Taxing Simply

District of Columbia Tax Revision Commission

Taxing Fairly

Full Report

District of Columbia Tax Revision Commission
1755 Massachusetts Avenue, NW, Suite 550
Washington, DC 20036
Tel: (202) 518-7275
Fax: (202) 466-7967
www.dctrc.org

The Author

Michael Ettlinger
Tax Policy Director
Institute on Taxation and Economic Policy
Washington, D.C.

APPENDIX II-B

A Distributional Analysis of the District of Columbia Tax System

Michael Ettlinger

At the request of the D.C. Tax Revision Commission, the Institute on Taxation and Economic Policy (ITEP) undertook a distributional analysis of the District tax system using the ITEP Microsimulation Tax Model.[1]

Overall distribution of current District taxes

The District, like most states, relies on a mixture of property, consumption, and income taxes. The impact of all of these taxes on the residents of the District is reflected in the tables that follow.

In general, the District's overall tax system can be characterized as "flat" or "modestly regressive." Although the best-off 1 percent of residents pays less District tax as a share of income than any other income group, the difference in the effective tax rate on the highest earners and on other families in the District is not as substantial as it is in most states. Across the rest of the income spectrum, there is no clear-cut correlation between income level and tax burden.

This lack of an overall pattern is actually the result of several distinct patterns in particular taxes overlaying each other. The District's consumption taxes are clearly regressive, taking more as a share of income from lower- and middle-income families than from the well-off. On the other hand, the personal income tax is somewhat progressive.

The District's property tax burden by income level is, of itself, the result of the interaction of several different phenomena. Underlying the distribution of property taxes paid by families (including individuals) is the distribution of property values. Although residential values rise with income, they tend not to be as high relative to income at the top of the income spectrum. At lower income levels, however, property values tend to be quite high compared to income. Thus, the underlying distribution of residential property taxes usually is regressive.

The District, however, has several provisions to counteract this underlying pattern. First is the District's $30,000 homestead exemption. This provision is of much greater proportional value to those with lower-value homes than those with higher-value homes. In addition, the District has two "circuit breaker" programs that provide relief from the property tax burden for those with lower incomes. At different income levels, different elements of the underlying property value distribution and the impact of these property tax relief provisions have different impacts.

When the patterns of the income, consumption, and property taxes are summed, the "bumpy" overall distribution emerges (Summary Report, Figure 13).

Distributional tables

This analysis consists of four distributional tables. These tables show taxes as a percent of income for different income groups. Figure II-h is a distribution for all resident taxpayers in the District. This table is divided by income quintiles. Each quintile represents 20 percent of the population, ordered by income. The top quintile is split into subgroups so that differences between upper-middle income and wealthy taxpayers can be observed.

Figures II-i, II-j, and II-k show incidence for subgroups of the District's population. These groups are the nonelderly married, the nonelderly unmarried, and the elderly. These tables are structured around commonly used income breakpoints instead of the quintiles. The percentage of the group in each income category is shown in the first line of these tables. Note that the nonelderly married table has income breakpoints that are double those of the tables for the nonelderly unmarried and the elderly. This is to capture better the income range seen in the distribution of married couples. Also, to some extent, it is meant to reflect that a given dollar income amount means something very different for a married couple and a single person.

To a large degree, the distributions of taxes for the subgroups shown differ from each other for reasons of homeownership patterns, targeted tax breaks for the elderly, and different income levels for different subgroups.

Married nonelderly

Married nonelderly couples generally show the highest tax level. This reflects several characteristics of the group. First, incomes are significantly higher in this group than in the others. Thus, this group pays more in the progressive income tax. Also, married couples who are not able to split their incomes most advantageously on their District tax returns may pay more income tax than their single counterparts.

These married couples also pay more in property tax. This reflects greater homeownership in the group and more valuable homes that benefit less from the homestead exemption.

Consumption taxes are slightly lower for the nonelderly married than for the nonelderly unmarried. This reflects two offsetting phenomena. First, the married group is analyzed at higher incomes so these regressive taxes are less as a share of income. On the other hand, consumption is higher when there are two adults than when there is one.

Consumption taxes for the nonelderly married are higher than for the elderly. This reflects the somewhat lower consumption patterns of the elderly.

