DC Fiscal Policy Institute

Independent Research. Poverty Solutions.
Better DC Government.

REVENUE: WHERE DC GETS ITS MONEY

February 9, 2017

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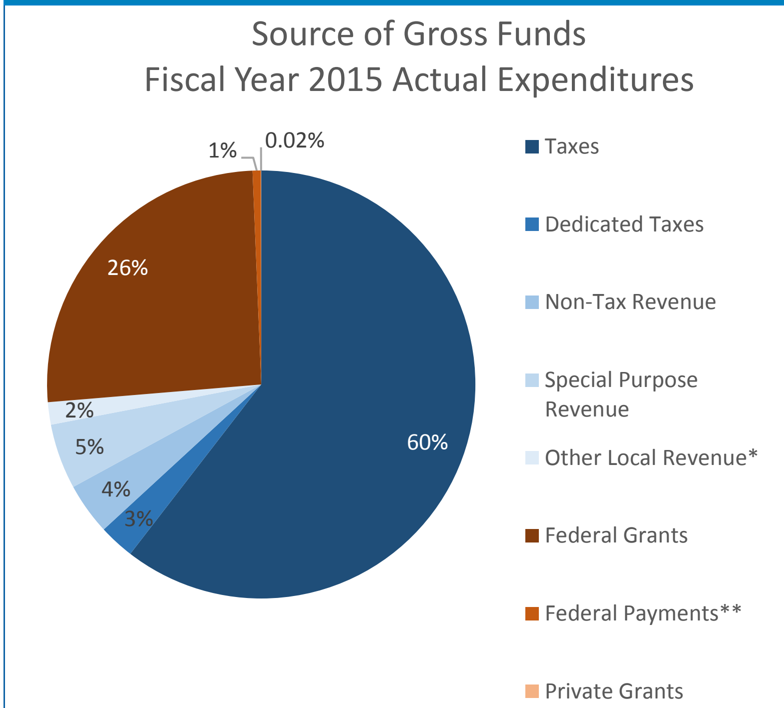
Introduction

The DC government collects revenue in a variety of ways from its residents, businesses, and the federal government. These revenues are used to fund the wide array of services provided by the District, from schools to health care to libraries to road construction. The DC government collected about $10.5 billion in revenue in fiscal year (FY) 2015, with the largest sources being local taxes and federal funds. Other sources include various non-tax revenues such as licenses, fees, and private grants and donations. Much of the city's non-tax revenue is described as "special purpose" revenue because it is devoted to specific purposes.

All of these funding sources together are called "gross funds." **Figure 1** shows a breakdown of gross funds revenue for FY 2015. The District's major revenue sources are discussed below.

Figure 1



*Other Local Revenue includes lottery revenue transferred to the general fund, and seven additional items found in lines 7 through 14 of Table 2-1.
**Federal Payments is net of fund balance use, and transferred into local funds to cover administrative costs.
Source: Fiscal Year 2017 Budget & Financial Plan, Tables 2-1 and 2-5.

Taxes

Taxes account for roughly 60 percent of the revenue collected by the DC government. Most tax revenue becomes part of the city's general fund and is used to fund the basic services included in the District's budget. Some taxes, known as dedicated taxes, can only be spent on specific activities. For example, all parking sales taxes are dedicated to the District's annual funding responsibility for Washington Metropolitan Area Transit Authority (WMATA). (The District's dedicated tax sources are discussed in more detail on page 36.)

DC has 22 local taxes **(Table 1)**. In FY 2015, collections from these taxes totaled $6.4 billion. The three largest sources of tax revenue are real property, individual income, and sales and use taxes. Together, they accounted for almost 64 percent of all tax revenue.

Table 1

FY 2015 DC Tax Revenues

Tax	Revenue (in millions)
Individual Income	$1,868.0
Corporate Franchise	$308.0
Unincorporated Business Franchise	$139.8
Sales and Use	$1,315.3
Alcoholic Beverages	$6.2
Cigarette	$31.5
Motor Vehicle Excise	$46.6
Motor Fuel Tax	$25.3
Real Property	$2,194.5
Personal Property	$57.2
Public Space Rental	$36.1
Public Utility	$145.9
Toll Telecommunications	$56.2
Insurance Premiums	$104.5
Healthcare Provider	$12.9
Hospital Bed	$31.9
ICF-IDD (Institutions Serving Individuals with Developmental Disabilities) Assessment	$5.0
Ballpark Fee	$34.9
Deed Recordation	$257.9
Deed Transfer	$198.3
Economic Interests	$24.4
Estate	$48.3
Total Tax Revenue	**$6,432.1**

Source: FY 2017 Proposed Budget and Financial Plan, Table 3-3. All tax revenues presented here include dedicated funds.

Individual Income Tax

Individual income taxes account for more than one quarter of the city's tax revenue and raised about $1.87 billion in FY 2015. The District's individual income tax—the tax DC residents pay on their annual income—is the city's most progressive tax. This means that higher-income residents pay a larger share of their income in taxes than do lower-income residents. This occurs because the DC income tax, like the federal income tax and state income taxes in most states, has a graduated rate structure under which higher-income households are subject to a higher income tax rate than lower-income residents.

Glossary of Individual Income Tax Terms

Adjusted gross income — total income of an individual or family that is subject to taxation

Individual income tax — a tax levied on an individual's or household's income

Net taxable income — adjusted gross income minus deductions and exemptions

Net taxes owed — tax responsibility minus credits

Personal exemption — amount per member that a household can subtract from their income before taxes; lowers the amount of taxes a household has to pay

Personal income — an individual's or family's income before taxes

Standard deduction — amount that an individual or family can subtract from their income before taxes, if they are not itemizing their deductions; lowers the amount of taxes a household has to pay

Tax bracket — an income range that is subject to a particular tax rate; DC has six tax brackets: $10,000 and less; $10,001-$40,000; $40,001-$60,000; $60,001-$350,000; $350,001-$1,000,000; and over $1,000,000

Tax credit — lowers the amount of taxes an individual or family has to pay; a refundable credit means that if a family's tax credit is larger than what it must pay in taxes, it receives the difference as a refund

How the DC Income Tax Works: Calculating the DC income tax occurs in several steps:

1) **Determining Adjusted Gross Income (AGI):** This is the total amount of income subject to the tax. In DC, AGI includes wages, investment income, and unemployment benefits, among other sources. Several major sources of income are <u>not</u> taxed in DC, and thus are not included in AGI. These include social security and public assistance benefits.

2) **Subtracting Deductions and Exemptions:** The District allows a number of deductions from AGI, including a personal exemption for every member of the

household and either a standard deduction or itemized deductions. (DC's itemized deductions are based on the federal deductions.) Some filers may qualify for targeted deductions, such as a deduction for contributions to a college savings plan. AGI minus deductions and exemptions equals *net taxable income*.

How the Income Tax Works: An Example*

A single mother with two children living in the District earns $27,000 per year. She does not have any other income sources, so her adjusted gross income is $27,000. She takes the standard deduction ($6,650) and can apply a personal exemption ($1,775) for each family member, plus an additional personal exemption DC allows head of household filers to claim.

1) Adjusted Gross Income (AGI): $27,000

2) Standard Deduction: $6,650
   Personal Exemptions: $1,775 x 4 = $7,100
   Total Deductions: $13,750

Subtracting the total deductions from the AGI leaves a net taxable income of $13,250.

3) The income tax rates are then applied to the family's net taxable income:
   First $10,000 taxed at 4% rate: $10,000 x 0.04 = $400
   Income between $10,000 and $40,000 taxed at 6% rate: $3,250 x 0.06 = $195
   Total Tax (before credits): $595

4) The family qualifies for the DC Earned Income Tax Credit (EITC) and receives a credit of $2,229.

After subtracting their tax responsibility, the family receives a refund of $1,634.

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*This example uses 2016 deductions, exemptions, and tax rates. DC EITC is 40% of federal credit allotted by the IRS.

Sources: IRS, "2016 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates"; OTR, "2016 District of Columbia (DC) Individual Income Tax Forms and Instructions."

3) **Calculating Tax Responsibility before Credits:** DC's income tax rates are applied to net taxable income to determine an individual or household's tax responsibility (before credits).[1] DC's marginal income tax rates, along with those in Maryland and Virginia, are listed in **Table 2**.

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[1] The District also has an option, called "combined filing separate" in which each member of a married couple can count their income separately to allow both spouses to take advantage of the lower tax brackets and rates.

Table 2

Comparison of Income Tax Rates, Standard Deductions, and Personal Exemptions in DC, Maryland, and Virginia* - 2015

	DC		Maryland**		Virginia	
Tax Rates (apply to income after deductions)	Up to $10,000:	4%	State income tax:	_	Up to $3,000:	2%
	$10,001-$40,000:	6%	Up to $1,000:	2%	$3,001-$5,000:	3%
	$40,001-$60,000	6.5%	$1,001-$2,000:	3%	$5,001-$17,000:	5%
	60,001-$350,000:	8.5%	$2,001-$3,000:	4%	Over $17,000:	5.75%
	$350,001-$1,000,000	8.75%	$3,001-$100,000:	4.75%		
	Over $1,000,000	8.95%	$100,001-$125,000:	5%		
			$125,001-$150,000:	5.25%		
			$150,001-$250,000:	5.5%		
			Over $250,000:	5.75%		
			County income tax	_		
			Montgomery:	3.2%		
			Prince George's:	3.2%		
Standard Deduction	Married:	$10,275***	Married:	$4,000****	Married:	$6,000
	Single:	$5,650	Single:	$2,000	Single:	$3,000
	Head of Household:	$6,650	Head of Household:	$2,000		
Personal Exemption	Married:	$3,550	Up to $150,000:	$3,200	$930	
	Single:	$1,775	$150,001-$175,000:	$1,600		
	Head of Household:	$3,550	$175,001-$200,000:	$800		
			above $200,000:	$0		

*DC, Maryland, and Virginia all have a "combined filing separate" option allowing each member of a married couple to count their income separately to allow both spouses to take advantage of lower tax rates.

**Maryland has 2 separate tax bracket, rate, and personal exemption systems. One is for taxpayers filing jointly, surviving spouse, or head of household. The other is for all other individual taxpayers. Rates, brackets, and personal exemptions in this chart are for the second set of taxpayers.

***These values represent new thresholds that will go into effect for tax year 2017 due to tax cuts that were triggered in September, 2016.

****In Maryland, the Standard Deduction ranges from $3,000 to $4,000 for married couples and $1,500 to $2,000 for single and head of household filers, depending on the taxpayer's income. For more information see Maryland 2015 State & Local Tax Forms and Instruction.

Sources: Office of DC Chief Financial Officer, "Tax Rates and Revenues, Individual Income and Business Taxes"; Office of DC Chief Financial Officer, "Individual Income Tax Filing FAQs"; Office of DC Chief Financial Officer, "2015 Individual Income Tax Information; "Maryland 2015 State & Local Tax Forms & Instructions"; VA Department of Taxation, "Individual Income Tax"; VA Department of Taxation, "Deductions"; VA Department of Taxation, Exemptions"; ITEP.

4) **Subtracting Credits from Tax Responsibility:** The District also allows certain credits to be subtracted from tax responsibility. Credits operate as a dollar-for-dollar reduction in tax responsibility. A family with $1,000 in tax responsibility and $100 in tax credits, for example, would have a final tax bill of $900.

The District's income tax includes a number of tax credits, including a tax credit for child care expenses and an Earned Income Tax Credit (EITC). Many DC tax credits are *non-refundable*, meaning they can only bring a final tax bill down to zero. If a household qualifies for credits that are larger than its tax bill, the credits eliminate its tax responsibility, but the household does not receive the excess tax credit amount as a refund. Other tax credits, like the EITC, are *refundable*, which means that families get money back if the credit amount is greater than their tax responsibility.

Tax responsibility minus credits equals *net taxes owed*.

Comparison of Tax Rates and Responsibilities Liabilities with Maryland and Virginia: The District's individual income tax rates are similar—and in some cases lower—than Maryland's, and higher than those in Virginia **(Table 2)**. In Maryland, counties and Baltimore city levy their own local income taxes in addition to the state-level tax. In tax year 2016, Maryland's local income tax rates ranged from 1.75 percent to 3.2 percent.

Examining the tax responsibilities of families at different income levels, a family of three earning $25,000 in the District receives a refund of $732, mostly due to DC's local EITC **(Table 3)**. As a result, DC's responsibility at this income level is the lowest in the region. The District has a lower income tax responsibility for a family of three earning $50,000 when compared to Maryland, but a higher income tax responsibility when compared to Virginia. Looking at families of three with incomes of $150,000, the District's income tax responsibility is lower than in Maryland and higher than in Virginia.

Table 3

Comparison of Income Tax Responsibilities in DC, Maryland, and Virginia in 2014

Adjusted Gross Income	$25,000*	$50,000**	$100,000***	$150,000***
Washington, DC	-$732	$1,557	$4,148	$7,158
Montgomery County, MD	-$371	$2,135	$5,255	$8,301
Prince George's County, MD	-$419	$2,119	$5,275	$8,349
Fairfax County, VA	$0	$1,489	$3,597	$5,862
Arlington County, VA	$0	$1,497	$3,711	$5,873

*Assumes a family (two parent earners and one child) receives a child care subsidy that covers all of their child care expenses, takes the standard deduction and all applicable personal exemptions, and receives the DC or state Earned Income Tax Credit (EITC).

