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TAX AND OTHER REVENUE ISSUES IN THE FY 2012 BUDGET

SUMMARY

MAYOR'S BUDGET PROPOSAL

- The proposed FY 2012 budget includes $158 million in additional revenues. This includes $81 million in new taxes and fees, and $77 million raised without changes in rates or fees.
- The revenue increases include $35 million in income taxes on higher-income households, $19 million from increases in taxes on corporations and other businesses, and $18 million from increasing the tax at parking garages. .
- The budget also includes $77 million in other revenues, primarily from increasing the amount of income tax withheld from employed District residents.
- The proposed budget includes a provision to implement "combined reporting," a policy that prevents multi-state corporations from sheltering income and avoiding paying taxes to the District. Combined reporting was adopted in 2009 but has not yet been implemented.

Mayor Gray's proposed FY 2012 budget includes about $160 million in additional revenues to help address the city's ongoing budget problems. Some $127 million would be used to help address the $322 million gap between expected revenues and the costs of maintaining services, and the remainder would be used to address shortfalls in the District's fund balance. Even with these increases, tax collections in 2012 would remain $150 million lower than in 2008, when the recession began. .

Roughly half of the new revenue — $81 million — would come from a variety of tax and fee increases, including an increase in income taxes for households with incomes above $200,000, an increase in the tax charged at parking garages, and an increases in the minimum tax paid by corporations and other businesses.

The budget also would raise $77 million from provisions that do not raise rates or fees. This would come primarily from increasing the amount of income tax withheld from paychecks of employed DC residents and by increasing the withholding from residents who pay estimated quarterly income taxes. For many people, the additional withholding would be returned as part of a tax refund when they file a 2012 tax return in 2013. The budget also would raise revenue by extending the hours that alcohol can be sold in stores, enhancing the city's access to the bank accounts of delinquent taxpayers, among others.

Finally, the Gray budget includes legislation to implement a corporate tax provision initially adopted in 2009 — called "combined reporting" — that limits the ability of large multi-state corporations from sheltering income and avoiding paying tax on profits in DC. This will generate $23 million but was already assumed in DC's revenue projections because it was approved in 2009.

Taxes and Fees

The FY 2011 budget would raise $81 million through a variety of tax and fee increases, primarily income taxes and taxes on parking at lots and garages.

Income tax changes — $35.4 million

New Income Tax Bracket at $200,000: The proposed budget would create a new tax bracket of 8.9 percent for taxable income (income after deductions) above $200,000. The current top tax rate of 8.5 percent starts at $40,000 of taxable income. As an example, the new rate would result in $400 tax increase for a family with $300,000 of income.

Because two-earner DC households are allowed to split their income when filing, for some families the tax increase would not go into effect until taxable income exceeds $400,000. Among families with incomes between $200,000 and $350,000, for example, only 55 percent would see any tax increase from the rate change, according to the DC Chief Financial Officer.

Limit Amount of Itemized Deductions for Higher-Income Households: The budget would limit the amount of itemized deductions that can be claimed by families with incomes above $200,000. Under the proposal, the disallowed amount would equal 5 percent of income above $200,000. For example, if a family has income of $300,000, the reduction in allowed itemized deductions would be $5,000 — 5 percent of $100,000 ($300,000 minus $200,000). If the family's total itemized deductions were $30,000 before the limit, the new provision would reduce the deductions to $25,000. With fewer deductions, the family's total taxable income would be $5,000 higher. At a tax rate of 8.9 percent, this family would pay $445 more in taxes.

