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WHAT REVENUE CHANGES ARE IN THE MAYOR'S PROPOSED FY 2014 BUDGET?

Mayor Gray's proposed fiscal year (FY) 2014 budget includes $69 million in additional revenues, equal to about 1 percent of the city's locally funded budget. The bulk would come from expansion of automated traffic enforcement, a new fee on hospitals that will be used to fund Medicaid services and generate federal matching funds, and improved tax compliance measures. The budget includes no broad-based fee or tax increases.

The proposed FY 2014 budget includes one tax reduction, which would restore a tax break for interest earned on bonds issued by other cities and states that had been eliminated in 2011 though not yet implemented. This would make the District the only jurisdiction in the nation to provide a blanket tax exemption for all out-of-state bonds. The budget also supports tax abatements for various development projects, including several that had been approved in prior years, at a total cost of $800,000 in lost revenue in FY 2014.

Finally, the budget includes two tax reductions on a "contingent priority list," items that will get funded if revenues rise above current projections. One provision would reduce the property tax rate on the first $3 million of any commercial property's value. The second provision would implement improvements adopted in 2012 to DC's tax credit for lower-income homeowners and renters with high property taxes, known as Schedule H. The Schedule H tax credit has not been modified since it was adopted in the mid-1970s and has many limitations. Legislation adopted by the DC Council in 2012[1] — which was not funded — addressed many of these problems. Together, these contingent tax cuts would cost roughly $15 million in FY 2014.

SUMMARY

MAYOR'S BUDGET PROPOSAL

- The proposed fiscal year 2014 budget includes $69 million in additional revenues, mostly from expansion of automated traffic enforcement cameras. The budget includes no major tax or fee increase on residents or businesses.
- The proposed budget includes one notable tax cut. The budget would re-establish a tax break for residents investing in bonds issued by other cities and states. This would make DC the only jurisdiction to offer a blanket tax exemption for out-of-state bonds. The budget also would fund a number of tax abatements for development projects, with a total revenue loss of less than $1 million in 2014.
- The proposed budget includes two tax cuts that would go into effect if revenues rise above current projections. One provision would reduce the commercial property tax rate in a way intended to help small businesses. The second provision would implement legislation adopted in 2012 to improve DC's tax credit for low-income residents with high property taxes, known as Schedule H.

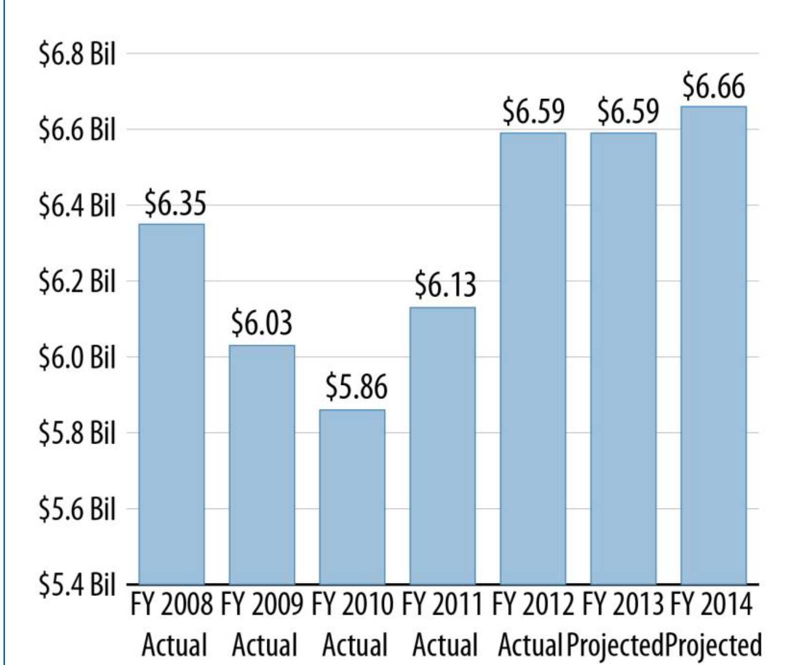
[1] B19-0164, "The Schedule H Property Tax Relief Act of 2011"

DC's Revenues in 2014 Show Recovery from the Great Recession

The District's tax collections have grown sharply in recent years, erasing drops that occurred during the Great Recession, but leaving revenues only modestly above pre-recession levels. DC's tax collections dropped sharply in the Great Recession, falling by nearly $500 million in 2009 and 2010 and leading to substantial cuts in public services. The city's revenue collections started to rise in fiscal year 2011, in part due to a variety of tax and fee increases, but continued to remain below pre-recession levels.

