DC Fiscal Policy Institute

An Affiliate of the
Center on Budget and Policy Priorities
820 First Street NE, Suite 460
Washington, DC 20002
(202) 408-1080 Fax (202) 408-1073
www.dcfpi.org

May 21, 2012

TAX AND OTHER REVENUE INITIATIVES IN THE FISCAL YEAR 2013 BUDGET

The fiscal year (FY) 2013 budget includes $88 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 $82 million.

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

Even with these increases, revenue collections in FY 2013 will 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 — will 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.

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

SUMMARY

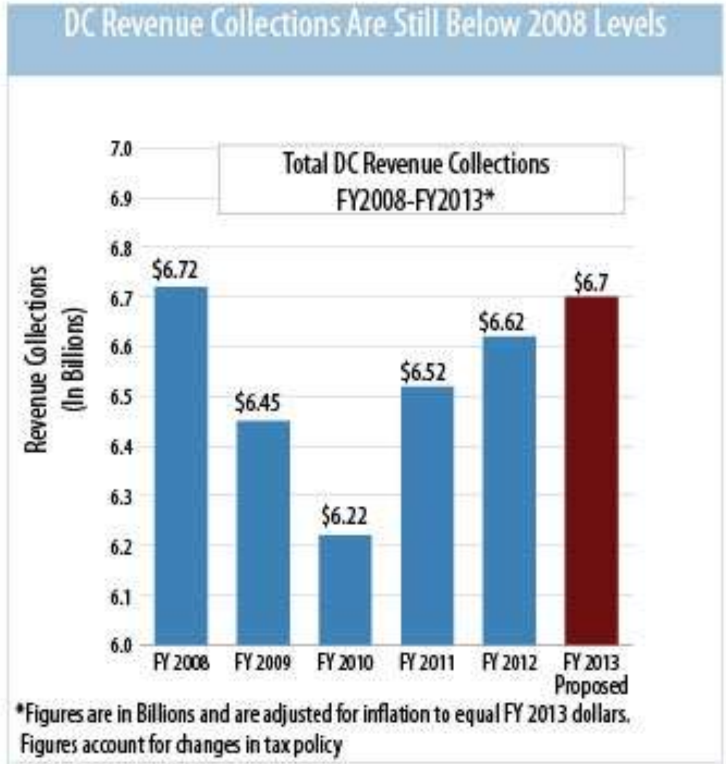
MAYOR'S BUDGET PROPOSAL

- The proposed fiscal year 2013 budget included $90 million in additional revenues.
- It included $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 proposed generating $5 million by extending hours of alcohol sales.
- The mayor proposed raising $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 included two tax cuts that would go into effect if revenues rise above expected levels. One would restore a tax break for interest on out-of-state municipal bonds and the other would reduce the commercial property tax rate.

FINAL COUNCIL VOTE, MAY 15

- The final adopted package will raise $88 million in FY 2013.
- The Council voted to extend alcohol sales hours in a more limited way, only on local and federal holidays and on selected weekends.
- The Council added another tax reduction to be funded if revenues rise. It would increase the income eligibility limit for a senior citizens' property tax credit from $100,000 to $125,000.

The third largest source of revenue comes 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 calls for adjusting them for inflation just 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 falls most heavily on lower-income residents.



A fourth source of revenue in the budget would raise $3 million in sales taxes from alcohol and food sales at restaurants and bars by allowing them to stay open later on holidays and selected holiday weekends. The adopted proposal scaled back a proposal from Mayor Gray that would have allowed stores to sell alcohol earlier in the morning and allowing bars to stay open later all year long.

Finally, the FY 2013 budget includes some revenue *reductions*, including tax abatements for four projects approved in prior years, at a cost of $750,000 in FY 2013. In addition, there are three 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. Finally, the revenue priority list includes a provision to increase the income eligibility limit in DC's senior citizens' property tax credit from $100,000 to $125,000.

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.[1] This remains about $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 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 Fiscal Year 2013 Budget

The budget will raise about $88 million from a variety of sources, as shown in Table 1.

TABLE 1

Revenue Increases in the 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 Restaurant & Alcohol Sales	$3.1
Establish Taxi Flag Drop Fee	$1.1
Other	$4.3

Improved Compliance with Taxes and Fees: The FY 2013 budget will 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:

- **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 will increase tax collections by $16 million.

[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.

- **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 FY 2013 budget will 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 is $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 proposed, however, to adjust these benefits for inflation only from 2011 to 2012. The Council accepted this proposal, which will have the following effect:

- The standard deduction in the income tax will 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 will increase modestly, DC residents will see modest declines in their tax bills. Yet because the deductions will 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 had been 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 changes to these deductions make the tax system slightly less progressive.

Expanded Hours for Alcohol and Restaurant Sales: Mayor Gray proposed allowing stores to start selling alcohol at 7:00 a.m. rather than 9:00 a.m., and to 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 was expected to generate more alcohol sales and $5.3 million in additional taxes as a result.

The DC Council modified this proposal significantly. It allows stores to start selling alcohol as early as 7:00 but only if that is part of an approved voluntary agreement with neighborhood residents. In addition, it allows bars to stay open one hour later only on all holidays, and for the entire weekend on selected holiday weekends (New Year's Eve, Memorial Day, Labor Day, and Independence Day). The proposal allows these establishments to sell food for 24 hours on these weekends.

The Council's adopted plan will raise $3.2 million.

Other Sources of Revenue: The 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 will 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 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 $12 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: The 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.

- **Commercial Property Tax Rate Reduction:** The first 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.

  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.

- **Restore Tax Break for Out of State Municipal Bonds:** The second tax 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 24th item on the priority list.

  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 final budget 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.

- **Raise Income Limit for Senior Citizens' Property Tax Credit:** Under current law, senior citizens and residents with disabilities qualify for a 50 percent reduction in their property tax bill if total household income is less than $100,000. A third tax cut proposal on the revenue priority list would increase the income limit for this credit to $125,000, in recognition of the fact that the income limit has not been adjusted for 20 years. The beneficiaries of this change, which is 25th on the revenue priority list, are seniors and residents with disabilities and incomes between $100,000 and $125,000.