DC Fiscal Policy Institute

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WHAT REVENUE CHANGES ARE IN THE MAYOR'S PROPOSED FY 2016 BUDGET?

SUMMARY OF THE MAYOR'S PROPOSED FY 2016 BUDGET

- Includes tax and fee changes that will increase revenue by $36 million, a relatively modest increase equal to just 0.5 percent of total local revenues. The new revenues will help support new initiatives in the budget around homeless services, among others.
- The largest increase in revenue comes from a proposed sales tax increase from 5.75 percent to 6 percent – which, for example would add 25 cents to a $100 purchase. The new sales tax rate would raise $22 million in additional revenue.
- Increases the tax rate on commercial parking from 18 percent to 22 percent, raising $10 million. All new revenue from that increase will go to support improvements to the Washington Metropolitan Area Transit Authority (WMATA).
- Maintains Tax Revision Commission recommendations set to be implemented during tax year (calendar year) 2015: expanding the earned income tax credit to childless workers, raising the standard deduction, phasing out personal exemption for high-income households, and eliminating some individual income tax credits and deductions.
- Beginning in FY 2017, the proposal creates a property tax abatement for Qualified High Tech Companies that lease a building in the District and make improvements to the leased space. The companies could claim up to 50 percent of the value of improvements made. Total tax abatements are capped at $3 million per year or $15 million over 5 years.

Mayor Bowser's proposed fiscal year (FY) 2016 budget includes modest revenue increases to support more funding for affordable housing, homeless services, and other human services. The changes to taxes and fees would boost revenues by $36 million, equal to about one-half of 1 percent of the city's locally funded budget.

DC's Revenues in 2016 Continue to Recover from Recession, But Growth is Slowing

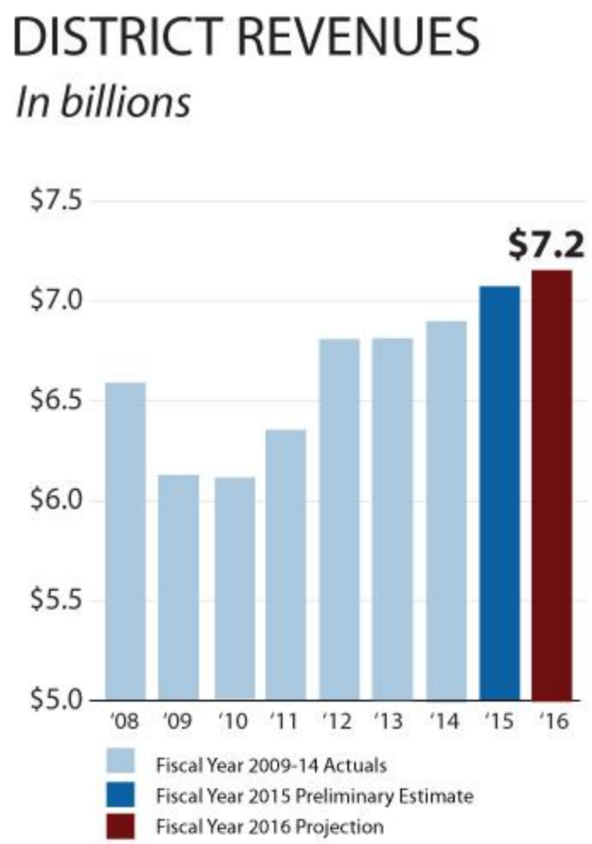
The District's tax collections have grown substantially since 2009, erasing drops that occurred during the Great Recession. However, revenue growth has slowed in the last couple of years.

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 collections started to rise in FY 2011, in part due to a variety of tax and fee increases, but continued to remain below pre-recession levels.

Projected revenues in FY 2016 total $7.2 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. However, **Figure 1** shows that revenue growth is starting to slow. The growth rate since 2012 is about half the rate from 2010 to 2012.

Figure 1

Revenues Are Growing, but Beginning to Slow



Source: FY 2010-15 Proposed Budget and Financial Plan, Chapter 3, cfo.dc.gov

Revenue Changes in the Mayor's Proposal

The mayor's proposed budget makes several policy changes to increase revenue in FY 2016.

Sales Tax Rate Increase: The proposed FY 2016 budget would raise the sales tax rate from 5.75 percent to 6 percent. That would restore the District's rate to where it was during the late recession years (2010 to 2013) and would put the District in line with the sales tax rate in Maryland and Northern Virginia. The sales tax change would increase revenues by $22 million.

