DC Fiscal Policy Institute

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WHAT REVENUE CHANGES ARE IN THE MAYOR'S PROPOSED FY 2015 BUDGET?

SUMMARY OF THE MAYOR'S PROPOSED FY 2015 BUDGET

- Includes tax and fee changes that together would reduce revenues by $27 million next year. The largest cut is a reduction in the income tax rate on taxable income between $40,000 and $60,000, based on a recommendation of the DC Tax Revision Commission.
- Partially or fully implements other commission recommendations: a cut in the business income tax rate, a change in the way multistate companies determine DC profits, an increase in taxes on non-cigarette tobacco products to match the cigarette rate, and a business income exemption to encourage investment firms to locate in DC.
- Maintains the 8.95 percent income tax rate on taxable income above $350,000 rather than allowing it to expire in 2016 as under current law.
- Implements a law passed earlier this year to exempt long-term lower-income senior homeowners from property tax.
- Implements a law passed earlier this year to prevent homeowners with minor unpaid property tax bills from losing their home due to tax liens.

Mayor Gray's proposed fiscal year (FY) 2015 budget includes a variety of changes to taxes and fees that would result in a $27 million reduction in revenues, equal to about one-third of one percent of the city's locally funded budget. The proposed revenue changes would start to implement a number of recommendations issued by the DC Tax Revision commission in February 2014.

The mayor's budget calls for reducing the income tax rate for taxable income between $40,000 and $60,000, which would partially implement a commission recommendation. This would reduce income taxes by $200 to $400 for moderate- and higher-income households. The budget also proposes to maintain a top income tax on income above $350,000, following a commission recommendation, rather than let the rate expire at the end of 2015 as under current law. The budget would maintain the same top rate of 8.95 percent, however, rather than letting it fall to 8.75 percent as recommended by the commission. Maintaining the rate will raise revenues relative to current law starting in FY 2016, and this would be used to fund portions of the mayor's budget proposal that are phased in over time.

Other commission recommendations partially or fully reflected in the budget include a reduction in the business income tax rate, an increase in taxes on non-cigarette tobacco products to match the cigarette rate, and a business income tax exemption to encourage investment firms to locate in the District.

The proposed budget also includes a tax cut that was not recommended by the commission — to eliminate property taxes for low and moderate-income senior homeowners who have owned property in the city for a number of years. As discussed below, this provision would provide substantial tax reductions for senior homeowners but no additional help to senior reenters, even though they are more likely than homeowners to face high housing cost burdens.

The FY 2015 budget also implements a set of provisions passed into law earlier this year that will help prevent homeowners who have minor unpaid property tax bills from losing their home due to tax liens and fines.

Lastly, the proposed budget includes several contingent tax cuts that would go into effect if DC's revenues rose above current projections. These range from an expansion of the Earned Income Tax Credit to a further reduction in the business income tax rate to an increase in personal exemption and standard deduction, and come largely from recommendations of the tax commission.

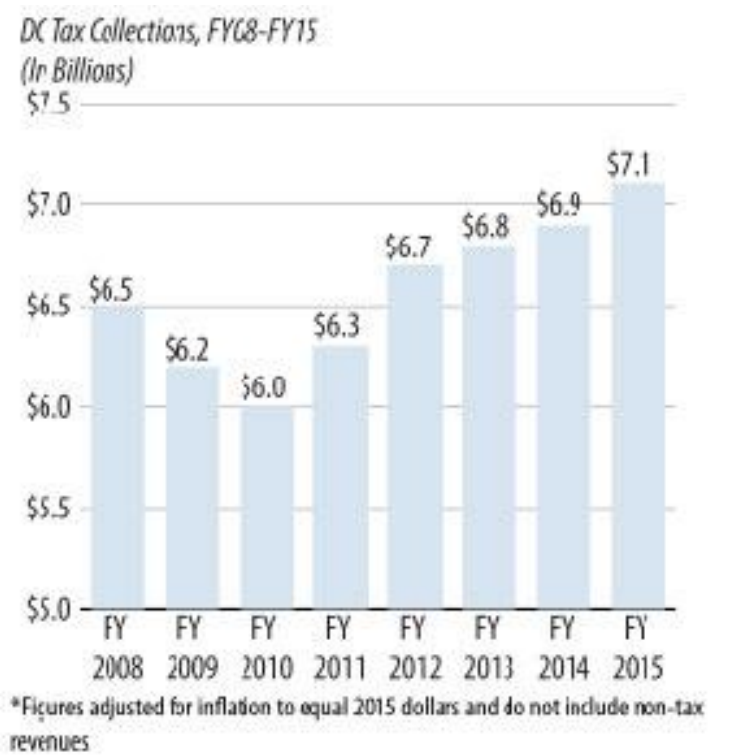
DC's Revenues in 2015 Show Recovery from the Great Recession

The District's tax collections have grown sharply in recent years, erasing drops that occurred during the Great Recession. DC's tax collections dropped sharply in FY 2009 and FY 2010 — falling by nearly $500 million — which led to substantial cuts in a range of programs and services. The city's revenue collections started to rise in fiscal year 2011, in part due to a variety of tax and fee increases, but continued to remain below pre-recession levels.

