DC Fiscal Policy Institute

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TAX AND REVENUE ISSUES IN THE FY 2011 BUDGET

Mayor Fenty's proposed FY 2011 budget called for raising about $100 million in additional revenues to help address the city's sharp drop in revenue collections — limiting the amount of budget cuts needed to create a balanced budget. Roughly one-third of the Mayor's proposed revenue increases were from higher traffic and parking fees and fines, making this the second year in a row for increases in this area. Another third of the increases were from new levies on health care providers, mainly a one percent fee on hospital patient charges. The other proposed revenue increases included increases in business fees – such as a fee when steel plates need to be placed in streets – and an increase in a fee applied to phone bills that is used to support 911 services.

The DC Council rejected and modified several of the Mayor's tax proposals, and it also adopted some new revenue increases. In particular, the Council rejected an increases in parking meter rates, and in the "E911" tax. It also rejected mayoral proposals to reduce the DC Earned Income Tax Credit and to scale back "NET 2000" tax subsidies for high-tech corporations. The Council adopted a new property tax rate for vacant property, and it extended DC's general sales tax to purchases of soda and medical marijuana.

After considering the Council actions, revenue increases in the final FY 2011 budget total $85 million.

This review highlights the revenue increases included in the FY 2011 budgets, as well as revenue proposals introduced by both the Mayor and Council that ultimately were rejected. And it describes a handful of tax reductions included in the FY 2011 budget, mostly implementing tax reductions for selected commercial developments that were approved last year but not funded at the time

SUMMARY

MAYOR'S BUDGET PROPOSAL

- The proposed FY 2011 budget included $99 million in additional revenues, including $34 million from traffic and parking fees and fines and $34 million from new charges on health providers, some of which would be used to draw down federal Medicaid funds.
- Other increases include $10 million in various business fees and $7 million from increasing a fee applied to phone bills that supports 911 services.
- The budget proposed reducing the DC Earned Income Tax Credit by $1 million.
- The budget proposed scaling back tax incentives for high-tech companies by $1.3 million.

FINAL COUNCIL VOTE, May 26

- The Council's revisions resulted in a final budget with $85 million in revenue increases, $14 million less than in the Mayor's proposed budget.
- The Council revised and scaled back the proposed tax on hospitals.
- The Council eliminated proposed increases in parking meter rates, the 911 fee. It eliminated proposed reductions to the EITC and incentives for high-tech companies
- The Council voted to apply the sales tax to soda and medical marijuana, and it created a new property tax rate for vacant property. The Council adopted a provision to increase current tax collections from delinquent taxpayers.

I. Review of Revenue Proposals in the FY 2011 Budget

The FY 2011 budget includes a variety of revenue increases, some that were proposed by the Mayor and some that were proposed by the DC Council.

Adopted Revenue Increases that Were Proposed by the Mayor

Traffic Fines and Parking: The FY 2011 budget will raise $30 million through increased fees and fines in this area.

- **$28 million - Traffic Fines:** The budget authorized the increase of 71different fines for motor vehicle moving infractions such as speeding, running a red light, running a stop sign, turning from the wrong lane, and passing a stopped school bus.

- **$2.3 million – Other:** Residential parking permits will increase from $15 to $25. The District's current fee is lower than fees charged in Arlington County and Montgomery County. Alexandria charges $15 for the first vehicle registered at an address, $20 for the second, and $50 for the third. The budget also proposes to charge a fine when cars are towed out of rush hour lanes.

  As discussed below, the DC Council rejected a mayoral proposal to increase parking meter rates by $3.6 million.

Health-Related Taxes and Assessment: The FY 2011 budget will raise $20 million through new or increased levies on health providers.

- **$6.3 million – $1,500 assessment on licensed hospital beds:** The Mayor's proposed budget would have created a 1 percent charge on net patient revenue for hospitals and set penalties on hospitals that do not pay the fee on time, raising $25 million. The Committee on Health ejected this proposal and instead recommended setting a $1,500 assessment per licensed hospital bed. The full DC Council accepted the committee's proposal.