**Assumes family (two parent earners and one child) takes the standard deduction and all applicable personal exemptions.

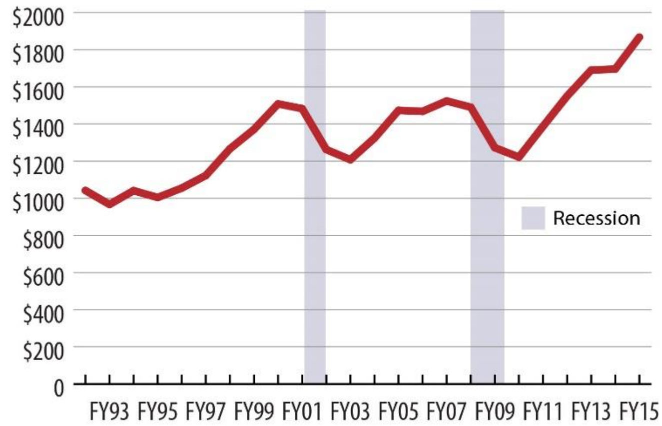
***Assumes family (two parent earners and one child) itemizes their deductions and takes all applicable personal exemptions.

Source: CFO, State and Local Household Tax Burdens: DC's are the Lowest in the Metro Area.

DC Income Tax Collections: **Figure 2** shows DC individual income tax revenue from 1992 to 2015, with dollar amounts adjusted for inflation. The figure shows that income tax collections generally follow the economic cycle. During the national economic boom of the late 1990s, DC income tax revenues increased greatly before peaking and decreasing from 2000 to 2003. Income tax revenues in the District began to increase again in 2004, as the national and local economy expanded. Revenue started decreasing again in 2007 as a result of the Great Recession.

Figure 2

DC Individual Income Tax Revenue, FY 1992-2015, in millions of 2015 dollars



Source: DC Tax Facts, 2016.

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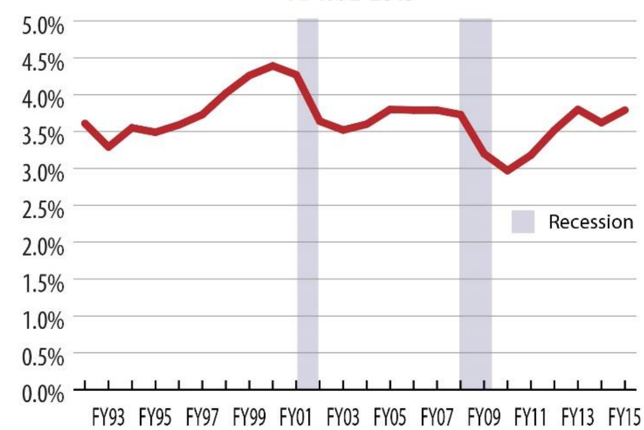
Another way to look at individual income tax revenue is to examine how much people pay in income taxes as a percentage of their personal income. **Figure 3** shows that individual income tax revenue peaked at 4.4 percent of the District's total personal income in 2000 and decreased to less than 3.0 percent in 2010. In recent years, it has increased again to 3.8 percent.

Changes to the Individual Income Tax: DC's income tax has been modified substantially over time. Some of the major changes are highlighted below.

Figure 3

DC Individual Income Tax Revenue as a Percentage of Personal Income, FY 1992-2015



Source: DC Tax Facts, 2016, Table1; Bureeau of Economic Analysis, SA1 Personal Income Summary: Personal Income, Population, Per Capita Personal Income

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1) **Rate Changes and Bracket Changes:** Over the past 20 years, the District has modified its individual income tax brackets and lowered the tax rate for each bracket. **Table 4** (on page 11) outlines the changes to the individual income tax, starting with the Tax Parity Act of 1999.

2) **Earned Income Tax Credit:** The District has also helped to lower the income tax responsibility for low-income families by adopting an Earned Income Tax Credit (EITC) and by raising the standard deduction and personal exemption. These households get a tax credit based on their wages and the number of children in their home, and if that credit exceeds the amount of taxes owed, they get the difference as a refund.[2]

   Over 57,000 households in the District benefit from the EITC, lifting an average of 14,000 people out of poverty each year. Those extra dollars not only help individual households but the District's economy as a whole, because research shows that low- and moderate-income households quickly spend those dollars for food, rent, and other staples. The EITC put approximately $129.9 million into DC's economy in 2014, according to the Center on Budget and Policy Priorities.[3]

   In 2001, the District adopted its own EITC and set it at 10 percent of the federal credit.

   The District has expanded its EITC several times since then, to 40 percent of the federal credit starting in 2009. The maximum DC EITC benefit for tax year 2016 will be $2,507 for a family with three or more children.[4] The DC Council acted in 2014, following recommendations of the DC Tax Revision Commission, to expand the DC EITC for households without children in two ways. First, the maximum credit increased from about $200 to about $500. Second, the credit expanded so that more childless households can receive the maximum credit, up from those who make under $14,000 to those that make under $23,000.[5] These changes mean a great deal for low-wage workers without children. A worker earning $18,000 would go from owing $533 in income taxes to receiving a refund of $102, almost entirely as a result of the expanded EITC.

   The DC EITC is one of the largest state-level EITCs. In conjunction with the federal EITC, it boosts low-income, working families' earnings by as much as 63 percent.[6]

3) **Standard Deduction and Personal Exemption:** Since 2006, the District has increased its standard deduction from $2,000 to $5,650 for single adults and its personal exemption from $1,370 to $1,775. These changes have reduced the amount of income that is subject to the DC income tax.

[2] DCFPI. 2014. "Making Work Pay Through the Earned Income Tax Credit."
[3] Center on Budget and Policy Priorities. 2014. Get it Back Campaign, EITC Participation by State.
[4] IRS. "2016 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates."
[5] DC Tax Revision Commission. 2014.
[6] DC Fiscal Policy analysis of figures from the Center on Budget and Policy Priorities' "Policy Basics: The Earned Income Tax Credit" (2016).

Table 4			
Changes in Income Tax Brackets & Rates			
Before Tax Parity Act (1998)		Current	
Up to $10,000	6%	Up to $10,000	4%
$10,000 to $20,000	8%	$10,000 to $40,000	6%
$20,000 and above	9.5%	$40,000 to $60,000	6.5%
		$60,000 to $350,000	8.5%
		$350,000 to $1,000,000	8.75%
		Over $1,000,000	8.95%

Source: DC Tax Facts, 2016.

Business Income Taxes

Just as individuals pay taxes on their income, businesses in the District also are required to pay taxes on their earnings. There are two types of business income taxes: the corporation franchise tax and the unincorporated business franchise tax, which applies mainly to small businesses and real estate firms. Together, these taxes raised over $447 million in FY 2015, which accounted for just under 7 percent of the city's tax revenue.

Glossary of Key Business Franchise Tax Terms

Apportionment — formula used to determine the taxes of a business that operates in multiple states

Business franchise tax — a tax levied on a business's income

Depreciation — the loss in value of business equipment and other assets

Net operating loss — the amount of a business's losses that exceed its profits

Net taxable income — adjusted gross income minus deductions and exemptions

Non-business income — any income that is not earned as part of regular business activities, such as income from interest or dividends

Tax credit — lowers the amount of taxes a business has to pay

Total gross income — the total amount of income earned by a business

The District's unincorporated business tax reflects the city's unique situation of not being able to tax the income of non-residents. Most states tax unincorporated businesses through the individual income tax. That is, the income of the small business is treated as the income of the owners and is reported on their personal income tax returns. In DC, however, if an owner of an unincorporated business does not live in the District, any personal income tax they would pay on business profits would go to their state of residence. Therefore, the unincorporated business tax makes it possible for the District to collect taxes from all businesses operating within its boundaries, whether the business owners live in DC or not. The unincorporated business tax does not apply to certain professionals, such as doctors and lawyers.

The business franchise tax has been shrinking as a share of total DC tax collections. In 2015, these taxes accounted for more than 7 percent of total tax revenue, compared with 9 percent in 2001.

How the Business Franchise Taxes Work: The main steps for calculating the District's business franchise taxes are as follows:

1) **Determining Total Gross Income:** This is the total amount of income earned by the business and includes gross receipts, dividends, interest, gross rental income, royalties, and capital gains, among others. Unincorporated businesses must pay the franchise tax if their gross income exceeds $12,000.

2) **Calculating Deductions:** The District allows both corporations and unincorporated businesses to take deductions from gross income for expenses like salaries and wages, repairs, rent, depreciation, and federal taxes. Unincorporated businesses are not allowed to deduct the owner's salary fully from gross income. Instead, they can take a deduction equal to 30 percent of the owner's salary. Corporations also can deduct advertising expenses and pensions or profit-sharing plans. Deductions are subtracted from total gross income to calculate the business's net income.

3) **Determining Taxable Income:** There are a few additional steps that businesses have to take to calculate their total taxable income before they can apply the tax rate.

    a. Net Operating Loss Deduction: If a business operated at a loss in a year prior to 2000, that loss can be claimed as a deduction against current income. This is called the net operating loss deduction. The District allows a deduction for any net operating loss carried forward by a business from a year before 2000. This amount is subtracted from net income.

    b. Non-Business Income: Non-business income and related expenses are not included in businesses' taxable income. Non-business income is any income that is not earned as part of regular business activities, such as income from interest or dividends. This is subtracted from net income as well.

    c. Apportionment: Some businesses subject to the District's franchise taxes also do business outside of DC. To determine how much of a business's income is taxed in the District, the business multiplies its net income by an apportionment factor set in DC's franchise tax law. The District's apportionment factor is based on the share of business's total sales that take place in the District. Some states apportion income by also considering a share of a business's property and payroll that are in that jurisdiction. The District shifted to a sales-only factor in FY 2015.

d. Exemptions: Unincorporated businesses can take an exemption of $5,000. This amount is subtracted from their taxable income.

Once a business's total taxable income is calculated, it is multiplied by the tax rate to determine the business's tax responsibility. The tax rate for both of DC's business franchise taxes is 9.0 percent.[7]

e. Subtracting Credits: The District allows businesses to subtract certain credits from their tax responsibilities. Credits operate as a dollar-for-dollar reduction in tax responsibility. A business with $3,000 in tax responsibility and $400 in tax credits, for example, would have a final tax bill of $2,600. DC's business income tax credits include a credit for employing and providing health insurance to low-income employees if the business is located in an economic development zone; leasing space to a nonprofit child development center; providing homeownership assistance to employees; and providing paid leave for employees to serve as organ donors. Tax responsibility minus credits equals net taxes owed.

[7] The new tax rate will go into effect in tax year 2017 due to recent tax-cut triggers.

How the DC Business Franchise Tax Works: Unincorporated Business Example

The owner of a car maintenance and repair shop has gross income of about $300,000 each year. Since the business's income is above $12,000, the store is required to pay the unincorporated business tax.

1) Total Gross Income: $300,000

2) Deductions: The owner can take deductions for the shop's rent payments, salaries, interest, federal taxes, and depreciation.

   Salaries Deduction: $145,000
   Depreciation Deduction: $2,900
   Interest Deduction: $1,000
   Rent Deduction: $34,000
   Federal Tax and Other Deductions: $25,400
   Total Deductions: $208,300

Deductions are subtracted from the total gross income to calculate the business's net taxable income: $300,000 – $208,300 = $91,700

3) Exemptions: The owner can also subtract a $5,000 exemption from the business's net taxable income. $91,700 – $5,000 = $86,700

4) The tax rates are then applied to the business's net taxable income: $86,700 x 9.0% = $7,803. Total Tax (before credits): $7,803

5) Credits: The store does not qualify for any credits.

Therefore, the business pays a tax of $7,803.

Businesses are required to pay a minimum tax even if a business reports negative income for a given year. The minimum tax is $250 for business with gross receipts of less than $1 million, and $1,000 for those with gross receipts of $1 million or more. In the District, more than half of corporations pay only the minimum tax amount, because they are able to claim enough deductions and credits to reduce their tax responsibility to the minimum level.[8]

Comparison of Business Franchise Taxes with Maryland and Virginia: DC's franchise tax rate is now 9.0 percent and has been reduced from 9.975 percent since 2014. Under current law, the franchise tax rate will be reduced to 8.25 percent in a series of steps if the District's tax collection projections rise above certain levels. (This is known as a tax-cut trigger mechanism.) DC's rate remains higher than in Maryland and Virginia. If DC's rate falls to 8.25 percent due to tax-cut triggers, the District rate would match Maryland's.

However, simply comparing rates can be misleading, given that most DC businesses pay the minimum tax. In addition, Virginia business pay both a franchise tax on profits and a gross

[8] OCFO, Seble Tibebu.

receipts tax on all of their revenues. DC and Maryland do not have a business gross receipts tax. A 2013 report done for the DC Tax Revision Commission found that there were not notable differences in income taxes paid by businesses in the three jurisdictions. The study concluded that, although the District has a higher business income tax rate than Virginia and Maryland, the "tax burden in the District for C-corporations is not significantly different from its Maryland and Virginia neighbors." This is, in part, because "the gross receipts tax in Virginia in some situations eliminated the tax savings of the Commonwealth's 6 percent [business] income tax rate."[9]

How the DC Business Franchise Tax Works: Multi-State Corporation Example

A store that is part of a national pharmacy chain located in DC earns $8 million a year. This business is subject to the District's corporation franchise tax.

