DC Fiscal Policy Institute

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WHAT ARE THE TAX AND REVENUE CHANGES IN THE FY 2014 BUDGET?

The adopted fiscal year (FY) 2014 budget includes $74 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 mayor's budget included no broad tax increases.

The FY 2014 budget includes five tax reductions that will total $31 million in FY 2014. They include a cut in the sales tax rate; expansion and improvements to the "Schedule H" property tax credit for lower-income homeowners and renters; re-establishment of a tax break for interest earned on bonds issued by other cities and states (legislation to eliminate this tax break was adopted in 2011 but had not been implemented); expansion of eligibility for a 50-percent property tax credit for senior homeowners; and a sales tax exemption for the utilities that restaurants use to prepare food.

The adopted budget set aside $18 million to implement tax changes recommended by the Tax Revision Commission, which will issue its final recommendations at the end of calendar year 2013. The Mayor and DC Council will determine which recommendations to implement.

The budget also supported tax abatements for various development projects, including several that had been approved in prior years, at a total cost of $1.3 in lost revenue in FY 2014.

The FY 2014 budget includes a small number of increases in fees or charges for services, a higher fee

SUMMARY OF CHANGES IN THE FY 2014 BUDGET

- The fiscal year 2014 budget includes $74 million in additional revenues, mostly from expansion of automated traffic enforcement cameras. There are no major tax increases.
- The budget includes several tax reductions. The largest is a cut in the general sales tax rate from 6 percent to 5.75 percent, which will reduce collections by $20 million.
- Another tax cut implements improvements in DC's tax credit for low-income residents with high property taxes (Schedule H).
- The budget re-establishes an income tax exemption for interest earned from out-of-state municipal bonds.
- The budget increases the income eligibility for DC's senior 50 percent property tax credit, from $100,000 to $125,000.
- $18 million in new revenues, identified shortly before the budget was adopted, were set aside to implement recommendations that will come from the Tax Revision Commission.
- The budget also funds several tax abatements for development projects, with a total revenue loss of $1.3 million in 2014.
- The budget includes an increase in the fine for parking in a street-sweeping zone, and additional parking enforcement. These changes will add $3.3 million in FY 2014.
- The FY 2014 budget changes the gas tax to protect its long-term viability, but the change does not raise revenues in 2014.

for residents who park during a street-sweeping restriction, new parking enforcement staff, and additional parking meters. These changes would raise $3.3 million in FY 2014.

The budget changes the way the tax on gasoline is structured, to protect the long-term viability of this revenue source, but without raising additional revenue in the near-term.

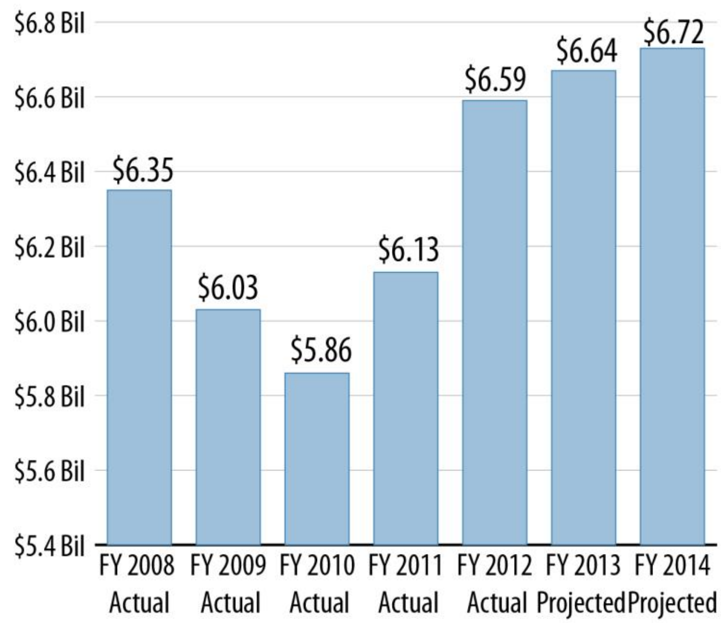
Finally, the FY 2014 budget directs potential future revenues in several ways. A portion of future sales tax and cigarette tax revenues would be dedicated to the arts and smoking cessation programs, respectively. And if federal legislation is approved to allow DC and the states to tax online sales more broadly, the new revenues would be dedicated to WMATA and to homeless services.

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

DCFPI Analysis of DC Budget and CFO Quarterly Revenue Forecasts

Projected revenues in FY 2014 total $6.72 billion.[1] 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 nearly $900 million, or 15 percent, higher than the low point in the recession in FY 2010.

[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.

- **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 about 1 percent per year.

- **Federal cuts are projected to affect the DC economy and tax collections in 2014.** Revenues in 2014 (excluding changes adopted in the FY 2014 budget) are projected to be just 1.2 percent higher than in 2012, adjusting for inflation, despite significant population growth. This slow growth 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.

