

D.C. Tax Revision Commission Policy Options
Policy Option #57: Eliminate “Notch” in
Deed Tax Rate by Using Marginal Rates

MEMORANDUM

Proposal: Eliminate “notch” in deed tax rate by using marginal rates

Tax Type: Deed recordation and transfer tax

Origin: Rodney Green

Commission Goal: Fairness and modernization

Current Law

The deed recordation and transfer taxes (deed taxes) are imposed when taxable properties in D.C. are sold or transferred. The deed recordation tax is imposed on the recording of all deeds to real estate in the District (and is considered a tax on the buyer). At the same time, the deed transfer tax is also imposed on each transfer of real property (but is considered a tax on the seller). The deed recordation tax must also be paid on the increased value when commercial property is refinanced.

The basis of both taxes is the consideration (amount paid) for the property, including cash, property other than cash, mortgages, liens and a security interest in non-residential property. If there is no consideration or the consideration is nominal, the tax is based on the fair-market value of the property.

For all real property (other than residential properties valued at less than \$400,000), the rate for each tax is 1.45% of total consideration or fair-market value. Therefore, the combined deed tax rate for a transfer of residential property valued at \$500,000 or any commercial property would be 2.9%. For residential properties valued at less than \$400,000, the rate for each tax is 1.1% of total consideration or fair-market value—for a total of 2.2%.

There is a “notch” effect with D.C.’s deed taxes because the rate on the *entire* transaction rises for a residential property valued at \$400,000 or more. The total deed taxes due on a sale of a residential property valued at \$399,000 would be \$8,778 (0.022 x \$399,000), but because of the notch effect the total deed taxes due on the sale of a residential property valued at \$400,000 would be \$11,600 (0.029 x \$400,000), an increase of \$2,822.

The District dedicates 15% of deed tax revenue to the Housing Production Trust Fund, which funds a variety of affordable housing programs. In fiscal year 2012, deed tax revenue totaled \$284.9 million, with \$163.4 million from the recordation tax and \$121.5 million from the transfer tax.

Proposed Change

Eliminate the “notch” or “bump” in the deed tax rate by applying the higher rate of 1.45% to the *additional* value of the transaction above \$399,999, rather than the *entire* value of a transaction valued at \$400,000 or more.

Reason for Change

The present “notch” or “bump” in the deed tax rate is unfair and distorts behavior as people try to structure property transactions to avoid this effect.

Using the previous example, a \$1,000 increase in the purchase price of a residential property (from \$399,000 to \$400,000) currently triggers a \$2,822 increase in the deed recordation and transfer taxes. That merely creates a trap for the unwary or causes buyers and sellers to manipulate their sales price. By applying the higher rate to the additional value, the \$1,000 increase in purchase price results in a negligible tax increase.

Pros

- Would make the tax fairer by smoothing out the increase in deed taxes for residential property transactions at or slightly above \$400,000.
- Eliminate the “notch” effect would remove the incentive to price a home below \$400,000 for tax reasons.
- Could make D.C. more competitive in attracting middle-class residents looking to purchase homes priced around the current notch (\$400,000 to \$500,000).

Cons

- Would lose tax revenue.

Revenue Impact

The Office of Revenue Analysis estimates that in the first year of implementation changing to marginal tax rates would lose \$9.4 million.