Overall, the nonelderly married show a more consistently regressive pattern than do the other groups. To a significant degree, this reflects their higher incomes. In the overall distribution discussed above, the tax system is more consistently regressive at incomes above $40,000. Eighty-four percent of nonelderly married couples have incomes greater than $30,000, and 60 percent have incomes of more than $60,000. The income breakpoints were chosen to reflect the relative wealth of this group. Thus, it isn't surprising that the distribution would appear regressive for this group.

Unmarried nonelderly

The unmarried nonelderly pay relatively low property taxes. This reflects low levels of homeownership, lower-value homes, and benefits of income-based tax relief provisions.

This group pays income taxes in a pattern similar to that of married couples. At lower incomes, the burden is lower — possibly reflecting an inability of married couples to split their income to take maximum advantage of the District's rate structure. This also may reflect more untaxed income among the unmarried.

Elderly

The elderly show lower levels of tax than do the nonelderly. This reflects several aspects of District tax law.

First, the low-income elderly receive more generous property tax circuit breaker relief than do the nonelderly. In addition, a significant portion of elderly income is not subject to the personal income tax. This income includes social security income, a significant portion of pension income, and tax-exempt interest. In addition, consumption as a share of income tends to be lower for the elderly, reducing their consumption tax burden.

Business taxes and "exporting"

Included in these distributional tables are business taxes. Business taxes are ultimately borne by individuals — in the form of higher prices for purchased goods, lower returns on investments, or lower wages. One important additional note is that a great deal of business taxes are, effectively, exported out of state. Taxes paid by nonresident owners of District businesses are not reflected in the distributional tables presented here. These tables show only District taxes paid by its citizens.

Business taxes are, for the most part, shown on separate lines in the tables. Business income reported on the personal income tax is, however, included in the single personal income tax line. Also, half of rental residential property tax is included in the "Property taxes on families" line. This is consistent with our incident assumption that half of rental residential property tax is borne by renters. The District's circuit breaker property tax relief also is included, as an offset, in this line.

Comparisons with states

Although a comprehensive comparison with other states is beyond the scope of this analysis, previous work by ITEP provides some insight. An analysis of 1995 taxes in all 50 states and the District showed that the District has a less regressive tax system than is typical nationally. This study of the nonelderly married found that, nationally, the burden on the lowest quintile was, on average, about 1.6 times greater than on the wealthiest 1 percent of the study population. Middle-income taxpayers were found to pay 1.2 times as much. In the District, the study found that both the middle- and lowest-income quintiles paid 1.1 times as much as the best-off 1 percent.[2]

Distributional analysis of the D.C. Tax Revision Commission proposals

The D.C. Tax Revision Commission's recommendations for overhauling the District's tax system include a complete overhaul of the District's system of business taxation — replacing the District's four existing business taxes with a single business activities tax — and important changes in the personal income and property taxes. The overall effect of these reforms is to increase the progressivity of the District's tax system (Summary Report, Figure 25). This increase in progressivity is primarily driven by changes in the personal income and property taxes. The introduction of the business activities tax, examined in isolation, has a mildly regressive effect on the District's tax system.

Personal income tax

The Commission's recommendations for changing the District's personal income tax simplify the tax system by linking to the federal system, which has the effect of increasing the exemption and standard deduction amounts. This lowers taxes for middle- and lower-income District residents.

The net effect of the proposed changes in the personal income tax, including changes in the tax rates, is a tax cut for the poorest 60 percent of District residents. The next-richest 20 percent of District residents are, on average, unaffected by the proposal, while the richest 20 percent of District residents see a small tax increase of 0.2 percent of income.

Business activities tax

The centerpiece of the Commission's business tax proposal is the business activities tax, which would replace existing corporate and business taxes. The business activities tax would be levied upon every business enterprise in the District at a rate of 1.5 percent of its "business activity tax base." The tax base includes three components: wages and salaries, interest paid for the use of money or property, and dividends paid.

ITEP's analysis of the business activities tax shows its incidence to be almost flat. That is, the business activities tax takes a similar percentage of income — around 0.4 percent of income — from each income group. This is because a portion of the business activities tax will be passed through to District taxpayers. Since the taxes replaced by the business activities tax are progressive, however, the net effect of the switch to the business activities tax is slightly regressive.