Revenue Increases in the Fiscal Year 2014 Budget

The adopted fiscal year (FY) 2014 budget includes $74 million in additional revenues, equal to about 1 percent of the city's locally funded budget (see **Table 1**). The adopted budget also includes a number of tax reductions and several tax abatements for various development projects. The revenue changes are described below.

Expanded Automated Traffic Enforcement: The FY 2014 budget will generate $43 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 will raise $13 million through a variety of measures to improve compliance with DC's taxes. Some $4.4 million will result from better use of federal matching programs to identify taxable sales and income, and $7.6 million will come from enhanced technology to detect errors or abuse.

Table 1
Revenue Changes in the FY 2014 Budget

	Amount (In $ Millions)
Revenue Increases	
Expanded Automated Traffic Enforcement	$43.0
Hospital Provider Fee	$12.4
Enhanced Tax Compliance	$12.8
Expand Parking Enforcement & meters	$2.3*
Increase Street Sweeping Violation Fee	$1.0
Other	$2.8
Revenue Decreases	
Reduce general sales tax rate by ¼ percent	$19.8
Re-establish tax break for out-of-state bonds	$1.7
Sales tax exemption for restaurant utilities	$3.5
Expand/Update Schedule H Credit	$5.4
Increase income limit for senior property tax credit	$0.7
Tax abatements for development projects	$1.3

* Net increase after staffing costs

Hospital Provider Fee: The budget includes 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.

Increased Fee for Violation of Street Sweeping Restrictions: The budget increased the fee for cars that park on street in violation of street-cleaning parking restrictions, from $30 to $45. This will raise $1 million.

Expanded Parking Enforcement: The budget includes funding to hire 30 additional parking enforcement staff, which will raise $600,000 per year after taking into account the added personnel costs. Other parking related initiatives will add $1.7 million.

Other Sources of Revenue: The FY 2014 budget projects $800,000 in revenue from enhanced food inspection, 350,000 from improved surplus property sales practices, 50,000 from an increase in a fee assessed on healthcare providers, $320,000 in enhanced debt collection for United Medical Center hospital, and $1.3 million in new assessments on homeowners in flood-prone areas. The assessments will be used to fund flood assistance services.

Revenue Reductions in the Fiscal Year 2014 Budget

The budget includes several new tax reduction provisions, and it funds tax abatements to several development projects as well as providing a blanket tax exemption to all affordable housing developed under a specific DC program. Together, these total over $31 million in FY 2014.

In addition, the Council set aside $18 million in the FY 2014 budget to allow it to implement some of the recommendations from the Tax Revision Commission, which will be completed by the end of calendar year 2013. The set-aside was made possible by a revenue forecast issued during the week of the final budget vote that identified a substantial increase in expected revenue collections. Most of revenue increase was used to increase spending on priority services and to reduce the general sales tax rate (see below). The remainder was set aside for future tax reductions.

Sales Tax Rate Reduction: The sales tax rate for general purposes was reduced from 6 percent to 5.75 percent, which will result in $20 million in lost revenues in FY 2014. (The District has separate sales tax rates for some types of purchases, such as restaurant meals, car rentals, and hotels. Those rates were not adjusted.) The sales tax rate had been raised from 5.75 percent to 6 percent on a temporary basis in FY 2010, but later the change was made permanent. The FY 2014 reduction will return the sales tax to its rate from 1995 to 2010.

Schedule H Property Tax Relief: Legislation was adopted in 2012 to improve Schedule H, a tax credit for lower-income residents when rents or property taxes are high relative to income.[2] Schedule H is a property tax credit, but it helps both homeowners and renters because it assumes a portion of a household's rent — 20 percent under the new law — reflects property taxes passed on by the landlord. Schedule H provides assistance to households struggling with rising rents or property taxes, and thus can help DC residents stay in their homes amidst sharply increasing housing costs.

Schedule H has not been updated for 35 years and has several problems that result in very few residents claiming it. The changes funded in the FY 14 budget address many of those problems, including 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.

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[2] B19-0164, "The Schedule H Property Tax Relief Act of 2012".

- **Increasing the maximum annual credit amount from $750 to $1,000.** The maximum credit amount has also not been adjusted for 35 years, and has remained at $750.

- **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 follows this practice.

As many as 125,000 will 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.

Expanded Income Eligibility for the Senior Property Tax Break: Under current law, senior homeowners with income under $100,000 qualify for a 50 percent cut in property taxes. That income limit has not been adjusted in a number of years, as is the case for many parts of the DC income tax. The FY 14 budget funds the Age in Place Tax Credit Act, which increases the income limit for this tax credit to $125,000 and adjusts it for inflation in subsequent years. The practical effect is to provide property tax reductions for seniors with incomes between $100,000 and $125,000. This tax reduction will cost $700,000 in FY 2014.

Out-of-State Bonds Tax Break: The FY 2014 budget includes a provision to restore a tax break for interest earned on government bonds issued in other states. The DC Council voted in 2011 to eliminate this tax break for new investments in out-of-state bonds but has delayed implementation since then. The budget thus makes permanent the policy of offering a tax exemption for all such investments, including new ones.

