

Government of the
District of Columbia



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District of Columbia Tax Expenditure Report

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District of Columbia Tax Expenditure Report

Table of Contents

ACKNOWLEDGEMENTS II

INTRODUCTION.....III

SUMMARY DATA ON DISTRICT OF COLUMBIA TAX EXPENDITURES.... XII

I. FEDERAL CONFORMITY TAX EXPENDITURES..... XIII

II. LOCAL TAX EXPENDITURES.....XX

III. LOCAL INDIVIDUAL TAX EXPENDITURES XXX

PART I: FEDERAL CONFORMITY TAX EXPENDITURES..... 35

INCOME TAX 36

EXCLUSIONS..... 36

ADJUSTMENTS..... 148

DEDUCTIONS..... 159

SPECIAL RULES..... 197

PART II: LOCAL TAX EXPENDITURES..... 208

INCOME TAX.....209

REAL PROPERTY TAX.....267

DEED RECORDATION AND TRANSFER TAX.....308

SALES TAX.....326

INSURANCE PREMIUMS TAX.....347

PERSONAL PROPERTY TAX.....350

UNUSED LOCAL TAX EXPENDITURES (NO ONE IS TAKING THEM)363

UNUSED LOCAL TAX EXPENDITURES (UNKNOWN IF USED)359

UNUSED LOCAL TAX EXPENDITURES (IMPLEMENTING REGULATIONS NOT YET WRITTEN)...375

District of Columbia Tax Expenditure Report

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Jeffrey S. DeWitt
Chief Financial Officer

District of Columbia Tax Expenditure Report

Introduction

D.C. Law 13-161, the “Tax Expenditure Budget Review Act of 2000,”¹ requires the Chief Financial Officer to prepare a biennial tax expenditure budget that estimates the revenue loss to the District government resulting from tax expenditures during the current fiscal year and the next two fiscal years. The law defines “tax expenditures” as “the revenue losses attributable to provisions of federal law and the laws of the District of Columbia that allow, in whole or in part, a special exclusion, exemption, or deduction from taxes ... or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”²

The Chief Financial Officer prepared the first required tax expenditure budget as part of the proposed fiscal year 2003 budget. This report, which estimates the revenue forgone due to tax expenditures in fiscal years 2016 through 2019,³ covers more than 200 separate tax expenditure provisions. Several tax expenditures were also removed since the previous tax expenditure report, because they are no longer applicable. Additionally, this tax expenditure budget expands on the summary data of the District’s tax expenditures in prior versions to include a section on individual tax provisions, which are granted to specific firms, and organizations. Presenting these individual tax provisions, in addition to the categorical tax provisions reported in the past, provides a more comprehensive view of the District’s tax system.

Understanding Tax Expenditures

Tax expenditures are often described as “spending by another name,” or “disguised spending.” Policymakers use tax abatements, credits, deductions, deferrals, and exclusions to promote a wide range of policy goals in education, human services, public safety, economic development, environmental protection, and other areas. Instead of pursuing these objectives through direct spending, policymakers reduce the tax liability associated with certain actions (such as hiring new employees) or conditions (such as being blind or elderly) so that individuals or businesses can keep and spend the money, often for particular purposes. Unlike tax expenditures, direct spending programs usually receive an annual appropriation and the proposed funding levels are reviewed during the annual budget cycle while tax expenditures remain in place unless policymakers act to modify or repeal them; in this respect, they are similar to entitlement programs. Also, direct spending programs are itemized on the expenditure side of the budget, whereas revenues are shown in the budget as aggregate receipts without an itemization of tax expenditures. For example, a program to expand access to higher education could offer tax deductions for college

¹ D.C. Law 13-161 took effect on October 4, 2000, and is codified in § 47-318 and § 47-318.01 of the D.C. Official Code.

² See D.C. Official Code § 47-318(6).

³ Although the law requires that the tax expenditure budget estimate the revenue loss for the current fiscal year and the next two fiscal years, this report covers the current year and the following *three* fiscal years to be consistent with the District’s four-year financial plan and budget. The four-year time frame for the District’s financial plan and budget is mandated by Public Law 104-8, the “District of Columbia Financial Responsibility and Management Assistance Act of 1995.” See D.C. Official Code § 47-392.01(b).

savings instead of increasing student loans or grants. Regardless of which approach the government uses, there is a real resource cost in terms of forgone revenue or direct expenditures.

There are two types of tax expenditures: (1) federal conformity tax expenditures, which apply U.S. Internal Revenue Code provisions to the D.C. personal and corporate income taxes, and (2) local tax expenditures authorized only by D.C. law. By conforming to the federal definition of adjusted gross income (with several exceptions), the District adopts most of the exclusions and deductions from income that are part of the federal personal and corporate income tax systems. Most other states with an income tax use federal adjusted gross income as the basis for their income tax.

An example of the federal conformity tax expenditure is the home mortgage interest deduction: the District follows the federal practice of allowing taxpayers to deduct home mortgage interest payments. In addition to the 106 federal conformity provisions covered in this report,⁴ there are 165 tax expenditures established by local law. An example of a local tax expenditure is the homestead deduction, which allows all D.C. taxpayers who live in their own home to deduct a certain amount (\$71,700 at the time of this writing) from the taxable value of the home. Both federal conformity and local tax expenditures warrant regular scrutiny to make sure they are effective, efficient, and equitable, and to highlight the tradeoffs between tax expenditures and other programs.

Since the previous tax expenditure budget was published in 2014, policymakers have established six new local tax expenditures. These involve: (1) interior renovation tax rebate for qualified high technology companies (2) urban farming and food security, (3) alternative fuel vehicle conversion and infrastructure credit, (4) deeds to property transferred to a named beneficiary of a revocable transfer on death, (5) exemption on security interest instrument, and (6) investment funds exemption from unincorporated business franchise tax. Since the previous report, two local tax expenditures have been removed as it is no longer possible for anyone to take the provisions, based on their terms. These are the job growth tax credit and the credit for qualified social electronic commerce companies. Policymakers also repealed three local tax expenditures: (1) the first-time homebuyer credit for D.C. government employees, (2) the subtraction for long-term care insurance premiums, and (3) the exclusion for D.C. and federal government pension income.

The tax expenditure budget aims to subject tax preferences to the same scrutiny as direct appropriations. The itemization of tax expenditures provides policymakers with a more complete picture of how the government uses its resources so they can consider how to allocate resources more effectively. For example, if ineffective or outmoded tax expenditures were eliminated, policymakers could free up resources to expand high-priority direct spending programs or cut tax rates. This exercise is designed to provide policymakers with the information they need about tax expenditures to make sound fiscal policy decisions.

Structure of the Report

This tax expenditure budget and accompanying report, prepared by the staff of the Office of Revenue Analysis (ORA), offers extensive background information on each tax expenditure in

⁴ A small number of federal conformity tax expenditures are not included in this report because they concern tax benefits for industries, such as agriculture and mining, which are non-existent or almost non-existent in the District of Columbia.

addition to estimates of the revenue forgone for fiscal years 2016 through 2019. The report provides (1) the statutory basis and year of enactment for each provision, (2) a description of the tax expenditure and how it is structured, (3) the purpose of the tax expenditure, and (4) a discussion of impacts.

The report begins with a summary table that provides an overview of the District's tax expenditures. The summary table classifies the tax expenditure according to the type of tax and provides the statutory authority, year of enactment, policy area, and estimated revenue loss for fiscal years 2016 through 2019.

The body of the report is organized into separate parts for federal conformity (Part I) and local tax expenditures (Part II). The local tax expenditure section includes sub-sections for each of the District's major taxes: personal and business income taxes, real property tax, deed recordation and transfer tax, sales tax, insurance premiums tax, personal property tax, local tax expenditures (unknown if used), unused local tax expenditures (no one is taking them), and unused local tax expenditures (implementing regulations not yet written). Additionally, this report adds three new categories to the end of the Summary Table: (1) local tax expenditures whose usage is unknown, (2) local tax expenditures that have not been used, and (3) individual tax expenditures. These new categories are briefly explained below.

Local tax expenditures whose usage is unknown: There are some local tax expenditures in the District's tax code for which it is difficult to determine whether or not they are being used. One of the reasons the usage of some local provisions is unknown is due to a lack of information on the tax provision. An example of a local tax expenditure whose usage is unknown is the employer-assisted home purchase tax credit where questions pertaining to the tax credit are not captured on the business income tax form; instead, the credit is combined with other tax credits into a single line on the tax form. It is therefore difficult to determine whether or not companies claim the employer-assisted home purchase tax credit when completing the tax forms.

Local tax expenditures that have not been used: For several of the local tax expenditures, we know they are not being used in the District because the regulations needed to implement the tax expenditures have not been written by the agency assigned to administer them. In other cases, tax provisions in the District have not been used, and it is unclear why no one is taking advantage of the tax provisions.⁵

Individual tax expenditures: Individual tax expenditures are those for which the recipient of the tax preference is specified by name in the authorizing legislation. The recipient of an individual tax provision is granted the tax benefit based on specific circumstances. This is in comparison to categorical tax expenditures, which may be taken by anyone who is eligible for them. The list of individual tax expenditures represents those that have been identified in the OCFO's Housing Tax Expenditure Review, and Annual Unified Economic Development Report. Of the 38 individual tax expenditures that have been identified thus far, 32 are housing-related. ORA will continue to update this listing as individual tax provisions are identified through our comprehensive review of the District's tax expenditures as mandated by D.C. Law 20-155.