The sales tax is a broad-based tax but lower-income households pay more of it as a share of their income, which means it is not always the ideal way to raise revenue. Lower-income families spend all or nearly all of their income each month, while higher-income families put more of their income into savings or in other ways that are not subject to sales tax. However, the proposed sales tax increase is modest – just 25 cents for every $100 taxable purchase – and many residents will benefit from offsetting income tax cuts for low-and-moderate income residents that go into effect in 2015. The income tax reductions will outweigh the sales tax increase for a large share of households. DC's combined taxes for low-income residents are the second lowest in the nation according to the Institute for Tax and Economic Policy.

[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.

Commercial Parking Tax Rate Increase: The Mayor's proposed budget would increase the tax rate for commercial parking from 18 percent to 22 percent and would raise $10 million. The tax is levied on the gross receipts from commercial vehicle storage and parking lots. The revenue would be dedicated to a fund for the improvement and maintenance of the Washington Metropolitan Area Transit Authority (WMATA).

Taxing E-Cigarettes and Other Vaporized Nicotine Products: The proposed FY 2016 budget would tax e-cigarettes and vaporized nicotine products at the same rate as traditional cigarettes and other tobacco products. The DC Council adopted a unified tax rate for all tobacco products in FY 2015, but excluded e-cigarettes due to insufficient evidence of harmful health effects. Several national health organizations (including the Center for Disease Control, the American Heart and Stroke Society, American Cancer Society Cancer Action Network, and the Coalition for Tobacco Free Kids) have determined that e-cigarettes have the potential to harm health and should be taxed and regulated like other tobacco products. The mayor's budget proposal is consistent with these recommendations.

Revenue Increases Through Small Changes to the Individual Income Tax: The budget proposal would make three small changes to the individual income tax to raise $3.6 million. The first change would lengthen the statute of limitations for tax audits, allowing the District more time to conduct audits. The second change would set the standard deduction for a married person filing separately from a spouse at one-half the standard deduction for a married couple filing jointly. The District's standard deduction exempts a certain portion of income from taxes.

Table 2

Sales Tax Boost Raises Most Money in Mayor's Revenue Recommendations In FY 2016 and FY 2017

Mayor's Proposed Revenue Changes	**FY 2016** (In Millions)	**FY 2017** (In Millions)
Sales Tax Rate from 5.75% to 6%	$22.2	$23.1
Commercial Parking Tax from 18% to 22%	$9.9	
E-cigarette & Vapor Product Tax Parity	$0.4	$0.5
Changes to Individual Income Tax	$3.6	$3.6
Tax Abatement for High-Tech Companies*	--	($3.0)

*$3 million in grant funding exists for Qualified High Tech Companies in FY 2016.

Lastly, the proposed budget changes the eligibility for the District's Low Income Credit, which reduces income taxes for residents with very low incomes. The change was made because, currently, a part-year resident with a high income can qualify for the Low Income Credit if their income is only a small amount of their total income while living in the District. The proposed budget changes income eligibility so that part-year residents must annualize their income earned in the District and compare that amount to the District's eligibility threshold.

New Property Tax Abatement for Qualified High Tech Companies: The FY 2016 proposed budget funds $3 million worth of grants to help Qualified High Tech Companies (QHTCs) renovate and improve work space leased in the District. Beginning in FY 2017, these grants would turn into commercial property tax abatements for a company if it has a minimum of 50,000 square feet of commercial space and a lease of at least 12 years. The tax abatement would be worth up to 50 percent of the value of improvements made to the work space, but could not exceed $1 million per company. The mayor's proposal puts a cap on tax abatements so that total abatements cannot exceed $3 million per year or $15 million over five years. The proposed abatement would add to numerous tax breaks offered already to QHTCs – including breaks in corporate income tax, retail sales, and other property tax protections.

New Special Purpose Fund for Bicycle Safety Improvement and Dedicated Funding Stream: The proposed budget also creates a continuing fund for bicycle and pedestrian roadway safety improvements that will receive $500,000 annually from automated traffic enforcement fines.

Revenue Changes Related to Implementation of Tax Commission Recommendations in Tax Year 2015

The proposed FY 2016 budget reflects implementation of a number of provisions adopted last year that will have their first effect on residents – and on the city's tax collections – in 2016. These provisions, passed as part of the FY 2015 budget, partially implement recommendations of the DC Tax Revision Commission. The impact on revenue can be seen in **Table 2**.

