995 million from reserve accounts

[184] Governor O'Malley proposed a modest change in tax policy: creating a 2 percent "quality assessment" on nursing homes with more than 45 beds. Funds generated by the assessment would be used to generate matching federal Medicaid dollars to raise reimbursements for nursing homes serving Medicaid recipients.

and by spending only $263 million to replenish those accounts (Department of Budget and Management, 2007: 6-7). At the end of FY 2008, the state's revenue stabilization account would fall to its statutory minimum, preventing officials from tapping that revenue source the next year (Department of Legislative Services, 2007a: 57).

The Department of Legislative Services reported that the governor's FY 2008 budget cut spending by only $152 million, and that only $80 million of the spending cut would be ongoing (Department of Legislative Services, 2007a: 3). After removing reserve fund transfers and FY 2007 deficiency appropriations (which inflate the budget denominator), DLS estimated that overall growth in the governor's FY 2008 budget totaled 5.7 percent, and that general fund growth equaled 8.8 percent (Department of Legislative Services, 2007a: 18). *The Baltimore Sun* opined that the governor's budget "simply means the day of reckoning for the state's finances has been postponed for 12 months." (The Baltimore Sun, 2007b). Because most legislators shared Governor O'Malley's priorities[185] and the state constitution limits the legislature's power to shift or increase appropriations, the governor's budget fared well in the General Assembly, which approved an FY 2008 budget that trimmed $228.6 million from the governor's request (Department of Legislative Services, 2007d: 6-7).

Tax Policy Legislation Considered in 2007. Legislators largely followed Governor O'Malley's direction in seeking to reduce waste and inefficiency in state government before seeking higher taxes, while also trying to build consensus on a long-term budget solution (Smitherman and Green, 2007; Green, 2007a). Thus, the 2007

[185] The General Assembly's report on the final FY 2008 budget bill echoed the priorities cited by Governor O'Malley when he released his budget, such as increasing education aid by almost $700 million; raising community college funding by 18 percent; and expanding access to health care. See Maryland General Assembly, "Conference Committee Report on House Bill 50 – the Budget Bill," dated April 9, 2007.

regular session served, in effect, as a tax policy scrimmage. Legislators floated tax policy options and tested the level of support without enacting major changes. In fact, only three tax policy measures enacted during the session would have even a modest impact, defined as a revenue effect of at least $10 million in any year from FY 2008 to FY 2012. Despite the deadlock, both chambers were starting negotiations on a broader tax package which would take shape in a special session later in the year, as discussed in the next segment of this chapter.

Among significant pieces of tax policy legislation (involving an annual change of $100 million or more in revenue), a cigarette tax increase moved closest to enactment during the 2007 regular session. HB 754 would double the cigarette tax from $1 to $2 per pack, raising $219.9 million in FY 2008 to expand eligibility for Medicaid and the Maryland Children's Health Programs (Department of Legislative Services, 2007e). HB 754 sailed through the House on a 102-37 vote, but then stalled due to the opposition of Senate President Miller, who insisted that new revenues be reserved to reduce the structural deficit rather than to start or expand programs (Smitherman, 2007a)[186] and directed his caucus not to approve legislation that would cost more than $250,000 per year (Skalka, 2007). Delegate Sheila Hixson, the chairman of the House Ways and Means Committee, stated in an interview that, "Politically, Mike Miller didn't want to raise taxes." Ms. Hixson added that the House supported HB 754 because of the "health reasons … That was the turn-on in the House."

[186] In describing the legislation as "fiscally irresponsible," Senator Miller likened the bill to "building an addition on your house when you can't even pay your mortgage." See Laura Smitherman, "Health Care Bill Passes in House; Proposal Faces Opposition by Senate Leaders Who Don't Want to Fund It with Tobacco Tax," *The Baltimore Sun*, March 17, 2007, p. 1.B.

Senator Miller was consistent in his efforts to block a piecemeal approach to tax policy. In late February, he introduced legislation (SB 950) to authorize slot machine gambling, a key initiative of former governor Ehrlich that had been supported by the Senate but opposed in the House (Montgomery and Whitlock, 2004).[187] Senator Richard Madaleno, a member of the Budget and Taxation Committee, described the Senate President's action as a signal that, "No revenue package is going to pass without slots."[188] Although some regard gambling revenues as a form of non-tax revenue, the slot-machine proposals in Maryland are treated as tax measures in this dissertation because they would transfer a share of gross receipts from a private, regulated business activity to the state.

A more modest bill to broaden the base of the state transfer tax and local recordation tax also got caught in the House-Senate stalemate. HB 475 would apply both taxes to the transfer of property worth $1 million or more effected through a sale of a "controlling interest" in a corporation or other business. Many developers had avoided transfer and recordation taxes by acquiring most or all of a limited liability company (the controlling interest) with no other major assets but the property, rather than directly purchasing the property. By closing this loophole, HB 475 would generate $14 million annually for the state, as well as $48 million annually for localities (Department of Legislative Services, 2007f). HB 475 cleared the House on a 101-35 vote. Senator Ulysses Currie (D-Prince George's), chairman of the Budget and Taxation Committee, introduced similar legislation (SB 616) but did not take further action, stating that, "I

[187] The House approved a scaled-down slots bill in 2005 after rejecting slots legislation in 2003 and 2004.

[188] Senator Ulysses Currie, chairman of the Budget and Taxation Committee, echoed that view in telling *The Baltimore Sun* that, "In the Senate, there is a feeling that slots has to be a part of the package … we realize with a billion-and-a-half structural deficit, slots has to be part of the solution." See Laura Smitherman and Andrew A. Green, "Tax Increase Discussions Under Way; New Revenue Would Fund Priorities, Close Budget Gap," *The Baltimore Sun*, February 27, 2007, p .1.B.

think we might want to wait and consider it next year as part of a large fiscal package, rather than piece by piece." (Harris, 2007).

During the 2007 regular session, Maryland legislators introduced one bill to make the personal income tax more progressive and generate more revenue (HB 1420) while also introducing four bills to expand the general sales tax. Two of the sales tax bills would raise the tax rate from 5 percent to 6 percent: HB 393 would dedicate half of the new revenue to mass transit funding, while HB 846 would earmark all of the new revenue for an Education Trust Fund. The other two bills would expand the sales tax base: HB 448 targeted a wider range of services, including engineering, temporary staffing, and management consulting, whereas HB 1022 covered a smaller number of specialized sectors such as tanning salons and home moving.

Although these bills did not move beyond a public hearing and all were introduced in the House, they still served as possible foundations of a plan to address the structural deficit. Both bills raising the sales tax to 6 percent would generate more than $700 million annually, closing half of the structural deficit (Department of Legislative Services, 2007g and 2007h). House Ways and Means Chairman Hixson (who sponsored HB 393 and HB 448) acknowledged in an interview that she introduced the bills to test support for a sales tax increase and expansion, stating that, "We'd go out there to find where the votes were. The idea is which one would sell the best. It's dealing with the art of the possible."

Finally, legislators in both houses proposed tax increases to support transportation programs. These bills were as follows:

- SB 949, introduced by Senator Miller, would raise the motor fuel tax from 23.5¢ to 35.5¢ cents per gallon, generating an estimated $406.7 million for the

Transportation Trust Fund (TTF) in 2008 (Department of Legislative Services, 2007i);

- HB 821, introduced by Delegate Hixson, would increase the motor fuel tax from 23.5¢ to 33.5¢ per gallon and also apply the general sales tax to motor fuel, generating an estimated $773.9 million for the TTF in FY 2008 (Department of Legislative Services, 2007j); and

- HB 761, introduced by Delegate Hixson, would raise the motor vehicle excise tax from 5 percent to 6 percent, generating an estimated $145 million for the TTF in FY 2008 (Department of Legislative Services, 2007k).

Although none of the transportation funding bills advanced beyond a public hearing, the governor expressed willingness to consider a motor fuel tax increase without endorsing a specific bill (Green, 2007b). The Greater Baltimore Committee and the Greater Washington Board of Trade endorsed Senator Miller's bill, while the Maryland Chamber of Commerce backed a 5-cent increase (Green, 2007c, Green, 2007d).

Tax-cut proposals did not advance due to concern about the structural deficit. SB 526, which would increase Maryland's refundable earned income tax credit (EITC) from 20 to 25 percent of the federal EITC, and SB 182, which would raise the estate tax threshold to $2 million in FY 2008 and to $3.5 million in FY 2009 and 2010, were reported unfavorably by the Budget and Taxation Committee. Companion bills in the House did not receive any committee action.

A review of the General Assembly's legislative data base identified nine tax policy measures that were enacted during the 2007 regular session. The only three bills projected to have a modest revenue impact ($10 million or more annually) were (1) SB 101, "Nursing Facilities – Quality Assessment – Medicaid Reimbursement," (2) HB 1257/SB 945, "Income Tax – Captive Real Estate Investment Trusts," and (3) HB 598, "Maryland Heritage Structure Rehabilitation Tax Credit Program." As shown in

Appendix 5.1 at the end of this chapter, the other six other tax policy laws were even smaller in scope, extending tax incentives that were already in place or making slight changes in eligibility for tax credits and deductions.

SB 101, which would impose an assessment of up to 2 percent of net operating revenues on freestanding nursing facilities with 45 or more beds, was the only tax policy change included in Governor O'Malley's FY 2008 budget. SB 101 easily gained approval (41-6 in the Senate and 137-0 in the House), because the assessment would not only raise an estimated $16.0 million in FY 2008 and $111.1 million from FY 2008-2012, but also generate the same amount in matching federal Medicaid funds. The new revenue would in turn be used to increase Medicaid reimbursement rates for nursing facility providers (Department of Legislative Services, 2007l), winning the support of many of the organizations that would be taxed.

HB 1257 and SB 945 (which were identical) also commanded nearly unanimous support[189] as a way to close a corporate tax loophole created by the use of captive real estate investment trusts (REITs), which are owned or controlled by a single organization. Some corporations had evaded taxes by forming a captive REIT to own their real property and then paying rent to the captive, which could then be deducted as a business expense. Because REITs are exempt from corporate income tax on dividends paid to shareholders, the captive REIT could then pay the dividends to another subsidiary located in a state that did not tax the dividends, completing the shell game. HB 1257 and SB 945 closed the loophole by denying captive REITs the deduction for dividends paid on the

[189] HB 1257 passed the House on a 137-0 vote and the Senate on a 42-5 vote. SB 945 passed the Senate on a 44-3 vote and the House on a 139-0 vote.

corporate income tax, thereby increasing projected revenues by $10 million in FY 2008 and $53.3 million from FY 2008-2012 (Department of Legislative Services, 2007m).

The enactment of the captive REIT legislation while most other significant tax policy bills failed in the 2007 regular session illustrates how a focusing event can break a policy stalemate. Individuals interviewed for the dissertation emphasized that a February 1, 2007, article in *The Wall Street Journal* highlighting Wal-Mart's use of the captive REIT loophole to avoid $230 million in state taxes from 2000 to 2003 (Drucker, 2007) stirred outrage and impelled Maryland lawmakers to take action. Warren Deschenaux, the director of policy analysis for the Department of Legislative Services, noted that, "Wal-Mart is a dirty word in liberal circles," reflecting disdain that hardened during a legal battle over a Maryland health insurance law that targeted Wal-Mart in 2005.[190] The *Wall Street Journal* article made the problem of the captive REIT loophole salient, and the negative image of Wal-Mart made the policy solution – denying the deduction for dividends paid – politically appealing. The captive REIT evasion seemed so brazen that the Maryland Chamber of Commerce did not oppose the legislation.[191] As a result, interviewees stated, enactment of the legislation was not controversial.

Finally, both houses of the General Assembly voted unanimously to extend the Maryland Heritage Structure Rehabilitation Tax Credit Program for FY 2009 and

[190] Maryland legislators had enacted legislation, overriding Governor Ehrlich's veto, which required large companies to spend a minimum amount on employee health benefits. Wal-Mart was the only employer that would have been affected. In 2006, the law was struck down in a U.S. District Court ruling.

[191] Specifically, the Chamber stated that it would support SB 945 with certain amendments. See Maryland Chamber of Commerce, "Legislative Position: SB 945," dated March 20, 2007.

2010.[192] DLS estimated that extending the program would cost the state $29.1 million in FY 2009 and $29.2 million in FY 2010 (Department of Legislative Services, 2007n).

Overall, the tax policy changes enacted during the 2007 regular session were minor, projected to raise FY 2008 tax revenues by $25.4 million, or 0.2 percent,[193] due to the nursing home quality assessment and the captive REIT legislation. Most (six) of the nine tax policy laws enacted were projected to reduce revenue, but the costs were usually small, and all of the revenue-reducing bills sailed through the legislature – four with unanimous votes in both chambers, and two with a unanimous vote in one chamber.

Despite the lack of major tax policy changes, the 2007 session represented a first step in linking policy solutions to the widely-recognized problem of Maryland's structural deficit. To use Kingdon's terminology, Maryland lawmakers were adding ingredients to the "policy primeval soup" – the proposals that circulate among the policy community and are later sifted for policy solutions based on their political feasibility, technical feasibility, and resource requirements. In a special session held in the fall of 2007, the soup would rise from a slow simmer to a full boil.

As summarized in Table 5.10 (see next page), Maryland lawmakers reviewed a broad range of tax policy options during the 2007 regular session, which calls into question the study proposition (#2) that state officials will usually perform a limited search for tax policy options, focusing on modest adjustments to current taxes. The options included increases to both of Maryland's two largest taxes (the personal income

---

[192] The credit was equal to 20 percent of qualified expenditures incurred in renovating a certified historic structure, with a maximum of $50,000 for a residential project and $3 million for a commercial project.

[193] Author's calculation based on fiscal and policy notes prepared by the Department of Legislative Services (available at www.mgaleg.maryland.gov) and Department of Budget and Management, *Maryland Budget Highlights: FY 2008* (January 2007), Appendix B.

Table 5.10
Tax Policy Options Considered in the 2007 Regular Session
of the Maryland General Assembly

Tax	Tax Increase Bills	Tax Cut Bills
Personal and Corporate Income		HB 598 – extend heritage structure tax credits ENACTED SB 67 – provide credits to businesses that voluntarily ban smoking
Personal Income	HB 1420 – widen tax brackets and create new top 6% bracket	HB 223/ SB 526 – increase earned income tax credit to 25% of federal EITC
General Sales	HB 393 – increase rate to 6%; dedicate half of increase to mass transit HB 448 – tax broad range of services HB 846 – increase rate to 6% and dedicate new revenues to education HB 1022 – tax selected services	
Corporate Income	HB 1257/SB 945 – close captive REIT loophole ENACTED	
Excise	HB 288/SB 207 – double cigarette tax to support health care programs HB 754 – double cigarette tax to expand access to health insurance HB 761 – raise vehicle excise tax to 6% HB 821 – raise gas tax to 33.5¢/ gallon SB 949 – raise gas tax to 35.5¢/ gallon	
Other	HB 475/SB 616 – eliminate controlling-interest loophole in transfer tax HB 130/SB 101 – allow 2% assessment on nursing homes ENACTED SB 950 – authorize video lottery gambling at seven sites	HB 73 – raise estate tax threshold to $2 million SB 182 – raise estate tax threshold to federal level

Note: only bills with a first-year revenue impact of $10 million or more are included.
Source: Legislative data base of the Maryland General Assembly, found at www.mgaleg.maryland.gov.

tax and the sales tax) as well as gross receipts and excise taxes; base-broadening measures (captive REIT, controlling-interest, and sales taxation of services bills), and tax cuts (estate tax, EITC expansion). The contrast to the neighboring District of Columbia is striking; as shown in Chapter 4, D.C. policymakers rarely introduced legislation to increase taxes or broaden the tax base, instead crafting legislation on the "floor" of the council (the Committee of the Whole) without public hearings.

One factor was the size of the General Assembly: Maryland's 188 legislators would almost inevitably generate more tax policy options than the 13-member D.C. Council, for example. Another factor was leadership: House Ways and Means Chairman Hixson was willing to introduce and hold hearings on tax increase bills that many elected officials would find politically perilous; as shown in Table 5.10, more of these proposals originated in the House than in the Senate.

As the regular session ended, Maryland officials promised to resolve the structural deficit that persisted. Governor O'Malley vowed to "go about the business of finding cost savings and making our state government work" while "working with both houses to develop a comprehensive solution to the state's structural deficit." (Skalka, 2007). Senate President Miller stated that decisions would have to be made about state revenue, adding, "That's a nice word for taxes." (Smith, 2007). Senator Currie, the Budget and Taxation Committee chairman, concluded that, "This year is just a sideshow, compared to what we have before us." (Green, 2007e).

Tax Policy Decisions During the 2007 Special Session

Maryland policymakers kept their promises to address the structural deficit, enacting a major deficit-reduction package in a special session of the General Assembly called by Governor O'Malley in the fall of 2007. As a shaky economy threatened to worsen the structural deficit, the governor proposed a package of tax increases after making additional spending cuts to show his commitment to use state tax dollars wisely.

In early May, Governor O'Malley directed his cabinet to reduce spending by at least $200 million as a first step in closing the $1.4 billion deficit projected for FY 2009 (Governor Martin O'Malley, 2007d), which resulted in approval of $213 million in general-fund cuts by the Board of Public Works in July.[194] One month later, the governor told the summer conference of the Maryland Association of Counties that, "The hard truth is that we can only balance the budget by raising revenue and reducing our rate of spending." (Governor Martin O'Malley, 2007e).

Analysis by the Department of Legislative Services reinforced the view that the state's fiscal problems were dire and helped persuade legislators of the need to act. In late June 2007, DLS reiterated that the state's cash balance would plummet and the estimated deficit would wipe out the rainy day fund in FY 2009 as spending kept growing faster than revenues (Department of Legislative Services, 2007o: 17-22). DLS also presented a scenario in which the FY 2009 budget was balanced entirely through $1.46 billion in spending cuts. By outlining more than $500 million in cuts to education aid, a freeze on state worker pay, and tuition increases at state colleges and universities, the

[194] The cuts involved reducing middle management, eliminating vacant positions, curbing overtime, conserving energy, and other measures. See Governor Martin O'Malley, "Governor O'Malley Cuts Over $280M from State Budget to Address $1.4 Billion Deficit," July 10, 2007.

DLS analysis made the budget tradeoffs clearer to lawmakers and supported the view that revenue increases would be needed (Department of Legislative Services, 2007p: 6-16).

Revised revenue estimates issued in mid-September added to the sense of urgency about Maryland's fiscal position. The Board of Revenue Estimates reduced the FY 2008 revenue estimate by $132.5 million, mostly due to ongoing weakness in sales tax receipts, and projected modest revenue growth of 4.7 percent in FY 2009 (Comptroller of Maryland, 2007).

Governor's Tax Package. Having reviewed the state budget to identify spending cuts – and hoping to increase funding for education, transportation, and health care – the governor concluded he had to raise revenues to tackle the rest of the structural deficit. The governor's plan, which he framed as a comprehensive, long-term solution (Governor Martin O'Malley, 2007f), included tax increases estimated at $6.4 billion from FY 2008 through FY 2012, accounting for 95 percent of the total deficit reduction ($6.7 billion) projected over the five-year period.[195] Additional spending cuts would total $260 million and video lottery terminal (slots) licensing fees would add $50 million (Department of Legislative Services, 2007q: 4). The tax increases and spending cuts were packaged into five separate bills that the governor transmitted to the General Assembly.

Individuals interviewed for the dissertation agreed that the governor's decision to call the special session made sense from both policy and political standpoints. John Favazza, who served as co-chief of staff to House Speaker Busch from 2005 to 2011, stated that progress on other issues could have been jeopardized if the governor waited until the 2008 regular session to address the structural deficit, adding that, "The governor

---

[195] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007.

just wanted to get this in the rear-view mirror, and then get back to governing and legislating." State Senator Richard Madaleno noted that a special session – which takes legislators away from their jobs and families – "focuses everyone's attention on the subject at hand" and pushes toward a "quick resolution focused on one set of issues."

The net tax increase proposed by Governor O'Malley in the 2007 special session was one of the largest in the nation in recent years. In FY 2009, the first full year of implementation, the estimated tax increase of $1.3 billion would represent a 9.2 percent increase in state tax revenues.[196] Table 5.11 (see next page) summarizes the tax policy changes proposed by the governor and their revenue impact from FY 2008 to FY 2012.

Although the governor framed his tax package as progressive and emphasized elements designed to provide tax relief to low- and moderate-income residents, the specifics were largely shaped by the need to generate large sums of new revenue. By the fall of 2007, the projected budget shortfall for FY 2009 had increased to $1.7 billion (Governor Martin O'Malley, 2007g). Tax increases were selected largely based on two related factors: (1) political feasibility, reflected in approval by one chamber (usually the House) in recent years, and (2) comparisons to tax burdens in other states, which provided a test of which tax increases would be most politically acceptable (or least objectionable) while minimizing damage to Maryland's economic competitiveness. Paradoxically, the broad scope of the governor's tax plan included many incremental tax changes – part of the governor's strategy of spreading the burden widely.

---

[196] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, and Department of Budget and Management, *Maryland Budget Highlights: FY 2008* (January 2008), Appendix B.

Table 5.11
Governor's Tax Policy Proposals, 2007 Special Session
(dollars in millions)

Tax Policy Changes	FY 2008-2012 Revenue	% of Total Tax Revenue FY 2008-2012
Sales Tax	**$3,460**	**53.8%**
Rate Increase to 6%	$3,290	
Expansion to Certain Services	$247	
Tax Holidays	-$77	
Personal Income Tax	**$475**	**7.4%**
Rate Adjustments	$864	
Increase Refundable EITC to 25%	-$145	
Double Personal Exemption for Seniors and Blind	-$62	
$50 Sales Tax Rebate for Low-Income Households	-$182	
Corporate Income Tax	**$675**	**10.5%**
Rate Increase to 8%	$514	
Combined Reporting of Income	$161	
Property Tax	**-$428**	**-6.7%**
Rate Cut of 3¢ per $100 of Assessed Value		
Cigarette Tax	**$724**	**11.2%**
Double Rate from $1 to $2/Pack		
Vehicle Titling Tax	**$701**	**10.9%**
Rate Increase to 6%		
Motor Vehicle Fuel Tax	**$270**	**4.2%**
Index Tax to Construction Cost Index		
Property Transfer Tax	**$63**	**1.0%**
Close Controlling-Interest Loophole		
Gross Receipts Tax	**$496**	**7.7%**
Video Lottery Terminal (Slots) Tax		
Total, All Taxes	**$6,436**	**100.0%**

Note: The "rate adjustments" listed under "Personal Income Tax" include the creation of two new top income tax brackets at 6% and 6.5%, which would increase revenue, and the widening of the 4% tax bracket, which would decrease revenue. The impact of each change was not broken out in fiscal and policy notes prepared by the Department of Legislative Services.

Sources: Department of Legislative Services, "Fiscal and Policy Note, House Bill 2," October 30, 2007, and Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007.

The governor's tax package was also carefully balanced, affecting both individuals and businesses, while earmarking funds for high-priority programs to highlight the benefits of the higher taxes that would be imposed. More than one-third (39 percent) of the new tax revenues collected from FY 2008 to 2012 would be earmarked for particular programs, most notably transportation, K-12 education, and higher education,[197] reflecting the governor's effort to show that the revenues would be used to fulfill important needs and provide core services (Governor Martin O'Malley, 2007h). The reliance on earmarking was much greater than the traditional practice in the state: in FY 2007, only 18 percent of tax revenues were dedicated to special funds.[198]

Given the size of the deficit, Governor O'Malley had little choice but to rely on one or both of the state's two most productive levies: the personal income tax and the general sales tax. The governor proposed a sales tax increase from 5 to 6 percent, as well as an expansion of the tax to cover real property management, tanning, massage, physical fitness, and sauna services, reviving a proposal that had passed the House in 2004 to finance the Bridge to Excellence Act. Moreover, Maryland's sales tax revenues were among the lowest in the nation both as a share of personal income (Maryland ranked 45th) and on a per-capita basis (Maryland ranked 43rd). Based on the precedent of the 2004 legislation and the national comparisons, the governor chose the sales tax as the main source of new revenue (Governor Martin O'Malley, 2007b). As shown in Table 5.11, the sales tax would generate 54 percent of the new tax revenue from FY 2008 to FY 2012.[199]

Although the sales tax would generate large sums of new revenue, it would undermine another important goal of the governor's: tax fairness (which was also a

---

[197] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007.

[198] Author's calculation using data from Maryland Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, and Maryland Department of Budget and Management, *FY 2008 Budget Highlights* (January 2007), Appendix B.

[199] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

concern of liberal legislators). DLS estimated that the 1 percent increase in the sales tax rate would be highly regressive, absorbing 12.7 percent of income for households with less than $5,000 in annual income, compared to 0.6 percent of income for households with more than $150,000 in annual income (Department of Legislative Services, 2007r: 38). To ease the burden on low-income families, the governor proposed a $50 income tax credit for households with annual incomes up to $30,000, which would offset most or all of the sales tax rate increase for those residents, according to DLS (Department of Legislative Services, 2007r: 39). The tax package also included annual "sales tax holidays" on back-to-school clothes and energy-efficient appliances, which the governor touted as another source of aid to low- and moderate-income families even though the tax-free purchases would be available to all.[200]

The governor's tax plan largely used the personal income tax to promote fairness. The personal income tax would generate only 7 percent of additional tax revenue from FY 2008 to 2012 because tax increases for high-income households would be coupled with tax relief for low-income residents (similar to personal income tax changes approved by the House in 2004) to soften the impact of the sales tax increase.[201] At the top of the income scale, Governor O'Malley sought to create two new top tax brackets of 6.0 and 6.5 percent, which would start at $150,000 and $500,000 of income, respectively, for single filers. By also expanding the 4.0 percent tax bracket for lower-income residents[202]

[200] See Governor Martin O'Malley, "Governor O'Malley Announces Plan to Cut Maryland Property Taxes by 3 Cents," press release dated September 20, 2007.

[201] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

[202] The 4 percent income tax bracket applied only to the range of $2,000 to $3,000 in taxable income under current law. The governor's plan would extend the 4 percent bracket to $15,000 in taxable income for single filers and $22,500 for joint filers.

and increasing the state EITC for low-income working families,[203] the governor estimated that his plan would reduce income taxes for 95 percent of residents (Governor Martin O'Malley, 2007i).[204] He also proposed extra tax relief for senior citizens and the blind by raising their additional tax exemption from $1,000 to $2,000.[205]

Although the governor used the sales and personal income tax changes to pursue very different policy objectives, he used modest reductions in each tax in similar ways to mute the economic and political impact of the tax increases. The EITC expansion and the $50 sales tax credit were both aimed at protecting low-income families from tax increases. While the credit negated the sales tax rate increase for low-income families, the EITC made them better-off overall. DLS estimated that two-thirds of the benefit from the EITC expansion would flow to families with annual incomes of $10,000 to $20,000 (Department of Legislative Services, 2007r: 28). At the same time, each tax was also modified to provide tax relief targeted to important constituencies (senior citizens, parents of school-aged children) or activities with wholesome social images (back-to-school purchases, energy conservation), without respect to income. In fact, the non-means-tested tax relief provisions would benefit higher-income residents more because they spend more on consumption and save more money from exemptions due to their higher marginal tax rates.

---

[203] Specifically, the state's refundable earned income tax credit (EITC) would increase from 20 to 25 percent of the federal EITC. A non-refundable EITC equal to 50 percent of the federal credit would be unchanged.

[204] DLS issued a slightly less optimistic estimate that 76 percent of residents would enjoy an income tax cut from the governor's proposal, while 22 percent would face an increase and 2 percent would see no change. See Department of Legislative Services, "Fiscal and Policy Note: House Bill 2," October 30, 2007, p. 15.

[205] Under current law, all residents were entitled to a personal exemption of $2,400 per person. Senior citizens and the blind received an extra personal exemption of $1,000 per person.

From FY 2008 to 2012, the tax offsets for low-income families (EITC increase and sales tax rebate) were estimated to result in a revenue loss of $245 million, while the non-means-tested offsets (sales tax holiday and personal exemption increases) would cost a roughly equal amount, $207 million.[206] Joe Bryce, the governor's chief legislative officer, stated that these tax breaks – which increased the amounts by which other taxes would have to be raised – reflected an effort "to try to anticipate where criticisms of the package would come from," and to abate these sources of opposition, a practical application of Hettich and Winer's theory that policymakers will create special tax rates to minimize the most intense sources of political opposition to taxes.

By proposing a corporate income tax rate increase as well as two measures to close business tax loopholes, Governor O'Malley furthered his claim that the tax package was fair in two important ways. First, the rate increase ensured that the higher tax burden would not be borne only by individuals. Second, the loophole closures were targeted at larger businesses with multi-state operations that often had greater resources and mobility to avoid taxes than did local, small businesses or individuals. Overall, corporations would be hit fairly hard in the governor's tax plan: although the corporate income tax accounted for 6 percent of state tax revenue, it would provide 11 percent of the new revenue sought by the governor from FY 2008 to FY 2012.[207]

Specifically, the governor sought to bolster the Transportation Trust Fund and spending on higher education by raising the corporate income tax rate from 7 percent to 8 percent (half of the additional corporate income tax revenue would flow to transportation,

---

[206] Author's calculation using data from Department of Legislative Services, "Fiscal and Policy Note: HB 2," October 30, 2007, p. 6.

[207] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

and half to higher education). As with the sales tax, the governor used comparisons to neighboring states to justify the rate increase, stating that Maryland's corporate income tax rate would still be lower than that of Pennsylvania, New Jersey, West Virginia, Delaware, and the District of Columbia (Governor Martin O'Malley, 2007h). The Greater Baltimore Committee endorsed the corporate tax rate increase because the proposal "would be a direct investment into two of the components of a strong vibrant business environment." (Greater Baltimore Committee, 2007b: 2). The earmarks would also promote the adoption of the governor's entire revenue package, because continued earmarking of corporate income tax revenue after FY 2009 was made contingent on voter approval of slot-machine gambling in the November 2008 elections (if slots were not approved, the additional corporate income tax revenue would flow into the general fund).

The major part of the governor's plan to bolster the corporate tax base by closing loopholes was a requirement for combined reporting of corporate income. This policy (also described in chapter 4, the D.C. case study) is designed to stop tax avoidance schemes, such as the captive REIT structure described earlier, by requiring corporations to include income from all subsidiaries in their Maryland tax calculation. In addition, the governor sought to apply the state transfer and local recordation taxes to the transfer of a controlling interest in real property, which the House of Delegates had approved during the 2007 regular session. To underscore the fairness issue, Governor O'Malley cited a comptroller's report stating that nearly half of Maryland's largest companies did not pay any corporate income tax in 2005. Combined reporting would address this inequity, the governor contended, while closing the controlling-interest loophole would require corporations and other businesses to pay the transfer taxes that families and small businesses must pay (Governor Martin O'Malley, 2007j).

Another type of business tax – a gross receipts tax on video lottery (slots) facilities – was critical to the governor's long-term fiscal plan. Although slots revenue would be minuscule from FY 2008 through 2011 as sites were selected, licenses awarded, and facilities built, receipts would jump more than six-fold in FY 2012, to an estimated $422 million, or 22 percent of total new tax revenue. [208] From that year onward, slots would provide the second-largest source of new tax revenue in the governor's plan. The governor proposed a 70 percent tax on gross proceeds from slots, with 50 percent of gross proceeds dedicated to a new Education Trust Fund that would support Bridge to Excellence Act implementation and school construction.[209] By calling for 15,000 slot machines at five sites, the governor approached the position of the Senate, which had passed a bill to authorize 15,500 slot machines at seven sites in 2005. O'Malley had campaigned on a platform of "limited slots" (Olson and Drew, 2007) and previously suggested that legislation approved by the House in 2005 authorizing 9,500 slot machines at four sites would be a reasonable compromise (Smitherman and Drew, 2007).

Finally, Governor O'Malley proposed a set of excise tax increases to enhance transportation spending and discourage smoking. Specifically, the Transportation Trust Fund would receive additional revenues from increasing the motor vehicle excise tax from 5 percent to 6 percent; adjusting the state motor fuel tax by a construction cost

---

[208] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

[209] The governor's plan would allocate 50 percent of gross slots revenue to the Education Trust Fund; 8.5 percent to enhance horse racing purses and support a Racetrack Renewal Fund; 5.5 percent to local governments where the slots licensees were located; 5 percent to the state for administrative costs; and 1 percent for a small, minority, and women-owned business investment account. The other 30 percent of gross slots revenue would be retained by the slots licensees.

index; earmarking existing rental car tax revenue; and ending transfers to the general fund. When combined with the corporate income tax revenue discussed earlier, the excise taxes dedicated to transportation would increase Trust Fund revenue by nearly $400 million annually, or almost 20 percent (Governor Martin O'Malley, 2007h). A 6 percent vehicle excise tax had been part of the budget bill passed by the House in 2004, once again reflecting how the governor repackaged many prior legislative proposals in the 2007 tax plan. The final proposal in the governor's tax plan was to double the cigarette tax from $1 to $2 per pack, a change that the House had approved in the regular session just six months earlier; this revenue would flow into the general fund.

Excise taxes would bear a relatively heavy burden in the governor's tax plan. The cigarette tax, which accounted for only 2 percent of state tax revenue, would provide 11 percent of the new tax revenue sought by the governor from FY 2008 to FY 2012,[210] making it the second-largest source of new tax revenue for the first five years (it would then be overtaken by the gross receipts tax on slots licensees). The vehicle excise tax, which generated 5 percent of state tax revenue, would provide 11 percent of the new tax revenue requested by the governor from FY 2008 to FY 2012, [211] making it the third-largest tax revenue source during that period. The motor fuel tax was an exception to this pattern: currently generating 6 percent of state tax revenue, it would provide 4 percent of the new tax revenue proposed by the governor from FY 2008 to 2012. [212] Overall,

[210] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

[211] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

[212] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

consumption taxes (the sales tax, tobacco tax, vehicle excise tax, and motor fuel tax) would provide 80 percent of the new tax revenue in the governor's tax plan.[213]

The property tax was the only levy targeted for a net reduction in the governor's deficit-reduction plan: it would drop by one cent per $100 of assessed value in FY 2010, 2011, and 2012, respectively, reducing the rate from 11.2¢ per $100 of assessed value to 8.2¢. The combined effect of the sales, income, and property taxes, the governor contended, would be a net tax reduction for 83.5% of Marylanders; only high-income households would suffer a tax increase (Governor Martin O'Malley, 2007b). Delaying the property tax reductions until FY 2010 was another part of an attempt to tie the controversial issue of slots to more popular steps: the property tax cuts would take place only if slot-machine gambling was approved by the voters, under the governor's plan.

Although the property tax cut increased the amount of deficit reduction needed, it may have helped blur the magnitude of the overall tax increase. A press release stating the governor's intention to increase the sales tax was headlined, "Governor O'Malley Announces Plan to Cut Maryland Property Taxes by 3 Cents," and referred to the three-cent cut in the property tax and the one-cent increase in the sales tax as though they were comparable (Governor Martin O'Malley, 2007b). Partly because the denominators are different (a one-cent increase in the sales tax per dollar spent is much more significant than a three-cent reduction for every $100 of assessed property value), the sales tax increase would total $3.5 billion over five years while the property tax cut would result in

[213] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

a revenue loss of $428 million.[214] Gerald Prante of the Tax Foundation opined that, "Cutting property taxes and raising other taxes is merely a bait-and-switch. You appease the voter's hatred of property taxes, a very transparent tax, by raising other more-hidden taxes they end up paying – like the corporate income tax and sales taxes." (Prante, 2007).

The property tax-cut proposal points to a more general pattern in which smaller tax cuts or other benefits are used to ease the passage of tax increases. The governor's tax plan included five such "sweeteners": the property tax cut, sales tax holidays, EITC increase, personal exemption increase for senior citizens and the blind, and sales tax credit for low-income households, which would cost an estimated $817 million from FY 2008 to FY 2012. If the governor had not included these tax breaks, he could have met his deficit reduction target with $6.4 billion (rather than $7.2 billion) in other tax increases.[215] Thus, the cost of the tax "sweeteners" was a 13 percent increase in new taxes on other taxpayers (the value of the tax breaks divided by the net tax increases).

Senate Consideration of the Tax Package. The Senate acted first on most of the major tax issues, approving with only minor modifications the legislation reported by its Budget and Taxation Committee.[216] The Senate tax plan was projected to generate $6.8

[214] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

[215] Author's calculation using data from Department of Legislative Services, "Fiscal and Policy Note: House Bill 2," October 30, 2007, and Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

[216] One reason why the committee version was mostly adopted by the Senate is that the committee was consulting closely with the Senate leadership as it crafted the package, according to interviewees.

billion in new revenue from FY 2008-2012, $400 million more than the governor's proposal, reflecting increased sales tax revenue as well as adjustments to other taxes.[217]

The Senate approved the sales, corporate income, and cigarette tax rate increases, and endorsed the governor's slots proposal with a minor change in the allocation of the proceeds.[218] At the same time, the Senate amended the tax package to address complaints by groups that argued they were being unfairly or disproportionately targeted. The changes blunted the progressive edge of the income tax changes proposed by the governor and curtailed his efforts to expand the tax base, reflecting the Senate's reputation for moderate views on tax policy (interviewees attributed this moderation partly to the Senate leadership, as well as the older average age of senators and their longer tenures in office).

First, the Senate rolled back the governor's proposal to create new top personal income tax rates of 6.0 and 6.5 percent, instead opting for top rates of 5.0 and 5.5 percent. Montgomery County senators insisted on this change because their constituents would absorb more than 80 percent of the increase in the personal income tax while many other counties enjoyed reductions[219] (Green, 2007f; Green, 2007g; Carson, 2007). Montgomery County wielded considerable leverage because its eight senators, all Democrats, represented one-third of the 24 votes needed to pass the tax package in the Senate (Maryland General Assembly, 2007: F-1 – F-13). Parity considerations also

---

[217] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Senate Action on Administration's Proposals: 2007 Special Session," November 14, 2007, p. 4.

[218] The committee increased the slots revenue that would be returned to licensees from 30 percent to 33 percent, thereby reducing the state's share to 67 percent. The goal was to maintain high-end slots facilities that would be a draw for patrons.

[219] Author's calculation using data from Department of Legislative Services, "Fiscal and Policy Note: House Bill 2," October 30, 2007, p. 15.

played a role in the decision to lower the top personal income tax rates: Montgomery County officials and business groups argued that the governor's plan would make Maryland's rates uncompetitive with surrounding states (Hansen, 2007; Maryland Chamber of Commerce, 2007b). Whereas the governor's bill was projected to increase the annual income tax liability of Montgomery County residents by $127.4 million, the Senate bill reduced the amount to $54.8 million (Department of Legislative Services, 2007r: 18; Department of Legislative Services, 2007s: 18).

To recoup some of the revenue loss from the lower top tax rates, the Senate rejected the governor's proposals to broaden the 4 percent tax bracket and provide a $50 sales tax credit, further eroding the income tax changes that were added to offset the regressive sales tax increase. At the lower end of the income scale (taxable income of $10,000 or less), taxpayers would receive only a 6.8 percent personal income tax cut under the Senate plan, down from 14.8 percent under the governor's plan. At the top end (taxable income of over $1 million), taxpayers would pay 12 percent more, down from 33.1 percent under the governor's plan (Department of Legislative Services, 2007r: 15; Department of Legislative Services, 2007s: 15). The need to recoup the lost income tax revenue also led the Senate to delete the proposed reductions in the property tax. Interviewees noted that the property tax cut was not credible to legislators because the Board of Public Works sets the tax rate. Lawmakers can make a property tax cut possible by reducing state borrowing, but they cannot ensure that a given rate is implemented.

The Senate rejected combined reporting of corporate income due to concerns about economic competitiveness and administrative burden raised by the Greater Baltimore Committee and Maryland Chamber of Commerce, as well as large, multinational businesses like Marriott International and Discovery Communications (Smitherman, 2007b; Rodricks, 2007).[220] In an interview, Senator Richard Madaleno stated that the political calculus for combined reporting was unfavorable because it would create a lot of winners and losers, an outcome that is anathema to many elected officials. Mr. Madaleno added that concerns about economic competitiveness resonated with legislators because neighboring states had not implemented combined reporting.[221] More generally, as lawmakers debated a wide range of tax increases and base-broadening measures, their political capital and willingness to take difficult positions had to be conserved for the most important items. As legislators prepared to increase personal income tax rates for the first time since the 1960s while also raising the corporate tax rate, combined reporting "was one of those things where people just felt uncomfortable," according to Senator Madaleno.

The third major change made by the Senate in response to concentrated political opposition concerned the governor's proposal to extend the sales tax to health clubs, property management services, tanning salons, and massage services. Opponents of the sales tax on health clubs, organized by the International Health, Racquet & Sportsclub Association, contended that the tax would discourage physical activity and hamper efforts to combat rising rates of obesity, while bringing protesters to do push-ups and jumping

[220] Firms headquartered in Maryland, such as Marriott and Discovery Communications, were more likely to face bigger tax burdens because they have high Maryland apportionment factors due to their large shares of personnel and property located in Maryland. Under combined reporting, the high apportionment factors would be applied to more income from the company's units. On the other hand, firms with low apportionment factors would be more likely to face lower tax burdens.

[221] At the time, 21 states had implemented combined reporting, but most were in the Midwest or West. See testimony of Matt Gallagher, Governor's Deputy Chief of Staff, Joseph C. Bryce, Senior Policy and Legislative Advisor, and Kevin Hughes, Governor's Legislative Office, on Senate Bill 2/House Bill 2, "Tax Reform Act of 2007," Section 5, "Corporate Income Tax – Combined Reporting," Senate Budget and Taxation Committee and House Ways and Means Committee, October 31, 2007, p. 2.

jacks outside the state house. Business groups also argued that the property management tax would harm renters, worsen an affordable housing crisis, and hasten a downturn in the housing market.[222] In response to pressure from the targeted industries, the Budget and Taxation Committee voted to extend the sales tax to a different set of services – computer services, landscaping, and video arcades – after hasty, ad-hoc deliberations.

Interviewees stated that the Department of Legislative Services had prepared a list of services that were exempt from the sales tax, along with an estimate of revenues that could be raised by taxing each service, and that legislators kept trying new permutations of the sales tax expansion to dampen the opposition. Legislators "would look at the list and say, 'What gets us X amount of money?'" Senator Madaleno recalled, comparing the process to a Chinese menu in which one selects an item from column A and an item from column B. Interviewees noted that the process honed in on economic sectors that were not represented by lobbyists. One reason why computer services, landscaping, and video arcade businesses were targeted is that they had not been included in previous bills to broaden the sales tax base and therefore had not needed to organize in response.

Taxing computer services became part of the Senate's tax plan for two particular reasons (besides the lack of political opposition): (1) it would raise a relatively large amount of money, and (2) it seemed like a less onerous way to generate money from the corporate sector than combined reporting, which the Senate opposed (Wagner, 2007). In explaining the decision to tax computer services, Senate Budget and Taxation Committee Chairman Ulysses Currie stated in an interview that, "Well, we were looking for

[222] Groups opposing the tax on property management services included "Real Estate: Maryland," a coalition of trade associations and real estate firms, the Maryland Chamber of Commerce, Maryland State Builders Association, Maryland Self-Storage Association, Maryland Multi-Housing Association, Inc., the National Association of Industrial and Office Properties, and the International Council of Shopping Centers.

revenues. Computers and computer services were a growing commodity at that time. We didn't want to tax people who we felt could not afford to pay taxes." Although the committee's action was assailed as a "bait and switch" for targeting a new set of services with no notice to those affected and no public hearing (The Baltimore Sun, 2007a), the fast pace of the special session left the industries little time to object, and the Senate adopted the committee substitute (Green, 2007g, Marbella, 2007).

The politically-driven deliberations on the sales tax expansion obscured the policy reasons that had brought the issue onto the public agenda. DLS and private organizations such as the Institute on Taxation and Economic Policy had pointed out that the sales tax base was eroding as consumption shifted from goods to services (Department of Legislative Services, 2007s: 42; Institute on Taxation and Economic Policy, 2007a: 6). Although the proposal to expand the base was an effort to begin addressing this shift, the Senate's decision to adopt tax policy options that had received little scrutiny hindered the goal. In the end, industries were targeted for taxation not on the basis of an informed judgment about how to modify the sales tax to reflect a changing economy; instead the process devolved into a game of political musical chairs. Joe Bryce, the governor's chief legislative officer, stated in an interview that, "Don't raise the rate, expand to services – everybody says it, but no one does it once it becomes specific."

Due to the size of the computer services industry, the Senate bill increased the revenue yield from the sales tax by more than $700 million over five years, relative to the administration's proposal.[223] The combination of the sales tax changes and the lower

[223] The computer services tax alone was expected to generate more than $200 million annually, more than three times as much as the new services targeted for taxation by Governor O'Malley. See Department of Legislative Services, "Fiscal and Policy Note (Revised): Senate Bill 2," November 13, 2007, and Department of Legislative Services, "Fiscal and Policy Note: House Bill 2," October 30, 2007.

personal income tax rates meant that the Senate's tax package would rely on the sales tax for 62 percent of the total tax increase, up from 54 percent in the governor's plan.[224]

Finally, the Senate substituted general revenues for some of the benefit taxes (the motor vehicle excise and fuel taxes) that the administration planned to use for the Transportation Trust Fund. While raising the motor vehicle excise tax from 5 percent to 6 percent, the Senate also allowed a deduction for the value of a trade-in vehicle, which would reduce the revenue yield by more than half (Department of Legislative Services, 2007s: 3), and also rejected the governor's proposal to index the gas tax. To compensate for the loss in earmarked transportation revenue, the Senate dedicated one-half of the revenue generated by the sales tax rate increase to the TTF.

A primary effect of the Senate's actions, according to an analysis by the Institute on Taxation and Economic Policy (ITEP), which focuses on issues concerning tax fairness and adequacy), was to make the tax package regressive. ITEP found that the poorest 20 percent of households would face the largest percentage tax increase under the Senate Budget and Taxation Committee's plan, which was adopted with very few changes by the Senate (Institute on Taxation and Economic Policy, 2007b).

More generally, the Senate's actions on the tax package diluted the governor's proposals and blurred the policy rationales that underpinned them. The Senate rejected a motor fuel tax increase, but also deleted a property tax cut. While approving an increase in the corporate income tax rate, the Senate blocked the proposal to implement combined reporting of corporate income. The vehicle excise tax increase and the transfer tax on

---

[224] Author's calculation using data provided in Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2, and Department of Legislative Services, "Summary of Senate Action on Administration's Proposals: 2007 Special Session," November 14, 2007, p. 4.

controlling interests in real property were both reduced by more than half (the former due to a deduction for the value of a trade-in vehicle and the latter due to a stricter definition of controlling interest). The moderate political views held by many senators, as well as the tendency toward compromise inherent in a body representing different geographical, demographic, and economic interests, led the Senate toward the center on many of the key tax policy issues. By watering down many of the governor's proposals, the Senate stymied the goals of making the tax system more progressive and broadening the base.

House Consideration of the Tax Package. Consistent with its reputation for being more liberal on tax and other issues, the House restored some progressive elements of the governor's tax plan, adopting with few changes amendments crafted by its Ways and Means Committee.[225] The House bill promised to raise more tax revenue ($6.6 billion) from FY 2008 to FY 2012 than either the administration bill ($6.4 billion) or the Senate bill ($6.3 billion), reflecting the House's decision to generate more revenue from both the personal and corporate income taxes.[226]

First, the House inched the top personal income tax rate up to 5.75 percent (the Senate had dropped the top rate from 6.5 percent to 5.5 percent) and started the top bracket at lower levels ($200,000 for single filers and $250,000 for joint filers) than the governor and Senate ($500,000 for all filers). In addition to endorsing the EITC increase, the House raised the personal exemption from $2,400 to $3,200 for single filers with

---

[225] As in the Senate, the House committee version of the tax plan was mostly adopted by the full chamber because committee members consulted closely with the House leadership in crafting the package.

[226] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the House Ways and Means and Appropriations Committees: 2007 Special Session," November 10, 2007, p. 1, and Department of Legislative Services, "Comparison of Revenues Under Administration, House, and Senate Plans: 2007 Special Session," November 15, 2007, p. 3.

income up to $100,000 and joint filers with income up to $150,000, while gradually lowering the personal exemption to $600 for those with higher incomes. The changes to the personal exemption represented a small back-door tax increase on affluent households[227] as well as a tax cut for low- and middle-income residents.

The House also opted for a higher corporate income tax rate than the governor or Senate (8.75 percent vs. 8 percent) and approved the governor's plan for combined reporting of corporate income, unlike the Senate. One reason why a higher corporate income tax rate was necessary was that the House did not approve any change to the sales tax base. Although House Ways and Means Committee Chairman Sheila Hixson had supported measures to expand the sales tax base, she stated in an interview that, "It just doesn't sell. We just can't get the votes on that."

As the Senate had done, the House earmarked half of new sales tax revenue for the Transportation Trust Fund and scuttled the administration's benefit tax approach, rejecting the governor's proposal to index the motor fuel tax and allowing a 50 percent deduction from the vehicle excise tax for the value of a trade-in[228] (the House agreed to raise the motor vehicle excise tax from 5 percent to 6 percent). The House also approved the governor's proposal to double the cigarette tax from $1 to $2 per pack.

Overall, the House budget package relied less on the sales tax, which comprised only 49 percent of net new revenue[229] (compared to 54 percent in the governor's plan and 62 percent in the Senate plan). The House would generate more corporate tax revenue

[227] The personal exemption would drop by $1,800 for those in the top bracket, which would translate into a tax increase of $103.50 ($1,800 * .0575).

[228] The Senate had approved a 100 percent deduction of the value of a trade-in vehicle.

[229] Author's calculation using data from Department of Legislative Services, "Comparison of Revenues Under Administration, Senate, and House Plans: 2007 Special Session," November 15, 2007, p. 3.

(15 percent of new revenue, compared to 11 percent for the governor and 7 percent for the Senate) and personal income tax revenue (12 percent, compared to 7 percent for the governor and 9 percent for the Senate).[230] Despite the reduced reliance on the sales tax in the House bill, the governor's claim that 83 percent of Maryland residents would enjoy a net tax cut from the budget package seemed to have slipped out of reach. A DLS analysis of four prototypical families with annual incomes of $40,000, $75,000, $150,000, and $750,000, respectively, found that each family would pay more under the House Ways and Means plan than under current law (Department of Legislative Services, 2007t: 4).

Although the House was willing to take more extreme stands on some issues (such as the corporate income tax rate) than either the governor or Senate, it acted in many cases to reduce or equalize tax burdens, just as the Senate had done. Under the House plan, personal income tax rates would rise for wealthy taxpayers, but not as much as the governor sought; the sales tax would rise but the base would not be broadened; the motor fuel tax increase was blocked and the vehicle excise tax increase was diluted. Executive leadership seemed to represent the strongest potential force for revamping the tax system while the legislature seemed more protective of the status quo.

Table 5.12 (see next page) summarizes the tax plans approved by both chambers during the special session and shows the differences that had to be bridged before enactment.

[230] Author's calculation using data from Department of Legislative Services, "Comparison of Revenues Under Administration, Senate, and House Plans: 2007 Special Session," November 15, 2007, p. 3; Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2; and Department of Legislative Services, "Fiscal Summary of Senate Action on Administration's Proposals: 2007 Special Session," November 14, 2007, p. 4.

Table 5.12
Comparison of Senate and House Tax Packages, 2007 Special Session (FY 2008-2012 revenues in millions)

Tax	Senate	House of Delegates
Sales Tax Revenue (FY 08-12)	**$4,196**	**$3,449**
Tax Rate	6.0%	6.0% general rate, 7.5% for hotels
Tax Base Expansion	computer services, landscaping, video arcades	--
Tax Holidays	2 tax-free periods to begin in FY 2011	--
Personal Income Tax Revenue	**$593**	**$858**
Tax Rates/Brackets	top rates of 5.0% and 5.5%	top rates of 5.25%, 5.5%, and 5.75%
Personal Exemption	raise to $2,600	raise to $3,200 for income up to $100K, then phase down
EITC	expand refundable credit to 25%	expand refundable credit to 25%
Other Groups	double exemption for blind and elderly to $2,000	--
Corporate Income Tax Revenue	**$493**	**$1,063**
Tax Rate	8.0%	8.75%
Combined Reporting	no	yes
Gross Receipts Tax	**$459**	**$459**
Video Lottery Terminals (Slots)	tax 67% of gross receipts	tax 67% of gross receipts
Cigarette Tax	**$720**	**$716**
Tax Rate	raise from $1 to $2 per pack	raise from $1 to $2 per pack
Vehicle Titling Tax Revenue	**$297**	**$499**
Tax Rate	6.0%	6.0%
Trade-in Offset	yes – 100% of value	yes – 50% of value
Property Transfer Tax Revenue	**$24**	**$56**
Close Loophole	yes, if 90% of property is transferred	yes, if 80% of property is transferred
Amusement Tax Revenue	**$23**	**$0**
	applies 20% tax on electronic bingo and tip jars	--
Total Tax Revenue, FY 2008-12	**$6,346**	**$6,640**

Sources: Department of Legislative Services, "Summary of Administration's Proposals As Amended by the House Ways and Means and Appropriations Committees: 2007 Special Session," November 10, 2007; Department of Legislative Services, "Fiscal Summary of Senate Action on Administration's Proposals: 2007 Special Session," November 14, 2007; and Department of Legislative Services, "Comparison of Revenues Under Administration, Senate, and House Plans: 2007 Special Session," November 15, 2007.

Conference Committee Agreement on the Tax Package. Legislative leaders faced a challenge in reconciling the House and Senate bills, because several of the bills had passed with razor-thin margins. The constitutional amendment on slot-machine gambling (HB 4), which was a precondition of higher taxes for many senators, cleared the House by only one vote more than the required three-fifths supermajority, and the slots implementing legislation (SB 3) received the bare majority needed for passage. The Senate the personal and corporate income tax increases (SB 2) with 24 votes, also the bare minimum needed in the 47-member chamber.

House and Senate negotiators not only moved toward the middle, but also yielded on matters of high priority to the other body, enabling agreement on a tax package estimated to generate almost $6.6 billion in new revenue from FY 2008 to 2012, more than $100 million above what the governor had proposed. The sales tax accounted for a higher percentage of total tax revenue (64 percent) than it had in the administration, House, or Senate plans, partly due to reductions in revenue from other taxes, most notably the personal income and motor vehicle levies.[231]

The Senate prevailed in setting the top personal income tax rate at 5.5 percent (rather than 5.75 percent), starting at a taxable income level of $500,000. In return, the Senate acceded to the House in increasing the personal exemption from $2,400 to $3,200for low- and moderate-income families and then phasing down the exemption to $600 at higher income levels.[232] These changes almost negated the personal income tax

[231] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, pp. 2, 4.

[232] Specifically, the $3,200 exemption could be claimed by single filers with taxable income up to $100,000, and joint filers with income up to $150,000. The exemption would decline in steps to a

as a source of new revenue: it provided only 3 percent of net revenue in the final package,[233] while continuing to serve as a source of progressivity in the tax package.

To maintain funding for the Transportation Trust Fund (which would receive 6.5 percent of total sales tax revenue, or approximately 40 percent of the revenue from the sales tax rate increase), the House and Senate agreed to apply the sales tax to computer services for five years but deleted the taxes on landscaping and video arcades that had passed the Senate.[234] Although expanding the sales tax base seemed appealing from the perspective of sound tax policy, the approach withered in the practical domain of politics. John Favazza, the co-chief of staff to the House Speaker, recalled that, "As soon as an idea (for expanding the sales tax base) popped up, someone would make a case as to why it would damage a particular industry." All of the proposals "would get picked off – that was the reality," he added. House conferees were not enthusiastic about taxing computer services, but yielded to the Senate because of the projected revenues the tax would generate and the lack of intense opposition (Wagner, 2007). Warren Deschenaux, the director of policy analysis for DLS, noted in an interview that the computer services tax

---

minimum of $600 for single filers with taxable income over $200,000 and joint filers with income over $250,000.

[233] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, pp. 2, 4.

[234] Taxable computer services would include computer facilities management and operations, custom computer programming, computer systems integrators, computer system consultants, computer disaster recovery services, and hardware or software installation, maintenance, and repair. Internet access service, computer training, and the repair of property that includes a computer component would not be taxable.

remained in the final bill because, “The industry was not being represented by anyone who was watching what was going on.”[235]

The corporate income tax was set at 8.25 percent, with 60 percent of the new revenue flowing into the general fund and 40 percent flowing to a newly-established Higher Education Investment Fund. Due to strong opposition from the Maryland Chamber of Commerce and other business groups (Maryland Chamber of Commerce, 2007c), combined reporting of corporate income was rejected in favor of a study to be carried out by a business tax reform commission. The conference committee also approved the governor’s original proposal to close the controlling-interest loophole in the property transfer tax with a six-month delay in the effective date.

The two chambers also reached agreement on slot-machine gambling, approving 15,000 video lottery terminals at five sites, as the governor had proposed. Interviewees stated that putting gambling on the ballot as a constitutional amendment gave skeptical legislators latitude to vote in favor.[236] The authorizing statute provided that 67 percent of gross revenues would flow to the state, the bulk of which would be earmarked for an Education Trust Fund to support the Bridge to Excellence Act. As noted earlier, the revenues from the tax on slots facilities would serve as the second-largest long-term

---

[235] Several firms and organizations, such as EDS, Verizon, and the Montgomery County Chamber of Commerce, testified against the computer services tax, but these efforts were fairly ad-hoc. By contrast, the video arcade industry hired former state senator Laurence Levitan, who chaired the Senate Budget and Taxation Committee, to represent them in their efforts to remain exempt from the sales tax.

[236] As Senator Ulysses Currie stated in an interview, “We didn’t vote for slots. We voted to give the public the opportunity to vote.”

source of tax revenue in the budget package, providing 22 percent of tax revenue in FY 2012 when the five sites were expected to be operating.[237]

The cigarette tax increase emerged unscathed; the dollar per-pack increase made it the second-largest source of tax revenue (11 percent) in the final budget package.[238] Neil Bergsman, director of the Maryland Budget and Tax Policy Institute,[239] described the cigarette tax as "our favorite sin tax." Despite opposition from tobacco farmers and retailers, the cigarette tax was the easiest tax to raise due to widespread concern about the health effects of smoking, according to interviewees.[240] Proponents of the tax increase once again highlighted state comparisons, noting that Maryland's $1 per-pack tax fell at the national median. Rather than stay in the middle of the pack, proponents argued that Maryland should be a national leader in reducing the harm of smoking through higher taxes. At $2 per pack, Maryland's cigarette tax would rise to fourth-highest in the nation (Department of Legislative Services, 2007u: 20-21).

Benefit taxes to support transportation funding were almost entirely absent from the final tax package. The House yielded to the Senate in allowing a vehicle excise tax

[237] Author's calculation using data from Department of Legislative Services, "Summary of Administrations' Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, p. 4.

[238] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, pp. 2, 4.

[239] The Maryland Budget and Tax Policy Institute was a private research group that focused on how state policy decisions affect low- and moderate-income families and was part of the same national network (the "State Priorities Partnership") as the D.C. Fiscal Policy Institute and Virginia's Commonwealth Institute for Fiscal Analysis. The Maryland Budget and Tax Policy Institute is now called the Maryland Center on Economic Policy.

[240] A poll conducted by "Health Care for All – the Maryland Citizens' Health Initiative" found that 69 percent of likely Maryland voters supported the cigarette tax increase. See Vincent DeMarco, President, Maryland Citizens' Health Initiative," testimony before the House of Delegates Ways and Means Committee, October 31, 2007.

deduction equal to 100 percent of the trade-in value, limiting the tax to 19 percent of new transportation funding and 5 percent of total net new revenue.[241] The trade-in deduction was sought by the Maryland Automobile Dealers Association; interviewees stated that this concession smoothed the approval of the vehicle excise tax increase. Both chambers had already deleted the governor's proposal to index the gas tax, which failed because (1) gasoline prices were near all-time highs, surpassing $3 per gallon at the retail level (U.S. Energy Information Administration, 2014), and (2) legislators were unwilling to reduce their control over gas taxes by allowing automatic increases, a point that was repeatedly raised in the policymaker interviews.

Final passage of the tax policy changes was smoothed by the General Assembly's insistence on $550 million in FY 2009 spending cuts.[242] In that respect, the budget process had come full circle: spending cuts were both a prelude and a coda to the tax increases approved in the 2007 special session, showing a commitment by policymakers to strive for efficiency at the same time that they asked residents to pay more in taxes.

Governor O'Malley hailed the legislature's deficit-reduction package as "a fair, long-term solution to the inherited $1.7 billion structural deficit," and signed the bills into law (Governor Martin O'Malley, 2007k). The details of the tax package as enacted are summarized in Table 5.13 (see next page).

[241] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, p. 3.

[242] The reductions included a freeze in the basic per-pupil funding level for state education aid in FY 2009 and FY 2010, a transfer of $77 million from the state employee health insurance fund, elimination of 500 vacant positions in state government, and more than $200 million in other cuts to be made by the governor.

Table 5.13
Tax Policy Changes Enacted in 2007 Special Session
(dollars in millions)

Tax and Policy Changes	FY 2008-2012 Revenue	% of Total Revenue FY 2008-2012
Sales Tax	**$4,169**	**63.6%**
Rate Increase to 6.0%	$3,290	
Tax Expansion to Computer Services	$895	
Tax Holidays Beginning in FY 2011	-$20	
Personal Income Tax	**$198**	**3.0%**
Top Brackets of 5.0%, 5.25%, and 5.5%	$951	
Personal Exemption Increase and Phase-out	-$592	
Refundable EITC Increased from 20% to 25%	-$160	
Corporate Income Tax	**$619**	**9.4%**
Rate Increase to 8.25%		
Gross Receipts Tax	**$476**	**7.3%**
Video Lottery Terminals (Slots) Tax		
Cigarette Tax	**$716**	**10.9%**
Double Rate from $1 to $2/Pack		
Vehicle Excise Tax	**$297**	**4.5%**
Rate Increase to 6.0%	$701	
Allow 100% Trade-in Offset	-$403	
Property Transfer Tax	**$56**	**0.8%**
Close Loophole on 80% Transfer of Interest		
Admissions Tax	**$23**	**0.4%**
Apply 20% tax on electronic bingo and tip jars		
Total, All Taxes	**$6,554**	**100.0%**

Source: Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly," November 30, 2007.

The tax plan was substantial in its size, scope, and impact on government programs, representing the most sweeping change in Maryland's tax system in 40 years. The final package would increase annual state tax revenues by an estimated 9.3 percent in FY 2009,[243] far exceeding the 1 percent standard for a significant increase. As in the

[243] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, pp. 2, 4, and Department of Budget and Management, *Maryland Budget Highlights: FY 2008* (January 2008, Appendix B.

governor's original proposal, 39 percent of the new tax revenue anticipated from FY 2008 to 2012 period would be earmarked for transportation, K-12 education, higher education, and several smaller programs.[244] The tax package approved by the General Assembly was less regressive than the Senate plan (largely due to the personal exemption increase for low- and middle-income households) but more regressive than O'Malley's proposal. ITEP found that the poorest 20 percent of households would bear a tax increase equal to 0.8 percent of their incomes, compared to 0.4 percent for the middle quintile and 0.5 percent for the top 1 percent (Institute on Taxation and Economic Policy, 2007c).

Although the governor's carefully-crafted tax plan, balancing the goals of revenue adequacy and progressivity, as well as rate increases and base-broadening measures, was diluted by the General Assembly, the final bill still represented a significant achievement. Even though the General Assembly increased the percentage of new revenue derived from the sales tax and weakened the governor's proposal to make the personal income tax more progressive, the top income tax bracket would now start at an income level of $500,000, rather than the $3,000 level set 40 years ago. The governor had also ended a stalemate on gambling that had stymied tax policy discussions in Maryland for nearly a decade. *The Baltimore Sun* hailed the final package as "an impressive victory for Mr. O'Malley, with significant and lasting implications. At a minimum, it means the state's structural deficit has finally been brought under control beyond the piecemeal, 'take from Peter to pay Paul' approach of the last administration." (The Baltimore Sun, 2007c).

[244] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, pp. 2-4.

Maryland's 2007 tax package serves as an example of "punctuated equilibrium," in which years of slow or incremental change are periodically interrupted by major changes. The structural deficit had built for years and weakening revenue forecasts made the problem even more urgent. The need to reform Maryland's tax system and increase its capacity to generate revenue rose to the top of the policy agenda due to the leadership of Governor O'Malley, who called the special session to focus exclusively on the structural deficit. The governor could act boldly due to a favorable political environment; his party held large majorities in both legislative chambers and the next elections were three years away. In this case, the governor served as a "policy entrepreneur" who joined a widely-recognized problem and an auspicious political climate to a policy solution, combining previous proposals approved by the House or Senate, as well as other ideas, into a major package of tax increases. Individuals interviewed for the dissertation stated that the governor's initiative was decisive in enacting tax increases to address the structural deficit. After fighting constantly with a Republican governor for the prior four years and often battling to an internal stalemate on budget and tax issues, the House and Senate needed and welcomed executive leadership to provide policy direction.

The General Assembly's willingness to support the governor's initiative was critical as well to the enactment of the 2007 tax package. Interviewees noted that a powerful motivation for legislators was the desire to help a new Democratic governor succeed, and relatedly, to show that Democrats could govern effectively while controlling both the executive branch and the legislature. Given the wide acceptance that the structural deficit was a serious long-term problem, lawmakers wanted to attack the deficit so they could focus on issues such as education, health care, and transportation in 2008. John Favazza, the co-chief of staff to House Speaker Busch, stated in an interview that:

> I think there was a strong commitment to Governor O'Malley being successful. The Speaker had said, "Governor, you lead, we'll be there for you." A lot of details and compromises had to be made, but there was a commitment to get it done, to help the new governor be successful … Let's have three years after that to govern.

The Maryland example suggests how difficult it is to enact a major tax increase at the state level – and that the sharp change characteristic of a punctuated equilibrium model may be very unusual. Even with a unified Democratic government commanding large majorities in both houses of the legislature and the next elections for state office three years away, key parts of the tax package were approved with only one vote to spare. The success of the tax package resulted not only from a favorable political alignment, but also the skillful use of legislative procedure. The introduction of the governor's deficit-reduction plan as five separate bills was pivotal because it allowed legislators to show that they were not inveterate tax-and-spend liberals by voting against some of the bills while voting yes on others when their support was most critical.[245] Because several pieces of the tax package passed one chamber with the minimum number of votes or one vote to spare, the structuring of the tax package was clearly critical to the final outcome.

Maryland's 2007 tax package also calls into question another proposition (#3) set out in Chapter 1: that state policymakers "emphasize political acceptability in evaluating tax policy options, at the expense of normative principles such as revenue capacity,

[245] Joseph Bryce, the governor's chief legislative officer, stated in an interview that, "You had to find different people – some people weren't going to vote for a sales tax increase. We broke it up in that way, realizing you may have to build coalitions and majorities separately" on each of the six bills.

efficiency, and equity." As noted earlier, the items in the governor's tax package were selected partly based on political feasibility, reflecting provisions that either the House or Senate had previously approved, as well as comparisons to tax rates in neighboring states. The General Assembly also responded to political pressures in revising the tax package, such as by eroding the progressive nature of the governor's personal income tax proposals and rejecting combined reporting of corporate income. But at the same time, Maryland policymakers transformed an essentially flat personal income tax into a progressive tax, increasing the EITC and personal exemption at the lower end of the income scale and raising tax rates at the upper end – changes that were not necessarily politically popular. Moreover, the tax increases approved in 2007 were intended to bolster the long-term revenue capacity of the state tax system to fulfill commitments such as those made in the Bridge to Excellence Act. Unlike their counterparts in other states, Maryland lawmakers acted to address revenue needs before an economic downturn, reflecting their willingness to look beyond current circumstances and political pressures.

Even though revenue increases and spending cuts totaling $1.9 billion were scheduled for FY 2009, a residual structural deficit remained because the governor and General Assembly had increased funding for transportation, higher education, health care, and Chesapeake Bay cleanup in the 2007 special session bills. DLS projected a baseline structural deficit of $168 million for FY 2009; ongoing revenues would not cover ongoing spending until FY 2012 (Department of Legislative Services, 2007v: 8). As the economy weakened in 2008 and 2009, the budget gap would reopen despite the significant progress made during the 2007 special session toward eliminating it.

Tax Policy Decisions in 2008

The governor and General Assembly were reluctant to revisit tax policy issues in 2008 only weeks after approving a major tax increase. As the governor's public approval rating fell to 35 percent in a January 2008 poll by *The Baltimore Sun* and a majority of residents expressed opposition to the 2007 special session tax package (Olson, 2008), Maryland officials tried to shift attention to education, the environment, public safety, and other issues. Nevertheless, intense opposition from business groups forced policymakers to reconsider their decision to apply the sales tax to computer services. Policymakers ultimately reversed course by repealing the sales tax expansion (which was dubbed the "tech tax") and approving a three-year tax increase on high-income residents, as well as additional spending cuts and fund transfers to offset most of the lost revenue.

FY 2009 Budget Process. Governor O'Malley proposed an FY 2009 operating budget of $31.6 billion, an increase of 5.7 percent from the FY 2008 budget (Department of Budget and Management, 2008: 6), while cutting baseline spending by $550 million as required by the special session legislation.[246] The general fund would comprise almost half ($15.2 billion) of the budget, and would grow by 5.4 percent (Department of Legislative Services, 2008a: 23). The governor did not include any tax policy initiatives in his FY 2009 budget, although he proposed two new tax incentives as separate legislation. Instead, the governor sought to use the additional revenues generated from the 2007 tax package to implement his policy priorities, such as freezing tuition at state

[246] The Department of Legislative Services stated that the governor's proposed FY 2009 budget "is consistent with the special session actions" and itemized the spending cuts in the governor's budget. See Department of Legislative Services, "Fiscal Briefing," January 21, 2008, p. 3.

colleges and universities, expanding Medicaid and children's health insurance, and boosting spending on transportation and Chesapeake Bay cleanup.

Senator Ulysses Currie, who chaired the Senate Budget and Taxation Committee from 2002 through 2010, warned in early January 2008 that it would be "almost impossible" to maintain the computer services tax (which would not take effect until July 1, 2008) due to a backlash from business groups (Dechter, 2008a). Technology executives, who were caught unaware when the tech tax was proposed in the 2007 special session, had hired experienced lobbyists including Governor O'Malley's former communications director to push for repeal. The industry was armed with a compelling message: that the tax would put Maryland firms at a competitive disadvantage because neighboring states did not tax computer services, thereby hampering a vital source of jobs and economic growth (Smith, 2008; Dechter, 2008a). Governor O'Malley and Senate President Miller expressed opposition to repeal, and House Speaker Busch also appeared skeptical, reflecting leaders' desire to move on to other issues (Dechter, 2008a). Nevertheless, six bills to repeal the tax were introduced by the end of January.[247] One of the bills (HB 196) gained 73 sponsors, a majority of the 141-member House of Delegates.

Concern about the tech tax was heightened by reports that Maryland web design, data processing, and other computer firms were being encouraged to relocate by officials from Delaware and Pennsylvania. Business leaders and company owners contended that the computer industry is particularly mobile because it does not rely on large capital investment or physical plant, stoking fears that Maryland could suffer major losses in a growing economic sector (Dechter, 2008b). Moreover, the symbolism surrounding the

[247] The relevant bills were HB 187, HB 196, HB 253, HB 326, SB 41, and SB 46.

technology industry as a source of new, high-paying jobs was powerful and helped to mobilize support for repeal. In an interview, Jay Hancock, who was a columnist for *The Baltimore Sun* during the study period, cited the state's desire to become a "Silicon Harbor" and stated that the furor over the tax "was as much a symbolic issue as it was a substantive fiscal issue. People could say that (the tax) sent an anti-technology message. That was not a good strategic message for Maryland to send."

