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WHAT REVENUE CHANGES ARE IN THE FY 2015 BUDGET?

The fiscal year (FY) 2015 budget includes a variety of changes to taxes and fees that would result in a $31 million reduction in revenues, equal to about four-tenths of a percent of the city's locally funded budget. Most notably, the FY 2015 budget includes several significant changes to DC's tax system following recommendations issued by the DC Tax Revision Commission in February 2014. Several of the recommendations would be partially or fully implemented in FY 2015. The remainder would be "triggered" — or implemented — in future years if revenues grew beyond a certain level.

Major changes will be made to DC's individual income, business income and sales taxes. The income tax rate for taxable income between $40,000 and $60,000 will fall from 8.5 percent to 7 percent. This reduces income taxes by $300 to $600 for moderate- and higher-income households. The budget also maintains a top income tax rate on income above $350,000 — following a commission recommendation — rather than let the rate expire at the end of 2015 as under current law. In addition, the FY 2015 budget will increase the standard deduction, expand the Earned Income Tax Credit for childless workers and phase out the personal exemption for high-income households.

Other commission recommendations partially or fully reflected in the FY 2015 budget include a reduction in the business income tax rate, an increase in taxes on non-cigarette tobacco products, an expansion of sales tax to certain services, and a business income tax exemption to encourage investment firms to locate in the District.

The budget includes provisions to implement most of the remaining recommendations of the DC Tax Revision Commission in future years. These changes are subject to triggers in future fiscal years — meaning that the changes would go into effect if DC's revenues rise above the projections in February of each year. These changes range

SUMMARY OF FY 2015 BUDGET

- Includes tax and fee changes that will reduce revenues by $31 million next year. The largest is a decline in the income tax rate on taxable income between $40,000 and $60,000, based on DC Tax Revision Commission recommendation.
- Implements two other changes to reduce taxes for low- and moderate households: expanding the Earned Income Tax Credit for childless workers and raising the standard deduction.
- Implements other commission recommendations: a cut in the business income tax rate, a change in the way multistate companies determine DC profits, an increase in taxes on non-cigarette tobacco products, an expansion of sales tax to selected services, and a business income exemption to encourage investment firms to locate in DC.
- Maintains the 8.95 percent income tax rate on taxable income above $350,000 rather than allowing it to expire as under current law. Calls for reducing the tax rate to 8.75 percent on income between $350,000 and $1 million in future years.
- Expands the Schedule H property tax credit and allows interest-free property tax deferrals for lower-income senior homeowners.
- Implements a law passed earlier this year to prevent homeowners with minor unpaid property tax bills from losing their home due to tax liens.
- Adopts provisions to adopt most remaining tax commission recommendations if future revenue increase triggers are met.

from further reductions in the business income tax rate to further increases in personal exemption and standard deduction.

Beyond tax changes tied to the commission's recommendations — the budget expands the Schedule H low-income property tax credit for certain low and moderate-income seniors and allowing seniors who have owned property in the city for a number of years to defer their property taxes with no interest charges.

In addition, the FY 2015 budget implements a set of provisions passed into law earlier this year that will help prevent homeowners who have minor unpaid property tax bills from losing their home due to tax liens and fines. The budget also created a locally funded low-income housing tax credit that will draw private investment into affordable housing.

Table 1
Total Tax & Revenue Changes in the FY 2015 Budget*

	In $ Millions
Tax Commission-Recommended Changes	
Reduce Income Tax Rate	($37.5)
Reduce Business Income Tax Rate	($20.0)
Change Business Income Apportionment	$20.0
Exempt Investment Firms from Income Tax	($4.4)
Equalize taxes on Tobacco Products	$7.0
Broaden Sales Tax Base to Services	$9.2
Other Revenue Changes	
Senior Schedule H Expansion and Property Tax Deferment	($4.8)
Protections for Delinquent Homeowners	($1.3)
Locally Funded Low-Income Housing Tax Credit	($1.0)
Tax abatements	($3.5)
Alternative Fuel Incentives	($0.5)
Improved Tax Compliance	$6.1
Total	($30.7)

*There are several tax changes being made in the FY 2015 budget that do not have a fiscal impact until FY 2016. See Table 2 for a list of these changes and their fiscal impact.

