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) 325-8839
www.dcfpi.org

Testimony of Jenny Reed, Policy Director
DC FISCAL POLICY INSTITUTE

At the Public Oversight Hearing on the
FY 2015 Budget Request Act of 2014 and the FY 2015 Budget Support Act of 2014
District of Columbia Committee of the Whole
May 9, 2014

Chairman Mendelson and members of the committee, thank you for the opportunity to testify today. My name is Jenny Reed and I am the Policy Director at the DC Fiscal Policy Institute. DCFPI engages in research and public education on the fiscal and economic health of the District of Columbia, with a particular emphasis on how policies impact low- and moderate-income families.

I am here today to testify on some of the proposed tax changes in the fiscal year (FY) 2015 budget. More specifically, I am here to testify in support of the Mayor's proposal to create a new tax bracket for middle-incomes, as recommended by the D.C. Tax Revision Commission, and to maintain the top rate on incomes over $350,000 (or $700,000 for a two earner family).

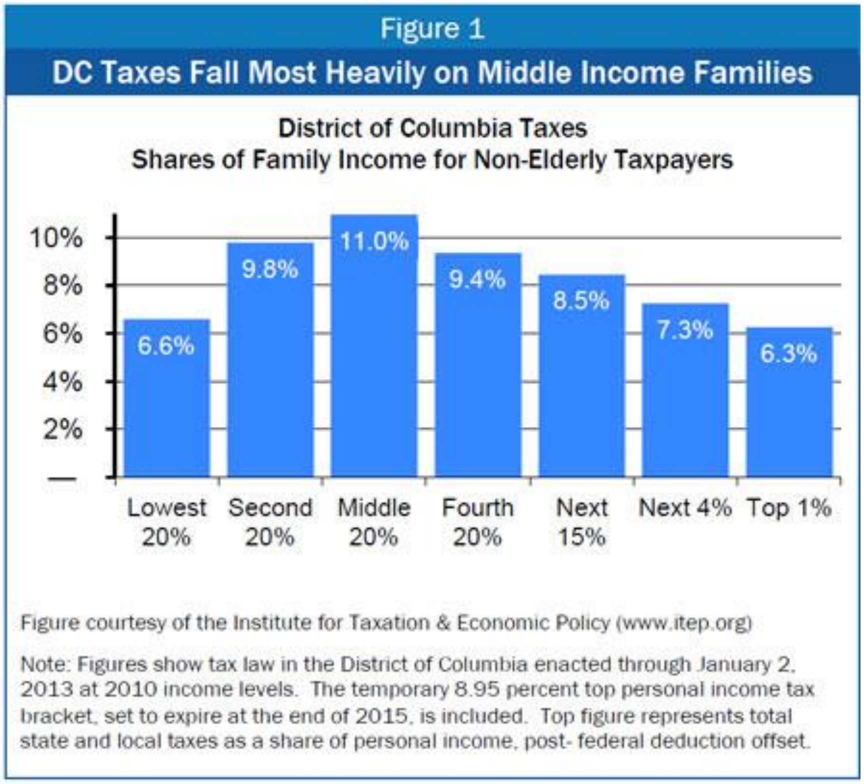
I also want to ask that the Council fund two important tax changes in the FY 2015 budget that were recommended by the tax commission: an expansion of the Earned Income Tax Credit for childless adults and an increase in the income tax standard deduction. These are not in the mayor's proposed budget but were placed on the budget's "wish list," or contingent priority list.

Lastly, I want to express concern over the Mayor's proposal to eliminate property taxes for certain elderly homeowners. While DCFPI agrees that the District should provide property tax assistance to low- and moderate-income residents who struggle to keep pace with the rising costs of living in DC, we have concerns about the structure of this proposal and believe that expanding DC's current low-income property tax credit, Schedule H, would target help more fairly and efficiently.