At a more mundane level, concerns about tax administration also sparked opposition to the computer services tax. Because computers have become so integral to the economy and the delivery of services, it was difficult for Maryland officials to provide clear guidance on what was taxable (Dechter, 2008b; Department of Legislative Services, 2007v: 44-45), reinforcing a sense that the tax was poorly and hastily conceived in a back-room deal.

Using this array of arguments, business groups organized opponents of the tax on a district-by-district basis to contact their legislators in what interviewees described as a relentless and "absolutely brilliant" lobbying effort. By raising fears about economic competitiveness in an industry that seemed like a beacon of growth and opportunity, the industry groups put the issue back on the policy agenda. Still, opponents of the tax needed to join a policy solution – a substitute method to reduce the structural deficit – to the problem they had highlighted and the political interest they had created. The tech tax repeal would require policymakers to offset an estimated revenue loss of $1.14 billion from FY 2009 to FY 2013 (Department of Legislative Services, 2008b).

A bill to increase motor fuel taxes by 4¢ per-gallon in two consecutive years (SB 567) would have completely offset the revenue loss from repealing the computer tax

(Department of Legislative Services, 2008c: 1, 7-9).[248] Despite support from the Maryland Chamber of Commerce, the bill did not advance beyond a public hearing because legislators were unwilling to increase motor fuel taxes at a time when gasoline prices were rising. Similarly, legislators introduced four bills (HB 904, HB 1310, SB 232, and SB 562) proposing steep increases in state excise taxes on distilled spirits, wine, and beer, but none of the bills advanced beyond a public hearing.

Another alternative emerged late in the 2008 session: SB 1004, which would create two new top personal income tax rates of 6.0 and 6.5 percent for five years. SB 1004 was projected to increase general fund revenue by $845.5 million from FY 2009 to FY 2013 (Department of Legislative Services, 2008d), enough to offset three-quarters of the revenue loss from repealing the tech tax. SB 1004's two top rates were the same as Governor O'Malley had proposed during the 2007 special session, although the top rates envisioned in SB 1004 would start at higher incomes than the governor had planned.[249]

As the Senate prepared to vote on the FY 2009 budget in early March, the Board of Revenue Estimates made the task of balancing the budget and repealing the tech tax more difficult, reducing the revenue estimates by $74.7 million in FY 2008 and $258.2 million in FY 2009 (Board of Revenue Estimates, 2008a).[250] Nevertheless, pressure on

---

[248] Although motor fuel tax revenue is dedicated to the Transportation Trust Fund, the bill would have freed up sales tax revenue that had been dedicated to the TTF. Under SB 567, the sales tax revenue would be shifted to the general fund to make up for the revenue loss from repealing the computer services tax.

[249] SB 1004 would start the 6.0 percent tax bracket at an income level of $750,001 and the 6.5 percent bracket at an income level of $1,000,001. By contrast, Governor O'Malley had proposed starting the 6.0 percent bracket at income of $150,001 for single filers and $200,001 for joint filers, while starting the 6.5 percent bracket at income of $500,001 for all filers.

[250] Personal income and sales tax collections were falling below projections due to weak economic growth; in fact, sales taxes had fallen for two consecutive months for the first time since the 1991 recession. See Board of Revenue Estimates, letter to the Honorable Martin O'Malley, Governor of the State of Maryland, dated March 6, 2008.

lawmakers remained strong as overflow crowds packed a Senate hearing on legislation to repeal the tech tax. Only two organizations (the Maryland Budget and Tax Policy Institute and the League of Women Voters) urged the committee to retain the tax, while dozens of firms and business groups supported repeal. In response to the strong public pressure, Senator Currie (whose Budget and Taxation Committee had crafted the tech tax) expressed support for SB 1004 (which became known as the "income tax surcharge" or the "millionaire's tax") as an alternative to the tech tax (Dechter, 2008c), and Governor O'Malley followed suit the next day, stating that it was unfair to expand the sales tax to just one industry (Dechter and Olson, 2008).

In the end, the governor and legislative leaders pieced together a compromise to repeal the computer services tax, which was folded into SB 46, the "Budget Financing Act," the companion bill to the appropriations act. First, the income tax surcharge was scaled back: there would be only one new top tax bracket of 6.25 percent applying to annual income over $1 million. In addition, the new top rate would be limited to tax years 2008, 2009, and 2010. As a result, the income tax surcharge was projected to raise only $328.5 million from FY 2009 to 2013, less than one-third of the revenue loss from repealing the computer services tax.[251] Second, the bill redirected 1.2 percent of total sales tax revenue from the Transportation Trust Fund to the general fund. Finally, the bill required the governor to submit $50 million in annual budget cuts for approval by the Board of Public Works. SB 46 fully offset the revenue loss from the tech tax repeal only

[251] Author's calculation using data from Department of Legislative Services, "Fiscal and Policy Note (Revised): Senate Bill 46, April 4, 2008, pp. 7-8.

in FY 2009 and FY 2010, resulting in a net loss of $204.4 million for the general fund over five years.[252] Table 5.14 details the general-fund impact of SB 46.

Table 5.14
Provisions and General Fund Impact of 2008 Budget Financing Act
(dollars in millions)

Provision	**FY 2009 Impact**	**FY 2009-13 Impact**
Repeal sales tax on computer services	-$214.0	-$1,136.1
Create new top personal income tax rate of 6.25 on annual income over $1 million (tax years 2008-2010 only)	$154.6	$328.5
Redirect 1.2% of sales tax revenue from Transportation Trust Fund to general fund	$65.0	$353.4
Cut $50 million in ongoing general fund expenditures	$49.9	$249.8
Net impact on general fund	**$55.5**	**-$204.4**

Source: Department of Legislative Services, "Fiscal and Policy Note (Revised): Senate Bill 46," April 4, 2008.

Interviewees broadly agreed that precedent was a major reason why legislators settled on the millionaire's tax as the only tax policy offset to the computer services tax repeal. Because a three-year personal income tax surcharge of 6 percent imposed from 1992 to 1994 had not sparked a major political backlash, legislators were willing to use this policy tool again (the fact that the increase had in fact been temporary lent some credibility to the promise that this tax increase would be time-limited). By limiting the tax increase to those with taxable annual income of $1 million or more, proponents could also argue that the tax would affect only a tiny sliver (0.3 percent) of taxpayers

[252] Author's calculations using data from Department of Legislative Services, "Fiscal and Policy Note (Revised): Senate Bill 46," April 4, 2008.

(Department of Legislative Services, 2008e: 8); most legislators had very few constituents who would be affected.

These arguments helped SB 46 gain the grudging support of most Montgomery County legislators, who faced the difficult choice of whether to accept higher income tax rates that they had opposed in 2007 in order to repeal the computer services tax and protect the county's significant technology sector. Even though 41 percent of those paying the millionaire's tax would be Montgomery county residents (Department of Legislative Services, 2008e: 10), six of eight county senators and 14 of the county's 24 delegates voted in favor of SB 46, clearing the path to enactment.[253] In addition, many liberal Democratic legislators believed it was appropriate for those who had prospered economically to bear more of the tax burden; Senator Richard Madaleno stated in an interview that raising the personal income tax increase on the wealthy was "like dangling candy in front of a bunch of liberals." Agreement on the tech tax repeal in turn smoothed the adoption of a $31.2 billion operating budget, including $15.0 billion in general fund spending (Department of Legislative Services, 2008f: 3-8), reflecting a reduction of approximately $400 million from the governor's proposed budget.

Other Tax Policy Legislation Considered in 2008. The governor proposed two new tax incentives during the 2008 session. SB 207/HB 377, the "Solar and Geothermal Tax Incentive and Grant Program," would exempt solar and geothermal energy equipment from the sales tax as well as state and local property taxes. SB 206/HB 366, the "BRAC Community Enhancement Act," would allow communities to request

---

[253] The Senate approved SB 46 by a vote of 30 to 17, and the House approved SB 46 by a vote of 93 to 44. Voting data are from the Maryland General Assembly's Internet site, www.mgaleg.maryland.gov.

corporate, personal property, and real property tax credits when seeking designation as Base Realignment and Closure (BRAC) Revitalization and Incentive Zones (which were similar to enterprise zones).[254] With Maryland expected to gain 40,000 to 60,000 jobs from the Pentagon's BRAC initiative, the bill was intended to direct growth in population and employment to developed areas (including those in need of revitalization) with transportation, utilities, and other infrastructure already in place (Governor Martin O'Malley, 2008; Department of Legislative Services, 2008g: 7-9).

By tying policy goals to tax cuts, the two bills won near-unanimous support in the General Assembly and became law.[255] Delegate Hixson, the House Ways and Means Committee chairman, emphasized the prevailing image of the activity being subsidized, stating in an interview that renewable energy is "the future, and we're investing in it," and likening the issue to "motherhood, apple pie." Similarly, John Favazza from Speaker Busch's office observed that tax incentives can readily be used as vehicles to advance popular causes, stating that, "Solar stuff specifically became the flavor of the month on the renewable side … We knew the governor was going to continue to do stuff on solar, and it had some Republican support" because BP Solar was located in an area represented by several Republican legislators. Likewise, the BRAC tax incentives attracted support because of their association with economic development and military bases, which were located in districts with legislators from both parties.

[254] The cost of the corporate income tax credits would be borne entirely by the state. The bill would also authorize credits of 80 percent against the local personal and real property taxes. The state would reimburse the localities for half of the cost of the local property tax credits.

[255] SB 206, the "BRAC Community Enhancement Act," was approved 131-2 by the House and 46-0 by the Senate. HB 377, the "Solar and Geothermal Tax Incentive and Grant Program," was approved 140-0 b y the House and 42-5 by the Senate.

Legislators introduced a broad array of tax relief bills, which were much more diverse than the tax increase bills legislators considered during the 2008 session. A number of tax incentive bills sought to encourage employment of targeted groups, such as people with disabilities (HB 280), students in work-based learning programs (SB 297), and recipients of Temporary Assistance to Needy Families payments (SB 314). Legislators also sought to reduce income taxes for particular groups, such as military retirees (HB 549, SB 315, and SB 625), members of the Coast Guard Auxiliary (SB 12), and law enforcement and emergency services workers (SB 581). Finally, lawmakers introduced a wide range of tax relief bills designed to promote various activities, such as donations to non-profits offering scholarships, innovative education programs, or teacher training (SB 373); contributions to college savings plans (HB 1534); and purchases of energy-efficient boilers (HB 977).

From this broad array of options, legislators enacted 16 tax policy bills in 2008, including the two measures proposed by the governor (Appendix 5.2 at the end of the chapter summarizes the 16 tax policy bills). All but one of the tax policy bills enacted in 2008 would have a negative fiscal impact,[256] according to estimates prepared by DLS. The bills that successfully navigated the legislative process had modest costs: only one bill would entail a first-year revenue loss of more than \$500,000,[257] reflecting informal guidelines set by the leadership to limit new initiatives to an annual cost of \$250,000 as the economy weakened and projected revenues fell. Warren Deschenaux, DLS' director of policy analysis, noted in an interview that the guideline meant that minor tax cuts were

[256] SB 662, the only bill that would increase revenue, would impose a 25% surcharge on the transfer tax on agricultural land in order to increase funding for land preservation programs.

[257] Two of the 15 measures did not have a precise fiscal impact estimate due to data limitations.

essentially “free” to legislators because they did not have to be offset. Similarly, the governor’s chief legislative officer, Joe Bryce, stated that, “Everybody loves a tax cut … You come in and you make your case, and it’s only a little bit of money.” Among the 16 tax policy bills enacted in 2008, 12 received a unanimous vote in the House and another 12 won a unanimous vote in the Senate,[258] illustrating how targeted tax cuts served as a rare area of bipartisan accord in a politically polarized environment.

By enacting these tax relief bills, Maryland policymakers could point to accomplishments in the following areas:

- economic development: providing tax credits for cellulosic ethanol technology research and development (HB 140); extending income tax deductions for artists working in designated zones to jewelry and clothing designers (HB 680); and the “BRAC Community Enhancement Act” (SB 206).

- job creation and workforce development: extending tax credits for hiring employees with disabilities (HB 280); extending job creation tax credits (HB 721); and reauthorizing tax credits for work-based learning programs (SB 297).

- equitable treatment of different groups: providing a vehicle excise tax exemption for returning service members (HB 669); offering a recordation and transfer tax exemption for domestic partners (SB 597).

The bill (HB 140) providing tax credits for cellulosic energy research and development (R&D) indicates the extent to which legislators were willing to craft tax breaks for narrow groups. Businesses engaging in cellulosic energy R&D would qualify for a state R&D tax credit established in 1999, but Maryland legislators were willing to create a separate tax credit for this industry even if it were at least partially redundant.[259]

---

[258] The 12 bills that received unanimous votes in each chamber were not identical.

[259] The tax credits for cellulosic ethanol R&D were not completely redundant because they provide a more generous benefit (10 percent of eligible expenses, subject to a cap), than the general R&D credit (3 percent of base R&D expenses and 10 percent of R&D expenses above the base, also subject to a cap).

The net change in the FY 2009 tax burden resulting from legislation approved during the 2008 regular session would be a small reduction (0.4 percent), primarily reflecting the repeal of the computer services tax and its partial offset by the income tax surcharge (the cut to the tax burden would grow in the out-years, because the income tax surcharge would expire after FY 2011).[260] With regard to tax policy, the 2008 session was largely an exercise in correcting a major error of the 2007 special session, but it offers a number of insights for this dissertation.

The backlash against the computer services tax provides a vivid example of the problems that can ensue when policymakers fail to analyze fully the economic, social, and political implications of a tax policy. Because the tax was hastily approved, without public hearings, as a way to meet budget targets, lawmakers did not anticipate or respond to the serious concerns about economic competitiveness, administrative feasibility, and transparency that arose. By choosing the computer services tax based largely on expediency (and, ironically, its perceived political acceptability), supporters also lacked a compelling rationale for the tax and could not counter opponents' arguments that the tax was a threat to the economy of the future and the good jobs it might bring.

Still, the computer services tax was a departure for Maryland policymakers from a generally careful review process. Although the tax increases approved in the 2007 special session were not popular, they did not create a backlash and remained in effect (with some adjustments) as of this writing in 2015, reflecting the selection of tax policy

[260] Author's calculation using data from Department of Budget and Management, *Maryland Budget Highlights: FY 2009*, Appendix B, and "Fiscal and Policy Notes" prepared by the Department of Legislative Services for tax policy bills enacted in 2008. The fiscal and policy notes are available at www.mgaleg.maryland.gov.

options based on precedent, a spreading of burdens among individual and business taxpayers, and measures to protect low-income residents from tax increases.[261]

In light of the discontent stirred by a tax policy that was poorly vetted, it is not surprising that Maryland policymakers resorted to a more incremental approach based on precedent in choosing the income tax surcharge to partly replace the computer services tax. Lawmakers also emphasized political acceptability in designing the income tax surcharge by applying it to a tiny sliver of taxpayers (the top 0.3 percent) and limiting it to three years.

The repeal of the computer services tax also points out how difficult it was for Maryland lawmakers to pursue the goals of tax reform in the face of highly-concentrated political opposition. Just as the goal of greater fairness in taxation had been diluted during the 2007 special session when legislators reduced the top personal income tax rates and rejected combined reporting of corporate income, the goal of long-term revenue capacity was undermined when legislators failed to replace more than $200 million of the estimated revenue lost (FY 2009 to 2013) by repealing the computer services tax in 2008. This example supports proposition #7 of this dissertation – namely that, “The pendulum swings of state tax policy and the political bias toward providing tax benefits leave long-term economic and demographic changes that threaten state tax systems unaddressed.”

[261] Republican Larry Hogan won a surprise victory in Maryland’s gubernatorial election in 2014 after pledging to roll back taxes increased by Governor O’Malley and the General Assembly. Nevertheless, Hogan’s attack on the tax increases included other increases approved during the 2011 to 2014 period.

Tax Policy Decisions in 2009

After the difficult battles to enact tax increases in the 2007 special session and to repeal the computer services tax in 2008, Maryland policymakers were unwilling to consider tax increases in 2009 even though the sinking economy continued to create large budget gaps. The budget shortfall and falling economy also left policymakers with little room to provide tax cuts, leading to a relatively quiet legislative session from the standpoint of tax policy. The projected $8.5 million first-year reduction in the state tax burden resulting from tax policy changes enacted in Maryland in 2009 equaled a net tax cut of less than one-tenth of 1 percentage point.[262]

Between June 2008 and March 2009, projected FY 2010 general-fund revenues for the state dropped by $2.2 billion, more than 14 percent of the general-fund baseline,[263] reflecting the effects of the sub-prime mortgage crisis, a sharp drop in the stock market, and a freeze in the credit markets. Nor was any relief in sight as Maryland policymakers began work on the state's FY 2010 budget. The Board of Revenue Estimates warned that, "With the housing market still falling, consumer spending under pressure, and business confidence faltering, the downturn will accelerate in the first half of 2009," (Board of Revenue Estimates, 2008b: i), and that the state's economic growth was unlikely to resume until 2010 at the earliest (Board of Revenue Estimates, 2008b: 8).

[262] Author's calculation using data from Department of Budget and Management, *Maryland Budget Highlights: FY 2010*, Appendix B, and "Fiscal and Policy Notes" prepared by the Department of Legislative Services for tax policy bills enacted in 2009. The fiscal and policy notes are available at www.mgaleg.maryland.gov.

[263] Author's calculation using data from Department of Legislative Services, "Senate Budget and Taxation Committee: Report on House Bill 100 – the Budget Bill, House Bill 101 – the Budget Reconciliation and Financing Act," March 31, 2009, p. 4.

FY 2010 Budget Process. As Governor O'Malley sought to close a $2.2 billion gap in preparing his FY 2010 budget request, the only bright spot was an economic stimulus package being crafted by newly-elected President Barack Obama. The governor estimated that the state would receive $350 million in federal stimulus funds for Medicaid, education, and infrastructure in FY 2010 that could replace general funding (Department of Budget and Management, 2009). Revenue measures accounted for only $28 million (1 percent) of the governor's gap-closing plan,[264] which relied on fund balances, transfers from special funds to the general fund, cost-shifting from the general fund to the capital fund, a salary freeze, and program cuts to balance the budget.

Although the $31.6 billion FY 2010 operating budget proposed by Governor O'Malley amounted to a 2.3 percent gain from FY 2009 (Department of Budget and Management, 2009: 6), the increase mostly reflected expected growth in federal funds (Department of Legislative Services, 2009a: 73-75). By contrast, the $14.4 billion FY 2010 general fund budget reflected a 1.3 percent decrease from FY 2009 (Department of Budget and Management, 2009: 8; Department of Legislative Services, 2009b: 1). The governor was able to boost education funding by 1 percent, to $5.4 billion, and impose a fourth consecutive annual freeze on tuition at state colleges and universities (Department of Budget and Management, 2009: 12-15; Department of Legislative Services, 2009b: 5), but the goal of aligning long-term spending and revenues had faded. The Department of Legislative Services estimated that ongoing revenues would fall almost $1.1 billion short of ongoing spending in FY 2010 (Department of Legislative Services, 2009a: 22).

---

[264] Author's calculation using data from Department of Legislative Services, "Fiscal Briefing," January 26, 2009, p. 3. The revenue measures included not only two tax policy changes discussed below but also fee increases, federal reimbursements, and cost settlements or recoveries in various programs.

The "Budget Reconciliation and Financing Act of 2009" (HB 101/SB 166), introduced by the governor to make statutory changes needed to balance the budget, included two minor tax policy changes, each with a projected revenue impact of less than $10 million in FY 2010. First, the governor proposed repealing the state's business tax credit for the purchase of Maryland-mined coal by public utilities and co-generators and suppliers of electricity.[265] Maryland policymakers had whittled down the coal credit after years of debate, acting in 2006 to cap the credits at $9 million annually in tax years 2007 to 2010, $6 million in tax years 2011 to 2014, and $3 million in tax years 2015 to 2020. After 2020, the credit would be eliminated. The governor's proposal to repeal the credit was consistent with his strong environmental views and efforts to discourage use of fossil fuels while promoting renewable forms of energy. Moreover, interviewees noted that Western Maryland, where coal is mined, is a predominantly Republican area where the governor had little support, and that repealing the credits may have seemed preferable to other measures that would have to be taken to reduce the budget gap.

Second, the governor proposed redirecting $6.5 million in tax revenues ($2.6 million from the motor fuel tax and $3.9 million from the short-term vehicle rental tax) from the Chesapeake and Atlantic Coastal Bays 2010 Trust Fund to the general fund. The Fund had been created in the 2007 special session to implement a multi-state agreement to reduce pollution in the Chesapeake Bay and its tributaries, and was then expanded in 2008 to include environmental programs in the Atlantic coastal bays.

[265] Specifically, public service companies and specified co-generators and suppliers of electricity could claim a $3 credit per ton of Maryland-mined coal purchased against the public service franchise tax and the corporate income tax.

Maryland's fiscal position got a big boost, and then took another blow, as the General Assembly reviewed the FY 2010 budget. The American Reinvestment and Recovery Act (ARRA) of 2009 proposed by President Obama and approved by Congress in February delivered almost $1.7 billion in additional federal aid to Maryland in FY 2010,[266] far more than the $350 million assumed in the governor's budget. Although much of the aid could be used only to increase state spending in areas such as job training and mass transit, Governor O'Malley proposed allocating discretionary funds to rescind education cuts and halt plans to lay off 700 state workers (Governor Martin O'Malley, 2009a). At the end of March, the Board of Revenue Estimates reduced its projections of general-fund revenues for the third time in a year, lowering the FY 2009 estimate by $444.5 million and the FY 2010 estimate by $716.5 million, as tax receipts continued to plummet in "the worst downturn since 1982, if not in the post-war period." (Board of Revenue Estimates, 2009a). The combined effect of the federal aid influx and the general fund shortfall led legislators to craft a final FY 2010 budget of $32.3 million in total funds, $700 million more than the governor had proposed, at the same time that they cut the general fund to $13.8 billion, a reduction of more than $500 million from the governor's request (Department of Legislative Services, 2009c: 4).

ARRA presented legislators with several tax policy questions, because it included the following federal income tax incentives that could also be mirrored in state income tax rules: (1) expanding the earned income tax credit for large families and married couples, (2) allowing a deduction for state vehicle excise taxes paid on the purchase of a

[266] Author's calculation using data from Department of Legislative Services, "Conference Committee Report on House Bill 100 – the Budget Bill, Report on House Bill 101 – the Budget Reconciliation and Financing Act," April 11, 2009, p. 4.

new car or truck, (3) offering a $2,400 deduction for unemployment insurance benefits, and (4) deferring taxation on income that results when a business buys back or exchanges debt. Legislators decided to conform the state income tax code to the ARRA provisions expanding the EITC, excluding unemployment insurance benefits, and deducting vehicle excise taxes, while disallowing the deduction for income arising from the cancelation of debt. The decision to adopt three of the four federal tax breaks, which was projected to cost $29.5 million in forgone tax revenue during FY 2010 (Department of Legislative Services, 2009d: 36), reflected widespread support for the stimulus package proposed by the president as well as a belief that tax incentives targeted at low-income individuals (the EITC and unemployment insurance provisions) would be particularly beneficial. Legislators rejected the deferral of taxation on the cancelation of debt income not only because it would benefit corporations, but also because it was particularly expensive – the projected revenue loss was $116.0 million in FY 2010 and $69.6 million in FY 2011 (Department of Legislative Services, 2009d: 36).

At the same time, the General Assembly made several modest tax policy changes to bolster general fund revenues. Although legislators rejected the governor's proposal to repeal the tax credit for Maryland-mined coal, they reduced the credit by 50 percent over the FY 2010-2013 period, saving $12 million. This compromise largely reflected the importance of geographic interests in the budget process and the tendency of legislators to defer to colleagues on issues of major importance in their districts, as well as the impact of personal relationships. Interviewees noted that repealing the coal tax credits would mean reneging on the 2006 agreement to phase out the credits, which had served as the basis for long-term investment and contracting decisions by the affected firms.

Moreover, interviewees agreed that respect for Republican Senator George Edwards, who represented Western Maryland and was known for being collegial, was decisive in preserving the credits. "It's a lot of personality things," stated Speaker Busch's co-chief of staff John Favazza. "It wasn't the lobbying of Mettiki Coal; it was the lobbying of Senator George Edwards" that saved the coal tax credits.

In addition, legislators increased from $6.5 million (proposed by the governor) to $21.5 million the transfer of motor fuel and rental car tax revenue from the Chesapeake Bay Trust Fund to the general fund in FY 2010. Within two years, a fund that was intended to generate $50 million annually for Chesapeake Bay cleanup had been reduced to $10 million, reflecting a pattern in which taxes are dedicated to high-priority purposes in order to facilitate enactment, and then later converted to general revenues. Table 5.15 (see next page) summarizes the tax policy items included in the FY 2010 budget and its companion bill, the budget reconciliation act.

Maryland policymakers did not consider more significant tax increases because they believed they had reached the limits of political feasibility by raising taxes in the 2007 special session. Speaker Busch's aide John Favazza recalled that, "In terms of that (four-year) term, we had done the tax thing. We weren't going to go back." Other interviewees echoed that point. Only three bills to increase tax revenues – two bills to raise alcoholic beverage excise taxes and a bill to impose the sales tax on communication services – were introduced by Maryland legislators in 2009,[267] but even these measures targeting narrower parts of the tax base were non-starters. Asked in a *Baltimore Sun*

[267] HB 1160 would have more than doubled excise taxes on liquor, wine, and beer, while dedicating most of the new revenue to services for the developmentally disabled and victims of domestic violence, sexual assault, and child abuse. SB 729 would have quadrupled the alcohol excise taxes and dedicated most of the

Table 5.15
Tax Policy Decisions in Maryland's Fiscal Year 2010 Budget

Budget Provision	Projected Fiscal Impact
Provide $6 million for Biotechnology Investment Tax Credits in FY 2010	None
Reduce Heritage Structure Rehabilitation Tax Credits by $7.7 million in FY 2010	$7.7 million, FY 2010
Limit Maryland-mined coal tax credit to $4.5 million annually, FY 2010-12, and to $6.0 million annually, FY 2013-14	$4.5 million, FY 2010 $12.0 million, FY 2010-14
Conform Maryland income tax code to federal law expanding the EITC, allowing deduction for vehicle excise taxes, and increasing deduction for unemployment insurance payments	-$29.5 million, FY 2010
Redirect $8.4 million of motor fuel taxes and $13.1 million of rental car taxes from Chesapeake and Atlantic Coastal Bays 2010 Trust Fund to general fund in FY 2010	$21.5 million, general fund -$21.5 million, special fund (FY 2010 only)
Reauthorize Higher Education Investment Fund for FY 2010 and dedicate 6 percent of corporate income tax revenue to Fund	None
Redirect transfer tax revenue from Program Open Space to general fund in FY 2010	$31.0 million, general fund -$31.0 million, special fund (FY 2010 only)

Sources: Department of Legislative Services, "Conference Committee: Report on House Bill 100 – the Budget Bill, Report on House Bill 101 – the Budget Reconciliation and Financing Act," April 11, 2009, and Department of Legislative Services, "Fiscal and Policy Note (Revised), House Bill 101," July 29, 2009.

interview about the merits of raising taxes in "areas that haven't been touched in decades, like alcohol," Speaker Busch stated that, "The appetite – not only by legislators but also the general public – for any kind of further tax increases is limited." (Dechter, 2009a). Senate President Miller answered the same question by stating that, "In my opinion, the best tax to raise at this point in time would be a gas tax … but quite frankly, the political

new revenue to services for the developmentally disabled and for addiction prevention and treatment services. HB 1182 would have repealed the franchise tax on telephone businesses while applying the sales tax to the electronic transmission of audio, data, video, voice, or other services, including cable services.

will is not there. If there was a will, that would be the best service to the public." (Dechter, 2009b). The Maryland Chamber of Commerce and the Greater Baltimore Committee continued to support a gasoline tax increase, but this option gained little traction due to policymakers' concerns about raising the tax during a severe recession (Hancock, 2009).

Other Tax Policy Legislation Considered in 2009. Governor O'Malley introduced two tax policy measures as part of his 2009 legislative agenda. First, HB 309/SB 258 would extend the Maryland Heritage Structure Rehabilitation Tax Credit program (set to expire at the end of June 2010) through the end of FY 2014 and remove the requirement for an annual appropriation of its commercial credits. In place of the annual cap, the heritage structure credits for commercial properties would be limited to $100 million over four years. Second, HB 308/SB 275 would reauthorize the Higher Education Investment Fund created during the 2007 special session, and continue to dedicate 6 percent of corporate income tax revenue to the Fund, reducing general fund revenues by $46.5 million in FY 2010 (Department of Legislative Services, 2009e: 1).

The governor's proposal to remove the annual appropriation caps on the heritage structure tax credit program, leading to an estimated revenue loss of $73.4 million from FY 2011 to FY 2014 (Department of Legislative Services, 2009f: 1), seems puzzling in light of the recession and fiscal crisis. The governor was seeking to undo restrictions that the General Assembly had established in response to spiraling costs of the program, which rose more than six-fold from tax year 2000 to 2002, exceeding $60 million in 2002 (Department of Legislative Services, 2009f: 8). To control costs, legislators had set the annual cap on commercial credits (which represented the bulk of total credits) in 2004 and also required that commercial credits be funded through appropriations to a reserve fund that would make the costs visible. Interviewees stated that the governor viewed the tax credits, which had been heavily used in Baltimore due to its older building stock, as a catalyst for economic and community development. The General Assembly did not approve the governor's bill, instead leaving the existing rules in place for another year, but the proposal shows the persistent interest in tax incentives for economic development even during a fiscal crunch. Similarly, due to concerns about strains on the general fund, the legislature did not act on the governor's bills (HB 308/SB 275) to permanently dedicate 6 percent of corporate tax revenues to the Higher Education Investment Fund, instead approving a one-year extension.

Even in the depths of the recession, the number of tax relief bills introduced by Maryland lawmakers exceeded the number of tax increase bills in 2009. A wide range of targeted tax cuts were offered to encourage energy conservation and protect the environment, promote economic development, and benefit particular groups such as veterans and domestic partners. The General Assembly approved 10 tax policy measures in 2009 as stand-alone legislation, most of which were minor in scope and fiscal impact, as summarized in Appendix 5.3 at the end of the chapter. Only one of the 10 measures would have increased revenues; six were projected to reduce revenue and three had no fiscal impact. None of the tax relief measures enacted by Maryland policymakers in 2009 had an annual cost of $1 million or more.

Two other patterns are notable in the tax policy measures enacted by the General Assembly in 2009. First, lawmakers routinely extended tax credits for economic development and employment with little analysis of their long-term goals or impact, individually or collectively. For example, in 2009 legislators granted the third consecutive one-year extension of business tax credits for employers who hire workers with disabilities. Because the votes to extend these tax credits were unanimous in both chambers in 2007, 2008, and 2009, it is surprising that legislators could not agree on a long-term reauthorization that would provide employers and workers with more certainty. Thus, the credits for hiring workers with disabilities (as well as other employment tax credits, such as those for welfare recipients) seem like ways of distributing benefits rather than as a considered means to a desired end. Second, lawmakers made repeated, incremental attempts to widen the scope of many tax benefits, allowing them to claim credit for helping various constituencies while limiting the cost in forgone revenues. For example, after exempting domestic partners from taxes on the transfer of property in 2008, legislators exempted domestic partners from estate and inheritance taxes in 2009. As posited by Hettich and Winer, Maryland policymakers regularly meted out tax benefits to earn goodwill from specific groups and reduce political opposition to taxation with modest costs that were not noticed on an individual basis.

More generally, the unwillingness of Maryland policymakers to consider tax increases to close a $2.2 billion budget gap in 2009 suggests that large tax increases at the state level follow a pattern of punctuated equilibrium. Because of strong anti-tax sentiment, policymakers are willing and able to enact major tax increases only in rare circumstances like that which prevailed in Maryland in 2007, when there was unified Democratic control of government, large Democratic majorities in both legislative chambers, and no statewide elections for another three years. This unusual confluence of factors made the 2007 special session tax package possible, but also depleted all of the political capital, if not courage, that lawmakers had amassed to increase taxes, effectively removing tax increases from the policy agenda until after the 2010 elections.

Maryland's tax policy deliberations in 2009 also partly support the proposition (#2) that policymakers tend to perform a limited search for tax policy options. The most notable piece of evidence concerns tax expenditures: two years into the deepest recession since World War II and the fiscal crisis that it caused, Maryland policymakers had considered only one proposal to curtail a tax expenditure that was already on the books: the governor's proposal to repeal the credits for coal mined in Maryland, which the General Assembly retained after cutting the annual credit caps in half. The Maryland case study highlights the strong support for tax incentives and their popularity as a policy tool: even as the governor was proposing the repeal of the coal tax credits in 2009, he proposed a significant expansion of the heritage structure tax credits (which was not adopted) and the General Assembly approved or expanded three tax exemptions for renewable energy.[268]

[268] These measures were HB 1171, which provided sales and property tax exemptions for residential wind energy equipment used to generate electricity; SB 554, which allowed a personal income tax deduction for the cost of upgrading a septic system using the best available nitrogen removal technology; and SB 621, which extended a sales and property tax exemption for solar energy equipment to include those who use the equipment to supply electricity to the electric grid.

Tax Policy Decisions in 2010

By the start of 2010, both the national and Maryland economies began to emerge from the worst downturn since the 1930s, entering a period of weak growth. General fund revenues were projected to increase by 3.0 percent in FY 2011 (Board of Revenue Estimates, 2009b: 11), the first increase in three years. The desire to spark the recovery and create jobs led Maryland officials to consider a number of tax-cut proposals in 2010, but the state's continuing fiscal gap served as a powerful constraint. For the second consecutive year, Maryland policymakers enacted a very modest net tax cut in 2010, equal to $14.9 million, or 0.1 percent of total tax revenues, in the first year.[269]

FY 2010 Budget Process. Governor O'Malley had to close a budget gap of $2 billion in crafting his FY 2011 budget (Governor Martin O'Malley, 2009b; Department of Legislative Services, 2010b: 2,4), reflecting the sharp reductions in revenue and higher costs that resulted from the recession. In fact, FY 2011 general-fund revenues were expected to remain below FY 2007 levels (Board of Revenue Estimates, 2009b: 13).

Despite the large budget gap, the governor and legislative leaders continued to declare tax increases off-limits in 2010. Policymakers were not only fatigued from the difficult tax policy debates of 2007 and 2008 but also preparing for the fall 2010 elections in which the governor and all 188 legislators would be on the ballot. Former governor Robert Ehrlich, who tried to unseat O'Malley in 2010, and other Republicans sought to make the 2007 tax increases an election issue and were energized by the growth of the anti-tax "tea party" movement. At the start of the year, Governor O'Malley told *The*

---

[269] Author's calculation using data from Department of Budget and Management, *Maryland Budget Highlights: FY 2010*, Appendix B, and "Fiscal and Policy Notes" prepared by the Department of Legislative Services for tax policy bills enacted in 2010. The fiscal and policy notes are available at www.mgaleg.maryland.gov.

Baltimore Sun that, "I think it is counterproductive to raise any tax in the midst of a recession and the unemployment that we have. And frankly, I hope that any tax increases that I've had to do as governor are behind us and not ahead of us." (Davis, 2010).

The governor's $32.1 billion budget request for FY 2011, a 0.8 percent drop from the FY 2010 budget (Department of Budget and Management, 2010a: 7), included only $44 million in new revenues resulting from policy changes (Department of Legislative Services, 2010c: 6). Instead, the governor closed the budget gap by extending budget cuts made the previous year (including local aid reductions, employee furloughs, and a salary freeze) and using special fund balances and federal stimulus dollars to replace general fund spending (Department of Budget and Management, 2010a: 9; Department of Legislative Services, 2010b: 2). The reliance on short-term patches led *The Baltimore Sun* to describe the governor's budget as held together by "gum and baling wire" (The Baltimore Sun, 2010a).

The governor included a relatively minor tax increase in the FY 2011 budget (despite describing the budget as involving no new taxes): an increase in the "quality assessment" on nursing homes from 2 percent to 4 percent of total operating revenue. All of the revenue from the nursing home assessment would continue to be earmarked for a special fund used to reimburse nursing facilities under the Medicaid program. As in 2007, the nursing home assessment was a relatively easy tax to increase because it would generate matching federal Medicaid funds that could benefit the payers. In addition, Governor O'Malley reprised his 2009 proposal to eliminate the Maryland-mined coal tax credit. Finally, the governor proposed shifting more than $200 million in earmarked corporate income, property transfer, admission and amusement, short-term vehicle rental, and motor fuel tax revenues to bolster the general fund in FY 2010 and FY 2011 (Department of Legislative Services, 2010d: 53, 55-56, 61-63).

The General Assembly made only minor changes to the governor's FY 2011 budget, reducing general fund appropriations by $57.1 million (Department of Legislative Services, 2010e: 4-8). Legislators approved the increase in the nursing home quality assessment proposed by the governor, which would generate $27 million in revenue for nursing home reimbursements as well as $27 million in federal matching funds. At the same time, legislators once again rebuffed the governor's proposal to repeal the coal tax credits, maintaining the prior year's agreement to cut the maximum annual credit in half through FY 2014. Lawmakers from Western Maryland, where the state's coal industry is located, successfully argued that the credit was essential to preserving jobs (Lazarick, 2010). In addition, legislators approved the governor's proposals to shift earmarked revenues to the general fund while authorizing an additional transfer of motor fuel tax revenues to the general fund. The tax policy changes included in the FY 2011 budget are summarized in Table 5.16 (see next page).

Legislators introduced seven major bills to raise tax revenue – defined as bills that would generate at least $500 million over the next five fiscal years – during the 2010 session in order to improve the long-term fiscal health of the state or restore program funding. Although none of these bills were enacted, they still offered policymakers a range of options that could be developed and modified in future years. The bills (summarized in Table 5.17) covered a wide range of taxes – the personal income tax, corporate income tax, motor fuel tax, alcohol excise taxes – and had the potential to influence future tax packages, just as bills that were considered in prior years became

Table 5.16
Tax Policy Decisions in Maryland's Fiscal Year 2011 Budget

Budget Provision	Projected Fiscal Impact
Increase nursing home quality assessment from 2% to 4%	$44.0 million, FY 2011 $240.7 million, FY 2011-15
Redirect motor fuel tax revenues from Gasoline and Motor Vehicle Revenue Account to general fund	$1.65 billion, general fund -$1.65 billion, special fund (FY 2011-2015)
Redirect corporate income tax revenues from Transportation Trust Fund and Higher Education Investment Fund to general fund	$34.0 million, general fund -$34.0 million, special funds (FY 2010 only)
Redirect rental car and motor fuel tax revenues from Chesapeake and Atlantic Coastal Bays 2010 Trust Fund to general fund	$30.1 million, general fund -$30.1 million, special fund (FY 2010 and 2011)
Redirect admission and amusement tax revenues from Special Fund for Preservation of Cultural Arts to general fund	$5.8 million, general fund -$5.8 million, special fund (FY 2010 and 2011)
Redirect transfer tax revenue from Program Open Space to general fund	$54.0 million, general fund -$54.0 million, special fund (FY 2011 only)

Sources: Department of Legislative Services, "Fiscal and Policy Note: Senate Bill 141," September 1, 2010, pp. 9-10, 52-55, 57-60, 65.

part of the tax package enacted in the 2007 special session. By continuing to develop and review tax policy options, Maryland lawmakers continued to stir Kingdon's "policy primeval soup."

Among the tax increase bills introduced in 2010, SB 717/HB 832, the "Lorraine Sheehan Health and Community Services Act of 2010," enjoyed the broadest support, with eight sponsors in the Senate and 41 sponsors in the House. The Abell Foundation, public health advocates, and social service providers formed a coalition to support the

Table 5.17
Major Tax Increase Bills Introduced During the 2010 Session
of the Maryland General Assembly

Legislation and Revenue Impact, FY 2011-15	**Level of Support/Outcome**
HB 10, "Teacher and Employee Pension Sustainability and Solvency Trust Fund." Would generate almost $900 million by making "millionaire's tax" permanent and requiring combined reporting of corporate income. Revenue would be earmarked to finance state's unfunded pension liability.	1 sponsor – reported unfavorably by House Appropriations and Ways and Means Committees
HB 479, "Motor Fuel Tax – Increase." Would generate $1 billion for Transportation Trust Fund by raising gas tax by 2¢/year for five years.	2 sponsors – no action beyond public hearing
HB 584, "Corporate Income Tax – Combined Reporting." Would generate $600 million by mandating combined reporting of corporate income.	16 sponsors – no action beyond public hearing
HB 832/SB 717, "The Lorraine Sheehan Health and Community Services Act of 2010." Would generate $1.1 billion by increasing alcohol taxes more than six-fold and earmarking funds for developmental disability, mental health, addiction prevention and recovery, and Medicaid programs.	8 sponsors in Senate and 41 sponsors in House – no action beyond public hearing in each chamber
SB 354, "Corporate Income – Combined Reporting – Pension Sustainability Trust Fund." Would generate $500 million by requiring combined reporting of corporate income. Revenue would be earmarked to finance state pension costs.	9 sponsors – no action beyond public hearing
SB 827, "Motor Fuel Tax – Index." Would generate $1.1 billion for Transportation Trust Fund by indexing gas tax on a quarterly basis.	1 sponsor – no action beyond public hearing

Sources: Fiscal and Policy Notes prepared by the Department of Legislative Services on each bill, available at www.mgaleg.gov, and legislative data base of the Maryland General Assembly, also found at www.mgaleg.maryland.gov.

Note: The two bills requiring combined reporting (HB 584 and SB 354) have different fiscal impact estimates because they would take effect in different tax years.

legislation, which would enact steep increases in alcohol excise taxes[270] and dedicate the proceeds ($1.1 billion over five years) to developmental disability, addiction treatment

[270] Specifically, the tax on distilled spirits would rise from $1.50 to $10.03 per gallon, the tax on wine would rise from 40¢ to $2.96 per gallon, and the tax on beer would rise from 9¢ to $1.16 per gallon.

and prevention, mental health, and Medicaid programs (Department of Legislative Services, 2010f: 1). Supporters argued that the tax increases were long overdue – Maryland's tax on distilled spirits was set in 1955 and the tax on beer and wine had not been changed since 1972 (Carson, 2010; Linskey, 2010) – and could also reduce the harms associated with alcohol abuse. Still, the alcohol tax increases faced strong opposition from business groups, such as the Restaurant Association of Maryland and the Maryland State Licensed Beverage Association, which argued that higher taxes would hurt retailers already reeling from the recession and shift purchases to nearby states – a classic case of concentrated benefits for some groups and concentrated costs for others generating a vigorous political battle. Because the general sales tax (which applies to alcoholic beverages) had been raised in 2007, opponents also argued that it was unfair to subject the industry to a second tax increase in three years (Maryland State Licensed Beverage Association, 2010; Restaurant Association of Maryland, 2010).

Although the strong anti-tax sentiment of the election year and concern about the economy blocked any movement on the Lorraine Sheehan Act, the pros and cons of the proposal were subject to scrutiny by lawmakers and the public, providing a basis for further discussion of alcohol excise tax rates in future years.[271] The debate over the Lorraine Sheehan Act also highlighted the complicated political dynamics of earmarked tax proposals. Several interviewees stated that earmarking funds for health and social welfare programs generated opposition from lawmakers who believed it was unfair to protect funding for those programs while other programs absorbed sharp budget cuts. Thus, the political value of an earmarked tax proposal may depend on the relative merits

[271] In 2011, Maryland legislators increased the sales tax on alcoholic beverages from 6 percent to 9 percent.

of the programs to be financed compared to other programs, as well as the pressures on the budget at any given time.

Other Tax Policy Legislation Considered in 2010. Tax incentives, which promised to increase the resources available to firms for hiring and investing, were a critical part of Governor O'Malley's response to ongoing economic hardship. The state's unemployment rate had more than doubled in two years from 3.5 percent to 7.3 percent, (Board of Revenue Estimates, 2009b: i, 7), creating pressure for policymakers to respond. The governor proposed the following tax policy changes to promote job creation and retention in Maryland while easing the burden of taxes on businesses:

1. offering businesses a $3,000 refundable "Job Creation and Recovery Tax Credit" for each unemployed worker hired full-time in 2010. The total value of the credits would be capped at $20 million.

2. rolling back unemployment insurance tax increases that were automatically triggered by a drop in the balance of the state's Unemployment Insurance Trust Fund.[272]

3. reauthorizing the Heritage Structure Rehabilitation Tax Credit, which would be renamed the "Sustainable Communities Tax Credit" and expanded to cover neighborhood revitalization and transit-oriented development projects, while giving extra weight to projects adopting green-building principles. The governor proposed allocating $50 million in credits over three years.

The emphasis on job retention and creation allowed Governor O'Malley to claim partial victories on his tax policy agenda. The proposal for a job creation and recovery tax credit did not arouse great enthusiasm among businesses concerned about the lack of demand for their products, or from legislators. Still, business and worker groups generally welcomed the plan (Leaderman, 2010; Kay, 2010; Rosen, 2010), which was

[272] Unemployment tax rates ranging from 0.6 to 9.0 percent of covered wages in 2009 were set to rise to a range of 2.2 to 13.5percent in 2010 (a given firm's rate depends on its history of layoffs). The governor proposed lowering the 2010 rates to a minimum of 1.8 percent and a maximum of 12.9 percent.

funded in the governor's proposed budget. After the Maryland Chamber of Commerce persuaded legislators to increase the credit per unemployed worker hired from $3,000 to $5,000 (Kay, 2010), the Senate approved the legislation, 45-0, and the House followed suit on a 134-6 vote. The credit was largely a symbolic response to economic distress, because it could be claimed only for 4,000 jobs ($20 million/$5,000 per job) – only 5 percent of the 79,400 jobs that had been lost in Maryland since employment peaked in February 2008 (Spending Affordability Committee, 2009: 3). Interviewees noted that it would be incongruous and unwise from a political standpoint to oppose the job creation and recovery credits despite doubts about their effectiveness; in this case, the image of doing something to promote employment was as important as the reality.

Legislators also approved a compromise on the governor's proposed revisions to the heritage structure tax credit, expanding it to support community revitalization and transit-oriented development, while rejecting the governor's request to remove the annual cap on commercial credits. This was still a major victory for the governor, because legislators had blocked his reauthorization bill the prior year amid concerns about the deficit and the large proportion of benefits that went to Baltimore City (Wagner, 2010). At the start of the 2010 session, Senate President Miller had stated that the program should be allowed to lapse (The Baltimore Sun, 2010b; The Baltimore Sun, 2010c; Bykowicz, 2010a). Nonetheless, the program was saved by blurring its focus; non-historic structures were now eligible for credits, reflecting how tax credits can be readily attached to leading or emerging issues on the policy agenda. "This is tying the historical credit into smart growth, which takes it into the green environment," Warren

Deschenaux, DLS' director of policy analysis, stated in an interview.[273] Democratic legislators' desire to help the governor in his reelection bid also affected the outcome. "At the end of the day, it came down to, 'We want the governor to be successful,'" Speaker Busch's aide John Favazza stated in an interview.

The governor's proposal to lower unemployment insurance tax rates was opposed by business groups because it included provisions that they believed would raise costs and tax rates in the future (Bykowicz, 2010b).[274] This opposition led the General Assembly to delete the tax cut from unemployment insurance legislation.

Governor O'Malley introduced two additional tax policy measures intended to promote another important part of his agenda: energy conservation and environmental protection. SB 281/HB 469 would replace a motor vehicle excise tax credit for hybrid vehicles with a $2,000 vehicle excise tax credit for plug-in electric vehicles. SB 287/HB 464, the "Maryland Clean Energy Incentive Act of 2010," would extend clean energy income tax credits for five years to encourage use of solar, wind, geothermal, biomass, and other renewable sources of electricity. Both bills passed easily because incentives for environmental protection and energy conservation did not create large or visible costs for any group.[275] In addition, the total costs of the credits were relatively modest. The clean energy incentive tax credits would remain capped at $25 million for the life of the

[273] Among the groups testifying in favor of the legislation were the Maryland League of Conservation Voters and the Chesapeake Bay Foundation.

[274] The lower tax rates were to be funded with money that the federal government would grant if Maryland made a number of other policy changes, such as a new formula that would increase benefits as well as allow payments to unemployed workers who enroll in job training rather than first looking for work.

[275] HB 464 was approved by the House on a 137-0 vote and the Senate on a 45-2 vote. HB 469 was approved by the House on a 139-0 vote and the Senate on a 46-0 vote.

program and the electric vehicle credit was projected to cost $3.8 million until it expired at the end of FY 2013 (Department of Legislative Services, 2010g: 1; Department of Legislative Services, 2010h: 1).

Legislators proposed an array of tax cuts in the 2010 legislative session, including four major tax cut bills (defined as costing more than $500 million over five years) that were shelved because they would require large program cuts and were sponsored by largely powerless Republican legislators.[276] A medium-size tax cut bill (estimated to cost as much as $50 million annually), SB 385/HB 946, the "Building Opportunities for All Students and Teachers (BOAST) in Maryland Tax Credit," started the session with better prospects (Department of Legislative Services, 2010i: 1-4). The bill, which was approved by the Senate in 2008 and was also introduced in 2007 and 2009, would offset 75 percent of donations made by a business or non-profit to provide scholarships to students or tuition aid for teachers at a private school, grants to public schools, or training to public school teachers. The House version was sponsored by a majority of members (75) and Governor O'Malley endorsed the legislation for the first time, contending that it would help public schools by stabilizing private-school enrollment (Governor Martin O'Malley, 2010). In addition, Archbishop Edwin O'Brien of Baltimore made a rare appearance to testify in favor of the bill, stating that it could have helped prevent the closing of 13 Catholic schools in Baltimore (Maryland Catholic Conference, 2010).

Nevertheless, the BOAST tax credits failed once again in the House Ways and Means Committee after passing the Senate on a 30 to 17 vote. The defeat of the

[276] These bills were SB 738 and HB 1286, which would lower the sales tax to 5%; SB 773, which would repeal the corporate income tax from 2010 to 2013; and SB 160, which would phase in a personal income tax subtraction of $3,000 for federal income tax payments. SB 773 and SB 160 were both rejected in unanimous votes of the Senate Budget and Taxation Committee; the other bills saw no action.

legislation was largely due to sharp, longstanding policy cleavages on education policy that drove the debate. Opponents such as the Maryland State Education Association and the NAACP Maryland saw the bills as a disguised version of private-school voucher proposals that could divert or undermine support for public schools (Maryland State Education Association, 2010: NAACP State of Maryland Conference of Branches, 2010). The opposition of teachers' unions, school boards, and civil liberties groups, as well as House Ways and Means chairman Sheila Hixson, ultimately doomed the BOAST legislation.[277] The unusual controversy over the legislation – most tax incentive bills that received a committee or floor vote passed with unanimous or near-unanimous votes – suggests that it is difficult to mobilize opposition to tax preferences unless a measure addresses controversial, divisive policy issues that are monitored by organized interests and spur them to take action. Otherwise, the costs of organizing citizens to oppose tax incentives that will impose negligible financial costs on them are too great to overcome.

Other tax cut measures spanned the range of state taxes and targeted an array of groups and activities. As in prior years, service members and veterans were an object of concern, as were economic development and employment.[278] The tax policy measures that were enacted as stand-alone legislation are summarized in Appendix 5.4 at the end of the chapter. Only one of the 14 bills (a measure to impose the vehicle excise tax on off-

---

[277] The BOAST legislation also suffered from design flaws cited by opponents. For example, there was no cap on the credits even though caps were used for many other Maryland tax credit programs. In addition, the 75 percent credit was relatively high, a concern that was noted by House Ways and Means Committee Chairman Sheila Hixson. See Andy Rosen and Nick DiMarco, "Private Schools Tax Credit Uncertain in House, Passes Senate," www.marylandreporter.com, March 17, 2010.

[278] Lawmakers proposed greater deductions of retirement income for members of the military (SB 1/HB 1) and continued sales tax exemptions for veterans' organizations (SB 237/HB 203). To promote economic development and job opportunities, lawmakers proposed extending tax credits for research and development (SB 64) and for hiring people with disabilities (SB 221).

highway recreational vehicles) was projected to increase revenues. The majority of the bills (11) would decrease revenues and two would have no net fiscal impact.

There were two notable patterns concerning the stand-alone tax policy measures enacted in Maryland in 2009, both reflecting the way that targeted tax cuts served as ways of distributing benefits or taking symbolic actions, rather than carefully chosen means of meeting a specified policy goal. First, policymakers continued to routinely extend tax credits that came up for sunset review (clean energy tax credits, credits for hiring employees with disabilities, and research and development tax credits) without undertaking the detailed reviews that program sunsets were supposed to trigger. In fact, in 2010 the tax credits for hiring qualified employees with disabilities received their fourth consecutive one-year extension without any changes to the program or any review of its effectiveness evident from the legislative record.

To the extent that information on tax incentives' effectiveness was available, it did not seem to affect policy decisions. The Department of Legislative Services observed that a cap on the R&D credits meant that they covered only 0.37 to 0.65 percent of R&D expenses for qualifying firms in 2007 (Department of Legislative Services, 2010j: 3-4), dampening the impact of the credits, but the credits were reauthorized without any changes in response to this finding. Similarly, DLS pointed out that an incremental job creation tax credit (which only rewards a firm that expands its payroll) was likely to be more effective in stimulating economic growth and employment than the administration's job creation and recovery tax credit (which would reward firms for hiring unemployed workers, regardless of total payroll), but the credit was not modified to reward growth in employment (Department of Legislative Services, 2010k: 9).

Appendix 5.1

Tax Policy Legislation Enacted during the 2007 Regular Session of the Maryland General Assembly

Legislation	Projected Fiscal Impact
HB 35, "Income Tax – Expensing of Section 179 Property." Extends state's decision to "decouple" from federal law allowing businesses to deduct costs of tangible personal property or computer software more quickly.	No fiscal impact because revenue estimates assumed decoupling would continue.
HB 392/SB 419, "Income Tax – Subtraction Modification – Military Retirement Income for Commissioned Officers." Extends military retirement income subtraction to certain individuals who retired from active duty before July 1, 1991.	-$118,000, FY 2008 -$604,000, FY 2008-12
HB 590, "State Taxes – Solar Energy Grants and Devices." Provides state property tax exemption for a solar energy device installed in a home, and allows an income tax subtraction for grants received under the Solar Energy Grant Program.	-$62,000, FY 2008 -$331,000, FY 2008-12
HB 598, "Maryland Heritage Structure Rehabilitation Tax Credit Program." Extends credit through FY 2010 and alters geographic restriction on awarding of commercial credits.	$0, FY 2008 -$58.3 million, FY 2008-12
HB 1257/SB 945, "Income Tax – Captive Real Estate Investment Trusts." Disallows for state income tax purposes the dividends paid deduction for a captive REIT.	$10.0 million, FY 2008 $53.3 million, FY 2008-12
HB 1386/SB 962, "Agricultural Ownership Entities – Homestead Tax Credit." Expands eligibility for state homestead property tax credit to "agricultural ownership entities."	Revenue loss cannot be reliably estimated.
HB 1422, "Property Tax – Exemptions – Bus Shelters." Allows state property tax exemption for bus shelters constructed by a private entity under an agreement with a state or local government, or a public college or university.	-$13,000, FY 2008 -$67,000, FY 2008-12
SB 101, "Nursing Facilities – Quality Assessment – Medicaid Reimbursement." Imposes quality assessment of up to 2% of net operating revenues on freestanding nursing facilities.	$16.0 million, FY 2008 $111.1 million, FY 2008-12
SB 1033, "Tax Credits for Individuals Facing Employment Barriers – Sunset Extension." Extends State Employment Opportunity Credit and Qualifying Employees with Disabilities Tax Credit through FY 2008.	-$436,000, FY 2008 -$1.2 million, FY 2008-12

Source: Internet site of the Maryland General Assembly, http://mgaleg.maryland.gov.

Appendix 5.2
Maryland Tax Policy Bills Enacted in 2008 as Stand-Alone Legislation

Legislation	Projected Fiscal Impact
HB 140, "Income Tax – Credit for Cellulosic Ethanol Technology Research and Development." Creates business tax credit for a portion of expenses on cellulosic ethanol technology R&D.	no fiscal impact, FY 2009 -$918,000, FY 2009-13
HB 280, "Tax Credits for Qualifying Employees with Disabilities – Sunset Extension." Extends business tax credits for one year.	-$202,000, FY 2009 -$655,000, FY 2009-13
HB 377, "Solar and Geothermal Tax Incentive and Grant Program." Exempts solar energy and geothermal equipment from sales tax, and exempts solar energy property from real property taxes.	-$158,000, FY 2009 -$1.2 million, FY 2009-13
HB 669, "Motor Vehicle Excise Tax – Exemption for Returning Military Members." Extends motor vehicle excise tax credit to service members who return to Maryland from or on active duty.	-$165,000, FY 2009 -$1.1 million, FY 2009-13
HB 680, "Arts and Entertainment Districts – Tax Benefits – Jewelry and Clothing Designers." Offers income tax deduction and other tax benefits to jewelry and clothing designers in arts and entertainment districts.	revenue loss cannot be reliably estimated
HB 721, "Job Creation Tax Credit – Termination Provisions." Extends job creation business tax credits through end of 2013.	no fiscal impact, FY 2009 -$3.7 million, FY 2009-13
HB 985, "Sales and Use Tax – Energy Star Product Exemptions – Boilers." Adds boilers to sales tax holidays starting in FY 2011.	no fiscal impact, FY 2009 -$13,000, FY 2009-13
HB 1534, "College Savings Plans of Maryland." Makes contributions to plans offered by broker-dealers eligible for state income tax deduction.	-$240,000, FY 2009 -$12.8 million, FY 2009-13
HB 1570, "Motor Vehicle Excise Tax – Leased Vehicles – Application of Trade-in Value." Allows trade-in value of a non-leased vehicle to be deducted from excise tax on a vehicle lease.	-$201,000, FY 2009 -$1.7 million, FY 2009-13
SB 12, "Subtraction Modification – United States Coast Guard Auxiliary." Reduces amount of service needed for U.S. Coast Guard Auxiliary members to qualify for income tax deduction.	-$8,000, FY 2009 -$44,000, FY 2009-13
SB 206, "BRAC Community Enhancement Act." Authorizes corporate income and personal property tax credits, as well as real property tax rebates, in BRAC Revitalization and Incentive Zones.	significant revenue loss cannot be reliably estimated
SB 297, "Tax Credit for Employer Established Work-Based Learning Programs for Students." Offers tax credits for a share of wages paid to students in work-based learning programs.	no fiscal impact, FY 2009 -$547,000, FY 2009-13
SB 314, "State Employment Opportunity Credit – Sunset Extension." Extends tax credits for hiring recent welfare recipients for one year.	-$202,000, FY 2009 -$690,000, FY 2009-13
SB 565, "Income Tax Credit – Bio-Heating Oil." Provides income tax credit for purchase of bioheating oil for space or water heating.	-$121,000, FY 2009 -$1.2 million, FY 2009-13
SB 597, "Recordation and Transfer Taxes – Exemptions – Domestic Partners." Exempts transfer of residential property between domestic partners from transfer and recordation taxes.	revenue loss cannot be reliably estimated
SB 662, "Agricultural Land Transfer Tax – Surcharge and Distribution of Revenue." Places 25% surcharge on transfer tax for agricultural land.	$3.1 million, FY 2009 $15.5 million, FY 2009-13

Source: Fiscal and Policy Notes prepared by the Department of Legislative Services, available at www.mgaleg.gov.

Appendix 5.3
Maryland Tax Policy Bills Enacted in 2009 as Stand-Alone Legislation

Legislation	Projected Fiscal Impact
HB 193, "Gaming – Bingo." Extends authority to operate electronic bingo machines until 7/1/12; raises state amusement tax on electronic bingo from 20% to 30%; and dedicates extra revenue to special fund for cultural arts.	$9.9 million, FY 2010 $29.7 million, FY 2010-14
HB 493/SB 800, "Biotechnology Investment Incentive Tax Credit." Clarifies that individuals are eligible for the credit.	no fiscal impact
HB 783, "Transfer Tax – Program Open Space Bonds – Land and Easement Acquisition." Allows use of transfer tax revenue to pay debt on Program Open Space bonds.	no fiscal impact redirects tax revenue from special fund to debt service
HB 1171, "Alternative Energy Tax Incentive Act of 2009." Exempts residential wind energy equipment used to generate electricity from the sales tax and state and local real property taxes.	minimal revenue loss, but cannot be reliably estimated
HB 1399, "Department of Housing and Community Development – Neighborhood and Community Assistance Program – Individual Donor Eligibility – Tax Credit." Expands credit to include donations made by individuals.	no fiscal impact due to annual cap on credits
SB 44, "Sales and Use Tax – Exemption – Veterans' Organizations." Extends tax exemption for sales to veterans' organizations until 6/30/12.	-$81,000, FY 2010 -$262,000, FY 2010-14
SB 554, "Chesapeake Bay Nitrogen Reduction Act of 2009." Allows an income tax deduction for the cost of upgrading a septic system using the best available nitrogen removal technology.	no fiscal impact, FY 2010 -$934,000, FY 2010-14
SB 604, "Tax Credits for Qualifying Employees with Disabilities – Sunset Extension." Extends business tax credits for hiring employees with disabilities for one year.	-$47,000, FY 2010 -$165,000, FY 2010-14
SB 621, "Sales and Use and Property Tax – Exemptions – Solar Energy Equipment and Property." Extends existing sales and property tax exemptions to include solar energy equipment and property used to generate electricity supplied to the electric grid.	revenue loss cannot be reliably estimated
SB 785, "Inheritance Tax – Exemption – Domestic Partners." Exempts a joint primary residence from estate tax if it passes to a domestic partner.	-$975,000, FY 2010 -$4.88 million, FY 2010-14

Source: Fiscal and Policy Notes prepared by the Department of Legislative Services, available at www.mgaleg.gov.

Appendix 5.4
Maryland Tax Policy Bills Enacted in 2010 as Stand-Alone Legislation

Legislation	Projected Fiscal Impact
HB 199/SB 520, "Homestead Property Tax Credit – Eligibility of Employees of the Federal Government Stationed Outside the State." Allows federal employees stationed out of state to maintain homestead tax credit on principal residence for up to six years.	-$9,000, FY 2011 -$46,000, FY 2011-15
HB 443, "Inheritance Tax – Exemption – Surviving Spouses of Predeceasing Descendants." Exempts from inheritance tax property that passes to a surviving spouse of a lineal descendant of the decedent.	revenue loss cannot be reliably estimated
HB 464, "Maryland Clean Energy Incentive Act of 2010." Extends clean energy incentive tax credit through 2015 and makes it refundable.	no fiscal impact, FY 2011 -$14.9 million, FY 2011-15
HB 469, "Motor Vehicle Excise Tax – Tax Credit for Electric Vehicles." Provides tax credit up to $2,000 against vehicle excise tax for purchase of a plug-in electric vehicle from 1/1/10 to 6/30/13.	-$279,000, FY 2011 -$3.8 million, FY 2011-15
HB 475, "Smart, Green, and Growing – The Sustainable Communities Act of 2010." Renames the Heritage Structure Rehabilitation Tax Credit and extends program through FY 2014. Makes "Main Street" communities and transit-oriented developments eligible for credits.	-$11.4 million, FY 2011 -$74.7 million, FY 2011-15
HB 855, "Sales and Use Tax – Exemption – Lodging at a Corporate Training Center." Provides sales tax exemption for lodging at Lockheed Martin Corporation's Center for Leadership Excellence.	-$371,000, FY 2011 -$1.9 million, FY 2011-15
SB 59, "Agricultural Land Transfer Tax – Distribution and Use of Revenue." Alters allocation of agricultural land transfer tax revenue.	no fiscal impact
SB 64, "Maryland Research and Development Tax Credit – Sunset Extension." Extends R&D tax credit through 6/30/21.	no fiscal impact, FY 2011 -$12.2 million, FY 2011-15
SB 106, "Labor and Employment – Job Creation and Recovery Tax Credit." Provides $5,000 tax credit for each unemployed worker hired before the end of 2010. Credits are capped at $20 million.	-$20 million, FY 2011 -$20 million, FY 2011-15
SB 139, "Property Tax – Exemption for Disabled Public Health Service and NOAA Officers and Surviving Spouses." Extends property tax exemption for disabled veterans to officers of the Public Health Service and the National Oceanic and Atmospheric Administration.	-$5,000, FY 2011 -$25,000, FY 2011-15
SB 221, "Tax Credits for Qualifying Employees with Disabilities – Sunset Extension." Extends tax credits for employing people with disabilities through 6/30/11.	-$68,000, FY 2011 -$190,000, FY 2011-15
SB 237, "Sales and Use Tax – Exemptions – Veterans' Organizations." Provides tax exemption for sales made to veterans' organizations that qualify as non-profits under section 501(c)(4) of the federal tax code.	revenue loss cannot be reliably estimated
SB 283/HB 470, "Higher Education Investment Fund – Tuition Stabilization and Funding." Makes permanent the distribution of 6% of corporate income tax revenue to the Fund.	no net fiscal impact – only shifts funds
SB 466, "Vehicle Laws – Off-Highway Recreational Vehicles – Titling." Imposes vehicle excise tax on off-highway recreational vehicles if sales and use tax was not paid.	$193,000, FY 2011 $1.2 million, FY 2011-15

Source: Fiscal and Policy Notes prepared by the Department of Legislative Services, available at www.mgaleg.gov.

Chapter 6

Virginia Case Study

Contents

> A funding system designed 21 years ago is no longer suitable for our 21st century needs. We must find a new source of long-term, sustainable revenue if we are to solve our problems.
>
> -- Governor Tim Kaine, State of the Commonwealth address, January 10, 2007

Summary

The Virginia case study offers a very different perspective on state tax policy formulation than the District of Columbia or Maryland case studies because of Virginia's more conservative, anti-tax ideology and its divided government during the case study period. By contrast, both D.C. and Maryland politics and governance were characterized by a more liberal ideology, reflected in Democratic party control of the executive and legislative branches from 2007 to 2010, which facilitated tax increases in D.C. to balance the budget during the Great Recession and in Maryland to correct a long-term budget imbalance. As shown in Table 6.1 (see next page), Virginia's divided government led to stalemate on tax policy during the case study years. Net reductions in the tax burden of less than one-tenth of 1 percent in 2007 and 2008 were followed by a small net tax increase in 2009 (0.4 percent) and almost no change (a reduction of three-hundredths of 1 percent) in 2010.

Table 6.1
Impact on Virginia Tax Burden from Statutory Changes, 2007-2010
(dollars in 000s)

Legislative Session	**Projected Change in Tax Revenues for Next Fiscal Year**	**% Change in Tax Revenues for Next Fiscal Year**
2007	-$4,537	0.0%
2008	-$3,843	0.0%
2009	$65,116	0.4%
2010	-$522	0.0%

Note: The annual change represents the projected revenue impact of statutory changes in tax policy in the upcoming fiscal year, divided by the budgeted (projected) amount of tax revenue in the current fiscal year.

Sources: Annual budget requests prepared by the Governor of Virginia, available at www.dpb.virginia.gov, and fiscal impact statements prepared by the Virginia Department of Taxation and Virginia Department of Budget and Planning, available at http://leg1.state.va.us.

Democratic governor Tim Kaine proposed tax rate increases during each of the case study years, but was rebuffed each time by the Virginia General Assembly except for a health provider tax that was enacted in 2010. Kaine's proposed increases in the vehicle excise tax (2007 and 2008), cigarette tax (2009), and the personal income and insurance premiums taxes (right before he left office in 2010) were defeated.

Major tax policy changes were blocked due to an obstructed "political stream," to use John Kingdon's terminology: Kaine and the state Senate (controlled by Republicans in 2007 and Democrats from 2008-2010) would accept only targeted tax cuts and the House of Delegates (controlled by Republicans from 2007-2010) would accept only the most minuscule tax increases (which were usually labeled "fees"). Even the multi-billion dollar budget gaps that Virginia lawmakers faced in 2009 and 2010 due to the economic downturn could not shake the anti-tax stance enforced by the House of Delegates and supported by Republican Governor Robert McDonnell, who succeeded Kaine in 2010.

After Virginia policymakers raised sales, cigarette, and deed recordation taxes in 2004, part of a major tax overhaul intended to provide sufficient funding for education and other services, tax policymaking in the state had entered a period of stasis. Still, this stability reflected the distinctive political alignment of the period and is not necessarily part of a long-term cycle of change and stability, as posited in chapter 1 (proposition #1).

Consistent with proposition #2 ("State officials will tend to conduct a limited search for tax policy options") and proposition #3 ("State officials emphasize political acceptability in evaluating tax policy options"), Virginia lawmakers considered a narrow range of tax policy options during the case study period – much narrower than their counterparts in D.C. and Maryland – and emphasized political acceptability in developing and evaluating those options. In a divided government where consensus was difficult to reach, large tax increases or decreases were unlikely, and policymakers had to focus on getting tax legislation through both houses of the legislature and signed into law by the governor. Although the severe economic hardship and fiscal problems caused by the recession led legislators from both ends of the political spectrum to introduce more sweeping tax policy bills in 2009 and 2010, including measures to revive the state estate tax and repeal the corporate income tax, these bills died in committee.

As shown in Table 6.2 (see next page), the tax rate changes that received serious consideration in Virginia from 2007 to 2010 – defined as proposals made by the governor in the budget or bills approved by at least one house of the General Assembly – were skewed toward the periphery of the tax system. Only three of the 18 tax rate changes that were seriously considered targeted broad-based taxes: (1) a .25 percent increase in the sales tax to finance transportation projects approved by the Virginia Senate in 2008, (2) a .5 percent cut in the sales tax on food, also part of the Senate's 2008 transportation financing bill,[279] and (3) a 1 percent increase in the personal income tax proposed by Governor Kaine in 2010. None of these proposals became law and the income tax increase was rejected in the House of Delegates by a 97-0 vote.

To avoid that kind of resounding defeat, most tax increase proposals in Virginia during the case study period were targeted at smaller, less visible levies, particularly excise taxes. Vehicle excise tax and motor fuel tax increases were proposed several times in transportation financing bills that were a focal point of debate in 2007 and 2008. Other excise tax proposals were even narrower, covering diesel fuel (a subset of the motor fuel tax), new tires, and digital media purchases in hotel rooms. Tax increase proposals from 2007 to 2010 also targeted the grantor's tax (a transaction tax paid by the seller of real property), the cigarette tax, and the insurance premiums tax – none of which provided as much as 3 percent of the state's tax revenue in FY 2006[280] – as well as health care providers, who were not subject to any taxes at the start of the case study period.

[279] The cut in the sales tax on food was designed to reduce the regressive impact of the increase in the general sales tax rate.

[280] Author's calculation based on data from Comptroller of Virginia, *A Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006* (December 2006), p. 44.