⁵ Tax expenditure estimates of \$0 under the Deed Recordation and Transfer Tax are not moved to these categories, as the estimates for these provisions will depend on whether property in each category is sold and transferred in the study period.

Each categorical tax expenditure is described in detail, including benefit levels (the amount of abatements, credits, deductions, deferrals, exclusions, and exemptions) and eligibility criteria.

The different types of tax expenditures are as follows:

- exclusions, which are items that are not considered part of a taxpayer's gross income for tax purposes, even though they increase his or her resources or wealth. Exclusions do not have to be reported on a tax return but still cause adjusted gross income to be lower than it otherwise would be. Employer contributions to health and retirement plans are examples.
- exemptions, which are per-person reductions in taxable income that taxpayers can claim because of their status or circumstances (such as being a senior citizen).
- adjustments, which are reductions in taxable income that are available to all tax filers who meet certain criteria, whether or not they itemize their deductions. Adjustments are also known as "above-the-line" deductions and are entered on the tax return.
- deductions, which are reductions to taxable income that must be itemized on the tax form. This option is not available to those who choose the standard deduction.
- subtractions, which are reductions from federal adjusted gross income that are used to derive District of Columbia adjusted gross income. Subtractions reflect income that is taxed by the federal government but not by the D.C. government.
- credits, which reduce tax liability directly instead of reducing the amount of income subject to taxation. Credits can be refundable (if the amount of the credit exceeds tax liability, the taxpayer gets the difference as a direct refund) or non-refundable (the amount of the credit cannot exceed tax liability).
- abatements, which are reductions in tax liability (typically real property tax liability) that are often applied on a percentage basis or through a negotiated process.
- deferrals, which delay the recognition of income to a future year or years. Because they shift the timing of tax payments, deferrals function like interest-free loans to the taxpayer.
- rebates, which are refunds provided to qualifying taxpayers as a separate payment (as contrasted with tax credits that are first applied as a reduction of tax liability).
- special rules, which is a category used for federal tax expenditures that involve blended tax rates or special accounting procedures and do not fit neatly into any other category.

Policy and Program Areas

Each tax expenditure is classified by one of 17 policy or program areas, such as education, health, social policy, and transportation. The policy areas, shown in the summary tables, largely mirror the categories used by the Joint Committee on Taxation (JCT) of the U.S. Congress in order to facilitate comparisons. Nevertheless, the categories were modified and expanded in several cases to make them more relevant to the District of Columbia. For example, the "business and

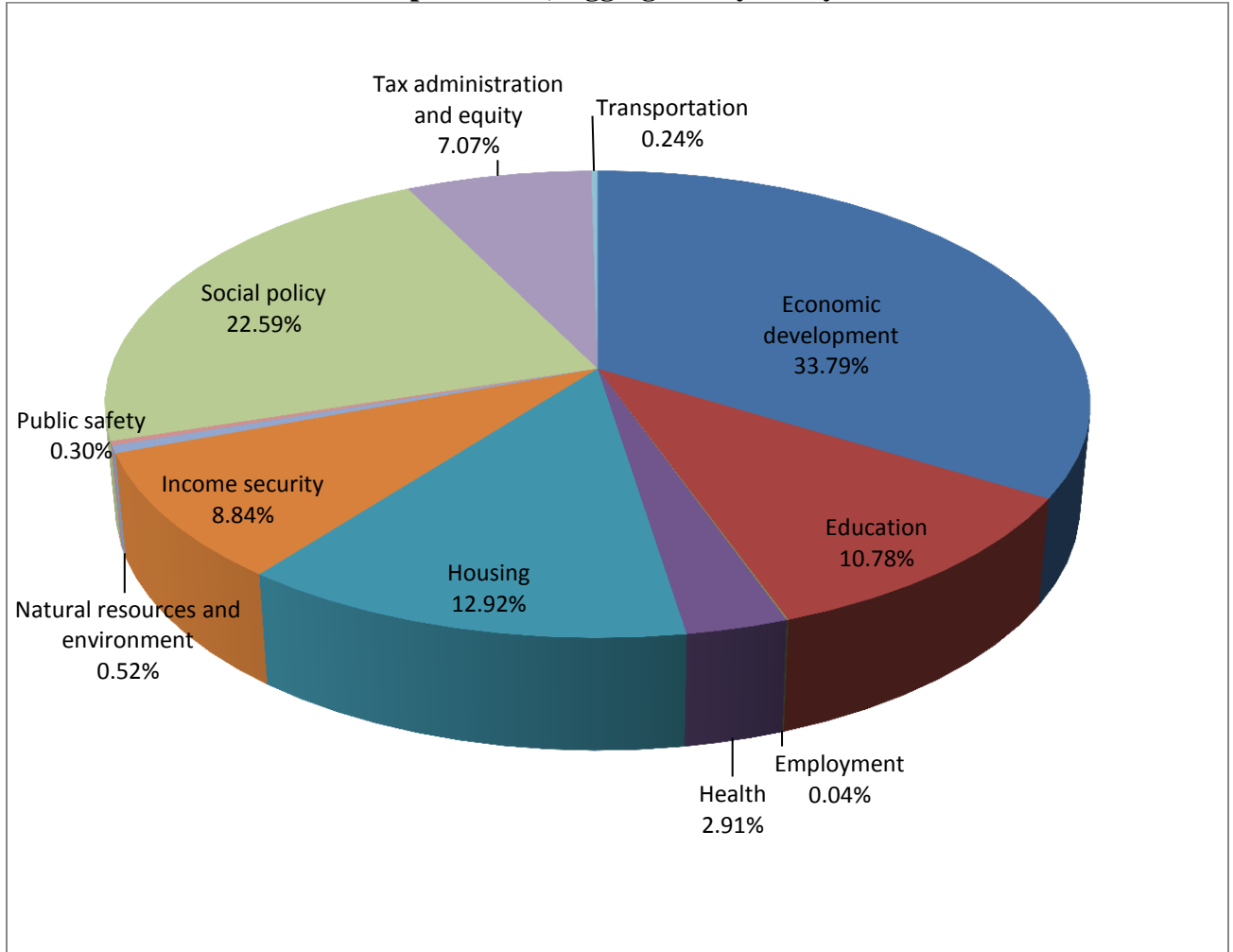
commerce” category used by the JCT was changed to “economic development” to reflect a policy focus of particular importance in the District, and a “public safety” category was added (there are no public safety tax expenditures at the federal level).

The four policy areas with the largest number of federal conformity provisions are economic development (27 tax expenditures), income security (15), education (10), and health (10). Nevertheless, the ordering of federal conformity tax expenditures by estimated revenue loss for each policy area (FY 2016) produces a different ranking. Income security provisions account for the largest estimated revenue loss due to the forgone revenue from employer-provided fringe benefits such as pension contributions, which are excluded from the employee’s taxable income (as are the earnings on those contributions). Health provisions rank second in revenue loss for federal conformity provisions, followed by housing and economic development. Many federal tax expenditures that are classified under economic development concern the definition or timing of different types of business income, expenses, reserves, and depreciation.

Assessing the District’s local tax expenditure provisions, the four policy areas with the largest number of categorical tax expenditures are housing (38 tax expenditures), economic development (25), social policy (14), and income security (14).⁶ Once again, the ordering of local tax expenditures by estimated revenue loss for each policy area produces a different ranking. The figure below presents total local District tax expenditures estimated revenue loss by policy area for fiscal year 2016. As the figure shows, tax preferences targeted to economic development make up the largest category of District spending through the tax code. This total includes the sales tax exemption for professional and personal services, as well as transportation and communications services, which together make up 90 percent of the total for economic development. Tax preferences for social policy, including sales and property tax exemptions for churches and nonprofit organizations, as well as the sales tax exemption for groceries, comprise the second largest aggregate amount of spending through the tax code by policy area.

⁶ The estimated revenue loss in these calculations is for FY 2016.

Table 1: Local FY 2016 Tax Expenditures, Aggregated by Policy Area



Source: ORA Analysis.

Note: Chart does not include tax expenditures that are not assigned to a policy area, such as the exemption of Federal and D.C. Government property from taxation. Further, summing tax expenditures does not take into account possible interactions among individual tax expenditures so it does not produce an exact estimate of the revenue that would be gained were any specific provision removed.

Important Caveats

While the pie chart of the aggregated local expenditures by policy area for FY 2016 above is given as an illustration of estimated revenue loss, a particular caution about the interpretation of the revenue loss estimates in this report deserves emphasis. The forgone revenue estimates are intended to measure what is being “spent” through the tax system, or alternatively, the amount of relief or subsidy provided through each provision. Nevertheless, the forgone revenue is *not* identical to the amount of revenue that could be gained by repealing the tax expenditure. There are three main reasons why:

- First, the estimates of revenue loss are “static” and therefore do not reflect behavioral changes that might occur if a tax expenditure were repealed. For example, if the District

eliminated the local supplement to the federal earned income tax credit, people might reduce their hours of work and their income tax payments could also drop.