The FY 2015 Budget Takes Steps toward Correcting DC's Unbalanced Tax System

A major focus of the commission was to correct DC's unbalanced tax system. Middle income residents pay a far higher share of their incomes in combined sales, property and incomes taxes than higher-income residents. (See **Figure 1**, next page.) The proposed FY 2015 budget would start to address that imbalance by including a new tax bracket for moderate- and high-income households and maintaining DC's top tax bracket for incomes over $350,000, both of which are supported by DCFPI. More specifically:

- **Income Tax Rate Reduction for Moderate- and Higher-Income Residents:** The proposed FY 2015 budget would reduce the income rate from 8.5 percent to 7.5 percent on income between $40,000 and $60,000 (or $80,000 to $120,000 for two-earner families). This would reduce revenues by $25 million. The commission recommended such a step but proposed reducing the rate further, to 6.5 percent, on a wider range of income.



  The proposed change would reduce taxes by up to $200 for a single-earner household and up to $400 for a two-earner household. It would 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.

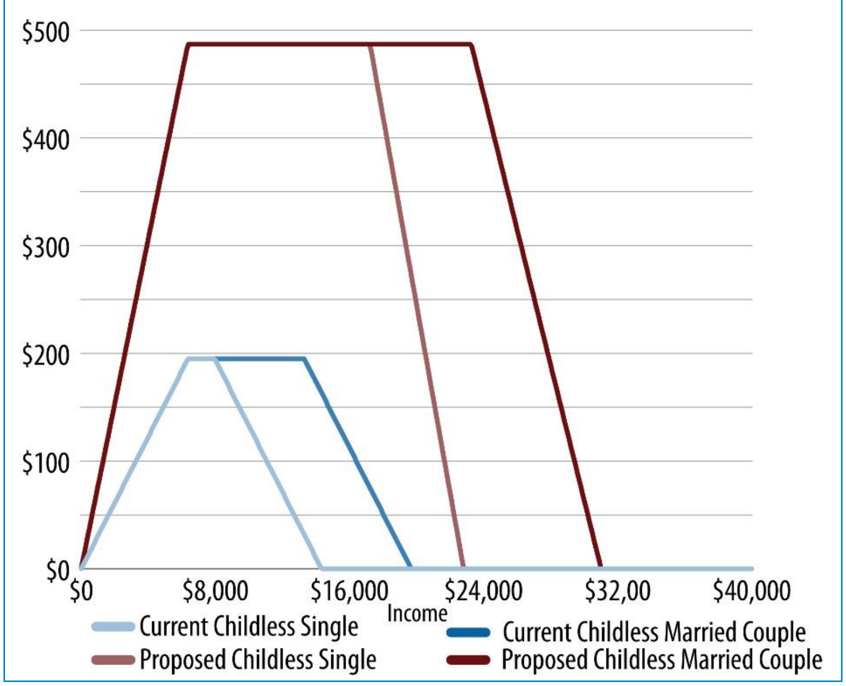
- **Maintain DC's Top Income Tax Bracket:** In order to offset some of the revenue loss from reducing income taxes on moderate-income households in the future, the FY 2015 budget also adopts the Tax Revision Commission recommendation to maintain a top income tax rate for residents with taxable incomes above $350,000 rather than letting it expire in 2016 as under current law. However, the proposed budget would keep the current top rate at 8.95 percent, while the commission had recommended lowering the rate to 8.75 percent. The difference between the mayor's proposal and the commission is relatively modest; a family with taxable 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.

  Maintaining the top rate would generate a substantial amount of revenue relative to current law — $20 million per year starting in 2016 — that helps to offset the cost of reducing taxes on middle income residents starting in FY 2016.