TABLE 2: REVENUE INCREASES IN THE PROPOSED FY 2012 BUDGET

	Amount (In $ Millions)
Taxes and Fees	
Income tax rate increase and itemized deduction limit	$35.4
Increase in minimum corporate income tax	$12.0
Double-weight sales in corporate income Tax apportionment formula	$7.2
Increase parking tax to 18%	$18.2
Increase sales tax on alcohol to 10%	$2.9
Extend sales tax to live theater	$2.3
Increase various motor vehicle fees	$3.0
Non-Tax increases	
Increase income tax withholding for wage Earners	$41.0
Increase income tax withholding for others	$24.0
Apply cigarette tax at wholesale rather than retail level	$1.1
Extend hours for alcohol sales	$2.4
Lease Carnegie Library to Convention Center Authority	$5.0
Allow advertising on Capital Bikeshare	$0.5
Increase access to delinquent taxpayers bank accounts	$3.0

This provision is similar to a provision that had existed in the federal income tax until a few years ago – and that was mirrored in DC's income tax. The federal itemized deduction limit was eliminated as part of tax breaks passed under President George W. Bush. Because DC had coupled to the federal provision, this also meant that the itemized deduction limit also was eliminated in the DC income tax.

Combined Impact of Income Tax Changes: Together, these provisions would raise $35 million in FY 2012. The combined impact of these changes on DC households would result in an average tax increase of $391 for families with incomes of $200,000 to $350,000 — or less than one-fifth of one percent of income — according to the Chief Financial Officer. The increase would average $992 for families with incomes of $350,000 to $500,000 — or less than one-third of one percent of income.[1] For a family earning just above $1 million, the tax increase would be about one-half of percent of income.

Business Income Tax Changes — $19.2 million

The proposed budget would increase business taxes in two ways – by raising the minimum corporate franchise tax and by changing the formula by which multi-state corporations determine the share of their profits that are taxable in the District. The budget also would increase business income tax collections by $23 million by closing corporate tax shelters that currently allow large multi-state corporations to avoid paying taxes to the District.

Minimum Franchise Tax — $12 million: Under DC's corporate income tax, businesses pay a minimum tax — currently $100 — even if their tax would be lower than that after deductions. Although the city's corporate income tax rate is set at 9.975 percent of taxable profits, two of three corporations pay just the minimum tax because they qualify for a variety of exemptions, deductions, and credits. DC's minimum corporate tax of $100 has not been adjusted for 28 years, meaning that it has lost significant ground to inflation.

The proposed budget would increase the minimum tax to $250 for corporations with gross receipts under $1 million, which would mainly adjust the minimum for inflation since it was last raised in 1983. (Simply adjusting for inflation would set the rate at $211.) For corporations with receipts of more than $1 million, the minimum franchise tax would be $1,000 under Mayor Gray's budget proposal.

Double-Weighted Sales in Apportionment Formula — $7.2 million: Under every state's corporate income tax law, corporations that operate in multiple states must determine their profits nationally and then apportion a share of those profits to each state where they do business. The apportionment formula for a given state usually takes into account the share of a company's sales, property and personnel in that state. Under current DC law, those factors are weighted evenly. Under Mayor Gray's proposed budget, a share of a company's sales that occur in DC would be doubly weighted. This would have the impact of increasing taxes on companies that sell a lot in the District but have most of their property and workforce outside the city. It would reduce taxes for companies that have a high share of their property and staff in DC but where a relatively low share of their sales occurs in DC. As such, the likely increases would fall mostly on out-of-state corporations with a physical presence that is outside of the city.

Combined reporting — $22.6 million: Mayor Gray's proposed 2012 budget includes legislation to implement a corporate tax provision, known as "combined reporting," that was passed by the DC Council in 2009. Combined reporting, which is required in 23 of the 45 states that have a corporate

[1] These averages reflect the total increase for families in these income groups, divided by the number of tax filers. The average includes families that would see no tax increase, such as a two-earner where each earns $125,000. While total income exceeds $200,000, the family would see no tax increase because neither worker earned above $200,000.

income tax, prevents large multi-state corporations from using corporate subsidiaries to shift profits to states with low or no corporate income tax. FN Implementing combined reporting will allow the District to collect $22.6 million in additional taxes in fiscal year 2012. These revenues are not reflected in tables in the FY 2012 budget because the revenues have been reflected in revenue projections since the legislation was adopted in 2009. But if the implementing legislation is not adopted this year, projected revenues for 2012 would be reduced by $22.6 million, widening DC's budget gap.

Other Taxes and Fees

Parking Tax - $18.2 Million: The budget would raise the tax charged on parking garages and lots from 12 percent to 18 percent.

