COALITION FOR COMMUNITY INVESTMENT

Revenue Raising/Budget Savings Ideas to Address DC's Budget Shortfall

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The District faces an extraordinary budget shortfall caused by the national economic crisis and falling local tax collections. DC's budget problems could continue to worsen, if upcoming revenue forecasts show increasingly bad news. While the needs for public services have not changed – schools, transportation, a clean environment, housing, health care, and more – our ability to pay for them has.

A balanced approach to dealing with DC deficits should include a mix of sensible revenue expansions and budget reductions. The District's leaders can start by aggressively seeking funds from the upcoming federal stimulus package, and using those funds to support services that otherwise might have to be cut. Beyond that, other steps can help the District find new revenues without overly burdening residents, businesses, or the DC economy.

This memo offers a range of options for increasing revenues or realizing budget savings. The Coalition for Community Investment endorses all of the options, but we do not recommend adoption of them all. Instead, this broad array of revenue ideas is intended to give a variety of options to policymakers.

This memo is divided into five categories of budget saving/revenue raising ideas:

- Revenue/Budget Savings that do not involve <u>any</u> changes in taxes or fees
- Revenue ideas that would change existing taxes but not raise them – such as closing corporate tax loopholes
- Expanding the base of a tax – like applying the sales tax on movie tickets to also include theater tickets
- Raising fees
- Increasing Taxes

BUDGET SAVINGS/REVENUE IDEAS THAT DO NOT INVOLVE CHANGING TAX RATES OR FEES

1) Issue Bonds for All School Modernization in the Near Future
The District funds its school modernization efforts in part by issuing bonds that are repaid over several years. The city also devotes more than $100 million in annual operating revenues to school construction.

The District should explore ways to fund school construction, at least in the near term, without using operating funds. The federal stimulus package may include funds that DC can use for these purposes. If not, the city could issue bonds for a greater share – or even all – of its school construction costs in the near term. Issuing an additional $100 million in school construction bonds would result in roughly $8 million to $10 million in annual bond re-payment costs. This shift would free up $90 million per year. The District faces a debt limit – debt payments cannot exceed 12 percent of the budget – but the debt limit should not affect ability to float additional school bonds in 2009 and 2010.

2) Improve Tax Collection Efforts

- Institute an amnesty program to collect overdue taxes. Participants agree to pay past-due taxes and fees but escape paying fines or interest.
- Explore other ideas to improve collection of existing tax obligations

3) Use Medicaid efficiently to maximize federal matching funds:

a. Enhance revenue by using federal Health Information Technology funds to improve Medicaid technology ystems.

- The Department of Health Care Finance is planning to implement in 2010 a new administrative services organization (ASO), which is the claims management system for the city's Medicaid programs. The District should continue to fully fund the planning efforts around this reform. Completion of the planning in 2009 will enable the District to better use federal funds in 2010.

b. Enhance revenue by maximizing Medicaid services.

- Medicaid is a federal matching program. Every dollar spent by the District is matched by $2.33 from the federal government, and this revenue largely goes to District providers. Conversely, every dollar cut from the District's Medicaid services exponentially reduces District revenue from the federal government.
- Scrutinize opportunities to ensure Medicaid coverage:
  1. Mental health case management. There is currently no Medicaid reimbursement for case management of mental health services. The District has recently developed case management contracts through the Department of Human Services, where it is funded through non-Medicaid dollars. Inclusion of case management within Medicaid will allow greater use of federal revenue dollars. The District should re-visit mental health case management.
  2. Use of specialty mental health services. The District has several expensive — but effective — specialty therapies available for children, such as multi-systemic therapy or functional family therapy. Additional programmatic planning and funding is needed to ensure that these therapies are maximized under the District's Medicaid program

REVENUE IDEAS THAT WOULD CHANGE TAXES BUT NOT RAISE RATES

1) Close Corporate Income Tax Loopholes. Across the country, multi-state and multi-national corporations take aggressive steps to avoid paying state-level corporate income taxes. In many states, corporate income taxes represent a small and declining revenue source. There are a number of steps that the District can take to limit the ability of national and multi-national corporations to avoid paying taxes in the District. This includes enacting "combined reporting," under which businesses with multiple subsidiaries must report as one entity, which greatly limits tax avoidance.

2) Increase the Minimum Corporate Franchise Tax from $100 to $500
DC's minimum franchise tax is just $100, and it has not been adjusted for 25 years. The vast majority of businesses in the city pay the minimum tax.

EXPANDING A TAX'S BASE

1) Eliminate Income Tax Exemption for Interest on Out-of-State Bonds

The District is one of just two states that allow residents to claim an income tax exemption for the interest they receive on state and local bonds issued in other cities and states. Every state with an income tax offers such exemption for interest from in-state bonds, which provides an incentive to support the state's infrastructure projects. But only DC and Indiana allow this exemption for interest on out-of-state bonds because it effectively represents a tax incentive to invest in other states' infrastructure. Why should the District offer tax exemptions to residents investing in road construction projects in California, for example?