The Commission also focused on two other critical changes to help improve the fairness of DC's tax system; expanding the Earned Income Tax Credit (EITC) for childless adults and raising the standard deduction. Both of these items were included on the mayor's "wishlist" (as items number two and 15, respectively) in the FY 2015 budget which would fund items, in order, if future FY 2015 revenue projections are higher than the February 2014 estimates upon which the budget will be based. These two items are important elements of increasing fairness in the tax system:

DC's Earned Income Tax Credit Can Help Make Work Pay for Adults without Children

Figure 2
Expanding the EITC For Childless Residents Would Provide Greater Benefits for Minimum Wage Workers



The DC Earned Income Tax Credit (EITC) provides substantial tax relief for low-income workers and helps make work pay for thousands of District families. However, the credit currently provides very little help to a big group of low-income residents: workers without children or without children living in their home.

DC's EITC is equal to 40 percent of the federal credit, making it the second largest state-level EITC among the 21 states that offer an EITC. However, the federal EITC for childless workers, on which the DC EITC is based, is small in both size and scope. This means DC's credit for these workers is even smaller — a maximum of $195 for singles — and it's available only to a very limited group of residents. Single workers with earnings of just $14,000 or more — which is equivalent to less than full-time work at the minimum wage — are ineligible.

This creates a significant disparity in the benefits received by two single adults. For example, a single parent with one child making the new minimum wage of $11.50 per hour and working 30 hours a week can receive the maximum EITC of $1,300. A childless single with the same amount of income — about $17,250 a year — would not be eligible for any EITC benefit at all and would instead owe DC income taxes of $500.

The commission recommended the following changes to the childless worker EITC (See **Figure 2**):

- The Childless Worker EITC would be set to 100 percent of the federal credit up to an annual income of about $17,000 (150 percent of the federal poverty line).
- Childless workers earning between $6,400 and $17,000 would receive the maximum credit of about $500. This income range includes someone working part-time to almost full-time at minimum wage.
- The credit would then phase out between 150 percent and 200 percent of the federal poverty line (about $23,000).

DCFPI supports this proposal because it provides substantial tax relief to a group of low-wage workers who currently face relatively high taxes. A childless worker employed 30 hours per week at $11.50 an hour would qualify for an EITC of $450 — which would eliminate 90 percent of her or his taxes. By accepting this proposal, DC would be the first state to create an EITC for childless adults that goes beyond the federal credit — continuing its national leadership in making work pay.

In addition, the Mayor's budget wish list only proposes to fund the expansion up to the maximum federal credit for a single worker and would not provide higher benefits for working poor married couples. We ask that Council adopt the Tax Revision Commission's proposal that would provide additional benefits to workers without children who are married and filing jointly.

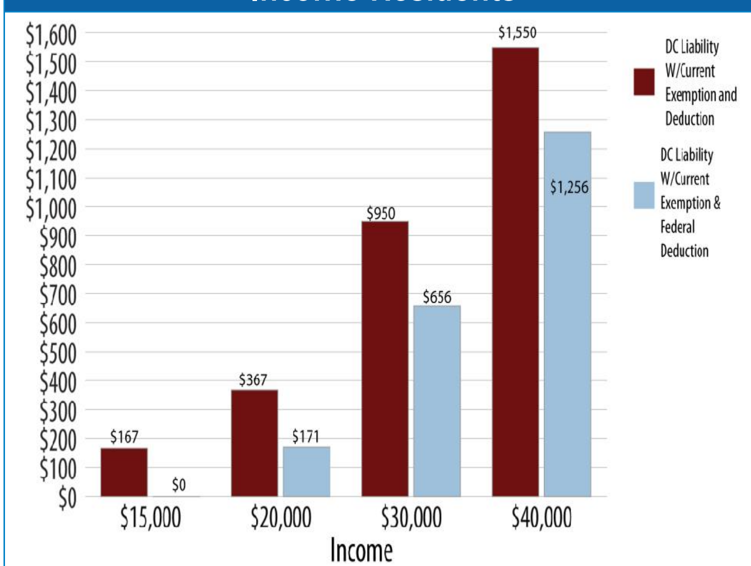
Increasing the Standard Deduction Can Help Reduce Taxes for Low and Moderate-Income Households and Increase the Effectiveness of DC Earned Income Tax Credit

The District's standard deduction is part of DC's income tax that is available to all residents, but provides the greatest benefits to families and individuals with low-and-moderate incomes. Despite the importance of this tax provision, the DC deduction is far lower than the federal standard deduction and similar deductions in many states. The low value means that the DC income tax does not do as much to shield lower-income families from taxes as the federal income tax or the income tax in many states.