- **$8.6 million – Impose DC's 2 percent insurance premium tax on HMOs for Medicaid receipts:** The District currently levies a 2 percent tax on health insurance premiums, but managed care organizations that provide Medicaid services have been exempted. Starting in FY 2011, Medicaid providers also will be subject to the 2 percent tax, and the new revenue will be used within the Medicaid program, which will generate $20 million in new federal Medicaid matching funds.

- **$4.7 million — tax on intermediate care facilities:** The Mayor's proposed budget reflected $1.7 million from a 1.5 percent tax on the gross revenue of intermediate care facilities that was adopted in 2006 but has not been implemented. The DC Council raised the rate to 5.5 percent, which generated an additional $3 million.

TABLE 1 REVENUE INCREASES IN THE FY2011 BUDGET	Mayor Proposed Budget (In $Millions)	Council-Approved Budget (In $Millions)
Traffic and Parking		
Traffic Fines	$28.0	$28.0
Parking Meters	$3.6	—
Residential Parking Permits	$1.2	$1.2
Other	$1.1	$1.1
Health Care		
1% Fee on Hospital Patient Revenue	$25.3	—
2% premium tax applied to Medicaid HMOs	$8.6	$8.6
$1,500 fee per licensed hospital bed	—	$6.3
Tax on Intermediate Care Facilities	$1.7	$4.7
Business Fees		
Steel Plate Fee	$3.1	$3.1
Technology Fee on Building Permits	$2.7	$2.7
Other	$3.8	$3.8
E-911 Fee Increase	$7.1	—
Miscellaneous Taxes and Fees	$4.0	$4.0
EITC Reduction	$1.0	—
High-Tech Tax Incentive Reduction	$1.3	—
Hospital and Medical Services Community Reinvestment	$5.0	$5.0
Apply Sales Tax to Soda	—	$7.9
Apply Sales Tax to Medical Marijuana	—	Unclear
Set 5%property tax rate on vacant property		$2.5
Denying Withholding to Delinquent Taxpayers	--	$4.4

Business Fees: The Mayor's budget proposed raising $ 10 million by establishing some new business fees and increasing others. This includes a $3 million from a new fee that businesses would pay when work on DC streets requires temporary use of steel plates, and an additional $3 million from increases building permit and corporate registration fees to pay for "enhanced technological capabilities." The Council did not modify these proposals.

Miscellaneous Fees and Taxes: The Mayor's FY 2011 budget proposed raising $4 million through increasing the tax on life insurance from 1.7 percent to 2 percent, requiring payment for copies of the transcripts from special education hearings, creating a fee to use space in the Charles Sumner School, and by creating or increasing a variety of other fees. The Council modified these modestly, including eliminating proposed fees for use of the Charles Sumner School and eliminating proposed fees for acquiring school-related transcripts.

Revenue from Prior Law: The budget reflects a $5 million payment expected from a private health provider under the recent Hospital and Medical Services Corporation Community Reinvestment Act. The Council did not modify these proposals.

Adopted Revenue Increases that Were Proposed by the DC Council

Vacant Property Tax Rate: The Committee on Public Works and Consumer Affairs recommended re-establishment of a new property tax rate on vacant property, equal to 5 percent of assessed value. The committee also supported a mayoral proposal to increase annual registration fees for vacant property. Properties actively listed for sale and rent, undergoing construction, facing economic hardship, pending predevelopment administrative review, and those subject to probate would be exempt from the higher tax on vacant property and from the vacant property registration fee.

In recent years, the Council voted to set a property tax on vacant properties equal to 5 percent of assessed value, which was subsequently raised to 10 percent of assessed value. In 2010, however, the Council voted to limit this 10 percent tax to blighted properties. Under that change, properties with vacant buildings that are not considered blighted would be taxed at the basic residential property rate (0.85 percent) or the basic commercial rate (1.85 percent) depending on the zoning for the land. The new changes for FY 2011 will increase the tax for these vacant, non-blighted properties to 5 percent.

With these changes, the District will have four real property tax rates in FY 2011.

