TAX AND REVENUE ISSUES IN THE FY 2010 BUDGET

Summary of Tax Issues in the Mayor’s Proposed Budget:
Mayor Fenty’s proposed FY 2010 budget includes $120 million in new revenues to help address the city’s sharp drop in revenue collections — which helped limit the budget cuts needed to create a balanced budget. The Mayor’s budget also includes a small amount of revenue reductions — including tax abatements adopted last year and the impact of some tax changes in the federal stimulus law on DC revenues.

The revenue increases include $20 million from enhanced compliance, $73 million in additional fees and fines, $17 million in tax increases and $11 million in other measures.

Some of the revenue increases reflect policy improvements, such as elimination of a corporate tax provisions that allow companies to shelter profits from DC taxation. Some of the changes, however, would make the DC revenue system less progressive by disproportionally increasing taxes and fees on low-income residents. The budget would eliminate cost of living adjustments for the standard deduction and personal exemption in the income tax and the property tax homestead deduction. In addition, a new proposed streetlight maintenance fee would add $51 per year to each DC household’s electricity bills. This fee would be hardest to bear for low-income households, many of whom already struggle to pay utility bills. A proposed increase in a tax attached to phone bills that supports 911 call services also is regressive.

Summary of Changes Adopted during Council Mark-ups:
During mark-ups, some Council committees found funds to eliminate the proposed streetlight maintenance fee, to cancel the increase in the 911 tax, and to maintain the cost of living adjustment to the standard deduction. The Council also identified funds to restore cost of living adjustments for the personal exemption and homestead deduction, but not until FY 2011. The Committee on Public Works and Transportation identified $21 million in additional revenues through enhanced parking enforcement. Some $12 million would come from restoring a proposed cut in parking enforcement staff; restoring the staff results in personnel costs but also generates ticket revenue that more than offsets the staff costs. An additional $7 million would come from installing parking enforcement cameras on street sweepers, and $1.6 million from enhance enforcement of litter laws.

SUMMARY

MAYOR’S BUDGET PROPOSAL
- The proposed FY 2010 budget includes $120 million in additional revenues — $20 million from enhanced compliance, $73 million in additional fees and fines, $17 million in tax increases and $11 million in other measures.

- Some increases reflect policy improvements, such as elimination of a corporate tax shelter. Some of the changes, however, would increase taxes and fees with a disproportionate effect on low-income residents. This includes eliminating cost of living adjustments (COLA) for the standard deduction, personal exemption, and homestead deduction; a new streetlight maintenance fee; and an increase in the 911 fee.

COUNCIL MARK-UP
- The DC Council restored the COLA for the standard deduction, eliminated the streetlight maintenance fee, and cancelled the increase in the 911 tax. The Council restored COLAs for the other provisions, but not until 2011.
More Detail on Tax Provisions in the FY 2010 Budget

The revenue increases in the FY 2010 budget are discussed in more detail below.

**Enhanced Tax Compliance:** The budget would raise $20 million through a tax amnesty program. Individuals and corporations that owe taxes prior to 2009 would not have to pay penalties if the taxes are paid.

**Council Action:** The Council did not change this provision.

**Fees and Fines:** The proposed budget includes $73 million in revenues from new or increased fees and fines. This includes $36 million from enhanced traffic law enforcement; $15 million from raising parking meter fees (a part of the fee increase was adopted last year by the DC Council); $12 million from a new “streetlight maintenance fee”; $7 million from increasing the fee placed on phone bills that helps cover the costs of emergency and non-emergency response services; and $3 million increases in other various fees. As described below, some of these fees would apply to all DC households and would be regressive because they would place a greater burden, as a share of income, on the city’s poorest households.

**Council Action:** During committee mark-ups, the Committee on Public Works and Transportation identified resources to eliminate the streetlight maintenance fee. The Committee on Public Safety and the Judiciary identified funds to eliminate the 911 tax increase.

**Closing Corporate Tax Loopholes:** The budget would raise $10 million by eliminating a “Delaware holding company” deduction in DC’s corporate income tax. Under current law, corporations are able can shift profits from DC to Delaware— which has no corporate income tax — by transferring income to a subsidiary company in Delaware that is created only for this purpose. When the income is transferred to the Delaware holding company, it is deducted from taxable income in DC. The District attempted to eliminate this deduction in 2004, but legislation proposed in the FY 2010 budget is needed to fully close this tax shelter.