Table 6.2
Tax Rate Changes Considered in Virginia, 2007-2010

Sponsor and Year	Proposal	Outcome
House Speaker William Howell, 2007	Increase diesel fuel tax to 17.5¢/gallon	Enacted
Delegate Glenn Oder and Senator Mary Margaret Whipple, 2008	Maintain $1 tax on sale of new tires (which was supposed to drop to 50¢)	Enacted
Senator Louise Lucas, 2009	Impose 10% tax on hotel-room purchase or rental of digital media	Enacted
Governor Tim Kaine, 2010	Impose 5.5% tax on intermediate care facilities for intellectually disabled	Enacted
Governor Tim Kaine, 2007	Increase vehicle excise tax to 5%	Not Enacted
Senator Richard Saslaw, 2008	Increase motor fuel tax by 1¢/gallon for five consecutive years	Not Enacted
Senator Thomas Norment, 2008	Impose 50% gross receipts tax on "instant racing" at 10 sites	Not Enacted
Governor Tim Kaine, 2008	Increase vehicle excise tax to 4%	Not Enacted
Governor Tim Kaine, 2008	Increase grantor's tax by 25¢ per $100 of assessed value	Not Enacted
Senate Democrats, 2008	Increase motor fuel tax by 1¢/gallon for six consecutive years	Not Enacted
Senate Democrats, 2008	Increase vehicle excise tax to 3.5%	Not Enacted
Senate Democrats, 2008	Increase state sales tax by 0.25%	Not Enacted
Senate Democrats, 2008	Reduce state sales tax on food by 0.5%	Not Enacted
Governor Tim Kaine, 2009	Double cigarette tax to 60¢ per pack	Not Enacted
Governor Tim Kaine, 2009	Impose 5.5% tax on intermediate care facilities for intellectually disabled	Not Enacted
Governor Tim Kaine, 2010	Increase personal income tax rate by 1%	Not Enacted
Governor Tim Kaine, 2010	Increase insurance premiums tax to 2.7%	Not Enacted
Senator Emmett Hanger, 2010	Adjust motor fuel tax using index of fuel efficiency	Not Enacted

Note: the tax rate changes included in Table 6.2 are those that were proposed by the governor or approved by at least one chamber of the General Assembly.

Governor Kaine's transportation financing proposals of 2007 and 2008, which sought to address a transportation funding shortfall estimated at $1 billion annually or more, provide the best examples of how tax policy proposals in Virginia were framed to increase their political acceptability – at the expense of normative principles such as efficiency and equity. The governor stated publicly that he would have preferred to raise the motor fuel tax to finance transportation improvements because the tax (1) allocates the costs of infrastructure according to an approximate measure of usage, and (2) collects revenue from out-of-state users. Nevertheless, the governor acknowledged that he did not pursue that option because the motor fuel tax is highly salient – paid by drivers at the pump every week – and an increase was politically unpopular, particularly in a time of soaring gas prices. Instead, the vehicle excise tax served as a more appealing substitute because most residents pay the tax only once or twice each decade. In describing the governor's strategy in formulating tax proposals, Wayne Turnage, who served as Kaine's chief of staff, stated that, "The obvious internal hurdle is whatever opposition exists politically in the House or the Senate. You have to ask, 'What will allow you to get a bill that funds what I'm asking to be funded?'"

After Governor Kaine's proposals to increase the vehicle excise tax to 5 percent failed in both 2006 and 2007, he paired a smaller vehicle excise increase tax (to 4 percent) with a grantor's tax increase in 2008, but this combination was also defeated. While the vehicle excise tax proposal sacrificed some of the advantages of the motor fuel tax in the name of political acceptability – the excise tax is not paid by out-of-state motorists – the grantor's tax proposal represented a complete departure from the principle of benefits taxation.[281] Imposed on the seller of real estate, the grantor's tax has no connection to use of the transportation network.[282] Rather, Governor Kaine chose this

[281] "Benefits taxation" refers to the principle that people should pay taxes in proportion to the benefits they receive from government programs. Benefits taxation is often seen as equitable because it aligns benefits and costs, while encouraging people to economize on their use of public services. See Joseph J. Cordes, "Benefit Principle," in *The Encyclopedia of Taxation & Tax Policy*, Second Edition (The Urban Institute Press, 2005), Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle, editors.

[282] Some have made a tenuous connection between the sale of homes and real estate developments that require new or improved roads, but the tax increase would have affected all home purchases.

levy due to its possible political acceptability: the General Assembly had approved a grantor's tax increase as an optional funding source for regional transportation authorities in 2007. In bypassing the traditional main source of transportation funding – the motor fuel tax – the governor would also give up the efficiency gains from a tax that encourages people to economize on use of the roads.

Social welfare and political concerns were intertwined in tax policy proposals considered in Virginia during the case study period. For example, Governor Kaine's proposal to double the cigarette tax was motivated by his desire to avoid further cuts to Medicaid (cigarette tax revenues were dedicated to Medicaid and other health programs), as well as his interest in discouraging smoking and preventing some of its harmful health effects. Although the cigarette tax increase was defeated, it also seemed politically feasible – in a relative sense – because policymakers had raised the tax in 2004, but to a level still far below the national median (and way below that of D.C. and Maryland). Nevertheless, the bulk of the evidence still suggests that political feasibility played a dominant role in shaping tax policy proposals in Virginia during the case study period. Governor Kaine proposed a broad-based tax increase (the 1 percent increase in the personal income tax) only during his last month in office, when political pressures on him were at their lowest. Interviewees struggled to provide a rationale for the governor's proposed insurance premium tax increase in 2010, suggesting that the relatively low salience of the tax was a key factor.[283]

Divided government and strong anti-tax sentiment in the House of Delegates not only pushed revenue policy proposals in Virginia toward the periphery of the tax system,

[283] One interviewee noted that the insurance industry benefits from stronger law enforcement, which can prevent insurance claims by deterring and punishing crime.

but also toward an array of non-tax sources. To a much greater degree than their counterparts in D.C. and Maryland, Virginia policymakers relied on fees, fines, and devolution of authority to other levels of government to fund public services, as illustrated by a major transportation funding package (HB 3202) enacted in 2007. After rejecting the governor's proposed increase in the vehicle excise tax, the legislature compromised with the governor on a state financing package of $2.1 billion over six years (less than half of the $4.8 billion in state funding sought by the governor) that diverted existing tax revenue streams (which provided $1.1 billion, or 52 percent of the total) and boosted fines and fees (which provided $880 million, or 42 percent of the total). A diesel fuel tax increase would yield $134 million, or 6 percent of total revenue.

To compensate for the significant reduction in state financing, a proposal authorizing regional bodies in Northern Virginia and Hampton Roads (the areas most plagued by traffic congestion) to raise a variety of taxes and fees was part of the 2007 transportation funding package. These revenue options would generate as much as $3 billion in regional transportation funding over six years, but none of the funding was guaranteed. Due to the strong anti-tax ideology in the House of Delegates, allowing lower levels of government to raise taxes was as far as lawmakers would go in terms of tax increases – and even this was a stretch for many legislators.

One category of fees included in the 2007 transportation financing bill – "abusive driver" fees imposed on motorists convicted of reckless driving, driving under the influence, and other serious violations – reflected the strenuous efforts made by Virginia lawmakers to identify non-tax revenue alternatives, as well as the damaging results that sometimes ensued. First proposed by Republican Delegate David Albo,[284] the abusive driver fees were included in Governor Kaine's transportation funding plan in an effort to win Republican support and were also part of a transportation funding package crafted by the Republican leadership of the legislature. Serving as a "sin fee," the abusive driver fees became law because they targeted egregious behavior that no one would defend.

One year later, the transportation financing law hailed as a landmark achievement largely collapsed when the Virginia Supreme Court ruled that the state could not delegate its taxing authority to regional bodies and a backlash to the abusive driver fees led to their repeal. Once abstract fees on "bad drivers" became realities for family members, neighbors, and friends – amidst claims of arbitrary enforcement – the abusive driver fees became untenable.[285] Although a 2-cent increase in the gasoline tax could have replaced the revenue lost from repealing the abusive driver fees, the governor and legislature could not agree on alternatives to the bad driver fees or the regional funding options. The House of Delegates proposed other non-tax sources of transportation funding, passing legislation to authorize toll collections and a bill to earmark royalties from offshore gas and oil drilling for transportation, but neither bill became law. The offshore drilling proposal reflects the lengths delegates would go to devise non-tax methods of financing transportation: even though offshore drilling was barred by a congressional moratorium and the state Department of Mines, Minerals, and Energy forecast that revenues from offshore drilling would not flow for at least five years, if ever (Department of Planning and Budget, 2008a), the plan was still preferable to a tax increase.

[284] Delegate Albo introduced bills to impose abusive-driver fees in 2005 (HB 1564) and 2006 (HB 314).

[285] Another factor that spurred public outrage was that the fees did not apply to out-of-state motorists.

The determination of Virginia policymakers to avoid tax increases also found expression in a number of steps to modify or strengthen tax collection and enforcement. In 2009, lawmakers who faced a $4.3 billion budget gap for the FY 2010-2011 biennium enacted three administrative measures to raise revenue: (1) adding 55 new tax compliance positions, (2) accelerating sales tax collections to shift revenues to FY 2010, and (3) offering a tax amnesty. These tax administration initiatives were projected to raise more than twice the amount of revenue during FY 2010 ($158.7 million) as tax policy changes to curb a tax credit program and close a corporate income tax loophole ($65.5 million).[286] In 2010, Virginia lawmakers also increased tax revenue by denying large retailers a sales tax "dealer discount" intended to compensate them for the costs of collecting the tax.

As shown in Table 6.2 (see p. 338), even narrowly-tailored tax increase proposals rarely succeeded in Virginia during the case study period: only three excise tax increases (on diesel fuel, new tires, and digital media purchases in hotels) and a tax on health care facilities for the intellectually disabled were enacted. These increases became law because (1) they were so small as to be almost invisible, and (2) they were earmarked to support specific programs (transportation, cleanup of illegal tire dumps, the film industry, and health provider reimbursements, respectively). The diesel fuel tax increase from 16¢ to 17.5¢ per-gallon was described as "tax equalization," rather than a tax increase, because the higher rate already applied to all other types of motor fuel. The new tire, digital media, and health care provider taxes were called "fees," even though they did not involve a payment for a good or service provided exclusively for the resident. In Virginia from 2007 to 2010, tax increases could be enacted only if they could be defined as fees or

[286] Author's calculations using data from House Appropriations Committee and Senate Finance Committee, *Summary of 2008-2010 Budget Actions: Chapter 781 (Introduced as House Bill 1600)*, May 21, 2009.

technical changes, and if they were so minute that they could escape notice – consistent with findings by Hettich and Winer, Brunori, and Lewis and Hildreth, that lawmakers will rely on less visible sources of tax revenue to reduce political opposition.

Table 6.3, which shows the estimated net changes in Virginia tax burdens from 2007 to 2010 by type of tax, reflects how the minor adjustments made during the case study period largely touched "other taxes" – an assortment of excise taxes – as well as the motor fuel tax. Although the corporation income tax increased by 3.5 percent, that figure is inflated by temporary limits on a land preservation tax credit and does not reflect a corporate tax cut (single-sales apportionment of corporate income) that would cause a major revenue loss in future years after it was phased in fully.

Table 6.3
Projected Annual Change in Selected Virginia Taxes from Statutory Changes, 2007-2010
(dollars in 000s)

Tax	**FY 2007 Baseline Revenue**	**Net Change In Revenue** (Projected)	**% Change in Revenue** (Projected)
Personal Income	$9,969,000	$5,533	0.1%
General Sales	$3,598,200	-$6,022	-0.2%
Corporation Income	$901,400	$31,225	3.5%
Motor Vehicle Fuel	$938,100	$19,800	2.1%
Other Taxes (Mostly Excise Taxes)	$341,700	$2,154	0.6%
Health Care Provider	$0	$8,486	Undefined

Note: The projected revenue change refers to the first fiscal year after the policy change was enacted, except for the health care provider tax. The second fiscal year is used for the health care provider tax because it would take effect in the middle of the first fiscal year after enactment.

Source: Author's calculations using data from annual executive budget requests published by the Department of Planning and Budget and fiscal impact statements prepared by the Department of Taxation and the Department of Planning and Budget, available at www.leg1.state.va.gov.

Although policymakers in D.C. and Maryland were able to increase cigarette taxes and health facility assessments during the case study period with little opposition, there was no such "low-hanging fruit" for Virginia policymakers; even the health care provider tax, which enjoyed support because it would generate federal matching funds that could be returned to the Medicaid program in the form of higher reimbursements, failed the first time it was proposed in 2009. Because of Virginia's history as a tobacco-producing state and the continued influence of tobacco companies such as Philip Morris, smokers and the tobacco industry were not as widely regarded as socially harmful as they were in D.C. and Maryland. Opponents of the cigarette tax increase also succeeded in defining the proposal as a "job-killer." Therefore, Virginia's cigarette tax rate remained at 30¢ per-pack throughout the case study period even as D.C. more than doubled its tax from $1 to $2.50 per-pack and Maryland doubled its tax from $1 to $2 per-pack. Based on the case study, a general hierarchy of taxes in Virginia ranked from most likely to be increased to least likely (with the understanding that any increases were unlikely), is shown and explained in Table 6.4 on the next page.

Virginia policymakers also did not search broadly for ways to close tax loopholes or otherwise broaden the tax base during the case study period. The only effort to close a loophole from 2007 to 2010 was Governor Kaine's proposal to deny captive real estate investment trusts (REITs) a corporate income tax deduction for dividends paid, a change that the legislature agreed to phase in to help close a large budget gap in 2009. Governor Kaine also proposed limiting the land preservation tax credit and repealing a federal domestic production deduction (which was mirrored in Virginia's corporate income tax),

Table 6.4
A General Hierarchy of Taxes in Virginia, 2007-2010
(ranked from most likely to be increased to least likely)

Tax(es)	Rationale for Increasing Tax and Evidence of Its Ranking
Health Provider	Opportunity to claim federal matching funds makes tax a "win-win. Assessment on facilities for intellectually disabled was enacted in 2010.
Narrow Excises	Tax increases on narrow industries attract little notice and can be termed fees. Policymakers raised or applied taxes to diesel fuel, new tires, and hotel purchases of digital media during case study period.
Motor Vehicle	Taxes on transportation users (benefit taxes) are seen as an equitable and efficient way to finance transportation improvements. Senate approved motor vehicle excise and motor fuel tax increases in 2008.
Cigarette	Harmful health effects of smoking and Virginia's low tax of 30¢ per-pack led Governor Kaine to propose doubling the tax in 2009.
Property Transfer	Deed recordation tax (paid by buyer of real property) and grantor's tax (paid by seller) are peripheral taxes, with lower rates than in neighboring states. Recordation tax revenues were reserved for transportation in 2007 and Governor Kaine proposed raising the grantor's tax to support transportation in 2008.
Insurance Premiums	Insurance premium taxes were dedicated to transportation in 2007 based on link between auto insurance coverage and use of the transportation system. Governor Kaine also proposed raising the tax in 2010 to fund law enforcement programs.
General Sales	The sales tax is the second-largest source of state tax revenue in Virginia. Senate approved a .25% sales tax increase in 2008 that would be earmarked for transportation and coupled with a .5% percent cut in the sales tax on food.
Corporate Income	Lawmakers seeking to promote business growth are more likely to propose corporate income tax cuts than increases, but they closed a loophole exploited by captive real estate investment trusts.
Personal Income	Rising incomes among wealthy increase the revenue capacity of the tax. Governor Kaine proposed raising the tax by 1 percent in 2010, but the House of Delegates unanimously rejected the proposal.

but only the land preservation proposal was adopted. Virginia lawmakers also protected the tax base by conforming the state income tax only in tax year 2009 to three new federal tax breaks included in the 2009 stimulus bill (the "American Recovery and

Reinvestment Act"), while "decoupling" entirely from another federal tax break.[287] Tax incentives crafted by President Obama and a Democratic Congress were low priorities for many Virginia lawmakers, and decoupling from these federal policies helped balance the budget during a fiscal crisis. Still, base-broadening efforts were few and far between; most notably, Virginia legislators did not introduce any bills to broaden the sales tax base during the case study period, unlike their counterparts in Maryland and D.C.

Evidence from the Virginia case study calls into question proposition #5, "State tax policy debates have an important symbolic dimension that has a powerful influence on the options that are selected." The symbolic aspects of tax policy debates were salient in Virginia, exemplified by (1) enactment of sales tax holidays for purchasing hurricane preparedness equipment, which illustrated policymakers' concern for coastal residents affected by Hurricane Isabel and other storms, (2) approval of tax incentives for the spaceflight industry, which enabled lawmakers to proclaim their support for a "cutting-edge" industry, and (3) enactment of tax incentives for job creation and economic development proposed by Governor Robert McDonnell, which demonstrated lawmakers' efforts to combat the job losses and social costs of the Great Recession. Nevertheless, the symbolism of these tax proposals was integral to the policy arguments, rather than distinct from them. For example, the image of protecting coastal residents from harm through the sales tax holiday was a visual manifestation of the policy rationale. The symbolic aspects of the tax policy debate help distill the meaning of a policy, in the same way that they do in debates about education, health care, or other topics. In some cases,

[287] Specifically, Virginia decoupled from a deduction for original issue discounts on high-yield debt obligations, and conformed to the deferral of certain income arising from the cancelation of debt, expansions to the Earned Income Tax Credit, and a deduction for the purchase of new cars only in 2009.

the policy debate may be superficial, giving more weight to symbols and images, but the symbolism still expresses the policy argument.

As in D.C. and Maryland, targeted tax cuts flowed steadily in Virginia, but the tax cuts were much less likely to be designed for individual companies or organizations than they were in D.C. As shown in Table 6.5, Virginia lawmakers enacted more than a dozen stand-alone tax policy measures (outside the annual budget process) during each of the case study years, which were heavily skewed toward finely-tuned tax cuts.[288] Among these measures, 38 were estimated to reduce taxes and only eight were estimated to increase taxes, while 10 were projected to have a neutral revenue impact and two had an unknown impact. The beneficiaries of these small doses of tax relief were quite diverse, ranging from churches to railroad companies, the printing industry, and military veterans, and to individual firms and non-profits such as Volkswagen and Habitat for Humanity.

Table 6.5
Fiscal Impact of Stand-Alone Tax Policy Bills Enacted in Virginia, 2007-2010
(dollars in 000s)

	2007	**2008**	**2009**	**2010**	**Total**
Bills Projected to Increase Tax Revenues	1	1	4	2	8
Bills Projected to Decrease Tax Revenues	12	8	11	7	38
Bills Projected to Have No Fiscal Impact	1	4	2	3	10
Bills with Unknown Fiscal Impact	1	0	0	1	2

Source: Fiscal impact statements prepared by the Virginia Department of Taxation and Virginia Department of Budget and Planning, available at http://leg1.state.va.us.

[288] In several cases, the fiscal impact of the stand-alone bills had been reflected in the annual budget.

The targeted tax cut measures enacted by the General Assembly from 2007 to 2010 were usually linked to broad public purposes, most notably economic development: 15 of the stand-alone tax laws approved during this period were designed to promote job growth or business development. But the tax incentives were sometimes targeted to benefit particular firms or industry segments and passed with little scrutiny.[289]

Targeted tax cuts provided a rare opportunity for bipartisan accord on economic and social policy in Virginia during the case study period. According to interviewees, Governor Kaine's policy initiatives were often blocked not only due to ideological differences but also because Republican leaders sought to deny Kaine the acclaim that his predecessor, Governor Mark Warner, had won after steering a tax increase through the legislature in 2004.[290] A break in this stalemate came in 2007, when Governor Kaine's bill to raise the personal income tax thresholds for low-income filers was unanimously approved by both the House and Senate (with some minor changes). The outcome reflected Kaine's skillful pairing of the conservative goal of tax cuts with the liberal goal of helping low-income families. Governor Robert McDonnell also used tax cuts to advance his economic agenda: four major parts of his "Jobs and Opportunities Agenda," unveiled in 2010, involved business tax incentives, and a fifth provision earmarked tax revenues to market the state wine industry. All but one of the five bills introduced to enact his proposals passed on unanimous or near-unanimous votes in both houses.

[289] For example, in 2008 Virginia lawmakers enacted a sales tax exemption for computer equipment purchased or leased by data centers meeting targets for job creation and capital investment. Intended to convince Microsoft to locate a data center in a struggling Southside Virginia community, the state weakened the job creation and wage requirements several times in unanimous votes.

[290] For example, Governor Warner and Senate Finance Committee Chairman John Chichester were named "Public Officials of the Year" in 2004 by *Governing* for leading the tax reform effort.

Although the stalemate on tax policy in Virginia from 2007-2010 would seem not to support proposition #6 ("The desire of state officials to claim credit for tax benefits, while deferring or disguising tax burdens, leads to asymmetries in state tax policies"), Virginia lawmakers continued to grant tax abatements, credits, and deductions during the fiscal crisis that peaked in 2009 and 2010, while the major step to reduce tax expenditures – the lower limit on the land preservation tax credit – was temporary and could shift costs to future years. As noted earlier, a measure enacted in 2009 allowing manufacturers to base their Virginia corporate income tax liability only on the percentage of sales in the state would have no immediate costs, but would result in a substantial revenue loss in later years (Department of Taxation, 2009a).[291] By shoring up the tax base only in the short-term, while delaying the costs of tax cuts, Virginia policymakers risked creating a long-term fiscal imbalance.

Partly due to the continuous allocation of tax benefits, Virginia policymakers left unaddressed the steady economic and demographic changes that threaten state tax systems, as posited by proposition #7. First, lawmakers not only failed to agree on new sources of transportation funding after the 2007 financing bill largely collapsed, but also departed from the tradition of benefit financing by refusing to increase the motor fuel or vehicle excise taxes. Instead, the more modest steps policymakers took to increase transportation funding included earmarking insurance premium and deed recordation taxes – general-fund revenues that would no longer help finance rising costs of education, health care, and other services. As discussed earlier, Virginia policymakers also left unchanged a sales tax base that was eroding due to the growth of untaxed services and

[291] The projected revenue loss would rise from $3.8 million in FY 2012 to $55 million in FY 2017. See Department of Taxation, "2009 Fiscal Impact Statement: HB 2437," dated February 23, 2009.

online transactions by firms with no nexus in the state.[292] At the end of 2010, Virginia's tax system looked much the same as it did at the start of 2007, but that meant that the tax system was increasingly maladapted for a changing economy and society.

[292] John Mikesell has estimated that Virginia's sales tax base covered only 26.9 percent of state personal income in 2010, below the national median of 34.5 percent in 2010, and down from Virginia's average of 40.5 percent for the 1970 to 2010 period. See John L. Mikesell, "The Disappearing Retail Sales Tax," *State Tax Notes* (63), March 5, 2012, pp. 779-780.

Background

The 2007 to 2010 period marked a period of divided government for the Commonwealth of Virginia,[293] unlike neighboring D.C. and Maryland which were under Democratic party control. Virginia Governor Tim Kaine, a Democrat, was starting the second year of his single four-year term (Virginia governors cannot serve consecutive terms), but Republicans held majorities in both the Virginia Senate (23 Republicans and 17 Democrats) and House of Delegates (57 Republicans, 40 Democrats, and 3 Independents). Virginia is one of the few states to hold elections in odd-numbered years; in the fall of 2007, all of the seats in the General Assembly would be on the ballot.

Compounding the partisan split in control of state government were schisms between the two legislative chambers. Republican senators were more moderate and willing to compromise with the governor than delegates were, partly because senators represented larger, more diverse districts. Moreover, the constant re-election pressures faced by delegates (who serve two-year terms, compared to four years for senators) gave Republican House members less room to stray from their party's anti-tax stance, which could lead to a primary challenge (Schapiro, 2006a). These differences had played a major role in tax policy debates in prior years (Wilkinson, 2004: 5).

The policy debate on taxes in Virginia had been fairly muted since 2004, when a compromise tax reform measure (HB 5018) designed to bolster an eroding tax base became law after Governor Mark Warner persuaded 17 Republican delegates to break ranks with the party leadership and support the plan. HB 5018 was projected to generate $1.4 billion in additional revenue over two years by increasing the state sales tax from 3.5

[293] Virginia is one of four states that is formally called a "Commonwealth."

percent to 4 percent; raising the cigarette tax from 2.5¢ to 30¢ per pack; applying a 10 percent tax to other tobacco products; boosting the state recordation tax; closing a corporate tax loophole for intangible and interest expenses;[294] and scaling back an income tax deduction for senior citizens[295] (Wilkinson, 2004: 5). The package also included some tax cuts, such as a three-year reduction in the state sales tax on food from 3 percent to 1.5 percent. In the difficult battle to steer tax increases through the House (which passed HB 5018 on a 52-45 vote), a plan approved by the Senate to increase Transportation Trust Fund revenues by raising the vehicle excise tax, motor fuel tax, and vehicle registration fees was shelved,[296] as was Governor Warner's proposal to raise the personal income tax on households with incomes over $100,000 per year.

The bitter debate in 2004 over tax reform, which sparked primary challenges against six Republican legislators who supported HB 5018 (Jenkins, 2005),[297] made Virginia lawmakers reluctant to consider tax increases despite a widespread view that transportation funding still needed to be addressed (Wilkinson, 2004). Extensive gerrymandering of legislative districts dimmed the prospects for compromise on transportation financing and other issues, because few legislators faced competitive

[294] This was known as the "Delaware Holding Company" loophole, in which companies made payments for patents or other intangibles to an out-of-state subsidiary where the income would not be taxed, and then deducted the payments from their corporate income.

[295] A $6,000 age deduction had previously been offered to all residents aged 62 and over. HB 5018 repealed the age deduction for 62- to 64-year-olds and subjected the deduction to a means test for those 65 and over.

[296] The Senate plan involved (1) raising the vehicle excise tax from 3 percent to 4.5 percent, (2) increasing the annual vehicle registration fee by $10, (3) raising the motor fuel tax by 3¢ per gallon, (4) increasing the diesel fuel tax by 4.5¢ per gallon, and (5) imposing a 5.5 percent wholesale tax on gasoline and diesel fuel.

[297] Only one of the six delegates was defeated in the primary, but several others had close, difficult races.

elections (Stroupe, 2009).[298] Many legislators would be vulnerable only in a primary election, making ideological conformity a virtue, because so many districts had been crafted to favor a particular party. On the other hand, pressure was building to cut taxes as the state began accumulating surpluses during a real estate boom. In 2005, the General Assembly decided to implement the 1.5 percent state sales tax on food immediately and the next year legislators suspended Virginia's estate tax.[299]

In 2007, Virginia officials once again faced the question of how to finance improvements in the state's clogged transportation system, a particularly salient issue in the Northern Virginia and Hampton Roads regions. In 1998, a state commission estimated that Virginia faced a 20-year funding gap of $53.8 billion for highways and $11 billion for other forms of transportation (Knapp, 2002: 3); officials had done little to address the gap. In 2006, lawmakers' inability to agree on transportation financing almost led to a government shutdown, and in a special session on transportation, separate plans by the governor and a group of Republican senators to boost annual transportation funding by almost $1 billion failed in the House of Delegates because they included tax increases (Craig, 2006).[300] While agreeing on the need for more transportation funding,

---

[298] For example, in 2003, only 9 out of 100 House races were competitive (the winner captured 55 percent of the vote or less) and only 3 of 40 Senate races were competitive. The same year, 69 of 100 House races and 22 of 40 Senate races were not contested by one of the two major parties. See Kenneth J. Stroupe, "Gerrymandering's Long History in Virginia: Will This Decade Mark the End?" *The Virginia News Letter*, Vol. 85, No. 1 (February 2009), Weldon Cooper Center for Public Service, University of Virginia, pp. 6-7.

[299] The estate tax was suspended, or made "dormant," because the long-term status of the federal estate tax was in doubt. The federal government had suspended a credit for state estate taxes, which provided a dollar-for-dollar reduction in the federal estate tax for each dollar of state estate tax paid. Because it was unclear if the federal credit would be permanently repealed, Virginia and other states kept their estate taxes on the books so they could reap estate tax revenue funded by federal credit if it were reinstated.

[300] Governor Kaine had proposed raising the vehicle excise tax from 3 percent to 5 percent while also increasing auto insurance premium taxes. Republican senators also called for a vehicle excise tax increase

Republican delegates insisted that increases could be financed by borrowing and better use of existing revenues (Gardner and Craig, 2006).

The Virginia economy appeared stable at the start of the case study period in 2007. Although Secretary of Finance Jody Wagner noted in December 2006 that national economic growth had slowed due to a cooling housing market and higher interest rates, growth in Virginia over the next two years was expected to outpace the rest of the nation (Secretary of Finance, 2006: 10-12). Still, regional disparities were a source of concern. Booming Northern Virginia had absorbed more than half of the state's employment gains in FY 2006, partly due to the flow of federal procurement dollars, while rural areas in Southside and Southwest Virginia continued to suffer from declines in manufacturing (Commonwealth of Virginia, 2006: A-7).

State Government Institutions and Budget Roles. The governor serves as chief executive in Virginia. He or she is elected for a four-year term and cannot serve consecutive terms, as noted earlier. After serving from January 2006 to January 2010, Governor Kaine was succeeded by Republican Robert McDonnell, who was the state attorney general from 2006 to 2010.

The Secretary of Finance, appointed by the governor, administers all financial transactions of the state and is responsible for forecasting and collecting revenues, managing the state's cash and investments, selling bonds, and preparing and executing the budget. The Department of Planning and Budget, Department of Taxation, Department of Accounts, and Department of the Treasury report to the Secretary of Finance. Virginia enjoyed a reputation for strong financial management, holding a triple-

---

from 3 percent to 5 percent, as well as an extension of the general sales tax to motor fuel and to auto repairs and maintenance. Both proposals also included fee increases.

A bond rating since 1938, longer than any other state. As of October 2006, Virginia was one of seven states with triple-A ratings from the three major bond-rating agencies (JLARC, 2007: 20).

In addition to the governor, the lieutenant governor and attorney general are elected statewide to four-year terms at the same time as the governor. The lieutenant governor presides over the Virginia Senate and succeeds the governor in case of disqualification, resignation, or death. The attorney general directs the Department of Law and provides legal advice and representation to all state agencies.

The Virginia General Assembly, intended to serve as a part-time "citizen legislature," convenes for an annual session on the second Wednesday in January. In even-numbered years, the legislature meets for 60 days, and in odd-numbered years the legislature meets for 30 days but customarily extends the session to 46 days. The governor may call legislators into special session at any time. The General Assembly is also required by the state constitution to reconvene on the sixth Wednesday after adjourning to consider legislative amendments or vetoes transmitted by the governor (no other matters may be considered). The reconvened session typically lasts one day.

The Virginia Senate is comprised of 11 standing committees that review legislation and conduct oversight. Committee assignments are determined by the majority caucus. The Clerk of the Senate assigns bills to committees; budget and tax matters fall under the purview of the Finance Committee.

The House of Delegates divides its work among 14 standing committees. The Finance Committee oversees taxes, and the Appropriations Committee oversees spending. The Speaker of the House, who is elected by his or her colleagues, presides over the House, appoints the chairpersons and members of each committee, and assigns bills to committees. Republican William Howell became speaker in 2003.

The General Assembly receives support from the Division of Legislative Services, a non-partisan, central staff agency that drafts legislation and conducts research for members of both houses, standing committees, and legislative study commissions. Senate Finance and House Appropriations are the only committees that employ their own permanent staff.

Virginia practices biennial budgeting. The budget is enacted in even-numbered years, and amendments to the budget are enacted in odd-numbered years. The governor "pre-files" his budget proposals by December 20th of each year, and the governor's budget is formally introduced in each legislative chamber on the first day of the regular session in January. After holding public hearings, the House Appropriations Committee and the Senate Finance Committee amend and approve the budget, which then goes to the floor of each body. After the House and Senate approve the budget bill with any changes they deem necessary, each bill "crosses over" to the other body where it is debated and voted on again. A conference committee resolves any differences between the two bodies, and the final budget bill is sent to the governor, who can veto the budget bill or particular line items, and can also amend the budget to revise proposed funding levels. The legislature can override a governor's veto or budget amendments by a two-thirds vote of both houses; in addition, the General Assembly can adopt the governor's budget amendments by a majority vote of both houses.[301]

---

[301] There are a variety of permutations with regard to the governor's budget amendments. The General Assembly can adopt some of the governor's budget amendments and send the budget bill back to the

The prohibition on serving consecutive terms limits the governor's ability to shape long-term changes in the state budget, a constraint which is compounded by the state's budgeting rules. When a new governor takes office, his or her predecessor has already proposed the biennial budget that the General Assembly will consider in the governor's first year. During the governor's second year in office, he or she proposes amendments to the biennial budget, so it is not until the third year that the governor leads the biennial budget process from start to finish. "As a result," one expert panel concluded, "seniority-laden legislative money committees tend to have greater institutional budget power and leverage in policy making than might otherwise be the case." (State Budget Crisis Task Force, 2012b: 12).

The governor is also responsible for ensuring that the state operating budget ends the biennium in balance. To prevent a deficit, the governor has the authority to reduce appropriations by up to 15 percent for any state agency or institution.

Components of Virginia's Tax System. During FY 2006 (July 1, 2005 to June 30, 2006), Virginia's tax revenue totaled $17.0 billion, or 55 percent of the Commonwealth's $31.0 billion in total revenue.[302] The bulk of the tax revenue ($14.1 billion) flowed into the state's general fund, the main operating fund that can be used flexibly to finance state

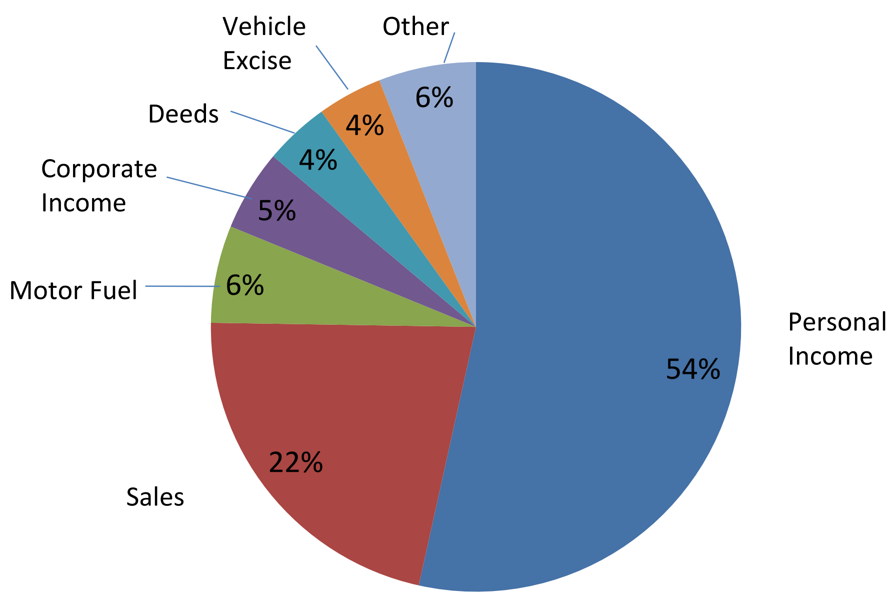
governor for signature. If the two houses cannot agree on whether to accept the governor's amendments (which can be considered *en bloc*), then the original bill goes back to the governor's desk.

302 Author's calculations using data provided in Comptroller of Virginia, *A Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006* (December 2006), p. 44, and Commonwealth of Virginia, *Executive Amendments to the 2006-2008 Biennial Budget* (December 2006), pp. A-12 – A-16.

programs. The rest of the tax revenue ($2.8 billion) flowed into the Commonwealth Transportation Fund and several other restricted or special funds. [303]

Virginia relies much more heavily on personal income tax revenue than most other states (Division of Legislative Services, 2010: 29-31, 37). During FY 2006, the personal income tax provided more than half ($9.2 billion, or 54 percent) of Virginia's total tax revenue, as shown below in Figure 6.1. The general sales tax was a distant second as a revenue source, generating $3.7 billion (22 percent) of Virginia's tax revenue in FY 2006. Virginia received smaller sums from the motor fuel tax ($938 million, or 6 percent); the corporate income tax ($838 million, or 5 percent); deed taxes ($670 million,

Figure 6.1
Virginia Tax Revenue by Source, FY 2006



Source: Author's calculations using data from Comptroller of Virginia, *A Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006* (December 2006), p. 44. Percentages may not add to 100 due to rounding error.

[303] Author's calculations using data provided in Commonwealth of Virginia, *Executive Amendments to the 2006-2008 Biennial Budget* (December 2006), pp. A-12, A-16.

or 4 percent); the motor vehicle excise tax ($593 million, or 4 percent); the insurance company premiums tax ($374 million, or 2 percent); tobacco taxes ($189 million, or 1 percent); the estate tax ($166 million, or 1 percent); and alcoholic beverage taxes ($155 million, or 1 percent).[304]

All Virginia counties and municipalities use their authority to impose a 1 percent sales tax, but the revenue from the local sales tax is not included in the sales tax revenue total cited above. Virginia localities are also permitted to levy their own cigarette taxes.[305] The state constitution reserves the power to tax real estate, coal and other mineral lands, and tangible personal property solely to local governments.[306]

As of January 2007, the state imposed a 4 percent sales tax and allocated 25 percent of the revenue to general local education aid, 12.5 percent to the Commonwealth Transportation Fund, and 6.25 percent to help localities meet the state's education Standards of Quality. The rest of the state's sales tax revenue was deposited into the general fund to be used without restrictions. Food purchased for home consumption was also taxed at a special state rate of 1.5 percent, with two-thirds of this revenue allocated to local education aid and one-third allocated to the transportation fund (localities added a 1 percent tax on food, for a total tax of 2.5 percent on food).

Several of the commonwealth's other taxes were dedicated for specific purposes at the start of the case study period. Motor fuel tax and motor vehicle excise tax revenues

---

[304] Author's calculations using data provided in Comptroller of Virginia, *A Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006* (December 2006), p. 44.

[305] Although the General Assembly in 1989 allowed local governments in Northern Virginia, Norfolk, and Virginia Beach to hold referenda to establish local personal and corporate income taxes of up to 1 percent to finance transportation programs, no locality has put the issue on the ballot.

[306] See Article X, Section 4 of the Constitution of Virginia.

were earmarked for the Commonwealth Transportation Fund. All revenues from state tobacco taxes were earmarked for the Virginia Health Care Fund, which finances Medicaid services and supports community health and disease diagnosis, prevention, and control programs. A portion (44 percent) of Virginia's wine tax and 50 percent of the grantor's tax (imposed on the seller of real property) were earmarked for general aid to localities. At the start of the case study period, Virginia's general fund comprised only 47 percent of the state operating budget, while non-general funds (which are restricted in their use and include federal funds as well as earmarked state funds) accounted for 53 percent (Senate Finance Committee, 2006).

As of early 2007, Virginia maintained a tax system that had been designed for a prior era (Virginia was similar to Maryland in this regard). The $17,000 income threshold for Virginia's top personal income tax rate of 5.75 percent had not been adjusted since 1987, and the income ranges for the lowest two brackets ($1 to $3,000, and $3,001 to $5,000, respectively) had not been changed since 1926 (Bowman, 2002: 6; Commission on Virginia's State and Local Tax Structure for the 21st Century, 2001: 30). Due to income growth and inflation, Virginia's graduated income tax structure was now almost flat. In tax year 2006, 77 percent of net taxable income was taxed at the top rate.[307]

Virginia's sales tax, the second-largest source of state tax revenue, had also become outmoded. Enacted in 1966 as a tax on the purchase of goods, the state sales tax

[307] Author's calculation using data from Virginia Department of Taxation, *Annual Report: Fiscal Year 2008*, p. 20.

generated little revenue from the growing service economy.[308] Although in 2001 the Commission on Virginia's State and Local Tax Structure for the 21st Century[309] had recommended imposing the sales tax on repair services, personal services, and amusements (Commission on Virginia's State and Local Tax Structure for the 21st Century, 2001: 27), lawmakers left the state sales tax base almost unchanged.[310]

Like Maryland, Virginia was also struggling to finance large commitments made in recent years. Governor James Gilmore, who served from 1998 to 2002, had campaigned on a promise to repeal the despised personal property tax on cars – a local tax that was to be supplanted by state aid over five years. While phasing out the car tax, Gilmore and the General Assembly increased general fund expenditures by 51 percent between FY 1997 and 2001, boosting funding for elementary, secondary, and higher education, Medicaid, prisons, and mental health programs (Conant, 2006a: 214-215, 219-221). Car tax relief was frozen at 70 percent of car tax liability when revenues plunged during the recession of 2001-2002 and was eventually capped at $950 million annually, a substantial cost nonetheless.

Although local taxes are beyond the scope of this study, the combined state-local tax burden may affect state officials' tax policy choices. The Division of Legislative Services reported that Virginia's state-local tax burden was relatively low in 2006. The

---

[308] In 2005, the Federation of Tax Administrators reported that Virginia imposed the sales tax on only 18 of 168 services, more than only six other states. See Federation of Tax Administrators, "Are You Being Served?" Tax Administrators News, Volume 69, Number 5, May 2005.

[309] The Commission was created in 1999 by the General Assembly to study the allocation of revenues and responsibilities for service delivery among the state and local governments, as well as how the tax structure should be modified to reflect economic, social, and technological changes. The Commission was known as the "Morris Commission" after its chairman Thomas Morris, the president of Emory and Henry College.

[310] There was one change to the state sales tax base made by HB 5018, the tax reform legislation of 2004: a sales tax exemption for purchases made by public utility companies was repealed.

average Virginian paid $3,940 in state and local taxes in 2006, just below the national average of $4,006. Reflecting Virginia's high income level, the state-local tax burden in 2006 equaled 9.8 percent of personal income (ranking 41st among the 50 states), below the national average of 10.9 percent (Division of Legislative Services, 2010: 7-9).

Table 6.6 (beginning on the next page) shows the taxes levied by the commonwealth in early 2007, along with their rates and actual revenue for FY 2006 (the most recent actual data available at the start of the study period).

Table 6.6
Virginia State Taxes at the Start of the Case Study Period (2007)

Tax and FY 2006 Actual Revenue (000s)	**Rates**
Personal Income Tax Personal Income ($9,206,525) – taxable income is based on federal adjusted gross income and modified for Virginia exemptions, deductions, additions, and credits.	 first $3,000 in taxable income: 2.0% $3,001 to $5,000 in taxable income: 3.0% $5,001 to $17,000 in taxable income: 5.0% over $17,000 in taxable income: 5.75%
Sales and Excise Taxes General Sales ($3,678,736) – sales of tangible property and selected services are taxable. Virginia dedicates 25 percent of state general sales tax revenue to local education aid, 12.5 percent to transportation, and 6.25 percent to implement the state's Standards of Quality for education. Two-thirds of state sales tax revenue from the sale of food for home consumption is dedicated to education aid and one-third is dedicated to transportation. Tobacco ($189,492) – tax is imposed on the sale of cigarettes and other tobacco products. All revenues are dedicated to the Virginia Health Care Fund. Alcoholic Beverages ($138,399) – tax is imposed on the retail purchaser, except for sales made to wholesale wine licensees. Sales of distilled spirits are made directly by the state government in Virginia.	 State Sales Tax: 4.0% Local Sales Tax: 1.0% Food purchased for home consumption is subject to a 1.5 percent state sales tax and the 1.0 percent local sales tax 30¢ per pack of 20 cigarettes 10% of manufacturer's price of cigars, smokeless tobacco, pipe tobacco, and roll-your-own tobacco Localities may also impose a cigarette tax Beer: 26¢ per gallon Wine: $1.51 per gallon Distilled Spirits: 20.0% of the sales price

Table 6.6 (p. 2)
Virginia State Taxes at the Start of the Case Study Period (2007)

Tax and FY 2006 Actual Revenue (000s)	**Rates**
Sales and Excise Taxes (cont.) Motor Fuel ($937,614) – gasoline and other fuels used by motor vehicles are taxable. The revenue is dedicated to the Commonwealth Transportation Fund. Motor Vehicle Excise ($593,092) – every issuance of title for a motor vehicle is taxable. The revenue is dedicated to the Commonwealth Transportation Fund.	 17.5¢ per gallon of gasoline, gasohol, and blended fuels 16¢ per gallon of diesel fuel 5¢ per gallon of aviation fuel 3.0% of fair market value
Business Taxes Corporate Income ($837,917) – tax is based on federal taxable business income and modified for Virginia additions and subtractions, as well as an apportionment factor to compute the amount of income taxed by Virginia. Insurance Premiums ($373,781) – tax is based on insurer's gross income from premium and subscription sales in Virginia.	 6.0% of taxable income 2.25% of gross income from accident and sickness; life insurance and accidental death and dismemberment; fire; water damage; burglary and theft; personal injury; property damage; credit; title; and motor vehicle policies 1.0% of gross income from sick benefit insurance policies 0.75% of gross income from subscription contracts to individuals for certain health services

Table 6.6 (p. 3)
Virginia State Taxes at the Start of the Case Study Period (2007)

Tax and FY 2006 Actual Revenues (000s)	**Rates**
<u>Business Taxes</u> (cont.) Public Service Corporations ($91,000) – tax is imposed on residential and commercial consumers of electricity and natural gas, as well as the gross receipts of water companies. Revenues are divided among the state's general fund, the State Corporation Commission's regulatory fund, and localities.	Electric: $0.00155 per kilowatt-hour (KWh) for first 2,500 KWh per month; $0.00099 per KWh for 2,501 to 50,000 KWh, and $0.00075 per KWh over 50,000 Natural Gas: $0.0195 per cubic foot (CCF) of gas used per month, imposed only on the first 500 CCF of gas used Water Companies: 2.0 percent of gross receipts
<u>Other Taxes</u> Deed Taxes (Recordation and Grantor's Taxes) ($669,810) – the transfer of property is taxable at the time a deed, lease, contract, or mortgage relating to real estate is recorded. The recordation tax is paid by the buyer of property, whereas the grantor's tax is paid by the seller. The grantor's tax does not apply to instruments securing a debt. One-half of the revenue from the grantor's tax is allocated to the locality where the property is located.	Recordation Tax: 0.25% of consideration paid for real property or actual value of the property conveyed, whichever is greater. Localities may also impose a recordation tax of 0.083%. Grantor's Tax: 0.1% of consideration paid for real property or actual value of the property conveyed, whichever is greater, exclusive of the value of any lien or encumbrance. No local option.

<u>Sources</u>: Comptroller of Virginia, *A Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006*; Virginia Division of Legislative Services, *A Legislator's Guide to Taxation in Virginia, Volume 1: State Taxes*, January 2010; Virginia Department of Taxation, *Annual Report: Fiscal Year 2006*.

Tax Policy Decisions in 2007

The tax policy decisions made by Virginia policymakers in 2007 were framed by amendments to the biennial budget proposed by Governor Kaine in mid-December 2006. Several factors including higher revenue estimates and unallocated transportation funds from the prior year yielded $1.2 billion in extra funding which the governor allocated mostly to "targeted investments" in transportation and education (Director of Planning and Budget, 2006: 2-6). The governor modified the budget to reflect the fiscal impact of one major tax proposal: a bill to increase the personal income tax filing threshold for individuals from $7,000 to $12,000, and for married couples from $14,000 to $24,000. This change would reduce tax revenues by an estimated $13.8 million in FY 2008 and $27.4 million in FY 2009 (Commonwealth of Virginia, 2006: A-18; Secretary of Finance, 2006: 23). The administration projected that 147,000 residents would no longer have to pay state income tax and that another 176,000 residents would no longer have to file a tax return in order to get a refund for taxes they had paid (Secretary of Finance, 2006: 23).

Nevertheless, the main tax policy issue in 2007 would be a reprise of the prior year's debate on whether to raise taxes to finance transportation projects. As stated by Delegate William Janis, transportation "was the issue that eclipsed everything else from a policy perspective, from a politics perspective, and from a legislative perspective." (Hardy and Schapiro, 2007a). In the annual December briefing of the legislature's "money committees" (House Appropriations, House Finance, and Senate Finance), Governor Kaine pledged to submit a plan for "long-term, sustainable" transportation funding, describing transportation as "the most urgent problem facing Virginia today." (Governor Tim Kaine, 2006: 2-4).

Although some conservative lawmakers vowed never to support tax increases, there was some reason to believe that compromise was possible. Another stalemate on transportation funding could hurt Republican efforts to retain control of both legislative chambers in the 2007 elections (Schapiro, 2006b; Schapiro and Stallsmith, 2006). Democrats needed to pick up four seats to take control of the Virginia Senate, although gaining a majority in the House seemed unlikely for Democrats. Back-to-back victories of Governor Kaine in 2005 and Democratic U.S. Senator Jim Webb in 2006 (who unseated Senator and former Governor George Allen, who led the Republican takeover of state government in the 1990s) showed Republican legislators in competitive districts that they could be vulnerable if they were seen as overly ideological and unable to govern (Schapiro, 2006b). The pressure to produce results also weighed on the governor, who made transportation a centerpiece of his gubernatorial campaign in 2005 (Shear, 2006).

Economic growth by itself would not resolve the transportation problem. In December 2006, the forecast for transportation fund revenues was revised downward by $41.9 million in FY 2007 and $51.1 million in FY 2008 due to weakness in the two largest funding sources, motor fuel and vehicle excise tax revenues (Secretary of Finance, 2006: 24). Even a strong economy was not likely to ease Virginia's transportation funding dilemma because lower-cost, more fuel-efficient vehicles were expected to limit growth of motor vehicle taxes and fees (Department of Taxation, 2006: 4-2–4-8).[311]

Transportation Financing Options. Due to the relatively conservative nature of Virginia's politics – and its lower house, in particular (Conant, 2010: 37-38) – the range

---

[311] In addition to the motor fuel tax and the vehicle excise taxes, motor vehicle registration and licensing fees, registration fees paid by interstate motor carriers, aviation fuel taxes, and rental car taxes were dedicated to the Commonwealth Transportation Fund.

of tax policy options considered in the transportation financing debate was narrow, even though a funding gap of at least $1 billion annually had been identified.[312] As in other states, policymakers sought to identify revenue sources that would reflect use of highways and roads in order to approximate a benefits tax, but the traditional mainstay of transportation financing – the motor fuel tax – did not receive serious consideration. Nor did Virginia policymakers consider using broad-based taxes to support transportation, as their neighbors in Maryland had done.

At one end of the political spectrum was a package of transportation financing bills offered by conservative Republican delegates Clifford Athey, Jeffrey Frederick, and Leo Wardrup.[313] These bills relied on borrowing and surplus revenues to finance transportation upgrades and mandated land-use and governance changes to make the transportation system more efficient and effective.[314] The only tax policy change put forward by the conservative delegates was a proposal to earmark one-third of insurance tax revenues for the transportation fund – a minor change because 27 percent of such revenues were already dedicated to transportation under current law.[315]

---

[312] The Northern Virginia Transportation Alliance estimated an even larger shortfall in state transportation construction funds: $2.75 billion for FY 2007. See Northern Virginia Transportation Alliance, "Virginia's Incredible Shrinking Highway Construction Fund and Rapidly Growing Shortfall," January 16, 2007.

[313] These bills included HB 2227, HB 2440, HB 2777, HB 3159, HB 3196, HB 3197, and HB 3198. Many of the bills included similar provisions with slightly different variations or combinations.

[314] For example, a proposed policy change would bar subdivision streets from being accepted into the Virginia Department of Transportation's secondary highway maintenance system if they did not meet state requirements. A proposed regulatory change would allow localities to charge impact fees on developments outside designated "urban transportation service districts," in order to limit suburban sprawl.

[315] Current law provided that all revenues derived from automobile insurance premium taxes would be dedicated to the Commonwealth Transportation Fund. These premiums accounted for approximately 27 percent of total insurance premium tax revenues. See Department of Planning and Budget, "2007 Fiscal Impact Statement: HB 2440," dated January 22, 2007.

At the other end of the political spectrum was Governor Kaine's transportation plan, introduced in January 2007. The governor sought to meet long-term transportation funding needs by (1) increasing the vehicle excise tax from 3 percent to 5 percent, (2) raising the vehicle registration fee by $15 in 2007 and another $5 in 2010, (3) increasing the registration fee for heavy trucks,[316] (4) imposing an "abuser fee" on motorists who drive under the influence, drive recklessly, or commit other offenses, and (5) permanently earmarking auto insurance premium taxes for transportation, a current policy that would expire after a major borrowing was paid off in FY 2012 (Governor Tim Kaine, 2007a). Projected revenue from the governor's plan would reach $660 million in the first year (FY 2008) and plateau around $850 million in FY 2012 (Governor Tim Kaine, 2007b), with the vehicle excise tax providing more than half of the revenue. The governor's plan and the projected revenues are outlined in Table 6.7 (see next page). The governor also proposed reserving half of future general-fund surpluses for transportation.

The bulk of the governor's transportation proposal ($4.0 billion over six years, or 84 percent) involved new revenues. The earmarking of auto insurance premiums taxes and 50 percent of general fund surpluses would represent the only sources of existing revenues. In addition, fines and fees would account for approximately one-third (32 percent, or $1.5 billion over six years) of the revenue.[317] The governor also proposed land-use and procedural reforms, such as allowing localities to deny rezoning requests if there was not enough transportation capacity to support new developments.

[316] The increase in heavy truck registration fees would vary depending on weight.

[317] Author's calculations using data from Office of the Governor, "Governor Tim Kaine's 2007 Transportation Revenue Proposal."

Table 6.7
Governor Kaine's 2007 Transportation Funding Proposal
(dollars in 000s)

Revenue Source	Estimated Revenue FY 2008	Estimated Revenue FY 2008-13
Vehicle Excise Tax Increase	$360,700	$2,473,400 (52%)
Vehicle Registration Fee Increase	$107,600	$812,500 (17%)
Auto Insurance Premium Earmark	$109,800	$753,900 (16%)
Abusive Driver Fees	$57,500	$570,400 (12%)
Heavy Truck Registration Fee Increase	$24,600	$147,600 (3%)
50% of General Fund Surpluses	Not Known	Not Known
Total Revenue	**$660,200**	**$4,757,800**

Source: Office of the Governor, "Governor Tim Kaine's 2007 Transportation Revenue Proposal."

The governor's transportation plan was strongly shaped by political constraints. Administration officials interviewed for the dissertation stated that the motor fuel tax was the preferred source of revenue because it was directly tied to use of the roads and would yield revenues from non-residents who drove in the state (this was an important factor because Virginia stands in the middle of the north-south I-95 corridor). Nevertheless, the governor did not propose a gas tax increase because it was viewed as having no chance of enactment, particularly in a time of sharply rising prices at the pump. Therefore, the governor pieced together a financing package with alternative revenue sources that were plausibly linked to transportation.

The vehicle excise tax became the centerpiece of the proposal because it would inject new money from drivers into the transportation trust fund (Governor Tim Kaine, 2007c), but was less salient than the gas tax; the excise tax might be paid only once every five to 10 years. Moreover, there was an equity argument for raising the vehicle excise tax to 5 percent: it would then match the 5 percent general sales tax rate, as Kaine had pointed out.[318] The governor further defended the vehicle excise tax increase by noting that Virginia's 3 percent rate was 44th highest in the nation and that Maryland, West Virginia, the District of Columbia, and Tennessee all charged 5 percent or more (Governor Tim Kaine, 2007a).

The inclusion of the abusive driver fees in the governor's transportation financing package illustrates how the anti-tax climate affected policy formulation. Republican David Albo had previously introduced legislation (HB 1564 in 2005 and HB 314 in 2006) to increase transportation funding by imposing additional civil penalties on drivers convicted of offenses such as reckless driving, driving while intoxicated, and driving with a suspended or revoked license. Administration officials stated in interviews that the governor included this proposal in his transportation financing plan in an effort to win Republican support – a decision that would later spark a strong voter backlash. In trying to avoid higher taxes, the governor embraced a fee proposal with very uncertain revenue-generating capacity. If the abusive driver fees discouraged dangerous driving, or if collecting the fines proved difficult, revenues would drop. Reflecting on the decision to include abusive driver fees in the financing plan, the governor's chief of staff Wayne Turnage stated that, "I think it is a function of we were desperate."

Staking out the middle ground in the transportation financing debate was a plan released by Republican leaders from both houses. The plan arose from negotiations

---

[318] The governor's talking points for a "Transportation Announcement" dated January 4, 2006, noted that, "There is no public policy reason why a parent buying children's shoes or diapers should pay a higher sales tax rate than someone buying a new car." This document was found in Governor Kaine's records at the Library of Virginia.

convened by Attorney General Robert McDonnell to avoid another stalemate on transportation and blunt attacks by a governor who had threatened to make transportation a major issue during the fall elections (Hardy, 2006; Shear, 2007a; Shear, 2007b). Interviewees also expressed the view that the attorney general wanted the legislature to address transportation funding so that it would no longer be an issue when he ran for governor in 2009. The leadership plan almost entirely avoided state tax increases (in line with the views of conservative Republican lawmakers) but authorized local tax and fee increases as well as state fee increases (which might gain support from Democrats and moderate Republicans who sought new revenues for transportation).

The Republican leadership plan would earmark $250 million per year in general fund revenues and half of any general fund surplus for transportation, while also increasing registration fees for vehicles and heavy trucks, raising fines on bad drivers and overweight trucks, and increasing the diesel fuel tax from 16¢ to 17.5¢ per-gallon. Although many Republican delegates had signed a pledge not to increase taxes, the diesel fuel tax increase was regularly described as way to "equalize" motor fuel taxes,[319] which were 17.5¢ per gallon for gasoline, ethanol, and blended fuels. The revenues generated by the plan would finance $2 billion in new transportation debt. In addition, the regional tax and fee options would allow Northern Virginia localities to generate an estimated $383 million and Hampton Roads localities to generate an estimated $209 million in annual transportation funding (Hardy and Schapiro, 2007b).

[319] For example, a House Appropriations Committee summary referred to the diesel tax increase as "diesel tax equalization." See Anne E. Oman, "HB 3202 Transportation Package," summary prepared by House Appropriations Committee staff, January 24, 2007.

The Republican leadership plan would have to overcome objections by the governor, Senate Finance Committee Chairman John Chichester (who was not part of the Republican leadership negotiations), and Democratic legislators to any shift of general fund revenues to support transportation, as well as the distaste among some legislators for authorizing tax increases even at the local level (Hardy and Schapiro, 2007b; Hardy and Whitley, 2007). Still, changes in what John Kingdon called the "politics stream" – voter dissatisfaction with traffic congestion and the upcoming legislative elections – seemed to have created an opening (a "policy window") for a successful initiative on transportation funding. Republican leaders in the House and Senate, who had been at odds since Republicans took control of both chambers in 2000, had now attached a plausible policy solution to a widely recognized problem.

Legislative Action on Transportation Financing. As the General Assembly began its work on transportation financing, the governor's plan (which was not introduced in its entirety in either chamber) quickly became an afterthought. Legislators were not moved by the governor's argument that a vehicle excise tax increase was justified (or at least reasonable) because Virginia's rate was below the national median as well as rates in neighboring states. Individuals interviewed for the dissertation noted that conservative legislators viewed Virginia's low vehicle excise tax as a competitive advantage that should be preserved. Moreover, interviewees emphasized that Republican leaders were dismayed that Governor Mark Warner had become a national figure, largely due to the tax package enacted in 2004 with bipartisan support, and were determined to deny Governor Kaine similar acclaim by strongly opposing his policy initiatives.

The Republican leadership plan, introduced in the House by Speaker William Howell to indicate the importance of the bill (HB 3202),[320] advanced due to a procedural maneuver. The speaker disregarded usual practice in bypassing the strongly anti-tax House Finance Committee, which might have blocked HB 3202, and referring the bill solely to the House Appropriations Committee (Shear, 2007c). Chaired by Delegate Vincent Callahan, who was under pressure to bring traffic relief to his Democratic-trending Northern Virginia district,[321] the Appropriations Committee sent HB 3202 to the House floor, where it was approved on a 61-37 vote. Projected to generate $846.7 million for transportation in FY 2008 and $3.3 billion over five years (FY 2008-12), HB 3202 would be funded primarily through general fund transfers and fees. The new tax revenue provided by a diesel fuel tax increase would account for only $109.3 million (3 percent) of the revenue raised from FY 2008 to 2012.[322]

By contrast, the more moderate Senate was unable to agree on a transportation plan. Senators Thomas Norment, Walter Stosch, and Kenneth Stolle, who had previously worked with finance committee chairman Chichester to seek new revenues (including tax revenue) for transportation, were part of the Republican leadership negotiations and no longer served as Chichester's allies on transportation funding. Moreover, Senator Chichester and other lawmakers willing to raise taxes to support transportation did not develop a well-defined proposal of their own, nor did they endorse the governor's plan.

---

[320] The custom was that the Speaker did not serve as chief patron (lead sponsor) of legislation.

[321] Delegate Callahan was described as being "at the top of the Democratic hit list." Both Governor Kaine and Senator Webb had carried Callahan's district by large margins. See Michael Hardy and Jeff E. Schapiro, "Stakes Raised as Roads Issue Returns," *The Richmond Times-Dispatch*, January 7, 2007, p. A-1.

[322] Author's calculation using data provided in Department of Planning and Budget, "2007 Fiscal Impact Statement: HB 3202," dated January 22, 2007.

The Senate Finance Committee amended a transportation financing bill (SB 1379) to impose the state sales tax on motor fuel, which would generate more than $500 million in new transportation funding each year. SB 1379 also included an annual general fund appropriation of $66 million for transportation (Senate Finance Committee, 2007; Shear, 2007d). Besides those major differences, SB 1379 resembled HB 3202 by raising the diesel fuel tax, increasing fees for vehicle registration, raising fines on bad drivers, and authorizing jurisdictions in Northern Virginia and Hampton Roads to charge various taxes and fees for regional transportation needs. Nevertheless, SB 1379 was withdrawn before a Senate floor vote because it was not clear that the bill would pass; interviewees stated that some senators were reluctant to vote for a bill to raise taxes that would have no chance in the House. The Senate did not pass a transportation financing bill before the deadline for legislation to "cross over" to the other body for consideration.

In their determination to avoid proposing a motor fuel tax increase, Democrats and moderate Republicans who supported higher taxes to finance transportation had divided themselves into separate camps. Although Senator Chichester and others who supported the sales tax on motor fuel emphasized that this revenue would grow with the economy and include payments from out-of-state drivers,[323] the governor and Democratic legislators strongly opposed any proposal to channel sales tax revenues to transportation because that could reduce funding for education, health care, and other services supported by the general fund. As stated by Brian Shepard, who served as Governor Kaine's policy director, there was a fear of "breaking the barrier into the

[323] It was estimated that 25 percent of motor fuel purchases were made by out-of-state residents. See Senate Finance Committee, "Senate Bill 1379 (Amendment in the Nature of a Substitute)," February 2007.

general fund," which could lead to a major drain on the fund because of the long list of unmet transportation needs.

The Senate had another chance to pass a transportation financing bill by amending HB 3202 after it crossed over from the House. This time, the Senate Finance Committee substituted a one-time, $150 vehicle registration fee that would generate an estimated $330 million annually and allow the state to avoid tapping the general fund for transportation. Other elements of the previous bill (SB 1379) remained largely intact. The Senate approved the substitute version of HB 3202 on a 23-17 vote, but the revised bill was assailed by conservative legislators who saw the vehicle registration fee as a thinly-veiled vehicle excise tax increase (Schapiro, 2007a; Hardy and Schapiro, 2007c).[324] Because the vehicle registration fee would be imposed after the purchase of a new vehicle costing $2,500 or more, this argument had merit. The House rejected the Senate bill, and a conference committee was appointed to resolve differences between the two bills.

Procedural rules once again influenced the legislative outcome as the conference committee on HB 3202 fashioned a final bill reflecting the House's position on two key issues: (1) bypassing any tax increases or a one-time vehicle registration fee, and (2) using the general fund as a financing source. Senate rules allow the chairman of the committee to which a bill was first referred – in this case, Senate Transportation Committee Chairman Martin Williams, who supported the Republican leadership plan – to name the conference committee members. Williams selected like-minded colleagues

---

[324] House Speaker William Howell was quoted as stating that the one-time, $150 vehicle registration fee was "little more than an inequitably assessed … increase in the titling tax." (The "titling tax" was another term for the vehicle excise tax). See Jeff E. Schapiro, "Senate Move Could Doom Roads Funding," *The Richmond Times-Dispatch*, February 14, 2007, p. A-1.

as Senate conferees, leaving out Senators Chichester and Russell Potts, who had crafted the Senate bill (Schapiro, 2007a). The conference committee earmarked $150 to $175 million in annual recordation tax revenue (a general-fund source) for transportation instead of appropriating $250 million in general fund dollars (Department of Planning and Budget, 2007) to mollify concerns that education, public safety, and human services spending would be curtailed. The conference committee deleted the diesel fuel tax increase even though it had been approved by both houses, but retained the abusive-driver fees. The revenues would be used to support $2.5 billion in new state borrowing for transportation (up from $2 billion in the original version of HB 3202). The only tax increases authorized by HB 3202 would be imposed by regional officials.[325]

The conference committee agreement on HB 3202 passed the House by a wide margin (64-34) and squeaked through the Senate (21-18). The bill passed largely due to a sense among Republican legislators that this was the best (if not only) deal possible given the differences between the House and Senate, and that it would deny Democrats an issue for the fall elections (Shear and Gardner, 2007; Hardy and Schapiro, 2007a). Several senators voted for the bill while stating their hope that the governor would amend it (Shear and Gardner, 2007; Hardy and Schapiro, 2007d).

HB 3202, as approved by the General Assembly, was projected to provide slightly more than half the state funding from FY 2008 to 2013 ($2.5 billion) that Governor Kaine

[325] Northern Virginia jurisdictions would be able to impose or increase the commercial real estate tax, grantor's tax, vehicle rental tax, driver's license fee, and hotel tax, which would generate more than $400 million in FY 2009 for regional transportation projects if all of the options were used. Hampton Roads jurisdictions would be able to impose or increase the commercial real estate tax, grantor's tax, driver's license fees, vehicle inspection fees, a sales tax on motor vehicle repairs, and a 2 percent tax on motor fuel, which would raise almost $200 million in FY 2009 if all of the options were used. See Department of Planning and Budget, "2007 Fiscal Impact Statement: HB 3202," dated March 19, 2007.

had sought in his transportation proposal ($4.8 billion). The difference was even more stark in terms of new state revenue (as opposed to transfers of existing revenue) estimated for the two plans from FY 2008 to FY 2013: $880 million in the General Assembly's bill, versus $4.0 billion in the governor's plan.[326] The General Assembly's bill also authorized roughly $3 billion in new regional funding over six years, but none of that was guaranteed.

Governor's Amendments to Transportation Financing Bill. Governor Kaine assailed HB 3202 as passed by the General Assembly because it would "drain almost $200 million a year from the General Fund, pitting transportation against our core priorities in public education, public safety, and public health," while failing to "address our well-documented statewide transportation needs." (Governor Tim Kaine, 2007c). He also contended that the bill did little for parts of the state outside Northern Virginia and Hampton Roads (Hardy and Schapiro, 2007e).

The governor's amendments to HB 3302 would increase the amount of transportation debt from $2.5 billion to $3 billion and stretch out the borrowing over 25 years. Although the governor reduced the amount of recordation tax revenue that would be dedicated to transportation funding, existing tax revenue streams would still provide more than 50 percent of the money provided by HB 3202 despite Kaine's concern about shifting general fund resources. Specifically, the governor sought to repay the new debt using one-third of insurance premium tax revenues and to fund additional road and transit projects by dedicating 12 percent of recordation tax revenues; he also reserved two-thirds

[326] Author's calculations using data from Office of the Governor, "Governor Tim Kaine's 2007 Transportation Revenue Proposal," and Department of Planning and Budget, "2007 Fiscal Impact Statement: HB 3202," dated March 19, 2007.

(up from one-half) of future budget surpluses for transportation. Finally, the governor restored the 1.5¢ per gallon increase in the diesel fuel tax, which would provide 6 percent of new state revenues in the amended bill.[327] The vehicle registration fee increases, higher penalties for overweight trucks, and abusive driver fees stayed in the bill.

Tax increases were devolved to lower levels of government, even though Kaine was said to view the regional tax options for Northern Virginia and Hampton Roads as an abdication of state responsibility (Hardy and Schapiro, 2007e). The regional and local taxes, as well as a range of fee options, would allow Northern Virginia communities to generate more than $400 million annually, and Hampton Roads communities more than $200 million annually, if all of the options were used.[328]

Because the governor had largely preserved the General Assembly's financing plan, avoiding a state tax increase (except for the minuscule diesel fuel tax increase), his amendments won grudging acceptance from Republican legislators (Gardner, 2007; Delegate Morgan Griffith, 2007; Richmond Times-Dispatch, 2007). Anxious for a truce on transportation funding (Hardy and Schapiro, 2007f), the House and Senate approved the governor's amendments by wide margins,[329] and HB 3202 became law. Table 6.8 (see next page) summarizes the state financing provisions of HB 3202 as enacted.

[327] Author's calculation using projections for FY 2008 through FY 2013 from Office of Governor Tim Kaine, "Financial Impact of Governor's Amendments to HB 3202," March 2007.

[328] Regional authorities would be able to impose a 2 percent rental car tax; increase the grantor's tax by 40¢ per $100; apply a 5 percent sales tax on auto repairs; levy a 2 percent gas tax (Hampton Roads only); and levy a 2 percent hotel tax (Northern Virginia only). The governor also gave local governments in the two regions direct authority to increase commercial property taxes and to impose a $10 vehicle registration fees so that the jurisdictions were not completely dependent on the regional bodies.

[329] The House vote was 85 to 15, and the Senate vote was 29 to 9.

Table 6.8
State Financing Provisions of House Bill 3202, As Enacted
(dollars in 000s)

Revenue Source	Estimated Revenue FY 2009	Estimated Revenue FY 2008-13
Insurance Premiums Tax Transfer	$137,000	$761,100 (36%)
Vehicle Registration Fee Increase	$62,400	$374,400 (18%)
Recordation Tax Transfer	$64,100	$335,400 (16%)
Abusive Driver Fees	$61,900	$323,500 (15%)
Truck and Trailer Registration Fee Increase	$27,000	$162,000 (8%)
Diesel Fuel Tax Increase	$20,900	$133,600 (6%)
Fine for Violating Weight Limits (Heavy Trucks)	$3,400	$20,400 (1%)
50% of General Fund Surplus	Not Known	Not Known
Total Revenue	**$376,700**	**$2,110,400**

Note: FY 2009 is highlighted in the middle column of this table because it represents the first full year of implementation. The right-hand column shows the revenue impact for FY 2008-13 because new revenues would begin flowing in FY 2008.

Source: Office of Governor Tim Kaine, "Financial Impact of Governor's Amendments to HB 3202," March 2007.

Although enactment of HB 3202 represented the first major infusion of state transportation funds in Virginia since 1986, the bill was expected to have a modest effect. The governor's original proposal for $4.8 billion in new transportation funding over six years (FY 2008 to 2013) had been whittled down to $2.1 billion; new revenues (as opposed to funding shifts) for transportation had dropped even more sharply, from $4.0

billion to $1.0 billion.[330] Some analysts noted that HB 3202 would barely reduce the statewide maintenance backlog and predicted that policymakers would have to revisit the transportation finance issue in several years (Craig, 2007a). Described by Senator Thomas Norment as "one of the ugliest bastard stepchildren" (Hardy and Schapiro, 2007g), HB 3202 was limited by sharp ideological divisions about taxes and spending among state lawmakers. The difficult path to enactment of even the most obscure tax increase – the diesel fuel tax – offered strong evidence that broad-based tax increases would be almost impossible in Virginia. This conclusion is reinforced by the decision of Virginia policymakers to earmark existing revenues for transportation from smaller, less visible taxes: the recordation tax and the insurance premiums tax.

In crafting HB 3202, Virginia lawmakers not only shifted tax burdens downward to regional and local officials, but they also obscured the costs of financing transportation by piecing together the funding package "with bits of this and scraps of that," in the words of *The Washington Post* (The Washington Post, 2007). The largest source of new revenues for transportation was a $10 increase in the vehicle registration fee. Moreover, in approving the abusive-driver fees, lawmakers seemed to spare law-abiding residents from some of the burdens of financing transportation while shifting costs to a dangerous but unknown group of bad drivers who deserved to pay more. In an interview, the governor's director of policy, Brian Shepard, noted that residents felt that the fees would not affect them, thinking, "Not me – I don't drive like that." He added that, "The perception of the fines started out as, 'Only bad guys are going to have to pay this.'" The

[330] Author's calculations based on Office of the Governor, "Governor Tim Kaine's 2007 Transportation Revenue Proposal," and Office of the Governor, "Financial Impact of Governor's Amendments to HB 3202," March 2007.

abusive-driver fees ultimately had more wide-ranging, complex effects, such as piling thousands of dollars in fees, legal costs, and insurance increases on low-income workers.