1) Total Gross Income: $8,000,000

2) Deductions: The business is eligible to take deductions for rent payments, salaries, interest, federal taxes, and depreciation.

   Total Deductions: $6,400,000

Deductions are subtracted from the total gross income to calculate the store's net taxable income: $8,000,000 – $6,400,000 = $1,600,000

3) To determine the amount of the tax that should be paid in DC, the business's taxable income is "apportioned" using a formula set by the District.*

   The formula is: (sales in DC/national sales) x total profits of corporation

   The sales factor is determined by dividing the value of the business's sales in the District by the total value of the business's sales in the District and other states. $150,000/$2,500,000 = 0.06

   0.06 x $1,600,000 = $96,000

So, the business's net taxable income in the District is $96,000.

4) The tax rates are then applied to the business's net taxable income: $96,000 x 9.0% = $8,640.

Total Tax: $8,640.

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*The apportionment factors used in this example are assumptions and are not necessarily reflective of the typical national pharmacy chain in DC.

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[9] DC Tax Revision Commission, Tax Overview. 2014.

Table 5 Comparison of Business Franchise Taxes in DC, Maryland, and Virginia			
	DC	Maryland	Virginia
Tax Rate	9.0%*	8.25%	6% 1% (Bank Franchise Tax)
Minimum Tax	$250 $1,000 for businesses with more than $1 million in gross receipts.	No minimum	No minimum
Apportionment Method for Multi-State Corporations	All corporations: single-factor formula based on sales	Manufacturers: single sales factor All others: three-factor formula with a double-weighted sales factor	Manufacturers who meet certain wage and employment number targets: can choose to use single sales factor Retailers: single sales factor** All others: three-factor formula with a double-weighted sales factor

*The new tax rate will go into effect in tax year 2017 due to recent tax-cut triggers.

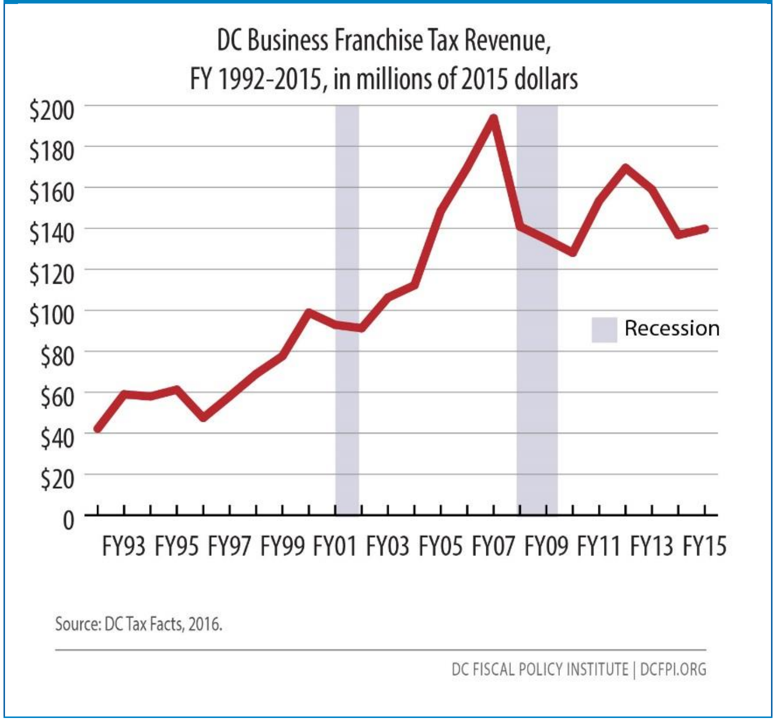
**For taxable years beginning on or after July 1, 2014, but before July 1, 2015, retailers must use a quadruple-weighted sales factor. For taxable years beginning on or after July 1, 2015, retailers must use the single sales factor method.

Sources: Office of the DC Chief Financial Officer, "Tax Rates and Revenues, Individual Income and Business Taxes"; Comptroller of Maryland, "Maryland Tax Regulation 03.04.03"; Virginia Department of Taxation, "Corporate Income Tax and Bank Franchise Tax, 2015 Instructions for Schedule 500A"

Maryland and Virginia use the same apportionment method as the District does for most corporations, but each state changes the formula to provide preferential tax treatment to certain kinds of businesses. Maryland uses a single-factor formula for manufacturers, meaning they are only taxed based on the percentage of their sales made in the state; the in-state presence of personnel and property are not factored into the state tax responsibility. In Virginia, manufacturers that meet certain wage and employment targets can choose the standard three-factor formula or a single factor formula based solely on sales as used by Maryland manufacturers. Since July 1, 2015, Virginia has used this single factor formula for all retailers.

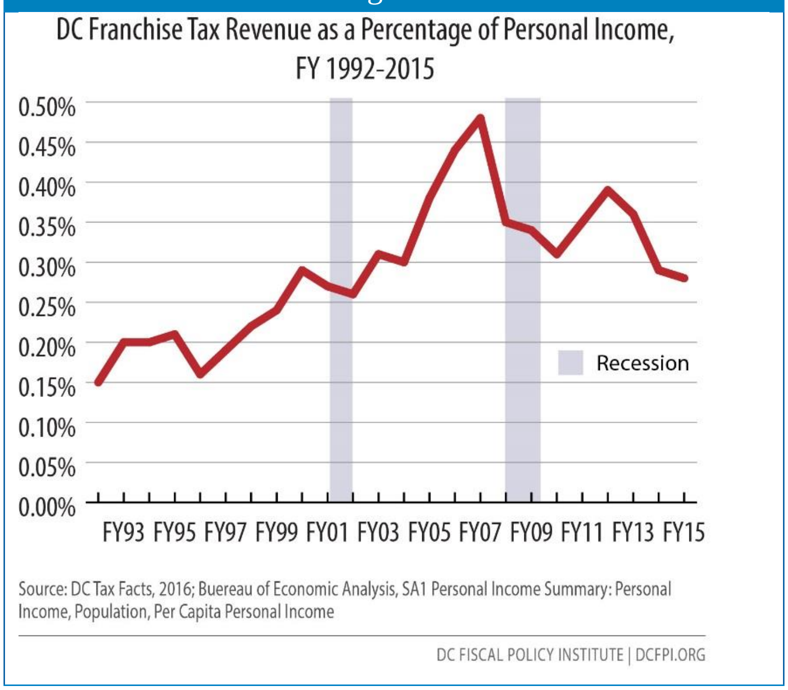
DC Business Franchise Tax Collections: **Figure 4** shows the amount of unincorporated business franchise taxes collected by the District from 1992 to 2015, adjusted for inflation. As with the individual income tax, business franchise tax collections tend to rise and fall with the economy. During the economic boom of the late 1990s, franchise tax revenues generally increased before falling by more than $100 million as the economy took a downturn between 2001 and 2002. Franchise tax revenues increased steadily from 2002 to 2007 and began to decrease again in 2008 with the start of the Great Recession. As the economy started recovering, revenues began to increase again in 2010.

Figure 4



Business franchise taxes as a share of personal income have fluctuated between 0.15 percent and 0.48 percent since 1993 **(Figure 5)**.

Figure 5



Changes to the Business Franchise Tax:

1) **Rate Changes:** Over the past 40 years the business franchise tax rate has fluctuated a bit. In 1976 it started at 8 percent, and increased to 10.5 percent by 1985. Since then it has declined. Most recently, it was reduced from 9.975 percent to 9 percent for tax year 2017 **(Table 6)**. Under current law, the rate could fall to 8.25 percent if the DC's revenue collections grow faster than prior projections.

2) **Tax Base Changes:** In addition, the types of businesses that are required to pay the tax also changed over the past 30 years. Beginning in 1980, professionals no longer had to pay the unincorporated business franchise tax. Financial institutions became subject to the tax in 1981.

Table 6

Major Changes to the Business Franchise Tax, 1976-2015

Fiscal Year Effective	Franchise Tax Changes
1976	Effective rate increased from 8% to 9.9%.
	Temporary increase for calendar year 1975 brings effective rate to 12%.
1980	Professionals no longer have to pay unincorporated business franchise tax.
1981	Financial institutions now have to pay corporation franchise tax.
1983	Minimum franchise tax increased from $25 to $100.
1985	Effective rate increased to 10.5%.
1987	Effective rate decreased to 10.25%.
1989	Effective rate increased to 10.5%.
1993	Effective rate decreased to 10.25%.
1994	Effective rate decreased to 9.7375%.
1999	2.5% surtax added to fund Convention Center, effective rate now 9.975%.
	2.5% surtax financing the Convention Center is shifted to the General Fund.
2012	Minimum franchise tax increased to $250. Minimum for businesses with gross receipts more than $1 million increased to $1,000.
2014	Apportionment formula changed. Sales in DC now double weighted.
	Effective rate decreased to 9.4%
2015	Effective rate decreased to 9.2%
2017	Effective rate decreased to 9.0%*

*As revenue continues to grow above projection, tax-cut triggers will cause the business franchise tax to decrease to 8.25%.

Sources: DC Tax Facts, 2016; Fiscal Year 2012 Budget Support Act of 2011; Mayor's Office of Budget and Finance, March 2016.

Property Taxes

The District levies two kinds of property tax. The *real property* tax is an annual tax on the value of land and buildings in the city. The District collected $2.2 billion in real property taxes in 2015, making it the city's single largest tax source. The *personal property* tax is a tax on business equipment, typically large equipment. It is a much smaller tax source, generating only $57 million in 2015. The remainder of this section will focus on DC's real property taxes.

How the Real Property Tax Works: Properties in the District are classified into four groups for property tax purposes. Class 1 comprises residential properties, including both homeowner properties and rental properties. Class 2 comprises commercial properties. Starting in FY 2011, the District has a Class 3 that includes vacant properties. Class 4 comprises properties defined as blighted, whether commercial or residential.

DC's real property taxes are calculated under the following process:

1) **Property assessment:** The tax calculation starts with an assessment by the city of each property's market value. These assessments are done annually by the District government and are intended to reflect each property's full market value. Assessments are published in March of each year and they affect tax bills in the subsequent year. Property owners who believe the assessment overstates a property's value can appeal the assessment.[10]

2) **Taxable assessment:** For all properties except owner-occupied homes, the District's property tax rate is applied to a property's full assessed value. In other words, for these properties, the full assessed value is the "taxable assessment." Homeowners, on the other hand, qualify for several tax reduction provisions, discussed below, which can result in setting the home's taxable assessment below its full assessed value.

3) **Limits on Taxable Assessments for Homeowners:** DC's homeowners qualify for several provisions that limit their taxable assessments and thus reduce their property taxes. These apply only to a homeowner's primary residence (i.e., they do not apply to a second home or to homes that an owner rents out).

   <u>Homestead Deduction</u>**:** Each homeowner can claim the Homestead Deduction for their primary home. The Homestead Deduction amount is deducted from the home's full assessed value. The deduction is set at $71,700 in 2015. DC law requires annual inflation adjustments for the Homestead Deduction.

   <u>Cap on Annual Increases in Taxable Assessments</u>: A DC homeowner's taxable assessment can increase by no more than 10 percent per year, even if a home's full assessed value increases by more than that. In a given year, a home's taxable assessment is determined by calculating two measures and then selecting the lower

[10] Information on the appeals process can be found at OTR, Real Property Assessment Appeals.

value: a) its full assessed value minus the Homestead Deduction; or b) its prior year taxable assessment plus 10 percent. (See the example on page 21). The 10 percent cap does not apply in the first tax year after a home is bought in the District; those new homeowners receive only the Homestead Deduction in the first year.

The assessment cap, combined with the Homestead Deduction, means that most owner-occupied DC homes have a "taxable assessment"—the amount to which the tax rate is applied—that is far lower than their full assessment. In 2013, for example, the taxable assessment for the typical DC home equaled just 86.5 percent of the home's full assessed value for middle-income earners.[11] In periods when property values are rising notably (more than 10 percent), the 10 percent cap results in tax bills increasing more slowly than the home's value. In periods when property values are rising slowly, a homeowner's tax bill may rise faster than their home's assessed value, if the home's taxable assessment is well below its full assessment.

[11] DCFPI. 2015. "DC Homeowners Pay the Lowest Property Taxes in the Region."

How the DC Real Property Tax Works: Homeowner Example

A DC resident lives in a home she owns. It has an assessed value of $400,000 in year one, $450,000 in year two, and $475,000 in year three.