**Council Action:** The Council did not change this provision.

**Eliminate Sales Tax Holidays:** The proposed budget would raise $1.3 million by eliminating the District’s two sales tax holidays, one in August and one after Thanksgiving. During the sales tax holidays, no sales tax is charged on schools supplies and clothing purchases under $100. Research has shown that sales tax holidays do not provide an economic boost as intended. They tend to shift when families and individuals make purchases, but they do not appear to increase overall sales each

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1 For a further description of the Delaware Holding Company tax shelter, see Center on Budget and Policy Priorities, *Growing Number of States Are Considering a Key Corporate Tax Reform*, September 2007.
For example, an analysis of New York state’s sales tax holiday found that retail sales increased during the week of the sales tax holiday, but they found that sales in the calendar quarter that included the sales tax holiday were not higher than in the prior year.²

**Council Action:** The Council did not change this provision.

**Eliminate Cost of Living Adjustments to Several Tax Benefits:** Mayor Fenty’s proposed FY 2010 budget would eliminate cost of living adjustments to three tax deductions — the homestead deduction in the property tax, the standard deduction in the income tax, and the personal exemption in the income tax. By freezing these deductions and exemptions at current levels, rather than allowing them to increase each year, DC residents will pay higher income and property taxes than they otherwise would. The impact of eliminating cost-of-living adjustments increases over time, as the deductions fall further behind an inflation-adjusted value with each passing year. The proposal would increase taxes by $7 million in 2010 and $17 million by 2013.

As discussed below, these deductions are progressive, because they provide a greater benefit to lower-income residents than to higher-income residents. Eliminating the cost of living adjustments thus will have a disproportionate impact on low-income DC residents.

**Council Action:** During committee mark-ups, the Committee on Public Works and Transportation identified additional revenues to restore the cost-of-living adjustment to the standard deduction. The Committee of the Whole identified funds to restore cost of living adjustments for the personal exemption and homestead deduction, but not until FY 2011.

**Applying Economic Interest Tax to Sales of Co-op Units:** When a residential or commercial property is sold in the District, the city levies deed recordation and deed transfer taxes, each of which is set at 1.45 percent of the property’s sale price. When a portion of a property’s value is sold — typically this occurs only with commercial properties — an “economic interest” tax of 2.9 percent applies, which matches the combined amount of deed recordation and deed transfer taxes. Neither of these taxes currently applies, however, when the owner of a residential co-op unit sells his or her share in the co-op. The proposed budget would apply the economic interest tax to such sales, generating $5 million in additional revenue.

**Council Action:** The Council did not change this provision.

**Set Floor on Taxable Assessments:** Under DC’s property taxes, homeowners qualify for several tax relief provisions on their primary home, including a homestead deduction and a 10 percent cap on the amount by which their taxable assessment can increase each year. As a result of these provisions, the taxable assessment for many homes — the assessment to which the tax rate is applied — is well below the full assessed value.³ The 10 percent cap provisions also can result in two homes of similar values having very different tax bills, if the homes were bought in different years. The proposed change would require that taxable assessments equal at least 40 percent of the home’s full assessed value. This would eliminate some of the unintended consequences of DC’s

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³ Some homes, in fact, have a taxable assessment of zero, and because taxable assessments can rise by only 10 percent each year, the taxable assessments of these homes will remain at zero as long as the current owner lives there.
property tax provisions, and it would help reduce the wide disparities in taxes paid by owners of homes of similar value. It would raise $5 million per year.

**Council Action:** The Council did not change this provision during mark-ups.

**Many Fee and Tax Increases in the Proposed FY 2010 Budget Are Regressive**

As noted, the Mayor’s FY 2010 budget proposed to eliminate annual cost of living adjustments to three tax benefits — the standard deduction and personal exemption in the income tax, and the homestead deduction in the property tax. Legislation passed in 2007 required all of these deductions to be adjusted upward for inflation each year, so that their real value will not drop over time. They were adopted because each of these deductions had not been adjusted for many years and had lost ground to inflation. Eliminating the annual inflation adjustments in these tax benefits would increase the taxes DC residents pay, with a disproportionate affect on low-income residents.

In addition to these tax changes, two fee increases in the proposed budget — the new streetlight maintenance fee and an increase in a fee that supports 911 services — would affect nearly all DC households. The streetlight maintenance fee would add $51 dollar to annual electricity bills, and the increased 911 fee would add roughly $10 a year to phone bills. While these fees may be manageable for middle and higher-income families, they would place a burden on low-income families, many of whom struggle to pay utility bills and sometimes face utility shut-offs as a result of non-payment. Because the fee increases would be the same dollar amount for all households, the impact would be regressive — that is, they would consume a greater share of income for low-income households.