- Second, the revenue loss for each tax expenditure is estimated independently, which does not account for interaction effects among different tax provisions. For example, D.C. law establishes that taxpayers may not claim both the local supplement to the earned income tax credit and the D.C. low-income credit. If the local earned income credit were abolished, more taxpayers might then claim the low-income credit.
- Third, the D.C. government may not be able to collect the full amount owed due to administrative reasons. For example, if the District disallowed for local income tax purposes an exemption or exclusion that is allowed on the federal income tax (a process known as “decoupling”), the District would probably not recoup all of the forgone revenue. That is because taxpayers would have to make a separate calculation on their District income taxes to add back the dollars that had been excluded, and compliance with this requirement would not be universal (nor would audits detect all violations).

Because of the factors described above, the total forgone revenue from tax expenditures is *not* equivalent to the sum of the individual estimates of forgone revenue. As the U.S. Government Accountability Office has stated:

While sufficiently reliable as a gauge of general magnitude, the sum of the individual revenue loss estimates has important limitations in that any interactions between tax expenditures will not be reflected in the sum ... Thus, the revenue loss from all or several tax expenditures together might be greater or less than the sum of the estimated revenue losses from the individual tax expenditures, and no measure of the size or the magnitude of these potential interactions or behavioral responses to all or several tax expenditures is available.⁷

Methodology

Summary statistics from D.C. tax returns were an important source of data for the tax expenditure budget and were particularly useful for estimating the forgone revenue from local income tax provisions. Unfortunately, in many instances tax expenditures cannot be estimated from available tax data because they involve income, property, or economic activity that is not taxed, and the relevant information is never reported to the Office of Tax and Revenue (OTR). Therefore, ORA often used data from federal agencies (such as the Census Bureau and the Bureau of Economic Analysis) and D.C. government agencies to estimate the number of beneficiaries and the revenue lost from certain tax expenditures.

OTR generally lacks information on federal conformity tax expenditures because the amounts excluded are not reported and the amounts deducted are subtracted from federal adjusted gross income, which is the starting point for a D.C. income tax return. Therefore, ORA’s federal conformity estimates represent a District of Columbia portion of the nationwide tax expenditure

⁷ U.S. Government Accountability Office, Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined (GAO-05-960, September 2005), p. 3.

estimates prepared by the JCT.⁸ ORA estimated the D.C. portion using two fractions: (1) a ratio representing the D.C. share of the relevant activity or population, such as D.C. taxable income divided by national taxable income, and (2) a ratio representing the D.C. average tax rate divided by the U.S. average tax rate.

Because of the methodological challenges and data issues, it is important to view the revenue estimates as indicating orders of magnitude rather than providing precise point estimates.

In addition, U.S. Internal Revenue Service rules provide that, “No statistical tabulation may be released outside the agency with cells containing data from fewer than three returns,” in order to protect the confidentiality of individual tax records.⁹ Tax expenditures with fewer than three claimants are therefore listed in this report as “no estimate,” except in the case of real property tax expenditures where different rules apply.¹⁰

Key Terms for Summary Tables

- too small: refers to a federal conformity tax expenditure with positive forgone revenue of less than \$50 million annually, according to the JCT. The revenue loss to the District from conforming to the federal policy would be very close to zero.
- \$0: refers to a federal conformity or local tax expenditure with forgone revenue that was actually \$0 or not applicable. The federal conformity tax expenditure estimates are shown separately for individuals and corporations. Some federal tax provisions apply only to either corporations or individuals. \$0 will therefore refer to the federal conformity tax expenditure estimate for which the federal tax provision is non-applicable.
- sunset: means that there will be no revenue loss because the provision has expired.
- minimal: refers to a local tax expenditure for which precise data are lacking, but the forgone revenue is estimated to be less than \$50,000 per year.
- no estimate: refers to a local tax expenditure for which precise data are lacking, but for which the revenue loss might not be minimal. In addition, “no estimate” refers to cases in which calculations cannot be made because of confidentiality rules.

⁸ In some cases, ORA used tax expenditure estimates from the U.S. Department of the Treasury and the Congressional Budget Office (CBO) when data from the Joint Committee on Taxation were not available.

⁹ U.S. Internal Revenue Service, Publication 1075, “Tax Information Security Guidelines for Federal, State, and Local Agencies and Entities” (January 2014), p. 116. Even if the taxpayers are not specifically identified, it might be possible for someone to figure out the confidential information from an estimate of revenue involving so few people or businesses.

¹⁰ D.C. Official Code § 47-1001 states that, “The Mayor shall publish, by class and by individual property, a listing of all real property exempt from the real property tax in the District. Such listing shall include the address, lot and square number, the name of the owner, the assessed value of the land and improvements of such property, and the amount of the tax exemption in the previous fiscal year.” IRS rules do not affect real property taxation because the federal government does not impose a real property tax.

Comments Welcomed

The Office of Revenue Analysis hopes that this report will contribute to a more informed discussion of budget and tax policy in the District of Columbia by providing clear and concise information both for policymakers and for the general public. ORA welcomes comments on the report and will use the feedback to improve future versions.

Summary Data on District of Columbia Tax Expenditures

I. Federal Conformity Tax Expenditures (Individual and Corporate Income Taxes)

#	Name of Tax Expenditure	Program Area	Year Enacted	Internal Revenue Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Federal Exclusions								
1	Capital gains on assets transferred at death	Economic development	1921	1001, 1014, 1023, 1040, 1221, and 1222	\$17,702	\$18,186	\$18,939	\$19,800
2	Capital gains on assets transferred as a gift	Economic development	1921	1015	\$2,725	\$2,993	\$3,282	\$3,242
3	Cash accounting, other than agriculture	Economic development	1916	446 and 448	\$2,272	\$2,272	\$2,375	\$2,375
4	Credit union income	Economic development	1937	501(c)(14) and 12 USC 1768	\$2,440	\$2,542	\$2,745	\$2,949
5	Distribution from redemption of stock to pay taxes imposed at death	Economic development	1950	303	too small	too small	too small	too small
6	Gain on like-kind exchanges	Economic development	1921	1031	\$17,513	\$17,927	\$18,440	\$19,164
7	Imputed interest	Economic development	1964	163(e), 483, 1274, and 1274A	\$387	\$452	\$452	\$452
8	Interest on small-issue qualified private-activity bonds	Economic development	1968	103, 141, 144, and 146	\$515	\$515	\$515	\$515
9	Magazine, paperback, and record returns	Economic development	1978	458	too small	too small	too small	too small
10	Small business stock gains	Economic development	1993	1202	\$905	\$905	\$996	\$996
11	Discharge of certain student loan debt	Education	1984	108(f), 20 USC 1087ee(a)(5) and 42 USC 2541-1(g)(3)	\$192	\$192	\$192	\$192
12	Earnings of Coverdell education savings accounts	Education	1998	530	\$96	\$96	\$96	\$96
13	Earnings of qualified tuition programs	Education	1997	529	\$865	\$1,154	\$1,346	\$1,442
14	Employer-provided education assistance	Education	1978	127	\$915	\$915	\$991	\$991
15	Employer-provided tuition reduction	Education	1984	117(d)	\$229	\$229	\$229	\$229
16	Interest on education savings bonds	Education	1988	135	too small	too small	too small	too small
17	Interest on state and local private-activity bonds issued to finance education facilities	Education	1968	103, 141, 142(k), 145, 146, and 501(c)(3)	\$4,641	\$4,895	\$5,156	\$5,410

#	Name of Tax Expenditure	Program Area	Year Enacted	Internal Revenue Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Federal Exclusions (cont.)								
18	Interest on state and local private-activity student loan bonds	Education	1965	103, 141, 144(b), and 146	\$776	\$776	\$903	\$903
19	Scholarship and fellowship income	Education	1954	117	\$2,788	\$2,884	\$3,076	\$3,269
20	Cafeteria plan benefits	Employment	1974	125	\$27,524	\$28,668	\$30,041	\$30,650
21	Employee awards	Employment	1986	74(c) and 274(j)	\$229	\$229	\$229	\$305
22	Employee stock ownership plans	Employment	1974	401(a)(28), 404(a)(9), 404(k), 415(c)(6), 1042, 4975(e)(7), 4978, and 4979A	\$1,283	\$1,363	\$1,363	\$1,444
23	Employer-paid meals and lodging (other than military)	Employment	1918	119 and 132(e)(2)	\$1,601	\$1,677	\$1,754	\$1,830
24	Housing allowance for ministers	Employment	1921	107 and 265	\$610	\$610	\$610	\$610
25	Miscellaneous fringe benefits	Employment	1984	117(d) and 132	\$5,871	\$5,947	\$6,100	\$6,252
26	Spread of acquisition of stock under incentive stock option plans and employee stock purchase plans	Employment	1981	422 and 423	(\$638)	(\$720)	(\$639)	(\$639)
27	Voluntary employees' beneficiary association income	Employment	1928	419, 419A, 501(a), 501(c)(9), and 4976	\$2,440	\$2,516	\$2,516	\$2,592
28	Interest on state and local private-activity bonds issued to support energy facilities	Energy	1980	103, 141, 142(f), and 146	too small	too small	too small	too small
29	Accrued interest on savings bonds	General fiscal assistance	1951	454(c)	\$839	\$839	\$839	\$839
30	Allocation of interest expenses attributable to tax-exempt bond interest by financial institutions (bonds interest for private nonprofit educational facilities)	General fiscal assistance	2009	141, 265(a), 265(b), and 291(e)	\$508	\$508	\$508	\$508
31	Interest on public-purpose state and local bonds	General fiscal assistance	1913	103, 141, and 146	\$31,412	\$32,291	\$34,548	\$35,513
32	Employer contributions for medical insurance premiums and medical care	Health	1918	105, 106, and 125	\$108,174	\$113,891	\$120,059	\$127,431
33	Interest on state and local private-activity bonds issued to support non-profit hospital construction	Health	1913	103, 141, 145(b), 145(c), 146, and 501(c)(3)	\$2,194	\$2,367	\$2,367	\$2,454