Residential property tax

The Commission's recommendations for the residential property tax include consolidating the different rates on owner- and renter-occupied housing into a single rate and replacing the four existing property tax relief measures with one targeted circuit breaker. The net effect of these changes is quite progressive. In particular, the Commission's proposal almost entirely eliminates the residential property tax burden on the poorest 20 percent of District residents and provides a cut in property taxes, on average, for all but the wealthiest 20 percent of District residents.

Business property tax

The Commission's recommendation for reforming the District's business property tax is broadly similar to those for the residential tax: consolidating multiple rates into a single, lower rate. Because only part of the burden of this tax is passed on to District residents, the effect of this tax burden change is very small. Most income groups see a drop in tax burden of around 0.1 percent of income.

Summary

Looking at all District taxpayers, the net effect of the Commission's provisions discussed above is progressive. The poorest 60 percent of District residents — those earning less than $38,000 per year — receive a net tax cut from the Commission's plan. The tax cut is greatest as a share of income for the 20 percent of District taxpayers who earn less than $16,000 annually; average taxes drop from 10.8 percent to 8.9 percent of income. The most important factors in this tax cut for those receiving a cut are the increased personal exemption and standard deduction amounts in the personal income tax and the cuts in the residential property tax. The fourth 20 percent of taxpayers — those earning between $38,000 and $61,000 — see, on average, a slight tax increase of 0.1 percent of income.

The effect of the Commission's proposal on the tax burden of the wealthiest 20 percent of District residents is mixed. While the top 1 percent finds their tax burden effectively unchanged, the next-highest 19 percent see a moderate tax increase of between 0.5 and 0.7 percent of income.

The subgroup of the District's population receiving the greatest tax cut from the Commission's plan is married nonelderly taxpayers. Married nonelderly taxpayers earning less than $30,000 see an average tax cut of more than 3.5 percent of their income due to the Commission's plan. Only the poorest 40 percent of these taxpayers, however, see a net tax cut from these reforms, whereas the poorest 60 percent of *all* taxpayers receive a net tax cut under the proposals. This reflects the higher income levels of married nonelderly taxpayers.

Conversely, more than 80 percent of single nonelderly taxpayers receive a net tax cut from the Commission's proposal, reflecting the lower-than-average income earned by these taxpayers. Only the 16 percent of single nonelderly taxpayers earning more than $50,000 per year receive a tax increase under the Commission's plan.

Elderly taxpayers benefit the least from the Commission's plan. In particular, only the 12 percent of elderly taxpayers earning less than $15,000 see an overall tax cut from the plan. All other income groups receive, on average, a net tax increase of between 0.7 percent and 1.6 percent of income. This increase is driven almost entirely by two factors: the elimination of the elderly property tax circuit breaker and the elimination of the exemptions for Social Security and some pension income. Because the existing tax burden on elderly District residents is low compared to that of the nonelderly population under current law, however, these changes still leave elderly District residents with a tax burden that is lower than the overall District average at most income levels.

Endnotes

[1] A detailed description of the Microsimulation Tax Model is available from the Institute on Taxation and Economic Policy.

[2] Ettlinger, Michael, et. al., *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*. Citizens for Tax Justice, 1996.

Figure II-h

Current Law and Changes Recommended by the D.C. Tax Revision Commission as Shares of 1998 Family Income for All Taxpayers