Income Tax Rate Reduction for Moderate- and Higher-Income Residents: The individual income tax rate falls from 7.5 percent to 7.0 percent this year on incomes between $40,000 and $60,000 (or $80,000 to $120,000 for two-earner families). This will reduce revenues by $38.4 million in 2016. The commission had recommended reducing the rate to 6.5 percent, and that cut will occur in future years if certain revenue targets are met.

Table 2

Tax Commission Recommendations' Revenue Impact In FY 2016

Tax Commission Policy Changes	FY 2016 (In Millions)
Reduce Middle Income Tax Rate	($38.4)
Raise the Standard Deduction	($15.6)
Expand EITC to Childless Workers	($10.8)
Phase-out Personal Exemption for High Income Households	$4.7
Eliminate Homebuyer Credit, Long-term Care Exemption, and Government Pension Exclusion	$3.7

***Note: This does not include the budget provisions which implement the remaining tax commission recommendations if future revenue increase triggers are met.*

The change reduces taxes by up to $100 for a single-earner household and up to $200 for a two-earner household. It reduces taxes for both moderate-income households and also for higher-income households. This is because high-income households pay lower rates on the first 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 is greatest for moderate-income households.

Raising the Standard Deduction: For tax year 2015, the standard deduction increases from $4,250 to $5,200 for singles and to $8,350 for married couples, partially implementing a recommendation of the tax commission. The standard deduction is especially important for low- and moderate-income families because they are more likely to claim it than higher-income households that tend to itemize deductions. The Tax Revision Commission recommended raising the standard deduction to the federal level, which is followed by six other states. The District will raise the standard deduction fully up to the federal level (currently $12,400 for joint filers) in future years, if certain revenue targets are met.

Expanding the Earned Income Tax Credit (EITC): For tax year 2015, eligibility for the credit increases from about $14,000 to $23,000 for workers without children in their home. In addition, the maximum credit increases from about $200 to almost $500. The District's Earned Income Tax Credit helps low-income families make ends meet by providing substantial tax refunds or reducing taxes substantially for working poor households. However, the credit until recently provided very little benefit to households without children in the home. The maximum credit for childless residents is less than $200 and it only goes to workers earning under $14,000 a year.

Phasing-Out the Personal Exemption for Higher Income Households: In tax year 2015, the DC personal exemption will phase-out for households with taxable income above $150,000, phasing out entirely at $275,000 of taxable income. Like the standard deduction, the personal exemption shields a portion of income from the income tax. The personal exemption is a deduction for each person in the household. The federal income tax phases out the personal exemptions for higher-income households, and the Tax Revision Commission recommended that DC follow a similar approach. The FY 2015 budget calls for increasing the personal exemption to match the federal exemption amount over the next five years.

Contingency Revenue Priorities List

The mayor's proposed FY 2016 budget includes provisions to reverse the sales tax and commercial parking tax increases, as well as a tax increase adopted last year, if the city's next revenue estimate shows an increase in projected tax collections for 2016. These tax code changes, in order of priority, are:

1. **Keep the sales tax rate at 5.75 percent rather than increasing to 6 percent.**
2. **Keep the commercial parking rate at 18 percent rather than increasing to 22 percent.**
3. **Repeal the expansion of the sales tax to cover health clubs and gym memberships, which was adopted in 2015 based on a recommendation of the Tax Revision Commission.**

These tax changes should not be a priority for use of growing tax collections. If revenues rise above current projections, those revenues could be used for a variety of important investments. For example, the 2016 budget only partially implements a plan to end homelessness, and additional revenues could allow fuller implementation of that plan. Additional revenues also could be used to implement further recommendations of the Tax Revision Commission, such as increasing the standard deduction or lowering the middle-income tax rate.

The repeal of the sales tax on health clubs and gym memberships is particularly inadvisable. It would partially undo the expansion of the sales tax to multiple services adopted in the FY 2015 budget. The Tax Revision Commission recommended broadening the base of the sales tax because the strength of DC's sales tax has declined. The sales tax was designed a century ago to tax personal consumption that largely consisted of goods. However, over the past 40 years, personal consumption increasingly has shifted toward services, such as using a cleaning service rather than buying cleaning supplies. To address this, DC – like many other states – has extended its sales tax over time to include more services.

The goal of the sales tax expansion was to make sure the sales tax applies broadly to consumer purchases, strengthening the sales tax and eliminating favoritism that exists with some purchases taxed and others not. Repealing the sales tax on one industry would weaken the sales tax and keep the District from having a more stable and modern tax system.