Projected revenues in FY 2015 total $7.1 billion.[1] This is $600 million higher than in FY 2008, a 10 percent increase after adjusting for inflation. This means that revenues have recovered significantly from the depths of the recession.

Figure 1

DC Revenue Collections Are Strong



Revenue Changes Based on Recommendations of the DC Tax Revision Commission

The proposed FY 2015 budget includes a number of provisions that partially or fully implement recommendations of the DC Tax Revision Commission.

Income Tax Rate Reduction for Moderate- and Higher-Income Residents: The proposed FY 2015 budget would reduce the income rate from 8.5 percent to 7.5 percent on income between $40,000 and $60,000 (or $80,000 to $120,000 for two-earner families). This would reduce revenues

[1] This includes taxes that are used for specific purposes, such as sales taxes used to pay off the Convention Center debt, but it does not "special purpose revenues," special fees tied to certain uses.

by $25 million. The commission had recommended reducing the rate to 6.5 percent on a wider range of income.

The proposed change would reduce taxes by up to $200 for a single-earner household and up to $400 for a two-earner household. It would reduce taxes for both moderate-income households and also for higher-income households. This is because high-income households pay the lower rates on the lower portion of their income and only pay the top rate on the portion of their taxable income that exceeds the threshold for the higher brackets. As a share of income, however, the benefit of the tax reduction will be greatest for moderate-income households.

Table 1
Revenue Changes in the Proposed FY 2014 Budget

	Amount In $ Millions
Tax Commission-Recommended Changes	
Reduce Income Tax Rate	($25.0)
Reduce Business Income Tax Rate	($20.0)
Change Business Income Apportionment	$20.0
Exempt Investment Firms from Income Tax	($4.4)
Equalize taxes on Tobacco Products	$7.0
Other Revenue Changes	
Senior Property Tax Elimination	($8.5)
Protections for Delinquent Homeowners	($1.3)
Tax abatements	($1.3)
Sidewalk Café fees	$1.1
Alternative Fuel Incentives	($0.5)
Improved Tax Compliance	$6.1
Total	($26.8)

Maintain DC's Top Income Tax Bracket: In order to offset some of the revenue loss from reducing income taxes on moderate-income households in the future, Mayor Gray's budget also adopts the Tax Revision Commission recommendation to maintain a top income tax rate for residents with taxable incomes above $350,000 rather than letting it expire in 2016 as under current law. However, the proposed budget would keep the current top rate at 8.95 percent, while the commission had recommended lowering the rate to 8.75 percent. The difference between the mayor's proposal and the commission is relatively modest; a family with income of $500,000 would pay $300 more per year in taxes — or less than one percent of income — with an 8.95 percent top rate than with an 8.75 percent top rate.

Maintaining the top rate would generate a substantial amount of revenue relative to current law — $20 million per year starting in 2016 — that helps to offset the cost of reducing taxes on middle income residents starting in FY 2016.

Reduction in Business Income Tax Rate, New Formula for Allocating Profits to DC: The FY 2015 budget would reduce the income tax rate for incorporated and unincorporated businesses from 9.975 percent to 9.4 percent, resulting in a tax reduction of $20 million.

This revenue loss would be offset by a change in how the profits of multistate corporations are apportioned to the District. State corporate income taxes require multistate business to calculate what portion of their national profits are allocated to a specific state, and this typically is based on the share of the corporation's personnel, property and/or sales that occur in that state. The proposed budget would implement "single sales weighting" under which profits would be apportioned to DC based only on the share of a corporation's sales that occur in DC. This would raise $20 million and would affect corporations that have a large volume of sales in the District but limited personnel or property.

Tax Exemption for Investment Firms: The budget proposes to exempt investment firms from DC's unincorporated business franchise tax. The DC Tax Revision Commission concluded that imposition of the tax discourages investment firms from locating in the District — or requires firms to engage in extensive tax avoidance. The commission recommended exempting these firms from tax on the earnings of their investors, creating a "safe harbor" for such investments.

Sales Taxes on Tobacco Products: The proposed FY 2015 budget would broaden the definition of tobacco products that are subject to sales tax, and it would set the tax rate on all tobacco products to equal the taxes levied on cigarettes. The goal is to simplify tobacco taxation and to ensure that the cigarette tax rate — which is intended to discourage consumption of cigarettes — applies to all tobacco products.

Revenue Proposals Not Related to Tax Commission Recommendations

The proposed FY 2015 budget includes a number of other revenue changes that were not part of the Tax Revision Commission's recommendations.

