DC Fiscal Policy Institute

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TAX AND OTHER REVENUE INITIATIVES IN THE PROPOSED FISCAL YEAR 2013 BUDGET

Summary of the Mayor's Proposed FY 2013 Budget

Mayor Gray's proposed Fiscal Year 2013 budget includes $90 million in additional revenues to help address the city's $172 million budget gap for next year.. Some of the revenue proposals would improve efforts to collect tax and non-tax revenues and to enforce the city's traffic laws, which require additional staffing and equipment. Taking these associated costs into account, the net revenue increase is $84 million.

The increase in revenues largely would occur without changes to fees or taxes on residents and businesses. Just $13 million of the proposed new resources would come from changes in tax policy. These include a proposal to limit planned increases in three tax deductions, and a proposal to create a new fee for taxi rides.

Even with these increases, revenue collections in FY 2013 would remain slightly lower than in FY 2008 — when the recession began — after adjusting for inflation. This suggests that the District's finances are recovering from the downturn but have not fully returned to pre-recession levels. While revenues are almost back to the FY 2008 level, the costs of many public services have risen, due to increased school enrollment, higher Medicaid caseloads, and other factors.

The largest share of the new revenues— $36 million — would come from efforts to improve compliance with existing taxes, fees, and fines. This includes new tools to ensure that retailers remit sales tax on all of their sales and creation of a new centralized unit to collect non-tax revenues, such as fines for parking and traffic violations that are owed.

SUMMARY

MAYOR'S BUDGET PROPOSAL

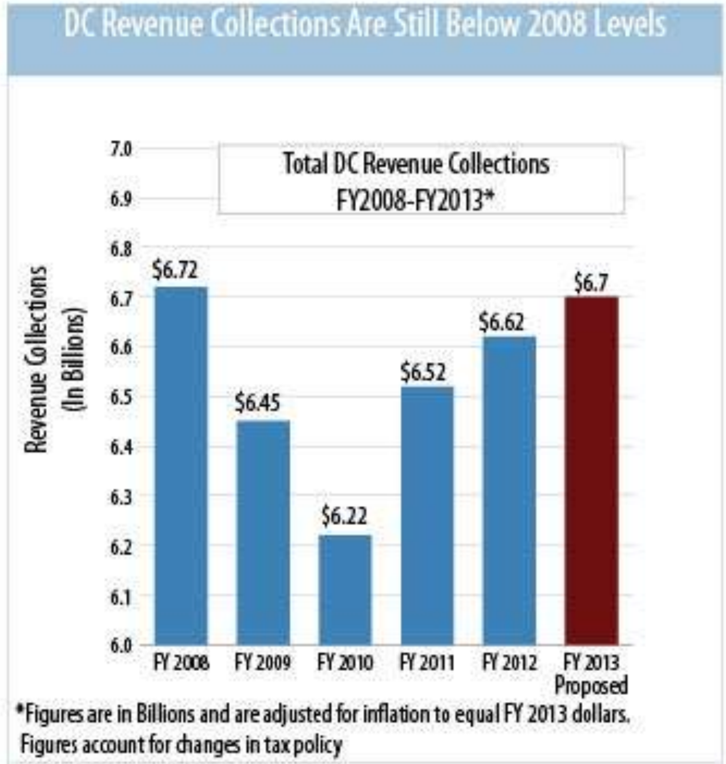
- The proposed fiscal year 2013 budget includes $90 million in additional revenues. It largely does not raise taxes on residents or businesses, with most of the new revenues coming from improved collection and compliance efforts.
- The increases include $36 million from enhanced compliance efforts for existing taxes, fees, and fines. Another $31 million would come from expansion of automated traffic enforcement. The budget would generate $5 million by extending hours of alcohol sales.
- The budget would raise $12 million by limiting required inflation adjustments in three tax benefits: the standard deduction and personal exemption in the income tax, and the homestead deduction in the property tax.
- The proposed budget includes two tax cuts that would go into effect if revenues rise above expected levels. This includes restoring a tax break for interest on out-of-state municipal bonds and reducing the commercial property tax rate.

COUNCIL MARK-UP

- The Council recommended against expanding the hours of alcohol sales.

The budget also would raise $31 million from expansion of automated enforcement of traffic violations, including new equipment to identify drivers who speed through red lights.

The third largest source of revenue would come from scaling back planned inflation adjustments in three tax benefits: the personal exemption and standard deduction in the income tax, and the homestead deduction in the property tax. Rather than adjusting these benefits for cost-of-living increases between 2007 and 2012, as required under current law, the budget would only adjust them for inflation between 2011 and 2012. With smaller adjustments to these tax benefits, DC residents will pay $12 million more in taxes than if the deductions had been increased for inflation for the full five years. Because these benefits provide the greatest benefits to low- and moderate-income residents, this modest tax increase would fall most heavily on lower-income residents.