- **Occupied Residential Properties:** 0.96 percent of assessed value for occupied residential properties
- **Commercial Properties:** 1.65 percent of assessed value for the first $3 million of assessed value, and 1.85 percent for the portion of assessed value above $3 million.
- **Vacant, Non-blighted Properties:** 5 percent of assessed value
- **Blighted Properties:** 10 percent of assessed value

Sales Tax on Soda: The DC Council considered several proposals to cover soda and other sugar-sweetened drinks under DC's sales tax. The Council rejected a proposal to apply a special sales tax on these drinks equal to one penny per ounce. It instead agreed to cover soda under DC's general sales tax, which has a rate of 6 percent. The approved tax of 6 percent is far lower than the proposed penny-per-ounce tax, which would have effectively equaled a rate of 10 percent or more. This will raise roughly $8 million in FY 2011.

The soda tax was considered in the context of funding the DC Healthy Schools Act. The original proposal to levy a tax of one penny per ounce was intended both to raise revenue for this Act and to promote public health. (The Healthy Schools Act, adopted in 2010, will improve the quality of food served in DC public and public charter schools and will increase the amount of time students are engaged in physical activity during the school day.) The tax would have been levied on beverage wholesalers, with the expected effect that retailers would pass on the tax to customers by raising the price of soda and other covered drinks. This, in turn, would be expected to encourage residents, particularly children, to drink less soda.

Sales Tax on Medical Marijuana: Under the budget approved by the DC Council, medical marijuana will be taxed at the 6 percent sales tax rate. It is not clear how much revenue this will generate.

Reduced Income Tax Withholding for Delinquent Taxpayers: The budget adopted by the Council includes a provision to prohibit delinquent taxpayers from reporting any exemptions on their income tax withholding form. This will result in additional taxes being withheld each paycheck from affected residents, which will help the District collect taxes owed from delinquent taxpayers. It will raise more than $4 million in 2011.

II. Revenue Proposals Considered But Rejected for the FY 2011 Budget

Several proposals to raise additional revenues were proposed by either the Mayor or Council but were not adopted in the final budget.

Parking meter rates: Mayor Fenty's budget proposed increasing the rates on meters that charge $0.75 per hour to $1 per hour. The budget proposal also would have increased rates for some meters in high-demand areas. The rate increases would have raised $3.6 million. This proposal was rejected by the DC Council.

E-911 Fee Increase: Mayor Fenty's budget proposed raising $7 million from a 39-cent increase in a monthly fee applied to phone bills that is used to supports 911 services. The fee applies to phone lines and cell phones held by businesses, residents, and the federal government. The DC Council rejected this increase.

Earned Income Tax Credit Reduction: The Mayor's proposed budget would have reduced the DC EITC, a tax credit for low-income workers, by $1 million. The District's Earned Income Tax Credit boosts take-home pay by providing tax relief and, in many cases, refunds to low-income workers, especially those with children. Nearly 50,000 households receive this credit. Under current law, DC's EITC is set at 40 percent of the federal EITC. This proposal would have reduced the credit to 39 percent of the federal credit. The DC Council rejected this reduction.

Reduction in High-Technology Incentives: The Mayor's budget proposed to reduce a set of tax incentives intended to encourage high-technology companies to locate in the District – called the "NET 2000" incentives. Under NET 2000, some high-technology companies receive a 5-year abatement of corporate income taxes, and after that period pay corporate taxes at a rate of 6 percent, which is below the District's standard corporate income tax rate of 9.975 percent. The incentive package also includes a sales tax exemption for certain purchase and certain sales, as well as tax credits tied to the number of employees hired.

The Mayor's proposal would have scaled back the corporate tax reductions for new applicants for NET 2000 benefits. Instead of receiving a 100 percent abatement of corporate income taxes in the first five years in the city, qualifying businesses would pay a tax rate of 6 percent. This would have save the District $1.3 million in 2011. The DC Council rejected this change.