Apply the Sales Tax to Live Theater — $2.3 million: The proposed budget would apply DC's 6 percent sales tax to live performances. Currently, the tax applies to events at the Nationals Ballpark and the Verizon Center, but not to other live performances.

Increase the Tax on Liquor for Off-premises Consumption — $2.9 million: The current tax on alcohol purchased at a store for off-premises consumption is 9 percent, while the tax on liquor purchased at a restaurant or bar is 10 percent. The Gray budget proposes to set the tax at 10 percent for all sales.

Implement Various DMV Fee Increases — $3 million: Fees would be increased for duplicate licenses, knowledge and road tests, and some other vehicle services.

Continue the General Sales Tax Rate at 6 Percent — no effect in 2012: In addition to these changes, the budget would eliminate a planned reduction in the sales tax rate to 5.75 percent in 2013. Under legislation passed in 2009, the sales tax was raised from 5.75 percent to 6 percent, with the increase was set to expire in 2013. The Mayor's budget would eliminate the planned sunset, leaving the rate at 6 percent in 2013 and beyond. This will increase revenues by $16 million starting in 2013.

Non-Tax Increases in Revenues

Mayor Gray's Budget would raise roughly $77 million in general revenues in 2012 through a variety of changes that do not alter tax or fee rates. The largest portion — $65 million — would come from increasing income tax withholding rules for DC residents.

Increase Income Tax Withholding — $65 million: Working DC residents have a portion of each paycheck withheld to cover their income tax liability. Income tax withholding helps ensure that residents do not owe large amounts of income tax when they file a tax return, and it also provides a steady stream of revenue to the District.

Residents who receive substantial amounts of income outside of employment — such as retirees and others with substantial investment income — also are subject to a withholding requirement. They are required to make estimated tax payments each quarter.

Mayor Gray's budget would increase the withholding amounts for both groups. For working DC residents, withholding would be increased by $160 each year, raising $41 million in 2012.[2] While residents are able to adjust withholding, which means that any worker who does not wish to have the additional $160 withheld can do so, the budget assumes that virtually no workers will make this adjustment.

The policy rationale for these withholding changes appears to be fairly limited, beyond raising revenues in 2012. The large majority of DC households receive a tax refund when they file a return, which suggests that the withholding amounts are sufficient for most workers under current law. This also means that for most families, the additional withholding in 2012 will be returned as a tax refund in 2013. (For this reason, the withholding provision is not expected to provide substantial revenues in future years.) No official reason has been provided for the increase in withholding, although some DC finance officials have noted that an increase in withholding would improve tax compliance. Some residents who owe substantial taxes, including back taxes, do not file a tax return. The additional withholding would help collect more of the taxes owed by these non-compliant residents.

While the added withholding for working DC residents would be relatively small, the impact could be significant for low- and moderate-income workers who already may face challenges meeting their basic needs. Moreover, the rationale for taking additional withholding from these workers is small, since 84 percent of filers under $50,000 already receive refunds under current withholding rules.

Alter the Application of the Cigarette Tax — $1.1 million: In addition to a tax of $2.50 per pack, cigarette sales also are subject to a 6 percent sales tax. The budget proposes to levy this tax on wholesalers rather than retailers, which is expected to improve collections. It would not alter the effective tax on cigarettes.

Extend Hours for Alcohol Sales — $2.4 million: The proposed budget would lengthen the amount of time that liquor could be sold in the District. The expected increase in sales would also lead to an increase in tax collections.

Payment from the Washington Convention and Sports Authority — $5 million: Under the proposed budget, WCSA would transfer $5 million to DC's general fund to reflect its use of the Carnegie Library. Because WCSA is a DC government entity, this is a fund transfer and not a fund increase.

Greater Access to Bank Accounts of Delinquent Taxpayers — $3 million: The budget would give the DC Chief Financial Officer greater access to bank accounts of delinquent taxpayers, resulting in greater tax collections.

Advertising in the Capital BikeShare Program — $0.5 million: The District would raise an anticipated $500,000 from selling advertising space through the bicycle sharing program.

[2] This would occur by altering the income tax withholding formula to not take into account DC's $4,000 standard deduction.