DC Fiscal Policy Institute
15 Years

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# What Revenue Changes Are In The Proposed FY 2017 Budget?

**SUMMARY OF THE PROPOSED FY 2017 BUDGET**

- DC's projected revenues are $7.45 billion in FY 2017. Revenues have grown very modestly in the last few years, partly due to continuing tax cuts.
- The fee and tax on hospitals that was implemented last year was extended this year. It will provide $17 million to help reimburse hospitals for Medicaid services delivered, but again will expire after one year without another legislative change.
- The proposed budget includes a very small expected revenue increase ($9 million) from new compliance measures and technical changes.
- The budget "sweeps" several funds that could have been used for better purposes.
- The limited increase in revenues partly reflects the impact of tax cuts that have been implemented since the FY 2016 budget. $45 million in tax cuts have been implemented in the past year. The proposed FY 2017 budget leaves these reductions in place and offers no offsetting revenue increases.
- Barring a legislative change, additional tax cuts will be triggered any time that the District's revenues grown faster than projected. This is problematic, because the Council should have the ability to deliberate and decide how to spend its revenue on a case by case basis, depending on the city's needs.

## DC's Revenues Will Grow Only Modestly in 2017

Projected revenues in FY 2017 total $7.45 billion, an increase of just 0.8 percent over last year, after adjusting for inflation.[1] Revenue growth has slowed dramatically in the last couple of years, in part due to implementation of tax cuts. In fact, revenue collections in 2017 will be roughly the same as in 2015. Slow revenue growth limits the ability to keep up with the rising costs of services or to make new investments to meet important needs of DC residents.

DC's tax and fee collections have fluctuated greatly over the past decade, as a result of the Great Recession and subsequent recovery. Revenues 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. Between 2010 and 2015, revenue collections grew a healthy 4 percent faster than inflation each year.

[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.

However, revenue growth has slowed to a crawl since then, as shown in **Figure 1**. The projected $7.45 billion in revenues in 2017 represents growth of just 0.2 percent annually since 2015, adjusting for inflation. As discussed below, the slow revenue growth partly reflects the impact of recently implemented tax cuts.

## Revenue Changes in the Mayor's Proposal

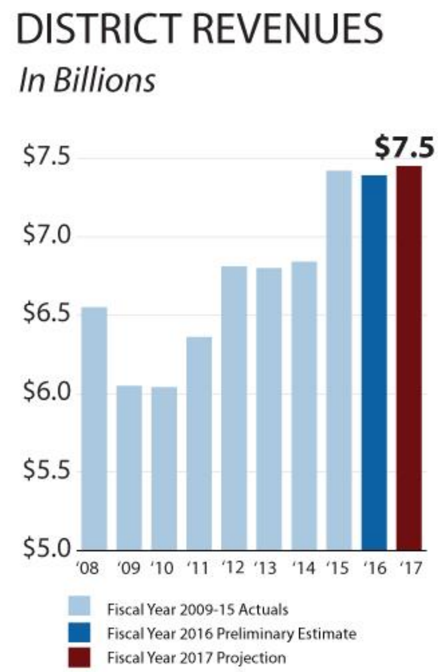
The mayor's proposed budget extends two taxes on hospitals adopted in 2016 and includes several modest policy changes to increase revenue in FY 2017. See **Table 1**.

**Hospital Fees to Pay for Medicaid Services Extended for an Additional Year:** The FY 2017 budget continues two taxes on hospitals, based on hospital revenues for in-patient and out-patient services, that were adopted in 2016 on a one-year basis. The taxes will be used to maintain Medicaid's 2016 hospital reimbursement rates for services for the District's "fee-for-service" beneficiaries, those not in the city's managed care program, who largely are elderly residents and residents with disabilities or chronic conditions. The District currently reimburses hospitals for 98 percent of the costs for in-patient services, far above the national average of 87 percent. Without a continuation of this tax, reimbursement rates would likely have been cut.

Together, the hospital taxes and outpatient fee will raise $17.1 million in dedicated local funding, and this will generate $40 million in federal Medicaid funds.

