

COUNCIL OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHAIRMAN
1350 Pennsylvania Avenue, NW
Washington, DC 20004

Memorandum

To: All Councilmembers
From: Phil Mendelson, Chairman
Date: June 23, 2014
Re: **FY 2015 BSA Amendment in the Nature of a Substitute**

Attached please find an amendment in the nature of a substitute (ANS) for Bill 20-750, the Fiscal Year 2015 Budget Support Act of 2014, that I am moving at tomorrow's Legislative Meeting. The ANS is the product of collaborative discussions between my office, the Members, the Office of the Budget Director, the Office of the General Counsel, the Office of the Chief Financial Officer, the Mayor and the executive agencies, and various other stakeholders. Notice of my intent to move the ANS was circulated to Members on Thursday, June 19, 2014.

Below is a description of some of the notable changes in the ANS.

I. Tax Revision Commission Implementation

The FY 2015 budget as proposed by the Mayor, certified by the CFO, and initially passed by the Council has two structural issues that the Council is addressing and *solving* in the FY 2015 BSA. The first issue is a potential \$181 million shortfall projected in the Financial Plan for FY 2016. The second is that there is no flexibility within the Capital Improvements Plan (CIP) to add any new capital projects between FY 2015 and FY 2020 because we are at the 12% limit on debt service as a percentage of operating expenses.

In order to resolve the OCFO's concerns with the FY 2016 imbalance, we will implement the Tax Revision Commission Implementation Act of 2014 as described below.

The following tax changes will become effective, automatically, on January 1, 2015:

Individual Income Taxes

1. Create a new individual income tax middle bracket of \$40,000 - \$60,000 at 7.0%.
2. Raise the standard deduction to \$5,200 for singles, \$6,650 for head of household, and \$8,350 for married residents.
3. Expand the local earned income tax credit (EITC) to single workers.
4. Eliminate certain tax expenditures (DC Homebuyer Credit, the Long Term Care Insurance Credit and the Government Pension Exclusion).

- Phase out the personal exemption by 2% for each \$2,500 above \$150,000, with a complete phase out at \$275,000.

Sales and Use Taxes

- Add a line to capture the use tax on the personal income tax return.
- Broaden the general sales tax to certain services.
- Unify taxation on tobacco products.

Business Taxes

- Reduce the Unincorporated and Incorporated Business Franchise Tax to 9.4%.
- Exempt passive investment vehicles from Unincorporated Business Franchise Tax.
- Change the franchise tax apportionment method to a single weighted sales formula .

The tax relief effective Tax Year 2016 and beyond will no longer be phased in on an annual basis but will be implemented as District revenues grow. Although the timing of the phase-in schedule cannot be guaranteed, tying implementation to increasing revenues actually increases the likelihood of *hastening* tax relief. Over the past four fiscal years, the average increase in revenue (net of legislative and policy changes) after the budget has been passed has been \$284 million per year. The net cost of the tax relief that will be subject to triggers will be \$143 million, or roughly half the annual revenue growth for each of the last four years.

The trigger mechanism is divided into two parts. The first applies from the time period beginning from the passage of the FY 2015 BSA through the February 2015 quarterly revenue estimate, which is the estimate used to build the Mayor’s proposed FY 2016 budget. The second part is effective once the FY 2016 budget is balanced and every year thereafter until the tax relief is fully implemented. The reason for the two-part trigger is to ensure that the FY 2016 imbalance of \$181 million is solved before the District incurs any new operating or tax expenditures. After the implementation of the FY 2015 tax relief, we will not implement any additional tax relief until the FY 2016 imbalance is solved. After that, implementation of the tax relief will be triggered from revenue growth realized after each fiscal year’s budget is approved. This will allow the Mayor and Council to have the same flexibility we currently have to use the growth in revenues projected in the February estimate for new policies and programs, and reserve revenue growth realized after the budget is set for tax relief.

The tax relief will be implemented in the order reflected in the chart below. The tax relief was broken down into smaller steps so that the relief can continue to be implemented, even if revenue growth is relatively small.

