D.C. Tax Revision Commission Policy Options

Subcommittee Package

MEMORANDUM

Proposal: Subcommittee package
Tax Type: Individual Income
Origin: Comprehensive package addressing several policy options
Commission Goal: Fairness, Simplicity, Broaden the base

The subcommittee has proposed two packages (Option A and Option B) to modify D.C.'s individual income tax. The packages are described below. The only difference between the two packages is how they phase out itemized deductions and personal exemptions for high-income taxpayers.

Current Law vs. Proposed Changes

Filing statuses

Current Law
D.C. allows residents to choose from eight filing options:

1. Single
2. Married filing jointly
3. Married filing separately
4. Married filing separately on same return
5. Registered domestic partners filing jointly
6. Registered domestic partners filing separately on same return
7. Head of household
8. Dependent claimed by someone else

The federal government allows taxpayers to choose from five filing options:

1. Single.
2. Married Filing Jointly.
3. Married Filing Separately.
4. Head of Household.
5. Qualifying Widow(er) With Dependent Child.

Proposed Change
Both Option A and Option B adopt the five federal filing options.

Brackets and rates

Current Law
D.C. applies the following four income tax brackets and rates:

Taxable Income	Rate
Up to $10,000	4%
$10,001 to $40,000	6%
$40,001 to $350,000	8.5%
$350,001 and above	8.95%

The top rate of 8.95% is repealed beginning in tax year 2016.

Proposed Change
Under the new system, there are two separate bracket systems.

Married-Joint, Qualifying Widower, Head of Household

Taxable Income	Rate
Up to $10,000	4%
$10,001 to $40,000	*6%*
$40,001 to $80,000	***6.5%***
$80,001 to $350,000	**8.5%**
$350,001 and above	8.95%

Single; Married filing separate

Taxable Income	Rate
Up to $10,000	4%
$10,001 to $40,000	*6%*
$40,001 to $60,000	***6.5%***
$60,001 to $200,000	***8.5%***
$200,001 and above	***8.95%***

Both Option A and B would extend the 8.95% rate permanently.

Standard deduction and personal exemption

Current Law
The standard deduction in D.C. is $4,100 for all taxpayers except those filing as married filing separately ($2,050). The personal exemption in D.C. is $1,675 for those filing as single and married filing separately, and $3,350 for those filing as married (joint) and head of household. The federal standard deduction is $6,100 for single/married-separate filers and $12,200 for married-joint/qualifying widower/head of household filers. The federal personal exemption is $3,900 per person for all taxpayers.

Proposed Change
Increase D.C.'s standard deduction and personal exemption to the federal levels.

Itemized deduction and personal exemption phase out

Current Law
D.C. phases out itemized deductions of higher-income taxpayers (starting at $200,000). Specifically, a taxpayer who earns more than $200,000 in adjusted gross income (AGI) must reduce her itemized deductions by 5% of every dollar she earns over $200,000. (Note: The income level is $100,000 for married taxpayers filing separately.) For example, if a taxpayer has $350,000 in AGI she loses $7,500 of her itemized deductions. The federal government also phases out itemized deductions, beginning at $300,000 for joint filers, $275,000 for head of household, $250,000 for individuals and $150,000 in the case of a married individual filing a separate return. The federal limitation is 3% of income above the threshold. The taxpayer above would lose an additional $1,500 of itemized deduction. The federal limit cannot reduce taxpayer's total deductions by more than 80%. There is no floor on the D.C. phase out.

The D.C. personal exemption is not phased out. The federal personal exemption is phased out for taxpayers with adjusted gross income (AGI) exceeding $250,000 for single filers and $300,000 for married filers. The exemption is reduced by 2% for each $2,500 in excess of the threshold. For example, married filers with $325,000 of AGI lose 20% of their personal exemption. The personal exemption is completely phased out at $372,500 AGI for single filers and $422,500 for married filers.

Proposed Change

Please note: Below is the only difference between Option A and Option B.

Option A
- Keep the current D.C. limitation on itemized deductions.
- Adopt a personal exemption phase out the follows the federal phase out (starting at $250,000) for singles and $300,000 for married filers.

Option B
- Have the D.C. limitation on itemized deductions reduce deductions by 7.5% (instead of 5%) for every dollar above the current thresholds.
- Adopt a personal exemption phase out that begins at $150,000 and reduces the exemption by 5% for every $2,500 in excess of the threshold.

EITC

Current Law
The D.C. earned income tax credit (EITC) is 40% of the federal credit. The size of the federal EITC is dictated by income, marital status and children. The benefit for taxpayers with children is significantly larger than the benefit for childless taxpayers. Currently the maximum federal EITC for childless workers is $487, with benefits phasing out at 100% at federal poverty level (FPL) and being completely eliminated at 150% of FPL. Please see Policy Option Memos No. 11 and No. 12 for more details.

Proposed Change
Increase the EITC for D.C. childless workers to 100% of the federal credit. Additionally, increase eligibility from phasing out beginning at 100% of FPL to beginning at 150% of FPL and ending at 200% of FPL. The intent is for this to be implemented as an add-on credit for the difference for childless taxpayers. This will leave the EITC unchanged for most recipients.

<u>Tax Credits</u>

Current Law
D.C. offers the following tax credits:

- D.C. employee first-time homebuyer credit (Policy Option Memo 19)
- Deduction for long-term care insurance (Policy Option Memo 20)
- Deduction for D.C./federal government retiree pensions (Policy Option Memo 21)

Proposed Change
Eliminate all three of these tax expenditures.

Revenue Impact

The Office of Revenue Analysis estimates that in the first year of implementation …

- Option A loses $126,875,322 in tax revenue in 2015.
- Option B loses $101,424,995 in tax revenue in 2015.
- Extending the 8.95% rate increases revenue by $23.25 million (75% x $31 million) in 2016 and $31 million in 2017 and beyond.
- Introducing a dual set of rates rather than a single bracket structure saves about $8 million.