#	Name of Tax Expenditure	Program Area	Year Enacted	Internal Revenue Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Federal Exclusions (cont.)								
34	Medical care and TriCare medical insurance for military dependents, retirees, retiree dependents, and veterans	Health	1986	112 and 134	\$1,136	\$1,178	\$1,220	\$1,220
35	Medicare Part A -- hospital insurance benefits	Health	1970	N.A./administrative	\$15,306	\$16,059	\$17,063	\$17,899
36	Medicare Part B -- supplementary medical benefits	Health	1970	N.A./administrative	\$10,790	\$11,375	\$11,961	\$12,588
37	Medicare Part D -- prescription drug benefits	Health	2003	N.A./administrative	\$3,764	\$3,847	\$3,889	\$3,973
38	Capital gain on sale of principal residence	Housing	1997	121	\$34,683	\$36,596	\$38,510	\$40,662
39	Interest on state and local private-activity bonds issued to finance housing	Housing	1980	103, 141, 142, 143, and 146	\$1,143	\$1,229	\$1,316	\$1,316
40	Compensatory damages for physical injury or sickness	Income security	1918	104(a)(2) - 104(a)(5)	\$1,279	\$1,279	\$1,279	\$1,279
41	Disaster mitigation payments	Income security	2005	139	too small	too small	too small	too small
42	Employer contributions for premiums on accident and disability insurance	Income security	1954	105 and 106	\$3,159	\$3,310	\$3,460	\$3,611
43	Employer contributions for premiums on group-term life insurance	Income security	1920	79	\$2,407	\$2,482	\$2,482	\$2,558
44	Employer pension contributions and earnings plans	Income security	1921	401-407, 410-418E, and 457	\$112,386	\$129,763	\$152,481	\$171,212
45	Income of trusts to finance supplemental unemployment benefits	Income security	1960	501(17)(A)	\$15	\$23	\$30	\$30
46	Investment income on life insurance and annuity contracts	Income security	1913	72, 101, 7702, and 7702A	\$38,095	\$38,813	\$39,896	\$40,853
47	Public assistance cash benefits	Income security	1933	N.A./administrative	\$3,684	\$3,772	\$3,684	\$3,684
48	Traditional and Roth IRA earnings and distributions	Income security	1997	219, 408 and 408A	\$7,803	\$8,427	\$9,051	\$9,715
49	Social Security and Railroad Retirement benefits	Income security	1938	86	\$12,623	\$13,356	\$14,089	\$14,918
50	Survivor annuities paid to families of public safety officers	Income security	1997	101(h)	too small	too small	too small	too small

#	Name of Tax Expenditure	Program Area	Year Enacted	Internal Revenue Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Federal Exclusions (cont.)								
51	Workers' compensation benefits	Income security	1918	104(a)(1)	\$3,761	\$3,836	\$3,912	\$3,987
52	Active income of controlled foreign corporations	International commerce	1909	11, 882, and 951-964	\$107,509	\$112,544	\$116,592	\$121,627
53	Allowances for federal employees working abroad	International commerce	1943	912	\$7,854	\$8,211	\$8,211	\$8,568
54	Income earned abroad by U.S. citizens	International commerce	1926	911	\$5,855	\$6,294	\$6,660	\$7,026
55	Inventory property sales source rule exception	International commerce	1921	861, 862, 863, and 865	\$1,678	\$1,777	\$1,777	\$1,777
56	Benefits, allowances, and certain pay for armed forces personnel	National defense	1925	112 and 134	\$2,522	\$2,690	\$2,858	\$2,942
57	Combat pay	National defense	1918	112	\$588	\$630	\$672	\$672
58	Military disability benefits	National defense	1942	104(a)(4), 104(a)(5) and 104(b)	\$126	\$126	\$126	\$126
59	Contributions in aid of construction for water and sewer utilities	Natural resources and environment	1996	118(c) and 118(d)	too small	too small	too small	too small
60	Earnings of certain environmental settlement funds	Natural resources and environment	2005	468B	too small	too small	too small	too small
61	Energy conservation subsidies provided by public utilities	Natural resources and environment	1992	136	too small	too small	too small	too small
62	Interest on state and local private-activity bonds issued to finance water, sewer, and hazardous-waste facilities	Natural resources and environment	1968	103, 141, 142, and 146	\$515	\$515	\$642	\$769
63	Employer-provided adoption assistance	Natural resources and environment	1996	23 and 137	\$305	\$305	\$381	\$381
64	Employer-provided dependent care	Social policy	1981	129	\$3,660	\$3,660	\$3,660	\$3,736
65	Foster care payments	Social policy	1982	131	\$451	\$451	\$451	\$451
66	Employer-provided transportation assistance	Transportation	1992	132(f)	\$3,965	\$4,193	\$4,346	\$4,498
67	Interest on state and local private-activity bonds issued to finance airport, dock and mass commuting facilities	Transportation	1968	103, 141, 142, and 146	\$1,291	\$1,291	\$1,291	\$1,418

#	Name of Tax Expenditure	Program Area	Year Enacted	Internal Revenue Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Federal Exclusions (cont.)								
68	Interest on state and local private-activity bonds issued to finance highway projects and rail-truck transfer facilities	Transportation	2005	103, 141, 142(m), and 146	\$127	\$127	\$261	\$261
69	G.I. Bill education benefits	Veterans' benefits	1917	38 USC 5301	\$715	\$775	\$830	\$876
70	Veterans' benefits and services	Veterans' benefits	1917	38 USC 5301	\$4,064	\$3,979	\$3,894	\$4,275
Federal Adjustments								
71	Interest on student loans	Education	1997	221	\$2,019	\$2,115	\$2,211	\$2,307
72	Contributions to health savings accounts	Health	2003	223	\$878	\$1,004	\$1,171	\$1,380
73	Health insurance premiums and long-term care insurance premiums paid by the self-employed	Health	1986	162(l)	\$2,926	\$3,098	\$2,754	\$2,754
74	Contributions to self-employment retirement plans	Income security	1962	401-407, 410-418E, and 457	\$64,043	\$70,372	\$77,135	\$84,606
75	Employee contributions to traditional Individual Retirement Accounts	Income security	1974	219 and 408	\$6,359	\$6,404	\$6,506	\$6,823
76	Overnight travel expenses of National Guard and Reserve members	National defense	2003	62(a)(2)(E) and 162(p)	\$42	\$42	\$42	\$42
Federal Deductions								
77	Accelerated depreciation of buildings other than rental housing	Economic development	1954	167 and 168	\$385	\$385	\$385	\$385
78	Accelerated depreciation of equipment	Economic development	1954	167 and 168	\$7,453	\$7,453	\$7,453	\$7,453
79	Small life insurance company taxable income	Economic development	1984	806	too small	too small	too small	too small
80	Amortization of business start-up costs	Economic development	1980	195	too small	too small	\$108	\$211
81	Completed contract rules	Economic development	1986	460	\$1,076	\$1,076	\$1,184	\$1,184