	Tax Changes Subject to Triggers	Estimate (in FY15 \$)
1	Reduce the rate on the new individual income tax middle bracket of \$40,000 - \$60,000 from 7.0% to 6.75%	6,588,079
2	Create a new individual income tax bracket of 350K to 1M at 8.75%, income greater than \$1M remains at 8.95%	3,630,272

Tax Changes Subject to Triggers (continued from previous page)		Estimate (in FY15 \$)
3	Reduce unincorporated and incorporated business franchise tax from 9.4% to 9.2%	6,950,000
4	Reduce the new individual income tax middle bracket of \$40,000 - \$60,000 from 6.75% to 6.5%	6,588,079
5	Reduce unincorporated and incorporated business franchise tax from 9.2% to 9.0%	6,950,000
6	Raise the estate tax threshold from \$1M to \$2M	4,500,000
7	Raise the standard deduction from \$5,200 for singles, \$6,650 for head of households, \$8,350 for married to \$5,650 for singles, \$7,800 for head of households and \$10,275 for married	7,858,949
8	Increase the personal exemption from \$1,675 to \$2,200	11,227,722
9	Raise the standard deduction from \$5,650 for singles, \$7,800 for head of households, \$10,275 for married to \$6,100 for singles, \$8,950 for head of households and \$12,200 for married to conform to the federal levels	7,858,949
10	Increase the personal exemption from \$2,200 to \$2,700	10,945,827
11	Reduce unincorporated and incorporated business franchise tax from 9.0% to 8.75%	8,700,000
12	Increase the personal exemption from \$2,700 to \$3,200	10,945,827
13	Raise estate threshold from \$2M to ~\$5.25M to conform to federal level	9,400,000
14	Reduce unincorporated and incorporated business franchise tax from 8.75% to 8.5%	8,710,000
15	Increase the personal exemption from \$3,200 to \$3,700	10,945,827
16	Reduce unincorporated and incorporated business franchise tax from 8.5% to 8.25%	8,710,000
17	Increase the personal exemption from \$3,700 to \$4,200 conform to the federal level, and repeal the Low Income Credit as it will now be obsolete	10,945,827

At the end of implementation, the following tax reductions will be fully implemented via the triggers: 1) a middle tax bracket of \$40,000 to \$60,000 at 6.5%; 2) a standard deduction that conforms to the federal level; 3) a personal exemption that conforms to the federal level; 4) an estate tax threshold that conforms to the federal level; and 5) an unincorporated and incorporated business franchise tax at 8.25% and that is at the same rate as neighboring Maryland.

Enhanced Progressivity in the DC Tax Code at Full Implementation				
	Existing Law		Full Implementation	
	Average Tax	Effective Tax Rates	Average Tax	Effective Tax Rates
Less than \$ -10,000	(\$319)	No Liability	(\$658)	No Liability
\$ -10,000 to \$ - 1,000	(\$99)	No Liability	(\$188)	No Liability
\$ - 1,000 to \$ 0	(\$292)	No Liability	(\$423)	No Liability
\$ 0 to \$ 10,000	(\$294)	No Liability	(\$435)	No Liability
\$ 10,000 to \$ 25,000	(\$385)	No Liability	(\$784)	No Liability
\$ 25,000 to \$ 50,000	\$1,022	2.8%	\$670	1.8%
\$ 50,000 to \$ 75,000	\$2,591	4.2%	\$2,155	3.5%
\$ 75,000 to \$ 100,000	\$4,105	4.7%	\$3,503	4.0%
\$ 100,000 to \$ 200,000	\$7,229	5.2%	\$6,528	4.7%
\$ 200,000 to \$ 350,000	\$14,829	5.8%	\$14,056	5.5%
\$ 350,000 to \$ 500,000	\$25,056	6.1%	\$24,493	6.0%
\$ 500,000 to \$ 1 M.	\$41,539	6.1%	\$41,885	6.2%
Greater than \$ 1 M.	\$157,063	5.9%	\$165,411	6.2%

The other structural issue for the FY 2015 budget is that the CIP. As proposed by the Mayor, certified by the OCFO, and initially passed by the Council, the CIP does not have any capacity to add any new capital projects between FY 2016 and FY 2020 because we are at the 12% limit on debt service. At the first reading of the FY 2015 BSA, the Council modified the automatic paygo provision from a fixed to floating base in order to invest approximately \$45 to \$70 million per year in the CIP. The savings that were achieved by modifying the paygo provision will now be recognized in the out years of the financial plan as paygo capital and used to replace a portion of the borrowed capital in the CIP. Reducing the borrowed capital used to pay for the District's capital projects will lower annual debt service, save operating funds in the out years, and - most importantly - reduce our debt ratio.