Restoring this tax break makes DC and North Dakota the only jurisdictions with an income tax to offer a blanket exemption for all out-of-state bond investments. It will cost $1.7 million in lost revenue in 2014, rising to nearly $4 million by 2017. Outside of DC, most states offer tax breaks only for bonds issued within the state, as an incentive to invest in that state's infrastructure.

Supporters of the tax break argued that the District offers residents only a limited number of DC bond options, and that this tax break is needed to protect seniors on limited incomes who live off such investments. While a small number of DC households rely on tax-exempt income for a notable share of their income – about 700 households get one-third or more of their income from such bonds – many very high-income residents appear to use out-of-state bonds as a tax shelter. Over three-fourths of tax-exempt income in the District in 2010 went to residents with income of $200,000 or more in income *in addition to their tax-exempt interest income*. In fact, just 81 DC households earned an average of $2 million from tax-exempt interest in 2010, accounting for nearly half of all tax-exempt interest earned in the District.

Sales Tax Exemption on Selected Restaurant Utilities: The FY 2014 budget will implement legislation adopted in 2011 to provide a sales tax exemption for the utilities used by restaurants to store and prepare food. This exemption reflects the fact that refrigeration and cooking are inputs into a restaurant's final products, and tax law often is designed not to tax the inputs to a business product, especially when the final product will be subject to sales tax. This provision will cost $3.5 million in 2014.

Tax Abatements: The budget would fund the following tax abatements, some of which were adopted in previous years but not 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
- Tregaron Conservancy — minimal impact
- Tibetan Community — $32,000 in FY 2014
- Bryant Mews Homeowners Association — $70,000 in FY 2014
- Basilica of the National Shrine of the Immaculate Conception — $207,000 in FY 2014
- Jubilee Housing Residential Rental Project — $237,000 in FY 2014

The FY 2014 also implements legislation adopted in 2010 that repeals the property tax for affordable housing purchased under the Land Acquisition for Housing Development program, and 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 the Howard Town Center mixed-use development that will cost $800,000 per year starting in 2016, and Parkside Mixed Income Apartments that will cost about $500,000 per year starting in 2015.

Changes to the Structure of DC's Gas Tax in the Fiscal Year 2014 Budget

The budget adopts changes to the way the District's motor fuel tax is structured. The tax on gasoline is dedicated to the city's Highway Trust Fund and is used to match federal highway funds.

Under current law, the gas tax is levied as a 23.5 cents tax per gallon, paid at the pump by the consumer. The FY 2014 budget eliminates this tax for gas and diesel fuel and replaces it with an 8 percent tax on the wholesale price of gas and diesel fuel, with the goal of raising the same amount of revenue in FY 2014. The change reflects a concern that increasing fuel efficiency of cars may lead to lower consumption, and that a tax based on the number of gallons of fuel purchased thus may decline over time. A tax on the dollar value of gas purchases is likely to be more stable, given the long-term trend of rising gas prices.

Provisions that Dedicate Future Revenues to Selected Purposes

The FY 2014 budget includes three provisions that would direct potential future revenues to selected purposes. This includes the potential for new sales tax revenue if federal legislation is adopted to allow DC and the states to collect sales tax more broadly from online sales.

- **Sales Tax on Online Sales:** Congress is currently considering legislation—the Marketplace Fairness Act-- that would allow DC and the states to require most Internet retailers to collect sales tax. If Congress passes this legislation, the new revenue will be used in part to replace the revenue the District currently receives from automated traffic enforcement. Fifty percent of revenues from automated traffic enforcement, up to $50 million, will be dedicated to a new End

Homelessness Fund, which would be used to end homelessness in the District via a comprehensive plan to be developed later in the year.

- **Sales Tax Dedicated to Arts Funding:** The budget requires that future sales tax collections that exceed the amount projected in February 2013 will be devoted to the DC Commission on Arts and Humanities, up to $22 million.
- **Cigarette Tax Dedicated to Smoking Cessation Services:** The budget requires that future cigarette tax collections that exceed the amount projected in February 2013 will be devoted to smoking cessation efforts. This will be in effect through FY 2017. Starting in FY 2018, 10 percent of all cigarette tax revenue will be dedicated to cessation. Currently, the District collects about $35 million in cigarette tax per year, meaning if revenue collections remain steady, cessation funding will increase by $3.5 million in FY 2018.

While the idea of dedicated funding often has popular appeal, there are several problems with this funding method. First, there is no guarantee that any of these new provisions will result in new funding for the intended services in the near term. To the extent that these efforts are a top priority for the District, having an uncertain funding mechanism does not make sense. Second, to the extent that these provisions do result in new future funding, they will take revenues that could be used for other services. These provisions in essence set the budgets for future years, outside of a discussion of the full budget and full range of budget priorities. Finally, dedicating funding provides a false promise of secure future funding. In practice, the Mayor and Council have reduced funding from dedicated levels for several programs in recent years, including the Housing Production Trust Fund, the Baseball Community Benefits Fund, and the Neighborhood Investment Fund.