


Government of the District of Columbia
Office of the Chief Financial Officer



Natwar M. Gandhi
Chief Financial Officer

MEMORANDUM

TO: The Honorable Kwame R. Brown
Chairman, Council of the District of Columbia

FROM: Natwar M. Gandhi 
Chief Financial Officer

DATE: April 17, 2012

SUBJECT: Fiscal Impact Statement – “Social E-Commerce Job Creation Tax Incentive Act of 2012”

REFERENCE: Draft bill shared with the Office of Revenue Analysis on April 11, 2012

Conclusion

Funds are sufficient in the FY 2012 budget and the proposed FY 2013 through FY 2016 budget and financial plan period to implement the bill. The bill will not have a fiscal impact through FY 2015, and is estimated to reduce real property and corporate franchise tax collections by \$2.95 million, combined, in FY 2016. The bill proposes to use the FY 2016 operating margin in the Mayor’s proposed FY 2013 through FY 2016 budget and financial plan to cover this cost.

Background

The bill provides¹ real property and corporate franchise income tax credits to social e-commerce companies. The bill defines a social e-commerce company as one that is a Qualified High Technology Company² which hired at least 850 employees to work in the District of Columbia between December 31, 2009 and January 1, 2012, and with “a primary business of marketing or promoting retail or service businesses by delivering or providing members or users with access to discounts or other commerce-based benefits.” Under current law, Qualified High Technology Companies already can claim real property and corporate franchise tax exemptions if they are located in a development zone for the first five years of their operations. Corporate franchise tax is permanently set at 6 percent for all Qualified High Technology Companies, regardless of their location, or after the first five years for those located in development zones. Current law provides no specific benefits for social e-commerce companies.

¹ The bill adds a new section, § 47-1817.09, to D.C. Official Code Chapter 18, Subchapter XVII of Title 47.

² Under D.C. Official Code §47-1817.01(5).

Real property tax credit

The bill provides a real property tax credit, called the New Hire Wage Credit, which equals to 10 percent of the salaries paid to new employees in the first 24 months of their employment, *adjusted* for the ratio of D.C. residents in the new hire pool.³ The *unadjusted* New Hire Wage Credit is up to \$5,000 per new hire per tax year. The *adjusted* New Hire Wage Credit is the total annual accrued amount multiplied by the Resident Hiring Factor, which is one of the three following amounts:

1. 100 percent if at least half of new hires are D.C. residents in that calendar year;
2. 75 percent if at least forty percent but less than half of new hires are D.C. residents; or
3. 50 percent otherwise.

The *adjusted* New Hire Wage Credit is capped at \$15 million dollars between FY 2016 and FY 2025. If the real property for which the Qualified Social E-commerce Company is occupied by multiple unrelated entities, the tax credit can be applied to the tax liability apportionable to the Qualified Social E-commerce Company in proportion to the space it occupies in the said building.

The real property tax credit calculated in this way can only be used for a District commercial real property owned or leased by the Qualified Social E-commerce Company so long as the property is larger than 200,000 square feet, has been constructed, or substantially rehabilitated, and equipped after June 1, 2012 and is the primary corporate headquarters.⁴

Corporate Franchise Tax Credit

The bill provides for a tax credit reduces Qualified Social E-Commerce Company's corporate franchise tax liability for five years starting FY 2016. The tax credit is based on the share of D.C. hiring as follows:

1. \$17.5 million, if at least half of new hires are D.C. residents in FY 2015, continuing each year through the end of the abatement period;
2. \$13.5 million, if at least 40 percent of the new hires are D.C. residents in the aforementioned period; or
3. \$9 million otherwise, again in the same period.

Other conditions

A Qualified Social E-Commerce Company will qualify for the real property and corporate franchise tax credits if meets the following requirements

1. It makes at least 50 new hires annually;
2. Employs at least 1,000 persons in the District starting FY 2016, through the end of the abatement period.
3. Develops a joint business activity with of the Deputy Mayor for Planning and Economic Development that addresses the following:

³ The bill defines a new hire as someone who was not employed by a Qualified Social E-Commerce Company before 2010, hired during calendar years 2010 through 2014, and fills an open-ended position of at least 35 hours per week for not fewer than 50 weeks per year. Excluded from this definition are the members of the board of directors, owners with direct or indirect stake of 5 percent or more, and spouses and dependents of members or owners. To count towards the New Hire Wage Credit, new hires must work for at least six months in the District of Columbia.

⁴ Furthermore, if the Qualified Social E-Commerce Company leases or subleases any portion of the real property for which it is claiming the credit, the New Hire Wage Credit is reduced by the ratio of the square footage of building area the Qualified Social E-Commerce Company occupies to the total square footage of building area.