The DC Fiscal Policy Institute supported the mayoral proposal to scale back the NET 2000 tax subsidies. While this set of incentives — which now costs the District roughly $6 million per year — is intended to boost high-tech employment in the city, a 2008 analysis by the DC Fiscal Policy Institute suggests that this package has not had a notable effect. High-tech employment did not grow faster than overall employment in DC in the 2000s, and DC's high-tech employment did not grow faster than in the suburbs.[1]

Moreover, the mayoral proposal reflected a rare effort to review the city's tax incentive programs and to modify those that are costly and/or ineffective. The District offers a number of tax incentives, and like in many states, there is little ongoing review of the cost-effectiveness of the incentives. (A new "Tax Expenditure Budget" for the District highlights the city's various tax exemptions, exclusions, and credits.[2]) Such reviews can be an important way to improve tax systems and raise revenues to address the fiscal crisis resulting from the recession.

Setting New Income Tax Brackets for High-Income Households: During the debate on the final budget, the Council considered an amendment by Councilmember Jim Graham to set a new income tax rate of 8.9 percent on taxable income above $350,000. (The current top tax rate is 8.5 percent.) Under the amendment, the revenues generated would have been used to restore cuts to a variety of services that largely affect low-income residents. This proposal was rejected by the DC Council.

The proposal to raise income taxes through new tax brackets for high-income households was supported by the DC Fiscal Policy Institute and several coalitions, including Save Our Safety Net (SOS) and the Fair Budget Coalition.[3]

Taxing the Income of DC Workers Who Live Outside the City: Councilmember Harry Thomas proposed amending DC's home rule charter to subject the income earned by DC government employees to DC's income tax, even if they live outside of the city. In most states, income of anyone who works in that state – including private sector workers and state employees – is taxed by that state because income taxes are levied based on where an employee works, not where they live. Due to congressional restrictions, however, the District is able to levy income taxes only on DC residents and not on non-residents who work in DC. The proposed change to tax non-resident DC government employees, which was not adopted by the Council, would require congressional approval.

Expanding the Sales Tax to Sports Tickets: A proposal from the Committee on Libraries, Parks and Recreation would levy a tax on tickets to sporting events of 50 cents for tickets that cost $10.02-$25.01 and $1 for tickets that cost $25.02 or more. (Tickets valued at $10.01 or below would be exempt from the tax, unless more than 10,000 people attend the event.) The tax on ticket sales would be used to fund recreation programs. This proposal was not debated by the full DC Council and was not included in the final budget.

III. Tax Reductions in the FY 2011 Budget

The FY 2011 budget included a small number of tax reductions, primarily to implement a variety of tax abatements for a number of development projects that were adopted in 2009. These include abatements for The Heights on Georgia Avenue and Park Place at Petworth.

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[1] DC Fiscal Policy Institute, *DC's High-Tech Tax Incentives Are Not Working: Proposal to Expand Tax Breaks for High-Technology Businesses Has Little Merit*, 2008.

[2] Office of the DC Chief Financial Officer, *District of Columbia Tax Expenditure Report*, 2010.

[3] See, for example, the Fair Budget Coalition fact sheet, a DCFPI analysis, and www.saveoursafetynet.com.

In addition, the Mayor's budget proposed $500,000 in new property tax abatements for non-profits that locate in selected "emerging" neighborhoods.

The Committee on Finance and Revenue recommended several additional tax abatements, but these were not included in the final budget..

- **Third and H Street, NE Economic Development:** Earlier this year, the Council approved a $5 million property tax abatement for a mixed-use development at this location, but the legislation has not gone into effect because the Council has not identified a way to offset the revenue loss. During budget mark-ups, the Committee on Finance and Revenue recommended technical changes to the bill.

- **Pew Charitable Trust:** The Committee on Finance and Revenue recommended an abatement of 40 percent of Pew's property taxes for a period of 30 years. The committee did not identify a way to offset the impact of this revenue loss.

- **Union Station Redevelopment Corporation:** The Committee on Finance and Revenue recommended eliminating property taxes paid by this group, which manages Union Station on behalf of the federal government, and replacing it with a $2 million annual "payment in lieu of tax." This payment also would be eliminated after 5 years. The committee did not identify the amount of revenue that would be lost as a result, and it did not identify a way to offset the revenue loss.