Income group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%: Next 15%	Top 20%: Next 4%	Top 20%: Top 1%
Average income in group	**$9,800**	**$22,100**	**$31,700**	**$48,300**	**$89,300**	**$232,000**	**$965,000**
Income range	**Less than $16,000**	**$16,000–$27,000**	**$27,000–$38,000**	**$38,000–$61,000**	**$61,000–$147,000**	**$147,000–$415,000**	**Over $415,00**
CURRENT LAW							
Sales, excise, and gross receipts taxes	**6.5%**	**5.4%**	**4.3%**	**3.5%**	**2.6%**	**1.8%**	**1.0%**
General sales tax, individuals	2.1	1.9	1.6	1.4	1.1	0.8	0.4
Excise and gross receipts taxes, individuals	2.1	1.6	1.3	0.9	0.7	0.5	0.2
Sales, excise, and gross receipts taxes, businesses	2.3	1.9	1.5	1.2	0.8	0.6	0.3
Property taxes	**1.9**	**2.5**	**2.1**	**1.8**	**1.9**	**2.1**	**1.7**
Property taxes on families	1.3	2.0	1.6	1.3	1.5	1.5	0.8
Property taxes on businesses	0.7	0.5	0.5	0.4	0.4	0.6	0.9
Income taxes	**2.4**	**3.8**	**4.3**	**5.9**	**6.3**	**6.3**	**6.6**
Personal income tax	2.4	3.8	4.2	5.9	6.3	6.2	6.4
Corporate income tax	0.0	0.0	0.0	0.0	0.1	0.1	0.2
Current total taxes	**10.8%**	**11.7%**	**10.7%**	**11.2%**	**10.8%**	**10.2%**	**9.3%**
CHANGES RECOMMENDED BY COMMISSION							
Property taxes on families	-1.2%	-0.8%	-0.6%	-0.1%	+0.2%	+0.2%	+0.1%
Business property taxes	-0.2	-0.1	-0.1	-0.1	-0.1	-0.2	-0.3
Personal income tax	-1.0	-0.6	-0.2	0.0	+0.2	+0.2	+0.2
Business activities tax (new)	+0.4	+0.4	+0.4	+0.4	+0.5	+0.4	+0.3
Tax change recommended	**-1.9%**	**-1.1%**	**-0.6%**	**+0.1%**	**+0.7%**	**+0.5%**	**0.0%**
Recommended total taxes	**8.9%**	**10.6%**	**10.1%**	**11.3%**	**11.5%**	**10.7%**	**9.4%**

Note: Totals may not add due to rounding.

Figure II-i

Current Law and Changes Recommended by the D.C. Tax Revision Commission as Shares of 1998 Family Income for Married Nonelderly Taxpayers

Income range	Less than $30,000	$30,000–$60,000	$60,000–$100,000	$100,000–$150,000	$150,000–$200,000	Over $200,000
% of couples in group	**16.4%**	**23.1%**	**25.7%**	**15.2%**	**6.8%**	**12.5%**
Average income in group	**$19,000**	**$47,100**	**$77,500**	**$123,100**	**$174,200**	**$608,000**
CURRENT LAW						
Sales, excise, and gross receipts taxes	**6.4%**	**5.2%**	**3.8%**	**2.4%**	**2.1%**	**1.2%**
General sales tax, individuals	2.1	2.0	1.5	1.0	0.9	0.5
Excise and gross receipts taxes, individuals	2.0	1.4	1.0	0.6	0.6	0.3
Sales, excise, and gross receipts taxes, businesses	2.3	1.7	1.2	0.7	0.6	0.4
Property taxes	**3.6**	**2.6**	**1.8**	**2.4**	**1.9**	**1.7**
Property taxes on families	3.0	2.0	1.5	2.0	1.7	1.0
Property taxes on businesses	0.5	0.6	0.3	0.4	0.3	0.7
Income taxes	**3.2**	**5.0**	**5.8**	**6.2**	**6.5**	**6.8**
Personal income tax	3.2	5.0	5.8	6.2	6.4	6.6
Corporate income tax	0.0	0.0	0.0	0.0	0.0	0.2
Current total taxes	**13.2%**	**12.7%**	**11.4%**	**11.0%**	**10.5%**	**9.7%**
CHANGES RECOMMENDED BY COMMISSION						
Property taxes on families	-2.0%	-0.5%	+0.1%	+0.3%	+0.1%	+0.0%
Business property taxes	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2
Personal income tax	-1.8	-0.2	-0.1	-0.1	-0.1	-0.1
Business activities tax (new)	+0.5	+0.5	+0.5	+0.5	+0.6	+0.3
Tax change recommended	**-3.5%**	**-0.4%**	**+0.4%**	**+0.8%**	**+0.7%**	**+0.2%**
Recommended total taxes	**9.7%**	**12.4%**	**11.8%**	**11.7%**	**11.2%**	**9.8%**

Note: Totals may not add due to rounding.

