DC Fiscal Policy Institute

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WHAT REVENUE CHANGES ARE IN THE FINAL FY 2016 BUDGET?

SUMMARY OF THE MAYOR'S FINAL FY 2016 BUDGET

- Includes tax and fee changes that will increase revenue by $24 million, equal to one-third of one percent of total local revenues. The new revenues combined with other savings will help support new initiatives in the budget.
- The largest tax change raises $16 million from a new fee and tax on hospitals. The dedicated taxes will help reimburse hospitals for Medicaid services delivered, but expires after one year.
- Increases fines for parking meter violations from $25 to $30, extends parking meter enforcement hours from 10 pm to midnight in certain areas, and increases the fines for parking violations in residential parking zones from $30 to $35. The changes will raise $4 million in additional revenue in FY 2016.
- Increases the tax rate on commercial parking, starting in FY 2018, from 18 percent to 22 percent. All new revenue from that increase will go to support improvements to the Washington Metropolitan Area Transit Authority (WMATA).
- Maintains Tax Revision Commission recommendations set to be implemented during tax year (calendar year) 2015: expanding the earned income tax credit to childless workers, raising the standard deduction, phasing out personal exemption for high-income households, and eliminating some individual income tax credits and deductions.
- Speeds up the time frame for implementing the rest of the Tax Revision Commission recommendations. If projected tax collections continue to grow in September, all new revenues will go toward recommended tax reductions. The June forecast projects $38 million in new revenues for FY 2016 and beyond, meaning it is likely that the September forecast will show growth above the February 2015 baseline and that tax cuts will be implemented.

The fiscal year (FY) 2016 budget includes modest revenue increases, largely to support an increase in Medicaid payments to hospitals. The changes to taxes and fees will boost revenues by $23.5 million, equal to one-third of 1 percent of the city's locally funded budget.

DC's Revenues in 2016 Continue to Recover from Recession, But Growth is Slowing

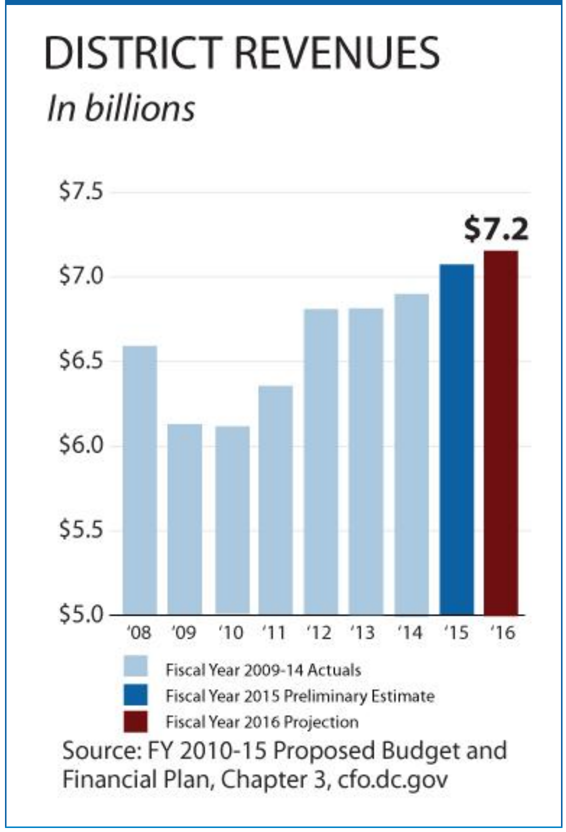
The District's tax collections have grown substantially since 2009, erasing drops that occurred during the Great Recession. However, revenue growth has slowed in the last couple of years.

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 collections started to rise in FY 2011, in part due to a variety of tax and fee increases, but continued to remain below pre-recession levels.

Projected revenues in FY 2016 total $7.2 billion.[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. However, **Figure 1** shows that revenue growth is starting to slow. The growth rate since 2012 is about half the rate from 2010 to 2012.

Figure 1

Revenues Are Growing, but Beginning to Slow



Tax Changes Adopted in Final Budget

The mayor proposed several tax changes that were included in the FY 2016 budget approved by DC Council. However, the DC Council elected not to adopt a proposed sales tax rate increase that would have raised the rate from 5.75 percent to 6 percent and increased revenue by $22 million. Instead the rate will remain at 5.75 percent. The final budget implemented the following:

Commercial Parking Tax Rate Increase: The budget increases the tax rate for commercial parking from 18 percent to 22 percent starting in FY 2018, raising $10.5 million per year. The tax is levied on the gross receipts from commercial vehicle storage and parking lots. The revenue will be dedicated to a fund for the improvement and maintenance of the Washington Metropolitan Area Transit Authority (WMATA). However, the budget includes a provision to eliminate this tax increase if funds are identified to replace the tax increase.