Other Tax Policy Legislation Considered in 2007. The political dynamics were almost exactly the opposite for tax cutting. The governor and General Assembly easily forged agreement on a wide range of tax relief legislation in 2007, primarily affecting the personal income tax and the general sales tax. Appendix 6.1 at the end of the chapter summarizes the 15 tax policy bills enacted by the General Assembly in 2007.

Governor Kaine was successful on his proposal to increase the personal income tax filing threshold from $7,000 to $12,000 for single filers, and from $14,000 to $24,000 for joint filers, beginning in 2008. The final bill raised the income tax thresholds slightly less than proposed by the governor for tax year 2008 but approached his target levels in 2012 ($11,950 for single filers and $23,900 for joint filers), while also increasing the personal exemption, from $900 to $930, beginning in 2008. Wayne Turnage, the governor's chief of staff, described this initiative as "a classic case of the governor using the right's ideology against them." By packaging aid to low-income residents in the form of a tax cut, the governor was able to advance social policy goals that were usually blocked in the General Assembly (for example, one of the governor's top priorities, expanding preschool education, was repeatedly stymied). The amended bill passed both houses unanimously and was signed into law by the governor.

As shown in Appendix 6.1, 12 of the 15 tax policy bills enacted in 2007 were projected to have a negative fiscal impact, and one was estimated to have a positive fiscal impact; the other two bills would have a neutral or unknown impact. Legislators of both parties and both houses supported the tax-cutting: 10 of the 12 tax-cut bills received unanimous votes in both houses. The other two tax cut bills received a unanimous vote in one house and the "closest" vote was 85 to 8.

Most of the tax cut legislation enacted by the General Assembly in 2007 was small in scope and cost: six of the 12 measures were projected to have an average annual cost of less than $100,000.[331] Still, the tax relief measures allowed legislators to advance social goals (and claim credit) in major policy areas: education (increasing college savings), health care (encouraging organ donations), energy (promoting alternative fuels), the environment (supporting recycling), and housing (improving homes for people with disabilities). Interviewees noted that legislators tended to consider targeted tax cuts in isolation, and that each measure's cost seemed negligible compared to the state's $15 billion general fund budget. "Energy efficiency, that sounds good," noted Betsey Daley, the Senate Finance Committee's staff director. "Organ donation, that sounds good. College savings – we like that. They don't tend to look at the cumulative effect. We have a certain amount of these every year."

Particularly notable was the General Assembly's willingness to chip away at the sales tax by authorizing sales tax "holidays" when consumers could buy specified items free of tax. In 2006, legislators approved an annual three-day "back to school" sales tax holiday in which school supplies with a price of $20 or less and clothing with a price of $100 or less were exempt from the sales tax. In 2007, the legislature debated three new sales tax holiday bills – for energy-efficient products (HB 1678 and SB 867), hurricane preparedness equipment (SB 1167), and computer systems, hardware, and software (HB

[331] There were several bills (see Appendix 6.1) for which the revenue loss could not be reliably estimated; this was generally the case when the revenue loss involved minuscule cots resulting from very infrequent transactions. In each case, the revenue loss was likely to be less than $100,000.

1659 and HB 2167) – and enacted the first two. The estimated revenue loss from the newly-authorized sales tax holidays was at least $12.5 million from FY 2008 to 2013.[332]

The enactment of new sales tax holidays for energy-efficient equipment and hurricane preparedness reflected a number of factors: lobbying by the Virginia Retail Federation and Virginia Chamber of Commerce; competition with Maryland and the District of Columbia (both of which offered sales tax holidays); and the desire to deliver benefits to different constituencies. The sales tax holiday for hurricane preparedness would cost an estimated $11.8 million from FY 2008 to FY 2013 (Department of Taxation, 2007), but interviewees noted that a $2 million annual cost was not a concern at a time when the economy was still growing. The devastation caused by Hurricane Isabel in 2003 and the vulnerability of Virginia's coastal communities gave proponents a potent image that dramatized the case for the hurricane preparedness tax holiday. Although interviewees stated that there was some discussion of research findings that sales tax holidays change the timing of purchases but do not boost economic activity, the visceral appeal of the tax break as a way to help hard-pressed households was decisive. Governor Kaine's chief of staff Wayne Turnage noted that, "The march of ideology is inexorable in terms of ignoring research. John Q. Public doesn't pay attention to those arguments."

In 2007, tax cut legislation was characterized by binary outcomes: most bills were either enacted or died in committee without a vote. The range of groups and activities targeted for tax relief was astonishing. Unsuccessful measures included tax credits for health insurance premiums paid by small businesses, electronic toll payments, bicycle

[332] Author's calculations using data from Department of Taxation, "2007 Fiscal Impact Statement: HB 1678," dated February 20, 2007, and Department of Taxation, "2007 Fiscal Impact Statement: SB 1167," dated February 27, 2007. The estimated revenue loss is a lower bound because the fiscal impact statement for HB 1678 (the energy-efficiency sales tax holiday) did not include the forgone revenues from the sales of ceiling fans, fluorescent light bulbs, and programmable thermostats, due to a lack of data.

use, adoption expenses, telework, in-home health care, prescription drug expenses, veterinarian services and animal adoptions, energy-efficient equipment, and research and development, as well as exemptions for military retirement income, licensed medical caregivers, and propane gas purchased for use in commercial greenhouses – just to name a few. The dichotomous outcomes for tax cut legislation points to the gatekeeping role of the finance committee chairmen, who determined which bills would receive committee consideration. A review of the Virginia Legislative Information System identified only three tax cut measures that were not enacted in 2007 after being approved by the House or Senate Finance Committee.[333]

By contrast, a review of the Virginia Legislative Information System did not identify any bills that would increase state tax revenue by $1 million or more annually, except for five bills that earmarked revenues for transportation funding.[334] Only one of the bills would have affected a broad-based tax (SB 1379, as introduced, would have increased the state sales tax to 5 percent in order to finance transportation projects). Only one of the bills (SB 1379, again) received a committee vote, and the general sales tax increase had already been removed from the bill at that point.

The difficult, multi-year debate that culminated in HB 3202 left Virginia officials eager to move on to new issues. Expressing his intent to focus on issues such as public education, health care, and the environment, Governor Kaine stated that, "You are not

[333] These bills were HB 2167, "Limited Exemption for Computer Systems, Computer Hardware and Software, and Calculators" (the sales tax holiday bill discussed earlier); HB 1843, "Income Tax: Public/Private Investment Tax Credit;" and SB 1394, "Neighborhood Assistance Tax Credit."

[334] The bills were HB 2071, "Motor Vehicle Sales and Use Tax; Increase for Transportation Purposes," HB 2190, "Motor Fuel Tax Increase," HB 2464, "Motor Fuels Tax and Road Tax; Rates and Refunds," HB 2606, "Motor Fuel Tax; Rate Increase," and SB 1379, "Transportation Futures Fund."

going to see me seeking significant upward adjustments in taxes during the remainder of my term. I am going to have to rigorously prioritize." (Craig, 2007b).

The governor's vow to avoid proposing additional tax increases (which he later reconsidered) seemed reasonable after the General Assembly had rejected a vehicle excise tax increase for two consecutive years. In 2007, a policy window had opened for transportation funding due to changes in the "politics stream" – most notably, Republican fears of losing control of the Virginia Senate after losses in previous elections. Although that change in the political climate led to enactment of the state's first major transportation financing package in 20 years, the strong anti-tax views of Republican delegates largely confined the state revenue sources to fines, fees, and shifts of current resources. Whereas the governor's initial proposal would have added almost $2.5 billion in vehicle excise tax revenues from FY 2008 to 2013, the final bill provided only $134 million in new tax dollars over that period by raising the diesel fuel tax.

Overall, there was almost no change in Virginians' tax burdens due to the tax policy changes enacted in 2007: tax revenues would fall by an estimated $4.5 million, or 0.03 percent, in FY 2008.[335] The small increase in the diesel fuel tax was offset by the higher thresholds for income tax liability, an increased deduction for college savings contributions, and other small tax cuts.

Consistent with proposition #2 set forth in the introduction, Virginia policymakers conducted a very narrow search for tax policy options. Most notably, lawmakers gave little consideration to raising the gasoline tax, even though it was the largest source of

[335] Author's calculation using data from Office of Governor Tim Kaine, "Financial Impact of Governor's Amendments to HB 3202," March 2007; Commonwealth of Virginia, *Executive Amendments to the 2006-2008 Biennial Budget*, pp. A-12 – A-16; and fiscal impact statements prepared by the Virginia Department of Taxation and Virginia Department of Budget and Planning, available at http://leg1.state.va.us.

transportation funding and the 17.5¢ per gallon tax rate had not been changed since 1986.[336] Although the governor viewed motor fuel taxes as the fairest and most direct way to finance transportation needs, he instead proposed raising the vehicle excise tax as a less salient, more politically palatable option and otherwise relied on non-tax options, such as abusive driver fees, to piece together a transportation financing package (consistent with proposition #3 about the primacy of political acceptability in tax policy decisions). The governor and General Assembly agreed to earmark a portion of insurance premiums and recordation tax revenues for transportation, with the only apparent rationale being the low visibility of both levies. In enacting HB 3202, the governor and legislature departed from benefits taxation – using taxes paid by those who use the transportation system – and thereby impeded efficiency, because benefits taxation encourages people to economize on their use of roads and highways.

Virginia policymakers approved a dozen tax cut bills in 2007, which often involved diffused costs that generated no opposition while numerous constituencies benefited. Nevertheless, the motivations for targeted tax cuts were more complicated than was assumed in case study proposition #5, which emphasized interest-group pressures that prevail outside the glare of public attention. Bills enacted to increase income tax deductions for college savings, allow an income tax deduction for organ donations, and provide sales tax holidays were intended to serve broad public purposes rather than simply to gain favor with special interests. As posited by Irene Rubin,

[336] Delegate Vivian Watts introduced legislation (HB 2606) to raise the gasoline tax by 10¢ per-gallon and increase the alternative use fee for certain motor carriers, but the bill died in the House Finance Committee.

targeted tax cuts can be seen as part of a "politics of protection" from tax burdens, but they often encompass political, social, and administrative concerns at the same time.[337]

The transportation financing bill enacted by Virginia policymakers in 2007 also points to the importance of institutional features in shaping tax policy decisions. Few legislators wanted to authorize regional bodies to impose taxes and fees to finance transportation: many Democrats favored a statewide solution and many Republicans opposed tax increases at any level of government. Yet a compromise allowing regional taxes and fees was approved by the legislature and signed into law, largely because the Republican leadership used procedural rules to clear several potential veto points – the anti-tax House Finance Committee, which was bypassed by Speaker Howell, and a conference committee which was stacked with Senate supporters of HB 3202 even though most senators were lukewarm about the bill. As stated by William Riker (1984: 1), "That a particular outcome occurs is a function of the decisive coalition that happens to exist at the time of decision, of the outer boundaries in a policy space of members' most preferred alternatives, of the sequence in which alternatives are considered, and of many other constraints … on the decision-making process." Virginia lawmakers compromised on HB 3202 because their preferences were so disparate and had to settle for second- and third-best policy tools that were in many cases minimally acceptable. As John Layman, chief economist for the Virginia Department of Taxation, stated in an interview, HB 3202 became law "because at the end of the day that's the only thing you could agree on."

[337] Many finely-targeted tax bills seek to correct an inequity in the tax code or an administrative problem. For example, HB 2148, enacted in 2007, would give railroad companies a sales tax exemption on the purchase of locomotives used to ship goods that would match the exemption already available for locomotives used to transport passengers.

Tax Policy Decisions in 2008

The 2008 session of the General Assembly was critical for Governor Kaine, providing his only opportunity to craft a biennial budget. The governor faced a slightly more favorable political environment, as Democrats gained four seats in the November 2007 elections to claim a 21-19 majority in the Virginia Senate. Democrats also picked up four seats in the Virginia House, leaving Republicans with a 54-44 majority (two seats were held by Independents).[338] At the same time, the departure of several Republican moderates from both chambers meant that the opposition party would be more uniformly conservative and determined to fight the governor (Schapiro, 2007b; Schapiro, 2007c).

Policymakers had to address challenges posed by a wilting economy and its effect on revenues. An economic slowdown and subprime mortgage crisis had led to double-digit declines in home sales in Virginia. Job growth was falling below expectations, while the slumping housing market and rising energy costs would reduce consumer spending (Commonwealth of Virginia, 2007: A6–A8; House Appropriations Committee, 2007: 4-6, 28-30, 33-36). To close a projected $641 million deficit for FY 2008 (Division of Legislative Services, 2007), Governor Kaine had proposed $300 million in budget cuts, which would be continued in the FY 2009-10 biennium, as well as the use of unexpended FY 2007 appropriations ($94 million) and a transfer from the state's rainy-day fund ($261.1 million), to maintain a balanced budget (Director of Planning and Budget, 2007: 4; Governor Tim Kaine, 2007d).

[338] Before the 2007 elections, Republicans held 57 seats, Democrats held 40 seats, and Independents held 3 seats in the House of Delegates. Although the Democrats took four seats from the Republicans in the 2007 elections, a Republican also unseated an Independent. As a result, the House was comprised of 54 Republicans, 44 Democrats, and 2 Independents in 2008.

The administration projected that general-fund revenue growth would be a tepid 3.3 percent in both FY 2008 and FY 2009, before picking up to 6.7 percent in FY 2010 (Commonwealth of Virginia, 2007: A-11). The weak growth rate for FY 2009 reflected not only the slowing economy but also the shift of insurance premium and recordation tax revenues to the transportation fund, approved in the 2007 transportation financing bill.

Fiscal Year 2009-2010 Biennial Budget. Bypassing tax increases and proposing only minor fee increases,[339] the governor's budget included only modest new initiatives, such as $56.3 million to expand preschool programs for low-income children, $41.6 million to improve mental health programs, and $7.8 million to launch a pilot health insurance program for low-income workers at small businesses (Commonwealth of Virginia, 2007: A-19–A-22; House Appropriations Committee and Senate Finance Committee, 2008: O-10). Kaine's budget also reflected the fiscal impact of two tax bills that were introduced as separate legislation. The first bill would conform Virginia's income tax code to most provisions of the federal tax code as of December 31, 2007. The second bill would close a corporate tax loophole related to property placed in company-owned or "captive" real estate investment trusts (REITs), similar to legislation that Maryland had enacted in 2007 (see chapter 4, pp. 257-258). The combined effect of the bills would be to increase revenue by $6.5 million in FY 2009 and $6.7 million in FY 2010 (House Appropriations Committee and Senate Finance Committee, 2008: 3).

The issue of transportation financing returned to the fore, as the "abusive driver" fees adopted in 2007 became "a lightning rod for voter discontent" (Schapiro, 2007d). A point of contention was that the abusive driver fees did not apply to out-of-state

[339] The new fees included increasing the driver's license renewal fee by $10, continuing a $1 increase in the vehicle registration fee, and raising permit costs for wells and septic tanks.

drivers,[340] which was challenged in court as a violation of the Constitution's equal protection guarantee (Knapp and Ng, 2007). Early reports also suggested that enforcement of the fees was arbitrary and that rules regarding some offenses were ambiguous (Joint Commission on Transportation Accountability, 2007). Moreover, Virginians began seeing the practical impact of the fees, as the abstract image of the dangerous driver was replaced by family members, neighbors, and friends who were charged.[341] Making a speedy retreat, legislators introduced 13 bills in each chamber to repeal the abusive driver fees (Virginia General Assembly, 2008: 124-134; 155-166). Governor Kaine also renounced his support of the bad-driver fees in January (Governor Tim Kaine, 2008a).

The furor over the abusive-driver fees gave those seeking more reliable sources of transportation revenue an opening to propose ways to replace the revenue loss from repealing the fees, estimated at $65 million annually. In addition, the 2007 transportation bill had reduced, but not eliminated the projected shortfall for road and bridge repair, which was estimated at $290 million annually (Nolan and Schapiro, 2008a) and starting to grow again as construction costs rose and transportation revenues fell below forecasts.

Governor Kaine continued to support raising the vehicle excise tax to finance transportation, but did not propose an increase in the budget after being defeated on the issue in the first two years of his term (Nolan and Schapiro, 2008a; Craig, 2008a). The governor kept his pledge to avoid tax increases even when the falling economy forced his

---

[340] This was due to a provision of the state constitution reserving all fines for the "Literary Fund," which provides low-interest loans to localities for public school construction. To earmark the bad-driver revenue for transportation, the charges had to be defined as "fees" tied to the issuance of a Virginia driver's license rather than fines that could apply to anyone – resident or non-resident – who committed specific offenses.

[341] As Robert Chase, president of the Northern Virginia Transportation Alliance, stated in an interview, "It wasn't someone necessarily who had run over three people or been convicted 10 times."

administration to revise the revenue forecast downward by an additional $339 million for FY 2008 and by $1.05 billion for the FY 2009-2010 biennium. Instead, Kaine proposed additional spending cuts, even for programs he had championed such as pre-kindergarten and foster care services, sought to tap $162 million more from the rainy-day fund, and increased debt financing in order to reduce outlays (Commonwealth of Virginia, 2008a).

Democratic senators who now held the majority were more willing to propose tax increases to support transportation than they were in 2007. Senator Linda Puller proposed legislation (SB 2) to apply the state sales tax to motor fuel, while Senate Majority Leader Richard Saslaw introduced legislation (SB 713) to increase the motor fuel tax by a penny per gallon for each of five years. Republican Senator Emmett Hanger also proposed a bill (SB 469) that would offset the revenue loss from repealing the abusive driver fees with a motor fuel tax increase of 2¢ per gallon.

The Senate approved the majority leader's bill to raise the motor fuel tax by a penny per-gallon for each of five years, which would generate almost $1.1 billion from FY 2009 to 2014 for the Highway Maintenance and Operating Fund (Department of Planning and Budget, 2008b). Senator Saslaw emphasized that the motor fuel tax had not been raised since 1986 and cited an annual deficit of $360 million in the highway maintenance fund (the $290 million deficit cited earlier plus the impact of repealing the abusive driver fees) in arguing for the bill (Nolan, 2008a). In explaining his choice of a gas tax increase rather than a vehicle excise tax increase, Saslaw stressed the need to spread the tax burden among different levies, noting that the General Assembly had authorized a 1 percent vehicle excise tax increase in Northern Virginia the previous year.

“You can’t dump tax on top of tax,” Saslaw was quoted as telling *The Washington Post*. “We hit (Northern Virginia residents) last year.” (Craig, 2008b).

Nevertheless, Democrats knew that the chances of enacting the gas tax increase were dim (Schapiro, 2008a). Breaking a tradition of passing a bipartisan budget, the Senate divided along party lines (21-19) in approving a budget that included the gas tax increase. The House approved its budget, which endorsed additional borrowing for transportation and avoided tax increases, by a 93-5 vote, and blocked the proposal to increase the gasoline tax when the budget went to a conference committee (Somashekhar and Craig, 2008). The defeat of the gasoline tax increase reflected not only the strong opposition from Republican delegates, but also the reluctance of Democratic delegates to raise the cost of gasoline when retail prices had breached the $3 per-gallon mark (U.S. Energy Information Administration, 2014).

Virginia policymakers also considered a gross receipts tax on gambling to finance transportation projects, although the scope of the proposal was smaller and garnered much less attention than the debate over slot-machine gambling in Maryland. SB 597, introduced by Senate minority leader Thomas Norment, would allow “instant racing” at 10 racetracks or wagering facilities, with the proceeds to be divided among the state, the licensee, the locality where betting took place, and the horsemen.[342] Half of the proceeds would be dedicated to highway maintenance.

SB 597 was not perceived as increasing taxes because of the voluntary nature of instant racing and had the advantage of collecting revenue from a new form of economic activity, but interviewees stated that the proposal was not taken seriously because the

[342] Instant racing involves betting on previously-run horse races with the names of the horses, as well as the dates and places of the races, hidden from participants.

House was unlikely to support an expansion of gambling. Although proponents of instant racing contended it could generate as much as $330 million annually in new revenue for the state, the Department of Planning and Budget noted that instant racing would not be fully implemented for as long as five years and deemed the fiscal impact “indeterminate” because it was not clear how many instant racing machines would be viable economically (Department of Planning and Budget, 2008c). The Senate approved SB 597, but the bill died in the House Finance Committee. Nevertheless, the bill reflects the appeal of peripheral revenue sources – a “sin tax,” in effect – to some Virginia lawmakers.

In light of the unyielding, unified opposition of Republicans to tax increases and the divisions among Democrats, the House and Senate approved a biennial budget with no new taxes and a $180 million bond issuance for transportation. The budget agreement deleted the only base-broadening measure proposed by the governor, which would bar captive REITs from deducting dividends paid to their corporate owners (the owners would typically be located in a lower- or no-tax state, thereby shifting revenues out of Virginia). The contrast with Maryland, which enacted a bill to close the captive REIT loophole by overwhelming bipartisan votes in 2007, was stark in this case and seemed to reflect the different ideologies of the two states (one interviewee noted that Maryland’s adoption of the proposal was not necessarily reassuring to Virginia lawmakers). The dissertation interviews did not offer a clear, consistent explanation for the defeat of the proposal, but several individuals suggested that the complexity of the issue and the governor’s sponsorship were major factors. In retaining the captive REIT loophole, lawmakers bypassed an estimated annual revenue gain of at least $6.3 million (Department of Taxation, 2008a). By contrast, the legislature unanimously approved the governor's proposal to conform the state income tax to most federal income tax rules, thereby adopting three new tax breaks at a projected cost of $6.4 million from FY 2009 to FY 2014 (Department of Taxation, 2008b).[343]

The General Assembly funded another tax break in the budget: a three-year sales tax exemption for equipment purchased or leased by data centers that meet certain investment and hiring requirements, a change estimated to cost $2.83 million in forgone revenue from FY 2009 to 2014 (Department of Taxation, 2008c). Interviewees stated that the data center exemption won unanimous support because it would help the Virginia Economic Development Partnership convince Microsoft to locate a data center in Mecklenburg County, a struggling community in Southside Virginia. In order to qualify for the exemption, the data center would have to create at least 100 new jobs at twice the prevailing average wage in the locality, while investing at least $75 million in the facility.

Other Tax Legislation Considered in 2008. Virginia legislators also continued to enact tax breaks outside of the budget process, a continuing area of bipartisan agreement. As summarized in Appendix 6.2 at the end of this chapter, the General Assembly enacted 13 tax policy bills as stand-alone measures in 2008, including the two tax-cut measures that were reflected in the biennial budget (conformity with the federal tax code and the sales tax exemption for data centers) and discussed previously. Only one of the 13 tax policy measures enacted in 2008 (HB 1398/SB 665, which would extend a $1 recycling charge for each new tire sold) would raise revenues,[344] whereas eight of the bills were

---

[343] These tax breaks were as follows: increased expensing for small businesses; an income tax exclusion for amounts transferred from the Hokie Spirit Memorial Fund (formed after the April 16, 2007, shootings on the Virginia Tech campus); and an income tax exclusion for debt forgiveness on troubled home loans.

[344] Even though the $1 recycling charge was characterized as a "fee," it is more properly seen as an excise tax because consumers did not receive an individual benefit in return.

projected to reduce revenues and four were expected to have no fiscal impact. Among the eight tax-cut bills approved by the General Assembly in 2008, there were dissenting votes on only two bills,[345] indicating the widespread support for allocating benefits through the tax system.

Particularly notable was legislators' interest in two types of tax relief measures with strong political appeal: (1) tax incentives for the spaceflight industry and (2) broader sales tax holidays. Enactment of legislation (HB 238/SB 286) providing a tax deduction for income resulting from spaceflights (of people or cargo) launched in Virginia resulted from five bills introduced in the House and two introduced in the Senate to promote the growth of the commercial spaceport at Wallops Island off Virginia's Eastern Shore. The spaceflight industry incentives won unanimous support in both houses due to a combination of geographic interests and powerful symbolism. Because Orbital Sciences Corporation, based in Northern Virginia, planned to launch its new rocket at Wallops Island, Northern Virginia legislators joined their Eastern Shore colleagues in promoting the bills. The spaceflight industry incentives also drew support because lawmakers wanted to diversify the economy and promote an "emerging" industry associated with technological innovation and scientific advancement, according to interviewees.

. Enactment of HB 1229, which added water-efficient products to the items eligible for the annual Energy Star sales tax holiday, also resulted from a flurry of legislation. There were nine sales tax holiday bills (several were identical), all of which were introduced in the House. As introduced, HB 1229 would have authorized a second

---

[345] These bills were SB 392, "Retail Sales and Use Tax Exemption – Sales of Textbooks by For-Profit Schools," and HB 833/SB 291, "Company Vehicles of Automotive Manufacturers. The voting data are from the Virginia Legislative Information System, http://leg1.state.va.us.

annual Energy Star sales tax holiday, allowed products purchased for commercial use to qualify, and added water-efficient products to the list of eligible products. The House Finance Committee removed the first two provisions in order to reduce the revenue loss, and HB 1229 easily cleared both the House (96-2) and the Senate (39-1).[346]

The sustained efforts to expand the sales tax holidays in 2007 and 2008 reflect an instance in which legislators were willing to expand popular tax relief measures without evidence of their impact. The back-to-school sales tax holiday had been authorized in 2006 and the Energy Star and hurricane preparedness holidays had been adopted in 2007; no evaluation had been done of their effects. Legislators pushed for expansion once again in 2008, and received another installment of benefits for their efforts.

An incentive package approved for Volkswagen reflected micropolitics at work. Targeted at automobile manufacturers with headquarters located in Virginia (a category that would apply only to Volkswagen upon its relocation from Michigan), the legislation (HB 833/SB 291) granted Volkswagen a motor vehicle dealer license and exempted the company from the vehicle excise tax and titling fees on vehicles leased to its employees (Volkswagen also received $6 million in state grants) (Governor Tim Kaine, 2007e). Although several legislators objected to special treatment for Volkswagen, the projected revenue loss was modest ($636,000 in FY 2009 and $1.15 million from FY 2009-2014) and the relocation of a company headquarters – estimated to create 400 new jobs – was highly appealing to most lawmakers (Department of Planning and Budget, 2008d;

[346] One reason why the House Finance Committee sought to curtail the cost of HB 1229 was that members also sought to enact HB 57, one of several bills that would add computers and computer-related projects to the back-to-school sales tax holiday. Although the House unanimously approved HB 57, the Senate Finance Committee did not act on the bill.

Governor Tim Kaine, 2007e). The Senate approved SB 291, 40-0, and the House approved the bill, 81-13.

The unanimous votes on six of eight tax-cut measures enacted by the General Assembly in 2008 did not mean that *any* tax relief bill could gain enactment if brought to a vote. One tax cut bill was very closely contested during the 2008 session: HB 1164, which would grant individuals and businesses a tax credit for donating to non-profit foundations that support public or private schools in the state. The bill was very similar to legislation introduced in Maryland, the "Building Opportunities for All Students and Teachers in Maryland Tax Credit," which was discussed in Chapter 5 (see pp. 327-328) and was also controversial. Although HB 1164 squeaked through the House on a 50-48 vote, it was defeated in the Senate Finance Committee, 11-3. HB 1164 was politically polarizing because it touched on the divisive issue of public support for private education and was seen by teacher unions and other opponents as a voucher program in disguise that would drain resources from public schools. HB 1164 serves as an exception that reflects a general rule: in the absence of sharp ideological fault lines policed by organized interest groups, mobilizing opposition to tax-cut bills in Virginia was a difficult prospect.

Virginia officials ended the 2008 regular session of the General Assembly with an even larger transportation funding deficit. First, both chambers overwhelmingly repealed the abusive driver fees enacted in 2007, but did not agree on a way to replace the lost revenue, reflecting the ideological polarization that gripped state government. Second, eight days before the session ended, the Virginia Supreme Court ruled that the taxing authority given to regional bodies in Northern Virginia and Hampton Roads in the 2007 transportation bill was unconstitutional because the bodies were unelected. The court decision created an additional annual funding gap of $500 million in the state's transportation budget, leaving the 2007 transportation bill in tatters and prompting the governor to call a special session of the legislature in June 2008 to devise a remedy.

Special Session on Transportation Financing. As the special session began, the governor and Senate Democrats argued that the failure of the 2007 plan underscored the need for a statewide solution including new revenues. For their part, House Republicans sought to shift taxing authority from the regional bodies to local governments as an easy fix (Whitley, 2008a; Nolan, 2008b; Somashekhar and Turque, 2008), while hardening their opposition to statewide tax or fee increases as the economy faltered and pocketbook concerns became more acute (Craig, 2008c; Craig and Kumar, 2008). New projections that the state highway construction budget faced a shortfall of nearly $3 billion over six years did not ease the stalemate (Kumar, 2008a), even as 85 percent of Virginians described transportation problems as "serious" or "somewhat serious." (Schapiro, 2008b).

In May, Governor Kaine issued a transportation financing plan intended to fill a $1 billion annual funding gap, reflecting shortfalls of $450 million for statewide maintenance (the gap had grown as construction costs rose and transportation revenues stagnated in a declining economy) and $550 million for Northern Virginia and Hampton Roads (Nolan, 2008c). Table 6.9 (see next page) summarizes the statewide component of the governor's 2008 transportation funding plan.

The governor sought almost the same amount of revenue from higher taxes ($2.1 billion over six years) as he had in his 2007 transportation plan ($2.5 billion over six years), but attempted to blunt anti-tax sentiment by spreading the burden of increased taxes more widely. First, the vehicle excise tax would rise from 3 percent to 4 percent

Table 6.9
Governor Kaine's 2008 Transportation Funding Proposal: State Revenues
(dollars in 000s)

Revenue Source	Estimated Revenue FY 2009	Estimated Revenue FY 2009-14
Vehicle Excise Tax Increase (to 4%)	$172,500	$1,187,400 (47%)
Grantor's Tax Increase (to 40¢ per $100)	$142,000	$909,500 (36%)
Vehicle Registration Fee Increase ($10)	$70,300	$432,800 (17%)
Total Revenue	**$384,800**	**$2,529,700**

Source: Office of the Governor, "Governor Kaine's 2008 Transportation Plan."

(rather than 5 percent as in prior proposals), generating approximately $200 million per year (Governor Tim Kaine, 2008b). Second, the real estate grantor's tax would increase by 25¢ per $100 of assessed value, raising roughly $150 million per year (Governor Tim Kaine, 2008b). The grantor's tax increase would be dedicated to rail, airports, ports, and other forms of mass transit. Third, the governor proposed a $10 increase in the annual vehicle registration fee, which would yield about $70 million per year for highway maintenance and operation (Governor Tim Kaine, 2008b). Finally, the governor's plan included a 1 percent general sales tax increase (exempting food) for Northern Virginia and Hampton Roads, generating approximately $400 million and $200 million annually for each region, respectively (Governor Tim Kaine, 2008b). The regional tax changes would be mandated by state law to comply with the Virginia Supreme Court decision.

The governor conceded that his decision not to join Senate Democrats in seeking a gas-tax increase was based on political concerns, stating that residents would feel "very hard hit by a gas tax … They view (gas) as a necessity of life." (Nolan and Schapiro, 2008b; Nolan, 2008c). He also told the Virginia Chamber of Commerce that the gas tax was the most logical revenue generator but was unfeasible due to Republican opposition (Whitley, 2008b). A poll conducted for the governor showed that 72 percent of residents were open to tax increases to finance transportation projects, but a gas tax increase received only 12 percent support at a time when fuel prices had soared (Schapiro, 2008b).

By halving the vehicle excise tax increase and including a statewide grantor's tax increase, the governor was acting to "spread the pain a little bit," as he stated in a radio interview, and thereby seeking to dampen opposition from any single group (such as the Virginia Automobile Dealers Association, which opposed the vehicle excise tax increase, and the Virginia Association of Realtors, which opposed a grantor's tax increase) (Nolan, 2008d; Craig, 2008d). Although the new plan was described as a "mishmash" by the *Richmond Times-Dispatch* (Richmond Times-Dispatch, 2008), there was a logic to the governor's choice of tax levies. As Kaine pointed out, both a 1 percent "initial registration fee" for vehicles (which was the same as a 1 percent vehicle excise tax increase) and a 40-cent grantor's tax per $100 of assessed value had been enacted as regional funding options the previous year (Governor Tim Kaine, 2008c; Governor Tim Kaine, 2008d). In effect, the governor was relying on precedent, arguing that the tax increases should be acceptable to address a major problem affecting the entire state if they were also acceptable for regional officials to impose in large parts of the state. Still, the governor was unable to enlist a chief patron for his bill in the Senate; the bill was introduced only in the House (HB 6026) by minority leader Wade Armstrong.

Senate Democrats took a different approach by advancing legislation (SB 6009) that blended three tax options, including the two main transportation benefit taxes. SB

6009 would increase the motor fuel tax by a penny per gallon for six consecutive years, raise the vehicle excise tax by .5 percent, and boost the statewide sales tax by .25 percent (exempting food). The bill was amended in the Senate Finance Committee to include a 0.5 percent tax cut in the sales tax on food in order to make the package more palatable politically and lessen its regressive impact. As amended, SB 6009 would generate an estimated $2.5 billion over six years for statewide transportation projects (Department of Planning and Budget, 2008e), the same amount as the governor's plan. The Senate bill also corrected the constitutional flaw in the regional funding plans by amending state law to impose taxes that would yield at least $300 million annually for Northern Virginia transportation projects and at least $200 million annually for Hampton Roads projects (Department of Planning and Budget, 2008e).[347]

Senate Democrats took a political risk in supporting a motor fuel tax increase when the average price of gasoline per gallon in the region had just breached $4 for the first time (U.S. Energy Information Administration, 2014).[348] Some observers noted that Virginia senators would not face elections until the fall of 2011 in explaining why Senate Democrats were willing to increase the tax (Schapiro, 2008c). Although Republicans and House Democrats contended that a gas tax increase would harm low- and middle-income families during a time of high gas prices and growing economic hardship, Senate Democrats maintained that the increase was so small that it would be dwarfed by normal price fluctuations (Craig, 2008d; Kumar, 2008b; Craig, 2008e). Moreover, supporters

[347] In Northern Virginia, the sales tax would be increased by an additional .5 percent, the hotel tax would be increased by $5, and the grantor's tax would rise by 40¢ per $100 of transaction value. In Hampton Roads, the sales tax would rise by an additional 1 percent and a 1 percent motor fuel tax would also be imposed.

[348] Specifically, the average retail gasoline price for all grades and all formulations reported by the U.S. Energy Information Administration for the lower Atlantic region (which includes Virginia) breached the $4 per gallon level on June 2, 2008, and remained above $4 per gallon until July 28, 2008.

emphasized that the cost would be borne, in part, by out-of-state drivers who use Virginia's highways (Kumar, 2008a; Craig, 2008e).

To avoid being viewed as obstructionist, House Republicans agreed to give the governor's bill and the Senate bill a floor vote, after initially killing the governor's bill in the Rules Committee (Kumar and Craig, 2008). The governor's bill received an unceremonious rejection of 98-0 because House Democrats decided to support a modified version of SB 6009, deleting the statewide motor fuel tax increase as well as a 1 percent motor fuel tax in Hampton Roads. Nevertheless, the revised version of SB 6009 won only one Republican vote and was defeated in the House, 59-39.

Legislators continued to look for transportation financing methods that seemed to be cost-free (economically and politically) because the incidence of the tax or fee was not clear or would fall on taxpayers with low status or visibility. In addition to the instant racing legislation, the abusive driver fees were an earlier manifestation of this pattern. Delegate Christopher Saxman and Senator Frank Wagner, both Republicans, introduced companion bills (HB 6006 and SB 6011) to earmark for transportation all future revenues and royalties received by the state from offshore natural gas and oil drilling. Even though Senator Wagner claimed that the bills "would not cost the taxpayers a nickel" (Schapiro, 2008d), they were largely a mirage. Congress had set a moratorium on drilling in coastal areas and federal action would be needed for states to share in any revenue from offshore drilling. Even if these obstacles were lifted, the state Department of Mines, Minerals, and Energy concluded that, "(I)t would still take approximately five to seven years after the lease sale in 2011 before any substantive revenue would result. DMME predicts that, should these contingencies take place, the amount of revenue resulting is indeterminate."

(Department of Planning and Budget, 2008a). Nevertheless, the House approved HB 6006 by a vote of 56-39. The Senate narrowly rejected the legislation, 18-16, showing the appeal of measures purporting to shift costs from residents to external targets such as the federal government (which would have to surrender royalties to the state), out-of-state oil companies, and their investors.

The regional funding strategy advocated by House Republicans also ran aground. First, the House approved legislation (HB 6019) authorizing toll collections to support road, bridge, and tunnel construction in Hampton Roads, but the Senate Transportation Committee killed the bill. Second, the House advanced legislation (HB 6055) amending state law to raise certain taxes and fees in Northern Virginia and Hampton Roads.[349] HB 6055 also included funding options that could be authorized by local governing bodies in Northern Virginia[350] but was marred by an inequity: instead of authorizing similar local options for Hampton Roads, it reserved 30 percent of annual growth in state tax revenue derived from the ports of Hampton Roads for transportation projects in that region. Northern Virginia officials blasted HB 6055 not only for abdicating state responsibilities, but also for shifting general fund revenues to Hampton Roads while calling on Northern Virginia localities to raise taxes (Craig, 2008f). After passage of HB 6055 grew doubtful – most Democrats and some conservative Republicans opposed the bill – the House approved a substitute that reserved 30 percent of net annual growth in state tax revenue "attributable to economic activity" at the ports of Hampton Roads, Dulles International

[349] The bill would have raised driver license fees and imposed a 2 percent car rental tax in Northern Virginia, while raising vehicle registration and inspection fees and also imposing a 2 percent car rental tax in Hampton Roads.

[350] These options were a 2 percentage-point increase in the hotel tax and a 40-cent increase in the grantor's tax per $100 of assessed value.

Airport, and Reagan National Airport to transportation projects in both regions. Once the effort to authorize taxes by lower levels of government had failed, House Republicans resorted to their other preferred funding method: earmarking revenues from existing tax streams in order to avoid raising taxes.

HB 6055 now had even less appeal to Democrats because it did not provide any new revenue source for transportation – statewide or regional. Critics also noted that it was almost impossible to determine how much tax revenue was generated by the ports and airports. As a result, the Senate Finance Committee rejected the legislation on a 10-3 vote on the session's final day (Northern Virginia Transportation Alliance, 2008), and the special session ended without any action to address the transportation funding deficit.

The stalemate on tax policy between a Democratic governor and a split legislature resulted in almost no change in Virginia tax burdens in 2008. The projected FY 2009 revenue impact of the 13 tax policy bills enacted in 2008 was a loss of $3.8 million, a net reduction in the tax burden of less than one-tenth of a percentage point.[351] Although developments in the problem stream – the backlash against the abusive driver fees and the state supreme court decision created an opening for other financing options to address Virginia's transportation funding deficit, the political stream was obstructed by divisions between the governor and legislature, the political parties, and the House and Senate. In fact, the political stream was even less favorable than in 2007 because lawmakers were not facing elections that would highlight voter frustrations about transportation.

[351] Author's calculation using data from Commonwealth of Virginia, *Executive Biennial Budget: 2008-2010*, pp. A-11 – A-17, and fiscal impact statements prepared by the Virginia Department of Taxation, available at http://leg1.state.va.us.

The range of tax policy options debated by Virginia policymakers was broader in 2008 than in 2007. The Senate considered legislation to increase the motor fuel tax, to impose the sales tax on motor fuel, and to raise the vehicle excise tax, and in the 2008 special session approved a bill (SB 6009) combining all of those options. The Senate's switch to Democratic control in the 2007 elections – as well as the distance from the next election cycle in 2011 – allowed for broader consideration of tax options to finance transportation programs. By contrast, the narrower range of tax policy options introduced in the House reflected the continued control of anti-tax Republicans. Legislation to increase the motor fuel tax (HB 1266) was introduced in the House, but was soundly defeated in committee. Otherwise, House bills to address transportation funding relied on borrowing, diverting some of the growth in existing revenue streams, and using non-tax revenue sources such as toll collections and royalties from offshore gas and oil drilling.

Virginia's tax policy debates in 2008 were largely limited to transportation funding: there were no proposals to increase or decrease personal income or corporation income tax rates, and no proposals to increase the general sales tax rate for non-transportation purposes. Governor Kaine's proposal to close the captive REIT loophole in the corporate income tax was the sole effort to broaden the tax base. Consistent with proposition #2 set forth at the outset of the dissertation, Virginia officials conducted a very limited search for tax policy options.

As posited in proposition #3 (state officials emphasize political acceptability in evaluating tax policy options), Virginia policymakers proposed tax increases using levies that were less salient or visible to taxpayers in an effort to overcome anti-tax sentiment. This pattern was evident in Governor Kaine's proposal of a vehicle excise tax increase for a third consecutive year, even though he acknowledged that the motor fuel tax is a better-calibrated benefits tax, and in his addition of a grantor's tax increase – an obscure tax with little connection to transportation use – to his transportation financing plan. Legislators also favored tax options that targeted or expanded the periphery of the tax system, reflected in the Senate's approval of legislation authorizing a gross receipts tax on instant racing despite its uncertain capacity to generate revenue. By using options such as the grantor's tax increase or instant racing instead of benefits taxes, lawmakers also neglected efficiency and equity concerns. A transportation tax linked to use of the highways, roads, or mass transit systems encourages people to economize on their use of the transportation network and allocates costs to beneficiaries.

The failure of the transportation financing proposals left targeted tax cuts as the only fertile ground for tax policy actions in Virginia during 2008. In enacting eight small tax cut bills, Virginia lawmakers emphasized economic development incentives, offering sales tax exemptions for data centers, income tax exemptions for spaceflight companies, and a vehicle excise tax exemption for automobile manufacturers. These tax incentives had a strong micropolitical flavor, being written exclusively or primarily to benefit a single company such as Microsoft (data center exemption), Orbital Sciences Corporation (spaceflight industry exemptions), and Volkswagen (auto manufacturer exemption). Because the tax cuts were associated with tangible benefits such as the recruitment of new businesses and the creation of jobs, and the benefits were concentrated on certain groups or regions while costs were widely diffused, the bills passed easily.

Tax Policy Decisions in 2009

In 2009, Virginia policymakers had to confront the ongoing, deepening national recession, and the fiscal problems it created. The fall of 2008 was marked by the crash of the housing market, turmoil in the financial sector, failing credit markets, and rising unemployment (Commonwealth of Virginia, 2008b: A-5 – A-6). In December 2008, Governor Kaine announced that projected general-fund revenue for the FY 2009-2010 biennium had plunged by $2.9 billion (Commonwealth of Virginia, 2008b: D-2).

The governor acted to close the $1.1 billion budget gap for FY 2009 by replacing pay-go capital outlays with debt, delaying a pay increase for state workers, laying off employees and eliminating vacant positions, imposing efficiency measures, shifting money from special funds, and withdrawing $490 million from the rainy-day fund. To eliminate the $1.8 billion budget gap for FY 2010, the governor had to propose education cuts for the first time, reducing funding by almost $400 million largely by reducing state aid for school support staff. He also sought more than $400 million in Medicaid cuts by freezing enrollment for some services and reducing reimbursement rates, while cutting most state agencies by 7 to 15 percent (Commonwealth of Virginia, 2008b). State government workers continued to feel a squeeze as the governor announced more layoffs and maintained a pay freeze in FY 2010.

Fiscal Year 2010 Budget Amendments. The governor's FY 2010 budget included several tax policy proposals, the most significant of which was to double the cigarette tax from 30¢ to 60¢ per pack in order to avoid further Medicaid cuts (cigarette tax revenues were earmarked for the Virginia Health Care Fund) as the budget gap grew and Medicaid costs rose due to the recession. The governor also argued that the tax increase would reduce negative externalities caused by smoking. By generating additional revenue of $154.9 million in FY 2010, the administration estimated that total cigarette tax revenues and revenues from the master settlement on national tobacco litigation would cover Virginia's Medicaid costs from smoking-related illnesses (Director of Planning and Budget, 2008: 17). In an interview, Governor Kaine's chief of staff, Wayne Turnage, described the administration's view as, "Why don't we tax cigarettes and increase (Medicaid) eligibility – tax a sinful product and use the revenue for a greater good?"

The governor also used national data to justify the cigarette tax increase, noting that a 60¢ tax would be half the national average and should therefore be viewed as modest (Commonwealth of Virginia, 2008b: A-18). In an interview with the *Richmond Times-Dispatch*, he dismissed concerns about the regressive nature of the tax because, "(A) tax like that is in the sin tax category. That's a kind of behavior that we ought to try to discourage." (Richmond Times-Dispatch, 2009a). Kaine also pointed to the peripheral nature of the cigarette tax, telling the General Assembly's money committees that he had kept a promise made in August 2008 to avoid "a general tax increase" and adding that, "The increase need not stretch Virginia families, as it is targeted to a specific, non-essential product. And it may, in fact, reduce our health care costs by encouraging some smokers to quit." (Governor Tim Kaine, 2008e; Governor Tim Kaine, 2008f).

The cigarette tax increase was part of a double-barreled attack on smoking in Virginia: the governor renewed an effort to ban smoking in restaurants and other public places, which would affect the debate on the tax increase. Also coupled with the cigarette tax increase was a proposal to shift the taxation of moist smokeless tobacco from a price-based tax to a weight-based tax, which was estimated to generate $2 million in FY 2010 (Secretary of Finance, 2008: 12).

The governor also proposed a much smaller health-related tax: imposing a 5.5 percent "provider assessment" on intermediate care facilities for the mentally retarded (ICF/MRs), which was projected to generate $7.1 million in revenue for the Medicaid program in FY 2010 as well as $7 million in federal matching funds (Department of Medical Assistance Services, 2009: 18). The state Department of Medical Assistance Services noted that this new tax (which was often termed a "fee") "will have little or no net effect on providers" because some of the new revenue would be used to increase Medicaid reimbursement rates for ICF/MRs – returning money to the health care facilities (Department of Medical Assistance Services, 2009: 18). Virginia officials could point to their neighbors to justify the provider assessment: D.C. had imposed provider assessments on nursing homes in 2004 and ICF/MRs in 2006, while Maryland had enacted provider assessments on ICF/MRs in 2004 and nursing homes in 2007.

The governor included two other measures in his FY 2010 budget that would increase tax revenue by broadening the base or limiting tax expenditures. First, he renewed his proposal (rejected the previous year by the General Assembly) to close the captive REIT loophole in the corporate income tax, which would generate an estimated $10 million in FY 2010 (Secretary of Finance, 2008: 12). In addition, the governor proposed saving $50 million by reducing the maximum annual land preservation tax credit per claimant from $100,000 to $50,000 (Secretary of Finance, 2008: 12). The credit was a valued tool for a governor who had pledged to preserve 400,000 acres of open space during his term. According to interviewees, reducing the maximum annual credit was largely a defensive measure to protect the credit against criticism of its spiraling costs.[352] Third, the governor included the standard federal tax conformity update, which was projected to increase revenue during the biennium by $7.7 million due to a provision intended to limit deferred compensation by offshore hedge funds (Senate Finance Committee and House Appropriations Committee, 2009: 3).

Although the tax increases and base-broadening measures could be seen as fiscal medicine, the governor also proposed several tax breaks to promote his policy goals for energy, the environment, and job creation, reflecting the continued use of tax policy as a resource allocation tool even during the height of the recession and fiscal crisis. The governor called for (1) a new income tax credit for solar and wind-powered electric generators installed by homes or businesses in Virginia, and (2) a new sales tax exemption for residential renewable energy systems. These incentives were estimated to reduce revenue by $2.2 million in FY 2010 (Secretary of Finance, 2008: 12). The governor also sought to extend the Major Business Facility Jobs Tax Credit, which provided a $1,000 credit for firms that created at least 100 new full-time jobs (50 full-time jobs in economically distressed areas or enterprise zones).

While bypassing broad-based tax increases, the governor proposed two administrative measures to increase tax revenue. First, he sought to repeal the policy allowing vendors to retain a small portion of the sales tax they collected in order to compensate them for administrative costs. Kaine contended that, "Modern cash registers and computerized accounting systems have made this 'dealer discount' an unnecessary

[352] The cost of the credits was an ongoing issue because initial costs had vastly exceeded estimates, leading lawmakers to establish a $100 million annual cap on credits and reduce the credit to 40 percent of the fair market value, starting in calendar year 2007.

diversion of tax dollars," while noting that employers were not compensated for withholding income and payroll taxes (Governor Tim Kaine, 2008f). Repealing the dealer discount was projected to increase sales tax revenue by $64.3 million in FY 2010 (Governor Tim Kaine, 2008f).[353] Business groups condemned the proposal as a backdoor tax increase that would reduce their operating margins (Kumar, 2009a; Schapiro and Whitley, 2009). In addition, the governor requested 55 additional tax compliance positions to generate $21.7 million in FY 2010 (Director of Planning and Budget, 2008: 6). Using administrative measures to increase tax revenues allowed the governor to avoid the political backlash associated with raising taxes (although there was still some resistance). Wayne Turnage, the governor's chief of staff, stated in an interview that the administration's goal was "to find a way to raise more revenue during a period when the General Assembly is resistant to any tax increase."

Transportation financing, the dominant tax issue of the prior three years, fell from the top of the policy agenda in Virginia. Although transportation revenues were sagging along with the rest of the economy, the long stalemate made state lawmakers reluctant to revisit the issue in 2009. Moreover, an economic stimulus plan being prepared by newly-elected President Barack Obama was expected to provide an infusion of federal funds for transportation (Governor Tim Kaine, 2008f; Nolan, 2008e).

The cigarette tax increase was denounced as a job-killer by Republican legislators (Schapiro and Nolan, 2008; Wagner and Kumar, 2008) and the governor's argument that a 60¢ tax per pack of cigarettes would remain well below the national average did not sway legislators. "The General Assembly was not moved by any sort of tax increases,"

[353] The dealer discount applied only to the first 3 percent of sales tax collected, and equaled 2 to 4 percent of that amount, depending on the vendor's total level of sales.

Secretary of Finance Richard Brown stated in an interview, and comparisons to other states were of little interest to legislators who believed that lower tax rates were a virtue (as in the vehicle excise tax debate of the prior year).

A bill (HB 2379) to increase Virginia's cigarette tax to the national median of $1.19, introduced by Delegate David Englin and favored by public health groups, was defeated unanimously in a House Finance subcommittee. The governor's bill (HB 2389) to double the cigarette tax to 60¢ per pack was defeated in the same subcommittee by an 8-2 vote. Any remaining hope of raising the tax by getting a bill through the Senate was dashed when the Senate Finance Committee deadlocked on the governor's bill (SB 947), 8-8. Democrat Roscoe Reynolds, representing a rural district in southwestern Virginia, joined all seven Republicans on the committee in blocking the cigarette tax increase.

Ideological differences and raw political calculations were important factors in the defeat of the cigarette tax increase. Interviewees agreed that Republican legislators, particularly in the House, still felt stung by the national attention and praise bestowed on Governor Warner after approval of the 2004 tax package, and were resolved not to give Kaine a similar victory. "Fool me once, shame on you. Fool me twice, shame on me," House Appropriations Committee staff director Robert Vaughn stated in describing this sentiment. In addition, the influence of large tobacco companies such as Philip Morris, which moved its headquarters to Richmond in 2003 and employed 5,500 people in Virginia (Nolan, 2008f), made the cigarette tax increase an uphill battle.[354]

Nevertheless, the defeat of the cigarette tax increase involved more than pure political power; it also reflected pocketbook concerns that resonated with lawmakers

[354] Philip Morris donated to 113 of 140 General Assembly members in 2008. See Pete Earley, "Tobacco's Money Trail in Virginia," *The Washington Post*, December 21, 2008, p. B7.

during a time of economic distress. Although lawmakers in Maryland (2007) and the District of Columbia (2008) had doubled their cigarette taxes with very little opposition due to the widespread view of smoking as harmful, Philip Morris and its allies portrayed a more positive image of the tobacco industry by emphasizing its importance to farmers, wholesalers, and retailers who were already suffering from the recession (Kumar, 2009a; Johnson, 2009). Policymakers were receptive to this more nuanced view of the industry because tobacco had long been a mainstay of the Virginia economy. In explaining his vote against the cigarette tax increase, Republican Senator John Watkins told the *Richmond Times-Dispatch* that, "Tobacco in my district means jobs, and in this session of the legislature, I will not vote against jobs." (Schapiro, 2009).

Although Maryland and D.C. officials had gained political benefits by targeting the unpopular tobacco industry, Philip Morris turned this approach on its head by arguing that it was unfair to single out one industry for a tax increase (Blackwell, 2008; Johnson, 2009). Legislators who voted against the tax increase echoed this argument (Kumar, 2009b). Because tobacco companies in Virginia were not a pariah group, concentrating costs on the industry through higher taxes generated much stronger opposition than in the District of Columbia or Maryland. Ultimately, public health concerns and the need to close a large budget deficit could not overcome the economic, social, and political clout of the tobacco industry or the antipathy to tax increases among conservative legislators.

Another factor that helped seal the defeat of the cigarette tax increase was the General Assembly's approval of a ban on smoking in restaurants and other public places, aided by House Speaker William Howell's surprise decision to support the ban. According to interviewees, some moderate and conservative legislators who voted for the smoking ban, which won support in key suburban, “swing” districts, felt the need to oppose the tax increase in order to preserve ties to the tobacco industry. The governor’s decision to challenge the tobacco industry on two fronts had partly succeeded, but lawmakers’ tendency to spread burdens meant that the cigarette tax increase was even less likely to gain enactment than it otherwise might have been.

Lawmakers needed to identify additional spending cuts or alternative revenue sources after defeating the cigarette tax increase. In addition, legislators rejected the tax on facilities for the intellectually disabled[355] and sought to retain the sales tax dealer discount. To recoup the lost revenue, legislators proposed further changes in tax administration, a more neutral ground in the highly-charged terrain of tax politics.

The FY 2010 budget approved by the General Assembly accelerated sales tax collections and authorized a tax amnesty while leaving the sales tax dealer discount unchanged. Large retailers (those with more than $12 million in annual taxable sales) were required to make an additional sales tax deposit in June 2010, shifting $97.8 million from FY 2011 to FY 2010, and the three-month tax amnesty was expected to generate net revenues of $38 million in FY 2010 (House Appropriations Committee and Senate Finance Committee, 2009: 2-3).[356] The enhanced tax compliance initiative proposed by Governor Kaine was also approved and was expected to yield $21.7 million in FY 2010 (House Appropriations Committee and Senate Finance Committee, 2009: 3).

[355] An increase in the federal matching rate for the Medicaid program included in the American Reinvestment and Recovery Act of 2009 provided resources to increase Medicaid reimbursements without imposing the tax. In addition, there was concern that the assessment would have unlawfully imposed extra costs on local governments that operate ICF/MRs. See House Appropriations Committee and Senate Finance Committee, “Summary of 2008-2010 Budget Actions,” May 21, 2009, pp. 56-57.

[356] Taxpayers would be allowed to pay delinquent tax liabilities in exchange for a waiver of late penalties and half of the interest charges. Taxpayers who did not participate would face a 20 percent penalty.

Near the bottom of the most severe economic and fiscal crisis in decades, Virginia lawmakers relied on tax policy to close only 1.5 percent ($65.5 million) of a $4.3 billion budget gap for the FY 2009-10 biennium[357] (the $2.9 billion gap cited earlier had grown by $800 million due to a lower revenue forecast issued in the spring of 2009, and also rose by $600 million due to mandatory spending increases, mostly for Medicaid and other health-care programs). Reflecting the aversion to tax increases, especially in the House of Delegates, Virginia policymakers approved changes in tax administration (sales tax acceleration, tax amnesty, and tax compliance initiative) estimated to yield more than twice as much revenue ($158.7 million) during the biennium as the tax policy measures.[358] As detailed in Table 6.10 (see next page), spending cuts of $1.9 billion dwarfed the $65.5 million in tax increases by a ratio of almost 30 to 1.[359]

Virginia policymakers did not explore more broad-based tax increase proposals that could have offset some of the $1.9 billion in spending cuts they enacted. Concerned that low- and moderate-income residents were bearing the brunt of fiscal austerity, several Democratic legislators introduced bills designed to increase tax revenues and shift part of the burden to wealthy residents. Nevertheless, none of these bills even received a committee vote. The bills were as follows:

---

[357] Author's calculation using data from House Appropriations Committee and Senate Finance Committee, *Summary of 2008-2010 Budget Actions: Chapter 781 (Introduced as House Bill 1600)*, May 21, 2009.

[358] Author's calculations using data from House Appropriations Committee and Senate Finance Committee, *Summary of 2008-2010 Budget Actions: Chapter 781 (Introduced as House Bill 1600)*, May 21, 2009.

[359] Author's calculations using data from House Appropriations Committee and Senate Finance Committee, *Summary of 2008-2010 Budget Actions: Chapter 781 (Introduced as House Bill 1600)*, May 21, 2009.

Table 6.10
Measures to Close Virginia's FY 2009-2010 Budget Gap
(dollar figures in 000s)

Deficit-Reduction Measure	Estimated Deficit Reduction	% of Total
Spending Cuts	$1,925,400	44.4%
Federal Stimulus and Other Federal Funds	$1,105,100	25.5%
Rainy-Day Fund Withdrawal	$490,000	11.3%
Borrowing to Replace Pay-Go Capital	$355,400	8.2%
Fund Balances and Transfers	$192,500	4.4%
Tax Administration	$158,700	3.7%
Tax Policy Changes	$65,500	1.5%
Non-Tax Revenues (Fees, Asset Sales, etc.)	$44,500	1.0%
Total Budget Gap	$4,337,100	100.0%

Source: House Appropriations Committee and Senate Finance Committee, *Summary of 2008-2010 Budget Actions: Chapter 781 (Introduced as House Bill 1600)*, May 21, 2009.

- HB 2376 and SB 1133, introduced by Delegate Englin and Senator Chapman Petersen, respectively. The bills would revive the state tax on estates with a gross value of more than $5 million and earmark the new revenue (estimated at $535.5 million from FY 2010 to FY 2015) for education, health, or human services programs (Department of Taxation, 2009b; Department of Taxation, 2009c);

- HB 1895, introduced by Delegate Vivian Watts. The bill would reinstate the tax on estates with a gross value of more than $3.5 million and use the revenue (estimated at $634.7 million from FY 2010 to FY 2015) to implement staffing standards at nursing homes (Department of Taxation, 2009d); and

- HB 2588, introduced by Delegate Englin. This was the first bill during the case study period to increase personal income tax revenues and make the tax more progressive. HB 2588 would reduce income tax rates for low- and moderate-income residents, start the 5.75 percent tax bracket at an income level of $75,001 (rather than $17,001), and create a new top tax bracket of 6.85 percent on annual incomes over $400,000. The bill would also cut some taxes – repealing the sales tax on food and exempting corporations with less than $100,000 in taxable income from the corporate income tax – limiting the six-year revenue gain to $261.6 million (Department of Taxation, 2009e).

The bulk (76 percent) of the tax revenue increase in the FY 2010 budget reflected enactment of the governor's proposal to reduce the maximum annual land preservation tax credit from $100,000 to $50,000 per claimant. Although the lower limit was projected to save $50 million in FY 2010 and $75 million in FY 2011 (Department of Taxation, 2009f), taxpayers affected by the policy were given two more years to claim unused credits. Therefore, the changes to the land preservation credit could shift some costs to future years. According to interviewees, the temporary nature of the changes (the annual cap would revert to $100,000 after FY 2011) made them acceptable to legislators, particularly in light of the large budget gap.

By phasing in the closure of the captive REIT loophole in the corporate income tax, the legislature diluted the other major effort to broaden the tax base. Because the House was reluctant to approve the governor's proposal, the budget agreement required only a 50 percent add-back of dividends paid to a captive REIT for the first two years, thereby halving the expected revenue gain from $10 million to $5 million per year (Department of Taxation, 2009g). Secretary of Finance Richard Brown noted that the legislature's decision to phase out the deduction in 2009, after rejecting any change in 2008, reflected the lack of better options as the fiscal crisis continued. "The thing is, you are in the middle of a recession," Secretary Brown stated in an interview. "You're not going to be able to do all of this (balancing the budget) on the spending side."

As part of the budget, Virginia legislators also approved a 10 percent tax on the rental or purchase of digital media in a hotel room – an extremely narrow excise tax that was termed a "digital media fee" and probably would not have been approved without that label. Nevertheless, this charge is more properly viewed as a tax because it is based on a percentage of certain economic activity. The Department of Taxation lacked sufficient data to estimate the revenue gain, which would be split evenly between the general fund and a new state Film Incentive Program Fund (Department of Taxation, 2009h). Another narrowly-targeted excise tax bill (HB 2010) to charge five cents for each disposable paper or plastic bag provided to consumers, modeled on legislation enacted in D.C. in 2008, did not receive a vote in the House Finance Committee.

Other Tax Policy Legislation Considered in 2009. Apart from the budget process, Virginia policymakers approved an array of tax breaks in 2009 despite the ongoing fiscal crunch. Among the 17 tax policy bills enacted in 2009, four were projected to have a positive fiscal impact; two were estimated to have a neutral fiscal impact; and 11 were scored as having a negative fiscal impact (see Appendix 6.3 at the end of this chapter for a summary of the tax policy bills enacted in Virginia in 2009). The four bills that would increase tax revenue (relating to land preservation tax credits, captive REITs, federal income tax conformity, and digital media purchases) were all reflected in the budget and discussed above. All but three of the 11 tax-reduction bills were narrow in scope and projected to cause a minimal revenue loss,[360] but HB 2437, which would let manufacturers base their Virginia corporate income tax liability solely on their share of sales in the state, was projected to cause a major, growing revenue loss after FY 2011.[361] The change was intended to encourage manufacturers to locate or remain in Virginia by removing the payroll and property apportionment factors that are often large for

[360] In these cases, the revenue loss was so small that it could not be reliably estimated, usually due to a lack of data.

[361] SB 978, "Income Tax: Dealer Dispositions," which would allow income from certain property sales to be recognized on an installment basis, was the other bill enacted in 2009 that involved a potentially significant revenue loss. Nevertheless, the Department of Taxation was unable to estimate the magnitude of the loss.

manufacturers. Because the single-sales factor would be phased in gradually after FY 2011, there was no revenue loss in the FY 2010-2011 biennium. Even though the forgone revenue would exceed $55 million in FY 2017 when the new formula was fully phased in (Virginia Department of Taxation, 2009a), HB 2437 passed unanimously in both chambers because legislators believed it would improve economic competitiveness and protect manufacturing jobs, according to interviewees.

One reason why the tax relief measures enacted by the General Assembly in 2009 were not more costly or extensive was that the bipartisan coalition in favor of targeted tax breaks weakened due to the recession and budget crisis. Partisan tensions also worsened when Governor Kaine became chairman of the Democratic National Committee in early 2009, spurring charges that he was neglecting his duties to the state (Nolan, 2010a). Although the Senate approved the governor's energy conservation measures – income tax credits for purchasing renewable energy systems (SB 1141) and a sales tax exemption for renewable energy systems (SB 1216) – the House did not act on SB 1141 and rejected SB 1216 on the House floor. The House also tabled or rejected bills approved by the Senate to (1) make landlords participating in "housing choice" voucher programs eligible for Neighborhood Assistance Act tax credits, (2) provide income tax credits to homebuyers, and (3) increase the value of land preservation tax credits for land donated for use as a public park or recreational facility.

For the second year in a row, the Senate killed a bill approved by the House (HB 1965) that would provide tax credits for public school construction and private school scholarships. The Senate also blocked legislation approved by the House (HB 2455) that would revise an investment tax credit to target bioscience, biotechnology, and other technology companies.[362] Both chambers unanimously approved the governor's bill (HB 2575) to extend the Major Business Facility Job Tax Credit for 10 years, reflecting the longstanding pattern in which tax incentives to promote job creation won almost reflexive support even though there was no evaluation of the credit's effectiveness.[363]

Largely due to the limit on the land preservation tax credit, the estimated net impact of the tax policy changes enacted by Virginia lawmakers in 2009 equaled a small tax increase of $65.1 million, or 0.4 percent, in FY 2010.[364] Even as Virginia officials faced a budget deficit projected at more than $2 billion for FY 2010, they avoided tax rate increases and made only marginal changes to tax incentives and the tax base while closing the budget gap through program cuts, transfers from special funds, and an infusion of federal aid through the American Recovery and Reinvestment Act, which offset $800 million in spending cuts, mostly to education and Medicaid (Conant, 2010: 37). Strong anti-tax views as well as concern that tax increases would harm a struggling economy combined to block any tax increases during 2009.

Consistent with proposition #2 set forth in the introduction ("State officials will tend to perform a limited search for tax policy options"), Virginia lawmakers considered a narrow range of tax policy options in 2009, focusing on excise tax proposals. In calling for a cigarette tax increase, Governor Kaine emphasized the peripheral nature of the tax,

---

[362] A sticking point was a House amendment disqualifying firms that performed research on human cells or tissue derived from induced abortions, or from stem cells directly obtained from human embryos.

[363] JLARC later noted that the $1,000 credit per new job – which had not been adjusted since 1994 – was likely too low to stimulate job creation. See Joint Legislative Audit and Review Commission, *Review of the Effectiveness of Virginia Tax Preferences*, Report to the Governor and the General Assembly of Virginia, January 2012, p. 90.

[364] Author's calculation using data from Commonwealth of Virginia, *Executive Amendments to the 2008-2010 Biennial Budget*, pp. A-8 – A-11, and fiscal impact statements prepared by the Virginia Department of Taxation, available at http://leg1.state.va.us. This figure is slightly different from the $65.5 million figure cited earlier because the latter figure did not include tax policy changes made outside the budget.

just as he had chosen a vehicle excise tax increase as a transportation funding source because the tax was less salient than a gasoline tax. Virginia lawmakers enacted the 10 percent tax on digital media purchased in a hotel, but this narrow excise tax was termed a fee, once again reflecting the constraints on tax policy measures considered in the state.

In fact, revenue policy options in Virginia 2009 were not focused even on peripheral taxes; instead, Virginia policymakers focused on tax administration measures as an alternative to rate increases or base-broadening efforts. The General Assembly adopted the governor's proposal to add 55 new tax compliance positions, and legislators added a tax amnesty and an acceleration of sales tax payments to the budget bill. Those three measures were enacted, while repealing the dealer discount failed, because the latter provision – which would increase sales tax receipts even though the tax rate would not change – most closely resembled a tax increase. At the height of the recession in Virginia, revenue-raising options were designed to maximize existing revenue flows. Increases in the three largest state taxes – the personal income tax, the general sales tax, and the corporate income tax – were not part of the policy debate.

Although political acceptability placed strong constraints on the tax policy measures considered in Virginia, political pressures did not dictate the choice of options from this narrow set. Because the cigarette tax had been raised in 2004 and neighboring states had raised their cigarette taxes, Governor Kaine had reason to believe that another increase in 2009 was possible, but policy goals such as reducing the cost of smoking-related illnesses were equally, if not more, important. Similarly, the influence of tobacco companies such as Philip Morris also helped defeat the cigarette tax increase, but concerns about its economic impact also influenced the outcome.

For the first time in the case study period, Virginia policymakers in 2009 enacted legislation to curb a tax expenditure (the limit on land preservation tax credits) and to close a tax loophole (the dividend deduction for captive REITs). Driven by the lack of more palatable budget-balancing options during the worst recession in 70 years, these were still tentative, tangential steps. As noted earlier, the lower cap on land preservation tax credits could push costs into the future and the captive REIT change was more timid than actions to protect the corporate tax base in Maryland and the District of Columbia. Maryland policymakers eliminated the captive REIT deduction in 2007 by overwhelming votes in both legislative chambers, while D.C. policymakers adopted combined reporting – a broader measure aimed at preventing many types of income shifting among corporate subsidiaries – in 2009. Similarly, while D.C. and Maryland had imposed health care provider assessments for years (as had dozens of other states), Virginia policymakers declined to tax facilities for the mentally disabled in 2009.

The half-hearted nature of policymakers' efforts to shore up Virginia's tax base is reflected by the ongoing flow of targeted tax cuts. In particular, the General Assembly unanimously approved tax breaks related to jobs and economic development, extending the Major Business Facility Job Tax Credit without evaluating its effectiveness and approving a major change in corporate income taxation (the single-sales factor) that was projected to cause a major revenue loss in FY 2015 and beyond. Consistent with proposition #7 ("The political bias toward providing tax benefits leaves long-term changes that threaten state tax systems unaddressed"), in 2009 Virginia policymakers approved a short-term reduction in tax benefits (the land preservation tax credit) while authorizing additional tax reductions and incentives on a long-term basis.

Tax Policy Decisions in 2010

Virginia Republicans began 2010 in a stronger position after major victories in the November 2009 elections. State attorney general Robert McDonnell, a Republican, claimed 59 percent of the vote in defeating Democratic state senator Creigh Deeds in the governor's race. Republican lieutenant governor Bill Bolling was re-elected, and state senator Ken Cuccinelli, one of the most conservative Republicans in the legislature, was elected attorney general. Although Democrats had hoped to gain control of the House of Delegates (Craig, 2009c), Republicans gained six seats to boost their majority to 59-39 (with two independents). Senators did not face elections in 2009, so Democrats held their majority, which grew to 22-18 when a Democrat won Cuccinelli's seat.

If tax increases had been very difficult to enact since the 2004 compromise, they would be even less likely now that the governor's office and House of Delegates were controlled by conservative Republicans. A graduate of Regent University, founded by Pat Robertson, Governor McDonnell had strong ties to conservative groups but downplayed social issues during the campaign while promising to create jobs and improve transportation (Helderman and Kumar, 2009). One of McDonnell's most effective television ads seemed to capture his opponent fumbling for words when asked his position on tax increases, a stark contrast to McDonnell's flat opposition to higher taxes (Helderman and Kumar, 2009; Helderman, 2009; Nolan and Schapiro, 2009).

The new governor and General Assembly would have to grapple with a budget gap that kept growing as the deep recession, now the longest since the Great Depression, reduced revenues and increased expenditures. Virginia's general-fund revenues had dropped by 9.2 percent in FY 2009, leaving annual revenue lower than it had been in FY

2006 (Commonwealth of Virginia, 2009: A-8). Although the economy appeared to be recovering by the end of 2009, the consensus forecast was for "sluggish output growth along with continuing job losses." (Commonwealth of Virginia, 2009: A-7). After a projected 2.7 percent decline in general-fund revenue for FY 2010 (which would be the first back-to-back decline in Virginia's recorded budget history), revenue growth was forecast to resume at modest rates of 3.8 percent in FY 2011 and 5.1 percent in FY 2012 (Commonwealth of Virginia, 2009: A-8; Secretary of Finance, 2009).

Governor Kaine had acted to close a projected FY 2010 deficit of $1.9 billion and reduce the shortfall for FY 2011, cutting agency budgets by more than $400 million, tapping the rainy-day fund, deferring state pension contributions, trimming the state workforce, furloughing state employees, and using federal stimulus funds (Governor Tim Kaine, 2009; House Appropriations Committee and Senate Finance Committee, 2010a:O-2–O-3). Because these were mostly one-time measures and federal stimulus funds would be largely depleted after FY 2011, a $4.5 billion gap loomed for the FY 2011-2012 biennium (Director of Planning and Budget, 2009: 6).