A fourth source of revenue in the Gray proposed budget would raise $5 million in alcohol taxes by allowing stores to sell alcohol earlier in the morning and allowing bars to stay open later.

Finally, the proposed budget includes some proposed revenue *reductions*, including tax abatements for four projects approved in prior years, at a cost of $750,000 in FY 2013. In addition, Mayor Gray put two tax cuts on a "revenue priority list," which would go into effect only if revenues rise substantially from expected levels. This includes restoring a tax break for interest DC residents earn on investments in out-of-state municipal bonds, a tax break that no state or city offers and that the District just eliminated last year. In addition, the "revenue priority list" includes a reduction in the commercial property tax rate for the first $3 million in assessed value. This is intended to serve as a small business tax break, although much of the benefit would go to large commercial buildings.

Summary of the Council Mark-Up

The DC Council marked up the mayor's budget proposals during the week of April 30. The full Council will hold its first vote on the entire budget on May 15.

The Council Committee on Human Services, which has jurisdictions over the Alcohol and Beverage Regulation Administration, recommended elimination of the mayor's proposal to extend hours of alcohol sales.

DC's Revenues in 2013 Will Finally Return to Pre-Recession Levels

The District's tax collections dropped sharply in the Great Recession, starting in FY 2009. Tax and other revenue collections fell by nearly $500 million over two years, leading to substantial cuts in public services. The city's revenue collections started to rise in FY 2011 but continued to remain below pre-recession levels.

The District's revenue collections in FY 2013 will total $6.7 billion, if the Mayor's revenue proposals are adopted.[1] This remains $20 million lower than revenues in FY 2008, the final year before the recession.

This suggests that DC's finances are recovering from the recession but still remain volatile.. The District has adopted a number of revenue increases in recent years, to address the effects of the weak economy on collections. Without these, total revenue collections in FY 2013 would remain well below pre-recession levels.

Moreover, the costs of public services tend to rise faster than inflation, especially in a recession when demand for some services increases, which further suggests that FY 2013 revenue levels will not be sufficient to support services at pre-recession levels. Enrollment in publicly funded schools has increased in recent years, and demand for services such as Medicaid has risen as a result of growing unemployment. Moreover, some core costs of providing public services, such as utility costs for public buildings or health benefits for public employees, have risen far faster than overall inflation. For example, funding for schools in FY 2013— DC public schools, DC public charter schools, and private school costs for students in special education — will be nine percent higher than in 2008, adjusting for inflation, and proposed FY 2013 funding for the Department of Health Care Finance is 21 percent above the FY 2008 level, adjusting for inflation.

Revenue Increases in the 2013 Budget

The mayor's proposed budget would raise about $90 million from a variety of sources, as shown in Table 1.

TABLE 1

Revenue Increases in the Proposed FY 2013 Budget

Revenue Initiative	Amount (In $ Millions)
Increased Tax and Fee Compliance	$36.3
Expanded Automated Traffic Enforcement	$31.1
Limit Inflation Adjustments for Personal Exemption, Standard Deduction, Homestead Deduction	$12.0
Expand Hours of Alcohol Sales	$5.3
Establish Taxi Flag Drop Fee	$1.1
Other	$4.3

Improved Compliance with Taxes and Fees: The FY 2013 budget would raise $36 million through a variety of measures to improve compliance with DC's taxes, fees, and fines. The budget allocates two million dollars for additional staffing and other costs to achieve these goals. The two largest sources of enhanced revenue collection are the following:

[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.

- **Improved Sales Tax Collections from Retailers:** Starting in 2013, the Internal Revenue Service will share information with the District on the total credit card transactions of each retailer. This will allow the District to better identify retailers who are not reporting all of their sales and not remitting sales taxes in full. This is estimated to increase tax collections by $16 million.

- **Centralized Collection Unit for Non-Tax Revenues:** The budget reflects $10 million in new revenues that will come from creating a new unit to improve collection of non-tax revenues. It is expected that the largest share will come from collection of parking ticket fines from non-residents.

Expanded Automated Traffic Enforcement: The proposed FY 2013 budget would generate $26 million by expanding resources used by the Metropolitan Police Department for automated enforcement of traffic violations, including acquiring new equipment and placing "speed on green" cameras to catch drivers who speed up to make it through a light. These efforts, combined with efforts to improve the efficiency of traffic citation issuance, would raise $31 million. Taking into account roughly five million dollars in new costs associated with these efforts, the net increase would be $26 million.

Scaled-Back Inflation Adjustments for Key Tax Benefits: Three tax benefits — the standard deduction and personal exemption in the income tax and the homestead deduction in the property tax — are required by law to be adjusted for inflation each year. But these benefits have been frozen in place since 2008, as a budget-savings measure. Inflation adjustments were scheduled to resume in 2013, with adjustments made to reflect inflation between 2007 and 2012. This would effectively bring these benefits to the level they would have been if they had not been frozen for several years.