Figure 1

DC Revenue Collections Have Recovered From the Great Recession



Figures are adjusted to equal FY 2014 dollars and do not include special purpose revenues

Projected revenues in FY 2014 total $6.66 billion.[2] Several things are worth noting about the city's expected tax collections:

- **Revenues have recovered significantly from the depth of the recession.** Tax and other revenue collections in FY 2014 will be $800 million, or 14 percent, higher than the low point in the recession in FY 2010.

- **Overall revenue growth since before the start of the recession is modest.** When both the fall in revenues during the recession and the increase in revenues in the recovery are taken into account, average revenue growth since FY 2008 is less than 1 percent per year.

- **Federal cuts are projected to affect the DC economy and tax collections in 2014.** Revenues in 2013 and 2014 are projected to be no higher than in 2012, adjusting for inflation. This is due almost entirely to the impact of expected federal budget cuts resulting from sequestration, which will reduce employment and contracting in the DC area and thus create a drag on the economy.

[2] 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.

Revenue Increases in the Fiscal Year 2014 Budget

Expanded Automated Traffic Enforcement: The proposed FY 2014 budget would generate $44 million by expanding the use of speeding and other automated traffic enforcement cameras to more locations.

Improved Sales and Income Tax Compliance: The FY 2014 budget would raise $12 million through a variety of measures to improve compliance with DC's taxes. Some $4.4 million would result from better use of federal matching programs to identify taxable sales and income, and $7.6 million would come from enhanced technology to detect errors or abuse.

Table 1
Revenue Changes in the Proposed FY 2014 Budget

	Amount (In $ Millions)
Revenue Increases	
Expanded Automated Traffic Enforcement	$44.1
Hospital Provider Fee	$12.4
Enhanced Tax Compliance	$12.0
Other	$1.2
Revenue Decreases	
Re-establish tax break for out-of-state bonds	$1.7
Tax abatements for development projects	$0.8

Hospital Provider Fee: The budget proposes a new that fee will be assessed on the gross patient-based receipts of every hospital in the District of Columbia. The funds will be used for Medicaid-eligible outpatient services provided by hospitals. The $12.4 million in local dollars generated by the fee will draw down $29 million in federal matching funds.

Other Sources of Revenue: The proposed FY 2014 budget projects $800,000 in additional revenue from enhanced food inspection, $350,000 from improved surplus property sales practices, and $50,000 from an increase in a fee assessed on healthcare providers..

Revenue Reductions in the Fiscal Year 2014 Budget

The proposed budget includes one tax reduction provision, to re-establish a tax break for interest earned on out state bonds. The proposed budget also would fund proposals adopted in recent years to provide tax abatements to several development projects and to provide blanket tax exemption to affordable housing developed under a specific DC program. Finally, the FY 2014 budget includes a "contingent priority" list of items that will get funded if DC's revenue collections improve, and the list includes two tax reductions.

Out-of-State Bonds Tax Break: The FY 2014 budget proposes to restore a tax break for interest earned on government bonds issued in other states. The DC Council eliminated this tax break for out-of-state bond investments made in or after January 2013.

Restoring this tax break would make DC the only jurisdiction in the nation to offer this tax break. It would cost $1.7 million in lost revenue in 2014, rising to nearly $4 million by 2017. Outside of DC, states offer tax breaks only for bonds issued within the state, as an incentive to invest in that state's infrastructure. Creating a tax break for bonds issued elsewhere would establish an incentive to invest in out-of-state infrastructure projects.

Supporters of the tax break say that it is needed to protect seniors on limited incomes who live off such investments. Yet most out-of-state bond holders in DC are not retirees and most are not low-income. In 2008, just 6 percent of all DC taxpayers hold out-of-state bonds, and only one-fourth of them have retirement income. Two-thirds of the income from out-of-state bonds goes to households with income over $200,000. In fact, just 2.4 percent of households with income from out-of-state bonds in a recent year — 482 households citywide — were retiree households with incomes below $50,000.