In 2008, the U.S. Supreme Court heard a challenge to the practice in most states of allowing a tax exemption for interest on in-state bonds but not for interest on out-of-state bonds. Numerous state organizations — including the National Governors' Association, the U.S. Conference of Mayors, and the Government Finance Officers Association — weighed in on this case in an effort to protect this practice. The state groups argued that offering an exemption to residents only for in-state bonds helps limit the cost of the exemption while also encouraging residents to purchase their state's bonds.

The DC residents who invest in tax-exempt bonds tend to be high-income. In 2005, some 70 percent of the tax-exempt interest received in DC went to residents with incomes of $200,000 or more. Even if DC eliminates this local tax exemption, residents who invest in out-of-state bonds would continue to qualify for a federal income tax exemption on the interest they receive.

2) Impose Sales Tax on All Ticket Sales

The sales tax on tickets at the Verizon Center and the Nationals stadium is 10 percent. Movie tickets are taxed at the basic rate of 5.75 percent. Live performances, however – plays, musicals, opera, dance, etc. – are not subject to any sales tax in the District. The District could extend the sales tax – at either the 5.75 percent rate or 10 percent rate – to tickets for live performances. Extending the sales tax to live performances would improve the equity of the sales tax – it is not fair that movie-goers pay sales tax but theater-goers do not – it also is a tax that would fall to a significant extent on non-residents.

3) Expand the Sales Tax to Cover Selected Services

The DC sales tax, like most state sales taxes, was created years ago when most retail sales were in the form of goods. Increasingly, however, our economy is becoming service-oriented, and services are a growing share of retail sales (such as grocery delivery, health clubs, pet grooming). The District has expanded its sales tax to cover some services, like labor costs for car repairs, but many services remain uncovered by the city's sales tax. The District could raise additional revenue by applying the sales tax to selected additional services that currently are not taxed, including pet grooming, security firms, and test preparation services. The District should select services to be taxed based on the potential to raise new revenue and the likely impact on new residents. Because the sales tax is a regressive tax, the District should be careful about extending the sales tax to services that are used largely by low- and moderate-income households.

Expanding the sales tax to more services has other advantages. It improves the fairness of the tax system to have all consumer purchases covered by the sales tax – it is not fair, for example, that buying a bottle of pet shampoo is taxed but having a business wash a pet is not. In addition, expanding the sales tax to more services helps ensure that sales tax revenues will grow from year to year along with the economy. In states where the sales tax applies primarily to goods, revenue growth tends to be slower than overall economic growth.

RAISING FEES

1) Increase Fees for Selected Licenses and Permits That Have Not Been Raised Recently

The District should undertake a review of fees that have not been adjusted for several years and that appear to be low relative to other states or to the value of the license. Increases could be tied to increases in inflation since the fees were last increased.

2) Increase Public Space Rental Fees:

- The District's residential parking permit fee ($15 per year) is low compared with other jurisdictions. The permit fee in Montgomery County, MD is $30 and the fee in Arlington, VA is $40.
- There are some indications that sidewalk café rental fees are low. The District could explore whether an increase in these rates is justified.

RAISING TAXES

1) Cigarette Tax. The District's cigarette tax is currently $2. While this is higher than in most states, raising the cigarette tax has been shown to reduce smoking. Because the District's health programs incur substantial expenses for smoking-related illnesses, the increase also can be justified as a way to reduce health expenditures.

2) Increase sales tax rates on commercial parking (currently 12 percent) and alcohol sold for off-premises consumption (9 percent). The tax on parking is noteworthy because the tax falls primarily on non-resident commuters.

3) Modify DC Individual Income Tax Rates, Including Setting the Top Tax Rate at a Higher Level

The District could modify its income brackets by creating a new bracket for families above a certain income level, like $500,000. This could be coupled with changes to DC's other income tax brackets as part of an overall reform. The District's current top tax rate applies to taxable income (income after deductions) of just $40,000. Maryland recently created a series of new tax brackets and rates for residents with incomes above $200,000 for a married couple. The top rate is for those making over $1 million. When combined with county income taxes, the top income tax rate in Maryland is now higher than DC's top rate of 8.5 percent (9.45 percent in Montgomery County, and 9.35 percent in Prince George's County). In addition to Maryland, a number of other states – including New Jersey, Rhode Island, and Vermont – have an income tax bracket for higher-income households that is above DC's top tax rate.

The Coalition for Community Investment represents over 160 diverse organizations and individuals committed to public investments that expand economic opportunity for our neighborhoods and families, and support a fair and transparent budget process.

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