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TAX AND REVENUE ISSUES IN THE FY 2011 BUDGET

SUMMARY

MAYOR'S BUDGET PROPOSAL

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

Mayor Fenty's proposed FY 2011 budget includes about $100 million in additional revenues to help address the city's sharp drop in revenue collections — which helped limit the amount of budget cuts needed to create a balanced budget. The Mayor's proposal also includes a small number of tax abatement – mainly implementing property tax reductions for selected developments that were approved last year.

Roughly one-third of the new revenue would come from traffic and parking fees and fines, making this the second year in a row for increases in this area. Another third of the increases would come from new levies on health care providers, mainly a one percent fee on hospital patient charges. The other revenue increases include 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.

One notable revenue change is a reduction in tax incentives for high-technology companies that open in the District – the NET 2000 incentives. A previous analysis by the DC Fiscal Policy Institute has suggested that this package — which includes substantial income and sales tax reductions – has not had a notable effect on high-tech employment in the District.

Finally, the FY 2011 budget represents the second year in a row in which the Mayor has proposed tax changes that have the impact of increasing taxes paid by low-income working residents. The FY 2011 budget proposal would reduce the size of the DC Earned Income Tax Credit, a tax benefit that has proven to be very effective at lifting working families with children out of poverty. The FY 2010 budget eliminated annual inflation increases in several deductions that largely benefit low-and moderate –income families — the standard deduction, personal exemption in the income tax and the property tax homestead deduction. While the impact of these changes is relatively modest, they reduce the after-tax income of residents who already face challenges meeting their basic needs.

The revenue increases in the proposed FY 2011 budget are discussed on more detail below.

Traffic and Parking: The FY 2011 budget would raise $34 million through increased fees and fines in this area.

TABLE 1 REVENUE INCREASES IN THE PROPOSED FY 2011 BUDGET	Amount (In $ Millions)
Traffic and Parking	
Traffic Fines	$28.0
Parking Meters	$3.6
Residential Parking Permits	$1.2
Other	$2.3
Health Care	
1% Fee on Hospital Patient Revenue	$25.3
2% premium tax applied to Medicaid HMOs	$8.6
Business Fees	
Steel Plate Fee	$3.1
Technology Fee on Building Permits	$2.7
Other	$3.8
E-911 Fee Increase	$7.1
Miscellaneous Taxes and Fees	$4.0
EITC Reduction	$1.0
High-Tech Tax Incentive Reduction	$1.3
Hospital and Medical Services Community Reinvestment	$5.0
Tax on Intermediate Care Facilities	$1.7

- **<u>$28 million - Traffic Fines</u>**: The budget would authorize 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.

- **<u>$3.6 million - parking meter rates:</u>** Meters that currently charge $0.75 per hour would be increased to $1 per hour.

- **<u>$2.3 million – Other</u>**: Residential parking permits are proposed to be raised 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

Health-Related Taxes and Assessment: The FY 2011 budget would raise $34 million through new or increased levies on health providers.

- **<u>$25 million – 1 percent assessment on patient revenue for hospitals:</u>** The proposed budget would create a 1 percent charge on net patient revenue for hospitals, of which 90 percent would be used for healthcare-related expenditures. In addition, penalties would be imposed on hospitals that do not pay the fee on time.

- **<u>$8.6 million – Impose DC's 2 percent insurance premium tax on HMOs for Medicaid receipts:</u>** The District currently levies a 2 percent tax on health insurance premiums, but managed care organizations that provide Medicaid services have been exempted. The new proposal would subject these providers to the 2 percent tax, and use the new revenue within the Medicaid program, which would generate $20 million in new federal Medicaid matching funds.

Business Fees: The budget would raise $ 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."

E-911 Fee Increase: Mayor Fenty's proposed budget would raise $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.

Miscellaneous Fees and Taxes: The FY 2011 budget would raise $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.

Revenue from Prior Law: The proposed budget reflects a $5 million payment expected from a private health provider under the recent Hospital and Medical Services Corporation Community Reinvestment Act, and it reflects $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.

Earned Income Tax Credit Reduction: The proposed budget would reduce by $1 million the DC EITC, a tax credit for low-income workers. 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 reduce the credit to 39 percent of the federal credit.

As noted, this would represent the second year in a row that the proposed budget would make tax changes that have the effect of increasing taxes paid by low-income working residents. The FY 2010 budget eliminated annual inflation increases in several deductions that largely benefit low-and moderate –income families — the standard deduction, personal exemption in the income tax and the property tax homestead deduction.

The immediate impact of these changes is relatively modest — a maximum of about $50 for a DC family with children. Nevertheless, these tax increases are significant for several reasons. First, they reduce the after-tax income of residents who already face challenges meeting their basic needs. Second, they reflect changes to sound tax policies. The EITC is widely regarded as successful in creating incentives to work and reducing poverty among working families. Adjusting tax benefits for inflation is considered in important so that they do not lose their value over time.[1] Finally, the FY 2010 budget and the FY 2011 proposed budget include no tax increases targeted on higher income families. Given that DC's overall tax system results in lower-income families paying a greater share of income in taxes than higher income families do, steps that increase taxes further on lower-income families are not advisable.

Reduction in High-Technology Incentives: One notable revenue change is a reduction in tax incentives for high-technology companies that open in the District – 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 below the District's standard corporate income tax rate. 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.

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[1] For more information, see DC Fiscal Policy Institute, *DC's Earned Income Tax Credit Supports Families Across the District*, 2008, and *Tax and Revenue Issues in the FY 2011 Budget*, 2009.

While this set of incentives — which now costs the District roughly $16 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.[2]

The Mayor's proposal would scale back the corporate tax reductions for new applicants for NET 2000 benefits. This would save the District $1.3 million in 2011.

This change is significant because it reflects an 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.[3]) Such reviews can be an important way to improve tax systems and raise revenues to address the fiscal crisis resulting from the recession

Tax Reductions in the FY 2011 Budget

The FY 2011 budget also includes 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.

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

Budget Hearing Schedule

Between April 12 and May 7, each DC Council committee will hold a hearing on the proposed budgets for the agencies the committee oversees. The committees will then hold "mark-up" votes to modify the Mayor's budget proposal between May 11 and May 13. A vote on the full budget will be held on May 12.

The Committee on Finance and Revenue budget oversight hearing will be held on Wednesday, April 28, and the committee mark-up vote will be held on May 12.

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[2] 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.

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