

DC Tax Revision Commission
June 24 Public Meeting
Testimony of Alma Hardy Gates

It is a pleasure to submit this testimony to the DC Tax Revision Commission (TRC) on behalf of myself and those seniors who joined forces in the spring of 2011 to advocate on behalf of a full repeal of the tax on out-of-state municipal bonds.

When Mayor Gray wrote to the TRC Chair in August of 2012, he noted, "Today the District of Columbia economy, although recovering from the national recession, is stronger than that of its surrounding jurisdictions... We have just sent our 17th consecutive balanced budget to Congress, our fund balance has been stabilized and is now rising again, and we enjoy a AAA bond rating on Wall Street for our income-tax secured bonds." In the same letter, Mayor Gray referenced municipal bonds, stating, "In addition to the bond fund implementation challenges, fairness issues, and revenue implications, there are other pros and cons to consider in analyzing this issue. For instance, by taxing out-of-state bonds, competition increases for District bonds, but there is a question as to whether the District issues enough bonds to support the District resident investment community."

At the time Mayor Gray sent his letter, Council and the Mayor had already delayed a bond tax that was enacted without hearings or testimony the prior year. Prior to May 2011, bond investors relied on the city's policy that no tax would be levied on income from out-of-state municipal bonds, which made these bonds an especially attractive investment choice for retirees living on fixed incomes. It provided financial security for seniors, knowing that even if bonds were called, their income from bonds would not be taxed.

This tax-exempt status ended abruptly in May 2011, when Council, not realizing the year would end with a surplus, sought to balance the budget by replacing a proposed higher marginal rate tax with a retroactive tax on income from out-of-state municipal bonds. Overnight, bondholders found themselves in a no-win situation. They were trapped. If they sold, their income was taxed and if they held onto investments, their income was taxed.

Following DC Council's May 2011 action, a group of seniors joined forces and began the difficult visits to the John A. Wilson Building and Members of Council.

It became crystal clear that some Councilmembers had little concept of a personal investment strategy, while others approached the bond tax from a purely political perspective that had nothing to do with the real issue at hand – balancing the budget. Following herculean efforts by this group of seniors, Council voted to support a grandfather, which would protect bond holders' income from tax through the end of the year. A second grandfather was granted for the following calendar year, and ended December 31, 2012.

For over two years, DC bondholders held their collective breaths as Council dallied around with their financial security and stability. The prolonged period of uncertainty for DC bondholders created hardship for some and caused anxiety for others.

In the spring of 2013, Mayor Gray included full repeal of the municipal bond tax in his budget; and, in May 2013, Council voted to fully repeal the tax on out-of-state municipal bonds.

Through oral and written testimony from members of the group of seniors that organized in the spring of 2011, the TRC will have received factual information on why the bond tax is wrong for DC. I would like to link these facts directly to the points in Mayor Gray's letter.

- Bond fund implementation challenges. There is not now, and never will be, a DC-only bond fund because there are simply not enough bonds issued in DC, sufficient variety among issuers, ample geographic diversification, or numbers of DC investors to warrant a DC-only bond fund. In addition, because of the challenges in identifying the income of non-DC bonds purchased after grandfathering in a bond fund, tax enforcement is extraordinarily complicated for both DC and the taxpayer.
- Fairness issues: The percentage of DC municipal bond investors who are seniors is significantly higher than the percent of DC's population that consists of seniors. Taxing an important component of a retiree's investments results in a tax that targets seniors.
- Revenue implications. Once the bonds were grandfathered, the projected four-year aggregate revenue was reduced to just under \$12 million. Because of the complexity in taxing income on non-DC bonds purchased after grandfathering that are in bond funds, probably half of this projected revenue would not be earned, bringing the four-year aggregate total to \$6 million. (Nationally, investors in municipal bonds split almost evenly

between funds and individual bonds.) During the Tax and Revenue Committee Budget Hearings, testimony was given suggesting an annual revenue of \$30 million, but this revenue is not even projected until 2025 or 2028 (in 12-15 years) – so far in the future that it is not very reliable or reflective of how investors are likely to act if there is a bond tax.

- Increased interest in DC bonds. There is no factual evidence that a tax on non-DC bonds would increase interest in DC bonds. However, there is evidence that, without a bond tax, DC bonds would become more attractive to a state that has 4.5 times DC's population. If there is no bond tax, Utah, which does not tax income on out-of-state bonds if the reciprocal state does not tax Utah bond income, will return to its previous position and not tax DC bond income, thus providing an incentive for Utah residents to invest in DC bonds. If the objective is to increase interest in DC bonds, it's wiser to encourage those living in a state with a large population to invest rather than to rely solely on the 18,000 bond investors in DC.
- Whether the District issues enough bonds to support the District resident investment community. The answer to this question, as demonstrated with the data provided is resoundingly "No." The well from which DC investors can draw is not deep. Just comparing DC to our neighbors in 2012: DC issued 15 bonds, had no DC-only bond funds or bond money market accounts; Maryland issued 97 bonds, had 45 available bond funds, and 1 bond money market account; and, Virginia, issued 136 bonds, had 44 available bond funds, and 5 bond money market accounts.

The TRC must base its recommendations to the Mayor on taxing out-of-state municipal bonds on valid data. Many statements made at Council budget and oversight hearings have been without merit, have exaggerated the wealth of seniors and have implied that seniors are using tax exempt bonds as a tax shelter. In fact, quite the opposite is true as many seniors are trying to survive and age in place in Washington, DC, a boomtown that US News and World Report listed as one of "The 10 Worst Places to Retire." A corresponding article in the Business Journals cites Washington as one of the best places for young adults and notes, "Washington features high income levels and a well-educated workforce...No market has a higher percentage of young adults with incomes above \$150,000."

The dichotomy illustrated by these two articles poses a challenge for the TRC as it reviews the structure of the current tax code and proposes needed revisions. The proposed changes the TRC sends to the Mayor must not unfairly target retired

seniors who have invested in the city, wish to age in place and continue to support the local economy, while at the same time providing a robust, equitable and competitive tax system that retains young professionals.

On March 28, 2013, the Mayor transmitted the FY 2014 Proposed Budget and Financial Plan to the DC Council. Included in that submission, the Mayor proposed a repeal of the out-of-state municipal bond tax with a goal of easing the burden on seniors who rely on bond income. In May, Council upheld the Mayor's proposal and voted to repeal the tax on out-of-state municipal bonds. There are no conditions placed on the repeal, which sends a clear signal to the TRC to support the Mayor's recommendation **to tax no out-of-state municipal bonds.**