Figure 1

**District Revenues Are Growing, but at a Slower Pace**




Source: FY 2010-17 Proposed Budget and Financial Plan, Chapter 3, cfo.dc.gov

However, similar to last year, these sources of revenue from hospitals will again be in place for only one year. This means that the issue of Medicaid reimbursements to hospitals will once again have to be revisited in the FY 2018 budget.

**Delay of Certain Business Income Deductions:** The proposed budget delays by five years the effective date for which business tax filers can claim certain deductions. This is expected to increase revenues by $7.4 million in FY 2017.

**Office of Tax and Revenue "Clean Hands" Initiative:** This initiative would allow the District to check for missing sales and income tax withholding when businesses seek various permits or services, such as contract approvals and license renewals. For FY 2017, the sales tax portion is expected to raise $500,000, and the income tax portion will raise $1.5 million.

**Supermarket Tax Credit Expanded:** The proposed budget allows one new grocery store in Ward 4 to qualify for the real and personal property tax exemptions for supermarkets in under-served areas. This is expected to cost $237,000 in FY 2017.

**Expanded Eligibility for High-Tech and Media Company Tax Credits in 2021:** Beginning in 2021, companies located in the Ballpark TIF area would be eligible for the Qualified High Technology Company (QHTC) designation, and a new designation of "Qualified Digital Media Company" would be created for some media companies. These designations allow companies qualify for certain tax breaks. The QHTC expansion is expected to cost $7.25 million in 2021.

Table 1

**Summary of Select Policy Proposals Impacting General Fund Revenues for FY 2017**

| Revenue Source | Fiscal Impact (In thousands) |
|---|---|
| Hospital Fund – Medicaid Hospital Inpatient Fee* | $10,400 |
| Delay certain deductions by 5 years | $7,443 |
| Hospital Provider Fee Fund – Medicaid Hospital Outpatient Fee* | $6,709 |
| Compliance Initiatives at OTR (income taxes) | $1,500 |
| Compliance Initiatives at OTR (sales/use taxes) | $500 |
| Supermarket Tax Credit | ($237) |

*Source: Mayor's Proposed Budget for FY 2017, Chapter 3, Revenue.*
** These are dedicated taxes that cannot be used in the local fund.*

## The Proposed Budget Sweeps Some Funds that Could Have Been Used for Better Purposes

The proposed FY 2017 budget removes funding from:

- **Healthy DC:** The proposed FY 2017 budget removes $6 million in accumulated resources from Healthy DC Fund to support other parts of the city's budget. This follows a similar sweep of Healthy DC Fund resources in 2016. The reduction leaves less money available for health services, including the locally funded Healthcare Alliance program and the local portion of DC's Medicaid program.
- **Crime Victim's Assistance:** The budget removes $2.6 million from the Crime Victims Assistance Fund, the fund that compensates victims of crime for costs like health and mental health services and lost wages.
- **Income Assistance to Residents with Disabilities:** The budget removes $1 million from the Supplemental Security Income (SSI) Payback Fund, a dedicated fund for the Interim Disability Assistance (IDA) program, which supports low-income residents with disabilities. IDA provides temporary cash benefits to individuals who have applied for federal SSI disability benefits and are awaiting an eligibility determination. When an individual is approved for SSI, the federal government reimburses the District for the IDA benefit the individual received. These reimbursement dollars are put into the SSI Payback Fund so the District can

provide benefits for future IDA applicants. The $1 million reduction translates to roughly 300 residents with disabilities who will be unable to get IDA assistance in 2017.

## Recent Tax Cut "Triggers" Have Limited the Ability to Fund New Investments

As a result of Council efforts to prioritize implementation of a tax cut package based on recommendations from the DC Tax Revision Commission, some $45 million in tax cuts has been implemented in the past year. These tax cuts contribute to the slow growth of revenues in FY 2017 and limit the ability to fund new initiatives.

Legislation adopted by the Council triggers automatic implementation of a series of tax cuts recommended by the Tax Revision Commission. The tax cuts are triggered when projected revenue collections increase after the given year's budget has been adopted. The tax triggers automatically devote 100 percent of these revenue increases to tax cuts, which means that none of the growing revenues is available to invest in new services.