DC's Revenues in 2015 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. DC's tax collections dropped sharply in FY 2009 and FY 2010 — falling by nearly $500 million — which led to substantial cuts in a range of programs and 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.

Projected revenues in FY 2015 total $7.1 billion.[1] (See **Figure 1**.) This is $600 million higher than in FY 2008, a 10 percent increase after adjusting for inflation. This means that revenues have recovered significantly from the depths of the recession.

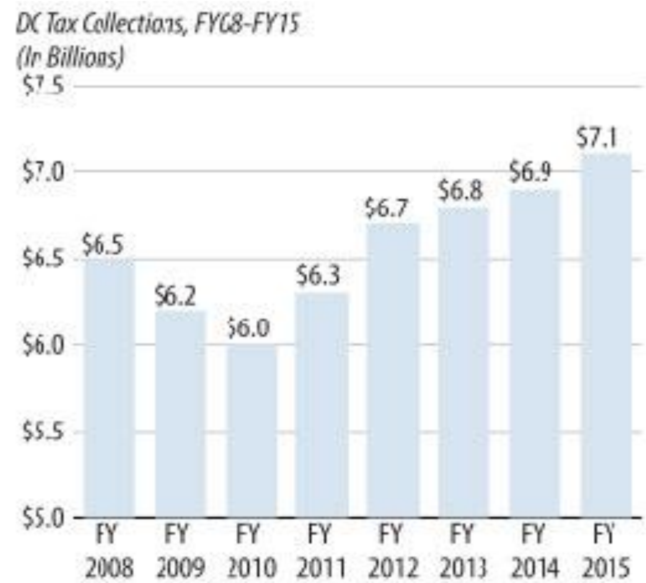
[1] This includes taxes that are used for specific purposes, such as sales taxes used to pay off the Convention Center debt, but it does not "special purpose revenues," special fees tied to certain uses.

Revenue Changes Based on Recommendations of the DC Tax Revision Commission

The FY 2015 budget includes a number of provisions that partially or fully implement recommendations of the DC Tax Revision Commission. These changes generally will take effect on January 1, 2015, but because residents will not file 2015 income tax returns until early 2016, many of the income tax changes will not have an impact on the District's budget and financial plan until FY 2016. **Table 2** highlights the timing of the fiscal impact for the changes that will take effect January 1, 2015.

Figure 1

DC Revenue Collections Are Strong



*Figures adjusted for inflation to equal 2015 dollars and do not include non-tax revenues

Source: FY 2015 Proposed Budget and Financial Plan

Income Tax Changes

Income Tax Rate Reduction for Moderate- and Higher-Income Residents: The FY 2015 budget will reduce the income rate from 8.5 percent to 7 percent on income between $40,000 and $60,000 (or $80,000 to $120,000 for two-earner families). This will reduce revenues by $37.5 million in FY 2015.

The change will reduce taxes by up to $300 for a single-earner household and up to $600 for a two-earner household. It will reduce taxes for both moderate-income households and also for higher-income households. This is because high-income households pay the lower rates on the lower portion of their income and only pay the top rate on the portion of their taxable income that exceeds the threshold for the higher brackets. As a share of income, however, the benefit of the tax reduction will be greatest for moderate-income households.

Maintain DC's Top Income Tax Rate: The budget also adopts the Tax Revision Commission recommendation to maintain a top income tax rate for high-income households, rather than letting it expire in 2016 as under current law. The budget maintains the current top rate at 8.95 percent starting at taxable income of $350,000, while the commission had recommended lowering the rate to 8.75 percent. The difference between the budget and the commission is relatively modest; a family with income of $500,000 would pay $300 more per year in taxes — or less than one percent of income — with an 8.95 percent top rate than with an 8.75 percent top rate.

The budget calls for reducing the income tax rate to 8.75 percent for taxable income between $350,000 and $1 million in future years, if certain revenue triggers are met.

Maintaining the top rate generates a substantial amount of revenue relative to current law — $19 million per year starting in 2016 — that helps to offset the cost of reducing taxes on middle income residents in FY 2016.