Year One

1) Taxable Assessment: Assessed Value less Homestead Deduction: $400,000 – $71,700 = $328,300

2) Tax: 85 cents per $100 of assessed value: $328,300 x ($0.85/$100) = $2,791

Year Two

1) Taxable Assessment is the lower of:
   a) Assessed Value less Homestead Deduction: $450,000 – $71,700 = $378,300
   b) Prior year Taxable Assessment plus 10%: $328,300 x 1.1 = $361,130

   The taxable assessment is $361,130

2) Tax: 85 cents per $100 of assessed value: $361,130 x ($0.85/$100) = $3,070

NOTE: The tax bill increased by 10 percent even though the Assessed Value increased 12.5 percent ($450,000 vs. $400,000)

Year Three

1) Taxable Assessment is the lower of:
   a) Assessed Value less Homestead Deduction: $475,000 - $71,700 = $403,300
   b) Prior year taxable assessment plus 10%: $361,130 x 1.1 = $397,243

   The taxable assessment is $397,243

2) Tax: 85 cents per $100 of assessed value: $397,243 x ($0.85/$100) = $3,376

NOTE: The tax bill increased by 10 percent even though the Assessed Value increased by 6 percent ($450,000 to $475,000). This is because the taxable assessment in Year Two was below the full assessment. In years when full assessments rise slowly, the taxable assessment starts to catch up to the full assessment.

4) **Determining tax responsibility prior to credits:** DC's property tax rates are set as an amount for every $100 of a property's taxable assessment. As noted, for all properties other than owner-occupied homes, the taxable assessment is the full assessed value.

Class 1, Residential:	$0.85 per $100

Class 2, Commercial: $1.65 per $100 for 1st $3 million in assessed value
$1.85 per $100 for value over $3 million

Class 3, Vacant Properties: $5.00 per $100

Class 4, Nuisance Properties: $10.00 per $100

NOTE: DC's classification of properties has changed significantly, and the tax rates for residential and commercial properties have been reduced. These changes are detailed below in the section on "Changes to the Real Property Tax."

How the DC Real Property Tax Works: Business Example

A Class 2 commercial property has an assessed value of $5 million.

1) Tax on first $3 million of assessed value: $1.65 per $100 of assessed value
$3,000,000 x ($1.65/100) = $49,500

2) Tax on assessed value above $3 million: $1.85 per $100 of assessed value
$5 million minus $3 million = $2 million
$2,000,000 x ($1.85/100) = $37,000

3) Total tax = $49,500 + $37,000 = $86,500

5) **Property Tax Credits and other Property Tax Relief Measures:** There are a number of provisions in the District's property tax to limit tax responsibility for certain groups of residents.

- Senior Citizen and Disabled Property Owner Tax Reduction**:** Senior citizens and people with disabilities who have incomes below $127,600 qualify for a 50 percent reduction in their property tax bill. This benefit is factored directly into tax bills. Some 19,166 seniors and residents with disabilities claimed this benefit in tax year 2015 in DC.[12]

- Low-Income Homeowner and Renter Tax Credit, Schedule H: Currently homeowners and renters with income below $50,000 qualify for the "Schedule H" tax credit, which has a maximum value of $1,000. The income eligibility for residents over age 70 is expanded to income below $60,000.[13] The credit is included on the DC income tax form. The size of the tax credit is based both on a household's income and its property tax bill. The credit amount is the greatest for households with very low incomes or very high property tax bills (or both). The credit is available to renters as well as homeowners, under the assumption

[12] Office of Revenue Analysis. 2016. District of Columbia Tax Expenditure Report, p. 301.
[13] DCFPI. 2014. "District of Columbia's Schedule H Tax Credit: Property Tax Assistance for Low-Income Renters and Owners."

that landlords pass their property taxes on to tenants through the rent.[14] Under Schedule H, 20 percent of a household's rent is considered their property tax payment.

The goal of Schedule H is to limit a resident's property taxes so that they equal no more than a modest share of their total income.

- Residents with less than $25,000 in adjusted gross income are eligible for Schedule H credit when property taxes exceed 3 percent of their income. The credit offsets any amount by which their taxes exceed 3 percent of adjusted gross income, up to $1,000.
- For those with incomes of $25,000 to $50,000, they can claim a Schedule H credit when their property taxes exceed 4 percent of their adjusted gross income.

To offset the impact of rising property values and housing prices on low-income residents, the Displacement Prevention Act of 2017 would boost the amount of the Schedule H refundable tax credit available to residents of "designated displacement risk zones." Schedule H helps low-income residents whose property taxes or rent are high compared to their income. In displacement risk zones, the bill would double the maximum Schedule H credit from $1,000 to $2,000, and would increase the share of rent that can be claimed toward the credit.[15] In addition, the bill would set up a Displacement Prevention Assistance Fund to help residents at risk of eviction or foreclosure know and exercise their rights through improved access to legal representation and tenant organizing resources. Access to legal assistance has been shown to reduce evictions, which are immensely harmful to families.

In tax year 2015, there were 21,899 D40 filers with a Schedule H, and 596 filers with a standalone Schedule H. Schedule H tax assistance totaled approximately $14.0 million in tax year 2014, or an average of approximately $780 per household.[16]

- Other Property Tax Reduction Measures: There are a variety of other property tax reduction provisions for lower-income residents or senior citizens including:
  - Low-income first-time homebuyers qualify for a 5-year property tax exemption.
  - Lower-income owners who have lived in their homes for 7 years qualify for a 5 percent cap on annual tax increases. Low-income owners and senior citizens can defer some or all of their property taxes, with payment due when the property is sold.

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[14] To claim the credit, the tax filer must have lived in DC for the full year. Only one person per tax filing unit can claim the credit, but there may be more than one tax filing unit in the household.

[15] DCFPI. 2016. "Boosting Schedule H Tax Credit Near Economic Development Projects Will Help Low-Income Residents Stay In Their Homes."

[16] OTR, Revenue Accounting Administration Schedule H Claims for Tax Year 2014. FOIA Request. In tax year 2014, there were 17,874 Schedule H filers.

6) **Provisions that automatically reduce property tax rates under certain conditions:** Under DC law, the property tax rates for both commercial and residential properties are reduced automatically under certain conditions.

- If total property tax collections from residential properties are expected to grow more than 7 percent from one year to the next, the tax rate is reduced so that the total collections will grow 7 percent.

- If total property tax collections from commercial properties are expected to grow more than 10 percent from one year to the next, the tax rate on the first $3 million is reduced so that the total collections will grow 10 percent.[17] The tax rate on the first $3 million of assessed value cannot fall below 90 cents per $100 of assessed value.

Comparison of Real Property Tax Rates and Responsibilities with Maryland and Virginia: For homeowners, property taxes in the District are far lower than in any other part of the region. This reflects the fact that the District's residential property tax rate is one of the lowest in the region and that the District offers property tax relief that many jurisdictions do not **(Table 7)**.

Table 7

Comparison of Regional Homeowner Property Tax Rates

	FY 2016 Rate[1]
Arlington County	$0.991
DC	$0.85
Fairfax County[2]	$1.13
Montgomery County[3]	$1.05 or higher
Prince George's County[4]	$1.446 or higher

[1] Rates per $100 of assessed value. Some jurisdictions levy additional flat fees per lot. These fees are not reflected in this chart.

[2] Range takes into account variation in Tax Districts.

[3] Range takes into account variation in Municipal District property taxes and Special Service Area taxes.

[4] Range takes into account variation in town tax rates. A small number of farms pay a special, lower tax rate not reflected in this range.

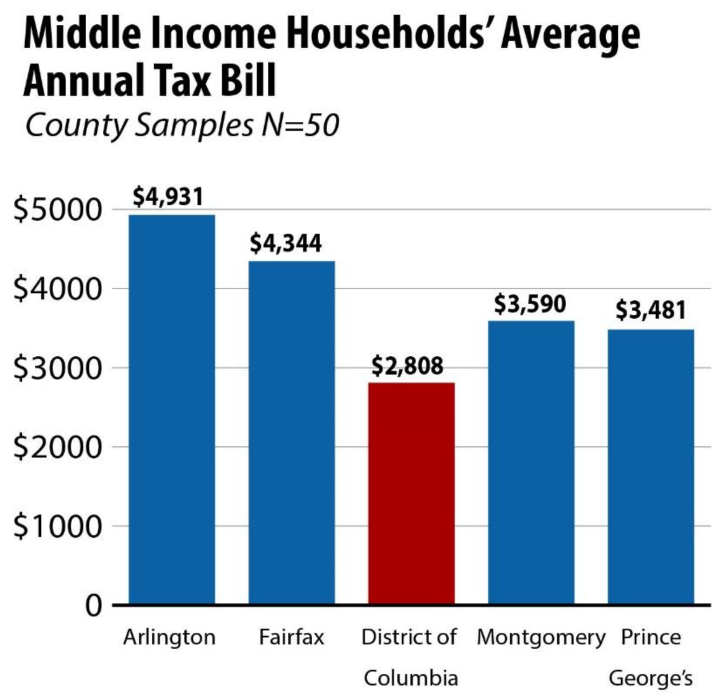
Sources: DCFPI, DC Homeowners Pay the Lowest Property Taxes in the Region (2015); Arlington, VA, FY 2017 Budget; Fairfax County, VA, Real Estate – Tax Rates and Fees; Maryland Department of Assessments & Taxation, 2015-2016 County Tax Rates

[17] DCFPI. 2008. "What's in the Final FY 2009 DC Budget?"

DC homeowners also pay lower tax bills, on average, than homeowners in nearby counties **(Figure 6)**. Among homes with an average sales price of $500,000, DC homeowners paid an average tax of $2,808, compared to $4,931 in Arlington County and $4,344 in Fairfax County, and $3,590 in Montgomery County and $3,481 in Prince George's County.[18] On the other hand, the District's property tax on commercial properties is the highest in the region.

Figure 6

Comparison of Homeowner Property Taxes in DC and Surrounding Counties, 2015



Source: DCFPI. 2015. DC Homeowners Pay the Lowest Property Taxes in the Region

DC FISCAL POLICY INSTITUTE | DCFPI.ORG

[18] DCFPI. 2015. "DC Homeowners Pay the Lowest Property Taxes in the Region."

Commercial Property Tax Rates

The tax rate for commercial properties worth $3 million and less in the District is $1.65 per $100. For properties worth more than $3 million, the first $3 million is taxed at a rate of $1.65. The rest of the value is taxed at $1.85 per $100 of assessed value.

These rates are the highest in the region **(Table 8)**. Commercial property tax rates in the Maryland suburbs vary, with a $1.162 rate in Bethesda and a $1.174 rate in Silver Spring. In Virginia, the commercial property tax rates also vary, with a rate of $1.159 in Crystal City and $1.518 in Tyson's Corner.

Table 8

Comparison of Regional Commercial Property Tax Rates*

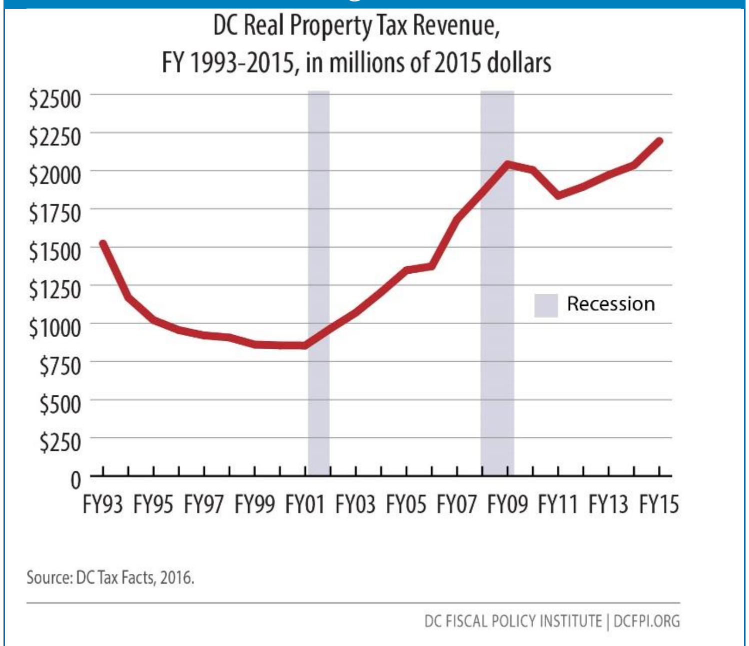
Washington, DC	$1.65 first $3 million; $1.85 above $3 million
Alexandria, VA	$1.073
Crystal City, VA	$1.159
Tyson's Corner, VA	$1.518
Reston, VA	$1.545
Bethesda, MD	$1.162
Silver Spring, MD	$1.174

* Rates per $100 of assessed value.