The $45 million in tax reductions implemented over the past year include:

- **Reduction in Middle-income Tax Rate:** The income tax rate for income between $40,000 and $60,000 has been reduced from 8.5 percent to 6.5 percent over the past two years. The reduction in the last year cost **$14 million**.
- **Reduction in High-income Tax Rate:** The income tax rate for income between $350,000 and $1 million was reduced this year from 8.95 percent to 8.75 percent. This costs $**5 million**.
- **Reduction in Business Income Tax Rate:** The corporate and unincorporated business franchise income tax rate has been cut from 9.975 percent to 9.0 percent over the last two years. The reductions in the last year cost **$19 million**.
- **Elimination of Estate Tax for Estates Worth between $1 million and $2 million:** The threshold for having to file estate taxes was increased from $1 million to $2 million, resulting in a **$6 million** loss in revenue.

## Continuing the Tax Triggers Will Make It Hard to Adequately Fund Services in 2018, Too

The tax triggers continue to be in effect, which means that additional tax cuts could be implemented after the FY 2017 budget is adopted. This would again sap revenues and limit the ability to fund new investments a year from now.

Under current law, if revenue forecasts issued after the FY 2017 budget is adopted show an increase in projected tax collections, those revenues will automatically be used to implement tax cuts recommended by the tax commission. The full list of tax changes yet to be made represent over $139 million in revenue reductions, a large enough figure that it is likely that no revenue growth will be available for other purposes. (See **Table 2** for the tax cuts and the order in which they would be implemented.)

| Table 2 | |
|---|---|
| **Tax Commission Recommendations Which Will Go Into Effect Via Revenue Triggers** | |
| **Tax Commission Policy Changes** | **FY 2017 Fiscal Impact (In Millions)** |
| Further increase the standard deduction to $5,650 for single and $10,275 for married residents | ($9.4) |
| Increase the personal exemption to $2,200 | ($13.8) |
| Finish raising the standard deduction and conform to federal levels | ($9.8) |
| Further increase the personal exemption to $2,700 | ($16.7) |
| Further reduce business franchise taxes to 8.75% | ($11.9) |
| Further increase the personal exemption to $3,200 | ($16.2) |
| Finish increasing the estate tax threshold to conform to the federal level | ($12.3) |
| Further reduce the business franchise taxes to 8.5% | ($11.9) |
| Further increase the personal exemption to $3,700 | ($15.6) |
| Finish reducing business income taxes to 8.25% | ($11.9) |
| Finish increasing the personal exemption to conform to the federal level | ($9.1) |

*Source: Mayor's Office of Budget and Finance, March 2016.*

Using additional revenue *solely* for tax cuts is problematic for several reasons:

- **Implementing the tax recommendations so quickly will limit the District's ability to address the rising costs of schools, healthcare, and transportation.** The costs of basic services grow every year. Much of the increase stems from natural growth in the costs of mandatory commitments like health care, school enrollment, and Metro needs. Rapidly implementing tax cuts over the coming months could slow revenue growth to a point where DC cannot cover the costs of essential services – or be able to address an unexpected spending need that may arise.
- **The DC Council passed a version of the tax package which did not include important revenue increases that balance the package.** The Tax Revision Commission recommended two revenue increases to offset recommended tax cuts, totaling $67 million, which the DC Council did not adopt. This means that the Council's tax cut plan cuts DC's revenues more than the Tax Commission intended. Given that, it would make sense for the DC Council to spread out implementation of tax cuts to make the impact more manageable.

Rather than automatically reducing taxes using all new revenue growth, additional revenues could instead be used to fund additional services that have been underfunded in proposed FY 2017 budget. For example, the $45 million in tax cuts implemented this year could have fully funded the Public Assistance Amendment Act of 2015, which would reform DC's Temporary Assistance for Needy Families (TANF) time limit to ensure that the basic needs of low-income children are met. This money could have been further used to provide funding to reduce the DC Healthcare Alliance six-month interview requirement to an annual interview, which would ease long lines and wait times at DC's social service intake centers.