Figure II-j

Current Law and Changes Recommended by the D.C. Tax Revision Commission as Shares of 1998 Income for Unmarried Nonelderly Taxpayers

Income range	Less than $15,000	$15,000–$30,000	$30,000–$50,000	$50,000–$75,000	$75,000–$100,000	Over $100,000
% of taxpayers in group	**22.7%**	**33.7%**	**26.7%**	**9.1%**	**3.9%**	**3.2%**
Average income in group	**$9,400**	**$23,500**	**$40,100**	**$62,100**	**$88,200**	**$237,000**
CURRENT LAW						
Sales, excise, and gross receipts taxes	**6.8%**	**5.3%**	**3.7%**	**2.9%**	**2.3%**	**1.4%**
General sales tax, individuals	2.1	1.9	1.4	1.2	1.0	0.6
Excise and gross receipts taxes, individuals	2.2	1.5	1.1	0.7	0.5	0.3
Sales, excise, and gross receipts taxes, businesses	2.4	1.8	1.2	0.9	0.7	0.4
Property taxes	**1.6**	**2.0**	**1.8**	**1.4**	**1.6**	**1.7**
Property taxes on families	1.0	1.5	1.4	1.1	1.1	1.1
Property taxes on businesses	0.6	0.5	0.4	0.3	0.5	0.6
Income taxes	**2.4**	**4.7**	**5.8**	**6.3**	**7.3**	**6.7**
Personal income tax	2.4	4.7	5.8	6.3	7.2	6.6
Corporate income tax	0.0	0.0	0.0	0.0	0.1	0.2
Current total taxes	**10.8%**	**11.9%**	**11.3%**	**10.6%**	**11.1%**	**9.9%**
CHANGES RECOMMENDED BY COMMISSION						
Property taxes on families	-0.9%	-1.2%	-0.5%	-0.1%	-0.2%	-0.1%
Business property taxes	-0.1	-0.1	-0.1	+0.0	-0.2	-0.1
Personal income tax	-1.1	-0.6	-0.3	-0.1	+0.0	+0.1
Business activities tax (new)	+0.4	+0.5	+0.5	+0.5	+0.5	+0.4
Tax change recommended	**-1.7%**	**-1.5%**	**-0.4%**	**+0.1%**	**+0.5%**	**+0.3%**
Recommended total taxes	**9.0%**	**10.5%**	**10.9%**	**10.8%**	**11.6%**	**10.2%**

Note: Totals may not add due to rounding.

Figure II-k

Current Law and Changes Recommended by the D.C. Tax Revision Commission as Shares of 1998 Family Income for Elderly Taxpayers

Income range	**Less than $15,000**	**$15,000–$30,000**	**$30,000–$50,000**	**$50,000–$100,000**	**Over $100,000**
% of taxpayers in group	**12.2%**	**27.9%**	**33.5%**	**12.2%**	**13.9%**
Average income in group	**$9,100**	**$24,600**	**$39,500**	**$68,400**	**$212,000**
CURRENT LAW					
Sales, excise, and gross receipts taxes	**6.2%**	**3.9%**	**3.3%**	**2.7%**	**1.3%**
General sales tax, individuals	2.3	1.4	1.2	1.0	0.6
Excise and gross receipts taxes, individuals	1.7	1.0	1.0	0.8	0.3
Sales, excise, and gross receipts taxes, businesses	2.3	1.5	1.1	0.8	0.4
Property taxes	**2.1**	**3.2**	**2.6**	**2.1**	**2.6**
Property taxes on families	0.7	2.6	1.9	1.2	1.4
Property taxes on businesses	1.4	0.6	0.7	0.9	1.2
Income taxes	**1.4**	**1.5**	**3.1**	**5.5**	**5.1**
Personal income tax	1.2	1.3	3.0	5.3	4.9
Corporate income tax	0.2	0.1	0.1	0.2	0.3
Current total taxes	**9.4%**	**9.5%**	**10.6%**	**10.3%**	**9.8%**
CHANGES RECOMMENDED BY COMMISSION					
Property taxes on families	+0.6%	+0.6%	+1.0%	+0.8	+0.2%
Business property taxes	-0.4	-0.2	-0.2	-0.2	-0.3
Personal income tax	-0.5	-0.6	+0.8	+0.9	+0.8
Business activities tax (new)	+0.1	+0.1	+0.1	+0.2	+0.3
Tax change recommended	**-0.4%**	**+0.9%**	**+1.6%**	**+0.0%**	**+0.7%**
Recommended total taxes	**9.7%**	**8.6%**	**9.0%**	**10.3%**	**9.1%**

Note: Totals may not add due to rounding.