Fiscal Year 2011-2012 Biennial Budget. Although the new governor would have to lead the state through the ongoing fiscal crisis, outgoing Governor Kaine submitted the biennial budget for FY 2011 and 2012 as required by Virginia law. Kaine proposed balancing the budget largely through $4.1 billion in spending cuts affecting almost every aspect of state government, including repeal of the $950 million annual state payment to local governments for car-tax relief (Director of Planning and Budget, 2009: 12; House Appropriations Committee and Senate Finance Committee, 2010a: O-2–O-3). To compensate local governments for losing the car-tax payments, Kaine also proposed legislation to phase in a 1 percent across-the-board increase in personal income tax rates, generating an estimated $1.9 billion in FY 2011 (Department of Taxation, 2010a). Revenue from the income tax increase would be earmarked for localities that repealed the car tax, a promise of former Governor Jim Gilmore that had only been partly fulfilled.[365]

Governor Kaine justified the proposed tax increase and elimination of car tax relief by stating that, "Additional cuts to law enforcement, to schools, or to health care at this point are both untenable and against the interest of citizens of the Commonwealth." (Commonwealth of Virginia, 2009: A-17). Interviewees stated that the governor proposed a broad-based tax increase during his last month in office not only because of his dismay about repeated rounds of budget cuts, but also his greater latitude to ignore political pressures at the end of his term.[366] Although the governor's tax plan had some merit from the standpoint of sound tax policy – it would replace state car tax relief, which was frozen at $950 million annually, with income tax revenue that promised to grow faster than the economy – two interviewees separately described the proposal as a "hail Mary" gambit born of desperation.

Kaine proposed three other tax increases as well as a range of fee increases to balance the FY 2011-12 budget.[367] First, he called for a 0.5 percent increase (to 2.75

[365] During the previous recession, Virginia had halted its multi-year effort to provide sufficient aid for local governments to eliminate the car tax. State car-tax relief was capped at $950 million, replacing a portion of local car tax liability for the first $20,000 in value of a personal vehicle.

[366] Although Kaine was elected a U.S. Senator in 2012, he entered the race only after entreaties by President Obama. Aides stated that Kaine did not plan to seek office again when his term as governor ended.

[367] The two main fee increases were (1) an 18-cent hike in monthly landline and wireless E-911 fees, which would generate $38.9 million during the biennium to fund disability or death benefits for public safety officers, and (2) a $10 increase in the deed recordation fee to provide $18.2 million for the Virginia Natural Resources Commitment Fund. See House Appropriations Committee and Senate Finance Committee,

percent) in the insurance premium tax on property and casualty insurers (Kaine dubbed this a “fee”), which would generate $44 million over two years for the Virginia Public Safety Fund to support local police, sheriffs, and counterterrorism efforts (House Appropriations Committee and Senate Finance Committee, 2010a: 10). Second, the governor renewed his proposal (rejected by the General Assembly in 2009) to impose a 5.5 percent tax on intermediate care facilities for the mentally retarded (ICF/MRs), which would generate $12.7 million in new revenues for the Medicaid program, as well as $12.5 million in federal matching funds during the biennium (Commonwealth of Virginia, 2009: B-128). Third, Kaine proposed that Virginia decouple from a federal income tax deduction for domestic production activities enacted in 2004, which would save an estimated $60 million over two years (House Appropriations Committee and Senate Finance Committee, 2010a: 8). The Center on Budget and Policy Priorities, a liberal research and advocacy group, had urged states to decouple, arguing that the deduction was too broad (covering industries such as food processing, software development, and construction) and slanted toward large corporations, which could receive deductions for production in other states. In 2008, D.C. had joined Maryland and 21 other states in denying the domestic production deduction (Johnson and Singham, 2010).

The governor also revived his proposal (rejected by the legislature in 2009) to repeal the “dealer discount” reimbursing firms for the administrative costs of collecting the sales tax. This change would increase sales tax revenue by $121.8 million over two years (House Appropriations Committee and Senate Finance Committee, 2010a: 10).

“Summary of the Governor’s Proposed Amendments to the 2008-2010 Budget and the Governor’s Proposed 2010-2012 Budget,” January 11, 2010.

Once again, the tax increases were castigated by Republican leaders (Kumar and Helderman, 2009; Whitley, 2009). In his address to the General Assembly two days after taking office, Governor McDonnell warned that, "(I)f you pass a bill in this recession that raises taxes on the hardworking families of Virginia, I will veto it. And if you pass a budget embedded with those same tax increases, I will not approve it." (Governor Robert McDonnell, 2010a). Democrats were not enthusiastic, either (Martz and Whitley, 2010; Helderman, 2010). When House Republicans held a floor vote on the income tax increase even though it had no chance of being reported out of committee, it was rejected, 97-0.[368] In addition, the House blocked the 0.5 percent increase in the life and insurance premiums tax that Kaine had proposed, arguing that the link between insurance premiums and law enforcement benefits was tenuous (Whitley, 2010a; Delegate Lacey Putney, 2010). Nevertheless, Kaine's most obscure – and peripheral – tax increase proposal, the provider assessment on ICF/MRs, was approved, reflecting the support of health care providers for a tax that would finance higher reimbursements from the state, augmented by matching federal Medicaid revenues.

The new governor (who had campaigned on the slogan, "Bob's for Jobs") focused on policies intended to spur the economy and create jobs, including a broad array of new or increased subsidies and tax credits. McDonnell's tax proposals not only reflected the view that lower taxes would spur innovation, job creation, and increased revenues, but also a belief that the state's tax and other business incentives needed to match those of neighboring states due to the mobility of capital (Governor Robert McDonnell, 2009;

[368] The bill (HB 1155) was referred to the House Rules Committee, which had the authority to send a bill directly to the House floor for a vote without recommending approval – thereby bypassing the House Finance Committee, which would never have approved the bill.

Governor Robert McDonnell, 2010b). The following five tax proposals were key parts of the governor's economic development agenda:

1. increasing from $3 million to $5 million the annual cap on the Qualified Equity and Subordinated Debt Investment Tax Credit for technology and science start-up businesses;

2. lowering the job creation thresholds for the Major Business Facility Job Tax Credit tax credit;

3. creating a "green jobs" income tax credit;

4. offering $5 million in income tax credits to film companies producing in Virginia; and

5. dedicating a portion of wine liter tax revenues to the Virginia Wine Promotion Fund.

The five tax policy changes proposed by Governor McDonnell were reflected in the budget and then approved in separate bills with overwhelming, bipartisan support.[369] Interviewees noted that the tax proposals were crafted during the governor's campaign and that it would have been difficult for legislators to oppose policies targeted at job creation in light of the recession and McDonnell's strong victory. Therefore, the tax incentives received little scrutiny and drew support from their geographical appeal, with benefits spanning the high-technology industries in Northern Virginia (the Qualified Equity and Subordinated Debt Investment tax credits) to farms in rural parts of the state (the Wine Promotion Fund) and historic sites such as Williamsburg and Jamestown (which were often used as film sites).

The governor contended that his "Jobs and Opportunities Agenda" (which included grant and regulatory programs as well as the tax incentives) would create 29,000

[369] Each bill passed the Senate unanimously and three of the five bills passed the House unanimously. Voting data are from the General Assembly's Legislative Information System, http://leg1.state.va.us.

new jobs in two years and generate more than $300 million in state revenue over five years, but this estimate was developed by the state's business promotion agency (Governor Robert McDonnell, 2010c), and was not scrutinized by the General Assembly. Nor did the legislature address a competing analysis by The Commonwealth Institute for Fiscal Analysis[370] (2010) which forecast greater harm – the loss of 37,000 jobs over two years – from further cuts in education, health, and human services programs made in order to maintain or lower taxes. Several other risks or uncertainties concerning the governor's tax incentives were not weighed by the legislature. For example, the possibility that reducing the job-creation thresholds needed to qualify for the Major Business Facility Job Tax Credit[371] might reward firms for jobs they would add anyway, as an economic recovery began, was not explored. In short, the tax incentives for job creation and economic development seemed to depend on good faith, and the positive symbolism of the incentives, rather than careful analysis of their impacts.

The Virginia Senate was the only source of tax policy proposals to help balance the budget and strengthen the state's revenue base. Although the Senate passed three bills that could be seen as maintaining tax rates or clarifying the tax base with regard to new economic activities, they were blocked by the House, which viewed the proposals as tax increases and barriers to economic growth. These bills were as follows:

- SB 452, sponsored by Sen. Mary Margaret Whipple, would have required online travel agencies (OTAs) to remit sales tax on hotel rooms based on the price paid

[370] The Commonwealth Institute for Fiscal Analysis analyzes fiscal and budget policy issues in Virginia with a focus on their impacts on low- and moderate-income residents. Along with the D.C. Fiscal Policy Institute and Maryland Center for Economic Policy (formerly the Maryland Budget and Tax Policy Institute), the Commonwealth Institute is part of the State Priorities Partnership coordinated by the Center on Budget and Policy Priorities. See www.thecommonwealthinstitute.org.

[371] The threshold would drop from 100 to 50 full-time jobs for most firms, and from 50 to 25 full-time jobs for firms in economically-distressed areas.

by customers to the OTA, rather than the discounted price paid by the OTA to the hotel. Despite unanimous approval by the Senate, SB 452 (which would yield an "unknown" revenue gain) was deleted from the budget and carried over to the 2011 session by the House Finance Committee (Department of Taxation, 2010b).

- SB 660, introduced by Sen. Emmett Hanger, would require online retailers such as Amazon to collect sales tax by changing the definition of nexus to include firms with in-state contracts to solicit customers. SB 660, estimated to yield as much as $17 million annually in state and local revenue (Department of Taxation, 2010c) passed the Senate on a 28-12 vote and was included in the Senate's budget, but was blocked by the House.

- SB 343, also introduced by Senator Hanger, would adjust the motor fuel tax using an index of fuel efficiency, rather than inflation, to offset the declining revenue resulting from more economical cars. Hanger's proposal would generate an estimated $969 million for transportation projects from FY 2011 to FY 2016 (Nolan, 2010b; Whitley, 2010b; Department of Planning and Budget, 2010). Despite approval by the Senate on a 31-9 vote, SB 343 was continued to the 2011 session by the House Finance Committee.

Several tax policy changes that would increase revenue became part of Virginia's biennial budget in 2010, but most of these provisions stemmed from a debate on whether to conform to federal income tax breaks approved in the 2009 American Recovery and Reinvestment Act. The stringent anti-tax stance that usually marked tax policy debates in Virginia did not apply in this case because federal tax breaks enacted by President Obama and a Democratic-controlled congress were not priorities for many Virginia lawmakers.

The federal conformity decisions involved (1) original issue discounts on high-yield debt obligations, (2) deferral of certain income arising from the cancelation of debt, (3) adjustments to the Earned Income Tax Credit (EITC) to ease the "marriage penalty" and provide more aid to families with three or more children, and (4) a deduction of excise taxes paid on the purchase of new cars. To prevent some of the revenue loss that would arise from these breaks, the House and Senate agreed to decouple from the first provision and allow the latter three benefits only in tax year 2009. Interviewees emphasized that the federal conformity decisions did not reflect a considered judgment on each tax break, but were simply part of the calculations made to balance the budget.

The conference committee also compromised on Governor Kaine's proposal to decouple from the domestic production activities deduction, opting to save $30 million over two years (rather than $60 million) by phasing out the deduction (House Appropriations Committee, 2010: 3-4). Nevertheless, a line-item veto by Governor McDonnell, who called the compromise "essentially a tax increase on eligible Virginia businesses" that "affects … decision making regarding whether or not to locate and bring jobs to Virginia" (Governor Robert McDonnell, 2010d: 2), forced legislators to leave the domestic production activities deduction intact.[372] One reason why the General Assembly adopted the governor's amendment to preserve the deduction, according to interviewees, is that it was an existing benefit valued by manufacturers; by contrast, the other departures from federal tax policy concerned new tax breaks. Retaining the deduction was also described as part of the governor's successful effort to bring Northrop Grumman's corporate headquarters to Virginia after a high-profile competition with Maryland and D.C. (Hedgepeth and Helderman, 2010).

Policymakers adopted one other tax policy change that would increase revenue in 2010, extending through tax year 2011 the $50,000 annual limit on land preservation tax credits per claimant that had been imposed in tax years 2009 and 2010. The extension was projected to save $50 million in FY 2012. The land preservation tax credit was the only state tax expenditure that lawmakers curtailed during the case study period.

[372] The deduction was maintained at 6 percent of qualified production activities, the level that applied for tax years 2007 through 2009, but Virginia did not follow the federal government in increasing the deduction to 9 percent for tax year 2010 and subsequent years.

In avoiding all but the most tangential tax increases, the General Assembly had to patch together a balanced budget by cutting more than $1 billion in health and human services programs, deferring $621 million in retirement payments, reducing other agency budgets, and transferring balances from various earmarked funds (House Appropriations Committee and Senate Finance Committee, 2010b: O-16 –O-24). Tax administration was also part of the budget-balancing effort: legislators compromised by denying the sales tax dealer discount to large retailers who were required to file their returns electronically, saving $98.2 million over two years (House Appropriations Committee and Senate Finance Committee, 2010b: 8), and serving as a back-door tax increase.

Other Tax Policy Legislation Considered in 2010. The continued weakness of the economy as well as the fourth consecutive year of severe budget cuts led lawmakers to make bolder tax policy proposals outside of the budget process, but they would have to pursue these options in future years due to the dire fiscal situation. Several conservative legislators proposed larger tax cuts that they argued would spark the state economy, while liberal legislators proposed tax increases to shore up spending on education, health care, and other services. Generally, these tax proposals languished in committee (tax cuts often stalled in the Senate Finance Committee, while tax increases were blocked in the House Finance or Appropriations Committees). In addition, lawmakers continued to propose targeted tax relief measures intended to advance economic and social goals, but as in 2009, many of the bills (eight) were approved by one chamber but not the other. The $4 billion-plus budget deficit heightened concerns about the cost of tax-cut measures, likely causing the defeat of bills that could have been enacted in better economic times with little resistance.

The most sweeping tax-cut proposals in 2010 focused on the corporate income tax, including bills in both chambers (HB 119 and SB 671) to eliminate the tax in order to give Virginia an "economic competitiveness that is just really unparalleled," in the words of Senate chief patron Ryan McDougle (Meola and Martz, 2010). Although HB 119 was approved by the House Finance Committee, the House Appropriations Committee did not act on the bill because of its six-year projected revenue loss of almost $3.6 billion (Department of Taxation, 2010d), as well as the incongruity of exempting corporations from taxes during an economic downturn (Meola and Martz, 2010). Other bills to reduce corporate income taxes for small businesses (HB 896), lower the tax rate on corporations that open new offices or expand existing offices (SB 325), and cut the corporate income tax rate from 6 percent to 5.75 percent (HB 860) did not move forward.

Conversely, Democratic legislators who had largely limited tax increase proposals to excise taxes in recent years introduced tax bills targeting income tax increases on affluent households. Senator Mamie Locke sponsored SB 705, the largest tax increase bill in 2010 (in terms of scope and revenue impact), which would generate $555 million in FY 2011 and $3.6 billion from FY 2011-16 to increase local education aid.[373] SB 705 included nine major changes to make the tax system more progressive and broaden its base, including a three-year, 3 percent personal income tax surcharge on high-income households; combined reporting of corporate income; and reinstatement of the estate tax. Delegate David Englin also re-introduced tax-reform legislation (HB 271) that he had sponsored in 2009 to cut personal income taxes at the low end of the income scale and

[373] Author's calculations using data from Department of Taxation, "2010 Fiscal Impact Statement: SB 705," dated February 15, 2010.

raise them at the top, while eliminating the state sales tax on food as well as corporate tax liability for firms with taxable income below $100,000.

Nevertheless, the broad-based tax increases in SB 705 and the personal income tax increases in HB 271 (even when paired with tax reductions) had no chance given the vehement opposition of Republicans and the ambivalence of many Democrats. The Senate Finance Committee rejected SB 705, 10-5, and HB 271 saw no action in the House Finance Committee. Three bills (HB 223, HB 275and SB 714) to reinstate Virginia's estate tax also died in committee, as they had in 2009.

In a time of divided government and an ongoing budget crisis, the tax policy measures enacted in Virginia in 2010 were mostly targeted tax cuts of modest size that generated little controversy. Appendix 6.4 at the end of the chapter summarizes the 13 tax policy bills enacted by the Virginia General Assembly in 2010, six of which were incorporated into the budget and have been discussed earlier. Among the 13 bills, only two were projected to generate revenue (the bill restricting the land preservation tax credit discussed earlier and a restructuring of the tax on non-cigarette tobacco products) and seven were estimated to lose revenue; three bills were scored as having no fiscal impact and one bill had an unknown fiscal impact.

Once again, divided government resulted in a minuscule change in tax burdens in Virginia: the estimated net change from tax policy measures enacted in 2010 amounted to a decrease of $500,000, or less than one-tenth of 1 percent in FY 2011.[374] Even as policymakers closed a $4.5 billion budget gap for the FY 2011-2012 biennium, they

---

[374] Author's calculation using data from Commonwealth of Virginia, *Executive Biennial Budget, 2010-2012*, pp. A-8 – A-13, B-128, and fiscal impact statements prepared by the Virginia Department of Taxation, available at http://leg1.state.va.us.

almost entirely avoided tax increases (and fee increases) because the "political stream" was obstructed both by a conservative governor who had pledged not to raise taxes and a Republican-controlled House of Delegates that espoused similar views.

Governor Kaine's proposal to increase the personal income tax reflected both the limited range of tax policy options considered in Virginia (proposition #2 set forth at the outset of the dissertation) as well as the strong constraints set by political acceptability (proposition #3). The only broad-based tax increase sought by the governor during his term, the personal income tax increase was proposed as Governor Kaine prepared to leave office, when political pressures were at their weakest. Offered as a "hail Mary" pass to avoid deeper budget cuts, the proposed income tax increase was not taken seriously and did not gain a single vote in the House of Delegates. Otherwise, the governor continued the pattern of seeking increases in narrow-based taxes by proposing to raise the insurance premiums tax and to impose a health provider tax on ICF/MRs.

As noted earlier, the dire fiscal situation prompted legislators of both parties to introduce more sweeping or innovative tax policy bills, also as predicted by proposition #2 (officials will tend to perform a limited search for tax policy options, in the absence of a major external shift such as an economic crisis or a shift in partisan control). But tax increases remained unacceptable from an ideological viewpoint and large tax cuts were unaffordable given the gaping budget deficit. Even legislation that sought to find a middle ground by clarifying or maintaining the taxation of goods or services in a changing economy (Senate bills to modify the definition of nexus for taxing Internet sales, define the taxable receipts of online travel agencies, and adjust the motor fuel tax using an index of fuel efficiency) ran aground on the shoals of divided government.

The tax policy increases approved in 2010 were tangential enough to meet the test of political acceptability. As noted earlier, health provider taxes were unusual in enjoying support from many payers who would benefit from the revenues and federal matching funds. The lower annual cap on the land preservation tax credit – extended an additional year in 2010 – did not spark opposition because it was temporary. Virginia policymakers protected the tax base by decoupling from federal deductions and credits enacted in the stimulus bill, but this action could be defended as not increasing taxes because the tax breaks were never part of the state tax code. By contrast, Governor Kaine's proposal to decouple from the federal domestic production deduction failed partly because Virginia had conformed to this policy since 2004; businesses argued that decoupling was "changing the rules in the middle of the game." Moreover, as lawmakers faced pressure to help people suffering from the recession, the symbolic value of the deduction as a way to help firms compete and create jobs outweighed claims that it was not cost-effective.

Creating jobs and promoting economic development were the dominant motifs in Virginia tax policymaking in 2010. The partisan gridlock that otherwise characterized the Virginia tax policy process did not apply to targeted tax cuts intended to spur particular sectors of the economy, as lawmakers granted overwhelming approval to Governor McDonnell's tax incentives to support science and technology startups, green jobs, the film industry, and major business facilities. Legislators also expanded tax breaks for data centers, reflecting the bipartisan consensus in favor of tax breaks targeted at economic development in industries expected to expand and provide good-paying jobs.

Appendix 6.1
Tax Policy Legislation Enacted by the Virginia General Assembly in 2007

Legislation	**Projected Fiscal Impact**
HB 1640, "Retail Sales and Use Tax; Exemption for Alternative Fuel Burning Stoves." Provides five-year sales tax exemption for multi-fuel heating stoves purchased for residential heating.	Revenue loss cannot be reliably estimated.
HB 1674/SB 999, "Sales and Use Tax Exemption; Free Distribution of Educational Materials." Extends sales tax exemption for educational materials provided free by publishers.	No fiscal impact because revenue estimate assumes extension of exemption.
HB 1678/SB 867, "Sales Tax Exemption; Energy-Efficient Products." Provides annual, 4-day "sales tax holiday" for energy-efficient products priced at $2,500 or less.	-$132,000, FY 2008 -$751,000, FY 2008-13
HB 1696/SB 1105, "Taxation; Conformity with Internal Revenue Code." Adopts federal income tax rules as of December 31, 2006.	-$1.9 million, FY 2008 -$11.8 million, FY 2008-13
HB 2059/SB 822, "Recordation Tax." Applies grantor's tax to the greater of the consideration paid or the actual value of the interest.	Revenue gain cannot be reliably estimated.
HB 2148, "Sales and Use Tax; Commercial and Industrial Exemptions; Railroad Rolling Stock." Exempts railroad rolling stock from sales tax.	Revenue loss cannot be reliably estimated.
HB 2220, "Income Tax; Deduction for Unreimbursed Organ Donation Expenses." Allows income tax deduction up to $5,000 for unreimbursed medical expenses of an organ or tissue donor.	-$55,000, FY 2008 -$330,000, FY 2008-13
HB 2498/SB 791, "Residential Tax Credit; Increased Accessibility and Visibility for the Disabled." Extends to new homes an income tax credit for retrofitting homes with accessibility features.	Revenue loss cannot be reliably estimated.
HB 2724, "Sales and Use Tax Exemption; Churches." Exempts tangible property used to maintain church property from sales tax.	Revenue loss cannot be reliably estimated.
HB 3022/SB 778, "Individual Income Tax; Filing Threshold." Increases income tax filing thresholds and personal exemption.	-$13.5 million, FY 2008 -$149.4 million, FY 2008-13
HB 3044/SB 870, "Income Tax Credit for Machinery and Equipment for Processing Recyclable Materials; Extend Sunset." Extends corporate tax credit for buying recycling machinery and equipment and also allows credit against personal income tax.	$0, FY 2008 -$2.5 million, FY 2008-13
SB 785, "Income Tax Deduction; Virginia College Savings Plan." Increases maximum annual deduction from $2,000 to $4,000.	-$7 to -$32 million per year
SB 1167, "Sales Tax Exemption; Hurricane Preparedness Equipment." Provides annual one-week "sales tax holiday" for hurricane preparedness equipment.	-$1.7 million, FY 2008 -$11.8 million, FY 2008-13
SB 1172, "Aircraft Sales and Use Tax; Deferral/Exemption." Provides aircraft sales tax exemption for Warbirds used for exhibit or for airshow and flight demonstrations.	Revenue loss cannot be reliably estimated.
SB 1283, "Individual Income Taxes." Allows exclusion of income and loss from S corporation that is subject to bank franchise tax.	Unknown

Source: Virginia General Assembly's Legislative Information System, http://leg1.state.va.us.

Appendix 6.2
Tax Policy Legislation Enacted in 2008 by the Virginia General Assembly

Legislation	Projected Fiscal Impact
HB 139, "Income Tax; Biodiesel and Green Diesel Fuels Producers Income Tax Credit." Provides income tax credits for producers of biodiesel fuels during first three years of production.	-$6,000, FY 2009 -$16,000 FY 2009-14
HB 238/SB 286, "Income Tax Exemption for Launch Services and Payload." Allows deduction of income from sale of spaceflight launch services, and service contracts with NASA.	Revenue loss cannot be reliably estimated, but is likely minimal.
HB 680, "Neighborhood Assistance Act Tax Credit." Allows a taxpayer to claim a tax credit for a donation even if it has already been claimed as a deduction for federal tax purposes.	No fiscal impact because credit program is capped.
HB 711, "Sales and Use Tax Exemption; Audio and Video Works." Extends sales tax exemption for audio and visual works through July 1, 2019.	No fiscal impact because revenue estimate assumes extension of exemption.
HB 833/SB 291, "Company Vehicles of Automotive Manufacturers." Exempts Volkswagen from vehicle sales tax for company cars.	-$636,000, FY 2009 -$1.2 million, FY 2009-14
HB 912/SB 582, "Income Tax; Conformity with IRC." Conforms Virginia income tax rules to federal rules as of Dec. 31, 2007.	-$3.3 million, FY 2009 -$6.4 million, FY 2009-14
HB 1229, "Sales and Use Tax; Energy and Water Conservation Products Tax Holiday." Adds water-efficient products to list of exempt products during annual "Energy Star Sales Tax Holiday."	Revenue loss cannot be reliably estimated.
HB 1309, "Income Tax; Riparian Waterway Tax Credit." Allows an individual's grantor trust to claim waterway tax credit.	-$45,000, FY 2009 -$270,000, FY 2009-14
HB 1388/SB 668, "Retail Sales and Use Tax Exemption; Computer Equipment for Data Centers." Exempts from sales tax computer equipment bought or leased for use in a data center. Firms must meet investment and hiring criteria to qualify.	-$1.8 million, FY 2009 -$2.8 million, FY 2009-14
HB 1398/SB 665, "Tire Recycling Fee." Extends $1 recycling fee for each new tire sold until July 1, 2011.	$1.9 million, FY 2009 $7.7 million, FY 2009-14
SB 5, "Retail Sales and Use Tax: Exemption for Printed Materials." Extends sales tax exemption for printing materials purchased by advertising businesses until July 1, 2012.	No fiscal impact because revenue estimate assumes extension of exemption.
SB 392, "Retail Sales and Use Tax Exemption – Sales of Textbooks by For-Profit Schools." Extends sales tax exemption for textbooks to students who attend for-profit schools.	$0, FY 2009 -$1.4 million, FY 2009-14
SB 700, "Neighborhood Assistance Tax Credits." Allows taxpayers to receive credits for donating marketable securities.	No fiscal impact.

Source: Virginia General Assembly's Legislative Information System, http://leg1.state.va.us

Appendix 6.3
Tax Policy Legislation Enacted in 2009 by the Virginia General Assembly

Legislation	Projected Fiscal Impact
HB 1737/SB 985, "Income Tax; Conformity." Conforms state income tax to U.S. Internal Revenue Code as of 12/31/09.	\$10.5 million, FY 2010 \$59.9 million, FY 2010-15
HB 1779, "Sales and Use Tax; Exemption of Sales by Non-Profit Entities." Exempts nonprofits from taxing sales of food, or tickets to events offering food, if sales are limited to 24 times a year.	Revenue loss cannot be reliably estimated.
HB 1790, "Neighborhood Assistance Act Tax Credits." Extends credits through 2011 and makes veterinarian services eligible for credits.	No fiscal impact because revenue estimate assumes continuation of credits.
HB 1803/SB 1021, "Sales and Use Tax; Entitlement to Certain Revenues." Allows Richmond to finance certain facilities using debt paid with revenue generated at the facility, and makes stadiums eligible for this type of financing.	Revenue loss cannot be reliably estimated.
HB 1891/SB 986, "Land Preservation Tax Credit." Reduces the maximum annual credit from \$100,000 to \$50,000 for two years.	\$50 million, FY 2010 \$125 million, FY 2010-15
HB 1938/SB 845, "Income Tax; Livable Home Tax Credit." Increases the maximum credit from \$500 to \$2,000 and raises the 25% credit for retrofitting to 50%.	Less than \$100,000 per year.
HB 2091/SB 868, "Sales and Use Tax; Entitlement to Revenues." Allows certain localities to finance expansion of a facility using debt issued between July 1, 2009, and June 30, 2012, to be repaid from sales tax revenue generated by the facility.	Revenue loss cannot be reliably estimated.
HB 2360/SB 944, "Sales and Use Tax; Fabrication of Animal Meat." Exempts from sales tax the preparing of meat or other food if the buyer supplies the food and it is consumed at home, or if the buyer is a nonprofit or donates the food to a nonprofit. The governor amended the bill to relax the job-creation and wage requirements for data centers claiming a sales tax exemption.	Revenue loss is minimal but cannot be reliably estimated. Fiscal impact statement did not reflect effect of governor's amendment.
HB 2378/SB 946, "Minimum Tax on Noncorporate Entities." Clarifies that minimum tax applies to telecommunications firms organized as non-corporate entities.	No fiscal impact because bill preserves status quo.
HB 2437, "Corporate Income Tax; Apportionment for Manufacturers." Allows manufacturers to use only the sales factor to apportion corporate income to Virginia.	\$0, FY 2010 -\$55.7 million, FY 2010-15
HB 2504/SB 1147, "Corporate Income Tax; Real Estate Investment Trusts." Includes certain dividend income in computing taxable income of captive real estate investment trusts.	\$5 million, FY 2010 \$10 million, FY 2010-15
HB 2575, "Income Tax; Major Business Facility Job Tax Credit." Extends credit through 1/1/2020, and allows credit to be taken over 2 years (rather than 3) during 2009 and 2010.	-\$265,000, FY 2010 \$0, FY 2010-15
SB 978, "Income Tax: Dealer Dispositions." Allows income from certain property sales to be recognized on installment basis.	Unknown but potentially significant revenue loss.

Appendix 6.3
Tax Policy Legislation Enacted in 2009 by the Virginia General Assembly (p. 2)

Legislation	**Projected Fiscal Impact**
SB 1309, "Recordation Tax; Exemption." Extends statewide an exemption for non-profits that acquire real property and purchase materials to construct or renovate affordable housing.	-$28,000, FY 2010 -$168,000, FY 2010-15
SB 1357, "Clean Fuel Vehicle Job Creation Tax Credit; Adds Cellulosic Biofuels." Expands scope of credit to new types of vehicles, components, and production of advanced biofuels.	Minimal or no revenue loss.
SB 1358, "Alternative Fuel Exemption for Agricultural Operations." Exempts from tax any alternative fuel produced by owner or lessee of a farm and used exclusively for his or her farm or motor vehicle.	Revenue loss cannot be reliably estimated.
SB 1421, "Digital Media Fee; Imposition." Creates 10% tax on hotel-room purchase or rental of digital media and allocates 50% of revenue to general fund and 50% to Motion Picture Fund.	Revenue gain cannot be reliably estimated.

Source: Virginia General Assembly's Legislative Information System, http://leg1.state.va.us.

Appendix 6.4
Tax Policy Legislation Enacted in 2010 by the Virginia General Assembly

Legislation	Projected Fiscal Impact
HB 141, "Land Preservation Tax Credit." Makes eligible certain charitable organizations already holding conservation easements.	No fiscal impact because credits are capped.
HB 302/SB 130, "Sales and Use Tax Exemption; Certain Computer Equipment and Enabling Software." Expands sales tax exemption for computer equipment purchased or leased by data centers to include chillers and backup generators.	-$2.4 million, FY 2011 -$2.7 million, FY 2011-16
HB 523/SB 428, "Income Taxes; Recognition of Income from Capital Gains." Grants income tax deduction for long-term capital gain from investing in a technology or science start-up with a main office in the state and under $3 million in annual revenues.	$0, FY 2011 -$2.5 million, FY 2011-16
HB 588/SB 237, "Alcoholic Beverage Control; Wine Liter Tax." Earmarks wine tax collected from farm wineries for Wine Board.	No net impact.
HB 624/SB 472, "Major Business Facility Job Tax Credit." Lowers standard for claiming credit from 100 to 50 new full-time jobs, and from 50 to 25 new full-time jobs in distressed areas.	Revenue loss cannot be reliably estimated.
HB 626/SB 478, "Tobacco Products Tax; Moist Snuff." Changes tax on moist snuff from 10% of manufacturer's price to 18¢/oz. and taxes loose-leaf tobacco on a unit and weight basis.	$240,000, FY 2011 $1.5 million, FY 2011-16
HB 764/SB 458, "Income Tax Credits: Landlords Participating in Housing Choice Voucher Programs." Offers landlords in housing choice voucher program an income tax credit equal to 10% of market value of rents and repeals low-income housing tax credit.	No fiscal impact.
HB 803/SB 623, "Income Tax: Green Jobs Tax Credit." Allows a $500 income tax credit for creating "green" jobs paying an annual salary over $50,000.	Revenue loss cannot be reliably estimated.
HB 861/SB 257, "Motion Picture Film Production Tax Credits." Provides income tax credits to companies with qualifying expenses of at least $250,000 on a film production in the state.	-$1.25 million, FY 2011 -$13.8 million, FY 2011-16
HB 1118/SB 619," Individual Income Tax: Virginia Military Relief Fund Payments." Allows individuals to subtract payments from Virginia Military Family Relief Fund from taxable income.	May result in minimal revenue loss.
HB 1298, "Sales and Use Tax Exemption; Certain Equipment Used in Large Data Centers." Lowers new job threshold for data center sales tax exemption from 50 to 25 for centers located in high-unemployment areas or enterprise zones.	Revenue loss cannot be reliably estimated.
SB 57, "Retail Sales and Use Tax; Countertops." Defines dealers who sell and install countertops as retailers who collect sales tax from customers rather than end users who pay tax themselves.	Net impact is unknown.
SB 233, "Land Preservation Tax Credit." Extends for one year a reduction in maximum credit from $100,000 to $50,000.	$50 million, FY 2011

Source: Virginia General Assembly's Legislative Information System, http://leg1.state.va.us.

Chapter 7

Cross-Case Analysis and Findings

Contents

> The question is whether the states are using (their) power to structure revenue systems that capture changing demographic, economic, institutional, and technological trends. On that score, state revenue systems are in need of review and reform so that they do not become obsolete.
>
> -- Robert D. Ebel and Marilyn Marks Rubin, "A Vision of the Future Sustainability of the States," in *Sustaining the States: The Fiscal Viability of American State Governments*, 2015.

The District of Columbia, Maryland, and Virginia case studies presented in the previous three chapters provide a wealth of information on tax policy decisions in three states that vary widely in terms of economics, politics, and demographics. To synthesize the data, narratives, and findings from each case study into a coherent, cross-cutting whole, I return to the four research questions posed in Chapter 1:

1. How were tax policy options developed in the three jurisdictions, and by whom?
2. How were tax policy options evaluated by decision-makers?
3. What factors or criteria determined which tax policy options were enacted?
4. What patterns in the tax policy decisions of the three jurisdictions might also apply to other states and other levels of American government?

Development of Tax Policy Options

Public officials can (1) raise or lower the rates of existing taxes, (2) broaden or narrow the base of existing taxes, or (3) establish new taxes or repeal existing taxes. Officials can use these building blocks to devise tax proposals ranging from simple (changes to a single tax) to highly complex (reform plans that revamp a number of taxes to advance goals such as revenue capacity, efficiency, equity, and transparency).

Policymakers do not need to rely on their own ingenuity in developing tax policy options. Ideas from professional associations such as the National Conference of State Legislatures, the National Association of State Budget Officers, and the Federation of Tax Administrators; publications such as *State Tax Notes*; and advocacy groups such as the Center on Budget Policy Priorities (CBPP) and the American Legislative Exchange Council filter into state deliberations on tax policy, reflecting a diffusion process that has become faster in the Internet age. For example, CBPP has consistently urged states to adopt and expand earned income tax credits and was instrumental in persuading D.C. lawmakers to establish an EITC in 2000 (Zahradnik and Lav, 2000).[375] Tax policy changes often spread among the states as officials imitate policies implemented elsewhere. Rhode Island enacted the first state EITC in 1986; today, 25 states offer an EITC (Cordes and Juffras, 2012: 311; Center on Budget and Policy Priorities, 2014: 1). After Louisiana became the first state to offer tax credits for film productions in 1992, the number of states providing tax credits to the film industry rose to 15 in 2005 and 40 in 2010 (Department of Legislative Services, 2014: 4; Henchman, 2011).

[375] Since that time, CBPP's D.C. affiliate, the D.C. Fiscal Policy Institute, has been credited with persuading D.C. policymakers to expand the EITC, a point that was made in interviews conducted for this dissertation.

In practice, the formulation of tax policy options is more complex than choosing suitable rate or base changes, or transplanting an idea from another state. Tax policy options have to be cultivated in order to take root and grow in the distinctive political and economic climate of a state. The distinction between developing and evaluating tax policy options is somewhat artificial; options are developed, tested, and refined to make sure that they are feasible politically and promote social welfare goals. Developing and advancing tax policy ideas – particularly tax increase proposals – requires a considerable investment of political capital because taxes are often a "hot-button" issue (Brunori, 2011a: 3-4) and redistribute resources.[376] Finally, formulating tax policy options often requires concerted outreach to various constituencies and consensus-building before a proposal receives serious consideration.

Institutional processes have a strong influence on states' ability to draw on this national marketplace of policy options, and to refine these and other ideas into tax policy proposals that reflect their own economic, political, and social conditions. Maryland was marked by a steady process of developing and evaluating tax policy options through the introduction of legislation covering a wide range of options, public hearings, and detailed analysis of tax policy bills. Maryland followed what legislative specialists call "regular order" – rules that govern a step-by-step, deliberative policy process including not only the introduction of legislation and public hearings, but also committee analysis, amendment, and approval; floor debate, amendment, and approval; and (in a bicameral legislature) conference committee reconciliation of different versions (see chapter 5, pp.

[376] A strong indicator of the hot-button nature of tax increases is that hundreds of public officials have taken the pledge of Americans for Tax Reform (ATR) to oppose *all* tax increases. ATR states that in the 2013-2014 period, 219 U.S. House members and 41 U.S. Senators took the pledge, and that 14 governors and 1,035 state legislators took the pledge. See www.atr.org.

223-224). D.C. represented the other end of the institutional spectrum, characterized by an ad-hoc search for tax policy options when particular needs or problems arose; cursory analysis of revenue, equity, efficiency, and feasibility impacts; and an irregular process in which tax policies were crafted in the D.C. Council's Committee of the Whole (see chapter 4, pp. 95-97). Virginia fell in the middle of these two extremes; its tax policy process was orderly and analytic, but also hampered by political constraints on the tax options that were considered (see chapter 6, pp. 340-344, 345-347). As described later in more detail, Maryland's long-term, ongoing process of evaluating tax policy options led to decisions that integrated political, economic, and social goals more effectively than the policy processes in D.C. or Virginia, and enabled Maryland policymakers to devote more attention to the revenue capacity, equity, and efficiency of their tax system.

The perceived lack of a serious problem or an unfavorable political environment may deter lawmakers from developing tax policy options. At the start of the case study period in the District of Columbia, officials who had enjoyed years of soaring revenues due to a housing boom saw no need to explore tax increases; moreover, opposition to raising taxes by Mayor Adrian Fenty (who pledged not to raise taxes when he ran for mayor) and Councilmember Jack Evans, the finance committee chairman, might have made such efforts futile. In Virginia, sharp divisions among a Democratic governor, a closely-divided Senate (which shifted from Republican to Democratic control in 2008), and a Republican-majority House dominated by conservatives mostly blocked major tax policy proposals from the agenda.

Because the development and consideration of tax policy options depends partly on the priority accorded to tax policy by senior government officials, the first proposition set forth in Chapter 1 posited that, "State tax policy undergoes cycles of change and stability, due to the selective attention of officials and periodic changes in 'problem streams' and 'policy streams' that elevate or lower the position of taxes on the policy agenda." This proposition reflected recent patterns in the case study states[377] and drew on two leading models of agenda-setting and policy formulation: John Kingdon's "multiple-streams" framework (Kingdon, 1995) and Frank Baumgartner and Bryan Jones' "punctuated equilibrium" framework (Baumgartner and Jones, 1993), both of which challenge the view that policy change in the United States is largely incremental (see discussion of both frameworks in chapter 2, pp. 34-42). Nevertheless, the case studies present a more complex view of how tax policy rises on state policy agendas and why officials become receptive to change. Due in part to strong anti-tax sentiment in the U.S., tax increases rise on the public agenda infrequently, often when economic or fiscal problems are dire, while tax-cutting is an ongoing agenda topic.

Finding #1: Tax Policy Changes in the States Follow a Pattern of "Punctuated Incrementalism." Tax Increases Are Considered Intermittently While Tax Cuts Are Considered Continuously.

The concept of the "policy agenda" or "public agenda" – which Kingdon defines as "a list of subjects or problems to which governmental officials, and people outside of government closely associated with those officials, are paying some serious attention at any given time" (Kingdon, 1995: 3) – is itself fairly nebulous. Kingdon notes that there

[377] Each state has been marked by a major tax policy change amid years of stability in tax policy. In 1999, D.C. lawmakers enacted the "Tax Parity Act," which phased in reductions in the personal income and real property taxes to approach parity with Maryland and Virginia. In 2004, Virginia lawmakers increased sales, cigarette, and deed taxes to boost funding for education and health-care programs. In 2007, Maryland lawmakers approved one of the largest state tax increases in recent years to address a long-term imbalance between spending and revenues.

are different agendas for top officials such as the president and cabinet members, and others with specialized roles in policy areas such as health or transportation (Kingdon, 1995: 3). Although there are ways to identify items on the governmental agenda, such as issues discussed in "State of the State" addresses or independent analyses of a legislative session, pinpointing an issue's position on the public agenda is largely a judgment call.

Tax policy is sometimes low on state government agendas; in 2010, for example, D.C. and Maryland policymakers sidestepped tax issues because they could not afford tax cuts in a time of large budget gaps and did not want to raise taxes in an election year. Nevertheless, the case studies indicate that taxation is always at least a secondary issue,[378] lurking near the agenda, for two reasons. First, annual budget cycles bring tax policies up for regular review as state officials strive to balance revenues and expenditures.[379] Second, tax policy is regularly used as a tool of economic and social policy, usually through tax incentives intended to promote activities as varied as saving for college, purchasing a home, or starting a business. Because tax policy serves as a lever for so many other goals, taxes are likely to be on the general governmental agenda – the issues that claim the attention of the chief executive and legislative leaders – or on the agenda of specialized policy communities that focus on issues such as education, housing, and the environment. Table 7.1 (see next page) details the author's judgments of tax policy's place on the public agenda in each case study state from 2007 to 2010, using the categories of "high on the agenda," "on the agenda," or "off the agenda."

[378] For example, in 2010 Maryland Governor O'Malley secured enactment of a $20 million job creation and recovery tax credit even though tax policy changes (such as tax rate increases and base-broadening measures) were largely "off the table" even as Maryland officials had to close a $2 billion budget gap.

[379] As the case studies show, budgets are considered annually even in a state like Virginia with biennial budgeting because revisions are necessary or considered desirable in the second year of the cycle.

Table 7.1
Tax Policy's Place on the Agenda in the Case Study States, 2007-2010

Year	**District of Columbia**	**Maryland**	**Virginia**
2007	*On* policy agenda Commercial property tax relief was a major issue (problem stream)	*High* on policy agenda 2007 special session focused almost entirely on taxes (problem and politics streams)	*On* policy agenda Taxes were major part of debate on transportation funding (problem stream)
2008	*Off* policy agenda Taxes were an issue only in context of health care legislation.	*On* policy agenda Repeal of computer services tax was a major issue, responding to major public outcry (problem stream)	*On* policy agenda Taxes were major part of debate in special session on transportation funding (problem stream)
2009	*On* policy agenda Repeated drops in revenue led to enactment of tax increases (problem stream)	*Off* policy agenda Policymaker fatigue from 2007 and 2008 tax policy debates kept taxes off the agenda.	*Off* policy agenda Transportation funding debate faded after stalemate of previous years.
2010	*Off* policy agenda Policymakers shied away from tax issues in an election year.	*Off* policy agenda Policymakers shied away from tax issues in an election year.	*Off* policy agenda New governor focused on jobs and economic development; only targeted tax cuts were considered.

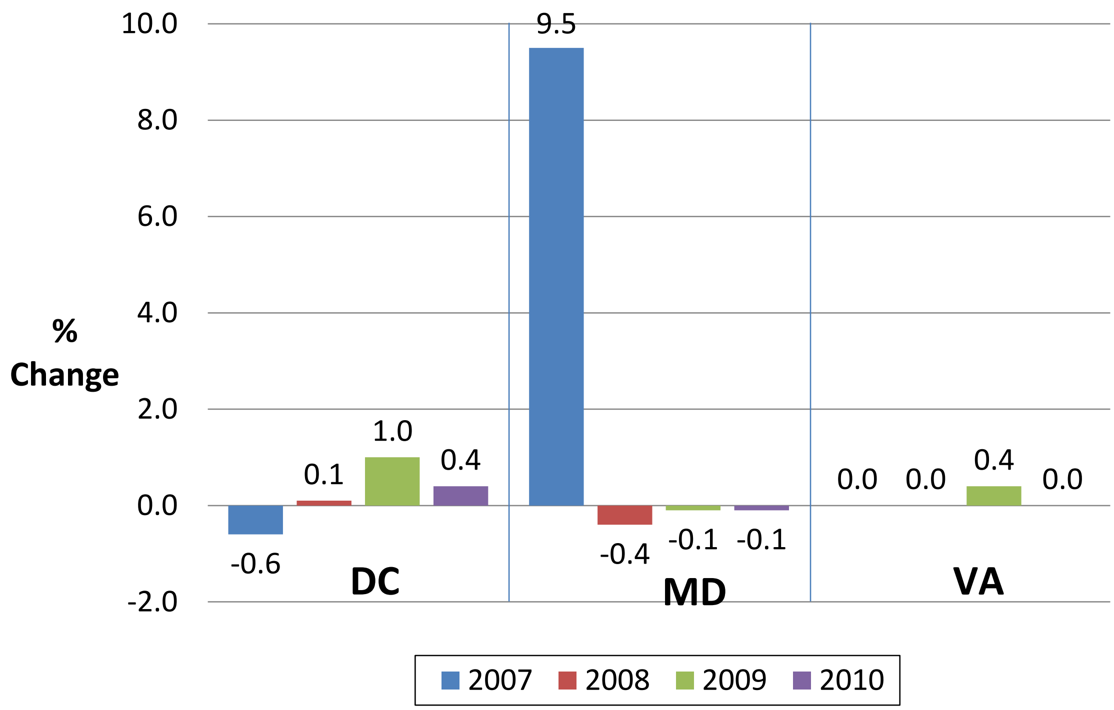
As shown in Table 7.1, Kingdon's heuristic that changes in the problem or politics streams are likely to elevate an issue on the governmental agenda is consistent with patterns in the case study states. For example, a major tax increase became the primary focus of a special legislative session in Maryland in 2007 because of (1) a growing structural deficit identified by state agencies (change in the problem stream) and (2) the election of a new Democratic governor and large Democratic majorities in both legislative chambers who were willing to consider tax increases (change in the politics stream). In 2007, D.C. policymakers made commercial property tax relief a priority after years of soaring property assessments prompted an outcry from business owners (change in the problem stream). After transportation was a dominant issue in Virginia during 2007 and 2008, triggering discussion of tax increases to fund transportation projects, the politics stream blocked transportation financing from the agenda in 2009 and 2010 as officials declined to reopen an issue on which they had repeatedly deadlocked.

Table 7.1 seems to offer evidence supporting conflicting claims that (1) state tax policies are subject to brief periods of sharp change surrounded by longer periods of stasis, and (2) state tax policy changes are primarily incremental. During the case study period, tax policy appeared to be high on the state policy agenda only in Maryland in 2007, when lawmakers enacted a first-year tax increase estimated at 9.3 percent to address the state's structural deficit. This was one of the largest increases in the nation in recent years and far greater than the 1 percent standard for significant change in a state's tax burden. On the other hand, tax policy was sometimes a major topic of debate even when little or no change in tax burdens resulted: Virginia's hard-fought battles about tax increases for transportation in 2007 and 2008 represent one example.

The case study points to a dichotomy: large tax increases (1 percent or more) happen rarely, occurring only when fiscal or economic problems are acute and political conditions are favorable enough to overcome anti-tax sentiment – as they were in Maryland in 2007 when Democrats controlled the executive and legislative branches, and statewide elections were three years away. Because major tax increases require lawmakers to expend a lot of political capital, they are usually loath (or unable) to raise taxes for many years afterward. John Favazza, who served as co-chief of staff to Maryland House Speaker Michael Busch, stated in an interview that after the tax package was approved, "In terms of that term (2007-2010), we had done the tax thing. We weren't going to go back."

While tax increases are on state policy agendas only intermittently, tax cuts – at least modest or targeted tax cuts – are continually on the agenda. Although Figure 7.1 shows net tax cuts only for D.C. in 2007 and Maryland in 2008, 2009, and 2010, the strong and ongoing flow of tax cuts is masked by tax increases that were necessary during a deep recession that began in December 2007 and created large budget gaps.

Figure 7.1
Percentage Change in Tax Burdens from Legislative Actions:
District of Columbia, Maryland, and Virginia, 2007-2010

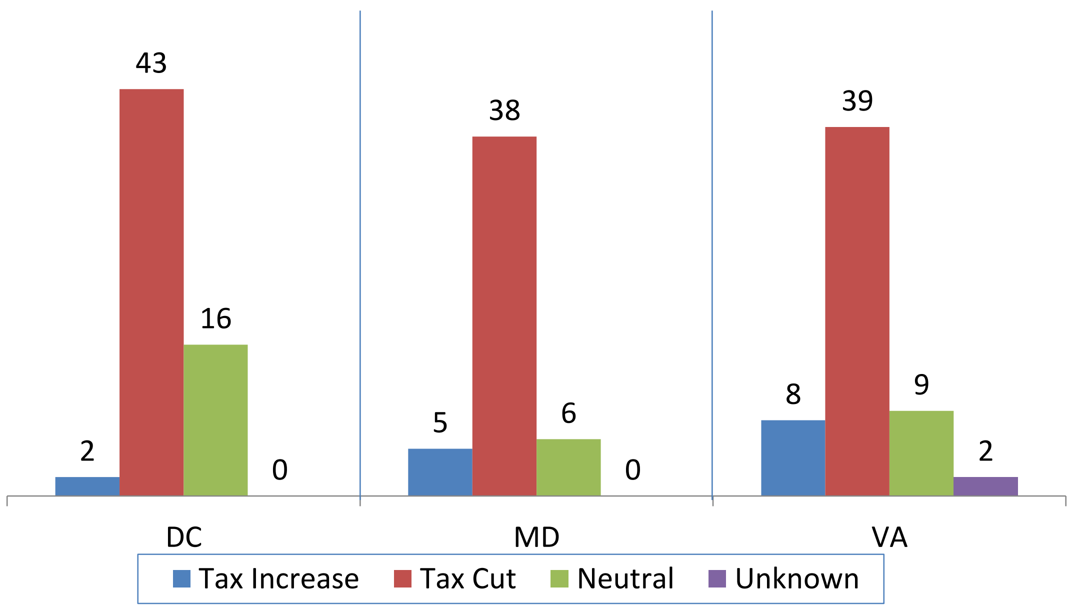


Notes: The annual percentage change reflects the projected revenue impact of statutory changes in tax policy in the next fiscal year, divided by the budgeted (projected) amount of tax revenue in the current fiscal year. The 9.5 percent figure for Maryland in 2007 reflects the tax policy changes made during the regular legislative session (a 0.2 percent increase) and in the special session (a 9.3 percent increase).

Sources: Author's calculations using data from annual budget requests prepared by the chief executive and fiscal impact statements prepared by relevant agencies (D.C. Office of the Chief Financial Officer, Maryland Department of Legislative Services, Virginia Department of Taxation, and Virginia Department of Planning and Budget).

Figure 7.2, which presents the number of stand-alone tax policy laws that were estimated to increase or reduce taxes in the three states from 2007 to 2010, shows a strong bias toward providing small doses of tax relief – a trend that might be even stronger in better economic times. The number of tax cut bills enacted in each state during the study period exceeded the number of tax increase bills enacted by lopsided margins – 43 to 2 in D.C., 38 to 5 in Maryland, and 38 to 8 in Virginia – suggesting that liberal states such as D.C. and Maryland are as likely to issue a steady stream of small tax breaks as conservative states such as Virginia.

Figure 7.2
Stand-Alone Tax Policy Laws in D.C., Maryland, and Virginia, 2007-2010, by Projected Revenue Impact



Source: Author's calculations based on fiscal notes prepared by the D.C. Office of the Chief Financial Officer, Maryland Department of Legislative Services, Virginia Department of Taxation, and Virginia Department of Planning and Budget.

Finding #2: The development of tax policy options seems to be enabled or limited by the structure and analytic capacity of key institutions, as well as the state's prevailing political ideology.

Consistent with theories of bounded rationality and punctuated equilibrium, proposition #2 of the case study posited that, "In the absence of a major external shift such as an economic crisis or a change in partisan control, state officials will tend to perform a limited search for tax policy options, focusing on modest adjustments to current taxes rather than more sweeping revisions." The evidence from the case studies was not strongly consistent with proposition #2, suggesting a more complex pattern in which the structure and analytic capacity of government institutions as well as the predominant ideology influence officials' willingness and ability to develop a range of tax policy options.

Maryland lawmakers, aided by the General Assembly's policy research arm, the Department of Legislative Services (DLS), and a tradition of holding hearings on all tax bills, were able to develop, examine, and refine tax policy options on an ongoing basis. By contrast, D.C. policymakers often developed tax policy options on an ad-hoc basis, in response to an immediate need such as a growing budget gap, partly because they lacked the institutional capacity and support available in Maryland. The D.C. chief financial officer, who administers tax policy and prepares and executes the budget, is not under the mayor's authority, and the council lacked a central policy or research arm similar to DLS that assessed the design and impacts of tax policies.[380] Because Virginia lawmakers were much more constrained in considering tax policy options due to divided government and

[380] The council also had a budget office with a director and five analysts, and in late 2008 established an Office of Policy Analysis (OPA) to assist councilmembers with policy work. Comprised of a director and four professional staff members, OPA's most important work on tax issues involved a study of the real property tax appeals process. OPA was abolished by a new council chairman in January 2011.

stronger anti-tax sentiment, both the fast-track approach characteristic of D.C. and the more in-depth analysis seen in Maryland were not evident. To use Kingdon's image of a "policy primeval soup" in which policy ideas are stirred and recombined, the case study states varied in how carefully officials tended the soup, thickened it with new ingredients, and allowed the mixture to simmer.

In Maryland, the tax policy soup might be compared to a stew; the mixture was fairly thick and was prepared slowly. Many tax policy bills that were enacted from 2007 to 2010 had been introduced in three or four previous legislative sessions and were examined in public hearings and fiscal notes that often led to adjustments. During the case study period, Maryland lawmakers reviewed a fairly wide range of tax policy bills affecting broad-based taxes (income and sales) as well as excise taxes (alcohol, motor fuel, cigarette), contradicting proposition #2's assumption that the search for tax policy options would be limited. The options considered in Maryland included increases or decreases to tax rates as well as adjustments to the tax base.

In particular, Maryland's 2007 tax increase package, which represented the most significant change in the state's tax policies in 40 years, built on years of preparatory work in vetting tax policy options. In the 2007 regular session of the General Assembly, which served as a "tax policy scrimmage," legislators held hearings on a bill to overhaul the personal income tax rate structure; two bills to increase the sales tax; two bills to expand the sales tax base; a bill to double the cigarette tax; a bill to raise the vehicle excise tax; two bills to increase the motor fuel tax; a bill to authorize and tax slot-machine gambling; and a bill to close a loophole in the property transfer tax (see chapter 5, pp. 252-256). Except for the motor fuel tax increase (which was proposed by the governor but rejected by the legislature), these proposals or modified versions of them became part of the tax package enacted during the 2007 special session.

The analytic support that Maryland legislators received from DLS in developing and evaluating tax policy alternatives was the strongest among the case study states. DLS prepares a "Fiscal and Policy Note" on each bill introduced in the General Assembly, which provides detailed analyses of current law, proposed changes, recent legislation or laws on the same subject, implementation issues, and economic impacts. The fiscal and policy notes on tax legislation also estimate the distributional impacts of major tax changes by income level or geographical area and compare Maryland's tax policies to those of surrounding states. The high-quality staff support provided by DLS helped ensure that tax policy changes were carefully reviewed from different vantage points. Despite some public displeasure over the tax increases approved during the 2007 special session (Olson, 2008), all of the tax policy changes stayed in place except for a hastily-conceived decision to apply the sales tax to computer services,[381] which avoided the usual process of public hearings and detailed analysis by DLS.[382]

By contrast, the tax policy soup in D.C. was a thinner gruel – almost the polar opposite to Maryland – even though both states were marked by a liberal outlook on public policy and Democratic party control of the executive and legislative branches. The range of tax policy options considered in D.C. was narrow both in absolute and relative terms (see chapter 4, pp. 95-97). D.C. policymakers did not propose any

[381] In 2012, Maryland modified its personal income tax rates, but kept the progressive rate structure adopted in 2007.

[382] The computer services tax was a last-minute amendment to a tax policy bill enacted during the special session. Because it was drafted in the Senate Budget and Taxation Committee after the Senate had held public hearings, the computer services tax was not subject to the same scrutiny as other tax policy changes considered and enacted during the special session.

increases in real property tax or business income tax rates from 2007 to 2010 (unlike their counterparts in Maryland, who increased the corporate income tax), and a 2009 bill to add a new top personal income tax rate was simpler than changes to the personal income tax in Maryland, which revamped rates, the personal exemption, and the earned income tax credit to make the tax more progressive. Tax-cut proposals in D.C. were more diverse, but lawmakers also relied on familiar tools – particularly caps on the annual growth of property taxes and calculated property tax rates tied to revenue targets – they had used in the past, even after the calculated rate unexpectedly created a shortfall in the FY 2008 budget. Moreover, there were no proposals in D.C. for more ambitious reforms that would raise some taxes and cut others, substitute one tax for another, or modify the tax base to improve the equity, efficiency, or reliability of the tax system.

Major tax policy changes in D.C. were often crafted in the Council's Committee of the Whole and added to annual budget bills in the days or weeks before a budget vote, without the benefit of public hearings held on individual pieces of legislation. One reason for the ad-hoc, piecemeal approach to tax policy formulation in D.C. was anti-tax sentiment among the mayor and finance committee chairman (as noted earlier), dimming the prospects for any bills that would increase taxes to move through the regular legislative process.[383] In this respect, D.C. and Maryland were quite different: Maryland Governor Martin O'Malley called the 2007 special session to initiate a major tax increase and legislative leaders in Maryland shepherded his tax package to enactment. Still, the ideological stance of key leaders on tax policy issues does not seem to explain fully the

[383] Councilmember David Catania stated in an interview that, "Bills to raise revenue find a swift end in the Finance and Revenue Committee."

stark differences in the development of tax policy options in D.C. and Maryland. Many D.C. legislators were willing to consider tax increases; most notably, they approved tax increases to close a large budget gap in 2009, and Mayor Fenty signed the budget bill containing the tax increases into law.

The other key factor is that of internal capacity. As noted earlier, the tax office was under the authority of the independent chief financial officer in D.C. and although the CFO provided analysis and advice to both the mayor and council, the expertise and knowledge of the District's tax specialists were an external resource rather than an integral part of the chief executive's budget deliberations.[384] Whereas both houses of the Maryland and Virginia legislatures receive policy advice and analysis from a non-partisan legislative services office, the two legislative staff members who work for the D.C. Council's Committee on Finance and Revenue report to the committee chairman rather than the entire council. In the absence of internal capacity, the mayor and council relied heavily on tax policy options and analyses offered by the CFO and the D.C. Fiscal Policy Institute (a non-profit research and advocacy group) in a tax policy process that was described in interviews as "ad-hoc," "reactive," and "piecemeal." Distributional impacts of tax policy changes by income class or geographical area, which were a regular part of tax policy discussions in Maryland, were generally absent from the tax policy process in D.C., except for several analyses performed by DCFPI.

The most notable example of D.C. policymakers' reliance on outside assistance stems from the tax package the council crafted during two weeks in July 2009 after a

[384] Another factor is that the CFO is supposed to play a neutral role as the official who prepares revenue estimates and determines whether budgets proposed by the mayor and approved by the council are balanced over a four-year period. This scorekeeping role, as well as concern that the CFO could usurp the powers of the mayor and council, keeps the CFO on the outside of the tax policy process unless his advice is formally sought. When asked for input, the CFO has defined his role as providing options, not recommendations.

$150 million reduction in projected revenues forced lawmakers to revise the FY 2010 budget (see chapter 4, pp. 170-174). The council approved a package of sales, cigarette, and gasoline tax increases, drawing from a list of 22 options prepared by the CFO's Office of Revenue Analysis. Almost all (18) of the options had not been the subject of legislation or public hearings, leaving legislators in a position of evaluating the options without detailed review or external input. Although the council held a public briefing to solicit views on how to close the budget gap, which included cursory discussion of an income tax increase, a gas tax increase, and a tax on snack foods (Neibauer, 2009a), there was no tax proposal for participants to assess; the tax plan was drafted *after* the briefing and was not discussed or analyzed before the vote was taken. Institutional processes for generating and evaluating tax policy options clearly vary among the states, and as discussed later, the truncated review that often preceded tax policy choices in D.C. resulted in less attention to the efficiency, equity, and revenue capacity of the tax system.

Table 7.2 (see next two pages), which details rate changes for six major tax types considered by D.C. and Maryland lawmakers from 2007 to 2010, shows the almost diametric differences in the policy processes of the two states (Virginia is not included because rate changes for major taxes were rarely considered, and never enacted, during the case study period). In Maryland, bills that would increase or lower personal income, sales, corporation income tax, motor vehicle, and alcohol taxes were introduced and subjected to public hearings each year; in D.C., bills to adjust tax rates were rarely introduced and tax rate changes were added to budget bills in the Committee of the Whole. Alcoholic beverage taxes present a particularly striking comparison: although Maryland did not enact any changes to alcohol tax rates during the case study period,

Table 7.2
Consideration of Rate Changes for Six Major Taxes in the District of Columbia and Maryland, 2007-2010

Tax	District of Columbia	Maryland
Personal Income Tax	2009 – Bill 18-243 would create new top tax rate for high-income households	2007 Regular Session – HB 1420 would lower rates at bottom of income scale and raise rates at the top. 2007 Special Session – HB 2/SB 2 would create new, higher top tax rates and increase the earned income tax credit. ENACTED 2008 – SB 1004 would impose higher top tax rates on very wealthy. Modified version was included in 2008 budget bill (SB 46). ENACTED 2008 – SB 537 would repeal rate increases enacted in 2007. 2010 – HB 1177/SB 913 would extend millionaire's tax enacted in 2008.
Sales Tax	No bills were introduced to alter sales tax rates, but a three-year rate increase to 6% was included in FY 2010 budget bill (Bill 18-203). ENACTED	2007 Regular Session – HB 393 and HB 846 would raise sales tax to 6%. 2007 Special Session – HB 5/SB 5would increase rate to 6%. ENACTED 2008 – SB 151 would reduce the sales tax to 5% on the Eastern Shore. SB 537 would reduce the sales tax to 5%. 2009 – HB 1016 and SB 748 would reduce the sales tax to 5%. 2010 – HB 1286 and SB 739 would reduce the sales tax to 5%.
Corporation Income Tax	No bills were introduced to alter corporate income tax rates.	2007 Special Session – HB 2/SB 2 would increase the corporate tax rate to 8.25%. ENACTED 2008 – SB 537 would reduce the corporate income tax to 7%. 2010 – SB 773 would repeal the corporate income tax.

Table 7.2
Consideration of Rate Changes for Six Major Taxes in the District of Columbia and Maryland, 2007-2010 (p. 2)

Cigarette Tax	Bill 17-700 would double the cigarette tax to $2 per pack. The legislation was folded into the FY 2009 budget bill (Bill 17-678). <u>ENACTED</u> FY 2010 budget bill was amended to increase the cigarette tax to $2.50 per pack. <u>ENACTED</u>	2007 Regular Session – HB 754 would double cigarette tax to $2 per pack. 2007 Special Session – HB5/SB 5 would double cigarette tax to $2 per pack. <u>ENACTED</u> 2008 – SB 537 would reduce cigarette tax to $1 per pack.
Motor Vehicle Taxes	No bills were introduced to alter motor vehicle tax rates, but an increase in the motor fuel tax to 23.5¢ per gallon was included in FY 2010 budget bill (Bill 18-203). <u>ENACTED</u>	2007 Regular Session – HB 761 would raise the vehicle excise tax to 6%. HB 821 and SB 949 would raise motor fuel taxes. 2007 Special Session – HB5/SB 5 would raise vehicle excise tax to 6%. <u>ENACTED</u> 2007 Special Session – HB 5/SB 5 would index motor fuel tax. 2008 – SB 537 would lower vehicle excise tax to 5%. SB 567 would raise gas tax by 8¢ over two years to finance repeal of computer services tax. 2009 – HB 423 and HB 747 would index the motor fuel tax. HB 746, HB 1214, and SB 722 would raise motor fuel taxes. 2010 – HB 479 would increase the motor fuel tax by 10¢ over five years. HB 969 and SB 827 would index the motor fuel tax.
Alcohol Taxes	No bills were introduced to alter alcohol tax rates.	2007 Regular Session – HB 757/SB 422 would double alcohol taxes. 2008 – HB 904 and SB 232 would more than double alcohol taxes. HB 1310/SB 562 would triple alcohol taxes. 2009 – HB 791/SB 729 would quadruple alcohol taxes. HB 1160 would more than double alcohol taxes. 2010 – HB 832/SB 717 would raise alcohol taxes more than six-fold.

policymakers introduced bills to raise alcohol taxes in each year from 2007 to 2010,[385] while in D.C. no bills affecting alcohol tax rates were introduced.

Another example of the cursory review given to tax policy changes in D.C. involves combined reporting of corporate income, which was part of the 2009 tax package and is regarded as a main way to prevent tax avoidance by hindering firms from shifting income among their subsidiaries. In Maryland, combined reporting bills were introduced and subject to public hearings in the General Assembly for at least four years before being included in Governor Martin O'Malley's 2007 tax plan. The extended process gave business groups a chance to convince the legislature not to adopt combined reporting; instead, the issue was referred to a study commission. By contrast, legislation mandating combined reporting was not introduced in D.C. and public hearings were not held; instead, councilmembers chose combined reporting from the CFO's list of revenue options to help balance the FY 2010 budget. Because combined reporting emerged as an issue so quickly in D.C. and went to an immediate vote as part of an omnibus tax package, business groups did not have a chance to comment on the proposal or mount any opposition. Maryland's tax policy process was more deliberative and transparent because a wider range of options was considered over a longer period of time, whereas in D.C., lawmakers chose from a smaller range of options subject to less public scrutiny.

In Virginia, major tax policy changes were blocked due to an obstructed "political stream," to use Kingdon's terminology: Governor Tim Kaine and the state Senate (controlled by Republicans in 2007 and Democrats from 2008-2010) would accept only

[385] In 2011, Maryland policymakers increased the sales tax on alcoholic beverages from 6 percent to 9 percent, once again reflecting a pattern in which tax policy proposals were floated for several years before changes were enacted.

targeted tax cuts and the House of Delegates (controlled by Republicans since 2000) would accept only the most minuscule tax increases, which were usually called “fees”. Even the multi-billion dollar budget gaps that Virginia lawmakers faced in 2009 and 2010 due to the economic downturn could not shake the anti-tax stance enforced by the House of Delegates and supported by Republican Governor Robert McDonnell, who succeeded Kaine in 2010.

In a divided government where consensus was difficult to reach, Virginia lawmakers had to focus on getting tax legislation through both houses of the legislature and signed into law by the governor (see chapter 6, pp. 338-340). Although the economic hardship and fiscal problems caused by the recession led legislators from both ends of the political spectrum to introduce more sweeping tax policy bills in 2009 and 2010, including measures to revive the state estate tax and repeal the corporate income tax, these bills languished in committee. The tax rate changes that received serious consideration in Virginia during the case study period – defined as proposals made by the governor in the budget or bills approved by at least one house of the General Assembly – were targeted at smaller, less visible levies, especially excise taxes. Vehicle excise tax and motor fuel tax increases were proposed several times in transportation financing bills that were a focal point of debate in 2007 and 2008. Other excise tax proposals were even narrower, covering diesel fuel, new tires, and digital media purchases in hotel rooms. Tax increase proposals in Virginia from 2007 to 2010 also targeted the grantor’s tax (a property transfer tax paid by the seller of real property), the cigarette tax, the insurance premiums tax, and health care provider taxes. Only one proposal made by the governor or approved by the House or Senate during the case study period would have cut tax rates: the Senate's 2008 transportation finance bill, which would have reduced the state sales tax on food.

Divided government and strong anti-tax sentiment in the House of Delegates not only pushed revenue policy proposals in Virginia toward the periphery of the tax system, but also toward an array of non-tax sources (see chapter 6, pp. 340-343). Much more than their counterparts in D.C. and Maryland, Virginia lawmakers relied on fees, fines, and devolution of authority to other levels of government to fund public services. Among the case study states, Virginia also made the greatest use of tax administration measures as an alternative to tax increases, generating revenue from a tax amnesty, tax compliance initiative, and acceleration of sales tax revenue approved in 2009, and repeal of a sales tax dealer discount (which compensates vendors for the cost of collecting sales taxes) for large retailers in 2010. At the bottom of the recession in 2009, when Virginia officials faced a $2.2 billion budget gap for FY 2010,[386] tax administration initiatives approved by the legislature were projected to raise more than twice as much revenue in FY 2010 ($158.7 million) as several minor tax policy changes ($65.5 million).[387]

Finding #3: The case study states rarely explored options to expand their tax bases, even during the worst recession since the 1930s. This finding suggests that states are not prepared to bolster shrinking tax bases even though many academic experts and reform plans call for broadening the tax base to facilitate lower tax rates and promote both equity and economic efficiency.

Despite differences in ideology and institutional capacity among the case study states, one pattern was common to their tax policy processes: a paucity of options to

[386] Author's calculation using data from Secretary of Finance, "Governor Kaine's Proposed Amendments to the 2008-2010 Budget," December 17, 2008, p. 12, and House Appropriations Committee, "HB 1600/SB 850 Budget Conference Highlights," February 28, 2009, p. 1.

[387] Author's calculations using data from House Appropriations Committee and Senate Finance Committee, *Summary of 2008-2010 Budget Actions: Chapter 781 (Introduced as House Bill 1600)*, May 21, 2009.

broaden the tax base, particularly by curtailing the tax abatements, credits, and exemptions (tax expenditures) that depart from standard tax policy to assist particular groups or promote certain activities. Although Maryland Governor O'Malley's 2007 tax package included several provisions to broaden the tax base – expanding the sales tax to cover certain services, mandating combined reporting of corporate income, and applying the property transfer tax to the sale of a "controlling interest" in a business with assets comprised largely of property – only the transfer tax change was enacted. In each state, only one tax expenditure was targeted for repeal (the credit for Maryland-mined coal, D.C.'s sales tax holidays, and Virginia's domestic production deduction), and the repeal effort succeeded only in D.C. (the credit for Maryland-mined coal was curtailed and Virginia's domestic production deduction remained intact).

As state officials faced general-fund budget gaps of 15 percent or more, their failure to scrutinize tax expenditures seems like a missed opportunity to save money and make the tax code more equitable and efficient. D.C. had authorized more than 100 abatements, credits, deferrals, and exemptions in local law, and allowed at least more than 100 more by conforming its income tax policies to federal law (Office of the Chief Financial Officer, 2010h: iii-iv). Maryland officials identified more than 300 tax expenditures (authorized by state law or through federal income tax conformity) costing as much as $6.5 billion in forgone revenue in FY 2010 (Department of Budget and Management, 2010b). Virginia's Joint Legislative Audit and Review Commission estimated that the commonwealth offered almost 200 state tax breaks that reduced taxpayer liability by approximately $12.5 billion in tax year 2008 (JLARC, 2012: i, 1).

Policymakers in the three states seemed to focus their attention on one or two tax expenditures that were outliers for various reasons, reflecting a review process that was fairly feeble. Virginia's land preservation tax credit was subjected to lower annual limits per taxpayer from 2009 through 2011 because the credit's costs had grown greatly in prior years (Division of Legislative Services, 2006: 2).[388] Governor O'Malley targeted the credit for Maryland-mined coal because coal mining and coal-fired electric power generation were not consistent with his environmental agenda (and perhaps because coal-producing Western Maryland was a Republican bastion). In D.C., the sales tax holidays became a tempting target for lawmakers facing a large budget gap in 2009 because the chief sponsor and champion had lost her seat the prior fall.

