D.C. to Enact Remaining Tax Cuts After Projection of Large Recurring Surplus

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February 28, 2017

All remaining tax cuts from the District of Columbia tax reform package passed in 2014 will take effect on January 1, 2018. An updated revenue estimate projects a sufficient recurring surplus to permit the increase of the standard deduction, personal exemption, and estate tax exemption level to federal conformity, and the reduction of the business tax from 9 percent to 8.25 percent.

Some people still don't believe us when we say the District of Columbia passed bipartisan tax reform in 2014.[1] Income taxes went down for middle-income earners and those earning up to $1 million, and 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. Some services lost their exemptions and have to collect general sales tax like all other businesses, and some little-used business credits were repealed.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 and the remaining 17 to take effect in ordered stages based on recurring revenue growth.[2] This is because D.C. takes its fiscal solvency very seriously (a hangover of the District's insolvency of the 1990s); 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 it's more, the surplus money is used to enact further items on the list, to take effect the following year. That report found that D.C. projects FY 2017 revenue of $7.355 billion, $221 million above the budget projection of $7.134 billion. Future year surpluses range from $175 million and up. The remaining tax reform package elements total $100.3 million, so the recurring surplus is sufficient for all remaining items to take effect next calendar year (with remaining money left over).

The table below shows the full list of implemented and not-yet-implemented provisions of the 2014 tax package:

The provisions taking effect in 2018 will benefit nearly all D.C. taxpayers, reducing income tax burdens especially for low-income individuals and lowering business and estate taxes. D.C.'s strong economic growth has permitted both a healthy budget and these tax changes. All taxpayers benefit, they preserve D.C.'s tax progressivity, and the changes enhance regional competitiveness.

Unfortunately, a coalition of groups has emerged to pressure the D.C. Council to cancel or postpone the tax changes ("pause" is their word), and instead spend both the saved surplus and the surplus set aside for the tax cuts. It is worth noting that the D.C. Fiscal Policy Institute has emerged as the organizers of the effort, as they were a leader of the 2014 tax reform effort that led to the tax changes being adopted. While the forthcoming tax changes (lower business taxes, recoupled estate tax, expanded standard deduction) may not align with the tax policy priorities of the DCFPI-led coalition, they were nevertheless integral to the 2014 package. Ending these reforms now, even temporarily, would be shortsighted. While we understand this coalition's concern about federal policy uncertainty, what is certain now is that reduced income tax burdens in 2018 for low-income families and individuals will not be realized if the Council delays the provisions set take effect.

Spending D.C.'s accumulated surplus would mean using one-time available funding for annually recurring expenses. This sets up the District for a budget crisis down the line. D.C.'s rainy day fund and other reserves (about 15 percent of general fund expenses) is healthy but not above the level recommended (13 to 18 percent) to cover any economic downturn. Additionally, D.C. should adhere to the prudent policy of never spending rainy day funds outside of bad economic circumstances.

Tax reform is hard. Everyone agrees in theory that broadening bases and lowering rates is good, fair, and competitive, but states rarely have well-structured tax codes because interests lobby to protect their favored exclusions, exemptions, and credits, keeping the tax base narrow. D.C. was able to overcome it and enact an impressive, far-reaching reform. The package should be permitted to continue taking effect as agreed in 2014.