For example, in the Mayor's proposed CIP the debt ratio is at 11.511% in FY 2016; using the paygo capital to replace borrowed capital will reduce the debt ratio to 11.395% in FY 2016. In FY 2018, when the Mayor's proposed CIP is virtually at the District's limit at 11.989%, this solution would have the ratio at 11.879%. While the ratios will still be high, this change will provide the District with the flexibility to invest in unforeseen capital projects. Without this change, there would be no capacity to invest in any new capital projects without reducing or eliminating existing or planned capital projects.

II. Summary of Other Changes in the FY 2015 BSA

In addition to the modifications made to Subtitle VII-B, the Tax Revision Commission Implementation Amendment Act of 2014, the ANS makes a number of technical, clarifying, and substantive changes to the FY 2015 BSA. New subtitles have been inserted, others stricken, and yet others amended in various ways. These changes are summarized below.

A. New Subtitles:

- **I-P, BEGA Establishment and Comprehensive Ethics Reform** – identical to emergency legislation (Bill 20-811) approved by the Council on June 3, 2014; amends the ethics-related filing requirements for ANCs.
- **I-Q, Attorney General Election** – addresses the ruling in *Zuckerberg v. D.C. Board of Elections and Ethics* by requiring the BOE to conduct the 2014 election for Attorney General with the procedural requirements for a special election, to coincide with the November 4, 2014 general election.
- **II-M, Adult Literacy Task Force** – requires the Mayor to establish an Adult Career Pathways Task Force, to be convened by the Workforce Investment Council, to develop a plan to connect adult basic skills programs to career pathways. (Funding for this subtitle – approximately \$175,000 – was included in the FY15 BRA, but the language for the subtitle had not yet been completed in time for 1st reading of the BSA.)
- **III-G, Marijuana Possession Decriminalization Evidence** – removes the requirement that a law enforcement officer provide a statement on the weight of the seized marijuana when a person who is charged with the civil offense of possession demands

a hearing before an ALJ, because possession of *any* amount of marijuana is a civil offense.

- IV-L, Jointly Operated Charter School – allows for one joint program formed by multiple existing charter schools, and approved by the Charter School Board, to be treated as a charter school for funding purposes. This subtitle is intended to address concerns raised by OCFO attorneys regarding the mechanism for funding students enrolled in such a joint program.
- IV-M, Public Education Reform Evaluation – establishes a fund under the District of Columbia Auditor to capture any end-of-year balance in the Auditor’s FY 2014 budget, to be used toward the Public Education Reform Amendment Act (“PERAA”) audit in FY 2015. Spending authority for such funds in FY 2015 would have to be identified at a future point, through, for example, a reprogramming.
- V-P, United Medical Center Transformation Initiative – sets forth the District’s policy and commitment toward ensuring there is an enduring, full service hospital east of the Anacostia River and the divestiture of UMC from District ownership and management; urges the Mayor and Huron Consulting Group to take appropriate steps toward those ends.
- VI-J, Anacostia River Toxics Remediation – although technically a new subtitle, this language was already approved at 1st reading; it is simply being relocated from Title X (where it had been set forth as §10013) to a separate subtitle for the sake of clarity.
- VII-Z, Affordable Housing Real Property Tax Relief – this language recommended by the OCFO would resolve an inadvertent statutory bar against certain Section 8 housing projects receiving tax exemptions. More specifically, it eliminates the “prior exemption” requirement of D.C. Official Code § 47-1002(20)(A)(ii) for a property receiving assistance under a renewal of a project-based Section 8 contract originally made under a new construction program.
- VII-AA, Anti-Deficiency Review Board – amends the local anti-deficiency statute to require that at least two thirds of the members of the review board be appointed by the CFO, and at least one member appointed by the Chairman of the Council from among Council staff.

B. Stricken Subtitles:

- Former II-P, Accrued Sick and Safe Leave Clarification Amendment – the Office of the General Counsel determined that the amendments that were to be made through this subtitle are no longer required, due to conforming amendments made in other legislation.
- Former III-G, Police Station Closure Justification – this subtitle had been added to the BSA through amendment at the Committee of the Whole markup. At markup, the movant and other Councilmembers agreed to continue to work on the issue before 2nd reading. Those discussions have led to an agreement to remove the subtitle from the BSA.