Taxing E-Cigarettes and Other Vaporized Nicotine Products: The FY 2016 budget taxes e-cigarettes and vaporized nicotine products at the same rate as traditional cigarettes and other tobacco products. The DC Council adopted a unified tax rate for all tobacco products in FY 2015, but excluded e-cigarettes due to insufficient evidence of harmful health effects. Several national health organizations (including the Center for Disease Control, the American Heart and Stroke Society, American Cancer Society Cancer Action Network, and the Coalition for Tobacco Free Kids) have determined that e-cigarettes have the potential to harm health and should be taxed and regulated like other tobacco products. The budget is consistent with these recommendations.

[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 Increases through Small Changes to the Individual Income Tax: The budget makes two small changes to the individual income tax to raise $2.5 million. The first change lengthens the statute of limitations for tax audits, allowing the District more time to conduct audits.

Secondly, the budget changes eligibility for the District's Low Income Credit, a credit that eliminates income taxes for residents with very low incomes. The change was made because, currently, a part-year resident with a high *annual* income can qualify for the Low Income Credit if their income while living in the District is low. The budget changes income eligibility so that part-year residents can qualify for the credit if their income earned while in the District, if converted to an annual figure, is lower than the Low-Income Credit eligibility threshold.

New Special Purpose Fund for Bicycle Safety Improvement and Dedicated Funding Stream: The budget also creates a continuing fund for bicycle and pedestrian roadway safety improvements that will receive $500,000 annually from automated traffic enforcement fines.

Changes to Traffic Enforcement for Metered and Residential Parking: The budget made three changes to parking enforcement that will add a total of $4.3 million in revenue in FY 2016 and $11.2 million a year after that. First, the DC Council increased the fine for parking in a time-expired metered spot from $25 to $30, bringing in about $1 million in each year. Second, the District increased the fine for parking in a residential parking zone beyond the time limit from $30 to $35 which raises about $300,000 in revenue a year. Finally, the District will extend the parking enforcement hours in premium parking zones from 10 pm to midnight, raising $3 million in FY 2016 and $10 million in each year thereafter.

Table 1

Dedicated Hospital Taxes and Changes to Traffic Enforcement Are Key Increases to Revenue In FY 2016 and FY 2017

Mayor's Proposed Revenue Changes	FY 2016 (In Millions)	FY 2017 (In Millions)
Commercial Parking Tax from 18% to 22%	-	-
E-cigarette & Vapor Product Tax Parity	$0.4	$0.5
Changes to Individual Income Tax	$2.5	$2.5
Changes to traffic enforcement	$4.3	$11.3
Inpatient & Outpatient Hospital Fees	$16.4	-
Changes to Reporting of Business Income in Combined Reporting		$3.7

*$2 million in grant funding exists for Qualified High Tech Companies in FY 2016.

Raises Fees on Hospitals to Pay for Medicaid Services for one Year: The mayor proposed cutting how much DC reimburses hospitals for in-patient services to Medicaid recipients. This local cut would have meant a loss of about $35 million in payments to hospitals ($10 million in local funds and $25 million in Federal Medicaid matching funds). The approved budget removes this cut by charging a fee on each hospital's gross receipts for inpatient services to all patients. The fee will be charged at a uniform rate to collect $10.4 million. As a result, DC will continue reimbursing in-patient hospitals at 98 percent of the cost of services.

The DC Council also added a $150,000 per-hospital fee on hospital outpatient gross receipts which will go toward increasing access to Medicaid outpatient services. The fee will raise $6 million.

These new sources of revenue from hospitals will be in place for only one year. The budget assumes that Medicaid payment rates to hospitals will fall in 2017. This means that it is likely that the issues of Medicaid reimbursements to hospitals and taxes on hospitals, will be revisited in the FY 2017 budget.

Changes the Reporting of Business Income to Eliminate Tax Havens: The approved budget also adds clarifying language to the District's combined reporting statue – the rules governing how multi-state corporations determine their income that is subject to taxation in the District. The budget adds clarity to the definition of tax havens and identifies jurisdictions that fall under that definition. By narrowing options for tax havens, corporations will have more income that must be reported to DC. The change will raise $3.7 million in revenue beginning in FY 2017.

Revenue Changes Related to Implementation of Tax Commission Recommendations in Tax Year 2015

The FY 2016 budget reflects implementation of a number of provisions adopted last year that will have their first effect on residents – and on the city's tax collections – in 2016. These provisions, passed as part of the FY 2015 budget, partially implement recommendations of the DC Tax Revision Commission. The impact on revenue can be seen in **Table 2**.

Table 2

Tax Commission Recommendations' Revenue Impact In FY 2016

Tax Commission Policy Changes	FY 2016 (In Millions)
Reduce Middle Income Tax Rate	($38.4)
Raise the Standard Deduction	($15.6)
Expand EITC to Childless Workers	($10.8)
Phase-out Personal Exemption for High Income Households	$4.7
Eliminate Homebuyer Credit, Long-term Care Exemption, and Government Pension Exclusion	$3.7

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

Income Tax Rate Reduction for Moderate- and Higher-Income Residents: The individual income tax rate falls from 7.5 percent to 7.0 percent this year on incomes between $40,000 and $60,000 (or $80,000 to $120,000 for two-earner families). This will reduce revenues by $38.4 million in 2016. The commission had recommended reducing the rate to 6.5 percent, and that cut will occur in future years if certain revenue targets are met.