Mayor Gray's budget proposes, however, to adjust these benefits for inflation only from 2011 to 2012. This would have the following effect:

- The standard deduction in the income tax would increase to $4,050 rather than to $4,550 if it were adjusted for inflation back to 2007.

- The personal exemption will remain at $1,675 rather than rising to $1,875.

- The homestead deduction will rise from $67,500 to $69,350, rather than to $75,950.

Because the standard deduction and homestead deduction would increase modestly under the mayor's proposal, DC residents would see modest declines in their tax bills. Yet because the deductions would not increase as much as called for under current law, resident tax bills still will be higher than if the increases in tax benefits under current law were left in place. For a family of four in the lowest income tax bracket, income tax payments will be $52 higher than if the full inflation adjustment were made. The limited adjustment to the homestead deduction means that a homeowner will pay $56 more in property taxes than if the full adjustment were made.

While these impacts are relatively small, it is worth noting that these tax benefits generally provide the most benefit to low-income residents, because the deductions equal a larger share of income for low-income residents than for high-income residents. Moreover, the standard deduction is primarily claimed by low and moderate-income residents, who do not have enough deductions to claim itemized deductions. As a result, the proposed changes to these deductions make the tax system slightly less progressive.

Expanded Hours for Alcohol Sales: The proposed budget would allow stores to start selling alcohol at 7:00 a.m. rather than 9:00 a.m., and it would allow bars to sell alcohol one hour later in the evenings, to either 3:00 a.m. or 4:00 a.m. depending on the day of the week. This is expected to generate more alcohol sales and $5.3 million in additional taxes as a result.

As noted above, the DC Council Committee on Human Services recommended against expansion of alcohol sales hours. The full DC Council will consider this recommendation when it votes on the budget on May 15.

Other Sources of Revenue: The proposed FY 2013 budget reflects roughly $5 million in other sources of revenue. This includes $1 million that will be raised from a new 50-cent fee added to every tax ride. The other sources include $1.8 million in savings for DC's revenue department by lowering the rate of interest it pays to taxpayers who have overpaid and are due a refund. The interest rate would be set a market rate but no higher than six percent. The budget also reflects $2 million from a settlement with providers that operate Intermediate Care Facilities (ICF/MR) related to a tax assessed on them.

Revenue Reductions in the Fiscal Year 2013 Budget

The proposed budget includes $750,000 in tax abatements for four projects, all of which had been adopted by the DC Council in recent years but not funded. The budget also includes $11 million in possible tax reductions that are part of a list of items that would get funded if revenue collections increase during FY 2013 beyond current projected levels.

Tax Abatements: These include a one-time tax refund for the Washington Ballet ($111,000), tax abatements for two affordable housing developments ($595,000), and a $55,000 tax abatement for United House of Prayer for all Peoples.

Contingent Tax Cuts: Mayor Gray's proposed budget includes a "revenue priority list," a list of items that would get funded if revenue collections for FY 2013 increase above current projected levels.

One proposal would restore a tax break for interest earned on government bonds issued in other states. Last year, the DC Council eliminated this tax break for all new investments made starting in 2012. This proposal is the 6th item on the priority list and would into effect if revenues increase by $68 million.

Until recently, the District and Indiana were the only jurisdictions to offer a tax exemption for interest on out-of-state municipal bonds. Most states offered the tax break only for bonds issued within the state, to create an incentive to invest in in-state government projects. Providing a tax break for interest on out-of-state bonds creates an incentive to invest in infrastructure projects in other states.

Both Indiana and the District eliminated this tax break in 2011. Both jurisdictions allowed the tax exemption to remain for existing investments and only eliminated the tax break for new investments. The mayor's proposal for FY 2013 would make the District the only jurisdiction in the nation to offer a blanket tax exemption for interest on bonds issued in other states.

The second tax reduction proposal on the mayor's revenue priority list would reduce the commercial property tax rate for the first three million dollars of a building's assessed value from $1.65 per $100 of assessed value to $1.55. This proposal would cost $10 million in FY 2013. It is the twelfth item on the revenue priority list and would go into effect if revenues rise about $100 million above expected levels.

This proposal builds on a tax provision adopted in 2008. That year, the DC Council adopted a reduction in the commercial tax rate for the first $3 million of any building's assessed value. The rate was reduced from the basic rate of $1.85 for every $100 of assessed value to $1.65.

This provision was adopted with the goal of providing tax assistance to small businesses, although much of the benefit goes to larger businesses. The tax reduction applies to all commercial properties, from the smallest to the largest. Because the lower tax rate applies to the first $3 million of any building's value, it provides the greatest benefit to smaller, lower-value buildings — which pay a lower rate on their entire building. The benefit is much smaller for higher-value buildings, because they get the lower rate only for a small share of their building's value.