Sources: Downtown DC Business Improvement District, "State of the Downtown, 2015"; Arlington, VA, Budget & Finance; Fairfax County, VA, Real Estate – Tax Rates and Fees; Montgomery County, MD—2016 Levy Year Real Property Tax Rate Schedule

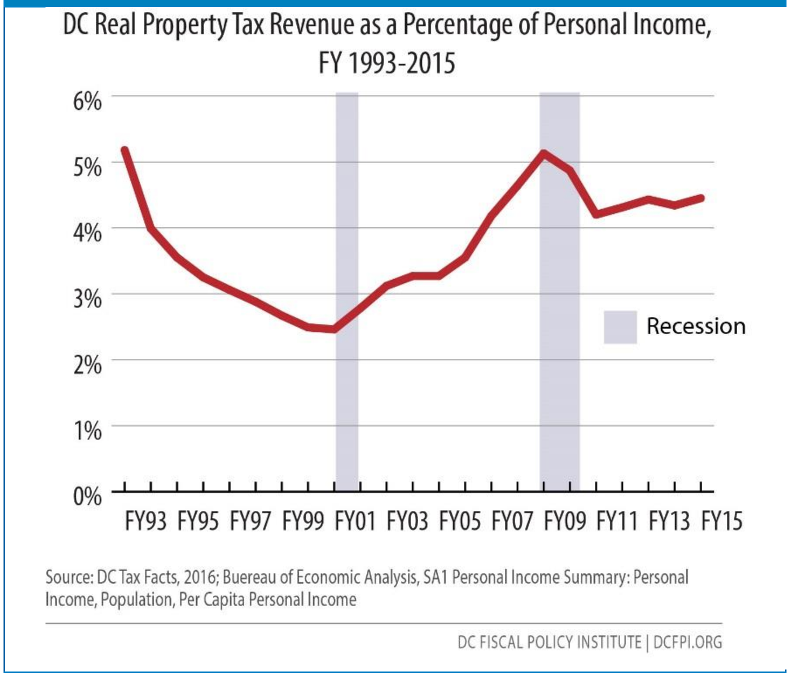
DC Real Property Tax Collections: DC's real property tax collections have fluctuated over the past two decades. Collections steadily declined from 1992 to 2001 **(Figure 7)**. As the economy began to improve after 2001, so did the amount of real property tax collections. Property tax collections decreased again beginning in 2009 as a result of the Great Recession, but have increased since 2011.

Figure 7



As a percentage of personal income, the District's real property tax revenues fell from just over 5 percent in 1993 to a low of 2.5 percent in 2001. In 2015, real property tax revenues were 4.5 percent of personal income **(Figure 8)**.

Figure 8



Much of DC's Land is Exempt from Property Tax

More than half of the land in the District of Columbia—56 percent—is exempt from the real property tax.[19] Most of this reflects properties owned by the federal government, but it also includes DC government properties, embassies, and non-profits such as universities, museums, and hospitals.

Changes to the Real Property Tax: The District government has made many changes to its property tax, including changes in how property tax classifications are structured and the amounts of rates and deductions. These changes are summarized in **Table 9**. Highlights include:

1) **Setting caps on annual assessment of residential properties:** Beginning in 2003, a DC homeowner's taxable assessment could increase by no more than 25 percent per year, even if a home's full assessed value increased by more than that. This cap was dropped to 12 percent in 2004 and 10 percent in 2006.

2) **Homestead Deduction:** There have been numerous increases to the Homestead Deduction. An annual inflation adjustment was adopted in 2009, but was not applied in years 2010 through 2012. The Homestead Deduction for 2015 is $71,700.

3) **Reductions in residential property tax rate:** In a series of reductions between 1979 and 2008, the residential property tax rate was reduced from $1.22 per $100 of assessed value to the current rate of $0.85.

4) **Reductions in tax rates for rental residential properties:** Starting in 2000, the District eliminated its separate classification for rental residential properties. This meant that the tax rate for these properties fell from $1.54 per $100 of assessed value to $0.96. Since classified with residential properties, this rate has been reduced three times to bring it to the current rate of $0.85.

5) **New split rate for commercial properties:** Effective in 2009, Class 2 properties are subject to a split tax rate structure. Tax rate for the first $3 million of the assessed property value is taxed at $1.65 per $100 dollars. Property value beyond the first $3 million is taxed at $1.85 per $100.

6) **Reclassification of abandoned and vacant properties:** Beginning in 2003, vacant and abandoned properties were put into a newly created Class 3. The rate for these properties increased from $1.85 to $5.00 per $100 of assessed value. In 2009, this rate increased to $10. In 2010 and 2011, Class 3 was redefined and Class 4 was added leading to the current structure. Class 3 is limited to vacant, improved properties with tax rate set at $5.00. Class 4 is for blighted properties, with a tax rate of $10. No changes have been made to reclassifications since 2011.

For changes to the real property tax dating back before 2008, see Appendix 1.

[19] OCFO. DC Tax Facts, 2016, Table 5.

Table 9	
Recent Major Changes to the Real Property Tax, 2008-2015	
Fiscal Year Effective	Real Property Tax Changes
2008	Homestead Deduction increased to $64,000. Reduce Class 1 rate from $0.88 to $0.85.
2009	New split tax rate structure for Class 2 properties. First $3 million in assessed value at $1.65 per $100. Excess of $3 million taxed at $1.85. Beginning of annual increase of Homestead Deduction by indexing, deduction increased to $67,500. Class 3 rate increased to $10.00.
2010	Homestead Deduction indexing delayed through FY 2013. Class 3 limited to vacant, improved properties deemed as blighted.
2011	Class 3 limited to vacant, improved properties with tax rate set at $5.00. New Class 4 for vacant, improved properties deemed blighted with tax rate set at $10.00.
2013	Homestead Deduction will increase by inflation from a base year of 2011 rather than the original base year of 2007. Homestead Deduction for 2013 will be $69,350.
2014	Increased the income eligibility for DC's seniors 50 percent property tax credit, from $100,000 to $125,000.

Sources: DC Tax Facts, 2016; Fiscal Year 2010 Budget Support Act of 2009; Fiscal Year 2011 Budget Support Act of 2010; "Real Property Recordation and Transfer Tax Form FP 7/C"; "Tax Rates and Tax Burdens: Washington Metropolitan Area 2009."

Sales and Use Tax

The sales and use tax is the District's third largest revenue source. In FY 2015, the District collected $1.3 billion in sales and use taxes, including cigarette, alcohol, motor vehicle, and fuel taxes. This accounted for 20 percent of total tax revenue.

In most states, the sales tax is the most regressive tax source. This means that the tax falls most heavily on low-income residents as a share of income for two reasons. First, because incomes are lower, therefore the fixed amount spent on a tax is higher. For example, a sales tax of $100 is 1 percent of income for someone making $10,000 per year, but just 0.1 percent for someone making $100,000 per year. Second, those with the least income typically spend all of the income they receive on basic goods. By contrast, higher-income persons do not spend their entire incomes; the portion of their incomes that they save is not subject to sales or other consumption taxes. As a result, lower-income households end up paying a larger proportion of their income in sales tax than do higher-income residents. In recognition of this, DC and many states have exempted items like food, medicine, and housing from their sales tax. This lessens the regressivity of the sales tax, but does not eliminate it **(Figure 9)**.

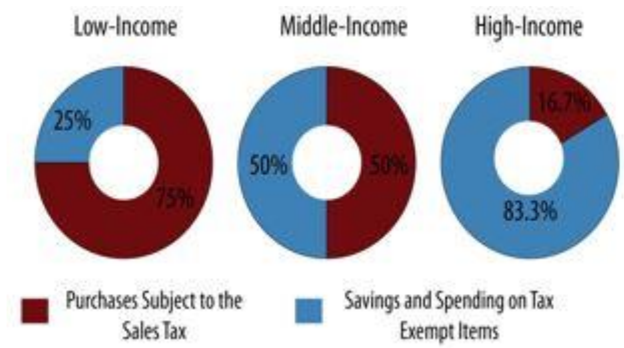
How the DC Use Tax Works: The use tax applies to items that are sold or purchased outside of the District and are transferred to the District for use. For example, when a

District resident buys a car outside of DC, the dealership charges the buyer the District's use tax rate. The use tax rates are the same as the sales tax rates.

DC's Sales Tax Rates Differ for Different Types of Purchases: Most goods and some services, including data processing, real estate, and employment services, are taxed at the general sales tax rate of 6 percent. Sales of other items in the District are taxed at a higher rate. For example, restaurant meals are taxed at a 10 percent rate and hotel rooms are taxed at a 14.5 percent rate. Sales of motor vehicles are taxed from 6 to 8 percent, depending on their weight. See **Table 10** for a full list of rates.

Figure 9

Typical U.S. Family Income Spent on Items Subject to the Sales Tax*



*Income is defined by the lowest ($0-$21,844), middle ($42,052-$67,766), and highest (more than $109,918) income quintiles by total US household income.

Source: Institute on Taxation and Economic Policy Microsimulation Model, 2017.

Table 10

Sales and Use Tax Rates in DC

	Rate
Most goods, some services, vending machine food	5.75%
Medical marijuana	6%
Purchase of motor vehicle	6-8%
Restaurant meals, liquor, rental vehicles, prepaid telephone cards, baseball tickets, merchandise sold at the baseball stadium, Verizon Center tickets, merchandise sold at Verizon Center, residential telecommunications	10%
Commercial telecommunications	11%
Hotels	14.5%
Motor vehicle parking in commercial lots, rolled tobacco products except for cigarettes, premium cigars, and pipe leaf tobacco products	18%
Cigarettes	$2.50 per pack of 20 cigarettes
Moist snuff tobacco	75¢/ounce
Heating Oil	residential: $0.17/gallon non-residential: $0.187/gallon
Natural Gas	residential: $0.0707/therm non-residential: $0.07777//therm
Electric distribution	residential: $0.0070/Kilowatt hour non-residential: $0.0077/ Kilowatt hr.
Motor vehicle fuel	23.5¢/gallon

Source: DC Tax Facts, 2016.

Some Goods, and Many Services, Are Exempt from the DC Sales Tax: DC taxes most goods, but exempts a few basic items, including grocery-type foods and medicine. The District's sales tax was created at a time when residents and businesses mainly bought goods, rather than paying for services. For that reason, the sales tax applies broadly to goods but not as broadly to services. This creates an inconsistent and largely regressive policy in which goods to perform a task on one's own are taxed, while services to do the same work is not. For example, cleaning products are taxed, but house cleaning services are not. Some services, such as dry cleaning and copying services, are subject to the sales tax, while many others, such as pet grooming, are excluded **(Table 11)**.

Table 11 Potentially Taxable Services Currently Not Subject to the Sales Tax
Art/Antique Collecting Advisory and Brokerage Services
Carpentry, Painting, Plumbing, and Similar Trades
Chimney Cleaning Services
Closet/Storage Design Consulting Services
Commissions On Auction Purchases/Sales (Brokerage Service)
Dating Services
Day Spa Services
Diaper Service
Fur Storage
General House Cleaning Services
Household Errand/"Personal Shopper"/Gift Consulting Services
Installation Charges - Other Than Seller Of Goods
Interstate Air Courier (Billed in DC)
Kennels
Magazine Subscriptions
Marine Towing Service (Including Tugboats)
Massage Services
Membership Fees In Private Clubs
Packing And Crating
Personal Instruction (Dance, Golf, Tennis, Etc.)
Pet Grooming
Professional Services Such As Accounting, Computer Training, Consulting, Engineering, Insurance, Legal, and Physician Services
Swimming Pool/Hot Tub Cleaning And Maintenance Services
Taxidermy
Weight Reduction Salons
Sources: Federation of Tax Administrators, 2007 Service Taxation Survey; OTR, Effective October 1 the District of Columbia Sales Tax Extends to Additional Services; OTR, Data Processing Services.

How the DC Sales Tax Works: Two Examples

Example #1: Two friends go out to dinner in the District.

Beverages: $3.00
Meals: $27.90
Total Before Tax: $30.90

Sales Tax: The tax rate for meals is 10 percent, so the sales tax is $30.90 x 0.10 = $3.09

Total cost of dinner: $30.90 + $3.09 = $33.99

Example #2: A parent buys decorations for a child's birthday party.

Pack of Balloons: $1.59
Streamers: $8.49
Total Before Sales Tax: $10.08

Sales Tax: These items would be subject to the general sales tax rate of 5.75 percent, so the sales tax would be $10.08 x 0.0575 = $0.58
Total cost: $10.08 + $0.58 = $10.66

Comparison of Tax Rates and Responsibilities in Maryland, Virginia, and Nationally: The District's general sales tax rate is lower than Maryland's rate and Northern Virginia's rate **(Table 12)**. Both DC and Maryland exempt food from their sales tax, while Virginia levies a 2.5 percent tax on food. Nationally, the combined average sales tax rate is 9.85 percent,[20] meaning DC's general sales tax is well below the national average.

Table 12
Comparison of Sales & Use Taxes in DC, Maryland, and Northern Virginia

	DC	Maryland	Northern Virginia[1]
Grocery-Type Food	Does not tax	Does not tax	2.5%
Most Goods and Some Services	5.75%	6%	6%
Vehicle Rentals	10%	11.5%	10%
Hotel Rooms	14.5%	6%	6.3%[2]

[1]Northern Virginia's general sales tax rate of 6% includes a state sales tax rate of 4.3%, a local sales tax rate of 1%, and an additional 0.7% state tax imposed in the localities that make up Northern Virginia and Hampton Roads.

[2] Virginia levies a 4.3% state sales tax but allows local jurisdictions to charge an additional local sales tax on hotel rooms, which only applies to certain planning districts in the state (Northern Virginia and Hampton Roads).