Table 2

Tax Commission Recommendations in the FY 2015 Budget and Timing of Revenue Impact

Tax Commission Recommended Changes	FY 2015 In Millions	FY 2016 In Millions
Reduce Middle Income Tax Rate	($37.5)	($38.4)
Raise the Standard Deduction	No Effect	($15.6)
Expand EITC to Childless Workers	No Effect	($10.8)
Maintain 8.95% Income Tax Rate	No Effect	$18.7
Phase-out Personal Exemption for High Income Households	No Effect	$4.7
Eliminate of Homebuyer Credit, Long-term Care Exemption, and Government Pension Exclusion	No Effect	$3.7
Reduce Business Income Tax Rate	($20.0)	($21)
Change Business Income Apportionment	$20.0	$21
Exempt Investment Firms from Income Tax	($4.4)	($4.4)
Equalize taxes on Tobacco Products	$7.0	$6.9
Broaden Sales Tax Base to Services	$9.2	$9.5
Adding Use Tax Line to Income Tax Return	No Effect	$1

***Note: This does not include the budget provisions which implement the remaining tax commission recommendations if future revenue increase triggers are met.*

Expanding the Earned Income Tax Credit (EITC):
The District's Earned Income Tax Credit makes work pay for low-income families by providing substantial tax refunds or reducing taxes substantially for working poor households. However, for households without children, the credit provides very little benefit. The maximum credit for childless residents is less than $200 and it only goes to workers earning under $14,000 a year. For tax year 2015, the budget expands eligibility to someone earning $23,000 and increases the maximum credit to almost $500. These changes will not affect revenue until FY 2016.

Raising the Standard Deduction: The District's standard deduction exempts a certain portion of income from taxes. It is especially important for low- and moderate-income families because they are more likely to claim it than higher-income households that tend to itemize deductions. The Tax Revision Commission recommended raising the standard deduction to the federal level, a best practice followed by six other states. For tax year 2015, the budget raises the standard deduction from $4,250 to $5,200 for singles and to $8,350 for married couples, partially implementing a recommendation of the tax commission. These changes will not affect revenue until FY 2016. The budget raises the standard deduction fully up to the federal level, if certain triggers are met, over several years.

Phasing-Out the Personal Exemption for Higher Income Households: Like the standard deduction, the personal exemption shields a portion of income from the income tax. The personal exemption is a deduction for each person in the household. The federal income tax begins to phase out the personal exemptions for higher income households. The Tax Revision Commission recommended that DC follow a similar approach, and in tax year 2015, the DC personal exemption will phase-out by 2 percent for every $2,500 of income that exceeds $150,000. At $275,000 of income, the personal exemption is completely phased out. These changes will not affect revenue until FY 2016. The budget calls for increasing the personal exemption to match the federal exemption amount over the next five years.

Eliminating the homebuyer credit, long-term care insurance deduction and government pension exclusion: The Tax Revision Commission recommended eliminating income tax deductions and credits that applied to or were claimed by narrow segments of filers in order to provide broad-based tax cuts. The FY 2015 budget eliminates the first time home-buyer credit for District government employees, the deduction for long-term care premiums, and the exclusion for government pension receipts from taxable income. For example, only 4,000 filers claimed long-term care insurance deductions. These changes will not affect revenue until FY 2016.

Business Tax Changes

Reduction in Business Income Tax Rate, New Formula for Allocating Profits to DC: The FY 2015 budget reduces the income tax rate for incorporated and unincorporated businesses from 9.975 percent to 9.4 percent, resulting in a tax reduction of $20 million in FY 2015.

This revenue loss is offset by a change in how the profits of multistate corporations are apportioned to the District. State corporate income taxes require multistate business to calculate what portion of their national profits are allocated to a specific state, and this typically is based on the share of the corporation’s personnel, property and/or sales that occur in that state. The budget implements "single sales weighting" under a share of a corporation’s national profits will be apportioned to DC based only on the share of a corporation’s sales that occur in DC. This will raise $20 million in FY 2015 and will especially affect corporations that have a large volume of sales in the District but limited personnel or property.

Tax Exemption for Investment Firms: The budget exempts investment firms from DC’s unincorporated business franchise tax. The DC Tax Revision Commission concluded that imposition of the tax discourages investment firms from locating in the District — or requires firms to engage in extensive tax avoidance. The commission recommended exempting these firms from tax on the earnings of their investors, creating a “safe harbor” for such investments. This will reduce tax collections by $4.4 million in FY 2015.