It is worth noting that eliminating the tax break for out-of-state bonds helped spike interest in investments in the District's infrastructure bonds. In 2012, DC's Chief Financial Officer reported that demand for DC bonds from DC residents was up significantly from the prior year and that this helped lower the costs of issuing those bonds. This progress would be lost if the District once again becomes the only state to offer a tax break for investing in bonds issued by any city or state.

As noted, when the DC Council eliminated this tax break, any investment made before January 2013 remained tax exempt, preserving the tax break for residents who had already made investments with the expectation that they would be tax free. Some residents who invest in mutual funds that include out-of-state bonds are concerned that they are at a disadvantage because the mutual fund's portfolio is constantly changing. This could potentially create "new" investments subject to tax, even for mutual fund shares that they have owned for years. The District could address this by maintaining the tax break for any mutual fund shares acquired prior to 2013, no matter how the composition of the fund changes.

Tax Abatements: The proposed budget would fund the following tax abatements that were adopted in previous years but not yet funded.

- United Negro College Fund — $340,000 in FY 2014
- Carver 200 Low-Income and Senior Housing — $99,000 in FY 2014
- Elizabeth Ministry Affordable Housing — $7,000 in FY 2014
- Gala Hispanic Theater — $44,000 in FY 2014
- Beulah Baptist Church — $59,000 in FY 2014

The budget includes other tax abatements with no costs in FY 2014, either because costs are limited to FY 2013 or because costs will start in FY 2015. The latter includes a tax abatement for Parkside Mixed Income Apartments that will cost about $500,000 per year starting in 2015.

Contingent Tax Cuts

The FY 2014 budget includes two tax reductions that are on the "contingent priority" list. These tax reductions will go into effect if the city's revenue collections rise above current projections.

Commercial Property Tax Rate Cut: Item 16 on the contingent priority list would reduce the commercial property tax rate for the first $3 million of a building's assessed value from $1.65 per $100 of assessed value to $1.55, resulting in a $10 million revenue loss in FY 2014. This builds on a tax provision adopted in 2008, when the rate for the first $3 million of assessed value was reduced from the basic commercial property rate of $1.85 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. Because the lower tax rate applies to the first $3 million of any building's value, it provides a greater benefit to smaller, lower-value buildings — which pay a lower rate on their entire building — than to higher-value buildings that get the lower rate only for a share of their building's value. Nevertheless, because the tax reduction applies to all commercial buildings, it is not highly targeted on small business. Moreover, because many small businesses are located in larger buildings, a modest tax reduction for a large building has only a modest impact on the taxes paid by a small tenant in that building.

Schedule H Property Tax Relief: Item 17 on the contingent priority list would implement legislation adopted in 2012 to improve Schedule H, a tax credit for lower-income residents when rents or property taxes are high relative to income.[3] Schedule H is a property tax credit, but it helps both homeowners and renters. Schedule H assumes a portion of a household's rent — 20 percent under the new law — reflects property taxes passed on to them by their landlord.

Schedule H has not been updated for 35 years and has several problems that result in very few residents claiming it. The changes adopted last year to address those problems include the following:

- **Raising the income eligibility limit from $20,000 to $50,000.** The income eligibility limit for Schedule H has remained $20,000 for 35 years.

- **Increasing the maximum annual credit amount from $750 to $1,000.**

- **Allowing people who share housing to claim Schedule H separately.** Current rules require people or families sharing a home to apply together even if they do not share income or file tax returns together. This often makes it impossible for people to qualify. Of 16 states with similar credits, 14 allow people in shared housing to claim the credit separately based on their income and their share of the rent. The legislation adopted in 2012 would follow this practice.

As many as 125,000 residents would be eligible for the updated Schedule H credit based on income, according to the Chief Financial Officer. Implementing these changes will cost $5.4 million in FY 2014.[4]

[3] B19-0164, "The Schedule H Property Tax Relief Act of 2011".

[4] The fiscal impact statement for the Schedule H legislation suggests the costs would be $10.9 million in FY 2014, and that is the figure reflected in the FY 2014 budget's "contingent priority" list. Yet this fiscal impact level assumes that families receiving federal housing choice vouchers, or other rental subsidy, would no longer be required to subtract the total value of their subsidies from their calculated Schedule H credit to get the actual refundable portion the family would ultimately be eligible for.. A review of the 2012 Schedule H legislation suggests that the rules governing residents in subsidized housing would not change. Without this change, the cost of Schedule H in FY 2014 would be $5.4 million.