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Federal and DC Tax Changes Are A Windfall for DC Residents With Incomes Above $500,000, But A Mixed Bag for Those Below $50,000

By Claire Zippel

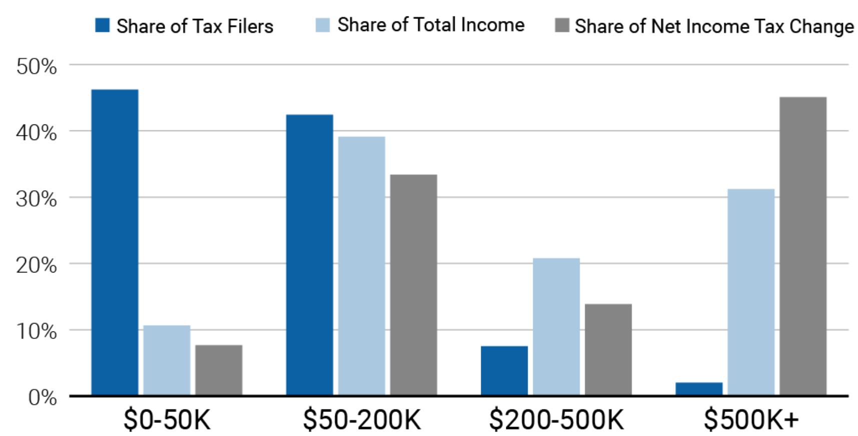
The District's high-income residents will collect outsized federal income tax cuts in 2019 due to the new federal tax law, according to estimates from the District's Office of Revenue Analysis. Low-income residents will see some benefits, too, but the combined effect of the federal law and linked DC tax changes will be a mixed bag for this group. Businesses in the District will see lower federal corporate taxes.

Large Federal Tax Cuts to High-Income DC Residents

In the District, as in the nation as a whole, the new federal tax law will drive large benefits to tax filers with incomes over $500,000. Among other tax changes that will disproportionately benefit high-income filers, the federal law reduced the top marginal income tax rate (which applies to taxable income over $500,000)[1] by 2.6 percentage points, from 39.6 percent to 37 percent. These filers will see little change in DC income taxes proportional to either their incomes, or DC income taxes owed.

- $254 million in federal income tax cuts will flow to DC filers with incomes[2] above $500,000. That amounts to $37,550 per filer.
- 41 percent of DC's total federal income tax cut will go to filers with incomes above $500,000—who comprise only 2 percent of DC tax filers and have 31 percent of the city's total income. This means filers above $500,000 will receive a disproportionate share of the cuts, even given their high incomes.

DC's Highest-Income Tax Filers Will Get An Outsized Share of Federal Income Tax Cuts



Note: Income refers to federal adjusted gross income (AGI). Filers with negative AGI are not shown but are included in totals. Figures are for tax year 2019. Federal income tax cuts refers to those due to the Tax Cuts and Jobs Act of 2017.
Source: DC Office of Revenue Analysis.

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- The average effective federal income tax rate for filers above $500,000 will fall 2.1 percentage points, from 27.9 percent to 25.8 percent.
- Filers above $500,000 will not see much change in DC income taxes. The average effective DC income tax rate for this group will stay about the same, at 6.3 percent.[3]

Mixed Picture for Low-Income DC Residents

The federal tax changes and linked DC tax changes will be a mixed bag for DC residents with incomes below $50,000. These filers will be affected mainly by three components of the new federal tax law. The law nearly doubled the standard deduction, which reduces taxable income. At the same time, the personal exemption, a deduction that taxpayers can take for each member of their household, was eliminated. Because DC tax law links these provisions to the federal code, these changes will affect filers' DC income taxes as well as federal income taxes. Meanwhile, the federal child tax credit was expanded, and marginal tax rates on the lower brackets were reduced.

The combined impact of these three moving parts on a tax filer's DC and federal income taxes owed will depend on their circumstances. For instance, the increase in the standard deduction may not offset the personal exemption for tax filers with multiple dependents.

- DC tax filers with incomes below $50,000 will see a federal income tax cut of $57 million, or $362 per filer. Meanwhile, these filers will see a $12 million increase in DC income taxes owed ($77 per filer), resulting in a combined net tax cut of $41 million, or $285 per filer.
- Federal income taxes will go down or stay the same for 89 percent of DC tax filers with incomes below $50,000. At the same time, 34 percent will see an increase in DC income taxes owed. The combined effect is that 13 percent of filers below $50,000 will owe more in combined DC and federal income taxes.
- 21 percent of the total increase in DC income taxes will be paid by filers below $50,000. These filers will get only 9 percent of the total decrease in federal income taxes.
- The average effective DC income tax rate for filers below $50,000 will grow from -0.1 percent to 0.2 percent. Yet when this is combined with the lower average effective federal tax rate for this group, the tax changes will still result in a lower overall (DC plus federal) average effective income tax rate: -1.7 percent, down from -0.6 percent.

DC Businesses Will See Lower Federal Tax Bills

District businesses will see a $460 million reduction in federal corporate income taxes. The federal tax law reduced the corporate income tax rate and repealed the corporate alternative minimum tax. Neither of these two provisions affect DC's corporation or unincorporated business taxes, whose rates have been lowered substantially in recent years. However, the law placed limitations on certain deductions, which will be reflected in the District's business taxes, and raise DC business revenues by $2 million. Combined, DC businesses will see a $438 million reduction in their income tax liabilities.

Estates

The federal tax law increased the estate tax exemption from $5.6 million to $11.2 million.[4] As the District's estate tax exemption is linked to the federal tax code, DC estate tax revenues will fall $6.5 million in fiscal year 2019.

DCFPI thanks the Office of Revenue Analysis for sharing their individual income tax estimates for this post. Read ORA's report on the impact of the Tax Cuts and Jobs Act on the District here.

[1] For single and heads of household filers. The top bracket for married filers begins at $600,000.
[2] Throughout this blog, income refers to federal adjusted gross income (AGI). Filers with negative AGI are not shown but are included in totals.
[3] More precisely, filers above $500,000 will see a -0.03 percent reduction in average effective DC income tax rate.
[4] For married couples, $22.4 million.