The change reduces taxes by up to $100 for a single-earner household and up to $200 for a two-earner household. It reduces taxes for both moderate-income households and also for higher-income households. This is because high-income households pay lower rates on the first 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 is greatest for moderate-income households.

Raising the Standard Deduction: For tax year 2015, the standard deduction increases from $4,250 to $5,200 for singles and to $8,350 for married couples, partially implementing a recommendation of the tax commission. The standard deduction 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, which is followed by six other states. The District will raise the standard deduction fully up to the federal level (currently $12,400 for joint filers) in future years, if certain revenue targets are met.

Expanding the Earned Income Tax Credit (EITC): For tax year 2015, eligibility for the credit increases from about $14,000 to $23,000 for workers without children in their home. In addition, the maximum credit increases from about $200 to almost $500. The District's Earned Income Tax Credit helps low-income families make ends meet by providing substantial tax refunds or reducing taxes substantially for working poor households. However, the credit until recently provided very little benefit to households without children in the home. The maximum credit for childless residents is less than $200 and it only goes to workers earning under $14,000 a year.

Phasing-Out the Personal Exemption for Higher Income Households: In tax year 2015, the DC personal exemption will phase-out for households with taxable income above $150,000, phasing out entirely at $275,000 of taxable income. 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 phases out the personal exemptions for higher-income households, and the Tax Revision Commission recommended that DC follow a similar approach. The FY 2015 budget calls for increasing the personal exemption to match the federal exemption amount over the next five years.

Budget Sets Priority for Implementing Remaining Tax Revision Commission Recommendations in Ways that Could Make it Hard to Fund Services in Next Year's Budget

The FY 2016 budget includes a provision to move forward in implementing the Tax Revision Commission Recommendations, if the revenue forecasts before next year's budget show an increase in projected tax collections. The budget calls for using all increases in revenues identified between February 2015 and September 2015 (that is from forecasts released in June and September 2015) to implement tax cuts recommended by the tax commission.

The June revenue forecast found that revenues are projected to grow by an additional $38 million in FY 2016 and beyond. If this projection is maintained in the next revenue forecast in September, $38 million of tax cuts will be implemented in 2016, including further reduction in the middle income bracket, an income tax rate cut for taxable income between $350,000 and $1 million, and a reduction in the business franchise tax. If the September revenue forecast shows a further increase in revenues, additional tax cuts would be triggered. (**See Table 3** for the tax cuts and the order they would be implemented.) The full list of tax changes represent $147 million in revenue reductions.

Table 3 Tax Commission Recommendations Which Will Go Into Effect Via Revenue Triggers	
Tax Commission Policy Changes	**Fiscal Impact (In Millions)**
Reduce the rate on the new individual income tax middle Bracket 7.0% to 6.75%	($5.7)
Lower taxes through “Millionaire Bracket” for incomes from $350K to $1M	($4.5)
Reduce business franchise tax to 9.2%	($9.2)
Reduce the rate for middle income bracket from 6.75% to 6.5%	($5.7)
Reduce business franchise tax to 9.0%	($9.2)
Raise estate tax threshold from $1 million to $2 million	($4.5)
Raise standard deduction: $5,650 for singles, $7,800 for HOH, $10,275 for married.	($7.8)
Raise standard deduction: $6,100 for singles, $8,950 for HOH, $10,275 for married.	($8.9)
Increase Personal Exemption to $2,200	($12.0)
Increase Personal Exemption to $2,700	($14.5)
Reduce business franchise tax to 8.75%	($11.4)
Increase Personal Exemption to $3,200	($14.0)
Raise estate tax threshold to conform with federal level	($9.4)
Reduce business franchise tax to 8.5%	($11.4)
Increase Personal Exemption to $3,700	($13.6)
Reduce business franchise tax to 8.25%	($11.4)
Eliminate the Low Income Credit and Increase Personal Exemption to Federal Level	($8.0)

Source: FY 2016 Budget Request Act Draft Report (Bill 21-157)

Using additional revenue solely for tax cuts is problematic for several reasons:

- **Implementing the tax recommendations so quickly may limit the District's ability to address the rising costs of schools, healthcare, and transportation.** The costs of basic services grow every year. Much of the growth stems from natural growth in the costs of mandatory commitments like healthcare, school enrollment, and Metro needs. Rapidly implementing tax cuts over the coming months could slow revenue growth to a point where DC cannot cover the costs of essential services – or be able to address an unexpected spending need that may arise.
- **The DC Council passed a version of the tax package which did not include important revenue increases that balance the package.** The Tax Revision Commission recommended two revenue increases to offset recommended tax cuts, totaling $67 million, which the DC Council did not adopt. This means that the Council’s tax cut plan would limit DC’s revenue growth more than the Tax Commission intended. Given that, it would make sense for the DC Council to spread out implementation of tax cuts to make the impact more manageable.