Sources: DC Tax Facts, 2016; Comptroller of Maryland "Sales and Use Tax"; Maryland Code 03.06.01.23 "Room Rentals"; Virginia Department of Taxation "Sales and Use Tax," "Virginia Local Tax Rates 2015," "FAQs - Sales and Use Tax on Sales of Alcoholic Beverages," "Does the sales and use tax apply to rentals of tangible personal property?, "Motor Vehicle Rental Tax Overview"; NCSL, Specific Statewide Taxes on Lodging – By State (2016).

[20] Vertex Inc., "2015 Vertex Tax Rate Report."

The Special Case of Alcohol Taxes: In addition to sales tax collected at time of purchase, the District, Maryland, and Virginia collect an excise tax from alcohol manufacturers and retailers. The cost of this tax is passed onto consumers in the form of higher retail prices. As shown in **Table 13**, the District's excise taxes are equal to Maryland's for beer, spirits, and wine containing more than 14 percent alcohol. Excise taxes on wine containing less than 14 percent alcohol are slightly lower, and taxes on sparkling wine are slightly higher. Across the board, the District's excise taxes are significantly lower than those charged in Virginia. The District's sales tax on alcohol charged at the time of purchase, on the other hand, is the highest at 10 percent.

Table 13

Alcohol Excise and Sales Taxes in DC, Maryland, and Virginia

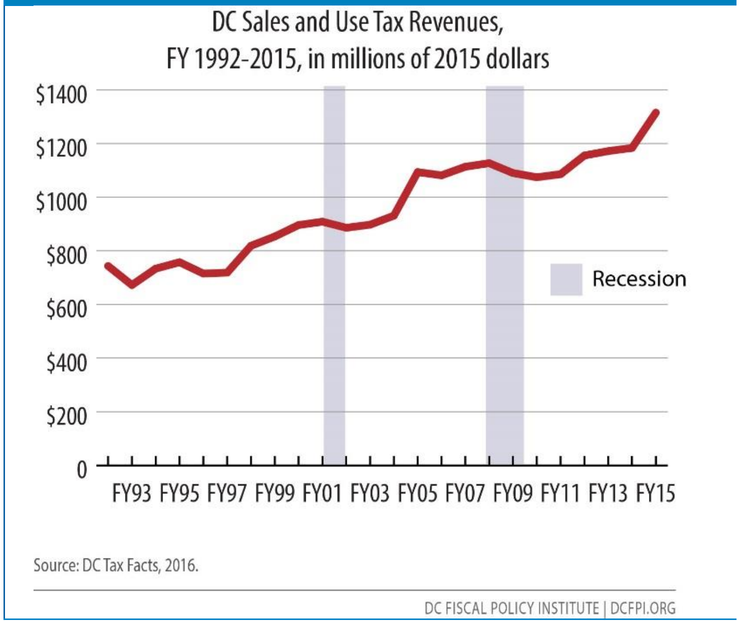
	DC	Maryland	Virginia
Excise Taxes			
Beer (per barrel)	$2.79	$2.79	$8.06
Spirits (per gallon)	$1.50	$1.50	20% of retail price
Wine (per gallon)			
14% or less alcohol	$0.30	$0.40	$1.51 plus 4%
More than 14% alcohol	$0.40	$0.40	$1.51 plus 4%
Sparkling wine (per gallon)			
14% or less alcohol	$0.45	$0.40	$1.51 plus 4%
More than 14% alcohol	$0.45	$0.40	$1.51 plus 4%
Sales Tax			
Intended for on-premises consumption	10%	9%	5-9%*
Intended for off-premises consumption	10%	9%	5%

*Virginia allows counties and cities to impose meal tax on alcohol intended for on-premises consumption.

Sources: DC Tax Facts, 2016; Virginia Department of Beverage Control, "Price List"; Maryland Comptroller, "FAQs - Sales and Use Tax on Sales of Alcoholic Beverages"; "Virginia Local Tax Rates 2015."

Sales and Use Tax Collections: Sales and use tax collections in the District have increased over time. Between 2010 and 2015, collections have increased slightly from $1.07 billion to $1.32 billion after adjusting for inflation **(Figure 10)**.

Figure 10



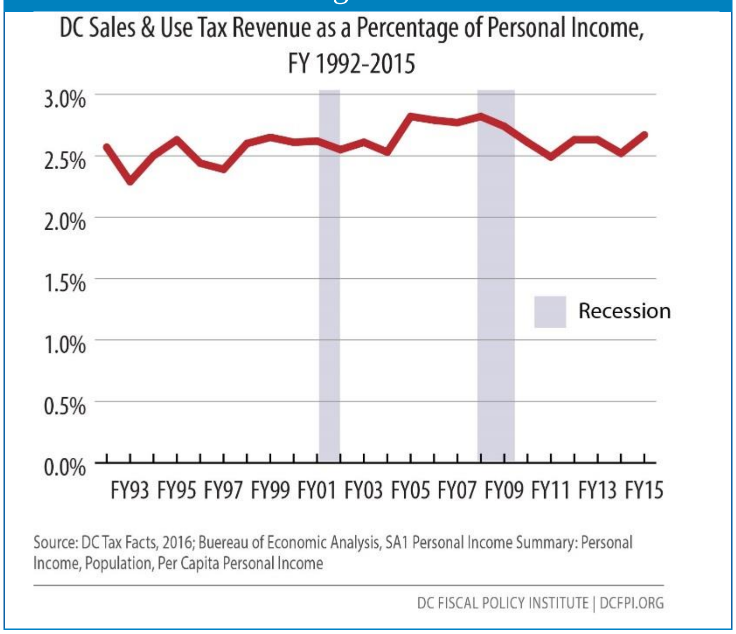
The sales and use tax has remained steady as a percentage of personal income—around 2.5 percent since 1992 **(Figure 11)**.

Changes to the Sales and Use Tax: The sales and use tax has undergone many changes over the past 30 years, both to its rates and it its base (the items subject to the sales tax). Highlights include:

1) The general sales tax rate peaked in 1994 at 7 percent. The current rate of 5.75 percent was set in 2013.

2) Tax rates on alcohol and tobacco products have increased a number of times in the past 30 years. Often called "sin taxes," these tax rates were not reduced when the general sales tax rate was reduced in 1995. The District's cigarette tax has increased from 6 cents in 1975 to $2.50 per pack in 2010. Alcohol for off-premises consumption (retail) has increased in a series of steps from 6 percent in 1992 to 10 percent in 2012. Alcohol for on-premises consumption has increased from 6 percent in 1975 to 10 percent in 1995.

Figure 11



3) Adding select services to the base: The District has applied the sales tax to new categories of services such as laundry services, data processing, security services, and courier services.

Many of these recent changes are summarized in **Table 14**. See Appendix 2 for a full list dating back to 1976.

Table 14

Recent Major Changes to Sales and Use Taxes, 2008-2016

Fiscal Year Effective	Sales & Use Tax Changes
2009	Cigarette tax increased to $2.00/pack.
2010	Sales tax holidays eliminated. Sales tax rate increased to 6%. Gas tax increased to 23.5¢/gallon. Cigarette tax increased to $2.50/pack.
2011	6% sales tax applied to medical marijuana and soda and other soft drinks.
2012	Retail alcoholic beverage tax increased from 9% to 10%. Armored car, private investigation, and security services now subject to sales tax.
2013	Professional services such as consulting, engineering, legal, and physician services are exempt.
2014	Sales tax rate decreased to 5.75%. Sales tax exemption for the utilities that restaurants use to prepare food.
2015	Broaden the definition of tobacco products that are subject to sales tax, and set the tax rate on all tobacco products equal to taxes levied on cigarettes. Expands the number of services subject to the 5.75% sales tax, including carpet and upholstery cleaning, car washes, storage of household goods, health clubs and tanning studios, bottled water delivered for home use, and bowling alleys and billiards parlors.
2016	Sales tax exemption for feminine hygiene products and diapers.*

*As of January 1, 2017, this change is approved but not yet funded, and therefore not currently in effect.

Sources: DC Tax Facts, 2016; Fiscal Year 2012 Budget Support Act of 2011; DCFPI Tax Toolkit.

Dedicated Taxes

Some taxes (or a portion of them) are used to fund specific programs. These are known as dedicated taxes. Currently, the District has ten dedicated taxes **(Table 15)**. These taxes fund services like affordable housing and healthcare, as well as other expenditures like the interest on the District's baseball stadium revenue bonds.

Table 15

DC's Dedicated Taxes

Dedicated Tax	Fund Description	Source of Funds	FY 2015 Amount
Washington Convention Center Fund	Provides funding for Convention Center construction, debt service, repairs, and operating expenses.	Hotel sales tax rate is 14.5%. 4.45% is dedicated to Fund with remaining 10.05% to General Fund. Sales tax rate is 10% on restaurants, rental cars, prepaid telephone cards, baseball game tickets, and merchandise sold at the baseball stadium. 1% is dedicated to Fund.	$133.79 million
Tax Increment Financing (TIF) Fund	Repayment of TIF and Payment In-Lieu-of-Taxes (PILOT) Financing Program bonds. TIF allows the incremental future revenue stream from a development project to be pledged to pay back bonds issued to finance the development.	Real property taxes and sales taxes transferred from general fund.	$57.50 million
Tax Increment Financing (TIF) Fund for Verizon Center	Payment of principal and interest on the loan used to renovate the Verizon Center.	Sales tax rate is 10% on Verizon Center tickets and merchandise sold at the Verizon Center. 4.25% is dedicated to Fund.	$3.48 million
Ballpark Fund	Services baseball stadium construction revenue bonds.	All sales taxes on baseball tickets, parking at the stadium, and stadium concessions. Share of non-residential public utility taxes: 1% of total 11% rate. $.0007 of total $.0077/Kilowatt hour rate for electricity. $.017 of total $.187/gallon for heating oil. $.00707 of total $.07777/Therm for natural gas. 1% of total 11% tax on gross charges of telecommunication companies. Multi-tiered fee levied on businesses with over $5 million in gross receipts.	$66.30 million
Washington Metropolitan Area Transit Authority (WMATA)	Helps meet the District's annual funding responsibility for WMATA.	All parking sales tax revenue.	$67.45 million

Table 15 (Cont'd)			
DC's Dedicated Taxes			
Dedicated Tax	Fund Description	Source of Funds	FY 2015 Amount
Housing Production Trust Fund	Funds the acquisition, construction, and rehabilitation of affordable multifamily housing projects.	15% of deed recordation and transfer tax revenue.	$73.01 million
Alcoholic Beverage Regulation Administration (ABRA) Reimbursable Detail Subsidy Program	Reimburses 25 percent of the costs incurred by Alcoholic Beverage Control (ABC) licensees for the hiring of Metropolitan Police Department (MPD) officers to work a detail outside of the establishment on Friday and Saturday nights between midnight and 4 a.m.	Annually $460,000 of sales tax revenue from alcoholic beverages intended for off-premise consumption.	$1.17 million
Nursing Facility Quality of Care Fund	Funds initiatives to improve the quality of nursing home care.	Nursing facilities pay an annual assessment per licensed bed.	$12.85 million
Hospital Fund	Funds Medicaid services.	Hospitals pay $3,788 annually per licensed bed.	$31.94 million
Stevie Sellows Quality Improvement Fund	Funds quality of care improvements in ICF-MR facilities, Intermediate Care Facilities that serve individuals with mental or developmental disabilities.	Each institution providing care to individuals with developmental disabilities pays an assessment of 5.5% of gross revenue.	$5.03 million

Sources: FY 2017 Approved Budget and Financial Plan; FY2015 Budget Support Act of 2012; DC Tax Facts, 2016; "Return of the Reimbursable Detail Subsidy"; DC ST § 10-1202.08, § 4-632, § 31-3514.02, and § 38-821.02; "Debt Cap Analysis - 2013 Revised Budget Scenario."

Special Purpose Revenue

About 7 percent of the District's revenue comes from special purpose revenue. These funds come from fines and fees that are collected by DC agencies and are used for specific purposes. The FY 2015 budget includes 174 approved special purpose funds that are expected to collect $525 million. The largest special purpose funds include: the Washington Metropolitan Area Transit Authority Parking Meter Revenue ($31.1 million), the OCFO Delinquent Debt Fund ($26.3 million), and the Business Improvement Districts Transfer Special Accounts Fund ($25.3 million).[21] Relevant examples of special purpose funds include:

- **Crime Victims Assistance Fund:** This fund supports outreach to crime victims and improved investigation of child abuse, neglect, and domestic violence. At the end of each year, the fund receives half of the remaining balance in the Crime Victims

[21] OCFO. 2015. District of Columbia Special-Purpose Revenue Funds Report.

Compensation Fund, a fund that receives its revenue from court filing fees and criminal fines and is managed by a federal agency within the DC Superior Court. In FY 2016, the fund received $1.0 million in special purpose revenues.

- **Home Purchase Assistance Program (HPAP) Repayment:** HPAP provides down-payment and closing cost assistance for first-time homebuyers with low to moderate incomes. The program is funded with a mixture of local and federal funds. HPAP's special purpose fund receives its revenue from HPAP participants' loan repayments. In FY 2016, the fund received $1.5 million in special purpose revenues.

- **Nuisance Abatement Fund:** This fund finances the cost of demolishing or rehabilitating a private property that violates DC housing or construction code. Revenue for the fund is collected from fees and penalties paid by owners of nuisance properties. In FY 2016, the fund received $5.0 million in special purpose revenues.