#	Name of Tax Expenditure	Program Area	Year Enacted	Internal Revenue Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Federal Deductions (contd.)								
82	Exception from passive loss rules for \$25,000 of rental real estate loss	Economic development	1986	469(i)	\$5,713	\$6,050	\$6,386	\$6,717
83	Expensing of depreciable small business property	Economic development	1958	179	\$4,054	\$2,198	\$2,095	\$1,674
84	Expensing of magazine circulation expenditures	Economic development	1950	173	\$94	too small	too small	too small
85	Gain on non-dealer installment sales	Economic development	1986	453 and 453A(b)	\$7,082	\$6,759	\$6,599	\$6,599
86	Life insurance company reserves	Economic development	1984	803(a)(2), 805(a)(2), and 807	\$3,159	\$3,258	\$3,258	\$3,258
87	Loss from sale of small business corporation stock	Economic development	1958	1244	\$51	\$51	\$51	\$51
88	Property and casualty insurance company reserves	Economic development	1986	832(b)	\$395	\$395	\$395	\$494
89	Research and development expenditures	Economic development	1954	174	\$5,227	\$5,721	\$6,017	\$6,017
90	Amortization of certified pollution control facilities	Energy	2005	169(d)(5)	\$395	\$296	\$296	\$296
91	Depreciation recovery periods for specific energy property	Energy	1986	168(e)	\$889	\$790	\$691	\$691
92	Blue Cross and Blue Shield companies	Health	1986	833	\$407	\$407	\$407	\$508
93	Medical and dental care expenses	Health	1942	213	\$7,586	\$7,791	\$8,337	\$9,363
94	Accelerated depreciation of rental housing	Housing	1954	167 and 168	\$4,713	\$4,607	\$4,607	\$4,500
95	Mortgage interest on owner-occupied residences	Housing	1913	163(h)	\$62,047	\$67,929	\$74,053	\$77,679
96	State and local property taxes on owner-occupied residences	Housing	1913	164	\$17,520	\$18,631	\$19,792	\$20,852
97	Casualty and theft losses	Income security	1913	165(c)(3), 165(e), and 165(h) - 165(k)	\$303	\$303	\$303	\$364
98	Deduction of foreign taxes instead of a credit	International commerce	1913	901	\$232	\$232	\$232	\$232
99	Charitable contributions	Social policy	1917/1935	170 and 642(c)	\$47,805	\$49,283	\$50,866	\$52,555

#	Name of Tax Expenditure	Program Area	Year Enacted	Internal Revenue Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Federal Deductions (cont.)								
100	Costs of removing architectural and transportation barriers to the disabled and elderly	Social policy	1976	190	too small	too small	too small	too small
Federal Special Rules								
101	60-40 rule for gain or loss from section 1256 contracts	Economic development	1981	1256	\$1,099	\$1,099	\$1,099	\$1,099
102	Interest rate and discounting period assumptions for reserves of property and casualty insurance companies	Economic development	1986	831, 832(b), and 846	\$2,728	\$2,728	\$2,728	\$2,728
103	Inventory accounting	Economic development	1938	475, 491-492	\$2,082	\$2,082	\$2,082	\$2,187
104	Special alternative tax on small property and casualty insurance companies	Economic development	1954	321(a), 501(c)(15), 832, and 834	\$108	\$108	\$108	\$108
105	Apportionment of research and development expenses for determining foreign tax credits	International commerce	1977	861-863 and 904	\$197	\$197	\$197	\$197
106	Interest-charge domestic international sales corporations	International commerce	1986	991-997	\$592	\$592	\$691	\$691

II. Local Tax Expenditures

#	Name of Tax Expenditure	Program Area	Year Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
D.C. INCOME TAX								
(Local Business and Personal Income Tax)								
D.C. Income Tax Exemptions								
107	Additional personal exemption for the blind	Income security	1987	§ 47-1806.02(d)	\$90	\$90	\$93	\$96
108	Additional personal exemption for the elderly	Income security	1987	§ 47-1806.02(e)	\$5,139	\$5,139	\$5,283	\$5,428
109	Investment funds exemption from unincorporated business franchise tax	Income security	2014	§ 47-1808.01(6)	\$4,620	\$4,851	\$5,094	\$5,348
D.C. Income Tax Subtractions								
110	Qualified high-technology companies: depreciable business assets	Economic development	2001	§ 47.1803.03(a)(18)	no estimate	no estimate	no estimate	no estimate
111	College savings plan contributions	Education	2001	§ 47-4501 - § 47-4512	\$1,163	\$1,163	\$1,163	\$1,163
112	Public school teacher expenses	Education	2007	§ 47-1803.03(b-2)	\$122	\$122	\$122	\$122
113	Health insurance premiums paid for a same-sex spouse or domestic partner (business income tax)	Health	2006	§ 47-1803.02(a)(2)(W)	\$376	\$397	\$419	\$442
114	Health insurance premiums paid for a same-sex spouse or domestic partner (personal income tax)	Health	1992	§47-1803.03(a)(15) and § 46-401(b)	\$93	\$97	\$101	\$105
115	Health professional loan repayments	Health	2006	§ 7-751.11	\$76	\$76	\$76	\$76
116	Housing relocation assistance and assistance payments	Housing	2002	§ 42-2851.05, § 42-3403.05, and 47-1803.02(a)(2)(R)	minimal	minimal	minimal	minimal
117	D.C. and federal government survivor benefits	Income security	1987	§ 47-1803.02(a)(2)(N)	\$4,522	\$4,717	\$4,915	\$5,128

#	Name of Tax Expenditure	Program Area	Year Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
D.C. Income Tax Subtractions (cont.)								
118	Disability payments for the permanently and totally disabled	Income security	1985	§ 47-1803.02(a)(2)(M)	\$95	\$99	\$103	\$108
119	Income of persons with a permanent and total disability	Income security	2005	§ 47-1803.02(a)(2)(V)	\$604	\$630	\$656	\$684
120	Social security benefits and railroad retirement	Income security	1985	§ 47-1803.02(a)(2)(L)	\$27,819	\$29,018	\$30,239	\$31,546
121	Social Security benefits for retired workers	Income security	1985	§ 47-1803.02(a)(2)(L)	included in #120	included in #120	included in #120	included in #120
122	Social Security benefits for survivors and dependents	Income security	1985	§ 47-1803.02(a)(2)(L)	included in #120	included in #120	included in #120	included in #120
123	Social Security benefits for the disabled	Income security	1985	§ 47-1803.02(a)(2)(L)	included in #120	included in #120	included in #120	included in #120
124	Rental assistance to police officers	Public safety	1993	§ 42-2902	minimal	minimal	minimal	minimal
125	Compensatory damages awarded in a discrimination case	Social policy	2002	§ 47-1803.02(a)(2)(U) and § 47-1806.10	\$34	\$35	\$37	\$38
126	Poverty lawyer loan assistance	Social policy	2007	§ 47-1803.02(a)(2)(X)	\$44	\$44	\$44	\$44
D.C. Income Tax Credits								
127	Qualified high-technology companies: business income tax exemption and reduction	Economic development	2001	§ 47-1817.06	\$16,891	\$17,651	\$18,446	\$19,276
128	Qualified high-technology companies: employee relocation incentives	Economic development	2001	§ 47-1817.02	included in #127	included in #127	included in #127	included in #127
129	Qualified high-technology companies: employment incentives	Economic development	2001	§ 47-1817.03	included in #127	included in #127	included in #127	included in #127
130	Qualified high-technology companies: incentives to employ disadvantaged workers	Economic development	2001	§ 47-1817.05	included in #127	included in #127	included in #127	included in #127

#	Name of Tax Expenditure	Program Area	Year Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
D.C. Income Tax Credits (cont.)								
131	Qualified high-technology companies: incentives to retrain disadvantaged workers	Economic development	2001	§ 47-1817.04	included in #127	included in #127	included in #127	included in #127
132	First-time home purchase for D.C. government employees	Employment	2000	§ 42-2506	\$180	\$144	\$108	\$72
133	Lower-income, long-term homeownership	Housing	2002	§ 47-1806.09 - § 47-1806.09f	\$4	\$4	\$4	\$4
134	Property tax circuit-breaker	Housing	1977	§ 47-1806.06	\$15,477	\$16,373	\$17,320	\$18,322
135	Earned income tax credit	Income security	2000	§ 47-1806.04(f)	\$65,096	\$66,543	\$67,751	\$68,930
136	Low-income credit	Income security	1987	§ 47-1806.04(e)	\$1,880	\$1,880	\$1,880	\$1,880
137	Farm to food donations (personal income tax)	Income security	2015	§ 47-1806.14	no estimate	no estimate	no estimate	no estimate
138	Farm to food donations (business income tax)	Income security	2015	§ 47-1807.12 and § 47-1808.12	no estimate	no estimate	no estimate	no estimate
139	Alternative fuel vehicle conversion and infrastructure credit (personal income tax)	Natural resources and environment	2015	§ 47-1806.13 and § 47-1806.12	\$661	\$842	\$1,078	\$1,078
140	Alternative fuel vehicle conversion and infrastructure credit (business income tax)	Natural resources and environment	2015	§ 47-1807.10 and § 47-1807.11	no estimate	no estimate	no estimate	no estimate
141	Child and dependent care	Social policy	1977	§ 47-1806.04(c)	\$12,078	\$12,078	\$12,078	\$12,078
REAL PROPERTY TAX								
D.C. Real Property Tax Abatements								
142	New or improved buildings used by high-technology companies	Economic development	2001	§ 47-811.03	\$37	\$37	\$0	\$0
143	Non-profit organizations locating in designated neighborhoods	Economic development	2010	§ 47-857.11 - § 47-857.16	\$153	\$153	\$153	\$153

