The District's Dime
Going Beyond the Budget Book

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Encouraging Investments in Other States' Infrastructure Should Not Be a 2014 Budget Priority

By Jenny Reed

Mayor Gray's budget shows that he wants to make a number of important investments to help DC residents — in education, housing, libraries, parks and more. That's why we're surprised that the mayor also wants to encourage investments *outside* of DC — by restoring a tax break to residents who invest in out-of-state bonds. That would make DC the only jurisdiction to offer this tax break, which ultimately will have costs that are more than half of what we spend each year on libraries.

Supporters of the tax break say that it is needed to protect seniors on limited incomes who live off such investments. Yet only one of 40 residents who invest in out-of-state bonds is a lower-income retiree. And 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 that they expected to be tax free.

Why should the District not re-instate the out-of-state bonds tax break?

- **The bond tax break is not critical to protecting low-income seniors.** Most out-of-state bond holders are not retirees and most are not low-income. In 2008, just 6 percent of all taxpayers hold out-of-state bonds, and only one-fourth of them had retirement income. Two-thirds of the income from out-of-state bonds goes to households with income over $200,000. In fact, just 2 percent of households with income from out-of-state bonds —482 households citywide — are retiree households with incomes below $50,000.

- **Bringing back the tax break is not needed to protect residents with current investments:** Some residents with investments in mutual funds are concerned that they are at a disadvantage. This is because bond managers will often re-arrange a portfolio, and when they do, some share of the resident's mutual fund could be considered a 'new investment' — and thus subject to tax — when they have in fact owned the shares for years. The District could fix the law so that the out-of-state bonds tax would not apply to mutual fund investments purchased before the law took effect, no matter how the composition of the fund changes.

- **The tax break would be very costly to the District**. While the out-of-state bonds tax break would cost just $1.7 million in 2014, it would result in nearly $13 million in lost revenue by 2017 and ultimately more than $30 million.

- **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 he District becomes once again the only state to offer a tax break for investing in bonds issued by any city or state.

For these reasons, the current law that maintains the exemption for current investments in out-of-state bonds — with possible tweaks — makes more sense than bringing back a tax break for higher-income households that no other jurisdiction offers.