C. Amended Subtitles:

Several purely technical amendments are made throughout the act. In some cases, applicability dates were added as required to properly implement the subtitles. The ANS also includes various substantive amendments, the bulk of which summarized as follows:

- I-E, Capital Policy and Reserve Account – a provision is inserted to clarify the mechanism for using any excess Debt Service funds to reduce borrowing costs.
- I-L, Statehood Initiatives Budgeting – a section is added to repeal a contingent sunset on the voluntary statehood income tax check-off.
- I-O, Financial Reporting – the date of the report required by the subtitle is changed from January 1, 2015 to October 1, 2014, and other amendments are made at the request of the OCFO.
- II-E, Film DC Incentive Fund – the subtitle is amended to make a minor change the name of the existing fund, to ensure that the name corresponds to the name used in the supporting documents for the FY 2015 Budget Request Act of 2014; the existing structure and purposes of the are kept in place.
- II-F, Free Transportation for Summer Youth – the subtitle is clarified to ensure that the transit subsidy may be used only for transportation of SYEP participants to and from their SYEP employment or related activities.
- II-G, Food Stamp Expansion – a clause is added to ensure that the new locally funded food stamp program will be established no later than October 1, 2015.
- II-H, Cable Television O-Type Transfer – the use of the transferred funds is stricken because the use of the funds is already set forth in the FY 2015 budget and financial plan.
- II-J, Retail Priority Area – the Bladensburg Road, NE Retail Priority Area is redefined; the New York Avenue NE Retail Priority Area is established.
- II-K, Residential Essential Service Subsidy Stabilization – the assessment for the Energy Assistance Trust Fund (“EATF”) is revised to reflect a consensus between the Public Service Commission and the District Department of the Environment on the cost of the remaining programs to be funded by the EATF.
- IV-K, Deputy Mayor for Education Grant-Making Authority – the grant for the development of a language immersion public charter school campus is restricted so that it cannot be used for the lease, renovation, or development costs of a temporary location.
- V-K, End Youth Homelessness – adds a plan for the Interagency Council to develop.
- V-L, Homeless Prevention Program Establishment – the subtitle is amended to apply specifically to families who are at risk of becoming homeless; other minor, clarifying amendments are included.
- VI-B, Capital Bikeshare Corporate Sponsorship Establishment – a requirement for Council review of Capital Bikeshare sponsorship agreements is revised to consist of a 30-day period of passive review.
- VI-F, Distributed Generation Amendment – an applicability date is added to the provision allowing a supplier to meet the non-solar tier one RPS requirement through solar credits that do not qualify for the solar carveout.

- VII-A, Subject to Appropriations Repealers – instead of being amended to be subject to funding, the credits set forth in the Tax Clarity Equity Act of 2013 are amended to be applied over a 3-year period beginning in tax year 2019. Further, the subject-to-funding clause of the Electric Company Infrastructure Improvement Financing Act of 2014 is repealed; this repealer was inadvertently omitted at 1st reading.
- VII-K, Residential Real Property Equity and Transparency Amendment – unfunded provisions that were erroneously included at 1st reading are now stricken.
- VII-N, Tax Transparency and Effectiveness – a number of changes are made at the request of the OCFO to align the reporting requirements with those data that are currently available.
- VII-O, Low-Income Housing Tax Credit – a look-back provision is inserted, and the contours of the initial year of the program are established.
- VII-P, IPW Fund, Destination DC Marketing Fund, and WMATA Momentum Fund Establishment – the Destination DC Marketing Fund is established, and the potential \$5 million that was originally dedicated entirely to the IPW Fund is now divided between the two funds.
- VII-R, Qualified High Technology Clarification – substantive provisions of the subtitle are removed to ensure that it is primarily clarifying in nature.
- IX-A, Local and O-Type Fund Amendments –section 9026 is amended to reflect the intent of the introduced version by repealing the DDOT Operating (Unified) Fund.
- IX-B, Local and O-Type Fund Transfers – a section is added to include the transfer of funds from the Recorder of Deeds Automation and Infrastructure Improvement Fund, a transfer that has already been incorporated into the FY 2015 budget and financial plan.

If you have any questions about this legislation or the FY 2015 budget and financial plan, please contact the Budget Director, Jennifer Budoff, at 724-5689.