#	Name of Tax Expenditure	Program Area	Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
D.C. Real Property Tax Abatements (cont.)								
144	New residential developments	Housing	2002	§ 47-857.01 - § 47-857.10	\$1,540	\$1,346	\$1,134	\$520
145	NoMA residential developments	Housing	2009	§ 47-859.01 - § 47-859.05	\$5,000	\$5,000	\$5,000	\$5,000
146	Urban farming and food security	Social Policy	2014	§ 47-868	\$341	\$289	\$286	\$284
D.C Real Property Tax Exemptions								
147	Development of a qualified supermarket, restaurant, or retail store	Economic development	1988	§ 47-1002(23)	\$6,140	\$6,263	\$6,389	\$6,516
148	High-technology commercial real estate database and service providers	Economic development	2010	§ 47-4630	\$700	\$700	\$700	\$585
149	Educational institutions	Education	1942	§ 47-1002(10)	\$124,128	\$124,748	\$125,372	\$125,999
150	Libraries	Education	1942	§ 47-1002(7)	\$425	\$427	\$429	\$431
151	Embassies, chanceries, and associated properties of foreign governments	General law	1942	§ 47-1002(3)	\$49,298	\$49,544	\$49,792	\$50,041
152	Federal government property	General law	1942	§ 47-1002(1)	\$876,621	\$881,004	\$885,409	\$889,836
153	District of Columbia government property	General law	1942	§ 47-1002(2)	\$215,928	\$221,758	\$229,741	\$237,323
154	Miscellaneous exemptions	General law	multiple years	multiple code sections	\$122,654	\$123,267	\$123,884	\$124,503
155	Hospital buildings	Health	1942	§ 47-1002(9)	\$15,216	\$15,292	\$15,368	\$15,445
156	Historic property	Housing	1974	§ 47-842 - § 47-844	\$9	\$9	\$9	\$10
157	Homestead exemption	Housing	1978	§ 47-850	\$58,443	\$59,027	\$59,617	\$60,213
158	Lower-income homeownership households and cooperative housing associations	Housing	1983	§ 47-3503	\$9,761	\$9,809	\$9,858	\$9,908
159	Multi-family and single-family rental and cooperative housing for low- and moderate-	Housing	1978	§ 47-1002(20)	\$1,085	\$1,090	\$1,095	\$1,101
160	Nonprofit housing associations	Housing	1983	§ 47-3505	\$10,845	\$10,899	\$10,954	\$11,008
161	Nonprofit affordable housing developers	Housing	2012	§ 47-1005.02	\$400	\$500	\$550	\$600

#	Name of Tax Expenditure	Program Area	Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
D.C. Real Property Tax Exemptions (cont.)								
162	Correctional Treatment Facility	Public safety	1997	§ 47-1002(25)	\$3,523	\$3,629	\$3,738	\$3,850
163	Art galleries	Social policy	1942	§ 47-1002(6)	\$2,423	\$2,435	\$2,447	\$2,459
164	Cemeteries	Social policy	1942	§ 47-1002(12)	\$6,358	\$6,389	\$6,421	\$6,453
165	Charitable organizations	Social policy	1942	§ 47-1002(8)	\$16,324	\$16,406	\$16,488	\$16,570
166	Churches, synagogues, and mosques	Social policy	1942	§ 47-1002(13)	\$67,350	\$67,686	\$68,025	\$68,365
167	Washington Metropolitan Area Transit Authority properties	Transportation	1966	§ 9-1107.01	\$9,732	\$9,781	\$9,830	\$9,879
D.C. Real Property Tax Credits								
168	First-time homebuyer credit for D.C. government employees	Employment	2000	§ 42-2506	\$104	\$61	\$27	\$14
169	Assessment increase cap	Housing	2001	§ 47-864	\$23,138	\$23,832	\$24,547	\$25,284
170	Credit for senior citizens and persons with disabilities	Housing	1986	§ 47-863	\$27,155	\$27,290	\$27,427	\$27,564
171	Condominium and cooperative trash collection	Natural resources and environment	1990	§ 47-872 and § 47-873	\$6,206	\$6,361	\$6,520	\$6,683
D.C. Real Property Tax Deferrals, Rebates, and Multiple Categories								
172	Qualified high technology companies: interior renovation tax rebate	Economic development	2015	§ 47-4665	\$0	\$3,000	\$3,000	\$3,000
173	Public charter school tax rebate	Education	2005	§ 47-867	\$1,173	\$1,205	\$1,248	\$1,289
174	Low-income homeowners	Housing	2005	§ 47-845.02	\$6	\$6	\$6	\$6
175	Low-income, senior-citizen homeowners	Housing	2005	§ 47-845.03	\$109	\$112	\$116	\$119

#	Name of Tax Expenditure	Program Area	Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
DEED RECORDATION AND TRANSFER TAX								
Deed Recordation and Transfer Tax Exemptions								
176	Educational institutions	Education	1962 and 1980	§ 42-1102(3) and §47-902(3)	\$1,424	\$1,467	\$1,511	\$1,556
177	Bona-fide gifts to the District of Columbia	General law	2011	§ 47-902(24)	\$0	\$0	\$0	\$0
178	Embassies, chanceries, and associated properties of foreign governments	General law	1962 and 1980	§ 42-1102(3) and § 47-902(3)	\$538	\$554	\$570	\$588
179	Federal government and DC government	General law	1962 and 1980	§ 42-1102(2) and § 47-902(2)	\$2,376	\$2,447	\$2,520	\$2,596
180	Other properties exempt from real property taxation	General law	1962 and 1980	§ 42-1102(4) and § 47-902(3)	\$1,389	\$1,431	\$1,474	\$1,518
181	Special act of Congress (recordation tax only)	General law	1962	§ 42-1102(4)	\$0	\$0	\$0	\$0
182	Cooperative housing associations	Housing	1983	§ 42-1102(14), § 47-3503(a)(2), § 47-3503(a)(3), § 47-902(11), and §47-3503(b)(2)	\$527	\$543	\$559	\$576
183	Inclusionary zoning program (transfer tax only)	Housing	2007	§ 47-902(23)	\$23	\$23	\$36	\$36
184	Lower-income homeownership households	Housing	1983	§ 42-1102(12), § 47-3503(a)(1), § 47-3503(a)(3), § 47-902(9), and §47-3503(b)(1)	\$0	\$0	\$0	\$0
185	Nonprofit housing associations	Housing	1983	§ 42-1102(13), § 47-3503(c), § 47-902(10), and §47-3505(b)	\$160	\$161	\$166	\$169
186	Nonprofit affordable housing developers	Housing	2012	§ 42-1102(32) and § 47-902(25)	\$156	\$159	\$164	\$167

#	Name of Tax Expenditure	Program Area	Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Deed Recordation and Transfer Tax Exemptions (cont.)								
187	Resident management corporations	Housing	1992	§ 42-1102(20), § 47-3506.01(b)(1), § 47-902(15), and §47-3506.01(b)(2)	\$0	\$0	\$0	\$0
188	Deeds to property transferred to a named beneficiary of a revocable transfer on death	Housing	2015	§ 42-1102(34) and §19-604	no estimate	no estimate	no estimate	no estimate
189	Exemption on security interest instrument	Housing	2015	§ 42-1102(33) and § 47-340.01	no estimate	no estimate	no estimate	no estimate
190	Charitable organizations	Social policy	1962 and 1980	§ 42-1102(3) and § 47-902(3)	\$401	\$413	\$425	\$438
191	Churches, synagogues, and mosques	Social policy	1962 and 1980	§ 42-1102(3) and § 47-902(3)	\$0	\$0	\$0	\$0
192	Tax-exempt entities subject to a long-term lease	Tax administration and equity	2003	§ 42-1102(27) and § 47-902(21)	\$0	\$0	\$0	\$0
D.C. SALES TAX								
Sales Tax Exemptions								
193	Energy products used in manufacturing	Economic development	1949	§ 47-2005(11)	\$5,102	\$5,316	\$5,529	\$5,734
194	Internet access service	Economic development	1999	§ 47-2001(n)(2)(F)	\$7,674	\$7,997	\$8,316	\$8,624
195	Materials used in development of a qualified supermarket	Economic development	2000	§ 47-2005(28)	\$992	\$1,034	\$1,075	\$1,115
196	Professional and personal services	Economic development	1949	§ 47-2001(n)(2)(B)	\$304,379	\$317,163	\$329,850	\$342,054
197	Qualified high-technology companies: certain sales and technology sales	Economic development	2001	§ 47-2001(n)(2)(G) and § 47-2005(31)	\$3,399	\$3,535	\$3,676	\$3,823
198	Transportation and communication services	Economic development	1949	§ 47-2001(n)(2)(A)	\$54,618	\$56,912	\$59,188	\$61,378

