Fair Budget Coalition

INVEST IN DC

DC Should Stop Giving Tax Breaks to Invest in Other States' Infrastructure

The District currently provides an income tax break to DC residents who invest in bonds issued by other states and cities to support infrastructure improvements. This means that DC is rewarding residents who invest in other states' infrastructure projects. Most states recognize that this is bad policy, and that is why outside of DC, only one state — Indiana — also allows such a tax break.

The District should eliminate the tax break for investing in out-of-state bonds. This would improve DC's tax system and raise a significant amount of revenue — up to $10 million a year — to help close DC's budget gap. Since this tax break mainly goes to households with incomes over $200,000 it also would make DC's tax system more progressive.

Eliminating the tax break for out-of-state bonds makes sense for a number of reasons:

- **Most states provide an income-tax break only when residents invest in their own state's bonds.** This creates an incentive for residents to support their state's infrastructure. Except for DC and Indiana, no state offers a tax break for residents to invest in out-of-state bonds, because they do not want to incentivize investment in other states' infrastructure.

- **Bonds issued by cities and states are federally tax exempt, and this exemption is much more significant to investors than the DC benefit.** More than three-fourths of the tax benefits DC residents get from investing in these bonds come from the federal tax exemption, because federal tax rates are higher than DC's tax rates. The federal benefit would not change if the DC income tax exemption is eliminated.

- **Removing the tax exemption is a progressive tax change.** Nearly three-fourths of the benefits from the current tax break goes to residents making $200,000 or more.

Questions?

The District is small; does that mean it would not have enough opportunities for people to invest in DC-issued bonds? A number of other states that are also small and are able to limit their tax exemption to in-state bonds, including Rhode Island, Delaware, Vermont, Montana, Hawaii, and Maine.

Should the elimination of the exemption apply only to future investments and not current investments? Most tax changes are not grandfathered in this way. Moreover, limiting the tax change to only future investments could make it difficult for both investors and the District to administer. Investors would have to keep track of which investments they made before the change, and after. This could be especially complicated for residents that make regular contributions to a mutual fund. And the District would likely have to add additional tax forms to explain the timing and different tax treatment of the investments.