Federal Grants

Grants from the federal government account for about 26 percent of the District's revenue. In FY 2015, the District received $2.7 billion in federal grants. DC receives many of the same grants that other states and cities receive, such as:

- **Community Development Block Grant (CDBG):** The federal government provides CDBG funds to cities and states to help create affordable housing, revitalize neighborhoods, and support economic development in low- and moderate-income communities. Funds are awarded based on a formula developed by the federal government. In FY 2015, the District received $13.1 million in CDBG funding.[22]

- **Medicaid:** The Medicaid program provides health insurance and prescription drug assistance for low- and moderate-income families and funding for long-term care for seniors and people with disabilities. The federal government pays 70 percent of the cost of DC's Medicaid program, and the District is required to fund the remaining 30 percent. The FY 2017 budget includes $2.2 billion in federal payments and $690 million in local funds for Medicaid.[23]

- **Temporary Assistance for Needy Families (TANF):** The District's TANF program provides job training, cash assistance, and other services to low-income families with children. DC shares the cost of the program with the federal government. In FY 2017, DC anticipates receiving $92.6 million from the federal government and must contribute $75 million in local funds.[19]

- **Title I:** The federal government provides Title I funds to schools serving large numbers of low-income children. The funds are distributed based on a formula developed by the federal government and can be used for extra instruction as well as

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[22] U.S. Department of Housing and Urban Development, "CDBG Expenditure Reports," PY2014.

[23] DCFPI. 2015. Budget Toolkit.

preschool, after school, and summer programs to help more students meet academic standards. The District received $42.8 million in Title I funding in FY 2015.[24]

Federal Payments

In addition to receiving grants, the District also receives payments from the federal government. These payments are direct appropriations from Congress to the District, usually for a particular purpose. Many are similar to earmarked funds that are appropriated by Congress for other jurisdictions.[25] Federal payments account for a relatively small share of the DC budget. In FY 2015, the District received $66.9 million in federal payments, which represents a little more than one percent of the budget.[26] Federal payments to the District include:

- **Resident Tuition Support:** The federal government appropriated $30 million in FY 2015 to provide college tuition payments for DC residents. The funds are designated to pay the difference between in-state and out-of-state public tuition for DC residents and to provide scholarships of $2,500 per year for residents who choose to attend eligible private colleges and universities.

- **Emergency Planning and Security Costs:** In FY 2015, the District received $12.5 million in reimbursements for security services provided at demonstrations and other events that occur due to the federal government operating in the District.

- **School Improvement & Vouchers:** DC received $15 million in FY 2015 for public charter school improvement and expansion.

Private Grants and Contributions

A small portion of the District's revenue comes from private grants and donations. In FY 2015, the DC government received $2.1 million in private grants and contributions, which equaled about one-fifth of one percent of the total budget.

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[24] Fiscal Years 2015-2017 State Tables for the U.S. Department of Education.

[25] One notable exception is the District's court and felony prison system. The D.C. Revitalization Act of 1997 shifted funding responsibility for the District's courts and felony prison system to the federal government. The federal government will appropriate nearly $270 million in FY 2013 for the District's court system and defender services. This funding is not reflected in DC's Annual Budget.

[26] FY 2017 Proposed Budget and Financial Plan, Executive Summary.

Tax-Cut Triggers & DC's Surplus

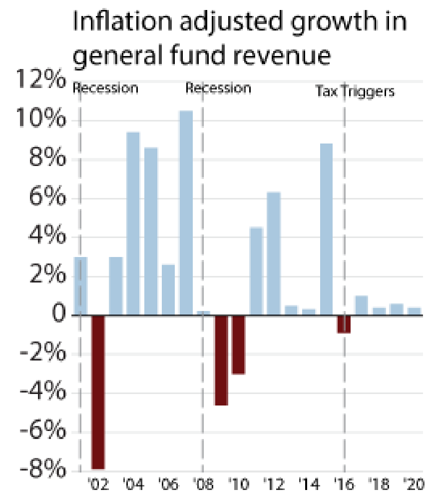
When revenues are higher than expected, the city has many options to respond. Recent policies include tax-cut triggers and turning surplus into savings. These policies are flawed because they do little to provide for much needed services.

1) Tax-Cut Triggers

Under a policy adopted by the DC Council in 2014, all growth in District's tax collections above the projections made in February 2014 has been devoted to a series of tax cuts recommended by the Tax Revision Commission.[27] The DC Chief Financial Officer makes projections of future revenue collections four times a year. If these revenue projections show that the city's revenues are rising faster than previously expected, tax cuts are automatically "triggered" to be adopted **(Figure 12)**.

Figure 12

Revenues after 2016 Will Grow Slowly with Tax Triggers in Place



Source: DC Chief Financial Officer DC FISCAL POLICY INSTITUTE

The Tax Revision Commission recommended a number of tax changes, including reducing income taxes for low- and moderate-income families, reducing the top income tax rate for the highest earners, cutting the business income tax, and eliminating taxes for estates worth up to $5.25 million (the federal estate tax threshold). The Commission also recommended some policies to raise revenues, some of which were adopted by the DC Council and others that were rejected. The overall changes make the DC tax system more progressive, in that they lower taxes the most for low- and moderate-income families.

The Council broke the tax reductions into a series of smaller steps. Some $102 million have been implemented due to rising revenues. This includes expanding the Earned Income Tax Credit, raising the personal exemption and standard deduction, cutting the top income tax rate, reducing business income taxes, and changing the threshold for owing estate taxes to $2 million from $1 million. Some $129 million have not yet been implemented and are waiting to be triggered. See **Table 16** for a full list of recent tax changes adopted by the Council, including those already in effect and those not yet in effect.

The tax cuts have locked the District into available revenue growth of less than 1 percent each year beyond inflation. The modest revenue growth allowed under the tax cuts is not enough to keep up with a growing population, increases in school enrollment, or rising Medicaid caseloads, or to address urgent problems such as the city's homelessness and affordable housing crisis.

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[27] DC Tax Revision Commission. 2014.

Equally important, the automatic nature of the tax cuts prevents the mayor and DC Council from making decisions about the use of growing revenues—whether they should be used for tax cuts, for important public investments, or some combination. The 2014 action established tax cuts as the only priority for use of growing revenues for the foreseeable future.

Table 16	
Initial Tax Changes & Triggers Already Implemented Have Cost Us $76 Million	
Tax Commission Policy Changes	**FY 2017 Fiscal Impact, in Millions**
Established a new individual income bracket of $40-60,000, reducing rates from 8.5% to 7.0%	($39.5)
Expanded the local Earned Income Tax Credit to childless workers	($11.4)
Raised the standard deduction to $5,200 for singles, $8,350 for married residents	($16.5)
Eliminated certain tax expenditures	$3.9
Expanded the general sales tax rate to certain services	$16.8
Phased out the personal exemption by 2% for each $2,500 above $150,000, with a complete phase out at $275,000	$4.9
Exempted passive investment vehicles from the unincorporated business franchise tax	($4.6)
Reduced the business franchise tax from 9.975% to 9.4%	($20.8)
Changed the franchise tax apportionment method to a single weighted sales formula	$20.8
Further reduced the rate on the new middle income tax bracket to 6.75%	($7.5)
New income tax bracket - $350,000 to $1M at 8.75%, income greater than $1M at 8.95%	($5.0)
Further reduce business franchise taxes to 9.2%	($10.1)
Finish reducing the rate on middle income tax bracket to the new rate of 6.5%	($7.5)
Tax Cuts Triggered Recently Will Cost Us Another $26 Million Next Year	
Reduce unincorporated & incorporated business franchise tax from 9.2% to 9.0%*	($10.1)
Raise the estate tax threshold from $1 million to $2 million*	($6.5)
Further increase the standard deduction to $5,650 for singles, $10,275 for married residents*	($9.4)
$129 Million in Additional Cuts Will Go Into Effect Via Triggers	
Increase the personal exemption to $2,200	($13.8)
Finish raising the standard deduction and conform to federal levels	($9.8)
Further increase the personal exemption to $2,700	($16.7)
Further reduce business franchise taxes to 8.75%	($11.9)
Further increase the personal exemption to $3,200	($16.2)
Finish increasing the estate tax threshold to conform to the federal level	($12.3)
Further reduce the business franchise taxes to 8.5%	($11.9)
Further increase the personal exemption to $3,700	($15.6)
Finish reducing business income taxes to 8.25%	($11.9)
Finish increasing the personal exemption to conform to the federal level	($9.1)

**Tax cuts "triggered" in most recent budget forecasts, but not yet implemented.*
Source: Mayor's Office of Budget and Finance, March 2016.

Going forward, a more balanced approach to tax triggers—one that doesn't devote 100 percent of revenue increases to tax cuts—would help the District fund necessary services.

2) Surplus Turns to Savings

The District's fund balance represents the city's accumulated assets, including various reserve funds. The fund balance has grown substantially in recent years, from $900 million in 2009 to $2.4 billion in 2016, due to years of annual surpluses and a policy to save 100 percent. The fund balance equals more than 25 percent of the city's locally funded budget.

DC's tax collections are rising sharply, according to a forecast released on September 30, 2016 by the DC Chief Financial Officer. It shows higher revenues than projected just a few months ago: an additional $180 million for the 2016 fiscal year that just ended, a $36 million increase for FY 2017, and a $20 million increase in FY 2018 and beyond. The 2016 increases reflect better than expected collections from business income taxes, deed recordation/transfer taxes, and estate taxes.[28]

Because a year-end surplus is not guaranteed every year, the District cannot use the surplus to fund programs or services that have ongoing costs, like hiring more teachers or providing permanent supportive housing to residents experiencing chronic homelessness. Instead, the surplus must be spent on one-time expenses, such as housing or school construction, or setting up a computer system for paid family and medical leave.

The District adopted a policy in 2010 to build enough cash in reserves to fund DC government fully for 60 days, based on thresholds recommended by the association of government finance officers. Legislation adopted that year requires the city to set aside all budget surpluses until this goal is met. DC currently has about 49 days' worth of operating cash. Having this much cash on hand is helpful mostly for the purpose of managing the city's cash flow, including paying bills in between periods when major tax payments are made. This limits the need for short-term borrowing during the year. Yet short term borrowing currently is a small cost to the city—just $2 million in interest payments in 2016—so it is not clear that the city needs to place a priority this year to build cash reserves.

Tax Abatements

The District sometimes uses tax policy to support economic development efforts. In particular, some projects receive tax abatements—in effect a waiver from having to pay property taxes or other taxes. These tend to be applied to larger projects and are occasionally paired with other subsidies.

Two recent examples are the DC United Soccer stadium and Adams Morgan Hotel.

- **DC United Stadium:** The District agreed to provide $150 million in direct assistance to purchase and prepare the land for a new soccer stadium, with the team

[28] DCFPI. 2016. "DC's Revenues Continue to Grow, but the Gains Will Not All Be Available, Due to Tax-Cut Triggers."

paying for construction of the stadium. The plan also includes $43 million in sales and property exemptions for the team. Additionally, deal calls for community improvements beyond the stadium, including restoration of a Circulator bus line to the Southwest Waterfront, improvements to the Randall Recreation Center in Southwest and the creation of a "workforce intermediary" to match stadium-area residents with jobs.[29] With the building of a new stadium, the DC United soccer team could become profitable, and its value could rise from $61 million in 2012 to $195 million in 2019, according to a report commissioned by the City Council.

- **Adams Morgan Hotel:** The District approved property tax abatements over a number of years that are worth $46 million to develop a luxury hotel in Adams Morgan. In return, the developer had to meet a number of requirements, including hiring 342 DC residents for the construction of the hotel, hiring DC residents for half of the jobs once the hotel is open, and others.[30] As of the fall of 2016, the developer—the Sydell Group—had hired just 90 city residents, far short of the amount required under legislation. As of January 2017, the status of the tax abatement remains undetermined as the Sydell Group has been given a timeline to meet all the requirements, and is being overseen by the Office of the Chief Financial Officer and the Department of Employment and Services. If the developer is able to meet the hiring targets, it would represent one of the most substantial community benefit packages tied to an economic development project in DC.

Tying tax abatements to community benefits is important, because economic research shows that economic development subsidies often do not bring additional jobs or economic activity that would have otherwise occurred.[31]

Until a few years ago, the District had no process to address the very basic question of whether a proposed tax abatement for a private development project was critical to that project moving forward. This contributed to situations where tax abatements were provided without clear justification. As one indication, a variety of development projects have been offered the same type of tax abatement in recent years—such as a 100 percent property tax break for 10 years—even though it is likely that the financing gaps differed significantly from project to project.