#	Name of Tax Expenditure	Program Area	Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Sales Tax Exemptions (cont.)								
199	Federal and D.C. governments	General law	1949	§ 47-2005(1)	\$225,696	\$235,175	\$244,582	\$253,631
200	Medicines, pharmaceuticals, and medical devices	Health	1949	§ 47-2005(14) and (15)	\$18,945	\$19,741	\$20,531	\$21,290
201	Groceries	Social policy	1949	§ 47-2001(n)(2)(E)	\$68,457	\$71,332	\$74,185	\$76,930
202	Materials used in war memorials	Social policy	1957	§ 47-2005(16)	\$0	\$0	\$0	minimal
203	Non-profit (501(c)(4)) organizations	Social policy	1987	§ 47-2005(22)	\$37,890	\$39,482	\$41,061	\$42,580
204	Semi-public institutions	Social policy	1949	§ 47-2005(3)	\$57,412	\$59,823	\$62,216	\$64,518
205	Miscellaneous	Tax administration and equity	1949	§ 47-2005	no estimate	no estimate	no estimate	no estimate
206	Public utility companies	Tax administration and equity	1949	§ 47-2005(5)	\$83,945	\$87,470	\$90,969	\$94,335
207	State and local governments	Tax administration and equity	1949	§ 47-2005(2)	minimal	minimal	minimal	minimal
208	Valet parking services	Transportation	2002	§ 47-2001(n)(1)(L)(iv-I)	\$256	\$268	\$281	\$292
D.C. INSURANCE PREMIUMS TAX								
Insurance Premium Tax Credit								
209	Certified capital investment by insurance companies	Economic development	2004	§ 31-5233	\$1,902	\$4,722	\$0	\$0
D.C. PERSONAL PROPERTY TAX								
Personal Property Tax Exemptions								
210	Digital audio radio satellite companies	Economic development	2000	§ 47-1508(a)(8)	no estimate	no estimate	no estimate	no estimate
211	Qualified high-technology companies	Economic development	2001	§ 47-1508(a)(10)	\$108	\$112	\$115	\$119
212	Qualified supermarkets	Economic development	2000	§ 47-1508(a)(9)	\$319	\$322	\$332	\$343

#	Name of Tax Expenditure	Program Area	Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Personal Property Tax Exemptions (cont.)								
213	Cogeneration Systems	Natural resources and environment	2013	§ 47-1508(a)(12)	\$0	\$1,370	\$1,370	\$1,370
214	Non-profit organizations	Social policy	1902	§ 47-1508(a)(1)	\$6	\$6	\$6	\$6
215	Motor vehicles and trailers	Transportation	1954	§ 47-1508(a)(3)	\$2,831	\$2,859	\$2,888	\$2,914
216	Public utility and toll telecommunications providers	Tax administration and equity	2001	§ 47-1508(a)(3A)	\$10	\$10	\$10	\$10
217	Wireless telecommunication companies	Tax administration and equity	1998	§ 47-1508(a)(7)	minimal	minimal	minimal	minimal
D.C. LOCAL TAX EXPENDITURES (unknown if used)								
Local Income Tax Credits								
218	Paid leave for organ or bone marrow donors	Health	2006	§ 47-1807.08 and § 47-1808.08	no estimate	no estimate	no estimate	no estimate
219	Employer-assisted home purchases	Housing	2002	§ 47-1807.07 and § 47-1808.07	minimal	minimal	minimal	minimal
D.C. UNUSED LOCAL TAX EXPENDITURES (no one is taking them)								
Unused Local Income Tax Credits								
220	Economic development zone incentives for businesses	Economic development	1988	§ 6-1501, § 6-1502, § 6-1504, and § 47-1807.06	\$0	\$0	\$0	\$0

#	Name of Tax Expenditure	Program Area	Year Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
Unused Local Real Property Tax Abatements								
221	Improvements to low-income housing	Housing	2002	§ 47-866	\$0	\$0	\$0	\$0
222	Preservation of section 8 housing in qualified areas	Housing	2002	§ 47-865	\$0	\$0	\$0	\$0
223	Single-room-occupancy housing	Housing	1994	§ 42-3508.06	\$0	\$0	\$0	\$0
224	Vacant rental housing	Housing	1985	§ 42-3508.02	\$0	\$0	\$0	\$0
Unused Local Real Property Tax Exemptions								
225	Resident management corporations	Housing	1992	§ 47-1002(24)	\$0	\$0	\$0	\$0
Unused Local Real Property Tax Deferrals, Rebates, and Multiple Categories								
226	Economic development zone incentives	Economic development	1988	§ 6-1501 - § 6-1503	\$0	\$0	\$0	\$0
227	Homeowners in enterprise zones	Housing	2002	§ 47-858.01 - § 47-858.05	\$0	\$0	\$0	\$0
Unused Local Personal Property Tax Exemptions								
228	Solar energy systems	Natural resources and environment	2013	§ 47-1508(a)(11)	\$0	\$0	\$0	\$0
229	Works of art lent to the National Gallery of Art by non-residents	Tax administration and equity	1950	§ 47-1508(a)(2)	\$0	\$0	\$0	\$0

#	Name of Tax Expenditure	Program Area	Year Enacted	D.C Code Section	Revenue Forgone (\$ in thousands)			
					FY 2016	FY 2017	FY 2018	FY 2019
D.C. UNUSED LOCAL TAX EXPENDITURES (implementing regulations not written)								
Unused Local Income Tax Subtraction								
230	Environmental savings account contributions and earnings	Natural resources and environment	2001	§ 8-637.03	\$0	\$0	\$0	\$0
Unused Local Income Tax Credits								
231	Brownfield revitalization and cleanup	Natural resources and environment	2001	§ 8-637.01	\$0	\$0	\$0	\$0
Unused Local Real Property Tax Credits								
232	Brownfield revitalization and cleanup	Natural resources and environment	2001	§ 8-637.01	\$0	\$0	\$0	\$0

III. Local Individual Tax Expenditures

#	Name of Development	Program Area	Year Enacted	D.C Code Section	Revenue Forgone FY 2016 (\$ in thousands)
D.C. Individual Real Property Tax Abatements					
233	14W And The YMCA Anthony Bowen Project	Economic development	2009	§ 47-4627	\$664
234	Third & H Streets, NE Development Project	Economic development	2010	§ 47-4634	\$475
235	2 M Street NE	Housing	2011	§ 47-4648	\$508
236	Georgia Commons	Housing	2008	§ 47-4610	\$183
237	2323 Pennsylvania Avenue, S.E., redevelopment project.	Housing	2010	§ 47-4638	\$95
238	Parkside Parcel E And J Mixed-income Apartments	Housing	2013	§ 47-4658	\$149
239	The Heights on Georgia Avenue	Housing	2010	§ 47-4628	\$114
240	Eckington One	Housing	2009	§ 47-1075	\$1,232
241	Park Place at Petworth, Highland Park	Housing	2010	§ 47-4629	\$787
242	The Pew Charitable Trusts	Social policy	2010	§ 47-4637	\$1,001
243	800 Kenilworth Avenue Northeast Redevelopment Project	Housing	2011	§ 47-4643	\$146
244	Central Union Mission	Housing	2011	§ 47-4651	\$0
245	Campbell Heights Project	Housing	2010	§ 47-4632	\$222
246	Golden Rule Rehabilitation Project	Housing	2008	§ 47-1079	\$378

#	Name of Development	Program Area	Year Enacted	D.C Code Section	Revenue Forgone FY 2016 (\$ in thousands)
D.C. Individual Real Property Tax Abatements (cont.)					
247	Douglas Knoll, Golden Rule, 1728 W Street And Wagner	Housing	2005	§ 47-1065	\$1,403
248	King Towers Residential Housing Rental Project	Housing	2009	§ 47-4639	\$220
D.C. Individual Real Property Tax Exemptions					
249	Parkside Terrace Development Project	Housing	2006	§ 47-4607	\$178
250	St Martin's Apartments LP	Housing	2009	§ 47-4620	\$447
251	View 14 Investments LLC	Housing	2010	§ 47-4623	\$830
252	The Elizabeth Ministry, Inc.	Housing	2013	§ 47-4657	\$15
253	Beulah Baptist Church, Dix Street Corridor Senior Housing LP	Housing	2011	§ 47-4654	\$55
254	4427 Hayes Street NE	Housing	2011	§ 47-4649	\$19
255	St. Paul Senior Living At Wayne Place	Housing	2011	§ 47-4642	\$50
256	Allen Chapel AME Senior Residential Rental Project	Housing	2011	§ 47-4641	\$15
257	Kelsey Gardens Redevelopment Project	Housing	2009	§ 47-4625	\$1,247
258	Carver 2000 Low-income And Senior Housing Project	Housing	2005	§ 47-4605	\$150
259	Affordable Housing Opportunitites, Inc. Project	Housing	2010	§ 47-1084	\$40
260	Dix Street Corridor Senior Housing LP	Housing	2011	§ 47-4654	\$10

#	Name of Development	Program Area	Year Enacted	D.C Code Section	Revenue Forgone FY 2016 (\$ in thousands)
D.C. Individual Real Property Tax Exemptions (cont.)					
261	SOME, Inc. & Affiliates	Housing	2008	§ 47-1078	\$138
262	Jubilee Housing Residential Rental Project	Housing	2010	§ 47-4633	\$235
263	Israel Senior Residences	Housing	2013	§ 47-4659	\$21
264	Wayne Place Senior Living	Housing			\$50
265	The Studio Theatre	Housing	2009	§ 47-1082	\$24
266	Jenkins Row Development Project	Housing	2005	§ 47-4603	\$340
267	United House Of Prayer For All People	Social Policy	2011	§ 47-1086	\$159
268	Tregaron Conservancy	Housing	2009	47-1077	\$6
D.C. Individual Real Property Tax Deferrals, Rebates, and Multiple Categories					
269	The Urban Institute	Social policy	2010	§ 47-4624	\$1,790
D.C. Individual Real Property Tax Future Tax Expenditures and Rebates					
270	Soccer Stadium	Economic development	2015	§ 47-4663	\$76,086
271	SeVerna, LLC	Housing	2014	§ 47-1095	\$1,738

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PART I: FEDERAL CONFORMITY TAX EXPENDITURES

Income Tax

Exclusions

1. Capital gains on assets transferred at death

Internal Revenue Code Sections: 1001, 1014, 1023, 1040, 1221, and 1222

Federal Law Sunset Date: None

Year Enacted in Federal Law: 1921

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$17,702	\$18,186	\$18,939	\$19,800
Total	\$17,702	\$18,186	\$18,939	\$19,800

DESCRIPTION: When property is transferred upon an owner’s death, unrealized capital gains on the property are excluded from taxable income. The basis of taxation for the heir is the market value of the property when the owner died, rather than the original cost of the asset (this is sometimes called a “step-up” in basis). Income tax is therefore not imposed on any appreciation that occurs before death.