As noted earlier, D.C. lawmakers strengthened their corporate tax base by requiring combined reporting of corporate income in 2009, and lawmakers in Maryland (2007) and Virginia (2010) took the more modest step of barring a particular form of corporate tax avoidance: the "captive REIT" loophole.[389] Although these were significant changes, the case study states did little or nothing to protect or expand their sales tax bases,[390] which were threatened by the growth of non-taxable services and

[388] The cost of the credits was an ongoing issue because initial costs had vastly exceeded estimates, leading lawmakers to establish a $100 million annual cap on credits and reduce the credit to 40 percent of the fair market value, starting in 2007. Individuals interviewed for the dissertation stated that backers of the program supported the lower limits as a way to insulate the program against criticism about its costs.

[389] This loophole is created when a corporation creates a subsidiary (a captive real estate investment trust) to own its property. The corporation pays rent, which is a deductible business expense, to the captive REIT, which avoids corporate income tax if it distributes at least 90 percent of its income in the form of dividends, which are paid to the corporate owner or another subsidiary in a low-tax or no-tax state.

[390] D.C. expanded its sales tax base to cover sugar-sweetened beverages and medical marijuana, and also required online travel agencies (OTAs) to pay hotel taxes on the full amount paid by hotel guests, rather than the discounted amount the OTA paid to the hotel. However, the OTA law was expected to result in extended litigation.

online commerce.[391] As with tax expenditures, efforts in each of the case study states to broaden the tax base to cover new types of economic transactions and counter tax avoidance were tentative or tangential. This consistent outcome suggests that the pleas of economists and tax reformers for policymakers to lower tax rates and broaden the base (Feldstein, 2010; Marron, 2011; Marr and Highsmith, 2011), thereby enhancing economic efficiency and equity, are unlikely to succeed.

The weak efforts to review or curb tax expenditures by D.C., Maryland, and Virginia policymakers may reflect the difficulties officials have in making distinctions among tax incentives or evaluating them. In each state during the case study period, dozens of tax abatements, credits, and deductions were created or extended, usually with overwhelming, bipartisan support. Tax expenditures represent a rare area of bipartisan agreement because they combine conservatives' interest in lowering taxes with liberals' interest in an activist government.[392] As a result, tax expenditures continued to grow during the case study period even as each state cut direct outlays by billions of dollars. Moreover, tax expenditures are more difficult to roll back because they are usually not subject to a direct appropriation and thereby escape annual budget review.

Table 7.3 (see next page) illustrates the half-hearted nature of efforts to curtail tax expenditures in D.C., Maryland, and Virginia by summarizing relevant policy changes in 2009, when tax expenditures received the most scrutiny due to the dire budget situation in each state. Only in Virginia did the savings from curbing tax expenditures exceed the costs of newly-authorized tax breaks.

---

[391] Electronic commerce escapes sales taxation if the vendor lacks nexus (a physical presence) in a state.

[392] A prime example comes from Virginia, where Governor Tim Kaine and the General Assembly reached a rare compromise in 2007 to increase the personal income tax filing thresholds. The policy reflected Kaine's interest in helping low-income households and the legislature's desire to cut taxes.

Table 7.3
Tax Expenditure Policy Changes in D.C., Maryland, and Virginia, 2009

State	Tax Expenditure Reductions (FY 2010 Projected Revenue Impact)	Tax Expenditure Increases (FY 2010 Projected Revenue Impact)
D.C.	Repeal of sales tax holidays: $1.3 million	Tax abatements or exemptions for 16 properties, projects, or neighborhoods: -$4.1 million Conformity to newly-enacted federal income tax breaks: -$5.9 million
Maryland	Reduced annual cap for Maryland-mined coal tax credit: $4.5 million	Extension of sales tax exemption for veterans' organizations: $81,000 Extension of tax credit for hiring workers with disabilities: -$47,000 Conformity to newly-enacted federal income tax breaks: -$29.5 million
Virginia	Lower annual limit on land preservation tax credit per taxpayer: $50 million	Higher caps for Livable Home Tax Credit: less than $100,000 Lower job creation requirement for data center sales tax exemption: revenue loss from governor's amendment was not estimated Extension of Major Business Facility Job Tax Credit: -$265,000 Statewide recordation tax exemption for affordable housing: -$28,000

Source: Author's calculations based on fiscal notes prepared by the D.C. Office of the Chief Financial Officer, Maryland Department of Legislative Services, Virginia Department of Taxation, and Virginia Department of Planning and Budget.

Evaluation and Selection of Tax Policy Options

The three propositions set forth in the introduction about the selection and evaluation of tax policy options proved overly broad or simplistic. Putative dichotomies between political and social welfare considerations that affect tax policy decisions, as well as "macropolitical" and "micropolitical" dimensions of tax policymaking faded upon further examination. Each proposition needed to be modified and made more precise in light of the case study evidence.

Finding #4: Although politics was inevitably a prominent aspect of tax policy decisions in the case study states, political motivations did not always outweigh normative principles such as revenue capacity, efficiency, equity, transparency, and administrative feasibility. The relative importance of political and normative concerns varied over time and place, but they were more likely to be inextricably linked rather than competing factors.

Proposition #3, which posits that, "State officials emphasize political acceptability in evaluating tax policy options, at the expense of normative principles such as revenue capacity, efficiency, and equity," not only fails to reflect the varying importance of political considerations in different times and places, but also makes a somewhat artificial distinction between factors that are closely intertwined. As discussed later, parity considerations – rough equivalence in tax burdens or rates with at least some neighboring states or national benchmarks – strongly influenced tax policy decisions in D.C., Maryland, and Virginia during the case study period, partly because the comparisons responded to interrelated political, economic, and social concerns. Policymakers could protect themselves from political opposition by pointing to similar tax policies in other states, while at the same time providing some assurance that their states could compete effectively with other states for residents, jobs, and investments.

Maryland's enactment of a large tax increase in 2007, before a fiscal or economic crisis was imminent, provides the strongest evidence against proposition #3: the governor and General Assembly took a political risk by increasing the sales, corporation, vehicle excise, cigarette, and personal income taxes to ensure that the state's tax system could finance program commitments (particularly in education funding). A main reason why Maryland policymakers looked beyond immediate political pressures and tried to bring long-term revenues into line with expenditures was the leadership of Governor Martin O'Malley, who called the 2007 special session and served as the "policy entrepreneur" who offered a solution to the widely-acknowledged problem of the structural deficit.

Finding #5: The salience of political factors seemed particularly high when (1) the tax policy process was marked by a short-term horizon and a reactive approach, as was often the case in D.C., and (2) anti-tax sentiment was very strong, as in Virginia.

One of the reasons why Maryland lawmakers were able to take the risky and politically risky step of raising taxes in 2007 was that the state's tax policy process had a long-term horizon, as discussed earlier, due in part to the strength of the institutions providing analysis and information to top officials. The structural deficit was highlighted in long-range forecasts prepared by the governor's Department of Budget and Management (DBM) and the General Assembly's Department of Legislative Services (DLS) and was widely accepted to be a problem due to the credibility both agencies had developed. After Governor O'Malley decided to address the structural deficit in the fall of 2007, DBM and DLS helped lawmakers analyze the effects of his tax plan and legislative amendments on revenue capacity, equity, efficiency, and feasibility. In particular, DBM estimated the net impact of the proposed income, sales, and property taxes on residents' net tax liability and detailed how the tax changes would affect prototypical households with different incomes (Bryce, Foster, and Gallagher, 2007). DLS went further by estimating the impact of the proposed personal income tax and sales tax changes for more than 10 income brackets, while projecting the impacts of the tax changes on each county (Department of Legislative Services, 2007r:14-20, 25-28, 34, 37-39; Department of Legislative Services, 2007s: 9-16, 20-22; Department of Legislative Services, 2007u: 11-13). DLS also estimated the impact of proposed changes in the Maryland's earned income tax credit and personal exemption by income class, going beyond aggregate impacts by tax to study the effects of specific changes to particular taxes (Department of Legislative Services, 2007s: 25) – a more granular level of analysis that was not duplicated in D.C. or Virginia.

Political motivations also determined an important tax policy decision (the computer services tax discussed earlier) in Maryland when lawmakers departed from their normal process of public hearings and detailed analysis by DLS. In order to meet an deficit-reduction target during the 2007 special session, Maryland legislators had to find new revenue sources when they rejected aspects of Governor O'Malley's tax plan (combined reporting of corporate income and sales taxation of property management, health club, tanning, and massage services). After combing through lists of other tax-exempt services to see if taxation would be politically feasible, senators agreed to tax computer services in order to tap the resources of thriving businesses in a way that might be less onerous than combined reporting (see chapter 5, pp. 290-292). The House accepted the proposal, with a five-year sunset, because of the need to meet the deficit-reduction target. In the span of several weeks, a new tax was crafted and enacted by legislators purely for political reasons; technology firms were not organized to object because most did not know the tax was being considered. Because the computer services tax had not been introduced as legislation or subject to public hearings,[393] the fairness of extending the sales tax to a single sector and the administrative challenges of taxing a highly mobile service were not assessed. The computer services tax sparked a backlash and was repealed before it took effect because Maryland lawmakers did not fully review the tax's political and economic ramifications (see chapter 5, pp. 277-279, 286-287).

While political motivations led to the enactment of the computer services tax when Maryland departed from its more deliberative, long-term process of developing and analyzing tax policy options, political concerns predominated in several D.C. tax policy decisions during the case study period, stemming from a hasty process that left little time to consider broader impacts on equity, efficiency, and revenue capacity. Most notably, the tax package crafted by the Council's Committee of the Whole during a two-week period in July 2009 included consumption tax increases (sales, cigarette, and gasoline) that were approved without discussion or analysis of the regressive impacts of these taxes.[394] The neglect of distributional impacts in D.C. stood in sharp contrast to Maryland, where DLS' analysis of the regressive effect of a sales tax increase reinforced other efforts to protect low-income residents, such as increasing the state's earned income tax credit. By contrast, the D.C. Council's package of tax increases was designed to

---

[393] Several business owners and representatives testified against the computer services tax at a November 14, 2007, hearing of the House Ways and Means Committee, but this was after the Senate had already approved the tax, which had not been included in an introduced bill that was subject to public hearings.

[394] General sales taxes are usually considered regressive because lower-income households spend more of their income on consumption; in addition, higher-income households may spend a greater percentage of their consumption on non-taxable services. Moreover, cigarette consumption is higher among low-income groups. See Robert D. Lee, Jr., Ronald W. Johnson, and Philip G. Joyce, *Public Budgeting Systems* (Sudbury, MA: Jones and Bartlett Publishers, 2008), 8th edition, pp. 109-122.

minimize political costs by exporting as much of the increased tax burden to commuters and tourists as possible, according to interviewees (see chapter 4, pp. 172-174).

Political imperatives predominated in two other D.C. tax policy decisions during the case study period: the doubling of the tax on vacant and abandoned properties in 2008 (and subsequent amendments in 2009 and 2010) and the repeal of sales tax holidays (discussed earlier). Each action followed several months of consideration, but the doubling of the vacant property tax followed an unorthodox process, originating as an amendment to a regulatory reform bill even though no legislation had been introduced to raise the tax (see chapter 4, pp. 146-149). Serious concerns about the effect of vacant properties on drugs, crime, and neighborhood decay propelled the vacant property tax increase, but there was no analysis of different tax rates or possible unintended effects, such as higher tax bills on those who vacate homes to serve in the military or diplomatic corps but keep their property in decent shape. Although there was an ample body of evidence that sales tax holidays shifted the timing of sales without stimulating new economic activity (Hawkins and Mikesell, 2001; New York State Department of Taxation and Finance, 1997; Harper, Hawkins, Martin, and Sjolander, 2003), D.C. lawmakers did not discuss the effectiveness or efficiency of the policy. Instead, interviewees agreed that the holidays were targeted for repeal solely on the basis of political expediency, as discussed earlier, as officials needed to close a large budget gap (see chapter 4, pp. 166-167).

Whereas analysis of the efficiency, equity, and administrative feasibility of tax policies was often performed directly by state agencies in Maryland, these issues were frequently raised only by external groups in D.C., most notably the D.C. Fiscal Policy

Institute. For example, when legislators considered a 5 percent annual cap on the growth in assessments for owner-occupied homes, DCFPI circulated findings that more than half of the benefit would accrue to those with homes valued at $750,000 or more (Lazere, 2007) – a point that helped seal the defeat of the proposal. Similarly, when the Finance and Revenue Committee unanimously approved a property tax abatement for CoStar with no discussion (Office of Cable Television, 2009b), the council engaged in a heated debate on the bill only after DCFPI enlisted a coalition of small businesses to assail the bill as inequitable (see chapter 4, pp. 201-202).[395] In contrast to the Maryland legislature, the D.C. Council did not routinely raise issues about the revenue capacity, equity, efficiency, and feasibility of tax policy options through its own institutions and processes.

In Virginia, strong anti-tax sentiment almost entirely removed considerations of sound tax policy (equity, efficiency, revenue capacity, administrative feasibility) from tax policy discussions, because only narrow, less visible levies were considered for tax increases and targeted tax cuts received little scrutiny. The transportation financing debates of 2007 and 2008 illustrate how political concerns framed the development and evaluation of tax policy options in Virginia (see chapter 6, pp. 368-383, 400-406). Governor Tim Kaine, who supported raising state taxes and fees to provide reliable, long-term sources of transportation funding, admitted that he preferred a motor fuel tax as the most equitable, efficient, and stable means of transportation funding, but instead proposed raising other taxes – most notably, the vehicle excise tax – because a gasoline tax increase was unpopular with the public and highly salient to residents (Whitley, 2008a; Schapiro, 2008b). In making a vehicle excise tax the centerpiece of his

[395] The bill was enacted after stricter job creation and local contracting requirements were added.

transportation financing proposals in 2006 and 2007, Kaine sacrificed the equity and efficiency gains from making out-of-state residents contribute to the state's transportation fund. When Kaine paired a grantor's tax increase with a smaller vehicle excise tax increase in 2008 to make his financing package more politically palatable, he moved even further away from benefits taxation and continued to sacrifice the efficiency gains that arise from linking tax payments to use of the transportation network. The governor also proposed increasing a number of smaller taxes such as the cigarette tax (in 2009) and the insurance premiums tax (in 2010), but did not take the more risky step of proposing a broad-based tax increase (a personal income tax hike) until his last month in office when political pressures were at their lowest.

Nevertheless, political and social welfare concerns were most often inseparable in tax policy decisions in the case study states, and policymakers strove to reduce the political costs associated with taxation even when they took unpopular positions. When Maryland lawmakers voted to increase taxes in 2007, this was a calculated risk: statewide elections were three years away and the tax package was designed to spread tax burdens widely among individuals and businesses so that no group would feel unfairly targeted. Maryland officials also earmarked almost 40 percent of the estimated revenues from the 2007 tax package for higher education, transportation, and Chesapeake Bay cleanup in the 2007 tax package – more than double the share of earmarked funds in the state's operating budget[396] – to make the tax increases more palatable. D.C. lawmakers who cut commercial property taxes in 2008 were responding to displeasure about soaring

[396] Author's calculation using data from Maryland Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly: 2007 Special Session," November 30, 2007, and Maryland Department of Budget and Management, *FY 2008 Budget Highlights* (January 2007), Appendix B.

assessments, but were also trying to protect the District's economic base from competition with suburban Maryland and Virginia jurisdictions with much lower rates. Similarly, when Virginia Governor Tim Kaine proposed doubling Virginia's cigarette tax in 2009, he had reason to believe that an increase was possible politically – Virginia's 30-cent tax per pack was a fraction of the $2 rate charged in D.C. and Maryland – but he also acted to finance spiraling health-care costs (cigarette taxes in Virginia were dedicated to health care) and to curb the harmful health effects of smoking. Political factors always figure strongly into tax policy decisions, and although it is important to understand how strong those influences are and why, it is probably more illuminating to explore how the self-protective desire to reduce political costs affects tax policy decisions – a topic that will be discussed later in greater detail.

Finding #6: Although symbolic dimensions of tax policy debates mattered in the case study states, symbols tended to have a decisive impact only when policy analysis of economic, social, and demographic impacts was lacking. Most often, symbols and images were used to reinforce and amplify policy arguments, as they do in any other policy field.

Symbols and images were regular features of tax policy debates in the case study states. When computer service businesses in Maryland successfully fought to repeal a sales tax on their products in 2008, the images of high-tech firms promoting innovation and developing the "knowledge economy" of the future were prominent. When D.C. policymakers pushed for lower commercial property tax rates in 2007, they repeatedly cited the plight of beloved small businesses such as Ben's Chili Bowl that were described as the "backbone" of the economy, even though all commercial property owners would benefit. Virginia lawmakers and business groups who advocated sales tax holidays for hurricane preparedness equipment linked their proposal to protecting residents from the devastation of Hurricane Isabel and other natural disasters.

While the symbolic aspect of tax policy debates – also reflected in national and state debates over the "death tax" (estate tax) – is important and may merit additional research, the evidence from the case study does not support proposition #5, which states that, "State tax policy debates have an important symbolic dimension that has a powerful debate on the options that are selected." The symbols and images used in the tax policy debates seemed like standard rhetoric designed to make policy arguments more vivid; essentially, the symbols were alternate ways of expressing the policy rationale. For example, in Maryland's debate over the computer services tax, the image of the high-tech, knowledge economy dramatized the argument that Maryland would lose computer industry businesses and jobs if it imposed a 6 percent sales tax that was not charged in almost every other state. Several political scientists echo the conclusion that symbols are an intrinsic part of substantive policy debate (Baumgartner and Jones, 1998: 25-27; Zahariadis, 2007: 76-79). For example, Deborah Stone contends that, "Political reasoning is reasoning by metaphor and analogy. It is trying to get others to see a situation as one thing and not another." (Stone, 2009: 9).

A notable exception to the finding that symbols and images were extensions of the policy arguments over taxes was D.C.'s debate over the tax on vacant and abandoned properties (see chapter 4, pp. 147-149). In this case, the imagery represented as a powerful force in its own right, marked by depictions of vacant property owners as "faceless, out-of-state corporations" and "slumlords" who fostered neighborhood decay, crime, and drug-dealing while waiting for a market upswing so they could cash in on their holdings. After the doubling of the vacant property tax in 2008 led to a host of unexpected problems, including the inability of some owners to finance property renovations during a recession and credit crunch, a new image briefly appeared – that of the elderly resident or military family who vacated a home temporarily and was hit with a spiraling property tax bill (see chapter 4, pp. 175-176). Although D.C. lawmakers limited the higher tax rate ($10 per $100 of assessed value) to blighted properties in 2009, they re-established the $5 rate for vacant, non-blighted properties in 2010. Throughout these reversals (called "legislative ping-pong" by one observer), D.C. officials responded to immediate political pressures, driven largely by sharp rhetoric and the unsavory image of the vacant property owner, and failed to analyze the impact of punitive taxes on different types of vacant property owners.[397] Although symbols may gain in importance when partisan clashes are especially bitter or policy analysis is lacking, they typically seem like a way to reinforce policy arguments in tax policy battles rather than a separate force.[398]

Finding #7: Although each of the case study states enacted a steady stream of targeted tax cuts, only D.C. was characterized by a vibrant "micropolitical" process in which tax benefits were allocated to individual properties, organizations, and neighborhoods. Although targeted tax cuts are used by lawmakers to mitigate opposition to taxation and allocate benefits to influential groups, the tax cuts vary in their purpose and cannot be viewed as a monolithic category.

Proposition #5, which posited that, "State tax policy operates at two largely distinct levels," a "macropolitical" level that affects a relatively large percentage of the

[397] In an interview, Councilmember Phil Mendelson stated that, "We passed it, and there was no thought and no analysis."

[398] The effective use of symbols in D.C. was also notable in 2010 when opponents of an advocacy group's proposal to broaden the sales tax on services dubbed the policy the "yoga tax." Yoga and fitness enthusiasts deluged councilmembers' offices with e-mails opposing the sales tax expansion. Although the council was not considering a sales tax expansion – no bill had been introduced on this subject and no legislator had announced support for the idea – Council Chairman Vincent Gray and other legislators reassured the public that they opposed the proposal.

population and is more responsive to public opinion, and a "micropolitical" level that involves smaller numbers of people and responds to interest-group pressure, was stated too imprecisely. Emmette Redford, who introduced the concepts of macropolitics and micropolitics, used the latter term to refer to situations resembling patronage, in which "individuals, companies, and communities seek benefits from the larger polity for themselves." (Redford, 1969: 83). Proposition #5 did not make a clear distinction between (1) highly disaggregated tax benefits, often designed for a single beneficiary, that would fit Redford's definition of micropolitics, and (2) tax benefits that are targeted to a subset of taxpayers but are not individually based. In short, the dichotomy of macropolitics and micropolitics was too simplistic; rather, there are several dimensions of tax policy formulation in terms of political dynamics and the populations affected.

Among the case study states, only the District of Columbia allocated a steady stream of micropolitical tax benefits during the 2007 to 2010 period; Maryland and Virginia, by contrast, offered only a few. At the same time, each of the case study states authorized tax cuts contingent on membership in a particular group (such as technology firms) or performance of a certain activity (such as saving for college) – what I will refer to as "targeted tax cuts" – but in a mirror image of the pattern for micropolitical tax benefits, Maryland and Virginia made greater use of targeted tax cuts than D.C. did.[399]

From 2007 to 2010, D.C. policymakers enacted 47 tax relief measures targeted at a single property, parcel, or organization (see chapter 4, pp. 108-112). Partly because a majority of D.C. elected officials sponsored at least one of these measures, support for

[399] D.C. lawmakers enacted several tax cuts targeting classes of taxpayers, such as a law providing tax credits to firms adding a specific number of jobs for D.C. residents at certain wage levels (D.C. Law 18-202, the "Job Growth Incentive Act of 2010"), but these targeted tax cuts were dwarfed by the number of tax cuts for individual recipients.

the bills was overwhelming; legislators were willing to support colleagues' bills in order to ensure support for their own.[400] The combined vote on the 47 tax relief measures was 157 to 2 in committee and 577 to 11 on final vote in the council.[401] The practice of regularly allocating tax benefits to specific properties and groups displays the classic elements of "micropolitics" outlined by Redford: intense interest by potential recipients and little attention from others, costs that are negligible individually but significant as a whole, and a policy of mutual non-interference among lawmakers who benefit politically from the process (Redford, 1969: 83-84). Although Maryland and Virginia policymakers also granted micropolitical tax benefits during the case study period,[402] these were more isolated incidents rather than regular features of the tax policy process as in D.C.

One reason why the micropolitical aspect of tax policy was so prominent in D.C., compared to Maryland and Virginia, is that D.C. lawmakers administer the real property tax, which is primarily a local tax in Maryland and exclusively a local tax in Virginia. D.C. officials made extensive use of their ability to grant abatements, credits, and exemptions for particular properties, resulting in many narrowly-targeted tax benefits.

Nevertheless, control of the real property tax does not seem to explain fully the proliferation of micropolitical tax policy measures in D.C., where lawmakers also used legislative procedures to hasten the flow of tax benefits to specific properties and

---

[400] As D.C. Councilmember Mary Cheh stated in an interview, "We all don't want to jump on the other person's thing," referring to councilmembers' willingness to support tax abatements and exemptions proposed by colleagues.

[401] Author's calculations using data from the D.C. Council Legislative Information Management System, found at www.dccouncil.us.

[402] Examples include Maryland's approval of a sales tax exemption for lodging at Lockheed Martin's training center and Virginia's approval of a vehicle excise tax exemption for Volkswagen's corporate automobiles.

organizations. Specifically, councilmembers employed a device known as the "subject to appropriations" clause, which allowed them to evade rules imposed by congress that bar enactment of legislation that the CFO deems to be inconsistent with a four-year financial plan and budget (see chapter 4, pp. 108-110, 143-144). The clause, which states that a law creating unbudgeted costs will not be implemented until financing is identified, was used to facilitate approval of more than two-thirds (32 of 47) of the micropolitical tax bills enacted from 2007 to 2010.[403] D.C. policymakers used the clause to offer a steady stream of tax benefits to identifiable projects and groups in all eight wards of the District without having to explicitly address the costs or weigh the merits of the tax relief bills against other priorities. Although lawmakers still had to identify financing before the tax relief could be provided, the enactment of the bills gave them a priority claim on additional resources and almost all were later funded.

The first-year cost of these micropolitical tax benefits, which totaled $9.2 million during the case study period,[404] appears modest, but most of the tax reductions applied to multi-year periods and in several cases, large costs were pushed to the out-years.[405] As a result, D.C. policymakers' willingness to grant discrete tax benefits risked long-term damage to revenue capacity (and equity) of the tax system. A reasonable estimate is that the $9.2 million annual cost could have funded 90 police officers or teachers.

---

[403] The subject-to-appropriations clause was not limited to tax policy bills; it was widely used for all types of bills.

[404] Author's calculations using data from fiscal impact statements prepared by the Office of the Chief Financial Officer, found at www.cfo.dc.gov.

[405] An example is D.C. Law 18-257, the "Redevelopment of the Center Leg Freeway (Interstate 395) Act of 2010," which disposed of D.C. air rights to allow construction of a mixed-use development. The act placed the District at a risk of a $12 million loss in property tax revenue outside of the financial plan. See Office of the Chief Financial Officer, "Fiscal Impact Statement: 'Center Leg Freeway (Interstate 395) PILOT and Air Rights Disposition Act of 2010,'" dated June 21, 2010.

Individually-targeted tax relief provisions also became part of the District's annual budget bills, reflecting the way that D.C. lawmakers used legislative procedures to promote micropolitics. Many of the tax relief measures that were enacted with a subject-to-appropriations clause were funded during the annual budget process, as were new tax relief provisions targeted at specific properties or organizations. By inserting these provisions into omnibus budget bills totaling several hundred pages, D.C. lawmakers could distribute dozens of individualized tax benefits with little scrutiny. Although the mayor and council both engaged in the practice of micropolitics, the council greatly widened its scope each year, reflecting legislators' desire to promote projects in their wards and the tangible results they could highlight. The pivotal year of 2009, when D.C. officials had to close an $800 million gap in the FY 2010 budget and then revise the budget to resolve a new $150 million gap, shows the strength of the micropolitical tax process in D.C. The council more than tripled (from 5 to 16) the number of parcel-specific tax breaks that Mayor Fenty proposed in the FY 2010 budget, and when the budget was revised all of the tax breaks remained intact even as taxes and fees were increased and additional budget cuts were made (see chapter 4, p. 177).

In Maryland, annual budget bills did not include tax relief measures targeted at particular properties, businesses, or organizations. Although most (38) of the stand-alone tax bills enacted in Maryland from 2007 to 2010 would cut taxes, many of these bills were intended to promote broad policy objectives such as environmental protection and energy conservation (eight bills) or economic development (four bills). Maryland policymakers also used tax-relief measures to benefit demographic groups. Military service members and veterans were the group most often targeted for tax relief, benefiting from minor modifications or extensions of existing tax breaks in each of the case study years. Although targeted tax relief measures allowed Maryland officials to earn goodwill from specific groups, they also had broader policy rationales. For example, the transfer, estate, and inheritance tax exemptions granted to domestic partners were intended to provide gay and lesbian taxpayers, who could not be legally married in Maryland at the time, the same tax exemptions available to married couples.

Virginia resembled Maryland in enacting a large number of targeted tax cuts (38) as stand-alone measures during the case study period, while also including several tax breaks in annual budget bills. In a time of divided government, targeted tax cuts were one of the few areas of bipartisan agreement in Virginia during the case study period. Many tax abatements, credits, and exemptions in Virginia were designed to promote broad public purposes, particularly job growth and economic development (15 of the 38 tax-relief measures). Governor Robert McDonnell, who took office in 2010, extensively used tax cuts to advance his economic agenda: four major parts of his "Jobs and Opportunities Agenda" involved business tax incentives, including measures targeting science and technology start-ups, the motion picture industry, and "green jobs."[406] Virginia lawmakers not only enacted tax incentives for industries (such as railroads and the printing industry) and demographic groups (particularly military veterans), as in Maryland, but also approved special tax benefits for particular firms or non-profits (Volkswagen, Microsoft, Habitat for Humanity) in several cases.

Tax incentives enacted in Virginia to benefit its nascent spaceflight industry encapsulate the complex motivations for narrowly-targeted tax benefits. In 2008,

[406] All but one of the bills introduced to enact McDonnell's proposals passed the General Assembly on unanimous or near-unanimous votes in both chambers, reflecting the popularity of targeted tax cuts.

Virginia lawmakers granted income tax exemptions for spaceflight launches in the commonwealth, which would at least initially benefit a single company, Orbital Sciences Corporation, which was designing rocket systems for launch at NASA's Wallops Flight Facility off the state's Eastern Shore (see chapter 6, p. 397). Nevertheless, the incentives were also designed to develop what state lawmakers saw as a "cutting-edge" industry that could expand rapidly. The spaceflight incentives received strong support from legislators in Northern Virginia (the site of Orbital's headquarters), but as with many micropolitical tax benefits, the rationale for the tax exemption went beyond the individual recipient to advance broader economic and social goals.

In all three states, micropolitical or targeted tax cuts were almost always approved on unanimous or near-unanimous votes, reflecting a framework proposed by James Q. Wilson (see chapter 2, pp. 43-46) to explain the enactment and expansion of government programs and initiatives. In emphasizing the incidence and concentration of costs and benefits as a key factor, Wilson predicted that policies that focused benefits on a small group while diffusing costs widely would be easy to enact because the beneficiaries would visibly support the policies while few people, if any, would be motivated to protest. The tax measures approved in D.C., Maryland, and Virginia during the case study period are highly consistent with this pattern, and the policymaker interviews and legislative records confirmed that the bills garnered intense support from beneficiaries while stirring little opposition among the public. Two similar bills that were rejected in Maryland and Virginia, which would have provided tax credits to non-profit groups providing private school scholarships and other education programs, highlight the unusual circumstances necessary for the defeat of a targeted tax cut bill (see chapter 5, pp. 327-328, and chapter 6, p. 399).[407] These bills failed because they involved a divisive social issue – namely, public support for private schools – that had long been the subject of interest-group organization on both sides. Unless tax-cut bills addressed strongly-contested public issues that could activate pre-existing coalitions to lobby against them, they were highly likely to pass.

Finding #8: Each of the case study states relied strongly on standards of parity in evaluating and selecting tax policy options. The parity standards usually involved comparisons with neighboring states but in some cases used national benchmarks or internal comparisons, reflecting the strategic nature of the benchmarking.

Strategic comparisons, usually to neighboring states, were extensively used by each of the case study states to develop, evaluate, and select tax policy options. Although the comparisons were used to justify tax cuts[408] as well as tax increases, they were particularly useful to policymakers in trying to defuse opposition to tax increases. Parity standards were especially important to policymakers because they (1) helped fashion tax policies that met tests of political acceptability in other states (or at least were less politically distasteful than the alternatives) and (2) supported the argument that the policy changes would not harm the state's appeal as a place to live, work, or operate a business.

Most notably, in devising the tax increases approved in 2007, Governor O'Malley and the Maryland General Assembly almost always chose tax rate increases and base-broadening measures that would position Maryland similarly to at least some of its neighbors. This benchmarking process was used to support the argument that Maryland

[407] The Maryland legislation was called the "Building Opportunities for All Students and Teachers (BOAST) in Maryland Tax Credit," and was introduced each year from 2007 to 2010. The Virginia legislation was HB 1164 (2010), entitled "Income Tax; Public/Private Education Investment Tax Credits."

[408] A primary example was when D.C. policymakers pointed to much lower commercial property tax rates in neighboring counties and cities to justify a reduction in D.C.'s commercial property tax rate.

would not be an outlier in terms of tax policy. In particular, the central role of the sales tax increase in the 2007 tax package stemmed largely from national and regional comparisons. Governor O'Malley emphasized that Maryland's sales tax revenues ranked 45th in the nation as a share of personal income and 43rd on a per-capita basis, suggesting that an increase would be tolerable; moreover, raising the rate to 6 percent would leave Maryland at par with Pennsylvania and West Virginia (Governor Martin O'Malley, 2007b). Similarly, the governor defended his proposal to raise the corporation income tax from 7 percent to 8 percent by noting that Maryland's rate would still be lower than that of neighboring Pennsylvania (9.99 percent), D.C. (9.975 percent), West Virginia (8.75 percent), or Delaware (8.7 percent) (Governor Martin O'Malley, 2007h) (see chapter 5, pp. 225-226, 266, 270).

Although Governor O'Malley and other policymakers offered these state comparisons as objective, they were highly strategic and the concept of parity was fairly malleable. The governor did not point out that Maryland's new sales tax rate of 6 percent would exceed that of D.C. (5.75 percent) and Virginia (5 percent), or that his proposed 8 percent corporation income tax would exceed Virginia's (6 percent). With so many possible benchmarks (national averages or medians, adjacent states, demographically similar states), state comparisons can never be objective, but officials in the case study states used them to mold and manipulate the debate.

D.C. lawmakers' concern about parity was especially acute in light of the District's status as a small jurisdiction (in population and size) adjacent to prosperous jurisdictions in Maryland and Virginia that compete with the District for jobs and residents. In fact, the modest package of tax increases approved by D.C. policymakers in

2009 was largely designed to attain parity with Maryland, as the new 6 percent sales tax rate and 23.5¢ per-gallon motor fuel tax would be identical to Maryland's rates (see chapter 4, pp. 172-174), although D.C. leapfrogged Maryland by increasing its cigarette tax from $2 to $2.50 per pack. In interviews, D.C. policymakers stated that attaining parity with Maryland offered a policy rationale (or at least a defense) for tax increases – namely, that D.C. would be unlikely to suffer losses of businesses, jobs, or residents – as well as evidence that the higher rates would not be intolerable or trigger a severe political backlash. Nevertheless, using Maryland as a standard of comparison ignored the fact that Virginia's sales, motor fuel, and cigarette tax rates were all lower than D.C.'s.

In many cases, tax policy debates were characterized by distinctive or competing uses of benchmarks; tax policy outcomes sometimes depended on which group's parity standard seemed more relevant or plausible. In Maryland, legislators who supported raising the cigarette tax to reduce the health hazards of smoking pointed out that doubling the tax to $2 per-pack would lift Maryland from the 20th-highest to 4th-highest rate in the nation (House Health and Government Operations Committee, 2007) – a rare case in which officials saw a high ranking in national tax comparisons as desirable.[409] During Maryland's 2007 special session, one of the most powerful arguments used to defeat the governor's proposal for combined reporting of corporate income was that none of the surrounding states had implemented it. In this case, the benchmark of neighboring states exerted more influence on lawmakers than the national standard emphasized by the

[409] At the time it was enacted, Maryland's $2 per-pack cigarette tax also exceeded the tax in all of the adjacent states. A similar argument (that cigarette tax rates *should* be relatively high) was used when D.C. doubled its cigarette tax to $2 per pack in 2008.

administration, which was that almost half (21) of the states with a corporate income tax had adopted combined reporting.

Internal standards of parity – rates for taxes that applied to similar types of economic activity – were also used to justify tax rate increases in the case study states. Changes to D.C.'s insurance premiums tax, which was adjusted first on the basis of an external comparison and then on the basis of an internal comparison, provide a good example. In 2008, D.C. lawmakers justified an increase the insurance premiums tax on health insurers from 1.7 to 2 percent, which would help finance access to health care for the uninsured, partly on the basis of parity with Maryland's 2 percent rate. In 2010, D.C. officials then increased the insurance premiums tax on life and property insurers, stating that this change would equalize taxes among insurance companies.[410] Similarly, D.C. Mayor Adrian Fenty's proposal to raise the economic interests tax in 2008 was intended to match the maximum combined rate for the District's deed taxes.[411] Each of these D.C. tax increases was approved without a dissenting vote, reflecting the appeal of parity measures. In Virginia, one of the few tax increases approved during the case study period – an increase in the diesel fuel tax from 16¢ to 17.5¢ per gallon enacted in 2007 – was justified as "equalizing" the diesel tax with other motor fuel taxes – and was not portrayed as a tax increase. Virginia Governor Tim Kaine similarly used an internal

[410] In arguing for the insurance premiums tax in 2010, D.C. Councilmember (now Mayor) Muriel Bowser framed the tax increase as a way to ensure that D.C. residents were not shortchanged, because maintaining a 1.7 percent tax on life and property insurers would be "leaving revenue on the table" in light of the 2 percent tax charged in Maryland and the 2.25 percent tax charged in Virginia. See Office of Cable Television, "Committee on Public Services and Consumer Affairs FY 2011 Budget Markup," May 13, 2010.

[411] D.C.'s economic interests tax is imposed when a company holding a certain amount of property is sold, while the deed tax is imposed when a property changes hands directly. Because the two taxes serve a similar purpose, it seemed logical and fair to equalize their rates.

equity argument for his unsuccessful proposals to raise the vehicle excise tax to 5 percent: he contended that it made no sense for consumers to pay a lower tax on vehicles than they did on other products (the general sales tax rate was 5 percent).

At times, policymakers went to extreme lengths in using benchmarks to justify tax policy proposals. In Maryland, Governor O'Malley and legislators who supported applying the property transfer tax to the sale of businesses with assets primarily comprised of property (closing the "controlling interest" loophole) pointed out that D.C., Delaware, Pennsylvania, and Virginia had already closed this loophole. When Maryland raised its vehicle excise tax to 6 percent as part of the 2007 tax package, one reason why car dealers were successful in advocating for a deduction for the value of a trade-in vehicle was that Delaware, Pennsylvania, New Jersey, North Carolina, and West Virginia offered such a deduction (Department of Legislative Services, 2007u: 24). When D.C. officials considered imposing an excise tax on sugar-sweetened beverages (dubbed the "soda tax") to fund school nutrition programs in 2010, they compromised by applying the regular sales tax rate to the beverages, partly because Maryland and Virginia also applied their general sales tax rates to soda.[412] The soda-tax compromise also met the standard of internal equity: sugar-sweetened beverages would be taxed at the same rate as most other goods (see chapter 4, pp. 194-195).

In rare cases, policymakers chose a tax rate that was out of line with their neighbors. In 2009, D.C. surpassed Maryland by increasing its cigarette tax from $2 to $2.50 per pack, which would now be the highest in the region, reflecting the view of

[412] In a written response to questions, Council Chairman Vincent Gray stated that, "This one-cent per-ounce tax would have placed an unprecedented tax on these products and would have placed us completely out of sync with other jurisdictions."

smoking as a harmful activity that should be discouraged. When Maryland lawmakers raised the top personal income tax rate to 8.7 percent (a 5.5 percent top state rate plus the maximum 3.2 percent local rate) in 2007, proponents acted to make the income tax more progressive even though Maryland would now exceed D.C.'s 8.5 percent top personal income tax rate, previously the highest in the region. One year later, when lawmakers imposed a three-year "millionaire's tax," Maryland's top personal income tax rate reached 9.45 percent, one of the highest rates in the nation. Although lawmakers would adopt tax rates that exceeded those of their neighbors in unusual circumstances, they were reluctant to do so: Maryland let its millionaire's tax expire as scheduled to reduce the disparity with its neighbors (and to fulfill the commitment that the increase was temporary). Maryland policymakers also reaped a backlash when they ignored parity standards and extended the sales tax to computer services in 2007: because no neighboring state (and very few states nationwide) imposed a sales tax on computer services, fears that the tax would harm Maryland's competitiveness in a key industry were particularly acute, hastening the repeal of the tax (see chapter 5, pp. 296-300).

Finding #9: If policymakers decide that a major tax increase is necessary, they may try to contain the political costs by spreading the increased tax burden widely and including some offsetting tax cuts for important or influential groups to abate the opposition.

As one of the largest state tax increases proposed and enacted in recent years, Maryland's 2007 tax package offers some insights about how a major tax increase can be structured to meet public policy goals and reduce public opposition. Consistent with Hettich and Winer's theory, Maryland policymakers sought to spread tax burdens widely and employ taxes that are less visible or salient, while including some tax cuts as sweeteners to help the fiscal medicine go down.

Given the size of the deficit, O'Malley had little choice but to rely on one or both of the state's two most productive levies: the personal income tax and the general sales tax. The governor chose the sales tax as the main revenue source while using the income tax primarily to reallocate the tax burden in a more progressive way, rather than to raise large sums of money – an approach that the legislature endorsed even though it reduced the top personal income tax brackets proposed by the governor and made other changes.[413]

The governor's tax package was also carefully balanced and included provisions designed to increase its fairness and political appeal. First, the plan asked corporations as well as individuals to pay higher tax rates. Second, it sought to broaden both the sales and corporation tax bases. By calling for combined reporting of corporate income and closing the "controlling-interest" loophole in the property transfer tax, Governor O'Malley tried to combat tax avoidance by larger businesses, particularly those with multi-state operations. Combined reporting would prevent businesses from shifting profits to out-of-state subsidiaries in states with low or no corporate income tax, while closing the controlling-interest loophole would require businesses with large property holdings to pay the same transfer taxes paid by families and small businesses (Governor Martin O'Malley, 2007j). Third, the tax package earmarked funds for high-priority programs – most notably transportation, K-12 education, and higher education – to highlight the benefits of the higher taxes that would be imposed, as noted earlier.

[413] The sales tax provided 64 percent of the projected revenue over five years, while the personal income tax accounted for only 3 percent as tax increases for high-income taxpayers were almost entirely offset by cuts for low- to moderate-income taxpayers. These calculations are based on data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly," November 30, 2007.

The governor's tax plan included items intended to blunt some of the most potentially harmful impacts, economically and politically. Because the sales tax increase was estimated to be highly regressive (Department of Legislative Services, 2007r: 38), the governor proposed widening the 4 percent personal income tax bracket for lower-income residents[414] and increasing the state earned income tax credit for low-income working families[415] to ease the burden on low-income households. In addition to the EITC increase, the governor proposed several other modest tax breaks to mute the economic and political impact of the tax increases: (1) doubling the extra personal exemption for senior citizens and the blind from $1,000 to $2,000, (2) providing a $50 income tax credit for households with annual incomes up to $30,000, (3) offering annual "sales tax holidays" on back-to-school clothes and energy-efficient appliances, and (4) reducing the state property tax by three cents per $100 of assessed value over three years.

Although the five "sweeteners" proposed by the governor were modified and curtailed by the General Assembly – the property tax cut was deleted, for example, and the sales tax holidays were delayed – folding several modest cuts into a tax increase package may facilitate enactment by defusing some of the flashpoints. Joe Bryce, Governor O'Malley's chief legislative officer, stated that the tax breaks – which would increase the amounts by which other taxes would have to be raised – reflected an effort "to try to anticipate where criticisms of the package would come from," and to abate

[414] The 4 percent tax bracket applied only to taxable incomes of $2,000 to $3,000 under current law. The governor's plan would extend the 4 percent bracket to $15,000 in taxable income for single filers and $22,500 for joint filers.

[415] Specifically, the state's refundable earned income tax credit (EITC) would increase from 20 to 25 percent of the federal EITC. A non-refundable EITC equal to 50 percent of the federal credit would be unchanged.

those sources of opposition, a practical application of Hettich and Winer's theory that policymakers will create special tax rates to minimize the most intense sources of political opposition to taxes.

The tax cuts included in the governor's plan were carefully designed to have broad appeal through provisions with no income test (the property tax reduction, the sales tax holidays, and increased personal exemptions) as well as items targeted at low-income households (the EITC and the $50 credit). Although the proposed property tax cut increased the amount of deficit reduction needed, it may have blurred the size of the overall tax increase. Governor O'Malley announced the sales tax increase and the property tax cut at the same time, (Governor Martin O'Malley, 2007b), creating an impression that a $3.5 billion sales tax increase over six years was roughly equivalent to a property tax reduction of $428 million during the same period[416] -- another benefit of including sweeteners in a tax increase plan.[417]

Although the General Assembly blocked the property tax cut, the $50 income tax credit, and the higher personal exemption for senior citizens and the blind, while delaying the sales tax holidays, legislators approved the EITC increase and added two other sweeteners to the tax package: a personal exemption that varied inversely with income (the personal exemption had previously been the same for all taxpayers) and the vehicle excise tax deduction mentioned earlier. The personal exemption reduction for high-

[416] Author's calculation using data from Department of Legislative Services, "Fiscal Summary of Administration's Proposals: 2007 Special Session," November 2, 2007, p. 2.

[417] Gerald Prante of the Tax Foundation contended that, "Cutting property taxes and raising other taxes is merely a bait-and-switch. You appease the voter's hatred of property taxes, a very transparent tax, by raising other more-hidden taxes they end up paying – like the corporate income tax and sales taxes." See Gerald Prante, "Maryland Gov. Wants More Revenue? Who Do You Go To? Smokers, Business, and Rich People, Of Course," The Tax Policy Blog, The Tax Foundation, September 19, 2007.

income households served as a less-visible way to protect low-income households and raise taxes on the wealthy, while the vehicle excise tax deduction secured the support of the Maryland Automobile Dealers' Association for a vehicle excise tax rate increase. In those ways, tax offsets helped shape the compromises necessary to enact the tax package.

Finally, the 2007 tax plan sought to spread higher taxes widely to create a sense of shared sacrifice. Even though the sales tax would provide almost two-thirds of new revenue, the plan also drew disproportionately on the corporate income tax as well as sin taxes on cigarettes and gambling to provide the rest of the resources. The percentage of new revenue derived from cigarettes (11 percent) was estimated to be more than five times their share of current revenue (2 percent), while revenue from slot-machine gambling would be a new source. By heavily taxing activities regarded as unsavory and taxing a new form of economic activity (slots) that was regarded as voluntary, Governor O'Malley and the General Assembly were able to avoid further increases in taxes that were more salient and therefore reduce public discontent about the tax plan.

Finding #10: More generally, policymakers may try to blunt the political costs of raising taxes by earmarking the revenues for high-priority programs. The case studies suggest that tax revenues are most likely to be earmarked when the program or programs being supported are a relatively high priority, the links between the tax and the activity being funded are strong, and the state's fiscal position is steady.

Earmarking of tax revenues was used not only by Maryland policymakers in 2007 to smooth the enactment of a major tax increase, but was also used by policymakers in all three states to move favored programs to the front of the funding queue and to make modest tax increases more acceptable. As shown in Table 7.4 (see next page), lawmakers in each state earmarked tax revenues on several occasions during the case study period; in fact, the four rate increases in Virginia from 2007 to 2010 all involved earmarking.

Table 7.4
Earmarking of Tax Revenues in the District of Columbia, Maryland, and Virginia, 2007-2010

District of Columbia	**Maryland**	**Virginia**
75 percent of revenues from new insurance premiums tax on HMOs and higher insurance premiums tax on Care First dedicated to Healthy DC Fund to expand access to health insurance. (2008) 5¢ tax on recyclable bags used at grocery stores established to support cleanup of Anacostia River (2009) $2,000 assessment on each licensed hospital bed established to support new Hospital Fund created to provide Medicaid services (2010) Assessment on intermediate care facilities for people with intellectual disabilities increased from 1.5 percent to 5.5 percent to support quality improvement fund. (2010) Sales tax revenues from sale of medical marijuana dedicated to Healthy DC Fund (2010) Insurance premiums tax on HMOs applied to receipts from low-income health programs such as Medicaid, with revenues dedicated to Healthy DC Fund (2010)	2 percent assessment on nursing homes established to generate new revenues and federal matching funds for Medicaid (2007) 40 percent of sales tax increase and all of vehicle excise tax increase dedicated to Transportation Trust Fund (2007) 40 percent of corporate income tax increase dedicated to new Higher Education Investment Fund (2007) 48.5 to 51 percent of gross receipts from slot-machine gambling facilities earmarked for new Education Trust Fund (2007)[418] Portions of motor fuel tax and car rental tax reserved for new Chesapeake Bay 2010 Trust Fund (2007) Assessment on nursing homes raised to 4 percent to generate new revenues and federal matching funds for Medicaid (2010)	Diesel tax raised from 16¢ to 17.5¢ per gallon to support Commonwealth Transportation Fund. (2007) One-third of insurance premiums taxes dedicated to Commonwealth Transportation Fund to repay bonds; 12 percent of deed recordation tax revenues dedicated to Fund for new road and mass transit projects. (2007) $1 tax on sale of new tires to clean up illegal tire dumping extended for three years. (2008) 10 percent tax imposed on purchase of digital media in hotel rooms, with half of revenues allocated to general fund and the other half to Motion Picture Opportunity Fund. (2009) 5.5 percent assessment imposed on intermediate care facilities for people with intellectual disabilities to generate new revenues and federal matching funds for Medicaid. (2010) Wine tax revenues dedicated to Wine Promotion Fund (2010)

[418] The percentage of revenues dedicated to the Education Trust Fund would vary depending on the license agreement signed with each slots facility.

Nonetheless, attempts to earmark tax revenues did not always succeed. Earmarking was more likely to gain approval when (1) the programs being funded were a relatively high priority, (2) the link between the revenue source and the programs being funded was compelling, and (3) the state's fiscal position was strong or at least steady.

In the District of Columbia, the most significant use of earmarking during the case study period involved the financing of Healthy DC, a program to expand access to health insurance for low- and moderate-income residents (see chapter 4, pp. 152-156). In 2008, D.C. lawmakers dedicated 75 percent of a new insurance premiums tax on health maintenance organizations (HMOs), as well as 75 percent of the revenue generated by a higher insurance premiums tax on CareFirst (a charitable, non-profit insurer), to Healthy D.C. The tax increases were approved as part of the District's FY 2009 Budget Support Act without any opposition. Even though insurance companies are far from beloved by the public, the policymaker interviews suggest that earmarking revenues to expand access to health care deterred any opposition that insurers might have mounted against the tax increases. At the time, the depth of the 2007-2009 recession was not yet fully perceived and a tax increase on HMOs and CareFirst would have been unlikely if the revenues were not earmarked for a high-priority goal, given the tax-cutting focus of D.C. officials when the economy was strong. Moreover, the link between the tax on health insurers and Healthy D.C. was plausible; the insurance companies would benefit from lower costs of uncompensated care if the number of uninsured residents were lowered.

A D.C. law approved in early 2009 to impose a 5¢ tax on recyclable carryout bags (the "bag tax") almost certainly depended on earmarking for its enactment (see chapter 4, pp. 179-180). The revenue from the tax would be deposited into a special fund to clean up the Anacostia River, which had been deemed "impaired" by the U.S. Environmental Protection Agency, triggering a requirement for the District to reduce pollution in the Anacostia watershed (Committee on Government Operations and the Environment, 2009: 3-4). Although bag taxes considered by other states and cities have been derided as regressive nuisance taxes (Wilson, 2013; Henchman, 2008a) – concerns that also surfaced during D.C.'s debate on the tax – earmarking the revenue for the Anacostia River generated critical support for the tax,[419] which was approved unanimously by the council. Proponents also established a plausible link between the tax and the activity funded, highlighting findings that plastic bags made up almost 50 percent of the trash in the Anacostia's tributaries (Committee on Government Operations and the Environment, 2009: 3). By taxing use of the bags, proponents successfully argued, lawmakers could reduce pollution in the Anacostia.

In 2010, when the District continued to face large budget gaps due to the Great Recession, earmarking tax revenues as a policy tool was rejected because large and continuing budget gaps made balancing the general fund budget the priority. According to interviewees, Councilmember Jim Graham's amendment to create a higher top personal income tax rate for households with incomes of $350,000 or more failed partly because the proposal tied the new revenues to increased funding for seven human services programs.[420]

---

[419] During the debate on Bill 18-150, Councilmembers Harry Thomas , Jr., and Jim Graham expressed worry about the tax's impact on low-income residents, but stated that they would vote yes to support the cleanup of the Anacostia River. See Office of Cable Television, "The Council of the District of Columbia, 'Tenth Legislative Meeting,' June 2, 2009," available at www.oct.dc.gov.

[420] For example, in response to written questions from the author, Council Chairman Vincent Gray expressed the view that the council should not be raising taxes in order to increase spending for particular programs during a budget crisis.

Although Maryland's 2007 tax increases might seem to offer a contrasting example – policymakers earmarked funds for elementary and secondary education, higher education, transportation, and Chesapeake Bay cleanup with a portion of the new tax revenues intended to resolve a structural deficit – the circumstances were different. Maryland lawmakers sought to correct a long-term imbalance between spending commitments and revenues, but the economy was still thought to be growing; an imminent fiscal crisis (rather than a long-term problem) had not emerged. Moreover, Governor O'Malley was acting in part to fulfill promises he made during his campaign, most notably a pledge to freeze tuition at state colleges and universities; in that respect, earmarking seemed like a way to finance existing commitments and therefore made sense from both a policy standpoint and a political standpoint.

In 2010, the failure of legislation in Maryland to enact steep increases in alcohol taxes[421] and dedicate the proceeds to developmental disability, drug treatment and prevention, mental health, and Medicaid programs echoed the unsuccessful effort in D.C. to earmark revenues from a new top personal income tax rate for safety net programs. Even though the bill (SB 717/HB 832, the "Lorraine Sheehan Health and Community Services Act of 2010") had eight sponsors in the Senate and 41 sponsors in the House, and was backed by a coalition of public health advocates, and social service providers, several interviewees stated that the bill generated opposition partly because lawmakers believed it was unfair to restore funding for certain programs while other programs were cut sharply (see chapter 5, pp. 321-324).

[421] Specifically, the tax on distilled spirits would rise from \$1.50 to \$10.03 per gallon, the tax on wine would rise from 40¢ to \$2.96 per gallon, and the tax on beer would rise from 9¢ to \$1.16 per gallon.

In Virginia, the role of earmarking was more clearly defined than in D.C. or Maryland: because of strong anti-tax sentiment, tax increases had almost no chance of being considered if the revenues were not dedicated to a particular purpose. All of the 17 tax rate increases proposed by the governor in his annual budget request or approved by at least one house of the General Assembly from 2007 to 2010 involved earmarked revenues, most often (10 of the 17 proposals) for the Commonwealth Transportation Fund. Earmarking did not give a tax increase strong prospects of success –only four very minor tax rate increases were enacted in Virginia during the study period – but all successful tax increase proposals involved earmarking. Virginia lawmakers also earmarked existing revenue streams, a favorite option for House Republicans. The 2007 transportation financing bill, for example, relied on earmarked insurance premium and deed recordation taxes for more than half of new state funding,[422] and in 2010 Governor Robert McDonnell dedicated wine tax revenues to a Wine Promotion Fund.

Finding #11: States disproportionately rely on smaller levies, particularly those that are less salient, for tax increases.

Although Maryland had to base its 2007 tax package on a sales tax increase to generate sufficient amounts of revenue to attack its structural deficit, most of the other tax increases enacted during the case study period were focused on smaller, more peripheral levies. This pattern was consistent with the theory of Hettich and Winer (1999), as well as the findings of Brunori (2011a) and Lewis and Hildreth (2011).

---

[422] Author's calculation using data from Office of Governor Tim Kaine, "Financial Impact of Governor's Amendments to HB 3202," March 2007.

As shown in Table 7.5 (see next page), D.C. policymakers reduced the political costs of taxation by relying disproportionately on two minor taxes – cigarette taxes and health care provider taxes (assessments on nursing homes, hospitals, and intermediate care facilities) – which rose an estimated 107 percent due to tax policy changes from 2007 to 2010.[423] In fact, the projected increase in cigarette taxes ($22.7 million) over the four-year period was greater than that for the general sales tax ($20.3 million), even though the FY 2007 base for the general sales tax was more than 40 times as large as the base of the cigarette tax. The three other taxes that D.C. lawmakers raised by more than 10 percent due to tax policy changes from 2007 to 2010 – the insurance premiums tax (36 percent), the economic interests tax (25 percent), and the motor fuel tax (13 percent) also had small bases, generating less than $60 million in revenue during FY 2007 (Government of the District of Columbia, 2007c: 4-14 – 4-16). By contrast, the District's three largest levies saw only slight increases or reductions from 2007 to 2010: the general sales tax was increased by 2.1 percent, while the personal income tax was cut 1.9 percent and the real property tax was reduced 6.3 percent.[424]

The reduction in the real property tax conceals an increase in its smallest component – the tax on vacant and abandoned property – which was doubled on property deemed "blighted" to punish owners who contributed to neighborhood decay and encourage them to refurbish their properties. The tax on cigarettes was more than

[423] Although all of the revenue increases cited here are projected amounts rather than actual amounts (which are impossible to isolate from other changes, such as those due to the economy), the projected changes are most relevant because they reflect the information policymakers had when they made their decisions.

[424] These are the author's calculations using data from District of Columbia budget documents and fiscal impact statements prepared by the Office of the Chief Financial Officer, available at www.cfo.dc.gov.

Table 7.5
Percentage Changes in Taxes Exceeding 5 Percent Due to Statutory Changes:
District of Columbia, Maryland, and Virginia, 2007-2010

District of Columbia	**Maryland**	**Virginia**
1. Health Care Provider Taxes, 107.3% 2. Cigarette Tax, 107.0% 3. Insurance Premiums Tax, 35.9% 4. Economic Interests Tax, 25.1% 5. Motor Fuel Tax, 13.0%	1. Health Care Provider Taxes, 469.7% 2. Gross Receipts Taxes, 328.4% 3. Cigarette Taxes, 56.8% 4. Sales Tax, 19.7% 5. Corporate Income Tax, 18.2% 6. Motor Vehicle Excise Tax, 8.5% 7. Property Transfer Tax, 6.5%	1. Health Care Provider Taxes, undefined increase

Notes: The increase in health care provider taxes in Virginia is listed as "undefined" because the taxes did not exist in the commonwealth prior to 2007. The percentage changes in the table refer to the cumulative first-year revenue impacts of statutory changes to the tax during the 2007-2010 period.

Sources: Author's calculations using data from annual District of Columbia, Maryland, and Virginia budget documents, as well as fiscal notes prepared by the D.C. Office of the Chief Financial Officer, the Maryland Department of Taxation, the Virginia Department of Planning and Budget, and the Virginia Department of Taxation.

doubled from 2007 to 2009 (from $1 per pack to $2.50 per pack). These sharp tax increases were enacted without a dissenting vote, reflecting the relative ease of increasing these small sin taxes for D.C. lawmakers. Similarly, the insurance premiums tax and the obscure economic interests tax were borne by groups without large or politically popular constituencies; there was no opposition to increasing either tax apparent from either the policymaker interviews or the legislative record.

As noted earlier, Maryland policymakers resembled their D.C. counterparts in relying disproportionately on sin taxes on cigarettes and gambling. Health provider taxes recorded a 470 percent increase in Maryland during the case study period (due to an assessment on nursing homes enacted in 2007 and increased in 2010), but gross receipts taxes (which include slot-machine gaming) increased an estimated 328 percent and tobacco taxes rose an estimated 57 percent, placing second and third, respectively, in percentage increases from 2007 to 2010. Two broad-based taxes, the sales tax and the corporate income tax, were projected to grow by smaller percentages (20 percent and 18 percent, respectively) reflecting the size of the rate changes for each tax enacted in 2007.

Although the prospect of increasing any tax in Virginia was remote, raising the personal income, sales, or corporate income taxes was even less likely – a reality reflected in the House's 97-0 rejection of outgoing Governor Tim Kaine's bid to raise the personal income tax rate in 2010. To avoid that kind of resounding defeat, most tax increase proposals in Virginia during the case study period were targeted at smaller, less visible levies, particularly excise taxes. As noted earlier, vehicle excise tax and motor fuel tax increases were proposed several times in transportation financing bills in 2007 and 2008. Governor Kaine's tax increase proposals also targeted the grantor's tax, the cigarette tax, and the insurance premiums tax – none of which provided as much as 3 percent of the state's tax revenue in FY 2006[425] – as well as health care providers, who were not subject to any taxes at the start of 2007. On the other side of the political aisle, Republican Senator Thomas Norment in 2008 proposed a gross receipts tax on gambling

[425] Author's calculation based on data from Comptroller of Virginia, *A Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006* (December 2006), p. 44.

at 10 "instant racing" sites to help finance transportation projects.[426] This proposal, which was smaller and garnered much less attention than the debate over slot-machine gambling in Maryland, passed the Senate but languished in the House because delegates were unwilling to expand state-sponsored gambling (see chapter 6, pp. 394-395).

Even narrowly-tailored tax increase proposals rarely succeeded in Virginia during the case study period: only three excise tax increases (the diesel fuel tax increase, tire recycling tax, and digital media tax) and a tax on intermediate care facilities for the intellectually disabled were enacted. These increases became law because they were (1) so small as to be almost invisible, and (2) earmarked to support specific programs (transportation, cleanup of illegal tire dumps, the state film industry, and health provider reimbursements, respectively). As noted earlier, the diesel fuel tax increase from 16¢ to 17.5¢ per-gallon was described as "tax equalization," rather than a tax increase, because the higher rate already applied to all other types of motor fuel. The new tire, digital media, and health care provider taxes were called "fees," even though they did not involve a payment in return for a good or service provided exclusively to the resident. In Virginia from 2007 to 2010, tax increases could be enacted only if they could be defined as fees or technical adjustments, and if they were so minute that they could escape notice.

In fact, revenue policy options in Virginia were not focused even on peripheral taxes; instead, Virginia policymakers focused on fees, fines, tax administration measures, devolution of authority to lower levels of government, and dedication of existing revenue streams to a much greater extent than their counterparts in D.C. or Maryland. The best example concerns the transportation financing package enacted by Virginia lawmakers in

[426] Half of the taxes levied on instant racing would be dedicated to the Commonwealth Transportation Fund and the other half would flow into the general fund.

2007, which relied on fees and fines for 52 percent of total state revenue[427] and the earmarking of insurance premium and deed recordation taxes for 42 percent of total state revenue. In addition, 50 percent of general-fund surpluses (which could not be estimated) would be dedicated to transportation. To supplement state funding, newly-created regional bodies in Northern Virginia and Hampton Roads were authorized to raise a variety of taxes and fees in order to generate as much as $3 billion in regional transportation funding over six years. Due to the strong anti-tax ideology in the House of Delegates, allowing lower levels of government to raise taxes was as far as lawmakers would go in terms of tax increases – and even this was a stretch for many legislators.

Finding #12: The tax policy decisions described in the case studies are strongly consistent with social construction theory, which posits that policy outcomes are shaped by the political power and social image of the groups affected by the policy.

The tendency of the case study states to choose peripheral levies for tax increases is often inconsistent with one of the major frameworks of policy change and development discussed earlier – namely, James Q. Wilson's model which focuses on the incidence and concentration of benefits and costs (see Chapter 2, pp. 43-46). Wilson posited that policies which spread benefits broadly while focusing costs on a small group – such as tax increases that burden a narrow group – are likely to fail because they arouse strong opposition from those adversely affected, exceeding support from those who benefit only slightly from the increased revenues. As discussed earlier, taxes on narrow groups (smokers, vacant property owners) and industries (insurance, health care facilities) absorbed the largest percentage increases in the District of Columbia from 2007 to 2010;

[427] These revenues would be generated by "abusive driver" fees, a vehicle registration fee increase, a truck and trailer registration fee increase, and a fine on heavy trucks for violating weight limits.

a similar pattern was apparent in Maryland, where health care facilities, gambling businesses, and smokers absorbed the largest percentage increases.

The main element missing in Wilson's framework appears to be the social image or perception of the target group: small groups such as smokers, gambling parlors, and insurance companies were selected to bear larger tax burdens because they are regarded as socially harmful or at least questionable from a social standpoint. In D.C., the negative image of vacant property owners spurred policymakers to enact a 100 percent tax increase without any analysis of possible unintended consequences.[428] The 150 percent increase in the D.C.'s cigarette tax did not spark the same level of rhetorical outrage, but was described in interviews as an easy step politically due to the negative image of smokers and the tobacco industry in the District. Moreover, even in cases that were consistent with Wilson's framework – such as the rapid reversal of Maryland lawmakers' decision to extend the sales tax to a sole industry, computer services – the social image of the target group seemed to affect the outcome. Technology firms not only assailed the sales tax expansion as inequitable, but also capitalized on the image of the computer services industry as a source of innovation and high-paying jobs in a new "knowledge economy."

Because the incidence and fairness of a benefit or cost are partly matters of interpretation, the concept of "social construction" of target populations, developed by Anne Schneider and Helen Ingram (see chapter 2, pp. 46-49), fills in some of the gaps in Wilson's typology. Schneider and Ingram contended that the design of public policy is

[428] In an interview, Councilmember Jack Evans, chairman of the Committee on Finance and Revenue, noted that legislators competed to "show that I'm tougher than you are" in sanctioning vacant property owners.

affected not only by the size and concentration of the benefits and burdens to be distributed, but also by depictions of target populations that are "normative and evaluative, portraying groups in positive or negative terms through symbolic language, metaphors, and stories." (Schneider and Ingram, 1993: 334). According to Schneider and Ingram, policymakers typically view target groups (such as senior citizens, homeowners, or welfare recipients) in positive or negative terms, and allocate benefits and burdens to reflect and maintain those images (Schneider and Ingram, 1993: 345; Ingram, Schneider, and deLeon, 2007: 107-108).

Table 7.6 (see next page) classifies a range of tax policy decisions in D.C., Maryland, and Virginia during the case study period using the social construction framework, which uses a four-part typology to classify target groups as "advantaged," "contenders," "dependents," and "deviants." As Schneider and Ingram would predict, "advantaged" groups with positive images as contributors to society were most likely to receive tax benefits, while "deviant" groups regarded as harmful absorbed major tax increases. "Contenders" with negative images but considerable political power in terms of membership or resources, and "dependents" with positive images but little political influence fell in the middle.

Nevertheless, groups targeted for tax increases or cuts do not always fall neatly into Schneider and Ingram's categories and politicians may be able to manipulate social images by combining or dividing groups into new categories. In D.C., the tax on vacant and abandoned properties was rolled back in 2009 for owners whose properties were unused but not blighted, reflecting the plight of military service members or elderly residents – highly sympathetic groups – who had to vacate their homes but kept them in

Table 7.6
Social Construction Theory Applied to Tax Policy Decisions
in the District of Columbia, Maryland, and Virginia, 2007-2010

	Positive Image	**Negative Image**
High Political Power	"Advantaged" Groups in this category are more likely to receive benefits because they are seen as contributors to society. *Examples*: commercial property tax relief for small businesses in D.C. (2007-2008); quick repeal of sales tax on computer services in Maryland (2007); doubling of income tax deduction for families saving for college in Virginia (2007)	"Contenders" Groups in this category are likely to receive hidden benefits because they are powerful politically but have a negative image. *Examples*: tax relief provided to all commercial property owners as part of "small business tax relief" in D.C. (2007-2008); vehicle excise tax deduction for a trade-in vehicle, sought by auto dealers in Maryland (2007); phase-in of law closing "captive REIT" loophole used by multi-state firms in Virginia (2009)
Low Political Power	"Dependents" Groups in this category are seen as deserving but benefits may be symbolic because the groups lack political power. *Examples*: job growth tax credits enacted in D.C. with a "subject to appropriations" clause (2010); employment tax credit for people with disabilities in Maryland that was subject to annual reauthorization (2007-2010); one-year expansion of earned income credit for low-income households in Virginia (2010).	"Deviants" Groups in this category are regarded as harmful and tend to absorb a disproportionate share of burdens. *Examples*: 150% increase in cigarette tax (2008-2009) and doubling of real property tax on blighted property owners (2008-2009) in D.C.; doubling of cigarette tax in Maryland (2007).

decent shape. In Maryland, two bills to provide domestic partners with deed tax and inheritance tax exemptions, respectively, were approved by narrow margins because supporters and opponents held very different views about the gay and lesbian residents who would be primary beneficiaries (Smitherman, 2008).

In Virginia, smokers and the tobacco industry would seem to fall into Schneider and Ingram's "contender" category – politically powerful due to the influence of companies like Philip Morris, which was headquartered in Richmond, but increasingly regarded as socially harmful (reflected in the approval of a ban on smoking in public places in 2009) – unlike in D.C. and Maryland where the image of smokers and tobacco companies was more uniformly negative and their political power was weak. Still, public attitudes toward a proposed cigarette tax increase in Virginia in 2009 were quite complex. Because of Virginia's history as a tobacco-producing state, the image of tobacco farmers trying to make a living during tough economic times was one of several factors leading legislators to reject the tax increase (see chapter 6, pp. 413-416).

In short, social images vary by time and place; they also conflict. Even though social construction theory cannot reflect all of the complex dynamics of political power and social image, it seems to add an important element to the understanding of state tax policy choices.

Finding #13: Although the parity, burden-sharing, earmarking, and other tax policy strategies described above recur in the case studies, political leaders exploit them in distinctive ways and use the institutional levers of power to produce different policy outcomes.

Although it may seem like a truism to emphasize the importance of political leadership and institutional processes in determining tax policy outcomes, the common patterns and strategies among the case study states do not unfold mechanically. As John Kingdon observed, when policy windows open because serious problems emerge, administrations change, or public opinion shifts, a governmental policy change may result only if enterprising political leaders or non-governmental actors seize the opportunity to join a policy solution to the problem. In addition, the process of choosing policy solutions is very dynamic and strategic; as noted by William Riker (1984), all of the options are not presented and considered at once, and they change over time. Therefore, the public officials and private actors who can structure the policy choice, using institutional roles, legislative procedures, or skillful strategy, can strongly influence the outcome (Riker, 1984).

As noted earlier, Maryland Governor Martin O'Malley was the boldest and most effective "policy entrepreneur" in the case study states between 2007 and 2010 (see chapter 5, pp. 263-274, 292). The need to reform Maryland's tax system and increase its capacity to generate revenue rose to the top of the policy agenda due to the leadership of Governor O'Malley, who called the special session to focus exclusively on the structural deficit. The governor could act boldly due to a favorable political environment; his party held large majorities in both legislative chambers and the next elections were three years away, but the plan was also risky because Democrats would be solely accountable for the tax increases that the governor proposed.

By administering fiscal medicine during the first year of his term, O'Malley hoped that voter dissatisfaction would recede before the 2010 elections and that the benefits of his budget plan might be evident. Although O'Malley might have deferred action on the structural deficit and patched together balanced budgets using accounting gimmicks or balance transfers from special funds, he persuaded Maryland lawmakers to approve a deficit-reduction plan based mostly on tax increases with the support of legislative leaders from both chambers. Individuals interviewed for the dissertation agreed that calling the special session increased the governor's odds of success, because the focus on one topic as well as legislators' desire to get back to their families and other jobs would encourage legislators to address the budget problem expeditiously.

Governor O'Malley's leadership during the 2007 special session was effective from both a policy standpoint and a political standpoint. Although a large tax increase is rarely greeted with enthusiasm, the governor was able to blunt some of the opposition by spreading the burden to corporations and individuals, including tax offsets for low-income households, and earmarking almost 40 percent of the new revenues for higher education and transportation to highlight the benefits of the tax increases. In addition, the governor brokered a compromise on slot-machine gambling, an issue that had divided the Maryland Senate and House of Delegates for years (Montgomery and Whitlock, 2004. The Senate saw the approval of slots as a pre-condition for other tax increases, while the House had long demurred. O'Malley resolved the stalemate through a skillful exercise in venue-shifting, proposing that legislation implementing slots would be contingent on a constitutional amendment decided by the voters. Subjecting slots to a referendum gave skeptics a way to support slots legislation on the basis of democratic choice,[429] paving the way for the General Assembly to approve slot-machine gambling at five sites, a decision that was ratified at the polls in November 2008. Finally, in consultation with legislative leaders, the governor introduced his deficit reduction plan as five separate bills – a pivotal decision because it allowed legislators to show that they were not inveterate tax-and-spend liberals by voting against some of the bills while voting yes on others when

[429] As Senator Ulysses Currie stated in an interview, "We didn't vote for slots. We voted to give the public the opportunity to vote."

their support was most critical.[430] Because several pieces of the tax package (including the constitutional amendment on slots, the implementing legislation on slots, and the bill approving income tax increases) passed one chamber with the minimum number of votes or one vote to spare, the governor's leadership in calling the session and skillfully using legislative procedures were clearly critical in guiding the plan to enactment.