Sales Tax Changes

Sales Taxes on Tobacco Products: The FY 2015 budget broadens the definition of tobacco products that are subject to sales tax, and it sets the tax rate on all tobacco products to equal the taxes levied on cigarettes. The goal is to simplify tobacco taxation and to ensure that the cigarette tax rate — which is intended to discourage consumption of cigarettes — applies to all tobacco products. This change will increase revenues by $7 million in FY 2015.

Broadens Sales Tax Base to Include More Services: The budget expands the number of services subject to the 5.75 percent sales tax, including carpet cleaning services, bowling alleys, and gym and yoga memberships. (See **Table 3**.) The Tax Revision Commission recommended these changes in recognition of shifts in the U.S. and District economies over time to include more services. This means that a sales tax tied largely to goods becomes less strong every year. This change will increase revenues by $9.2 million in FY 2015.

Table 3 Sales Tax Expansions In the FY 2015 DC Budget
Carpet & upholstery cleaning
Car washes
Storage of household goods
Health clubs & tanning studios
Bottled water delivered for home use
Bowling alleys & billiards parlors

Source: FY 2015 Budget and Financial Plan

Include a use tax line on returns: The District does not collect any sales when residents make purchase online or when they buy items originating from a remote location. A use tax line on the individual income will encourage residents to remit uncollected sales tax on items that were purchased remotely. These changes will not affect revenue until FY 2016.

Revenue Changes Not Related to Tax Commission Recommendations

The FY 2015 budget includes a number of other revenue changes that were not part of the Tax Revision Commission's recommendations.

Property Tax Assistance for Senior Residents: The budget provides an interest-free property tax deferral for residents who are 75 or older, have owned a home in the District for 25 years or more, have incomes below $60,000 and interest income below $12,500. This would reduce revenues by $2.8 million.

Secondly, the budget expands DC's property tax credit for lower-income households, known as Schedule H. Schedule H currently helps residents with incomes up to $50,000 and the benefit goes to homeowners and renters whose property taxes exceed a certain portion of their income. For renters, it is assumed a portion of rent pays for property tax. The budget expands income eligibility to $60,000 and increases the credit amount for residents aged 70 and older. Expanding a credit that benefits both homeowners and renters is important, as a significant portion of District seniors are renters.

Protections for Homeowners with Delinquent Property Tax Bills: The budget includes provisions to prevent homeowners with minor unpaid property tax bills from losing their home. Under current law, when a homeowner is behind on property taxes, the District can place a lien on the home and then sell that tax lien to a private party. The amount owed by the homeowner increases due to interest charges and can also increase if the lienholder adds legal fees and other charges. This has led to costs that balloon well beyond the initial tax delinquency, and it has forced some families to lose their home because they could not pay the higher costs.

These FY 2015 budget addresses these issues by implementing the Residential Real Property Equity and Transparency Act. More specifically, the budget would prohibit the sale of a residential real property tax lien if the amount owed is $2,500 or less. It also would allow homeowners to enter into a payment plan if the home is their primary residence and they owe $7,500 or less in taxes.

Establishment of a Locally Funded Low-Income Housing Tax Credit (LIHTC): A new locally funded low-income housing tax credit (LIHTC) is established with a $1 million pilot investment. The DC LIHTC will be managed by the Department of Housing and Community Development who also manages the federal LIHTC program and will be granted to affordable housing projects that already have federal LIHTC's allocated to them. LIHTC's allow developers to raise capital to develop affordable housing by selling the tax credits to investors. The program will closely match the federal LIHTC rules.

Tax Abatements: The budget provides a tax abatement of $1 million per year to the Urban Institute and an abatement for a health clinic leased by Whitman Walker Health that would be worth $250,000 in 2015 and about $500,000 in subsequent years. The budget also includes a $250,000 property tax refund to the United House of Prayer for All People and a $1.8 million tax abatement and refund for the Meridian International Center, which drops to about $570,000 in FY 2016. The budget also includes small tax abatements for the Scottish Rite Temple and the American Academy of Achievement. The abatements total $3.5 million in FY 2015.

Alternative Fuel Tax Incentives: The budget provides roughly $540,000 in tax credits to convert vehicles to alternative fuels and for the installation of alternative fuel infrastructure.