- a. Leveraging social electronic commerce companies' core business activities to assist District of Columbia retail businesses along disrupted corridors;
 - b. Coordinating social electronic commerce companies' offering of technology, marketing, social media and other training opportunities for District of Columbia small businesses;
 - c. Developing engineering-related programs to recruit, train and retain software developers in the District of Columbia;
 - d. Coordinating social electronic commerce companies' participation in the hiring of District of Columbia "STEM" (Science, Technology, Engineering and Math) students as part of the District's Summer Youth Employment Program.
4. Occupies the real property that is eligible for the New Hire Wage Credit through the duration of the abatement period, and not lease, or sublease the property to an unrelated entity in excess of 50 percent of the gross floor area, up to 200,000 square feet.
 5. Does not file for bankruptcy.

The bill stipulates that failing to meet the first three criteria outlined above will result in elimination of the tax credits for the period during which the Qualified E-Commerce Company is noncompliant. Failing to meet the last two requirements will result in the termination of the credits.

Financial Plan Impact

Funds are sufficient in the FY 2012 budget and the proposed FY 2013 through FY 2016 budget and financial plan period to implement the bill.

Given the bill's definition of a Qualified Social E-commerce Company, the Office of Revenue Analysis projects that only one company currently headquartered in the District, Living Social,⁵ could qualify for the proposed tax credits. The fiscal impact analysis is based on the assumption that no other company can qualify for the benefits.

Because both tax credits, real property and corporate franchise, cannot be claimed until FY 2016, the bill will not have a cost in FY 2012, and the first three years of the proposed FY 2013 through FY 2016 budget and financial plan. The credits will start in FY 2016 and will continue through FY 2025 for the real property tax credit, and for five years, through FY 2020, in the case of the corporate tax credit.

In FY 2016, the company is estimated to claim a real property tax credit of \$1.51 million. This estimate assumes that the company will relocate to a real property of at least 200,000 square feet that would be taxed at \$7.5 per square feet. This amount is consistent with the taxes generated from similar commercial properties in the District. (The bill allows for the use of real property tax credit for a property that is constructed or rehabilitated after June 2012. Therefore the estimate for the real property tax credit is not based on any specific property). In order to claim this tax credit, the company would have to hire at least 150 new hires in the first two years after the bill is effective, at least half of whom are District residents.⁶

⁵ For details on this company, see their corporate website, at <http://corporate.livingsocial.com/ourcompany>.

⁶ Alternatively, the company can hire 200 new hires, at least 80 of who are DC residents, or they could hire 300 new employees with no limitations on residency.

In FY 2016, the company is estimated to claim \$1.44 million corporate franchise tax credits. This estimate is based on the average corporate franchise tax collections from the top 20 companies in the District. This number is adjusted for the existing tax benefit to Qualified High Technology Companies, which reduces the corporate franchise tax rate to 6 percent.

The total tax benefit the company is estimated to be able to claim in FY 2016 is \$2.95 million. The Mayor's proposed FY 2013 through FY 2016 budget and financial plan includes an operating margin of \$4.1 million in FY 2016. The bill directs that this margin be used to account for the revenue reduction.

The bill will continue to have a fiscal impact outside of the financial plan period. The Office of Revenue Analysis estimates that the company will claim the full real property tax exemption of \$15 million by FY 2024. We also expect the company to claim an additional corporate franchise tax credit of \$6.4 million through FY 2020, when this tax credit expires. We estimate that the bill will reduce real property and corporate franchise tax collections by an additional \$22.8 million between FY 2017 and FY 2025. The table below depicts the out-year costs:

Estimated Revenue reduction outside the financial plan period			
	Corp Franchise ¹	Property ²	Total
FY 2017	\$1,500,000	\$1,580,000	\$3,080,000
FY 2018	\$1,570,000	\$1,650,000	\$3,220,000
FY 2019	\$1,640,000	\$1,720,000	\$3,360,000
FY 2020	\$1,710,000	\$1,800,000	\$3,510,000
FY 2021	-	\$1,880,000	\$1,880,000
FY 2022	-	\$1,960,000	\$1,960,000
FY 2023	-	\$2,050,000	\$2,050,000
FY 2024	-	\$850,000 ³	\$850,000
FY 2025	-	-	-
Total	\$6,420,000	\$13,490,000	\$22,860,000

Table Notes

¹ Corporate franchise tax obligation is assumed to grow at 4.5 percent annually.

² Real property tax obligation is expected to grow at 2.6 percent annually.

³ Real property tax credit is capped at \$15 million.