Legislative leadership – as well as "followership" – was also instrumental to the success of the tax package approved during Maryland's special session in 2007 (see chapter 5, pp. 292-293, 325-326). After fighting constantly with a Republican governor for the prior four years and often reaching internal stalemate on budget and tax issues, the Maryland House and Senate welcomed executive policy leadership. Interviewees noted that a powerful motivation for legislators was the desire to help a new Democratic governor succeed, and relatedly, to show that Democrats could govern effectively while controlling the executive and legislative branches.[431] These considerations helped lead Senate President Thomas V. "Mike" Miller and House Speaker Michael Busch to set aside strong differences over slot-machine gambling and support the governor's tax plan.

In the District of Columbia, Council Chairman Vincent Gray also played an important role in shaping tax policies in a way consistent with his own ideological views, although to a lesser extent than Governor O'Malley in Maryland. In each year during the case study period, major tax policy decisions were crafted in Mr. Gray's Committee of

[430] Joseph Bryce, the governor's chief legislative officer, stated in an interview that, "You had to find different people – some people weren't going to vote for a sales tax increase. We broke it up in that way, realizing you may have to build coalitions and majorities separately" on each of the six bills.

[431] John Favazza, the co-chief of staff to House Speaker Michael Busch, stated in an interview that, "I think there was a strong commitment to Governor O'Malley being successful. The speaker had said, 'Governor, you lead, we'll be there for you.' A lot of details and compromises had to be worked out, but there was a commitment to get it done … Let's have three years after that to govern."

the Whole, rather than the Committee on Finance and Revenue, reflecting the importance of the venue where tax policy choices are made. Because D.C. Mayor Adrian Fenty largely sought to maintain the status quo in tax policy and Finance and Revenue Committee Chairman Jack Evans preferred to reduce taxes, the Committee of the Whole became the only forum where tax increases could be devised (to support the "Healthy D.C." program to expand access to health insurance in 2008 and to help address a budget deficit in 2009). Chairman Gray also took the lead role in drafting a tax-cut package in 2007 after the Committee on Finance and Revenue failed to reach a clear consensus on which taxes to cut, and how to finance the tax cuts (see chapter 4, pp. 134-136).

Mr. Gray used his institutional role and council procedures both to shape tax cuts in 2007 and the tax increase package in 2009. In a revised FY 2008 budget bill circulated to his colleagues in the early-morning hours on the day of the budget vote (Stewart, 2007), Chairman Gray proposed a tax relief package with three elements: (1) raising the standard deduction and personal exemption and indexing both provisions for inflation, (2) increasing the homestead deduction and indexing it for inflation, and (3) reserving money for small business property tax relief. By skillfully balancing a number of competing interests, including residential property tax relief and commercial property tax relief, with income tax provisions that would particularly benefit low- and moderate-income households, Chairman Gray devised a tax-cut plan that passed the council with only one minor change. Moreover, in using the chairman's privilege to present a new version of the budget bill (known as an "amendment in the nature of a substitute") right before the vote, Mr. Gray denied his colleagues the time to analyze his proposal in depth or craft any alternatives (see chapter 4, p. 174). Councilmembers might have preferred another tax package, but the choice was structured in a way that gave the chairman considerable leverage – what Shepsle (1989) termed a "structure-induced equilibrium."

Similarly, the tax increase package crafted in the summer of 2009 to maintain a balanced FY 2010 budget was finalized two days before the budget vote based on a proposal made by the chairman (Craig, 2009b; DeBonis, 2009). Following a public briefing on the budget problem and several days of discussions among councilmembers, Chairman Gray once again balanced and reflected the views of his colleagues in devising a package that largely mirrored tax rates in Maryland and exported as much of the increased tax burden as possible, but his prerogative to present the blueprint only strengthened his leverage. As stated by Councilmember Phil Mendelson, "Vince presents the package and it's hard to unwind it." The budget bill including the tax increases was approved unanimously by the council.

Republican leaders in Virginia, particularly House of Delegates Speaker William Howell used institutional processes to shepherd a transportation financing package that almost entirely excluded tax revenues through the General Assembly in 2007. Facing legislative elections in the fall after two consecutive Democratic victories in governor's races as well as the triumph of Democrat Jim Webb over U.S. Senator and Republican icon George Allen in 2006, Republicans felt pressure to show progress on the high-profile issue of transportation funding. Prodded by other Republican elected officials, House and Senate Republicans who had feuded for years agreed on a plan to increase transportation funding by appropriating general funds, raising fines and fees, and creating regional bodies that could impose new taxes and fees to fund transportation projects in the traffic-plagued regions of Northern Virginia and Hampton Roads. Introduced as HB

3202, the plan was enacted with several amendments after procedural maneuvers helped the bill avoid defeat at the hands of conservative House Republicans (who opposed creating regional bodies that could raise taxes) and moderate senators of both parties (who thought that a statewide solution was needed). Specifically, Speaker Howell referred HB 3202 to the more moderate House Appropriations Committee, which passed the bill,[432] rather than the strongly anti-tax House Finance Committee, which might have killed the bill or amended it in ways that would lead to its ultimate defeat. After HB 3202 cleared the House and was sent to a conference committee to resolve differences with a Senate version, the House position largely prevailed because Senate Transportation Committee Chairman Martin Williams, who was sympathetic to the House version, had the prerogative to appoint Senate conferees. In each of the case study states, lawmakers used legislative tactics and procedures to enact tax increases as well as cuts, and to keep tax bills from passing, reflecting how tax policy decisions are affected by the way choices are structured, rather than resulting from an aggregation of preferences and rational choice of the best means to achieve society's preferences.

[432] The House Appropriations Committee was chaired by Republican delegate Vince Callahan of Fairfax County, a moderate whose district had been tilting toward Democrats in recent elections.

Tax Policy Outcomes

Finding #14: The case studies suggest that states are focusing on short-term challenges while neglecting the long-term revenue capacity, equity, and efficiency of their tax systems.

The case studies offered strong support for propositions #6 and #7 concerning state tax policy outcomes ("The desire of state officials to claim credit for tax benefits, while deferring or disguising tax burdens, leads to asymmetries in state tax policies," and "The pendulum swings of state tax policy and the political bias toward providing tax benefits leave long-term economic and demographic changes that threaten state tax systems unaddressed.") By focusing on the short-term imperatives of balancing the budget and using tax policy to deliver benefits and subsidize favored activities, D.C. and Virginia policymakers in particular neglected the long-term revenue capacity, equity, and efficiency of their tax systems.

The case study of Maryland, where policymakers took the unusual step of trying to resolve a long-term structural deficit before a fiscal crisis became imminent, paradoxically offers the strongest evidence that states are failing to address the long-term challenges facing their tax systems. Despite generating tax revenues estimated at $6.6 billion over five years – one of the largest tax increases in the nation since 2007 – the Maryland tax package was not projected to eliminate the state's structural imbalance even before the Great Recession of 2007-2009 placed additional strains on state budgets (Department of Legislative Services, 2007v: 5-9). Despite the governor's effort to shield low- and moderate-income residents from the tax increases and make Maryland's tax system more progressive, the enacted version relied on regressive sales and other consumption taxes for almost 80 percent of the projected revenue.[433] An ambitious attempt to revamp the Maryland tax system to reflect the modern economy and meet the needs of residents well into the future – a best-case scenario – succeeded only partly.

Although most elements of Maryland's 2007 tax plan stayed in place, reflecting the skillful way that it balanced policy goals with political pressures, Maryland policymakers were forced to retreat in their efforts to expand the sales tax base. The repeal in 2008 of the tax on computer services after a public backlash left the sales tax base unchanged and was not fully offset by other tax increases or spending cuts,[434] undermining the goal of long-term revenue capacity. Moreover, a step that policymakers took to replenish the general fund after they repealed the computer services tax – shifting sales tax revenues from the Transportation Trust Fund – meant that growing transportation needs would not be addressed.

As noted earlier, the effort of Maryland officials to strengthen the long-term capacity of the state tax system was at least partly successful because of a very unusual alignment of political forces. In 2007, Maryland returned to unified Democratic party control of the executive and legislative branches, with more than 2-to-1 Democratic majorities in both legislative chambers. The desire of Democratic legislators to help their new governor succeed and the three-year period until the next elections gave lawmakers additional reasons to take the risky step of supporting a large tax increase. Even in this best-case scenario, key pieces of the 2007 tax package passed with no votes or only one

---

[433] Author's calculation using data from Department of Legislative Services, "Summary of Administration's Proposals As Amended by the Maryland General Assembly," November 30, 2007.

[434] Lawmakers failed to replace more than $200 million in estimated forgone revenues, from FY 2009 to FY 2013, which resulted from repealing the computer services tax.

vote to spare, providing strong evidence that other ambitious efforts by states to ensure adequate revenues for the long-term will face difficult odds, particularly in less favorable political environments.

In contrast to their counterparts in Maryland, D.C. lawmakers did not focus on the long-term revenue capacity or the fairness of their tax system. A package of tax increases approved in 2009 was intended to help balance the FY 2010 budget and one of its main elements, a sales tax increase, was set to expire after three years. While the regressive nature of the sales tax is usually a prominent aspect of debates on increasing the tax (as it was in Maryland in 2007), there is no evidence that the distributional impact of the tax increase was discussed when legislators crafted the tax package, as discussed earlier. Although the package had to be developed in two weeks so D.C. officials could send a balanced budget to Capitol Hill, the lack of attention to equity issues was still notable because the other two main elements of the plan – cigarette and gasoline tax increases – also involved regressive consumption taxes.

More generally, by focusing tax increases on sin taxes during the case study period – cigarette taxes were raised by 150 percent and taxes on blighted properties were doubled – D.C. lawmakers boosted the taxes with the lowest revenue elasticities, as the higher taxes discourage the taxable activity.[435] In the District of Columbia, the revenue elasticity of the cigarette tax may be particularly low because of options for cross-border

[435] Economists have typically found that a 10 percent increase in the price of cigarettes reduces consumption between 2.5 and 5 percent. See Frank J. Chaloupka, K. Michael Cummings, Christopher P. Morley, and Judith K. Horan, "Tax, Price and Cigarette Smoking: Evidence from the Tobacco Documents and Implications for Tobacco Company Marketing Strategies," *Tobacco Control*, 11 (Supplement 1), 2002, pp. 162-172.

purchasing in Virginia, where cigarette taxes are much lower (Higginbottom, 2010).[436] After D.C. lawmakers raised the cigarette tax from $2 per-pack to $2.50 in 2009, cigarette tax revenues fell $12 million short (26 percent) of the forecast for FY 2010,[437] a gap that the CFO attributed to a shift in sales to Virginia and Maryland (Chief Financial Officer, 2010a: 2-3). The revenue performance of the tax on vacant and blighted property was also particularly poor after the rate increases imposed between 2007 and 2009: while tax liability for such properties more than quintupled, from $15.7 million to $85.6 million, tax receipts only doubled, from $11.7 million to $22.8 million, as more property owners challenged their tax bills and the collection rate dropped (Office of Revenue Analysis, 2009a). By contrast, the personal income tax, which tends to grow faster than the economy (Cordes and Juffras, 2012: 305; U.S. Government Accountability Office, 2010: 26-27), was subject to a net reduction in D.C. from 2007 to 2010 due to increases in the personal exemption, standard deduction, and earned income tax credit.

At the same time, by approving a steady stream of tax relief measures during the case study period, including 47 bills targeted at a single parcel, property, or organization, D.C. policymakers created a slow but persistent strain on the long-term revenue capacity of the tax system while also reducing the efficiency and equity of the tax system. In 2009 and 2010, D.C. lawmakers also used a new tactic to enact tax incentives for economic development projects: shifting the cuts outside the four-year window of the District's

[436] Virginia's cigarette tax has been 30¢ per-pack since 2005, much lower than D.C.'s tax, which was raised from $1 per-pack in 2007 to $2.50 per-pack by the end of 2009. Local governments in Northern Virginia also impose their own cigarette taxes ranging from 20¢ to 80¢ per-pack during the case study period.

[437] Author's calculation using data from Government of the District of Columbia, *FY 2010 Proposed Budget and Financial Plan: Meeting the Challenge*, Vol. 1, Executive Summary (September 2009), pp. 4-17, 4-20, and Government of the District of Columbia, *FY 2012 Proposed Budget and Financial Plan: One City Rising to the Challenge*, Vol. 1, Executive Summary (August 2011), p. 4-6.

financial plan, thereby evading a requirement to offset any negative revenue impact.[438] Not only did the proliferation of targeted tax cuts give certain organizations, activities, and economic development projects advantages that were not available to others in similar situations, but they also undermined the transparency of the tax system and the effectiveness of tax administration by adding many complicated provisions to the tax code. The sole significant measure D.C. policymakers approved to strengthen the tax base during the case study period– requiring combined reporting of corporate income – was almost accidental, chosen from a list of budget-balancing options in 2009 with little understanding of its purpose or impact. Other efforts to bolster the tax base were generally lacking,[439] even though D.C.'s tax base is constrained by large tracts of tax-exempt federal property and eroding due to the growth of non-taxable services (Fox, 2012: 410) and the profusion of tax expenditures.

In Virginia, the picture was simpler: the almost complete lack of change in tax policies during the case study period left the long-term economic and demographic changes that threaten the tax system unaddressed and a shortfall in the Commonwealth Transportation Fund grew. Lawmakers not only failed to agree on new sources of transportation funding after the 2007 financing bill largely collapsed, but also sacrificed the equity and efficiency gains that arise from benefits taxation of transportation. Instead, the more modest steps policymakers took to increase transportation funding included earmarking insurance premium and deed recordation taxes – general-fund

---

[438] For example, in 2010 the council approved a 15-year tax exemption for a luxury hotel that was estimated to result in $46 million in forgone revenue through FY 2029, well outside the period (FY 2011-FY 2014) in the District's financial plan and budget.

[439] In 2010, the council extended the sales tax to sugar-sweetened beverages and medical marijuana (the latter was in the process of being legalized in the District).

revenues that would no longer be able to support rising costs for education, health care, and other services. Virginia policymakers also left unchanged a sales tax base that was eroding due to the growth of untaxed services and online transactions by firms with no nexus in the state, while approving a stream of new, targeted tax cuts. In particular, the General Assembly unanimously approved tax breaks related to jobs and economic development, extending the Major Business Facility Job Tax Credit without evaluating its effectiveness and approving a major change in corporate income taxation (the single-sales factor) that was projected to cause a major revenue loss in FY 2015 and beyond.

Finding #15: The strong role of parity reinforces moderation in state tax policy decisions. States seem to pick out a position on a spectrum of tax rates and tax burdens that reflects the political preferences of residents, but states do not stray too far from national averages and may tend to regress to the mean (or median).

The evidence from the case studies is strongly consistent with Charles Tiebout's theory that individual mobility forces state and local governments to engage in competition similar to that found in a market (Tiebout, 1956). To attract and retain residents, Tiebout posited, state and local governments develop distinctive packages of services and taxes that reflect different preferences among the populace. Each of the case study states seemed to fill a distinctive niche in this subnational marketplace. Maryland was willing to raise personal income, sales, and corporate income taxes in order to finance higher levels of education, health care, and transportation spending; D.C. was struggling to shed its high-tax reputation while supporting generous public spending by exporting tax burdens as much as possible; and Virginia sought to attract businesses and residents by keeping taxes low to the possible detriment of education, human services, and transportation funding.

Even though states offer different levels of public services and taxes to their residents, the strong emphasis on parity seems to reinforce moderation in tax policy, even if the standards of parity are partial or approximate. Parity serves both as an aid and a crutch: state officials can summon the political will to raise taxes, if necessary, by pointing to neighboring states or similar states with higher rates; the argument, essentially, is that the sky has not fallen in those states. Although state officials need less courage to lower taxes, interstate comparisons can also highlight tax burdens that damage a state's economic competitiveness (particularly if the taxes are not financing high-quality public services). Nevertheless, the focus on parity may make state officials risk-averse and create a pattern in which state tax policies regress toward national averages. Although Maryland overhauled its personal income tax during the case study period and increased its capacity to finance program commitments, tax policy changes in D.C. were mostly incremental and tax policy changes in Virginia were almost non-existent. Reflecting a tendency to try to stay close to the mean, Maryland made its 2008 millionaire's tax temporary (its abortive computer services tax was also originally intended to sunset after five years) and D.C. made its 2009 sales tax increase temporary.

Finding #16: A general hierarchy of taxes constructed from the case studies shows that narrowly-targeted levies and sin taxes were the most likely to be increased, while broad-based taxes were the least likely to be increased. This pattern reinforces the conclusion that states are neglecting the long-term revenue capacity of their tax systems.

Table 7.7 (see next page) draws on the case studies to create a general hierarchy of taxes, ordered from most likely to be raised to least likely to be raised. The rankings, which are approximate rather than fixed because the likelihood of increasing a tax will vary by time and place, are based on the author's judgments as explained in the table.

Table 7.7
A General Hierarchy of Taxes in D.C., Maryland, and Virginia, 2007-2010
(ranked from most likely to be increased to least likely)

Tax or Taxes	Rationale for Increasing Tax and Evidence of Its Ranking
Health Provider	Opportunity to claim federal matching funds and increase Medicaid reimbursements made taxes a potential "win-win." Health provider taxes (on hospitals, nursing homes, and intermediate care facilities) were the only type of tax increased in each state during the case study period.
Cigarette	Public health concerns and negative views of smokers and the tobacco industry generated support for the tax increases. D.C. increased its cigarette tax by 150% and Maryland doubled its cigarette tax.
Other "Sin" Taxes	Concern about negative externalities bolstered support for the taxes. D.C. doubled its tax on blighted property and established a bag tax. Maryland enacted a gross receipts tax on slot-machine gambling and the Virginia Senate approved a bill to impose a gross receipts tax on "instant racing."
Sales	Rationales varied: Maryland's sales tax burden was relatively low by national standards, whereas D.C. officials saw the tax as more "exportable." Maryland increased its sales tax by 1% as centerpiece of 2007 tax package. D.C. raised its sales tax by 0.25% for three years. Virginia considered a sales tax increase to finance transportation projects.
Insurance Premiums	Taxing a narrow industry segment with a reputation for raising rates and limiting coverage generated less opposition than other tax increases. D.C. raised insurance premiums taxes, while Virginia earmarked a portion of insurance premiums taxes for transportation.
Property Transfer	Tax was relatively obscure and would be paid only at long intervals. D.C. raised its economic interests tax (a type of transfer tax), while Maryland closed a loophole in the transfer tax and Virginia earmarked a portion of deed recordation taxes for transportation.
Motor Vehicle	Taxes were considered a fair way to finance transportation needs. Maryland increased its vehicle excise tax to boost transportation funding. D.C. raised its motor fuel tax, but the new revenue was shifted to the general fund. Virginia debated vehicle excise and motor fuel tax increases to meet transportation needs.
Corporation Income	Tax was seen as a way to make businesses pay their fair share, but tax increases were also seen as a threat to economic competitiveness. Maryland was the only case study state to increase its corporation income tax from 2007 to 2010; D.C. expanded its corporate tax base by mandating combined reporting.
Personal Income	Some argued that wealthy residents could afford to pay more income tax, especially in a time of growing income inequality, but tax increases were seen as an impediment in competing for jobs, businesses, and residents. Maryland was the only case study state to raise personal income tax rates from 2007 to 2010; proposals to raise the tax failed in D.C. and Virginia.

Note: The real property tax is not included in the table because it is primarily a local tax in Maryland and exclusively a local tax in Virginia.

The hierarchy of taxes shown in Table 7.7 has different implications for politically liberal states such as D.C. and Maryland where officials are willing to debate and enact tax increases, and more conservative, anti-tax states such as Virginia where tax increases are often ruled out. Because of different attitudes toward taxation, policymakers in D.C. and Maryland (or another liberal state) might be more likely to raise a tax that ranks low in the hierarchy than policymakers in Virginia (or another conservative state) would be to increase a tax that ranks near the top. The items at the top of the hierarchy represent the taxes that lawmakers in Virginia would be most likely to *consider* increasing, given that the chances of enactment are so small.

At the top of the hierarchy are health care provider taxes, which were established in all of the case study states and also increased in two of the states from 2007 to 2010. The health provider taxes were a unique case, offering lawmakers a way to increase state revenues, secure federal matching funds by devoting some or all of the increased revenues to Medicaid, and assist the providers by using some of the new revenue to increase their reimbursement rates (Mitchell, 2012: 2).[440] D.C. policymakers enacted a hospital bed tax and increased the assessment on intermediate care facilities for people with intellectual disabilities in 2010; Maryland policymakers enacted a nursing home assessment in 2007 and increased it in 2010; and Virginia lawmakers established a tax on intermediate care facilities for the intellectually disabled in 2010.

Cigarette taxes, which were raised 150 percent (from $1 per-pack to $2.50 per pack) in D.C. and by 100 percent in Maryland (from $1 per pack to $2 per pack), rank

[440] Facilities with small operating margins or low percentages of residents receiving Medicaid usually opposed the tax increases.

second on the list. These large increases passed easily in both states, reflecting the cigarette tax's status as "low-hanging fruit" due to public concern about the harmful effects of cigarette smoking. Due to its history as a tobacco-producing state and the influence of tobacco companies such as Philip Morris, Virginia was one of the few states in the nation to defy the national trend of boosting cigarette taxes, maintaining its tax at 30¢ per pack throughout the case study period. Because policy decisions on cigarette taxes were strongly driven by public disapproval of smoking and the tobacco industry, cigarette taxes departed from the pattern in which states tried to maintain a reasonable level of parity in their tax rates, particularly with neighboring states. At the end of 2010, D.C.'s cigarette tax was more than eight times as high as Virginia's state tax, threatening the revenue-generating capacity of D.C.'s cigarette tax due to the large disparity with a bordering state (because Northern Virginia localities used their authority to add a local cigarette tax, D.C.'s tax was generally twice to four times as high as Virginia's).[441]

Policymakers were also likely to turn to other "sin taxes" to generate revenue, although the targets for punitive taxation varied by state due to economic, social, and political differences. In urban D.C., marked by high levels of income inequality, abandoned and decaying properties were a major issue, leading policymakers to double the real property tax on blighted properties in an attempt to reduce the number of such neighborhood trouble spots. D.C. lawmakers also approved a 5-cent excise tax on plastic carry-out bags because advocates framed the proposal as a way to curb pollution in the Anacostia River. Reflecting the popularity of sumptuary taxes, the cigarette and vacant

[441] As of January 1, 2011, the combined cigarette tax rate was $1.10 per pack in Alexandria City, 60¢ in Arlington County, and 80¢ in Fairfax County. See Office of the Chief Financial Officer, *Tax Rates and Tax Burdens: Washington Metropolitan Area* (September 2011), p. 17.

property tax increases, as well as the bag tax, were approved unanimously by the D.C. Council. By contrast, plastic bags were not widely regarded as having negative impacts in Virginia, where a bag tax proposal modeled on D.C.'s tax languished in committee. Gambling was a popular sin tax in Maryland and Virginia; although Maryland policymakers clashed bitterly over the merits of slot-machine gambling for years before authorizing it in 2007, they agreed that slots facilities should be taxed heavily (67 percent of gross revenues were to be paid in taxes). As noted earlier, the Virginia Senate approved a bill to tax the gross receipts from instant racing at 10 sites, but the bill was blocked in the House of Delegates.

Sales, insurance premiums, and property transfer taxes fill out the middle of the tax hierarchy depicted in Table 7.7. In a nationwide ranking, the sales tax might rank lower, because sales tax increases in Maryland and D.C. reflected distinctive factors in both states. Maryland policymakers favored a sales tax increase over a personal income tax increase because the state's sales tax burden, relative to total personal income and per-capita income, was relatively low; in D.C., a sales tax increase was seen as relatively palatable because visitors to the nation's capital and workers who commuted to the District from Maryland and Virginia would bear a significant share of the burden. Because the personal income tax and sales tax are the two largest sources of state tax revenue, policymakers may focus on the tax that is perceived as less burdensome (or most capable of generating the necessary revenues) when they need to raise broad-based taxes; in addition, public officials who seek to increase taxes in a progressive manner may rely on the personal income tax because it can be calibrated to reflect ability to pay. The insurance premium and property transfer taxes received varying degrees of consideration for tax increases in each of the case study states, but they were a focus of some attention because they are fairly narrow-based taxes with low salience.[442]

At the bottom of the hierarchy are motor vehicle, corporation income, and personal income taxes. Despite the longtime tradition of financing transportation projects through motor vehicle taxes, motor fuel taxes were unpopular because of their salience – linked to gas prices paid at the pump every week – and were especially unfeasible during a time of rising gas prices.[443] Motor vehicle excise taxes were increased in Maryland as a more politically acceptable alternative to a motor fuel tax increase, but vehicle excise tax increases were repeatedly rejected in Virginia. Corporation income taxes were increased from 7 percent to 8.25 percent in Maryland, but increases were not even considered in D.C. or Virginia. Although personal income taxes were raised at the top of the income scale in Maryland (and decreased slightly at the bottom of the scale), a new top tax rate for high-income households was rejected in liberal D.C. and a 1 percent increase the personal income tax rate proposed by lame-duck Virginia Governor Tim Kaine was rejected out of hand. As noted earlier, the relative acceptability of personal income and sales tax increases is likely to vary by state depending on the prevailing political ideology, the current burdens imposed by each tax, and the revenue capacity of each tax.

---

[442] In fact, these taxes are so narrow that the National Conference of State Legislatures does not report data on the annual changes in either tax as a separate category. Insurance premiums taxes would fall into NCSL's category of "corporation and business income tax" and the property transfer tax would be classified as a "miscellaneous" tax.

[443] David Sjoquist notes that, "Increasing fuel tax rates is politically unpopular. Most public opinion surveys find that only a minority of respondents support increases in the gasoline tax." See David J. Sqoquist, "State Tax Structures: Past Trends, Future Possibilities," in *Sustaining the States: The Fiscal Viability of American State Governments*, Marilyn Marks Rubin and Katherine G. Willoughby, eds. (Boca Raton, FL: CRC Press, 2015), p. 75.

The hierarchy of taxes depicted in Table 7.7 shows a roughly inverse relationship between the likelihood of the tax being raised and its revenue elasticity. At the top of the hierarchy, health care taxes might display steady revenue elasticity because the aging of the population and increasing health care costs maintain revenue levels, but as noted earlier, cigarette and other sin taxes fare poorly on revenue elasticity because the taxed activities may fall sharply (or shift locations) due to the high levels of taxation. The general sales tax, which falls in the middle of the hierarchy, is a steady but unremarkable performer in terms of revenue growth (Mikesell, 2012: 788), as are the motor fuel tax and insurance premiums taxes.[444] The personal income tax, which ranks near the bottom of the hierarchy, is the best-performing tax in terms of revenue elasticity due to progressive income tax structures and an increasing concentration of income among affluent taxpayers who pay the highest rates (Juffras and Cordes, 2012: 305; Bruce, Fox, and Tuttle, 2006). Corporation income tax revenues are the most difficult to categorize in terms of revenue elasticity because the tax is very volatile (Auerbach, 2011: 13; Felix, 2008: 69; Sobel and Holcombe, 1996: 543-544, 549).

The general hierarchy of taxes presented in Table 7.7 also helps flesh out the scholarship on "cutback management" discussed in Chapter 2 (see pp. 55-56). In a study of fiscal retrenchment strategies in eight states following the 2001-2002 recession, Michael Dougherty and Kenneth Klase found that states acted first to curb spending through less controversial measures such as travel and hiring freezes, across-the-board cuts, transfers from special funds and use of reserve funds, and delays of new initiatives –

[444] Because the sales tax is linked to consumption, it tends to grow evenly with the economy, although the growing percentage of consumption devoted to tax-exempt services may lower the elasticity of the tax. One reason why motor fuel tax revenues grow slowly is that automobiles have steadily become more fuel-efficient. Insurance premiums taxes may also grow at steady rates because people tend to purchase a base amount of insurance that remains relatively constant.

actions that would largely avoid reducing benefits (Dougherty and Klase, 2009: 612-615), and that deeper, targeted spending cuts and tax increases served as last resorts once the initial stopgap strategies were exhausted. Other scholars of cutback management have reported similar findings (Finegold, Schardin, and Steinbach, 2003; Holahan, Coughlin, Bovbjerg, Hill, Ormond, and Zuckerman, 2004; Boyd, 2008). The hierarchy shown in Table 7.7 offers detail on the order and manner in which specific levies are likely to be used: sin taxes and health care provider taxes are most likely to be the first choices, followed by other narrow-based peripheral taxes such as insurance premium and property transfer taxes, and broad-based taxes used as a last resort when budget gaps are too large to be covered by spending cuts and smaller taxes.

Implications of the Findings

Although this study of tax policy decisions in three states cannot generate findings that are generalizable to all American states, or to other levels of government in the U.S., this section reviews patterns in state tax policymaking to assess whether the findings might have broader applicability. The analysis is preliminary and may identify directions for future research to test the findings. The information on national trends in state tax policy formulation described below draws primarily on annual summaries of state tax policy actions prepared by the National Conference of State Legislatures as well as research and analysis by the Center on Budget and Policy Priorities, the Tax Foundation, and academics.

Agenda-Setting and Development of Tax Policy Options. Nationwide evidence suggests that state tax policy may follow a pattern of "punctuated incrementalism" that characterized the case study states. Incremental changes, particularly small but widely-distributed doses of tax relief, are regular features of state tax policy, interrupted periodically by significant tax increases. As shown in Table 7.8 (see next page), NCSL's annual summaries show that a small number of large tax increases often balance out a large number of small tax cuts.

In 2007, for example, states collectively enacted net increases in personal income, sales, and business income taxes, but the number of states cutting each tax exceeded the number of states raising the tax by margins greater than 2 to 1. Similarly, in 2008, more states cut their personal income, sales, and business income taxes than raised them, but only the personal income tax showed a net national decrease in projected collections. In 2009, states departed from this pattern of incremental change, raising taxes by the largest percentage since 1991 due to the large budget shortfalls caused by the Great Recession (NCSL, 2010b: vii). Net state tax changes jumped from an increase of $3.8 billion in 2008 to $28.6 billion in 2009 (NCSL, 2010b: 1), reflecting how state tax increases are clustered in times of fiscal duress (these figures refer to the estimated first-year impact of the tax changes, as do all of the annual state tax changes calculated by NCSL).[445]

Table 7.8
National Conference of State Legislatures' Annual Summaries of State Tax Actions: Changes in Personal Income, Sales, and Business Income Taxes, 2007-2010

Year	Personal Income Tax	Sales Tax	Business Income Tax
2007	7 states raised/25 lowered Net change: $31 million	8 states raised/20 lowered Net change: $95 million	8 states raised/18 lowered Net change: $1.1 billion
2008	7 states raised/15 lowered Net change: -$254 million	6 states raised/13 lowered Net change: $689 million	11 states raised/15 lowered Net change: $2.3 billion
2009	15 states raised/12 lowered Net change: $11.4 billion	17 states raised/6 lowered Net change: $7.2 billion	20 states raised/10 lowered Net change: $2.0 billion
2010	7 states raised/12 lowered Net change: -$656 million	10 states raised/10 lowered Net change: $1.7 billion	11 states raised/11 lowered Net change: $494 million

Sources: National Conference of State Legislatures, *State Tax Actions, 2007*, pp. 3-4; *State Tax Actions, 2008*, pp. 3-5; *State Tax Actions, 2009*, pp. 3-4; *State Tax Actions*, 2010, pp. 3-5.

Although it is impossible to use summary data to explore the institutional processes and structures that influence state tax policy decisions, the available evidence suggests that most states fall in the middle of a spectrum defined by Maryland's long-term, deliberative process at one end and D.C.'s short-term, ad-hoc process at the other.

[445] For example, the first-year impact of tax policy changes enacted in 2007 refers to the effects on the tax burden in FY 2009; the first-year impact of tax policy changes enacted in 2009 refers to the effects in FY 2010, and so on.

States tend to perform a limited search for tax policy options, focusing on modest changes to current taxes as well as policy tools they have used before or have borrowed from other states.

Even though many other states such as California and Wisconsin have displayed clear signs of a structural deficit (California Legislative Analyst's Office, 2008: 10-11; Conant, 2006b: 247-248; 251-252), which often resulted from program expansions and tax cuts approved during the late-1990s boom, most states did not take Maryland's long-term approach and only confronted questions of revenue capacity only during or after recessions in 2003-2004 and 2009. In 2007, only Alaska and Michigan joined Maryland in increasing taxes by more than 5 percent (NCSL, 2008a: 7); in 2008, only Indiana raised taxes by more than 5 percent (NCSL, 2009:9), which reflected a shift of the fiscal burden to the state in order to reduce local property taxes.

On the other hand, governors and legislators in other states (who are usually assisted by non-partisan fiscal, policy, or research units) did not conceive, enact, and sometimes reverse tax policy changes as rapidly as D.C. lawmakers did.[446] Conservative states where the Republican party controlled one or both branches of state government, such as Georgia, Kentucky, and South Carolina, were characterized by a very constrained discussion of tax policy options similar to that in Virginia; only the most peripheral or politically acceptable taxes (such as the cigarette tax) were considered (Lauth, 2006: 38-40; Lauth, 2010: 19-22; Henchman, 2008b). Academic research also shows that some

[446] For example, a set of case studies on state budgeting in 15 states, published in 2006, did not reveal rapid tax policy reversals similar to those that characterized D.C. from 2007 to 2010. See Edward Clynch and Thomas Lauth, eds., *Budgeting in the States: Institutions, Processes, and Politics* (Westport, CT: Praeger Publishers, 2006). The case studies describe the non-partisan fiscal offices that serve the governor or legislature, respectively, in many states, such as California's Department of Finance and its Legislative Analyst's Office; Connecticut's Office of Policy Management and its Office of Fiscal Analysis; and Nevada's Budget Office and Legislative Counsel Bureau.

states are characterized by a breakdown of regular order in formulating budget and tax policy (as in D.C.); finance committees are sometimes sidelined as legislative leaders craft the budget, often in summit-style negotiations with the governor (Snow and Rubin, 2006: 109-114; Bifulco and Duncombe, 2010: 61-62). In a case study of budgeting in New York State, Robert Bifulco and William Duncombe found that:

> (P)roposed legislation to amend the executive budget is typically negotiated by legislative leaders and the governor in closed-door sessions. Open legislative committee processes are rarely used. Budget legislation agreed to by the governor and legislative leaders is often made available to legislators only hours before floor votes are taken, without provision of any analysis of the consequences of proposed changes for fiscal deficits or local governments. Nor is there any politically independent body similar to the federal government's Congressional Budget Office or New York City's Independent Budget Office to provide authoritative, nonpartisan budget analysis. (Bifulco and Duncombe, 2010: 62).

The spread of tax policy ideas among the states is well illustrated by the spread of "Amazon tax" bills, which attempt to impose the sales tax on electronic retailers such as amazon.com by redefining nexus to apply to companies with in-state affiliates. After New York enacted the first Amazon tax in April 2008, Rhode Island and North Carolina followed suit in 2009 and Colorado did so in 2010. Governors in California and Hawaii vetoed Amazon tax bills, which were also considered in Connecticut, Illinois, Iowa, Maryland, Minnesota, Mississippi, New Mexico, Tennessee, Vermont, Virginia, and Wisconsin (Tax Foundation, 2010: 1-2, 4). Similarly, a growing number of states have adopted combined reporting of corporate income (as D.C. did in 2009) and changes in corporate income apportionment factors that reduce the weight given to payroll or property (adopted in Virginia in 2009) have spread rapidly among states (Mikesell, 2015: 36; Sjoquist, 2015: 73). States appear to draw from a national marketplace of tax policy ideas, although they seem most likely to borrow or adapt tax policy options that cut taxes (such as film production tax credits and sales tax holidays) or, as in the case of the Amazon tax bills, target out-of-state businesses.

The routinized, constrained nature of state officials' search for tax policy options largely leaves base-broadening efforts off the agenda, just as D.C., Maryland, and Virginia lawmakers made only sporadic attempts to curb tax expenditures and apply taxes to economic activities not presently included in the base. Because efforts to broaden the tax base were fitful even during the deep recession of 2007 to 2009 when policymakers had to search widely for ways to balance their budgets, this pattern strongly suggests that states do not have the analytic capacity or the political will to strengthen tax bases that are slowly eroding due to factors such as the growth of services and electronic commerce, the increased mobility of capital, and the aging of the population. NCSL's summaries show that states expanded tax incentives during 2007 and 2008 when the economy still appeared to be growing,[447] and then made scattered efforts to curtail or repeal tax expenditures in 2009 and 2010 at the same time that they authorized new tax expenditures. In 2009, while four states scaled back capital gains preferences, at least six states (including Maryland) conformed to new federal tax breaks enacted in the American Recovery and Reinvestment Act, two states approved homebuyer tax credits, and California authorized an employment tax credit (NCSL, 2010b: 3-4). In 2010, the pendulum on tax expenditures continued to swing both ways: a number of states

[447] For example, NCSL reported that six states (including Maryland and Virginia) approved permanent incentives or sales tax holidays for energy-efficient appliances in 2007, while six more states enacted sales tax holidays for energy-efficient appliances in 2008. In addition, NCSL reported that five states created or expanded film industry tax incentives in 2007 and four states did so in 2008. See National Conference of State Legislatures, *State Tax Actions, 2007* (Denver: National Conference of State Legislatures, 2008), p. 2, and *State Tax Actions, 2008* (Denver: National Conference of State Legislatures, 2009), p. 2.

suspended or capped income tax credits – reflecting the short-term nature of many efforts to strengthen the tax base – while adopting new tax incentives for job creation, renewable energy, and other purposes (NCSL, 2011a: 3-5).

The see-saw pattern of many states regarding tax expenditures during the case study period is reflected in state policies on sales tax holidays, which were authorized in Maryland in 2007, expanded in Virginia in 2007 and 2008, and repealed in D.C. in 2009. Florida canceled its sales tax holidays during 2008 and 2009, but reinstated them in 2010; Massachusetts canceled its sales tax holiday in 2009, but revived it in 2010; and Illinois declined to approve a sales tax holiday in 2009 but authorized a holiday in 2010 (Henchman, 2012: 1-5). As in the case study states, the recession and fiscal crisis led some states to briefly restrict tax expenditures, but these efforts were not sustained.

Efforts to broaden state tax bases were likewise tentative and tangential; in fact, Michigan repealed a new services tax before it could be implemented (just as Maryland repealed a computer services tax before it took effect) and Nebraska repealed a contract labor tax in 2007 (NCSL, 2008a: 2). Rhode Island appeared to be the only state to enact a systematic plan to broaden its tax base during the case study period, replacing itemized income tax deductions with a larger standard deduction in 2010 and limiting the number of income tax credits to eight in order to reduce the number of tax brackets and lower the top tax rate (NCSL, 2011a: 4). State policymakers seem unwilling or unable to curtail tax expenditures because of their popularity or because of their complexity (or both), while broader efforts to strengthen the tax base have also been sporadic.

Selection and Evaluation of Tax Policy Outcomes. National data suggest that selective parity considerations influence state tax policy decisions. As discussed earlier, state officials seem to choose a position along a spectrum of tax and service levels that reflects the politics, economics, and demographics of their states, and use strategic comparisons to justify their choices. Facing a $4.3 billion budget deficit for FY 2010, Illinois Governor Pat Quinn defended his proposal to increase the personal income tax rate from 3 percent to 4.5 percent by pointing out that his state would still have a lower marginal rate than most of its neighboring states (Bunch, 2010: 119). Although Quinn's effort that year was unsuccessful, in 2011 the governor and General Assembly agreed to raise the personal income tax rate to 5 percent and the corporate income tax rate from 4.8 percent to 7 percent, while reinstating the state estate tax. Neighboring New York and New Jersey also mirrored each other's personal income tax rates – with New York adopting New Jersey's 8.97 percent top rate in 2009 on incomes over $500,000 (McNichol, Nicholas, and Shure, 2009: 4),[448] while downplaying the lower-tax benchmark of 3.07 percent (a flat-rate tax) in next-door Pennsylvania.

Most of the personal income tax increases on high-income households that states approved in 2009 were temporary, reflecting states' desire to move back toward national means, and rates have since fallen in New Jersey, New York, North Carolina, and Oregon (NCSL, 2010b: 1; NCSL, 2012: 3-7). Reflecting this trend over a longer period, 12 of the 13 states that imposed top personal income tax rate of 10 percent or more in 1980 had dropped the rate below 10 percent in 2010 (Sjoquist, 2015: 63). Moreover, variation in state corporation income tax rates dropped between 1980 and 2012 (Sjoquist, 2015: 73).

[448] New Jersey then raised its top personal income tax rates to 10.25 percent for incomes between $500,000 and $1 million, and to 10.75 percent for tax year 2009.

The pattern in which states rely on peripheral tax increases also seems to apply nationwide. In studying tax policy changes in Georgia and 13 "peer" states from 1999 to 2009,[449] Robert Buschman divided taxes into "core" (personal income, corporate income, general sales, and gross receipts taxes) and "non-core" (excise, health care, gambling, and miscellaneous taxes) categories. Buschman found that the 14 states were more likely to cut core taxes and more likely to increase non-core taxes (Buschman, 2010: 16-17).

National data confirm that health care provider and cigarette taxes are the preferred options for states in raising taxes. States enacted more than $6 billion worth of new or increased health care taxes between 2001 and 2010 (Buschman, 2010: 15). According to the Federation of Tax Administrators, 47 states and D.C. raised cigarette taxes between 2000 and 2014 a total of 114 times (Federation of Tax Administrators, 2014). Since 1980s, the average state cigarette tax has increased more than threefold in real terms (Sjoquist, 2015: 77). In 2007, the projected net change in state tax revenues from tobacco taxes ($1.1 billion) and health provider taxes ($230 million) exceeded the net changes for the two most broad-based taxes: sales taxes ($95 million) and personal income taxes ($31 million) (NCSL, 2008a: 3). In 2010, sales taxes recorded the largest net increase of all state taxes nationwide ($1.7 billion), but health care taxes placed second ($1.3 billion) and tobacco taxes placed third ($603 million) (NCSL, 2011a: 3).

Nationwide, there was only modest change in motor fuel and vehicle excise taxes during the case study period, similar to the pattern in D.C., Maryland, and Virginia. The net increase in tobacco and health care provider taxes exceeded that of motor vehicle taxes in every year from 2007 to 2010 (states reduced motor vehicle taxes by $42 million

[449] The peer states were Georgia's neighboring states as well as other states that had triple-A bond ratings.

in 2007), even though motor vehicle taxes have a much larger base than tobacco taxes (NCSL, 2008a: 3; NCSL, 2009: 3; NCSL, 2010b: 3; NCSL, 2011a: 3).[450] State corporation and business income tax changes showed significant net increases from 2007 to 2009 ($1.1. billion in 2007, $2.3 billion in 2008, and $2.0 billion in 2009), but the bulk of the increases in 2007 and 2008 stemmed from only two states each year (NCSL, 2008a: 3-4; NCSL, 2009: 4; NCSL, 2010b: 4).

When states faced the largest budget gaps during the depths of the recession in 2009, they relied more on personal income tax changes (projected to increase state tax revenues by a net $11.4 billion in FY 2010) than on sales tax changes (projected to increase state tax revenues by a net $7.2 billion in FY 2010) in enacting the largest overall tax increases since 1991 (NCSL, 2010b: vii -3). Many of the state personal income tax increases targeted high-income households and most were temporary (NCSL, 2010b: 1-3). Because the personal income tax and the sales tax are the two largest sources of state tax revenue, states may turn to one or both to help close large budget gaps, basing the decision on their own economic, political, and social factors.[451]

Large tax increases in other states display some of the same features as Maryland's 2007 tax plan. In 2008, Indiana approved a net tax increase estimated at 6.6 percent in the first year (NCSL, 2009: 9) that increased sales taxes by 1 percent (from 6 percent to 7 percent) in order to provide local property tax relief. To protect low-income families from the regressive impact of the sales tax increase, Indiana policymakers

---

[450] According to the U.S. Census Bureau, state motor fuel tax revenues totaled $35.7 billion in FY 2006, the year immediately prior to the case study period, while state tobacco tax revenues totaled $14.5 billion. The Census does not report data on health care provider taxes as a separate category. Data from the 2006 Annual Surveys of State and Local Government Finances are available at http://www.census.gov//govs/local/historical_data_2006.html.

[451] Moreover, nine states lack a broad-based personal income tax and five states lack a general sales tax.

increased their EITC from 6 percent to 9 percent of the federal EITC and raised the state income tax deduction for renters (NCSL, 2009: 19-20) – actions similar to those taken in Maryland. In 2010, Kansas approved a 1 percent sales tax increase (from 5.3 percent to 6.3 percent) for three years as the main element of a 5.1 percent increase in the first-year tax burden (NCSL, 2011a: 8). Kansas officials also coupled the sales tax increase with an EITC increase (from 17 percent to 18 percent of the federal EITC) as well as a larger personal income tax credit for sales taxes paid on food (NCSL, 2011a:18-19).

Although the pairing of a sales tax increase and an EITC increase makes sense from a distributional standpoint, other states that based large tax increases on the personal income tax also included sweeteners to reduce some of the pain of higher taxes. Connecticut's 2009 tax increase, estimated to increase the tax burden by 6 percent in its first year (NCSL, 2010b: 7), created a new top personal income tax bracket with a 6.5 percent rate, imposed a 10 percent corporate income tax surcharge on businesses with more than $100 million in federal adjusted gross income, and raised the cigarette tax from $2 to $3 per pack, while increasing the thresholds for estate tax liability and promising a reduction in the sales tax from 6 percent to 5.5 percent if revenue targets were met (NCSL, 2010b: 14-15).

Not all major tax increases imposed by states in recent years have included offsets to mitigate the most damaging political or economic effects. Illinois Governor Pat Quinn's tax increase package, described earlier, initially included a proposal to triple the personal exemption from $2,000 to $6,000, which Quinn claimed would result in tax relief for 5 million people, but the personal exemption increase was not part of the tax package ultimately enacted in 2011 (Bunch, 2010, 119; NCSL, 2012: 24-25). Other states took the strategy of spreading out tax increases to an extreme, in what could be called a "kitchen sink" approach.[452]

Tax Policy Outcomes. The patterns in state tax policymaking discussed previously – those apparent in the case study states and those evident in national data – support the conclusion that there are sharp asymmetries in state tax actions. Modest tax cuts are offered on an almost continuous basis, while tax increases are clustered in times of economic distress (the pattern of "punctuated incrementalism" described earlier). As posited by Steven Gold, state tax policy decisions seem to swing from cutting tax rates and expanding tax incentives when the economy is strong and surpluses accrue, to increasing tax rates and patching holes in the tax base when the economy falters and budget gaps appear. Amidst these swings, the longer-term issues of revenue capacity, efficiency, and equity are often overlooked. Core, broad-based taxes with the strongest revenue capacity are more likely to be cut, while non-core, narrow-based sin and health care taxes are more likely to be raised. Even in the worst fiscal times, tax expenditures that reduce both efficiency and equity, while raising the costs of tax administration, are barely scrutinized, and the quiet erosion of the tax base due to the growth of services, the rise of electronic commerce, the mobility of capital, and the aging of the population

---

[452] In 2009, for example, New York State enacted a net tax increase estimated at 10.6 percent by raising top personal income tax rates, limiting itemized deductions for high-income taxpayers, expanding the sales tax base, increasing taxes on cigars and other non-cigarette tobacco taxes, raising beer and wine taxes, raising the hospital assessment tax, and changing the definition of nexus to include Internet companies with a brick-and-mortar affiliate in the state. The same year, Wisconsin took a similar approach in increasing taxes by an estimated 5.8 percent, including actions to raise the top personal income tax rate, reduce the capital gains exclusion, require combined reporting of corporate income, expand taxation of computer software, broaden the definition of nexus for sales taxation, boost taxes on cigarettes and other tobacco products, impose a new hospital assessment, and establish a tax on telephone service. See National Conference of State Legislatures, *State Tax Actions: 2009* (Denver: National Conference of State Legislatures, 2010), pp. 7, 26-28, 37-39).

(Pattison and Willoughby, 2015: 8; Mikesell, 2015: 50) goes largely unaddressed. As stated by economist John Mikesell:

> The productive parts of state revenue systems were installed typically in the 1960s or before, when the economic structure and social environment were much different than today. State tax systems continue to yield growing revenue, except during recessions, but there have been few dramatic changes in the systems in the last half century. While there have been many state tax reform and restructuring movements over the past decade, their practical impact has been minimal overall. The appropriate tax policy direction in these efforts has usually been clear, but political will to improve has been lacking. Future restructuring of state tax systems will require both." (Mikesell, 2015: 50)

Implications for Other Levels of Government. Although it seemed possible that this case study of tax policy decisions in three states might generate ideas or theoretical frameworks that could apply to other levels of American government, that hope was unrealistic. The political institutions and tax systems of the federal and local governments seem much too different from those of the states to suggest findings that might be relevant to other levels of government. As noted earlier, local governments depend much more heavily on one source of tax revenue, the real property tax, than state governments do; therefore, the dynamics of tax policy choice are much different at the county, city, and township level. The federal government has been characterized by a level of political gridlock, in which budget and program decisions are often made at the last possible moment, when they are made at all, that seems to exceed the partisan discord and stalemate that has increasingly flared up at the state level. Regular order – the consideration and enactment of bills in an orderly, predictable process involving review by committees, floor debate and amendments, conference committee negotiations, and approval by both chambers of a House-Senate compromise – has all but collapsed

(Gleckman, 2013), replaced by the use of massive omnibus appropriation and tax-extender bills crafted by legislative leaders in negotiations with the executive branch and repeated, short-term budget and program extensions.[453]

In interviews, several participants in Virginia's tax policy process compared the discord between Democratic Governor Tim Kaine and the Republican-controlled House of Delegates from 2006 to 2010 to the battles between President Obama and the Republican majority in the U.S. House of Representatives from 2011 through 2014. In both cases, taxes were a main point of contention; both Democratic chief executives advocated several tax increases while the Virginia and U.S. houses were staunchly opposed. Even so, Governor Kaine and the Virginia General Assembly still reached agreement on a number of major tax issues, including raising income tax filing thresholds in 2007, approving economic development incentives for data centers and the spaceflight industry in 2008, and closing a corporate tax loophole (the captive REIT loophole) in 2009. Similar actions were not apparent at the federal level (for example, in 2014 the president and congress could not agree on how to address "corporate inversions," a tax avoidance strategy in which an American firm would merge with a larger foreign company and establish a new corporate address overseas), suggesting that federal tax policy outcomes (or the lack thereof) result from very specific, distinct factors that differ from those in the states.

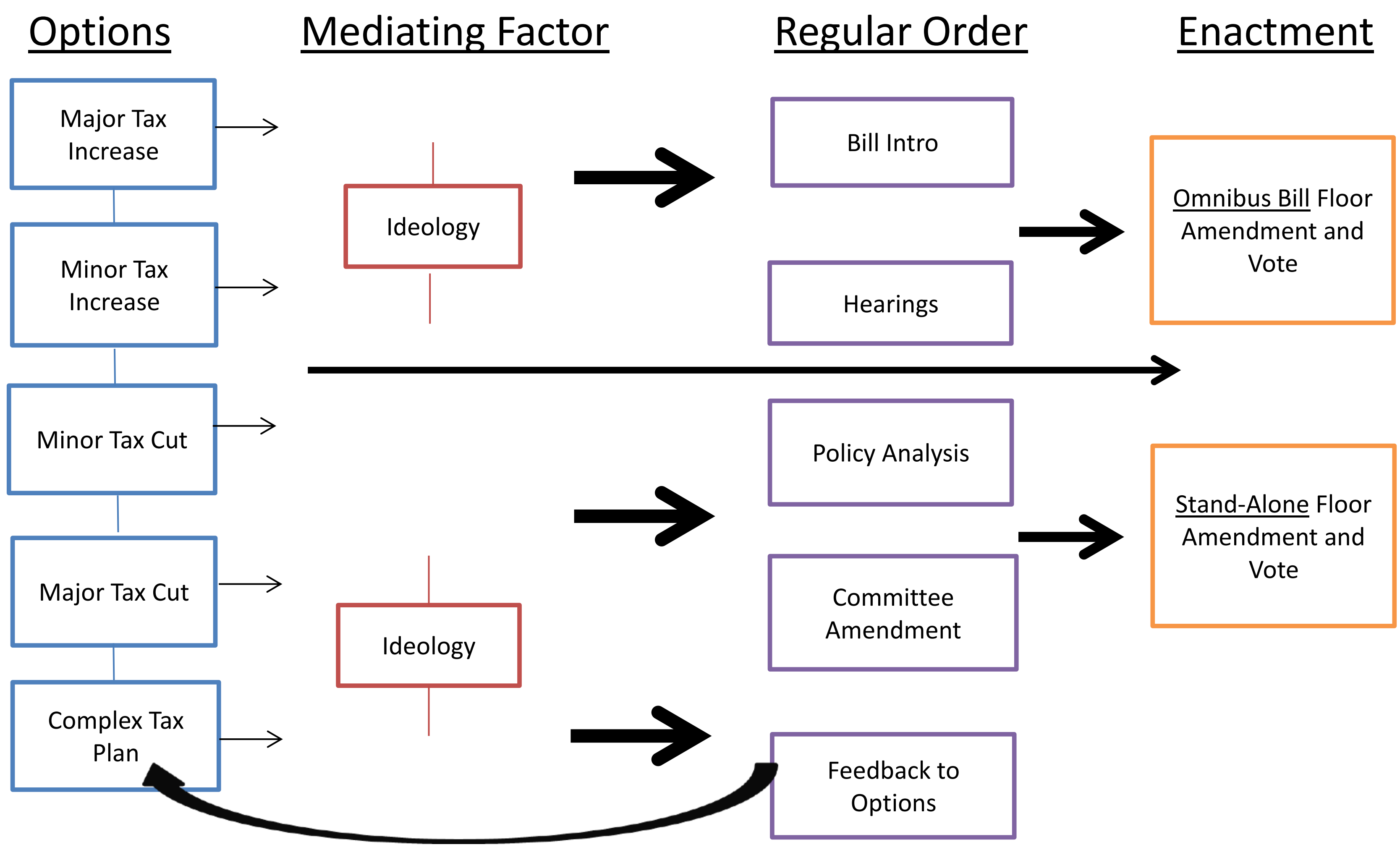
[453] One of the most prominent tax policy examples is the "fiscal cliff" negotiations of 2012, when the president and congress did not reach agreement until New Year's Eve on whether to extend all, part, or none of the tax cuts that were enacted under President George W. Bush and due to expire on that day (December 31, 2012) . Another example concerns the 50 or so "tax extenders" – temporary tax breaks that congress has repeatedly reauthorized for one- or two-year periods – that expired on January 1, 2014, but were retroactively extended by congress for one year in December 2014, just two weeks before the extenders would expire once again.

Directions for Future Research

The case studies and the cross-case analysis suggest a number of directions for future research to test and expand on the findings outlined in this chapter. With regard to *agenda-setting and the development of tax policy options*, more in-depth study of the processes that states use to generate and refine tax policy options is needed in light of the significant differences between D.C., Maryland, and Virginia shown in the case studies. Figure 7.3 (see next page) displays two prototypical paths for tax policy options – a process of "regular order" in which options are reviewed and subject to public input in a deliberative, step-by-step manner, as well as a fast-track process in which options bypass public hearings and committee review and are fashioned by the leadership on the "floor" of the legislature – but most state tax policy processes fall between these extremes. The roles of state government agencies, advocacy groups, and academics in generating tax policy options; the types of analyses that are performed (such as distributional studies); the institutional capacity of executive budget and tax offices; and the roles of legislative fiscal offices and finance committees all merit further exploration to better understand the breadth of tax policy options in the states and the ways they are scrutinized.

With regard to *evaluating and selecting tax policy options*, there is a considerable body of research on state budget and tax rules, such as the impact of line-item vetoes, supermajority requirements, and tax and expenditure limits, but less is known about other institutional processes such as the way that annual budget bills are used to make tax policy and the relative roles of the party leadership and the tax committees in state legislatures. These factors varied in the case study states and affected tax policy outcomes; for example, D.C.'s massive annual budget bills served as a vehicle to enact

Figure 7.3
Model of the Tax Policy Process



numerous tax breaks for single properties, projects, and organizations, whereas Maryland and Virginia did not use their annual budget bills that way. Finally, two strategies used to facilitate enactment of tax increases – earmarking and inserting tax benefits (sweeteners) to mitigate the most harmful economic or political impacts – deserve further examination. Some evidence from the case studies suggests that after earmarks are used to help enact tax increases, restrictions on the use of revenue are gradually eased, often during a fiscal crisis, and the long-run effect may be to bolster the unrestricted part of the general fund.

With regard to *tax policy outcomes*, the role and limits of parity standards in selecting tax policy options deserve further examination. A key question is whether selective parity results in a mirroring effect, as states try to match the rates of competitors and regress to the mean, or a "bootstrapping" effect as states exploit comparisons with higher-tax neighbors to increase rates gradually over time. There is some evidence that a bootstrapping pattern applies to sales taxes, which rose from a median rate of 3 percent in 1970 to 5.5 percent in 2007 (Mikesell, 2007: 631). A closely-related question is how states position themselves on a spectrum of high-tax/high-service states to low-tax/low-service states (and other combinations): do states tend to stay in the same place on that spectrum and how is the distribution of state tax and service levels changing over time?

In exploring these questions, quantitative studies including all 50 states as well as qualitative case studies will be needed. As stated by one scholar, "The single- and multi-state case study approaches have a strong logical basis as appropriate models of analysis. These approaches could provide studies which utilize more appropriate data, incorporate context, and allow us to address questions that are virtually impossible to pursue with the quantitative 50-state mode of analysis." (Stonecash, 1996: 570).

References

Adam, S., & Kriesi, H. (2007). "The network approach.". In P. A. Sabatier (Ed.), *Theories of the policy process.* (Second ed., pp. 129-154). Boulder, CO: Westview Press.

Advisory Commission on Intergovernmental Relations. (1995). *Significant features of fiscal federalism: Budget processes and tax systems, volume 1.* Advisory Commission on Intergovernmental Relations: Washington, D.C.

Anderson, J. E. (2003). *Public policymaking.* (Fifth ed.). Boston: Houghton Mifflin Company.

Auerbach, A. J. (2011). *"Consumption tax options for California.".* Sacramento, CA: Public Policy Institute of California.

Bachrach, P., & Baratz, M. (1962). "The two faces of power.". *American Political Science Review, 56*(4), 947-952.

Bailey, J. J., & O'Connor, R. J. (1975). "Operationalizing incrementalism: Measuring the muddles.". *Public Administration Review, 35*(1), 60-66.

Baumgartner, F. R., & Jones, B. D. (1993). *Agendas and instability in American politics.* Chicago: The University of Chicago Press.

Bell, M. (2012). "Real property tax.". In R. D. Ebel, & J. E. Petersen (Eds.), *The Oxford handbook of state and local government finance.* (pp. 271-299). New York: Oxford University Press.

Bennett, A., & Elman, C. (2006). "Qualitative research: Recent developments in case study methods.". *Annual Review of Political Science, 9*, 455-476.

Berry, F. S., & Berry, W. D. (1992). "Tax innovation in the states: Capitalizing on political opportunity.". *American Journal of Political Science, 36*(3), 715-742.

Berry, F. S., & Berry, W. D. (2007). "Innovation and diffusion models in policy research.". In P. A. Sabatier (Ed.), *Theories of the policy process.* (Second ed., pp. 223-260). Boulder, CO: Westview Press.

Bifulco, R., & Duncombe, W. (2010). "Budget deficits in the states: New York.". *Public Budgeting & Finance, 30*(1), 58-79.

Blackwell, J. R. (2008, December 18, 2008). "Plan Riles Philip Morris.". *Richmond Times-Dispatch*.

Block, F. (2009). "Read their lips: Taxation and the right-wing agenda.". In I. W. Martin, A. Mehrotra & M. Prasad (Eds.), *The new fiscal sociology: Taxation in comparative and historical perspective.* (pp. 68-85). New York: Cambridge University Press.

Board of Revenue Estimates. (2006). *Report on estimated Maryland revenues: Fiscal years ending June 30, 2007 and June 30, 2008.* Annapolis, MD: Maryland Board of Revenue Estimates.

Board of Revenue Estimates. (2008a). *Letter to the Honorable Martin O'Malley, Governor of the State of Maryland.* Annapolis, MD: Board of Revenue Estimates.

Board of Revenue Estimates. (2008b). *Report on estimated Maryland revenues: Fiscal years ending June 30, 2009 and June 30, 2010.* Annapolis, MD: Board of Revenue Estimates.

Board of Revenue Estimates. (2009a). *Letter to the Honorable Martin O'Malley, Governor, State of Maryland*. Annapolis, MD: Board of Revenue Estimates.

Board of Revenue Estimates. (2009b). *Report on estimated Maryland revenues: Fiscal years ending June 30, 2010 and June 30, 2011.* Annapolis, MD: Board of Revenue Estimates.

Bourdeaux, C. (2010). *"A review of state tax reform efforts.".* (Fiscal Research Center Report No. No. 216). Atlanta: Andrew Young School of Policy Studies, Georgia State University.

Bowman, J. H. (1998). "Real property taxation.". In District of Columbia Tax Revision Commission (Ed.), *Taxing simply, taxing fairly: Full report of the District of Columbia Tax Revision Commission.* (pp. 119-201). Washington, D.C.: District of Columbia Tax Revision Commission.

Bowman, J. H. (2002). *Virginia issues: Reforming the individual income tax.* Charlottesville, VA: Weldon Cooper Center for Public Service, University of Virginia.

Boyd, D. J. (2008). *"What will happen to state government finances in a recession?".* (Rockefeller Institute Fiscal Report). Albany, NY: The Nelson A. Rockefeller Institute of Government.

Bruce, D., Fox, W. F., & Tuttle, M. H. (2006). "Tax base elasticities: A multi-state analysis of long-run and short-run dynamics.". *Southern Economic Journal, 73*(2), 315-341.

Brunori, D. (2011a). *State tax policy: A historical perspective.* Washington, D.C.: The Urban Institute Press.

Brunori, D. (2011b). "Smoke 'em if you got 'em, states say.". *State Tax Notes, 60*(April 11, 2011), 109.

Brunori, D. (2012). "State corporate income taxes.". In R. D. Ebel, & J. E. Petersen (Eds.), *Oxford handbook of state and local public finance.* (pp. 333-351). Oxford: Oxford University Press.

Bunch, B. S. (2010). "Budget deficits in the states: Illinois.". *Public Budgeting & Finance, 30*(1), 105-129.

Burman, L. E. (2002, June 14, 2002). "Don't bury the estate tax.". Retrieved from www.taxpolicycenter.org/publications/urlprint.cfm?ID=900761

Buschman, R. (2010). *"A review of state revenue actions, 1999-2010.".* (Fiscal Research Center Report No. No. 217). Atlanta: Andrew Young School of Policy Studies.

Bykowicz, J. (2010a, January 14, 2010). "O'Malley calls for 'moderate' tuition rise.". *The Baltimore Sun*, p. A.1.

Bykowicz, J. (2010b, February 6, 2010). "Business community leery of tax cut.". *The Baltimore Sun*, p. A.2.

Campbell, A. L. (2009). "What Americans think of taxes.". In M. Prasad, I. W. Martin & A. Mehrotra (Eds.), *The new fiscal sociology: Taxation in comparative and historical perspective.* (pp. 48-67). Cambridge, UK: Cambridge University Press.

Carson, L. (2007, November 11, 2007). "2 senators support tax-plan changes.". *The Baltimore Sun*, p. G.1.

Carson, L. (2010, January 3, 2010). "Lawmakers, others resist call to raise alcohol tax.". *The Baltimore Sun*, p. G.3.

Carter, S. B., Gartner, S. S., Haines, M. R., Olmstead, A. L., Sutch, R., & Wright, G. (Eds.). (2006). *Historical statistics of the United States.* (Millennial ed.). Cambridge, UK: Cambridge University Press.

Center on Budget and Policy Priorities. (2014, January 2, 2014). *"Policy basics: State earned income tax credits.".* Washington, D.C.: Center on Budget and Policy Priorities.

Chief Financial Officer. (2007a, February 5, 2007). "Public briefing on the comprehensive annual financial report for FY 2006.": Committee of the Whole, Council of the District of Columbia.

Chief Financial Officer. (2007b, March 23, 2007). *Letter to the Honorable Adrian Fenty, Mayor of the District of Columbia.*

Chief Financial Officer. (2007c, February 28, 2007). *"FY 2008 expenditure baseline budget."* Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman, Council of the District of Columbia.

Chief Financial Officer. (2007d, May 8, 2007). *"Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia*.

Chief Financial Officer. (2008a, February 27, 2008). *"Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia."*

Chief Financial Officer. (2008b, March 20, 2008). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, transmitting the FY 2009 proposed budget and financial plan.*

Chief Financial Officer. (2009a, February 25, 2009). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia.*

Chief Financial Officer. (2009b, June 22, 2009). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia.*

Chief Financial Officer. (2009c, March 20, 2009). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, transmitting the FY 2010 budget and financial plan.*

Chief Financial Officer. (2009d, September 21, 2009). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia.*

Chief Financial Officer. (2009e, December 16, 2009). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia.*

Chief Financial Officer. (2010a, February 24, 2010). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia.*

Chief Financial Officer. (2010b, September 27, 2010). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, and the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia.*

Chief Financial Officer. (2010c, April 1, 2010). *Letter to the Honorable Adrian M. Fenty, Mayor of the District of Columbia, transmitting the FY 2011 budget.*

Clynch, E. J., & Lauth, T. P. (Eds.). (2006). *Budgeting in the states: Institutions, processes, and politics.* Westport, CT: Praeger Publishers.

Commission on Virginia's State and Local Tax Structure for the 21st Century. (2001). *Report to the Governor and the General Assembly of Virginia.* (House Document No. 22). Richmond, VA: Commonwealth of Virginia.

Committee on Finance and Revenue. (2007a, May 4, 2007). *"Report and committee recommendations on the fiscal year 2008 budget.".* Washington, D.C.: Council of the District of Columbia.

Committee on Finance and Revenue. (2007b, December 6, 2007). *"Report on Bill 17-20, the 'Small Business Commercial Property Tax Relief Act of 2007.'".* Washington, D.C.: Council of the District of Columbia.

Committee on Finance and Revenue. (2007c, December 6, 2007). *Report on Bill 17-86, the "Nuisance Properties Abatement Reform and Real Property Classification Amendment Act of 2007.".* Washington, D.C.: Council of the District of Columbia.

Committee on Finance and Revenue. (2009, April 28, 2009). *"Report and recommendations of the Committee on Finance and Revenue on the fiscal year 2010 budget request and budget support act for agencies under its purview.".* Washington, D.C.: Council of the District of Columbia.

Committee on Finance and Revenue. (2010a, May 13, 2010). *"Final report and recommendations of the Committee on Finance and Revenue on the fiscal year 2011 budget request and budget support act for agencies under its purview.".* Washington, D.C.: Council of the District of Columbia.

Committee on Finance and Revenue. (2010b, December 6, 2010). *"Report on Bill 18-969, the 'Adams Morgan Hotel Real Property Tax Abatement Act of 2010.'".* Washington, D.C.: Council of the District of Columbia.

Committee on Finance and Revenue. (2010c, July 12, 2010). *"Report on Bill 18-220, the 'Union Station Redevelopment Corporation Payment in Lieu of Taxes Act of 2010.'".* Washington, D.C.: Council of the District of Columbia.

Committee on Government Operations and the Environment. (2009, May 14, 2009). *"Report on Bill 18-150, the 'Anacostia River Clean Up and Protection Act of 2009."*. Washington, D.C.: Council of the District of Columbia.

Committee on Public Services and Consumer Affairs. (2007, September 25, 2007). *Report on Bill 17-86, the "Nuisance Properties Abatement Reform and Real Property Classification Amendment Act of 2007."*. Washington, D.C.: Council of the District of Columbia.

Committee on Public Services and Consumer Affairs. (2008). *Report on Bill 17-86, the "Nuisance Properties Abatement Reform and Real Property Classification Amendment Act of 2008."*. Washington, D.C.: Council of the District of Columbia.

Committee on Public Services and Consumer Affairs. (2010, May 13, 2010). *"Report and recommendations of the Committee on Public Services and Consumer Affairs on the fiscal year 2011 budget for agencies under its purview (draft)."*. Washington, D.C.: Committee on Public Services and Consumer Affairs.

Commonwealth of Virginia. (2006). *Executive amendments to the 2006-2008 budget.* Richmond, VA: Office of the Governor.

Commonwealth of Virginia. (2007). *Executive biennial budget, 2008-2010; amendments to the 2007 appropriations act.* Richmond, VA: Office of the Governor.

Commonwealth of Virginia. (2008a). Governor Kaine's recommended budget reductions to the General Assembly for fiscal years 2008, 2009, 2010. Richmond, VA: Commonwealth of Virginia.

Commonwealth of Virginia. (2008b). *Executive amendments to the 2008-2010 biennial budget.* Richmond, VA: Commonwealth of Virginia.

Commonwealth of Virginia. (2009). *Executive biennial budget, 2008-2012; amendments to the 2009 appropriation act.* Richmond, VA: Office of the Governor.

Comptroller of Maryland. (2007). *Letter to the Honorable Martin O'Malley, Governor of Maryland; the Honorable Thomas V. "Mike" Miller, Jr., President, Senate of Maryland; and the Honorable Michael E. Busch, Speaker, Maryland House of Delegates, regarding preliminary general fund revenue estimates.* Annapolis, MD: Comptroller of Maryland.

Comptroller of Maryland. (2012). *"Local income tax rates."*. Annapolis, MD: Comptroller of Maryland.

Conant, J. K. (2006a). "Virginia: Expenditure increases, tax cuts, and budget deficits.". In E. J. Clynch, & T. P. Lauth (Eds.), *Budgeting in the states: Institutions, processes, and politics.* (pp. 213-233). Westport, CT: Praeger Publishers.

Conant, J. K. (2006b). "Wisconsin: Institutions, processes, and policies.". In E. J. Clynch, & T. P. Lauth (Eds.), *Budgeting in the states: Institutions, processes, and politics.* (pp. 235-255). Westport, CT: Praeger Publishers.

Conant, J. K. (2010). "Budget deficits in the states: Virginia.". *Public Finance and Budgeting, 30*(1), 33-57.

Cordes, J. J., & Juffras, J. N. (2012). "State personal income taxes.". In R. D. Ebel, & J. E. Petersen (Eds.), *Oxford handbook of state and local public finance.* (pp. 300-332). Oxford: Oxford University Press.

Cordes, J. J., & Watson, H. S. (1998). "Business franchise and insurance taxes in the D.C. tax system.". In District of Columbia Tax Revision Commission (Ed.), *Taxing simply, taxing fairly: Full report of the District of Columbia Tax Revision Commission.* (pp. 381-441). Washington, D.C.: District of Columbia Tax Revision Commission.

Council Chairman Vincent C. Gray. (2009, July 20, 2009). *"Opening statement of Council Chairman Vincent C. Gray," Committee of the Whole public briefing on fiscal year 2009 and 2010 budget gap-closing.* Washington, D.C.: Council of the District of Columbia.

Council Chairman Vincent C. Gray. (2010, May 7, 2010). *"Opening remarks on the fiscal year 2011 budget support act," Committee of the Whole public hearing on Bill 18-731, the "Fiscal Year 2011 Budget Support Act of 2010."* Washington, D.C.: Council of the District of Columbia.

Craig, T. (2006, December 16, 2006). "Kaine budget seeks an added $1 billion.". *The Washington Post*, p. B.1.

Craig, T. (2007a, April 4, 2007). "Va. transportation bill on verge of approval.". *The Washington Post*, p. B.1.

Craig, T. (2007b, April 6, 2007). "Major tax hike not on Kaine's agenda.". *The Washington Post*, p. B.6.

Craig, T. (2008a, January 15, 2008). "Governor wants car tax hike weighed; raising sales levy would help fund Va. road repairs.". *The Washington Post*, p. B.1.

