D.C. Council Committee to Vote on Interrupting Tax Reform Package

May 18, 2017

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In 2014, the District of Columbia became a model for the country when it passed a comprehensive tax reform package. What was in it?

- Income taxes went down for low-income earners, middle-income earners, and those earning up to $1 million.

- All taxpayers are seeing more generous standard deductions and personal exemptions that will eventually match the federal level (as will the estate tax exemption level).

- Childless low-income workers see a larger Earned Income Tax Credit (EITC), from 40 percent of the federal credit to 100 percent of the federal credit.

- The District's hefty business tax is dropping from 9.975 percent to 8.25 percent, and the District adopted single sales factor apportionment.

- The estate tax exemption level would be recoupled to the federal level (matching Maryland).

- Some services lost their sales tax exemptions and now have general sales tax imposed on them like all other businesses, and some little-used business credits were repealed.

Strange political bedfellows came together to make it happen. An Urban Institute panel featuring speakers from the D.C. Fiscal Policy Institute and the Tax Policy Center highlighted elements of the tax package, which were developed by a blue ribbon tax reform commission. The Institute for Taxation and Economic Policy (ITEP) praised it as a good progressive reform. The National Taxpayers Union (NTU) called it "pro-growth reform done the right way." Grover Norquist's Americans for Tax Reform called it historic and applauded the tax relief. Scholars from the Cato Institute, Vox.com, the Center on Budget and Policy Priorities (CBPP), and Citizens for Tax Justice (CTJ) chimed in with positive statements.

On the coming together of groups that often disagree, *The Daily Caller* said hell had frozen over but themselves said "hats off" to the D.C. Council for enacting the package. Moody's, Fitch, and Standard & Poor's said the package reduced revenue in a manageable way and was not a credit concern. We at the Tax Foundation gave an award to D.C. Council Chair Phil Mendelson for his leadership on the reform.

The package was broken up into 26 discrete parts, the first nine taking effect immediately, with the remaining 17 set to take effect in ordered stages based on revenue growth. This is because D.C. takes its fiscal solvency very seriously (a holdover of the District's insolvency of the 1990s); now D.C. does better than most states on the health of its reserve and rainy day funds. Each February, the Chief Financial Officer calculates a new revenue projection and compares it to the revenue projected when the budget is adopted; if there's an increase, the surplus money is used to implement further items on the list. After strong revenue growth taking the budget from $7.1 billion in 2014 to a projected $8.6 billion in 2019, the last pieces of the tax reform (totaling about $187 million a year in reduced revenue) are due to take effect this year.

Or maybe not. Councilmember David Grosso (I-At Large) is moving an amendment in the Education Committee meeting this afternoon (he chairs it) to single out the estate tax recoupling component for indefinite delay (page 132), and there's been talk of others seeking to cancel or delay other components as well before the final budget is adopted. It would be unfortunate if this impressive, far-reaching tax reform is unraveled right as it is set to take final effect. Everyone agrees in theory that broadening tax bases and lowering tax rates is good, fair, and competitive, but interests lobby to protect their favored exclusions, exemptions, and credits. D.C. was able to overcome this by offering something for everyone, and only adopted the tax reform package because it was a comprehensive whole. Of the $1.5 billion in revenue growth since 2014, 88 percent has gone to spending growth and just 12 percent to tax cuts, and according to the D.C. Chamber of Commerce, nearly 60 percent of the tax relief has gone to low- and middle-income District families and 28 percent to reducing business tax burdens.

What is the estate tax exemption recoupling proposal that Grosso seeks to delay? D.C. and 11 other states have an estate tax, which like the federal estate tax imposes a large tax on the value of an estate after death. To prevent unintended impacts on middle-class households that may have large assets on paper (from a house that has appreciated in value, or from owning their own business), the federal estate tax exempts the first $5.49 million in value from tax (as do Delaware, Hawaii, Maine, and New York). Maryland has $3 million exemption level now, and is set to raise it to $4 million in 2018, and then the federal $5.49 million level in 2019 (it's indexed for inflation). D.C.'s exemption is $2 million, but set to recouple to the federal level this year unless Grosso's amendment is adopted. New Jersey is repealing its estate tax, and it's worth noting that Virginia has no estate tax. (The table below compares Virginia, Maryland, and the District.)

Legislators in blue states like Delaware, Hawaii, Maryland, and New York have preserved their estate tax but raised estate tax thresholds to the federal level because they recognize that a long-time resident who owns a small business shouldn't be subject to the estate tax just because the home they've owned for 20 or 30 years is now suddenly worth much more and their growing business has lots of assets. As D.C.'s home values climb upward, more residents who are not super-wealthy could find themselves above the $2 million exemption level, and forced to sell off pieces of the business or sell their homes to pay it.