Property Tax Elimination for Long-term Senior Homeowners: The budget provides funding to implement a bill adopted earlier in 2014 — the Senior Citizen Real Property Tax Relief Amendment Act. That law eliminates property taxes for residents who are 70 or older, have owned a home in the District for 20 years or more, have incomes below $60,000 and interest income below $12,500. This would reduce revenues by $8.5 million.

While the intent of this bill is sound — to prevent seniors from being priced out of their homes — the approach in the bill raises some concerns. Most important, it provides substantial tax reductions to homeowners but no assistance to renters. Yet nearly half of DC's seniors with incomes below $60,000 are renters rather than homeowners, and lower-income senior renters are more likely than homeowners to have high housing cost burdens. This means that while this legislation provides substantial tax assistance to some lower income senior residents, it leaves out the majority of seniors who are struggling with DC's high and rising housing costs.

A better approach to helping seniors address their property tax bills would be to expand DC's property tax credit for lower-income households, known as Schedule H. Schedule H serves both renters and homeowners, and both elderly and non-elderly residents. Schedule H currently helps residents with incomes up to $50,000. The income eligibility could be expanded to $60,000 – and the benefits could be enhanced specifically for seniors. This would meet the goals of the Senior Citizen Real Property Tax Relief Amendment Act while ensuring that all lower-income seniors and others get the help they need.

Protections for Homeowners with Delinquent Property Tax Bills: The budget includes provisions to prevent homeowners with minor unpaid property tax bills from losing their home. Under current law, when a homeowner is behind on property taxes, the District can place a lien on the home and then sell that tax lien to a private party. The amount owed by the homeowner increases due to interest charges and can also increase if the lienholder adds legal fees and other charges. This has led to costs that balloon well beyond the initial tax delinquency, and it has forced some families to lose their home because they could not pay the higher costs.

These FY 2015 budget would address these issues by implementing the Residential Real Property Equity and Transparency Act. More specifically, the proposed budget would prohibit the sale of a residential real property tax lien if the amount owed is $2,500 or less. It also would allow homeowners to enter into a payment plan if the home is their primary residence and they owe $7,500 or less in taxes.

Tax Abatements: The proposed budget would provide a tax abatement of $1 million per year to the Urban Institute and an abatement for a health clinic leased by Whitman Walker Health that would be worth $250,000 in 2015 and about $500,000 in subsequent years.

Higher Fees for Sidewalk Cafes: The budget would raise the fees charged to restaurants that use public sidewalks, raising $1.1 million in 2015.

Alternative Fuel Tax Incentives: The budget would provide roughly $500,000 in tax credits to convert vehicles to alternative fuels and for the installation of alternative fuel infrastructure.

Improved Compliance Measures: Through added staff, the District's Office of Tax and Revenue intends to improve tax billing, with a projection that this will raise $6.1 million in 2015.

Proposed Budget Allows Hospital "Bed Tax" to Expire

The District adopted a new tax on hospitals in FY 2011, levied at $2,000 per licensed hospital bed. The rate was increased to $3,800 per bed in FY 2012. The tax was set to be a temporary source of revenue during the recession, to provide local funds for Medicaid that would draw federal matching funds. The tax was set to expire in FY 2015, and the mayor's budget maintains that plan. The budget replaces those lost local funds with general funds to prevent any cuts to Medicaid services.

Contingent Tax Cuts

The FY 2015 budget includes several tax reductions that are on the "contingent priority" list. These tax reductions would go into effect if the city's revenue collections rise above current projections. It is worth noting that items on the contingent priority lists in recent years generally have not been implemented, either because revenues did not increase sufficiently or because the mayor and council chose different priorities when new revenues were realized.

Expanded Earned Income Tax Credit: The second item on the contingent priority list would expand the EITC for workers without children from $195 to $487, a recommendation of the DC Tax Revision Commission.

Reduce Business Income Tax Rate Further: The third item on the contingent priority list would reduce the income tax rate on incorporated and unincorporated businesses beyond the cut included in the budget. It would reduce the rate from 9.4 percent to 8.9 percent, making further progress on the tax commission recommendation to lower the rate to 8.25 percent.

Commercial Property Tax Reduction: The fourth item on the contingent priority list would reduce the commercial property tax rate on the first $3 million in assessed value for commercial properties, from $1.65 per $100 of assessed value to $1.55. This was not a recommendation of the tax commission.

Deed Recordation and Transfer Tax Reduction: Item 11 on the contingent priority list would reduce the tax rate on deed transfers and deed recordation, from 1.45 percent to 1.4 percent. This also was not a recommendation of the tax commission.

Increase Personal Exemption: Item 14 on the contingent priority list would increase the personal exemption in the income tax from $1,775 to $2,215, partially implementing a recommendation of the tax commission.

Increase Standard Deduction: Item 15 on the contingent priority list would increase the standard deduction in the income tax from $4,250 to $5,200, partially implementing a recommendation of the tax commission.

Estate Tax Reduction: Item 20 on the contingent priority list would increase the threshold for the estate tax from $1 million to $5.25 million, reflecting a recommendation of the tax commission.