Craig, T. (2008b, January 19, 2008). "Senate leader to push for increase in gas tax.". *The Washington Post*, p. B.3.

Craig, T. (2008c, June 19, 2008). "Getting ready for a bumpy ride on transportation.". *The Washington Post*, p. T.3.

Craig, T. (2008d, April 30, 2008). "Kaine may float gas-tax increase to offset shortfall.". *The Washington Post*, p. B.6.

Craig, T. (2008e, May 15, 2008). "Governor's road proposals have Va. democrats feuding.". *The Washington Post*

Craig, T. (2008f, July 8, 2008). "Regional tax idea a flop in N. Va.". *The Washington Post*, p. B.1.

Craig, T. (2009a, July 29, 2009). "Money woes stir debate over area's tax burdens.". *The Washington Post.*

Craig, T. (2009b, July 30, 2009). "Higher taxes in District likely: Tentative approval given to sales, gas, and cigarette rates.". *The Washington Post.*

Craig, T. (2009c, November 4, 2009). "Republicans appear to gain 5 seats, reverse trends in outer D.C. suburbs.". *The Washington Post.*

Craig, T. (2010a, May 26, 2010). "Shadow of politics hangs over D.C. budget as Fenty tangles with council members.". *The Washington Post*, p. B01.

Craig, T. (2010b, April 29, 2010). "Tax increases on D.C. Council agenda.". *The Washington Post*, p. B1.

Craig, T., & Kumar, A. (2008, June 24, 2008). "House is already rebuffing Kaine.". *The Washington Post*, p. B.1.

Craig, T., & Stewart, N. (2009, August 1, 2009). "D.C. Council approves tax hikes, spending cuts.". *The Washington Post.*

Creswell, J. W. (2014). *Research design: Qualitative, quantitative, and mixed methods approaches.* (Fourth ed.). Thousand Oaks, CA: Sage Publications, Inc.

D.C. Fiscal Policy Institute. (2007, February 1, 2007). *"Meeting D.C.'s challenges, maintaining fiscal discipline: Creating a healthy and progressive tax structure.".* Washington, D.C.: D.C. Fiscal Policy Institute.

D.C. Fiscal Policy Institute. (2008, January 3, 2008). *"Hiding the costs of business tax cuts: Bill 17-20 could lead to substantial tax cuts, but was designed to appear to have no effect on D.C. finances.".* Washington, D.C.: D.C. Fiscal Policy Institute.

D.C. Fiscal Policy Institute. (2009, July 7, 2009). *"Principles to guide efforts to address D.C.'s revenue shortfall.".* Washington, D.C.: D.C. Fiscal Policy Institute.

D.C. Fiscal Policy Institute. (2010, September 20, 2010). *"Giving away the station: Tax break for Union Station would cost city tens of millions in revenue."*. Washington, D.C.: D.C. Fiscal Policy Institute.

Davis, A. (2010, January 22, 2010). "O'Malley puts 'economic recovery' ahead of taxes.". *The Washington Post.*

Davis, O. A., Dempster, M. A. H., & Wildavsky, A. (1966). "A theory of the budgetary process.". *The American Political Science Review, 60*(3), 529-547.

Dechter, G. (2008a, January 5, 2008). "Tech tax resistance builds.". *The Baltimore Sun*, p. B.1.

Dechter, G. (2008b, February 22, 2008). "New tax stirs up threats to move.". *The Baltimore Sun*, p. A.1.

Dechter, G. (2008c, March 13, 2008). "New tax on top earners backed.". *The Baltimore Sun*, p. A.1.

Dechter, G. (2009a, January 11, 2009). "Tough choices. Q&A: Amid a nationwide economic slump, Maryland's powerful legislative leaders discuss the hard decisions facing this year's General Assembly, which starts Wednesday; Michael E. Busch; Speaker of the House.". *The Baltimore Sun*, p. B.1.

Dechter, G. (2009b, January 11, 2009). "Tough choices. Q&A: Amid a nationwide economic slump, Maryland's powerful legislative leaders discuss the hard decisions facing this year's General Assembly, which starts Wednesday; Thomas V. Mike Miller; Senate President.". *The Baltimore Sun*, p. B.1.

Dechter, G., & Olson, B. (2008, March 14, 2008). "O'Malley backs tech tax repeal.". *The Baltimore Sun*, p. A.1.

Delegate Lacey E. Putney. (2010). *"Floor comments: Conference report, House Bills 29 and 30."*. Richmond, VA: House Committee on Appropriations.

Department of Budget and Management. (2007). *Maryland budget highlights: FY 2008.* Annapolis, MD: Department of Budget and Management.

Department of Budget and Management. (2008). *Maryland budget highlights: FY 2009.* Annapolis, MD: Department of Budget and Management.

Department of Budget and Management. (2009). *Maryland budget highlights: FY 2010.* Annapolis, MD: Department of Budget and Management.

Department of Budget and Management. (2010a). *Maryland budget highlights: FY 2011.* Annapolis, MD: Department of Budget and Management.

Department of Budget and Management. (2010b). *Maryland tax expenditures report: Fiscal year 2010.* Annapolis, MD: Department of Budget and Management.

Department of Legislative Services. (2006). *Issue papers: 2007 legislative session.* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007a). *"Fiscal briefing.".* Annapolis, Maryland: Maryland Department of Legislative Services.

Department of Legislative Services. (2007b, January 10-12, 2007). *"The legislative wrap-up.".* (Issue 07-1). Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007c). *"Overview of Maryland's revenue structure: Presentation to the Senate Budget and Taxation Committee.".* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007d, April 2007). *"The legislative wrap-up.".* (Issue 07-14). Annapolis, MD: Maryland Department of Legislative Services.

Department of Legislative Services. (2007e, March 28, 2007). *"Fiscal and policy note (revised), House Bill 754.".* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007f, March 27, 2007). *"Fiscal and policy note (revised), House Bill 475.".* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007g, February 25, 2007). *"Fiscal and policy note, House Bill 393.".* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007h, March 11, 2007). *"Fiscal and policy note, House Bill 846.".* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007i, March 27, 2007). *"Fiscal and policy note, Senate Bill 949 821.".* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007j, March 11, 2007). *"Fiscal and policy note, House Bill 821.".* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007k, March 11, 2007). *"Fiscal and policy note, House Bill 761.".* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007l, April 25, 2007). *"Fiscal and policy note (revised), Senate Bill 101.".* Annapolis, MD: Maryland General Assembly.

Department of Legislative Services. (2007m, March 27, 2007). *"Fiscal and policy note (revised), House Bill 1257."*. Annapolis, MD: Maryland General Assembly.

Department of Legislative Services. (2007n, March 27, 2007). *"Fiscal and policy note (revised), House Bill 598."*. Annapolis, MD: Maryland General Assembly.

Department of Legislative Services. (2007o, June 27, 2007). *"Maryland's fiscal structure and the deficit within." Presentation to the Senate Budget and Taxation Committee, House Committee on Appropriations, and House Committee on Ways and Means.* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007p, June 27, 2007). *"Balancing the budget without new revenues." Presentation to the Senate Budget and Taxation Committee, House Committee on Appropriations, and House Committee on Ways and Means.* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007q, November 2, 2007). *"Fiscal summary of administration's proposals: 2007 special session."*. Annapolis, MD: Department of Legislative Services,.

Department of Legislative Services. (2007r, October 30, 2007). *"Fiscal and policy note: House Bill 2."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007s, November 13, 2007). *"Fiscal and policy note, Senate Bill 2."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007t, November 10, 2007). *"Summary of administration's proposals as amended by the House Ways and Means and Appropriations Committees: 2007 special session."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007u, December 4, 2007). *"Fiscal and policy note (revised), House Bill 5."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2007v). *Issue papers: 2008 legislative session.* Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2008a, January 21, 2008). *"Fiscal briefing."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2008b, January 31, 2008). *"Fiscal and policy note: House Bill 187."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2008c, March 10, 2008). *"Fiscal and policy note: Senate Bill 567."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2008d. March 11, 2008). *"Fiscal and policy note: Senate Bill 1004."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2008e, April 4, 2008). *"Fiscal and policy note (revised), Senate Bill 46."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2008f, March 20, 2008). *"Fiscal and policy note (revised): House Bill 366."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2008g, May 16, 2008). *"Fiscal and policy note (revised), Senate Bill 206."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2009a, January 26, 2009). *"Fiscal briefing."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2009b, January 2009). *"Quick look at the fiscal 2010 budget."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2009c, April 11, 2009). *"Conference committee: Report on House Bill 100 -- the budget bill, report on House Bill 101 -- the budget reconciliation and financing act."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2009d, July 29, 2009). *"Fiscal and policy note (revised): House Bill 101."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2009e, February 25, 2009). *"Fiscal and policy note, Senate Bill 275."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2009f, March 3, 2009). *"Fiscal and policy note: Senate Bill 258."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010a). *Maryland's budget process: Legislative handbook series, volume IV*. Annapolis, MD: Maryland Department of Legislative Services.

Department of Legislative Services. (2010b, January 2010). *"Quick look at the fiscal 2011 budget."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010c, February 2010). *"Fiscal briefing."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010d, March 4, 2010). *"Fiscal and policy note: House Bill 151."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010e, April 9, 2010). *"Conference committee: Report on Senate Bill 140 -- the budget bill, and Senate Bill 141 -- the budget reconciliation and financing act."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010f, March 9, 2010). *"Fiscal and policy note: Senate Bill 717."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010g, May 20, 2010). *"Fiscal and policy note (revised): House Bill 464."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010h, May 20, 2010). *"Fiscal and policy note (revised): House Bill 469."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010i, March 1, 2010). *"Fiscal and policy note: Senate Bill 385."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010j, January 26, 2010). *"Fiscal and policy note: Senate Bill 64."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2010k, May 20, 2010). *"Fiscal and policy note: Senate Bill 106."*. Annapolis, MD: Department of Legislative Services.

Department of Legislative Services. (2014). *Evaluation of the Maryland film production tax credit (draft).* Annapolis, MD: Department of Legislative Services.

Department of Medical Assistance Services. (2009, January 16, 2009). *"Overview of DMAS budget provisions, introduced budget: Presentation to the House Appropriations Committee."*. Richmond, VA: Department of Medical Assistance Services.

Department of Planning and Budget. (2007, March 19, 2007). *"2007 fiscal impact statement: HB 3202."*. Richmond, VA: Department of Planning and Budget.

Department of Planning and Budget. (2008a, June 24, 2008). *"2008 special session II fiscal impact statement: HB 6006."*. Richmond, VA: Department of Planning and Budget.

Department of Planning and Budget. (2008b, January 29, 2008). *"2008 fiscal impact statement: SB 713."*. Richmond, VA: Department of Planning and Budget.

Department of Planning and Budget. (2008c, February 21, 2008). *"2008 fiscal impact statement: SB 597."*. Richmond, VA: Department of Planning and Budget.

Department of Planning and Budget. (2008d, March 10, 2008). *"2008 fiscal impact statement: SB 291."*. Richmond, VA: Department of Planning and Budget.

Department of Planning and Budget. (2008e, June 23, 2008). *"2008 special session II fiscal impact statement: SB 6009."*. Richmond, VA: Department of Planning and Budget.

Department of Planning and Budget. (2010, January 22, 2010). *"2010 fiscal impact statement: SB 343."*. Richmond, VA: Department of Planning and Budget.

Department of Taxation. (2006, November 20, 2006). *"The economic outlook and revenue forecast through fiscal year 2010."*. (Governor's Confidential Working Papers). Richmond, VA: Department of Taxation.

Department of Taxation. (2007, February 27, 2007). *"2007 fiscal impact statement: SB 1167."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2008a, January 18, 2008). *"2008 fiscal impact statement: HB 975."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2008b, February 8, 2008). *"2008 fiscal impact statement: SB 582."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2008c, March 5, 2008). *"2008 fiscal impact statement: HB 1388."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2009a, February 23, 2009). *"2009 fiscal impact statement: HB 2437."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2009b, January 25, 2009). *"2009 fiscal impact statement: HB 2376."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2009c, January 25, 2009). *"2009 fiscal impact statement: SB 1133."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2009d, January 25, 2009). *"2009 fiscal impact statement: HB 1895."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2009e, January 29, 2009). *"2009 fiscal impact statement: HB 2588."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2009f, February 13, 2009). *"Fiscal impact statement: HB 1891."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2009g, February 24, 2009). *"2009 fiscal impact statement: HB 2504."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2009h, February 20, 2009). *"2009 fiscal impact statement: SB 1421.."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2010a, January 19, 2010). *"2010 fiscal impact statement: HB 1155."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2010b, February 12, 2010). *"2010 fiscal impact statement: SB 452."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2010c, February 18, 2010). *"2010 fiscal impact statement: SB 660."*. Richmond, VA: Department of Taxation.

Department of Taxation. (2010d, February 12, 2010). *"2010 fiscal impact statement: HB 119."*. Richmond, VA: Department of Taxation.

Director of Planning and Budget. (2006). *"Governor Kaine's proposed amendments to the 2006-2008 biennial budget. A briefing for the Senate Finance Committee, the House Appropriations Committee, and the House Finance Committee."*. Richmond, VA: Department of Planning and Budget.

Director of Planning and Budget. (2007). *"Overview of the governor's budget reduction plan: Presentation to the House Appropriations Committee."*. Richmond, VA: Department of Planning and Budget.

Director of Planning and Budget. (2008). *"Governor Kaine's proposed amendments to the 2008-2010 biennial budget."*. (A Briefing for the Joint Meeting of the Senate Finance Committee, House Appropriations Committee, and the House Finance Committee). Richmond, VA: Department of Planning and Budget.

Director of Planning and Budget. (2009). *"Governor Kaine's proposed amendments to the 2008-2010 biennial budget and Governor Kaine's proposed budget for the 2010-2012 biennium."*. Richmond, VA: Department of Planning and Budget.

District of Columbia Tax Revision Commission. (1998). *Taxing simply, taxing fairly: Summary report to the Mayor and Council of the District of Columbia.* Washington, D.C.: District of Columbia Tax Revision Commission.

Division of Legislative Services. (2006). *"2007 session: General Assembly issues."*. (Virginia Legislative Issue Brief No. 45). Richmond, VA: Division of Legislative Services.

Division of Legislative Services. (2007). *"2008 session: General Assembly issues."*. (Virginia Legislative Issue Brief No. 47). Richmond, VA: Division of Legislative Services.

Division of Legislative Services. (2010). *A legislator's guide to taxation in Virginia. Volume 1: State taxes.* Richmond, VA: Division of Legislative Services.

Dougherty, M. J., & Klase, K. A. (2009). "Fiscal retrenchment in state budgeting: Revisiting cutback management in a new era.". *International Journal of Public Administration, 32*(7), 593-619.

Drucker, J. (2007, February 1, 2007). "Wal-mart cuts taxes by paying rent to itself.". *The Wall Street Journal*

Du, D., & Lazere, E. (February 25, 2008). *"D.C.'s high-tech tax incentives are not working: Proposal to expand tax breaks for high-technology businesses has little merit."*. Washington, D.C.: D.C. Fiscal Policy Institute.

Ebel, R.D., & Newman, S.H. (2007, February 7, 2007). Testimony on Bill 17-20, the "Commercial Real Property Tax Credit Act of 2007," before the Committee on Finance and Revenue, Council of the District of Columbia.

Ebel, R. D., Petersen, J. E., & Vu, H. T. T. (2012). "Introduction: State and local government finance in the United States.". In R. D. Ebel, & J. E. Petersen (Eds.), *The Oxford handbook of state and local government finance.* (pp. 1-41). Oxford: Oxford University Press.

Ebel, R. D., & Rubin, M. M. (2015). "A vision of the future sustainability of the states.". In M. M. Rubin, & K. G. Willoughby (Eds.), *Sustaining the states: The fiscal viability of American state governments.* (pp. 287-298). Boca Raton, FL: CRC Press.

Federation of Tax Administrators. (2014). "Cigarette tax increases: 2000 - 2014.". Retrieved from www.taxadmin.org

Feldstein, M. (2010, July 20, 2010). "The 'tax expenditure solution for our national debt.". *The Wall Street Journal.*

Felix, R. A. (2008). "The growth and volatility of state tax revenue sources in the tenth district.". *Federal Reserve Bank of Kansas City Economic Review,* (Third Quarter), 63-88.

Finegold, K., Schardin, S., & Steinbach, R. (2003). *"How are states responding to fiscal stress?"*. Washington, D.C.: The Urban Institute.

Fox, W. F. (2012). "Retail sales and use taxation.". In R. D. Ebel, & J. E. Petersen (Eds.), *The Oxford handbook of state and local public finance.* (pp. 406-428). Oxford: Oxford University Press.

Fox, W. F. (2013). *"Sales taxes in the District of Columbia."*. Washington, D.C.: D.C. Tax Revision Commission.

Friedman, B. (2010, October 7, 2010). Testimony on Bill 18-969, the "Adams Morgan Hotel Real Property Tax Abatement Act of 2010,'" before the Committee on Finance and Revenue, Council of the District of Columbia.

Gardner, A. (2007, March 27, 2007). "Kaine's road plan increases borrowing.". *The Washington Post*, p. A.1.

Gardner, A., & Craig, T. (2006, September 29, 2006). "Va. transportation funding talks die.". *The Washington Post*, p. A.1.

Gist, J. R. (1974). "Mandatory expenditures and the defense sector: Theory of budgetary incrementalism.". *Sage professional papers in American politics.* (pp. 6-11). London: Sage Publications.

Gleckman, H. (2013, March 25, 2013). "Congress has not passed a 2014 budget, and probably won't.". Retrieved from www.taxpolicycenter.org

Gold, S. D. (1996). "State tax cuts of 1995: Is something new afoot?". *Public Budgeting & Finance, 16*(1), 3-22.

Government of the District of Columbia. (2007a). *Economic report of the District of Columbia: A fiscal perspective.* Washington, DC: Government of the District of Columbia.

Government of the District of Columbia. (2007b). *Comprehensive annual financial report: Year ended September 30, 2006.* Washington, D.C.: Office of the Chief Financial Officer.

Government of the District of Columbia. (2007c, March 23, 2007). *FY 2008 proposed budget and financial plan: Moving forward faster.* (Volume 1, Executive Summary). Washington, D.C.: Government of the District of Columbia.

Government of the District of Columbia. (2008, March 20, 2008). *FY 2009 proposed budget and financial plan: Getting the job done. Volume 1, executive summary.* Washington, D.C.: District of Columbia Government.

Government of the District of Columbia. (2009, March 20, 2009). *FY 2010 proposed budget and financial plan: Meeting the challenge. Volume 1, executive summary.* Washington, D.C.: Government of the District of Columbia.

Government of the District of Columbia. (2010, April 1, 2010). *FY 2011 proposed budget and financial plan: Maximizing efficiency. Volume 1, executive summary.* Washington, D.C.: Government of the District of Columbia.

Governor Martin O'Malley (2007a, January 19, 2007). *"Letter to the Honorable Thomas V. "Mike" Miller, President, The Senate of Maryland, and The Honorable Michael E. Busch, Speaker, the Maryland House of Delegates.".* Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007b, September 20, 2007). *"Governor O'Malley announces plan to cut Maryland property taxes by 3 cents."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007c, January 18, 2007). *"O'Malley introduces FY '08 budget."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007d, May 10, 2007). *"Governor directs cabinet to make $200 million in cuts."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007e, August 18, 2007). *"Maryland association of counties keynote."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007f, September 27, 2007). *"Governor O'Malley presents comprehensive solution to the state's structural deficit."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007g, October 15, 2007). *"Proclamation convening the General Assembly of Maryland in extraordinary session at Annapolis, Maryland on October 29, 2007."* (Executive Order 01.01.2007.23). Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007h, September 24, 2007). *"Governor O'Malley announces plan to invest in higher education and transportation."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007i, September 19, 2007). *"Governor O'Malley announces plan to reform Maryland's income tax structure."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007j, September 21, 2007). *"Governor O'Malley announces plan to close corporate loopholes."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2007k, November 19, 2007). *"Governor O'Malley signs legislation to secure Maryland's future; closes $1.7 billion structural deficit."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2008, January 21, 2008). *"Governor O'Malley introduces 2008 legislative agenda."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley (2009a, February 20, 2009). *"Governor Martin O'Malley announces plan to fully fund Maryland schools."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2009b, December 16, 2009). *"Statement from Governor Martin O'Malley on Board of Revenue Estimates budget projections."*. Annapolis, MD: Office of the Governor.

Governor Martin O'Malley. (2010, March 3, 2010). *Letter to the Honorable Ulysses Currie, Chairman, Senate Budget and Taxation Committee, re "Senate Bill 385 -- Building Opportunities for All Students and Teachers in Maryland (BOAST) Tax Credit."*. Annapolis, MD: Office of the Governor.

Governor Robert McDonnell. (2009, December 18, 2009). *"Statement of Governor-elect Bob McDonnell on Governor Kaine's proposed budget."*. Richmond, VA: Office of Governor-Elect Robert McDonnell.

Governor Robert McDonnell. (2010a, January 18, 2010). *"Address to the Joint Houses."*. Richmond, VA: Office of the Governor.

Governor Robert McDonnell. (2010b, January 16, 2010). *"Inaugural address of Governor Robert F. McDonnell."*. Richmond, VA: Office of the Governor.

Governor Robert McDonnell. (2010c, January 26, 2010). *"Governor Bob McDonnell unveils jobs and opportunities agenda."*. Richmond, VA: Office of the Governor.

Governor Robert McDonnell. (2010d, April 13, 2010). *"Letter to the House of Delegates: House Bill 30."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2006, December 15, 2006). *"Prepared remarks for the joint meeting of the General Assembly money committees."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2007a, January 4, 2007). *"Governor Kaine announces 2007 legislative initiative on transportation."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2007b). *"Governor Kaine's 2007 transportation revenue proposal.."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2007c, February 23, 2007). *"Statement of the governor on the Republican transportation proposal."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2007d, December 17, 2007). *"Governor Kaine's prepared remarks to joint meeting of the Senate Finance, House Finance and House Appropriations Committees."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2007e, September 6, 2007). *"Governor Kaine announces Volkswagen to locate U.S. headquarters in Fairfax County."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2008a, January 9, 2008). *"State of the Commonwealth Address."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2008b). *"Governor Kaine's 2008 transportation plan."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2008c, May 12, 2008). *"Governor Kaine unveils transportation plan."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2008d, June 23, 2008). *"Governor Kaine's speech to the Joint Transportation Special Session of the General Assembly."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2008e, August 18, 2008). *"Governor Kaine's prepared remarks to joint meeting of the Senate Finance, House Finance and House Appropriations Committees."*. Richmond, VA: Office of the Governor.

Governor Tim Kaine. (2009, December 18, 2009). *"Governor Kaine unveils proposed biennial budget for 2010-2012."*. Richmond, VA: Office of the Governor.

Greater Baltimore Committee. (2007a, October 31, 2007). *"House Bill 5, Transportation Investment Act: testimony presented to the Senate Budget and Taxation Committee, House Appropriations Committee and House Ways and Means Committee."*. Baltimore, MD: Greater Baltimore Committee.

Greater Baltimore Committee. (2007b, October 31, 2007). *"House Bill 2, Tax Reform Act of 2007: testimony presented to the House Ways and Means Committee, House Appropriations Committee, and Senate Budget and Taxation Committee."*. Baltimore, MD: Greater Baltimore Committee.

Green, A. A. (2006, November 16, 2006). "State's fiscal woes to linger; O'Malley will face string of deficits, analysts predict.". *The Baltimore Sun*, p. 1A.

Green, A. A. (2007a, March 13, 2007). "Democrats propose MD. budget reductions.". *The Baltimore Sun*, p. 1.A.

Green, A. A. (2007b, February 28, 2007). "Miller brings slots back to the table.". *The Baltimore Sun*, p. 1.B.

Green, A. A. (2007c, March 1, 2007). "Let the battle of the budget begin: Miller backs boost in gas tax of 50%.". *The Baltimore Sun*, p. 1.A.

Green, A. A. (2007d, March 17, 2007). "Gas tax plan gets a mixed reception.". *The Baltimore Sun*, p. 5.B.

Green, A. A. (2007e, April 8, 2007). "Spending deal is reached; O'Malley budget keeps funds for schools, stem cells.". *The Baltimore Sun*, p. 1.B.

Green, A. A. (2007f, November 6, 2007). "Miller gives slots a boost.". *The Baltimore Sun*, p. B.1.

Green, A. A. (2007g, November 7, 2007). "Panel reworks revenue package: Senate committee cuts top rates and leaves 'loopholes.'". *The Baltimore Sun*, p. A.1.

Greenberg, G., Miller, J., Mohr, L., & Vladeck, B. "Developing public policy theory: Perspectives from empirical research.". *American Political Science Review, 71*(December 1977), 1532-1543.

Griffith, M. (2007, April 1, 2007). "Compromise? the road to common ground.". *The Richmond Times-Dispatch*

Hamilton, B. (2012). "State tax administration: Seven problems in search of a solution.". In R. D. Ebel, & J. E. Petersen (Eds.), *The Oxford handbook of state and local public finance.* (pp. 463-496). Oxford: Oxford University Press.

Hamilton, L. (2012, July 25, 2012). "Why congress's future should lie in the past.". Retrieved from http://congress.indiana.edu.

Hansen, S. (1983). "Extraction: The politics of state taxation.". In V. Gray, H. Jacobs & K. Vines (Eds.), *Politics in the American state: A comparative analysis.* (pp. 415-433). Boston: Little, Brown.

Hardy, M. (2006, December 16, 2006). "Kaine unveils budget amendments.". *The Richmond Times-Dispatch*, p. B-2.

Hardy, M., & Schapiro, J. E. (2007a, February 25, 2007). "Assembly ducked road work with patch job.". *The Richmond Times-Dispatch*, p. A-12.

Hardy, M., & Schapiro, J. E. (2007b, January 19, 2007). "Va. GOP's deal on roads seems headed for trouble.". *The Richmond Times-Dispatch*, p. A-1.

Hardy, M., & Schapiro, J. E. (2007c, February 15, 2007). "Kaine sides with Senate on roads.". *The Richmond Times-Dispatch*, p. A-6.

Hardy, M., & Schapiro, J. E. (2007d, February 25, 2007). "Kaine condemns plan for transportation and pledges to rewrite it.". *The Richmond Times-Dispatch*, p. A-1.

Hardy, M., & Schapiro, J. E. (2007e, February 24, 2007). "GOP rolls out roads plan.". *The Richmond Times-Dispatch*, p. A-1.

Hardy, M., & Schapiro, J. E. (2007f, March 27, 2007). "Kaine solves road block.". *The Richmond Times-Dispatch.*

Hardy, M., & Schapiro, J. E. (2007g, April 5, 2007). "Road bill OK'd though it pleases few.". *The Richmond Times-Dispatch.*

Hardy, M., & Whitley, T. (2007, January 20, 2007). "Road plan reaction is lukewarm.". *The Richmond Times-Dispatch*, p. A-1.

Harper, R. K., Hawkins, R. R., Martin, G. S., & Sjolander, R. (2003). "Price effects around a sales tax holiday: An exploratory study.". *Public Budgeting & Finance, 23*(4), 108-113.

Harris, M. (2007, March 14, 2007). "Realty tax loophole costs state millions.". *The Baltimore Sun*, p. 1.A.

Hawkins, R. R., & Mikesell, J. L. (2001, March 5, 2001). "Six reasons to hate your sales tax holiday.". *State Tax Notes, 20*(10), 801-803.

Heclo, H. (1978). "Issue networks and the executive establishment.". In A. King (Ed.), *The new American political system.* (pp. 87-107, 115-124). 1978: American Enterprise Institute.

Hedgepeth, D., & Helderman, R. S. (2010, April 27, 2010). "Northrop to relocate to N. Va.". *The Washington Post*, p. A. 14.

Helderman, R. S. (2009, December 3, 2009). "Va. budget to test McDonnell's stance.". *The Washington Post*, p. B.1.

Helderman, R. S. (2010, February 12, 2010). "Va. budget to test McDonnell's stance.". *The Washington Post*, p. B.1.

Helderman, R. S., & Kumar, A. (2009, November 4, 2009). "GOP reclaims Virginia.". *The Washington Post.*

Henchman, J. (2008a, June 30, 2008). *"Proposed Seattle bag tax criticized."*. Washington, D.C.: Tax Foundation.

Henchman, J. (2008b, December 17, 2008). *“Kentucky, South Carolina, Virginia Propose Higher Cigarette Taxes.”.* Washington, D.C. Tax Foundation.

Henchman, J. (2011, June 2, 2011). *"More states abandon film tax incentives as programs' ineffectiveness becomes more apparent.".* (Tax Foundation Fiscal Fact No. 272). Washington, D.C.: Tax Foundation.

Henchman, J. (2012). *"Sales tax holidays: Politically expedient but poor tax policy.".* Washington, D.C.: Tax Foundation.

Hettich, W., & Winer, S. L. (1999). *Democratic choice and taxation: A theoretical and empirical analysis.* Cambridge, UK: Cambridge University Press.

Higginbottom, J. (2010, March 10, 2010). *"Georgia should refrain from relying on smokers to fill budget hole.".* (Fiscal Fact No. 215). Washington, D.C.: Tax Foundation.

Holahan, J., Coughlin, T. A., Bovbjerg, R. R., Hill, I., Ormond, B. A., & Zuckerman, S. (2004). *"State responses to 2004 budget crisis: A look at ten states.".* Washington, D.C.: The Urban Institute.

Hoover, K., & Donovan, T. (2008). *The elements of social scientific thinking.* (Ninth ed.). Boston: Thomson Wadsworth.

House Appropriations Committee. (2007, November 13, 2007). *"Budget outlook: 2008 session.".* Richmond, VA: House Committee on Appropriations.

House Appropriations Committee. (2010, March 14, 2010). *"HB 29 & HB 30 budget conference highlights.".* Richmond, VA: House Appropriations Committee.

House Appropriations Committee and Senate Finance Committee. (2008, January 7, 2008). *"Summary of the governor's proposed 2008-2010 budget.".* Richmond, VA: Virginia General Assembly.

House Appropriations Committee and Senate Finance Committee. (2009, May 21, 2009). *Summary of 2008-2010 budget actions: Chapter 781 (introduced as House Bill 1600).* Richmond, VA: Virginia General Assembly.

House Appropriations Committee and Senate Finance Committee. (2010a, January 11, 2010). *"Summary of the governor's proposed amendments to the 2008-2010 budget and the governor's proposed 2010-2012 budget.".* Richmond, VA: Virginia General Assembly.

House Appropriations Committee and Senate Finance Committee. (2010b, June 29, 2010). *"Summary of 2008-2010 budget actions: Chapter 872 (introduced as House*

Bill 29) and 2010-2012 budget actions: Chapter 874 (introduced as House Bill 30).". Richmond, VA: Virginia General Assembly.

House Health and Government Operations Committee. (2007). *"House Bill 754: Tobacco tax fact sheet."*. Annapolis, MD: House Health and Government Operations Committee.

Howard, C. (2009). "Making taxes the life of the party.". In I. W. Martin, A. K. Mehrotra & M. Prasad (Eds.), *The new fiscal sociology: Taxation in comparative and historical perspective.* (pp. 86-100). New York: Cambridge University Press.

Ingram, H., & Schneider, A. L. (1990). "Improving implementation through framing smarter statutes.". *Journal of Public Policy, 10*(1), 66-87.

Ingram, H., Schneider, A.L., & deLeon, P. (2007). "Social construction and policy design.". In P. A. Sabatier (Ed.), *Theories of the policy process*, pp. 93-126. Boulder, CO: Westview Press.

Jacobs, L. R., & Shapiro, R. Y. (2000). *Politicians don't pander: Political manipulation and the loss of democratic responsiveness.* Chicago: University of Chicago Press.

Jenkins, C. L. (2005, April 18, 2005). "6 Va. GOP mavericks may face challenge: Primary hopefuls cite vote on taxes.". *The Washington Post*, p. B01.

Johnson, C. A. (2009, February 9, 2009). "Tobacco tax will hurt many Virginians.". *Richmond Times-Dispatch.*

Johnson, N., & Singham, A. (2010, January 14, 2010). *"States can opt out of the costly and ineffective 'domestic production deduction' corporate tax break.".* Washington, D.C.: Center on Budget and Policy Priorities.

Joint Commission on Transportation Accountability. (2007). *Interim review of the results of abusive driver fees in Virginia and other states.* Richmond, VA: Joint Commission on Transportation Accountability.

Joint Legislative Audit and Review Commission (JLARC). (2007). *"Virginia compared to the other states: National rankings on taxes, budgetary components, and other indicators.".* Richmond, VA: Joint Legislative Audit and Review Commission.

Joint Legislative Audit and Review Commission (JLARC). (2012). *Review of the effectiveness of Virginia tax preferences.* (Senate Document No. 4). Richmond, VA: Joint Legislative Audit and Review Commission.

Jones, B. D. (1994). "Rationality in political choice.". *Reconceiving decision-making in American politics.* (pp. 21-57). Chicago: The University of Chicago Press.

Jones, B. D. (1999). "Bounded rationality.". *Annual Review of Political Science, 2*, 297-321.

Jones, B. D., Baumgartner, F. R., & True, J. L. (1998). "Policy punctuations: U.S. budget authority, 1947-1995.". *The Journal of Politics, 60*(1), 1-33.

Kay, L.F. (2010, February 27, 2010). "Senate OKs tax credit for hiring unemployed.". *The Baltimore Sun*, pp. A.2.

Key, V. O. (1940). "The lack of a budgetary theory.". *Public Administration Review, 34*(6), 1137-1144.

King, G., Keohane, R. O., & Verba, S. (1994). *Designing social inquiry: Scientific inference in qualitative research.* Princeton, NJ: Princeton University Press.

Kingdon, J. W. (1995). *Agendas, alternatives, and public policies.* (2nd ed.). New York: Longman.

Knapp, J. L. (2002). *"Virginia's fiscal condition: More than a short-term problem.".* (The Virginia News Letter Vol. 78, No. 1). Charlottesville, VA: Weldon Cooper Center for Public Service, The University of Virginia.

Knapp, J. L., & Ng, G. W. (2007). "Virginia abusive driver fees: An abuse of fines?". *Virginia Issues & Answers, 14*(1), 8-17.

Kumar, A. (2008a, May 14, 2008). "Kaine and GOP at odds on shortfall; forecast in error, Republicans say.". *The Washington Post*, p. B.1.

Kumar, A. (2008b, May 2, 2008). "Va. legislators try to map strategy on roads.". *The Washington Post*, p. B.1.

Kumar, A. (2009a, January 8, 2009). "Belts will be worn tighter this year.". *The Washington Post*, p. T.1.

Kumar, A. (2009b, January 29, 2009). "House panel rejects bill to hike tax on cigarettes.". *The Washington Post*, p. B.2.

Kumar, A., & Helderman, R. S. (2009, December 19, 2009). "Kaine proposes radical restructure.". *The Washington Post*, p. B.1.

Lauth, T. P. (2006). "Georgia: Shared power and fiscal conservatism.". In E. J. Clynch, & T. P. Lauth (Eds.), *Budgeting in the states: Institutions, processes, and politics.* (pp. 33-53). Westport, CT: Praeger Publishers.

Lauth, T. P. (2010). "Budget deficits in the states: Georgia.". *Public Budgeting & Finance, 30*(1), 15-32.

Lav, I. J. (2002). *"Cigarette tax increases: Cautions and considerations."*. Washington, D.C.: Center on Budget and Policy Priorities.

Lav, I. J. (2012). "Accomplishing state budget policy and process reforms.". In R. D. Ebel, & J. E. Petersen (Eds.), *The Oxford handbook of state and local public finance.* (pp. 871-893). Oxford: Oxford University Press.

Lazarick, L. (2010, February 3, 2010). "Business groups support jobs tax credit.". Retrieved from www.marylandreporter.com.

Lazere, E. (2009, December 9, 2009). "Oppose downtown business tax breaks -- please sign on today!". Retrieved from http://www.dcfpi.org/oppose-downtown-business-tax-breaks-%E2%80%94-please-sign-on-today.

Lazere, E. (2007, May 9, 2007). *"Finance Committee tax cut proposals would mainly benefit high-income residents: More progressive alternatives are not being considered."*. Washington, D.C.: D.C. Fiscal Policy Institute.

Leaderman, D. (2010, February 5, 2010). "Tax credit won't help them, some small-business owners say.". *The Baltimore Sun*, p. A.2.

Lee, R. D., Jr., Johnson, R. W., & Joyce, P. G. (2013). *Public budgeting systems.* (9th ed.). Burlington, MA: Jones & Bartlett Learning.

Levine, C. H. (1979). "More on cutback management: Hard questions for hard times.". *Public Administration Review, 39*(2), 179-183.

Lewis, C.W., & Hildreth, W. B. (2011). *Budgeting: Politics and power.* New York: Oxford University Press.

Lindblom, C. (1959). *"The science of 'muddling through.'"*. *Public Administration Review, 19*(2), 79-88.

Lindblom, C. (1961). "Decision-making in taxation and expenditures.". *Public finances: Needs, sources, and utilization. A conference of the universities - National Bureau for Economic Research.* (pp. 295-336). Princeton, NJ: Princeton University Press.

Linskey, A. (2010, January 13, 2010). "Md. advocates back increase in liquor tax.". *The Baltimore Sun*, p. A.2.

Lowi, T. J. (1964). "American business, public policy, case studies, and political theory.". *World Politics, 16*, 687-691, 713.

Majone, G. (1989). *Evidence, argument, and persuasion in the policy process*. New Haven: Yale University Press.

Marbella, J. (2007, November 9, 2007). "Keeping score on taxes no easy task.". *The Baltimore Sun*, p. B.1.

Marimow, A. E. (2006a, January 9, 2006). "Tax cut or gimmick?". Retrieved from http://voices.washingtonpost.com/annapolis/2006/01/tax_cut_or_gimmick.html.

Marimow, A. E. (2006b, January 26, 2006). "My tax increase is smaller than your tax increase.". Retrieved from http://voices.washingtonpost.com/annapolis/2006/01/my_tax_increase_is_smaller_tha.html.

Marr, C., & Highsmith, B. (2011, April 15, 2011). *"Reforming tax expenditures can reduce deficits while making the tax code more efficient and equitable."*. Washington, D.C.: Center on Budget and Policy Priorities.

Marron, D.B. (2011, February 2, 2011. Testimony on "Cutting tax preferences is key to tax reform and deficit reduction," before the Committee on the Budget, U.S. Senate.

Martin, I. W., Mehrotra, A. K., & Prasad, M. (2009). "The thunder of history: The origins and development of the new fiscal sociology.". In I. W. Martin, A. K. Mehrotra & M. Prasad (Eds.), *The new fiscal sociology: Taxation in comparative and historical perspective.* (pp. 1-27). New York: Cambridge University Press.

Martz, M., & Whitley, T. (2010, January 10, 2010). "State legislators brace for 'brutal' budget-balancing.". *Richmond Times-Dispatch.*

Maryland Catholic Conference. (2010, March 17, 2010). *"Statement to the House Ways and Means Committee re: House bill 946 -- BOAST tax credit," presented by Archbishop Edwin O'Brien, Archdiocese of Baltimore*. Baltimore, MD: Maryland Catholic Conference.

Maryland Chamber of Commerce. (2007a, October 31, 2007). *"Legislative position: Senate Bill 5/House Bill 5, transportation investment act."*. Annapolis, MD: Maryland Chamber of Commerce.

Maryland Chamber of Commerce. (2007b, November 1, 2007). *"Legislative position: Senate Bill 5/House Bill 5, transportation investment act."*. Annapolis, MD: Maryland Chamber of Commerce.

Maryland Chamber of Commerce. (2007c, November 14, 2007). *"Legislative position: Tax reform act of 2007 (SB 2 and HB 2) – restructuring of personal income tax rates."*. Annapolis, MD: Maryland Chamber of Commerce.

Maryland General Assembly. (2007). *Roster and list of committees: 2007.* Annapolis, MD: Maryland General Assembly.

Maryland State Department of Education. (2012). *"Bridge to excellence in public schools act.".* (Fact Sheet 63). Baltimore, MD: Maryland State Department of Education.

Maryland State Licensed Beverage Association. (2010, March 10, 2010). *Memorandum to the Honorable Ulysses Currie, Chairman, and members of the Senate Budget and Taxation Committee; the Honorable Thomas M. Middleton, Chairman, and members of the Senate Finance Committee, and the Honorable Verna Jones, "Oppose -- Senate Bill 717 -- the Lorraine Sheehan Health and Community Services Act of 2010.".* Westminster, MD: Maryland State Licensed Beverage Association.

Mason, J. (2002). *Qualitative researching.* (2nd ed.). London: Sage Publications.

Mattoon, R., & McGranahan, L. (2012). "State and local governments and the national economy.". In R. D. Ebel, & J. E. Petersen (Eds.), *The Oxford handbook of state and local public finance.* (pp. 137-155). Oxford: Oxford University Press.

Maxwell, J. A. (1992). "Understanding and validity in qualitative research.". *Harvard Educational Review, 62*(3), 279-300.

Mayor Adrian Fenty. (2007, March 23, 2007). *Letter to the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia.*

Mayor Adrian Fenty. (2008, March 20, 2008). *Letter to the Honorable Vincent C. Gray, Chairman of the Council of the District of Columbia.*

Mayor Adrian Fenty. (2009, March 23, 2009). Testimony on "The mayor's fiscal year 2010 budget and financial plan: 'meeting the challenge,'" before the Committee of the Whole, Council of the District of Columbia.

Mayor Adrian Fenty. (2010, November 23, 2010). *"FY 2011: Proposed gap-closing plan.".* Washington, D.C.: Government of the District of Columbia.

McNichol, E. C., Nicholas, A. C., & Shure, J. (2009). *"Raising state income taxes on high-income taxpayers.".* Washington, D.C.: Center on Budget and Policy Priorities.

Meola, O., & Martz, M. (2010, January 11, 2010). "Lawmakers push to scrap corporate income tax.". *Richmond Times-Dispatch.*

Merriam, S. (2009). *Qualitative research: A guide to design and implementation.* San Francisco: Jossey-Bass.

Meyers, R. T. (1994). *Strategic budgeting.* Ann Arbor, MI: The University of Michigan Press.

Mikesell, J. L. (2003). "Taxation: Criteria for evaluating revenue options.". *Fiscal administration: Analysis and applications for the public sector.* (6th ed., pp. 291-324). Belmont, CA: Thomson-Wadsworth.

Mikesell, J. L. (2007). "State sales taxes in fiscal 2006: Adding diversity to the national revenue portfolio.". *State Tax Notes, 45*(10), 627-633.

Mikesell, J. L. (2012). "The disappearing retail sales tax.". *State Tax Notes, 63*(777), 791.

Mikesell, J. L. (2015). "Changing state revenue strategies.". In M. M. Rubin, & K. G. Willoughby (Eds.), *Sustaining the states: The fiscal viability of American state governments.* (pp. 29-51). Boca Raton, FL: CRC Press.

Mill, J. S. (1848 (reprinted 2004)). *Principles of political economy.* Amherst, NY: Prometheus Books.

Mitchell, A. (2012, March 15, 2012). *"Medicaid provider taxes.".* Washington, D.C.: Congressional Research Service.

Montgomery, L. (2006, April 25, 2006). "At forum, Fenty vows not to raise D.C. taxes.". *The Washington Post*, p. B01.

Montgomery, L., & Silverman, E. (2006, September 21, 2006). "Fenty sweep is one for the record books.". *The Washington Post*, p. T2.

Montgomery, L., & Whitlock, C. (2004, April 6, 2004). "Miller vows to block Md. budget over slots.". *The Washington Post*, p. B01.

NAACP State of Maryland Conference of Branches. (2010, March 17, 2010). *"Testimony in opposition of HB 946: Building opportunities for all students and teachers (BOAST) in Maryland tax credit.".* Arnold, MD: NAACP State of Maryland Conference of Branches.

National Conference of State Legislatures. (2008a). *State tax actions, 2007.* Denver: National Conference of State Legislatures.

National Conference of State Legislatures. (2008b). *"Which states rely on which tax.".* Denver: National Conference of State Legislatures.

National Conference of State Legislatures. (2009). *State tax actions, 2008.* Denver: National Conference of State Legislatures.

National Conference of State Legislatures. (2010a). *"NCSL fiscal brief: State balanced budget provisions."*. Denver: National Conference of State Legislatures.

National Conference of State Legislatures. (2010b). *State tax actions, 2009.* Denver: National Conference of State Legislatures.

National Conference of State Legislatures. (2011a). *State tax actions, 2010.* Denver: National Conference of State Legislatures.

National Conference of State Legislatures. (2011b). *"How state tax policy responds to economic recessions."*. (NCSL Fiscal Brief). Denver: National Conference of State Legislatures.

National Conference of State Legislatures. (2012). *State tax actions 2011: Special fiscal report.* Denver: National Conference of State Legislatures.

Neibauer, M. (2009a, July 21, 2009). "D.C. Council members float tax hikes, wage freezes.". *The Washington Examiner.*

Neibauer, M. (2009b, March 24, 2009). "Shaw residents: D.C. Council shouldn't roll back nuisance property tax.". *The Washington Examiner.*

Neibauer, M. (2010, December 21, 2010). "Union station tax break pulled, again.". *Washington Business Journal.*

New York State Department of Taxation and Finance. (1997). *"The temporary clothing exemption: Analysis of the effects of the exemption on clothing sales in New York State."*. (Report to the Governor and the Legislature). Albany, NY: New York State Department of Taxation and Finance.

Newcomer, K. E. (2008). *"Planning and implementing case study research."*. Washington, DC: The George Washington University.

No D.C. Beverage Coalition. (2010). "Home page.". Retrieved from www.nodcbevtax.com.

Nolan, J. (2008a, February 16, 2008). "Gas-tax increase moves to House.". *The Richmond Times-Dispatch.*

Nolan, J. (2008b, March 20, 2008). "Kaine: Assembly must act on road woes.". *The Richmond Times-Dispatch.*

Nolan, J. (2008c, June 20, 2008). "Road session may run into traffic.". *Richmond Times-Dispatch.*

Nolan, J. (2008d, April 30, 2008). "Kaine promises transit proposal.". *The Richmond Times-Dispatch.*

Nolan, J. (2008e, December 24, 2008). "Kaine reflects on ’08 wins, losses.". *The Richmond Times-Dispatch.*

Nolan, J. (2008f, December 20, 2008). "State budget a work in progress.". *The Richmond Times-Dispatch.*

Nolan, J. (2010a, January 3, 2010). "Kaine had wins but took some lumps as governor.". *Richmond Times-Dispatch.*

Nolan, J. (2010b, February 19, 2010). "Virginia Senate weighs indexing gas tax to fuel efficiency.". *Richmond Times-Dispatch.*

Nolan, J., & Schapiro, J. E. (2008a, January 15, 2008). "Kaine defers on raising car sales tax.". *The Richmond Times-Dispatch.*

Nolan, J., & Schapiro, J. E. (2008b, May 13, 2008). "Kaine, GOP clash over transit solution.". *The Richmond Times-Dispatch.*

Nolan, J., & Schapiro, J. E. (2009, December 13, 2009). "Kaine to force tough choices on McDonnell.". *Richmond Times-Dispatch.*

Oates, W. E. (1972). *Fiscal federalism.* New York: Harcourt Brace Jovanovich.

O'Connell, J. (2009, April 28, 2009). "Cutting corporate tax rates, vacant property tax not a priority for D.C. Council.". *Washington Business Journal.*

Office of Cable Television. (2007a, May 4, 2007). *"Council of the District of Columbia: Committee on Finance and Revenue mark-up.".* [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television. (2007b, May 15, 2007). *"Council of the District of Columbia: Committee of the Whole Meeting.".* [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television. (2007c, February 7, 2007). *"The Council of the District of Columbia, Committee on Finance and Revenue, public hearing, Bill 17-19, the ‘Owner-Occupant Residential Tax Credit Act of 2007,’ Bill 17-20, the ‘Commercial Real Property Tax Credit Act of 2007,’ Bill 17-37, the ‘Estate and Inheritance Tax Re-Coupling Act of 2007,’ Councilmember Jack Evans, Chairperson.”.* [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television (2008a, January 29, 2008). *"Council of the District of Columbia, Committee on Public Services and Consumer Affairs: mark-up."*. [Video/DVD] Washington, D.C.: Office of Cable Television

Office of Cable Television (2008b, May 2, 2008). *"The Council of the District of Columbia, Committee of the Whole, public hearing, Bill 17-700, 'Healthy DC Act of 2008.'"*. [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television (2008c, May 13, 2008). *"The Council of the District of Columbia, 'twenty-seventh (additional) legislative meeting," Tuesday, May 13th, 2008, Vincent C. Gray, Chairperson."*. [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television (2009a, September 22, 2009). *"The Council of the District of Columbia, 'fifteenth (additional) legislative meeting,' Tuesday, September 22nd, 2009, Vincent C. Gray, Chairman."*. [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television (2009b, November 24, 2009). *"The Council of the District of Columbia, Committee on Finance & Revenue, 'mark-up," Tuesday, November 24th, 2009, Jack Evans, Chairperson."*. [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television (2010a, May 13, 2010). *"The Council of the District of Columbia, Committee on Public Services and Consumer Affairs, mark-up, Thursday, May 13, 2010, Muriel Bowser, Chairperson."*. [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television (2010b, December 6, 2010). *"Council of the District of Columbia, Committee on Finance and Revenue, 'mark-up,' Monday, December 6, 2010, Jack Evans, Chairperson."*. [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Cable Television (2010c, July 12, 2010). *"Council of the District of Columbia, Committee on Finance and Revenue, 'mark up,' Monday, July 12, 2010, Jack Evans, Chairperson."*. [Video/DVD] Washington, D.C.: Office of Cable Television.

Office of Revenue Analysis. (2009a, August 27, 2009). *"Taxation of vacant, abandoned and nuisance properties."*. Washington, D.C.: Office of Revenue Analysis.

Office of Revenue Analysis. (2009b, July 28, 2009). *"Revenue options, 2010-2013."*. Washington, D.C.: Office of Revenue Analysis.

Office of the Chief Financial Officer. (2007a). *Economic report of the District of Columbia: A fiscal perspective, 2007.* Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2007b, February 5, 2007). *"Fiscal impact statement: 'Commercial Real Property Tax Credit Act of 2007.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2007c, November 16, 2007). *"Fiscal impact statement (revised): 'Nuisance Properties Abatement Reform and Real Property Classification Amendment Act of 2007.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2008a, March 28, 2008). *"Fiscal impact statement: 'Fiscal Year 2009 Budget Support Act of 2008.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2008b, June 3, 2008). *"Fiscal impact statement: 'Fiscal Year 2009 Budget Support Act of 2008.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2009a). *"June 2009 revenue estimates."*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2009b, May 21, 2009). *"Fiscal impact statement: 'Union Station Redevelopment Corporation Payment in Lieu of Taxes Act of 2009.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2010a, April 20, 2010). *"Fiscal impact statement: 'Fiscal Year 2011 Budget Support Act of 2010.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2010b, July 1, 2010). *"Fiscal impact statement: 'Fiscal Year 2011 Budget Support Act of 2010.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2010c, April 19, 2010). *"Fiscal impact statement: 'Healthy Schools Act of 2010.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2010d, November 24, 2010). *"Fiscal impact statement: 'Fiscal Year 2011 Supplemental Budget Support Act of 2010.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2010e, October 6, 2010). *"Fiscal impact statement: 'Adams Morgan Hotel Real Property Tax Abatement Act of 2010.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2010f, April 8, 2010). *"Fiscal impact statement: 'Payment of Full Hotel Taxes by Online Vendors Clarification Act of 2010.'"*. Washington, DC: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2010g, March 19, 2010). *"Fiscal impact statement: 'OTO Hotel at Constitution Square Economic Development Act of 2009.'"*. Washington, D.C.: Office of the Chief Financial Officer.

Office of the Chief Financial Officer. (2010h). *District of Columbia tax expenditure report.* Washington, D.C.: Office of the Chief Financial Officer.

Office of the City Administrator. (2009, July 16, 2009). *"FY 2009 and FY 2010: Gap-closing plan overview."*. Washington, D.C.: Office of the City Administrator.

Olson, B. (2008, January 13, 2008). "Taxes fuel discontent.". *The Baltimore Sun*, p. A.1.

Olson, B., & Drew, J. (2007, November 19, 2007). "Lawmakers send question to November 2008 ballot.". *The Baltimore Sun*, p. A.1.

Ostrom, E. (2007). "Institutional rational choice: An assessment of the institutional analysis and development framework.". In P. A. Sabatier (Ed.), *Theories of the policy process.* (Second ed., pp. 21-64). Boulder, CO: Westview Press.

Parsons, W. (1995). *Public policy: An introduction to the theory and practice of policy analysis.* Cheltenham, UK: Edward Elgar Publishing Limited.

Pattison, S., & Willoughby, K. G. (2015). "Sustaining the states: An introduction.". In M. M. Rubin, & K. G. Willoughby (Eds.), *Sustaining the states: The fiscal viability of American state governments.* (pp. 1-12). Boca Raton, FL: CRC Press.

Prante, G. (2007, September 19, 2007). "Maryland gov. wants more revenue? Who do you go to? Smokers, business, and rich people, of course.". Retrieved from www.taxfoundation.org

Redford, E. S. (1969). *Democracy in the administrative state.* New York: Oxford University Press.

Reed, J., & Silverman, E. (2010, March 1, 2010). "Two troubling bills on Tuesday's D.C. Council agenda.". Retrieved from http://dcfpi.org/?p=1588.

Restaurant Association of Maryland. (March 10, 2010). *Letter to the Chairman and members of the Senate Budget and Taxation Committee, "Senate Bill 717: The Lorraine Sheehan Health and Community Services Act of 2010."*. Columbia, MD: Restaurant Association of Maryland.

Richmond Times-Dispatch. (2007, April 1, 2007). "Collision insurance.". *Richmond Times-Dispatch*.

Richmond Times-Dispatch. (2008, June 8, 2008). "Parallel tracks.". *Richmond Times-Dispatch.*

Richmond Times-Dispatch. (2009, January 18, 2009). "A conversation with Tim Kaine.". *Richmond Times-Dispatch.*

Riker, W. H. (1984). "The heresthetics of constitution-making: The presidency in 1787, with comments on determinism and rational choice.". *The American Political Science Review, 78*(1), 1-16.

Rosen, A. (2010, February 17, 2010). "Jobs tax credit has support, but not enthusiasm.". Retrieved from www.marylandreporter.com

Ross, J. (2009, November 12, 2009). "Testimony on Bill 18-431, the 'OTO Hotel at Constitution Square Economic Development Act of 2009,'" before the Committee on Finance and Revenue, Council of the District of Columbia.

Rubin, I. (2010). *The politics of public budgeting: Getting and spending, borrowing and balancing.* (Sixth ed.). Washington, D.C.: CQ Press.

Sabatier, P. A. (2007a). "The need for better theories.". In P. A. Sabatier (Ed.), *Theories of the policy process.* (Second ed., pp. 3-17). Boulder, CO: Westview Press.

Sabatier, P. A. (2007b). "Fostering the development of policy theory.". In P. A. Sabatier (Ed.), *"Theories of the policy process."* (Second ed., pp. 321-336). Boulder, CO: Westview Press.

Sabatier, P. A., & Weible, C. M. (2007). "The advocacy coalition framework: Innovations and clarifications.". In P. A. Sabatier (Ed.), *Theories of the policy process.* (Second ed., pp. 189-220). Boulder, CO: Westview Press.

Schapiro, J. E. (2006a, December 10, 2006). "From Venus: Former outsider, Williams is now member of club.". *The Richmond Times-Dispatch*, p. E-4.

Schapiro, J. E. (2006b, December 6, 2006). "Election year may force look at road plan: State legislators face pressure to remedy transportation woes.". *The Richmond Times-Dispatch*, p. B-2.

Schapiro, J. E. (2007a, February 14, 2007). "Senate move could doom roads funding.". *The Richmond Times-Dispatch*, p. A-1.

Schapiro, J. E. (2007b, November 7, 2007). "Parties' next fight comes in assembly.". *The Richmond Times-Dispatch.*

Schapiro, J. E. (2007c, November 14, 2007). "Conservatives in Va. Senate target Stosch.". *The Richmond Times-Dispatch.*

Schapiro, J. E. (2007d, December 6, 2007). "Report challenges bad driver fees.". *The Richmond Times-Dispatch.*

Schapiro, J. E. (2008a, February 21, 2008). "Fuel tax for roads won't pass.". *The Richmond Times-Dispatch.*

Schapiro, J. E. (2008b, April 13, 2008). "Poll offers insight on tax, roads.". *The Richmond Times-Dispatch.*

Schapiro, J. E. (2008c, May 25, 2008). "Virginia democrats divided over transportation fixes.". *Richmond Times-Dispatch.*

Schapiro, J. E. (2008d, June 19, 2008). "GOP plan: Fund roads with drilling money.". *Richmond Times-Dispatch.*

Schapiro, J. E. (2009, February 4, 2009). "Panel rejects bid to double cigarette tax.". *Richmond Times-Dispatch.*

Schapiro, J. E., & Nolan, J. (2008, December 17, 2008). "Kaine would double cigarette tax.". *Richmond Times-Dispatch.*

Schapiro, J. E., & Stallsmith, P. (2006, December 16, 2006). "Lawmakers open to change before election year.". *The Richmond Times-Dispatch*, p. B-2.

Schapiro, J. E., & Whitley, T. (2009, January 11, 2009). "'Challenging session' ahead: Atmosphere will be politically charged as budget debate unfolds.". *Richmond Times-Dispatch.*

Schick, A. (1966). "The road to PPB: The stages of budget reform.". *Public Administration Review, 26*(4), 243-258.

Schneider, A. L., & Ingram, H. (June 1993). "Social construction of target populations: Implications for politics and policy.". *American Political Science Review, 87*(2), 334-347.

Secretary of Finance. (2006, December 15, 2006). *"Governor Kaine's proposed amendments to the 2006-2008 budget: Economic outlook & revenue forecast. A briefing for the senate finance, house finance, and house appropriations committees."*. Richmond, VA: Secretary of Finance.

Secretary of Finance. (December 18, 2009). *"Governor Kaine's proposed 2010-2012 budget: Economic outlook & revenue forecast. A briefing for the senate finance, house finance, and house appropriations committees."*. Richmond, VA: Secretary of Finance.

Secretary of Finance. (2009, February 16, 2009). *"Revenue collections update and February reforecast."*. Richmond, VA: Secretary of Finance.

Senate Finance Committee. (2007). *"Senate Bill 1379 (amendment in the nature of a substitute)."*. Richmond, VA: Senate Finance Committee.

Senate Finance Committee and House Appropriations Committee. (2009, January 13, 2009). *"Summary of the governor's proposed amendments to the 2008-2010 budget."*. Richmond, VA: Virginia General Assembly.

Sharkansky, I. (1969). *The politics of taxation and spending,*. Indianapolis, IN: Bobbs-Merrill.

Shear, M. (2006, December 31, 2006). "Kaine carries vow to fix traffic into his 2nd year.". *The Washington Post*, p. C.1.

Shear, M. (2007a, January 4, 2007). "Election pressure could produce results.". *The Washington Post*, p. T.4.

Shear, M. (2007b, January 10, 2007). "Va. roads deal near, GOP leaders say.". *The Washington Post*, p. A.1.

Shear, M. (2007c, January 25, 2007). "Still plenty of potholes for transportation bill.". *The Washington Post*, p. T.4.

Shear, M. (2007d, January 30, 2007). "Gas tax for Va. projects pondered.". *The Washington Post*, p. B.11.

Shear, M., & Gardner, A. (2007, February 25, 2007). "Va. house, senate approve roads bill.". *The Washington Post*, p. A.1.

Sheffrin, S. M. (2013). *Tax fairness and folk justice.* New York: Cambridge University Press.

Shepsle, K. A. (1989). "Studying institutions: Some lessons from the rational choice approach.". *Journal of Theoretical Politics, 1*(2), 131-147.

Siegel, S. (2009, October 15, 2009). "Testimony on Bill 18-476, the 'High Technology Commercial Real Estate Database and Service Providers Tax Abatement Act of

2009," before the Committee on Finance and Revenue, Council of the District of Columbia.

Silverman, E. (2009, October 9, 2009). *"Cutting class: Why the D.C. Council's tinkering with the Class 3 property tax gets an F."*. Retrieved from http://www.dcfpi.org/cutting-class-why-the-dc-councils-tinkering-with-the-class-3-property-tax-gets-an-f.

Simon, H. (1945). *Administrative behavior: A study of decision-making processes in administrative organizations.* (1st ed.). New York: Free Press.

Sjoquist, D. L. (2015). "State tax structures: Past trends, future possibilities.". In M. M. Rubin, & K. G. Willoughby (Eds.), *Sustaining the states: The fiscal viability of American state governments.* (pp. 53-84). Boca Raton, FL: CRC Press.

Sjoquist, D. L., Wallace, S., & Winters, J. (2007, September 26, 2007). *"Selected fiscal and economic implications of aging."*. Atlanta: Andrew Young School of Policy Studies, Georgia State University.

Skalka, J. (2007, April 8, 2007). "Miller shows he is firmly in control.". *The Baltimore Sun*, p. 1.A.

Slemrod, J., & Bakija, J. (2008). *Taxing ourselves: A citizen's guide to the debate over taxes.* (Fourth ed.). Cambridge, MA: The MIT Press.

Smith, A. (1776 (reprinted 2003)). *An inquiry into the nature and causes of the wealth of nations.* New York: Bantam Dell.

Smith, C. F. (2007, April 15, 2007). "Democratic high-fiving before the storm.". *The Baltimore Sun*, p. 25.A.

Smith, C. F. (2008, January 27, 2008). "Hard lessons for the techies.". *The Baltimore Sun*, pp. A.11.

Smitherman, L. (2007a, February 8, 2007). "Plan aims to help uninsured; Md. house leaders seek to double cigarette tax for $600 million program.". *The Baltimore Sun*, p. A.1.

Smitherman, L. (2007b, November 7, 2007). "Senators rebuff loophole closing: O'Malley measure to tax profits sent out of state rejected.". *The Baltimore Sun*, p. D.1.

Smitherman, L. (2008, March 22, 2008). "Domestic partner bill advances in the senate.". *The Baltimore Sun.*

Smitherman, L., & Drew, J. (2007, October 27, 2007). "Call for slots referendum: O'Malley proposes to let voters decide.". *The Baltimore Sun*, p. A.1.

Snow, D. R., & Rubin, I. S. (2006). "Illinois: Constitutional versus negotiated powers.". In E. J. Clynch, & T. P. Lauth (Eds.), *Budgeting in the states: Institutions, processes, and politics.* (pp. 103-117). Westport, CT: Praeger Publishers.

Sobel, R. S., & Holcombe, R. G. (1996). "Measuring the growth and variability of tax bases over the business cycle.". *National Tax Journal, 49*(4), 535-552.

Somashekhar, S., & Craig, T. (2008, February 26, 2008). "Va. assembly kills plan for tax aid; hike in gas levy.". *The Washington Post*, p. B.1.

Somashekhar, S., & Turque, B. (2008, March 1, 2008). "Local officials buoyed by court ruling.". *The Washington Post*, p. B.1.

Spending Affordability Committee. (2006). *2006 interim report.* Annapolis, MD: Maryland General Assembly.

Spending Affordability Committee. (2009). *2009 interim report.* Annapolis, MD: Department of Legislative Services.

State Budget Crisis Task Force. (2012a). *Report of the state budget crisis task force: Full report.* New York: State Budget Crisis Task Force.

State Budget Crisis Task Force. (2012b). *Virginia report.* New York: State Budget Crisis Task Force.

State Budget Crisis Task Force. (2014). *Final report.* New York: State Budget Crisis Task Force.

Steinberger, P. J. (1980). "Typologies of public policy: Meaning, construction, and the policy process.". *Social Science Quarterly, 61*, 185-197.

Stewart, N. (2007, May 16, 2007). "Council approves district budget: Members also back tax relief package.". *The Washington Post*, p. B1.

Stewart, N. (2008, May 2, 2008). "Council to consider plan to aid businesses.". *The Washington Post.*

Stewart, N., & Craig, T. (2010, May 6, 2010). "Proposal to tax more D.C. services meets with protests.". Retrieved from http://www.washingtonpost.com.

Stewart, N., & Nakamura, D. (2008, May 13, 2008). "Property transfer, cigarette taxes likely to increase.". *The Washington Post.*

Stone, C. N. (1980). "Systemic power in community decision making: A restatement of stratification theory.". *The American Political Science Review, 74*(4), 978-990.

Stone, D. (2002). *Policy paradox: The art of political decision making.* New York: W.W. Norton & Co., Inc.

Stonecash, J.M. (1996). "The state politics literature: Moving beyond covariation studies and pursuing politics." *Polity, 28*(4), 559-579).

Stroupe, K. J. (February 2009). *"Gerrymandering's long history in Virginia: Will this decade mark the end?".* (The Virginia News Letter No. Vol. 85, No. 1). Charlottesville, VA: Weldon Cooper Center for Public Service, University of Virginia.

Tax Foundation. (2010). *"'Amazon tax' laws signal business unfriendliness and will worsen short-term budget problems.".* (Special Report No. 176). Washington, D.C.: Tax Foundation.

The Baltimore Sun. (2007a, November 8, 2007). *"Tax and consequences."*. Baltimore, MD: The Baltimore Sun, p. A.18.

The Baltimore Sun. (2007b, January 21, 2007). *"Delaying tactics."*. Baltimore, MD: The Baltimore Sun, p. 20.A.

The Baltimore Sun. (2007c, November 20, 2007). "The deficit, slain.". *The Baltimore Sun*, p. A.14.

The Baltimore Sun. (2010a, January 21, 2010). "Gum and baling wire.". *The Baltimore Sun*, p. A.14.

The Baltimore Sun. (2010b, January 19, 2010). "Balancing the books.". *The Baltimore Sun,* p. A.12.

The Baltimore Sun. (2010c, February 8, 2010). "Rethinking redevelopment.". *The Baltimore Sun*, p. A.12.

The Commonwealth Institute for Fiscal Analysis. (2010). *"When the other shoe drops: Job losses coming from state budget cuts in health care and education.".* Richmond, VA: The Commonwealth Institute for Fiscal Analysis.

The Washington Post. (2007, February 25, 2007). "No fix for transportation: In Richmond, a Republican funding bill falls flat.", p. B.6.

Thuronyi, V. (2005). "Tax.". In J. J. Cordes, R. D. Ebel & J. G. Gravelle (Eds.), *The encyclopedia of taxation & tax policy.* (Second ed., p. 375). Washington, D.C.: Urban Institute Press.

Tiebout, C. M. (1956). "A pure theory of local expenditures.". *The Journal of Political Economy, 64*(5), 416-424.

Tversky, A., & Kahneman, D. (1982). "Judgment under uncertainty: Heuristics and biases.". In D. Kahneman, P. Slovic & A. Tversky (Eds.), *Judgment under uncertainty: Heuristics and biases.* (pp. 3-20). New York: Cambridge University Press.

Twentieth Century Fund. (1937). *Facing the tax problem: A survey of taxation in the united states and a program for the future.* New York: Twentieth Century Fund, Inc.

U.S. Bureau of the Census. (2012a). *"State government tax collections: Summary report, 2011.".* (Government Division Brief). Suitland, MD: U.S. Bureau of the Census.

U.S. Bureau of the Census. (2012b). "State and county quick facts.". Retrieved from http://quickfacts.census.gov.

U.S. Bureau of the Census. (2012c). "American fact finder: Select economic characteristics, 2011 American community survey 1-year estimates.". Retrieved from www.census.gov/acs/.

U.S. Bureau of the Census. (2014, January 23, 2014). *"State government finances summary report: 2012.".* (Governments Division Briefs). Suitland, MD: U.S. Bureau of the Census.

U.S. Energy Information Administration. (2014). "Gasoline and diesel fuel update.". Retrieved from www.eia.gov/petroleum/gasdiesel.

U.S. Government Accountability Office. (2010). *State and local governments: Fiscal pressures could have implications for future delivery of intergovernmental programs.* (GAO-10-899). Washington, D.C.: U.S. Government Accountability Office.

U.S. Government Accountability Office. (2014). *State and local governments' fiscal outlook: 2014 update..* (GAO-15-224SP). Washington, D.C.: U.S. Government Accountability Office.

Virginia General Assembly. (2008). *2008 session summary.* Richmond, VA: Division of Legislative Services.

Wagner, E. (2010, February 2, 2010). "O'Malley working to keep historic credit alive.". Retrieved from www.marylandreporter.com.

Wagner, J. (2007, December 9, 2007). "Computer services firms want sales tax repealed.". *The Washington Post.*

Wagner, J., & Kumar, A. (2008, December 17, 2008). "Md., Va. eye even deeper cuts.". *The Washington Post*, p. A.1.

Walker, J. L. (1969). "The diffusion of innovations among the American states.". *The American Political Science Review, 63*(3), 880-899.

Wanat, J. (1974). "Bases of budgetary incrementalism.". *American Political Science Review, 68*(3), 1221-1228.

Ward, R. B. (2012). "Achieving fiscal sustainability for state and local governments.". In R. D. Ebel, & J. E. Petersen (Eds.), *The Oxford handbook of state and local government finance.* (pp. 917-936). Oxford: Oxford University Press.

Weaver, R. K. (1986). "The politics of blame avoidance.". *Journal of Public Policy, 6*(4), 43-70.

Weaver, R. K., & Rockman, B. A. (1993). *Do institutions matter? government capabilities in the united states and abroad.* Washington, D.C.: The Brookings Institution.

Weick, K. E. (1979). *The social psychology of organizing.* (2nd ed.). Reading, MA: Addison-Wesley.

Whitley, T. (2008a, March 8, 2008). "As budget talks falter, lawmakers set for OT.". *The Richmond Times-Dispatch.*

Whitley, T. (2008b, January 28, 2008). "Fees' repeal to leave budget gap.". *The Richmond Times-Dispatch.*

Whitley, T. (2009, December 19, 2009). "McDonnell, GOP lawmakers assail Kaine's budget plan.". *Richmond Times-Dispatch.*

Whitley, T. (2010a, March 21, 2010). "State budget's balancing tool: Fee increases.". *Richmond Times-Dispatch.*

Whitley, T. (2010b, March 1, 2010). "House panel carries over bill to index gas tax.". *Richmond Times-Dispatch.*

Wicksell, K. (1896). "A new principle of just taxation". In R. A. Musgrave, & A. T. Peacock (Eds.), *Classics in the theory of public finance.* ["Ein neues Prinzip der gerechten Besteuerung."] (J. M. Buchanan, Trans.). (pp. 72-117). London: Macmillan & Co., Ltd.

Wildavsky, A. (1964). *The politics of the budgetary process.* Boston: Little, Brown and Company.

Wilkinson, M. (2004). *"Funding Virginia services: A decade of contention.".* (The Virginia News Letter No. Vol. 80, No. 4). Charlottesville, VA: University of Virginia Weldon Cooper Center for Public Service.

Wilson, J. Q. (1974). *Political organizations.* New York: Basic Books.

Wilson, R. (2013, October 2, 2013). "Should Denver and New York City implement a plastic bag tax?". *The Washington Post.*

Wisconsin Legislative Fiscal Bureau. (2013). *"Individual income tax provisions in the states.".* (Informational Paper 4). Madison, WI: Wisconsin Legislative Fiscal Bureau.

Yin, R. Y. (2003). *Case study research: Design and methods.* (Third ed.). Thousand Oaks, CA: Sage Publications.

Zahariadis, N. (2007). "The multiple streams framework: Structure, limitations, prospects.". In P. A. Sabatier (Ed.), *"Theories of the policy process."* (Second ed., pp. 65-92). Boulder, CO: Westview Press.

Zahradnik, R., & Lav, I. J. (2000, February 9, 2000). *"A D.C. earned income tax credit could provide tax relief and reduce child poverty.".* Washington, D.C.: Center on Budget and Policy Priorities.