Improved Compliance Measures: Through added staff, the District's Office of Tax and Revenue intends to improve tax billing and compliance, with a projection that this will raise $6.1 million in 2015.

FY 2015 Budget Allows Hospital "Bed Tax" to Expire

The District adopted a new tax on hospitals in FY 2011, levied at $2,000 per licensed hospital bed. The rate was increased to $3,800 per bed in FY 2012. The tax was set to be a temporary source of revenue during the recession, to provide local funds for Medicaid that would draw federal matching funds. The tax was set to expire in FY 2015, and the budget maintains that plan. The budget replaces those lost local funds with general funds to prevent any cuts to Medicaid services.

Tax Reduction "Triggers" in Future Years

The FY 2015 budget also includes a provision to implement, or fully implement, the majority of recommended changes to DC's tax system by the DC Tax Revision Commission. The changes will be "triggered" — or implemented — if revenue collections surpass projections in future fiscal years. The triggers will be implemented in two parts. First, projected revenues in FY 2015 or FY 2016 must grow by at least $181 million between June 2014 and February 2015 before any additional tax changes can be implemented. The $181 million is needed to address a projected gap between revenues and expenditures in FY 2016. Any increase beyond the $181 million can be used to implement the changes *after* the FY 2016 budget is passed.

Starting after February 2015, further tax reductions will be triggered if the projections made after each year's February revenue estimate — the one used to set the budget each year — show an increase in expected tax collections. The changes will be implemented in the order laid out below. This process ensures that tax cuts will not compete with budget priorities; they will be implemented only if revenues rise after the budget has been adopted. The changes include:

Further Reduce Middle Income Tax Rates: The first item is to further reduce the rate of the new individual income tax middle bracket from 7 percent to 6.75 percent for incomes between $40,000 and $60,000.

Create New High Income Tax Bracket: The second item creates an income tax bracket of 8.75 percent for incomes between $350,000 and $1 million. Incomes above $1 million would be taxed at the current top rate of 8.95 percent.

Reduce Business Income Tax Rate Further: The third item further reduces the income tax rate on incorporated and unincorporated businesses from 9.4 percent to 9.2 percent.

Reduce Middle Income Tax Rate a Third Time: The fourth item further reduces the rate of the new individual income tax middle bracket from 6.75 percent to 6.5 percent for incomes between $40,000 and $60,000.

Reduce Business Income Tax a Third Time: The fifth item reduces the income tax rate on incorporated and unincorporated businesses from 9.2 percent to 9.0 percent.

Raise the Estate Tax Threshold: The sixth item raises the threshold at which households owe estate tax from $1 million in assets to $2 million.

Further Raise the Standard Deduction: The seventh item raises the standard deduction from $5,200 to $5,650 for singles, from $6,650 to 7,800 for Head of Households, and from $8,350 to $10,275 for married couples.

Increase Personal Exemption: The eighth item increases the personal exemption in the income tax from $1,675 to $2,200.

Raise the Standard Deduction to Match Federal Level: The ninth item raises the standard deduction to $6,100 for singles, $8,950 for Head of Households, and $12,200 for married couples — conforming to the federal levels.

Further Increase Personal Exemption: The tenth item further increases the personal exemption to $2,700.

Reduce Business Income Tax a Fourth Time: The eleventh item reduces the income tax rate on incorporated and unincorporated businesses from 9.0 percent to 8.75 percent.

Increase Personal Exemption a Third Time: The twelfth item further increases the personal exemption to $3,200.

Raise the Estate Tax Threshold to Conform to Federal Level: The thirteenth item raises the threshold at which households owe estate tax from $2 million in assets to $5.25 million — conforming to the Federal level.

Reduce Business Income Tax a Fifth Time: The fourteenth item cuts the income tax rate on incorporated and unincorporated businesses from 8.75 percent to 8.5 percent.

Increase Personal Exemption a Fourth Time: The fifteenth item further increases the personal exemption to $3,700.

Reduce Business Income Tax to Conform to Maryland's Level: The sixteenth item cuts the income tax rate on incorporated and unincorporated businesses from 8.5 percent to 8.25 percent.

Increase Personal Exemption to Match the Federal Level: The seventeenth item further increases the personal exemption to $4,200, matching the federal level. At this point, DC would also eliminate the Low Income Credit since it would no longer be needed.