In other cases, tax abatements were offered to projects that did not appear to need any financial help. For example, the District approved a $5.7 million tax abatement in 2009 for the View 14 residential development in Ward 1. In early 2011, the Council considered (but did not approve) an additional tax break for the project. Yet this project, in a rapidly gentrifying area, was sold by the developer in June 2011 at a price that "shatter[ed] the record for the highest price per square foot in the metro area for a Class A rental product."[32]

In response to criticism over previous District tax abatements, the Council passed the Exemptions and Abatements Information Requirements Act in the FY2012 budget. The

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[29] Washington Post. 2014. "D.C. Council approves soccer stadium deal, paving way for games in 2017."
[30] Washington Post. 2016. "In Adams Morgan, a promise yet to be filled."
[31] Global Studies Initiative, Subsidy Primer, The effects of subsidies.
[32] Washington Business Journal. 2011. "UDR closes on View 14 sale."

most important aspect of the legislation is that it requires the Chief Financial Officer to conduct a financial analysis of any project seeking a tax abatement to assess whether or not the project would be able to go forward in the absence of an abatement and how much abatement is needed for those projects that otherwise would not move forward. It also requires a listing of community benefits the developer has agreed to as well as a description of the number and quality of jobs that will be filled by District residents.[33]

One example of such an analysis was conducted for the Adams Morgan Hotel. The study commissioned by the CFO found that the hotel project faced a financing gap which prevented it from moving forward. Ultimately, this study helped to bolster the Sydell Group's case for the tax abatement, which was approved by the Council.

The cost of a tax abatement—the amount of revenue that the District would forgo—is one of the most important issues to address when considering an abatement. Tax abatements are a use of public resources to meet a specified goal, similar to funds expended on health care or libraries or transportation. Thus, tax abatements should be assessed based on their benefits relative to their costs.

The process for measuring the fiscal impact of a tax abatement should be straightforward, by measuring the revenues that would not be collected as a result. Yet proponents of tax abatements at times argue that the tax break would have little or no cost to the city.

- **The method currently used by DC's CFO to measure the fiscal effect of tax abatements is the preferred method.** The Office of the CFO measures the cost of an abatement by taking into account projections of property values and the taxes that would be raised by a given project under current property tax rates. The CFO compares this with the taxes that would be paid under the proposed abatement. The difference between the two is the fiscal impact.

- **Some tax abatement proponents falsely claim that the abatement will have no effect on tax collections.** In some cases, proponents of tax abatements suggest that they will not have a cost, particularly when the abatement promotes development on property that is currently vacant and therefore contributing little tax revenue. Yet, just because a property is currently vacant does not mean it will never develop if a subsidy is not granted. The District has one of the most vibrant and desirable commercial real estate markets in the country, which suggests that it often is not reasonable to assume that vacant land will not otherwise be developed. Moreover, allowing tax abatements for vacant land to be determined as having no cost would result in a tremendous weakening of the city's future tax base, since it could create incentives to adopt such tax abatements.

- **Recognize that the CFO's analysis may actually understate the ultimate cost of the abatement.** As noted, the CFO compares their projections of future property values and the taxes that would be raised by a given project to the taxes that would be paid under a proposed abatement. However, the CFO must oftentimes be conservative in their projection of future tax revenue. If, however, property values

[33] DCFPI. 2011. "Making Sense of the District's Tax Abatement Dollars: Nine Questions to Consider."

and their respective property taxes rise faster than the CFO's projections, the cost or foregone revenue as a result of the abatement increases. As part of a 2010 deal to lure the CoStar Group to relocate from Bethesda to downtown, the Council granted the developers a 10-year property tax abatement worth $6.1 million. However, after purchasing the property for $41 million, the CoStar Group sold it a little over a year and a half later for $101 million, in what the Washington Post described as "the most profitable flip of Washington commercial real estate from the recession to date."[34] This deal illustrates that had the District not awarded the CoStar Group tax abatement, the city could reasonably have expected to obtain much more than the $6.1 million in property tax revenue over ten years that the CFO projected.

The District's requirement to accurately measure the cost of proposed abatements, conduct an assessment of whether an abatement is needed for a project to be viable, and identify the community benefits of each project represent important progress toward ensuring that tax abatements for economic development projects are a good investment for the District.

[34] Washington Post. 2011. "CoStar to make $60M in sale of D.C. headquarters."

Appendix 1	
Major Changes to the Real Property Tax, 1976-2015	
Fiscal Year Effective	Real Property Tax Changes
1978	Owner-occupied single-family homes, condominiums and cooperatives assessed value reduced by $6,000 due to Homestead Deduction.
1979	Increased Homestead Deduction to $9,000. Three classifications established for determining the property tax rate. Class 1 (owner-occupied residential) set at $1.22/$100. Class 2 (other residential) set at $1.54/$100. Class 3 (commercial) set at $1.83/$100.
1980	Class 3 rate increased to $2.13.
1984	Class 3 rate decreased to $2.03. Public space rental formula changed from a fractional assessment basis (65%) to a method based upon the property's full assessed value.
1985	Commercial property divided into 2 classes: Class 3 (hotels and motels) set at $1.82, and Class 4 (other commercial) set at $2.03.
1987	Retired senior citizens, 65 or older, receive 50% reduction on real property taxes. Increased Homestead Deduction to $15,000.
1990	Increased Homestead Deduction to $30,000. Class 1 rate decreased to $0.96. Class 3 rate increased to $1.85. Established Class 5 for unimproved vacant land at rate of $3.29.
1991	Class 4 rate increased to $2.15.
1992	Senior citizen property tax relief eligibility expanded to include non-retirees. Eligibility limited to residents with annual household adjusted gross income under $100,000.
1994	Class 5 rate increased to $5.00.
1999	Began 3-year phase-in of a triennial assessment system. Properties divided into three triennial groups with one group reassessed each year.
2000	Began 3-year transition to new two-class system and rate structure **FY 2000** **FY 2001** **FY 2002** Class 2 $1.34 $1.15 $0.96 Part of new Class 1 (residential) Class 4 $2.05 $1.95 $1.85 Part of new Class 2 (non-residential) Class 5 $2.05 $1.95 $1.85 Part of new Class 2 (non-residential)
2003	Began 3-year transition to annual assessment. New 25% cap on annual taxable assessment growth of residential properties. Created new Class 3 (abandoned and vacant property) at $5.00.
2004	Homestead Deduction increased to $38,000. Cap on annual taxable assessment increases decreased to 12%.
2006	Class 1 rate reduced to $0.92. Homestead Deduction increased to $60,000. Cap on annual increases in taxable assessments decreased to 10%. Implemented Tax Deferral for Low-Income and Low-Income Senior Property Owners, allowing low-income property owners to defer annual increases in real property taxes and senior citizens to defer the entire annual tax bill. Implemented 50% tax credit for property owners with disabilities.
2007	Class 1 rate reduced to $0.88.

Appendix 1 (Cont'd)	
Major Changes to the Real Property Tax, 1976-2015	
Fiscal Year Effective	Real Property Tax Changes
2008	Homestead Deduction increased to $64,000. Reduce Class 1 rate from $0.88 to $0.85.
2009	New split tax rate structure for Class 2 properties. First $3 million in assessed value at $1.65 per $100. Excess of $3 million taxed at $1.85. Beginning of annual increase of Homestead Deduction by indexing, deduction increased to $67,500. Class 3 rate increased to $10.00.
2010	Homestead Deduction indexing delayed through FY 2013. Class 3 limited to vacant, improved properties deemed as blighted.
2011	Class 3 limited to vacant, improved properties with tax rate set at $5.00. New Class 4 for vacant, improved properties deemed blighted with tax rate set at $10.00.
2013	Homestead Deduction will increase by inflation from a base year of 2011 rather than the original base year of 2007. Homestead Deduction for 2013 will be $69,350.
2014	Increased the income eligibility for DC's seniors 50 percent property tax credit, from $100,000 to $125,000.

Sources: DC Tax Facts, 2016; Fiscal Year 2010 Budget Support Act of 2009; Fiscal Year 2011 Budget Support Act of 2010; "Real Property Recordation and Transfer Tax Form FP 7/C"; "Tax Rates and Tax Burdens: Washington Metropolitan Area 2009"

Appendix 2

Major Changes to Sales and Use Taxes, 1976-2016

Fiscal Year Effective	Sales & Use Tax Changes
1976	Groceries, non-prescription drugs, laundry, and dry cleaning exempted. Parking taxed at 8%, increased later in year to 12%. Hotels and restaurant meals sales tax rate increased from 6% to 8%. Public Utility rate increased from 5% to 6%. Motor vehicle tax rate increased from 5% to 6%. Instituted new motor vehicle tax rates based on 4 classes of vehicle weight. Rates range from 4% to 7%. Gas tax increased from 8¢ to 10¢/gallon. Cigarette tax increased from 6¢ to 10¢/pack.
1977	Cigarette tax increased to 13¢/pack.
1980	General rate increased from 5% to 6%. Sales of motor fuel subject to general sales tax rate. Hotel tax increased from 8% to 10%. Gas tax increased to 11¢/gallon. Candy, confectionery, chewing gum, and soft drinks taxed at 8%. Rental or leasing of vehicles and utility trailers now taxed at 8%.
1981	Sales Tax on motor fuel sales repealed. Gas tax increased to 13¢/gallon.
1982	8% sales tax on candy, confectionary, chewing gum, and soft drinks repealed. Gas tax now indexed to the Consumer Price Index for all urban consumers (CPI-U).
1983	Public Utility rate increased to 6.7%. Motor vehicles now divided into 2 weight-based classes. Vehicles weighing 3,499 lbs. or less subject to 6% rate. Those weighing 3,500 lbs. or more subject to 7% rate.
1985	Sales tax on vending machine items increased from 2% to 6%. Indexing of gas tax ends. Rate set at 15.5¢/gallon.
1987	Cigarette tax increased to 17¢/pack.
1989	Established 6% tax on real property, data processing, and information services. Established vendor credit of 1% of sales for filing returns on time. Restaurant meals and sales of alcoholic beverages increased from 8% to 9%. Hotel tax increased to 11%. Gas tax increased to 18¢/gallon.
1990	Exempted taxi cabs from motor vehicle tax. New residents now required to pay motor vehicle tax on cars transferred into the District.
1991	Sales tax on residential utility services repealed by temporary legislation. Public Utility rate increased to 9.7% temporarily.

Appendix 2 (Cont'd)	
Major Changes to Sales and Use Taxes, 1976-2016	
Fiscal Year Effective	Sales & Use Tax Changes
1992	Sales tax on alcohol intended for off premises consumption increased from 6% to 8%. Laundering services now subject to general sales tax. Public Utility rate set at 9.7% permanently. Two separate increases bring the cigarette tax to 50¢/pack.
1993	Snack foods, selected telecommunications services, all publications and newspapers subject to general sales tax. Gas tax increased to 20¢/gallon. Cigarette tax increased to 65¢/pack.
1994	Temporarily increase general sales tax to 7%. Courier and employment services subject to general sales tax. Public Utility rate increased to 10% temporarily. Gas tax increased for 4 months to 22.5¢/gallon.
1995	General sales tax rate reduced to 5.75%. Rate for restaurant meals and alcohol for on-premise consumption increased to 10%, the 1% increase used to fund Convention Center. Rate for hotels increased to 13%, 2.5% of this rate used to fund Convention Center.
1999	Sales tax rate for hotels increased to 14.5%, 4.45% of this rate used to fund Convention Center. Discontinued requirement that new residents pay motor vehicle tax on cars transferred into the District.
2000	Sales tax on Internet access eliminated.
2001	Sales tax on snack foods repealed. 1% vendor credit for on-time returns eliminated. August sales tax holiday created, runs Aug. 3-12.
2003	Public Utility rate increased to 11%. Sales tax rate for off-premises sale of alcohol increased to 9%. Cigarette tax increased to $1.00/pack.
2005	Permanent sales tax holiday implemented in August and November. New 10% tax on baseball tickets and stadium merchandise, devoted to Ballpark Fund. Public Utility rate decreased to 10% for residential customers. Non-residential remain at 11% with 1% devoted to baseball stadium financing. Non-residential rates for electricity and natural gas increase with portion going to stadium financing. Motor vehicles now divided into 3 weight-based classes. Rates range from 6% to 8%.
2006	Sales tax rate for certain tobacco products increased from 5.75% to 12%.
2009	Cigarette tax increased to $2.00/pack.
2010	Sales tax holidays eliminated. Sales tax rate increased to 6%. Gas tax increased to 23.5¢/gallon. Cigarette tax increased to $2.50/pack.
2011	6% sales tax applied to medical marijuana and soda and other soft drinks.
2012	Retail alcoholic beverage tax increased from 9% to 10%. Armored car, private investigation, and security services now subject to sales tax.

Appendix 2 (Cont'd)	
Major Changes to Sales and Use Taxes, 1976-2016	
Fiscal Year Effective	Sales & Use Tax Changes
2013	Professional services such as consulting, engineering, legal, and physician services are exempt.
2014	Sales tax rate decreased to 5.75%. Sales tax exemption for the utilities that restaurants use to prepare food.
2015	Broaden the definition of tobacco products that are subject to sales tax, and set the tax rate on all tobacco products equal to taxes levied on cigarettes. Expands the number of services subject to the 5.75% sales tax, including carpet and upholstery cleaning, car washes, storage of household goods, health clubs and tanning studios, bottled water delivered for home use, and bowling alleys and billiards parlors.
2016	Sales tax exemption for feminine hygiene products and diapers.*

*As of January 1, 2017, this change is approved but not yet funded, and therefore not currently in effect.

Sources: DC Tax Facts, 2016; Fiscal Year 2012 Budget Support Act of 2011; DCFPI Tax Toolkit