Raising the DC standard deduction to match the federal deduction would help exempt many working poor families from owing DC income tax, increase the effectiveness of DC's earned income tax credit for lower-income working residents, and provide substantial tax benefits to low- and moderate-income working families with incomes above poverty. This also would make DC's tax system more progressive.

Figure 3

Raising the Standard Deduction Would Help Lower The Tax Liability for Low and Moderate-Income Residents



The standard deduction is available to all tax filers, but taxpayers with certain eligible expenses — such as mortgage interest, property taxes, and charitable contributions — can choose to claim itemized deductions instead.[1] The DC standard deduction, which is currently set at $4,000, is especially important to renters and to lower-income residents because they typically do not have sufficient deductions to itemize. In DC, for example, some 75 percent of filers with incomes below $75,000 claim the standard deduction. The

[1] For more information on itemized deductions, see: http://www.taxpolicycenter.org/taxtopics/encyclopedia/Itemized-Deductions.cfm

vast majority of filers above that threshold, 88 percent, itemize deductions.
For example, **Figure 3** shows the effect of increasing the District's standard deduction to the federal level for a single head of household with two children, before taking tax credits into account. Adoption of the federal standard deduction level would decrease tax liabilities before credits. This in turn would increase the effectiveness of the DC Earned Income Credit because it would allow more families to get the EITC as a refund.

- For a family of three with income of $30,000, adopting the federal exemption and deduction would cut tax liability by nearly one third, from $950 to $656.
- After applying the Earned Income Credit, the same family would receive a refund of about $440 with the federal standard deduction, as a refund of $146 under current law.

We ask that the Council include funding for both of these important measures in the FY 2015 budget; however we understand that raising the standard deduction all the way up to the federal level may not be possible in one year because of the cost.

Targeting Property Tax Assistance on Those Who Need it the Most

The FY 2015 budget also proposes to fund Bill 20-318, "The Senior Citizen Real Property Tax Relief Act of 2013" which would eliminate taxes for senior homeowners who have lived in DC for at least 20 years, are at least 70 years old and have incomes less than $60,000.

We share the goal of the bill to provide property tax assistance to low- and moderate-income residents who struggle to keep pace with the rising costs of living in DC. At the same time, it is important to note that the District already has a number of tax provisions that help low-income seniors, including expansion this year of DC's Schedule H tax credit. The Schedule H changes will provide substantial assistance for lower-income residents with high property taxes or high housing costs relative to their income.

The Senior Citizen Real Property Tax Act would eliminate property taxes entirely for some DC residents but provide no tax help to other residents in very similar situations, raising concerns about its structure. A 69 year old resident would get no help while a 70 year old would pay no property taxes. A 70 year old resident who has lived in DC for 15 years would get no help while a 70 year old resident who has lived in DC 20 years would qualify for complete tax elimination. A long-term senior citizen resident would get help if they own their home but no help if they rent, even though a large share of residents are renters. In fact, half of all low-income seniors are renters, and they are more likely than senior owners to have high housing cost burdens.

Finally, the proposed bill does not include a mechanism to target relief to residents with the greatest challenges paying taxes. For example, it would provide the same relief for someone earning $20,000 in income as it does someone earning $55,000 in income.

For these reasons, we believe that the proper approach would be to expand the income eligibility for Schedule H, from the current $50,000 to the $60,000 level in the Senior Citizen Real Property Tax Relief Act. In addition, the Council could revise the Schedule H formula to enhance the benefits specifically for senior renters and homeowners. This would ensure that all lower-income seniors get the help they need, and it would target greater assistance on those facing greater property tax challenges.

Thank you for the opportunity to testify and I am happy to answer any questions.