The District's Dime
Going Beyond the Budget Book

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It's A Wrap! DC's Tax Revision Commission Votes on its Final Package of Recommendations

By Jenny Reed

Yesterday afternoon the DC Tax Revision Commission gave its final approval to a package of recommended changes to DC's tax system, including changes to sales, income and business taxes and a set of recommendations to improve tax administration. The total cost of the tax changes is $49 million, $31 million beyond the $18 million in tax reduction authority allocated to the commission this year by the DC Council.

The commission's recommendations take several important steps to improve the fairness of DC's tax system, by reducing high tax liabilities for thousands of low- and moderate-income residents. At the same time, the final package represents a compromise among differing interests, and it includes some individual recommendations that DCFPI's Ed Lazere, a commission member, had not supported.

The Commission heard early on that DC's tax system was not balanced, that low- and moderate-income DC residents paid the highest share of their income in combined sales, property and income taxes. The Commission looked at the income tax to make the following major changes to improve fairness:

- **Expand the earned income tax credit (EITC) for childless workers**. The EITC is an important tool to help boost the wages and take-home-pay of low-income workers. Unfortunately, the benefits available to workers without children are very low. A parent with one child qualifies for a maximum benefit of $1,300, while a single person with no children qualifies for a maximum of $190 in 2012. The commission recommended raising the maximum EITC benefit for childless workers to match the federal benefit, which was $475 in 2012.

- **Raising the personal exemption and standard deduction to match the federal levels.** DC's current deductions offer far less relief than the average state. Raising these deductions to federal levels would help provide tax relief to a large share of DC households with the greatest relief going to DC's low and moderate-income residents.

- **New income tax brackets and rates**. Currently, DC's tax system imposes high marginal tax rates on low-and moderate income residents. The commission proposed new brackets and rates to lower taxes on households with income between $40,000 and $60,000 (or $40,000 and $80,000 for married couples and heads of household).

Table 1

DC's Tax Revision Commission Proposes A New Middle Income Tax Bracket

Current Brackets & Rates		Proposed New Brackets and Rates			
All Filers	Tax Rate	Singles	Tax Rate	Married Couples & Head of Household	Tax Rate
$0-10,000	4	$0-$10,000	4	$0-$10,000	4
$10,001-$40,000	6	$10,001-$40,000	6	$10,001-$40,000	6
$40,001-$350,000	8.5	$40,001-$60,000	6.5	$40,001-$80,000	6.5
$350,001+	8.95	$60,001-$200,000	8.5	$80,001-$350,000	8.5
		$200,001+	8.75	$350,001+	8.75

- **Maintaining a top tax rate**. Until recently, DC's top income tax rate started at $40,000 of income. That changed when DC adopted a higher tax rate on income over $350,000. However, that top rate was set to expire at the end of 2015. The Commission though maintained a top tax rate on incomes above $200,000 ($350,000 for married couples and heads of household) but reduced the rate to 8.75 percent. Without this rate, DC's top income tax rate would have started at $60,000 of income (or $80,000 for married couples and heads of household) and would have made DC's income tax system more regressive.

- **Phase out the personal exemption for high-income households.** The Commission also proposed to phase out the personal exemption for households with incomes over $150,000, which is similar to federal income tax provisions that phase out this exemption.

The Commission also proposed to make important changes to the sales tax by expanding the base of goods and services that are covered by the sales tax. The Commission heard research that expanding the sales tax to cover services is important because services represent a steadily growing share of personal purchases.

- **Expand the sales tax to cover more services**. The commission proposed to include the following services in the sales tax: construction contractors, carpentry and other construction related services, storage of household goods, mini-storage, water for consumption at home, barber and beautician services, carpet and upholstery cleaning, health clubs and tanning studios, carwashes, bowling alleys and billiard parlors. These services were recommended to have the sales tax extended to them through research presented to the Commission.

- **Unify taxation of tobacco products.** The change would raise $7 million and would ensure that all tobacco products, including some newer tobacco products that are not currently subject to sales tax, would be covered.

Lastly, the Commission recommended two major changes that raise concerns because of the amount of revenues that would be lost and the fact that research shows that neither tax cut is necessary to improve competiveness.

- **Raising the estate tax threshold**: The Commission proposed to raise the estate tax threshold--the level at when estates become subject to tax-- from its current level of $1 million to $5.25 million at a cost of $16 million to the District. Yet research shows that estate taxes have a very modest effect on where people choose to live, and that cutting estate taxes will do little to encourage high-income residents to stay here. Other factors, like family and weather, have a much greater impact on migration decisions.

- **Lowering the business franchise and unincorporated business franchise tax.** The Commission proposes to lower the franchise tax from 9.975 percent to 8.25 percent in order to match Maryland's tax rate. Yet research presented to the Commission showed that a cut to the franchise tax wasn't warranted. DC has out-performed surrounding jurisdictions in business and job growth in the last decade, despite having a higher corporate income tax rate. The cut also means that a business' income will be taxed at a lower rate than moderate-income residents' income in DC. Nevertheless, business members of the commission argued that the regional economy is becoming increasingly competitive and that cutting the business income tax rate would send a strong signal that DC is business friendly.

What's next? The Commission now plans to write up their research and recommendations into a report and deliver those to the Mayor and Council in early 2014. Stay tuned to the District's Dime where we will have more information on the Tax Commission's recommendations.
To see the complete package of recommendations from the Commission, click here.