The regressive tax and fee increases would total $26 million. As noted above, the DC Council restored the cost-of-living adjustment to the standard deduction and eliminated both the streetlight maintenance fee and the increase in the 911 tax during their budget mark-ups. The Council also moved to restore the cost-of-living adjustments to the personal exemption and homestead deduction, but not until 2011.

The impact of eliminating inflation adjustments to the three tax benefits is described in more detail below.

**The Standard Deduction:** The standard deduction is an amount — $4,000 in most cases — that households are allowed to deduct from their income if they are not claiming itemized deductions. In the District, three-fifths of tax filers claim the standard deduction, and nearly all households that claim it have incomes under $50,000. The standard deduction is especially important to renters, since most do not have enough deductions that would allow them to itemize deductions.

The District’s standard deduction was set at $2,000 from 1987 to 2006. During that time, the value of the standard deduction lost substantial ground to inflation. The standard deduction was increased in both 2006 and 2007 — to $4,000 — and an annual inflation adjustment was adopted. The Mayor’s budget would freeze the standard deduction at this level.

**The Personal Exemption:** Under DC’s personal exemption, households are allowed to deduct $1,675 from their income for each person included on their tax return. While this deduction applies
to all taxpayers, the value is greater as a share of income for lower-income families. For example, a married couple with two children can claim personal exemptions totaling $6,700 this year. This amount would offset more than one-quarter of the income of a family earning $25,000 but less than seven percent of the income of a family earning $100,000.

DC's personal exemption was frozen at $1,370 from 1991 through 2006. The personal exemption was increased in 2006 and 2007 — to $1,675 — and an inflation adjustment was added. The Mayor’s budget would freeze the personal exemption at this level.

**The Property Tax Homestead Deduction:** The homestead deduction is an amount that DC homeowners are allowed to deduct from their home’s assessed value before the tax rate is applied. For 2009, the Homestead Deduction equals $67,500.

The homestead deduction is progressive because it offsets a higher share of a home’s value for owners of lower-value homes than for owners of higher value homes. For example, the homestead offsets more than 20 percent of the value of a home worth $300,000, but only 11 percent of a home assessed at $600,000.

The Homestead Deduction was set at $30,000 in 1991 and remained that level until 2003. It has been increased several times in recent years, reaching $64,000 in 2007. The most recent increase also included an annual cost of living adjustment. The Mayor’s budget would eliminate the cost of living adjustment by freezing the Homestead Deduction at $67,500.

It is worth noting that this change will not immediately affect all homeowners, as would elimination of inflation adjustments in the standard deduction and personal exemption. This is because DC homeowners also qualify for a 10 percent cap on the annual increase in their home’s taxable assessment. Each year, the home’s taxable assessment — the assessment level to which the tax rate is applied — is determined as the lower of two calculations:

- Last year’s taxable assessment plus 10 percent (1.1 times the prior year taxable assessment); or
- The full assessed value minus the homestead deduction.

For many homeowners in the District, the taxable assessment is lower when computed as last year’s taxable assessment plus 10 percent. For these homeowners, a change in the value of the homestead deduction will not have an immediate effect. Freezing the value of the homestead deduction will have the greatest effect on new homeowners, since they do not qualify for the 10 percent cap in the first year that they own their home. Some other homeowners also will be affected, if their full assessed value minus the homestead deduction is lower than their capped taxable assessment.

**Tax Reductions In the FY 2010 Budget**

The Mayor’s FY 2010 proposed budget also includes a small number of tax reductions, primarily to implement a variety of tax abatements adopted in 2008 and to reflect the impact that two federal tax reductions will have on DC's tax collections. The DC Council maintained each of these provisions during its budget mark-ups.
The FY 2010 budget would implement tax abatements that were adopted in 2008 for six projects. These include tax abatements for National Public Radio the Urban Institute, the Pew Charitable Trust, the Southwest Waterfront Development, the Georgia Commons Development, and the O Street Market project. The costs of these abatements in FY 2010 will total just $1.6 million, but will rise to $9 million by 2013.

The FY 2010 budget also reflects the impact of two federal tax changes included in the federal stimulus law. That law temporarily exempts income from unemployment compensation from taxation, and it would temporarily expand the federal Earned Income Tax Credit. The FY 2010 DC budget would allow unemployment benefits also to be exempt from DC income tax, a reduction of $4 million in revenues. Because DC has an earned income tax tied to the federal credit — residents can claim a DC EITC equal to 40 percent of the federal EITC — the expansion of the federal credit also result in greater DC EITC benefits. The DC EITC benefit expansion will total $1.8 million.

**Budget Schedule**

A vote on the full budget will be held on May 12.