DC Fiscal Policy Institute

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TAX AND REVENUE ISSUES IN THE FY 2011 BUDGET

SUMMARY

MAYOR'S BUDGET PROPOSAL

- The proposed FY 2011 budget included $99 million in additional revenues, including $34 million from increases in 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 would reduce the DC Earned Income Tax Credit by $1 million.
- The budget proposed scaling back tax incentives for high-tech companies by $1.3 million.

COUNCIL COMMITTEE MARK-UP

- Various committees recommended scaling back the proposed tax on hospitals and eliminating the 911 fee.
- Various committees proposed creating a new tax on sporting event tickets, applying the sales tax to medical marijuana, and creating a new property tax rate for vacant property.
- The finance committee recommended restoring the EITC and high-tech tax breaks.
- The finance committee recommended tax abatements for selected commercial entities.
- The net effect of the mark-up proposals would be to reduce revenues below the level in the Mayor's budget.

Summary of Tax Issues in the Mayor's Proposed Budget

Mayor Fenty's proposed FY 2011 budget included 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. The Mayor's proposal also included a small number of tax abatement – mainly implementing property tax reductions for selected developments that were approved last year.

Roughly one-third of the proposed 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 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 Mayor's budget proposed reducing 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.

Summary of the Tax Issues from Council Committee Mark-ups

During the week of May 11, all committees of the DC Council met to modify the budget proposed by Mayor Fenty for the agencies they oversee. During these "mark-up" hearings, a number of committees made revenue recommendations, including modifications to the Mayor's revenue proposals and a variety of new tax increases and tax reductions.

- The Committee on Health recommended eliminating the 1 percent tax on hospital patient revenue and replacing it with a hospital fee per licensed bed. The new proposal would generate $6 million, compared with $25 million from the proposed 1 percent assessment.

- The Committee on Public Safety and the Judiciary recommended eliminating the E911 fee increase.

- The Committee on Finance and Revenue recommended restoring the Earned Income Tax Credit to 40 percent of the federal credit, although it did not identify a way to fund it.

- The Committee on Finance and Revenue recommended restoring the full set of tax abatements under the NET 2000 high-technology tax incentives.

- The Committee on Finance and Revenue recommended several new tax abatements, including a 40 percent property tax break for Pew Charitable Trust for 30 years and a property tax break for the entity that manages Union Station.

- The Committee on Public Services and Consumer Affairs recommended creating a new property tax rate for vacant property equal to 5 percent of assessed value. The District has had a special tax rate on vacant land in prior years, but it eliminated it in 2009.

- The Committee on Libraries, Parks and Recreation recommended creating a new tax on some tickets for sporting events, and the Committee on Health recommended covering medical marijuana under the sales tax.

The precise fiscal effect of these proposals cannot be gauged, because cost estimates were not provided for all of them. But it is likely that the combined effect would be to reduce revenue collections below the level in the Mayor's budget.

Review of Revenue Proposals in the FY 2011 Budget

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

Traffic and Parking: The Mayor's FY 2011 budget proposed raising $34 million through increased fees and fines in this area.

TABLE 1 REVENUE INCREASES IN THE MAYOR'S 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.

<u>Council Committee Mark-Up Update</u>: The Council did not modify these proposals.

Health-Related Taxes and Assessment: The Mayor's proposed 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.

<u>Council Committee Mark-Up Update</u>: The Committee on Health recommended rejecting this proposal and instead recommended a $1,500assessment per licensed hospital bed. The hospital bed assessment would raise an estimated $6.3 million, compared to the $25.3 million that would have been raised by the tax on hospital revenues

Business Fees: The Mayor's budget proposal 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."

Council Committee Mark-Up Update: The Council did not modify these proposals.

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.

Council Committee Mark-Up Update: The Committee on Public Safety and the Judiciary recommended eliminating this proposed fee increase.

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.

Council Committee Mark-Up Update: The Committee on Public Services scaled back proposed fee increases on vacant property. The Council did not modify the other fee and fine proposals.

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.

Council Committee Mark-Up Update: The Council did not modify these proposals.

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.

Council Committee Mark-Up Update: The Council did not modify the EITC proposal, but the Finance and Revenue Committee report reflected an intent to restore the EITC to 40 percent of the federal credit at the final budget vote.

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.

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

Council Committee Mark-Up Update: The Committee on Finance and Revenue voted to restore the full set of tax incentives under the NET 2000 Act.

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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.
[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.

Other Tax Increases Proposed During Council Committee Mark-ups

A number of DC Council committees proposed other tax changes that would raise revenues and help restore budget cuts

Expanding the Sales Tax to Sports Tickets and Medical Marijuana: 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. The Committee on Health also proposed to extend the 6 percent sales tax to medical marijuana.

Reintroducing a Vacant Property Tax: The Committee on Public Works and Consumer Affairs recommended the re-establishment of a 5 percent tax on vacant property and a vacant property registration fee of $250. 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 the vacant property registration fee. In recent years, the Council voted to increase the tax on vacant and blighted properties to 10 percent, but in 2010 it voted to limit it to blighted properties. Under current law, vacant land is taxed at the basic residential property rate (0.96 percent) or the basic commercial rate (1.85 percent) depending on the zoning for the land.

Tax Reductions in the FY 2011 Budget

The proposed FY 2011 budget also 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.

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

Council Committee Mark-up Update: The Committee on Finance and Revenue recommended several additional tax abatements, but it did not identify a way to pay for them.

- **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.

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- Recommended an abatement of 40 percent of property taxes paid by Pew Charitable Trust for a period of 30 years. The committee did not identify a way to offset the impact of this revenue loss.

- Recommended eliminating property taxes paid by the Union Station Redevelopment corporation, 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.