PURPOSE: Although the original rationale for the exclusion is not clear, a justification currently used is that death should not trigger recognition of income.¹¹ One author notes that, “Part of the rationale for step-up in basis was that the gains were subject to the estate tax.”¹² In addition, there would be an administrative burden both for taxpayers and the IRS to determine the original price of assets that were purchased long ago.

IMPACT: The Congressional Research Service states that, “The exclusion of capital gains at death is most advantageous to individuals who need not dispose of their assets to achieve financial liquidity. Generally speaking, these individuals tend to be wealthier. The deferral of tax on the appreciation involved, combined with the exemption for the appreciation before death, is a significant benefit for those investors and their heirs.”¹³

With regard to efficiency, the failure to tax capital gains transferred at death encourages “lock-in” of assets (holding the same assets even though portfolio change might otherwise be more beneficial).¹⁴ CRS points out that, “Lower capital gains taxes may disproportionately benefit real estate investments and may cause corporations to retain more earnings than would otherwise be

¹¹ U.S. Senate, Committee on the Budget, Tax Expenditures: Compendium of Background Material on Individual Provisions, Senate Print 113-32, prepared by the Congressional Research Service (December 2014), p. 409.

¹² Gerald Auten, “Capital Gains Taxation,” in *The Encyclopedia of Taxation and Tax Policy*, Joseph Cordes, Robert Ebel, and Jane Gravelle, eds. (Washington, D.C.: The Urban Institute Press, 2005), p. 47.

¹³ U.S. Senate, Committee on the Budget, p. 411.

¹⁴ *Ibid*, p. 411.

the case, causing efficiency losses. At the same time, lower capital gains taxes reduce the distortion that favors corporate debt over equity, which produces an efficiency gain.”¹⁵

¹⁵ U.S. Senate, Committee on the Budget, p. 411.

Income Tax
Exclusions

2. Capital gains on assets transferred as a gift

Internal Revenue Code Section: 1015
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1921

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$2,725	\$2,993	\$3,282	\$3,242
Total	\$2,725	\$2,993	\$3,282	\$3,242

DESCRIPTION: When property is transferred as a gift during the lifetime of the owner, unrealized capital gains on the property are excluded from taxable income. The basis of taxation is the original cost of the asset paid by the donor, but the tax is not imposed upon the transfer. In addition, tax can be avoided entirely if the recipient holds the asset until death, when it can be transferred to an heir without triggering capital gains taxation.

PURPOSE: Although the original rationale for the exclusion is not clear, a justification currently used is that a gift should not trigger a recognition of income.¹⁶ In addition, another rationale might be that the transfer is subject to the gift tax.

IMPACT: The impact of the capital gains tax exclusion for gifts is somewhat similar to the exclusion for assets transferred at death (see Tax Expenditure #1, described on the previous pages). The exclusion of capital gains on gifts will be most advantageous to individuals who do not need to dispose of their assets to achieve financial liquidity, and to those who have more valuable assets. These individuals tend to be wealthier. In addition, the exclusion for capital gains on gifts encourages the “lock-in” of assets (maintaining the same assets even though portfolio change might otherwise be more beneficial).

¹⁶ U.S. Senate, Committee on the Budget, p. 411.

Income Tax
Exclusions

3. Cash accounting, other than agriculture

Internal Revenue Code Sections: 446 and 448
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1916

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$324	\$324	\$324	\$324
Personal Income Tax Loss	\$1,948	\$1,948	\$2,050	\$2,050
Total	\$2,272	\$2,272	\$2,375	\$2,375

DESCRIPTION: Employee-owned personal service businesses¹⁷ and other small businesses with average annual gross receipts of less than \$5 million for the last three years have the option of using the cash method of accounting instead of the accrual method. Using the cash method for tax purposes effectively defers corporation and personal income taxes by allowing qualified businesses to record income when it is received rather than when it is earned (the accrual method).

PURPOSE: The purpose of the exclusion is to simplify record keeping and eliminate an additional drain on the working capital of small businesses.

IMPACT: Small businesses and personal service corporations benefit from this provision. The Congressional Research Service states that cash accounting allows businesses to “exercise greater control over the timing of receipts and payments for expenses. By shifting income or deductions from the current tax year to a future year, taxpayers can defer the payment of income taxes or take advantage of expected or enacted reductions in tax rates. In addition, the cash method of accounting has the advantage of lower compliance costs and greater familiarity for individuals and small firms that are permitted to use it for tax purposes.”¹⁸

¹⁷ This category includes businesses in the fields of health, law, accounting, engineering, architecture, actuarial science, performing arts, or consulting.

¹⁸ U.S. Senate, Committee on the Budget, Tax Expenditures: Compendium of Background Material on Individual Provisions, Senate Print 112-45, prepared by the Congressional Research Service (December 2012), p. 497.

Income Tax
Exclusions

4. Credit union income

Internal Revenue and U.S. Code Sections: 501(c)(14) and 12 USC 1768
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1937

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$2,440	\$2,542	\$2,745	\$2,949
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$2,440	\$2,542	\$2,745	\$2,949

DESCRIPTION: The income of a credit union is exempt from corporate income tax. Credit unions are non-profit cooperatives organized by people with a common bond (such as membership in the same profession) that distinguishes them from the general public. Members of the credit union pool their funds to make loans to one another. The earnings that the credit union distributes to its depositors (as opposed to earnings that it retains) are subject to taxation.

Credit unions initially gained tax-exempt status in 1937 when they were included in a broader exemption for domestic building and loan associations. In 1951, a specific tax exemption for credit unions was enacted.

PURPOSE: According to the U.S. Government Accountability Office (GAO), credit unions “continue to be exempt because of their cooperative, not-for-profit structure, which is distinct from other depository institutions, and because credit unions have historically emphasized serving people of modest means.”¹⁹

IMPACT: Credit unions and their members benefit from this provision. The Congressional Research Service states that, “For a given addition to retained earnings, this tax exemption permits credit unions to pay members higher dividends and charge members lower interest rates on loans”.²⁰

Proponents of the exemption emphasize that credit unions are directed by volunteers for the purpose of serving their members, rather than maximizing profits. CRS also points out that, “[S]upporters argue that credit unions are subject to certain regulatory constraints not required of other depository institutions and that these constraints reduce the competitiveness of credit unions. For example, credit unions may only accept deposits of members and lend only to members, other credit unions, or credit union organizations.”²¹

¹⁹ U.S. Government Accountability Office, “Financial Institutions: Issues Regarding the Tax-Exempt Status of Credit Unions,” Highlights of GAO-06-220T, Testimony before the Committee on Ways and Means, House of Representatives, November 3, 2005.

²⁰ U.S. Senate, Committee on the Budget, p. 300.

²¹ Ibid, p. 300.

On the other hand, “Proponents of taxation argue that deregulation has caused extensive competition among all depository institutions, including credit unions, and that the tax exemption gives credit unions an unwarranted advantage over other depository institutions. They argue that depository institutions should have a level playing field in order for market forces to allocate resources efficiently.”²² The U.S. Treasury Department’s 1984 tax reform report to President Reagan proposed repealing the exclusion of credit union income on precisely those grounds.²³

It is also not clear to what extent credit unions serve people of low or moderate incomes and pass on the savings from the tax exclusion to credit union members. In testimony to the U.S. House Committee on Ways and Means in November 2005, a GAO official stated that, “[S]ome studies, including one of our own, indicate that credit unions serve a slightly lower proportion of households with low and moderate incomes than banks.”²⁴

²² U.S. Senate, Committee on the Budget, p. 319.

²³ U.S. Treasury Department, Tax Reform for Fairness, Simplicity, and Economic Growth, The Treasury Department Report to the President, Volume 1, Overview (November 1984), p. 133.

²⁴ U.S. Government Accountability Office, “Financial Institutions: Issues Regarding the Tax-Exempt Status of Credit Unions,” Statement of Richard Hillman, Managing Director, Financial Markets and Community Investments, before the Committee on Ways and Means, House of Representatives (GAO-06-220T), November 3, 2005, p. 9.

Income Tax
Exclusions

5. Distribution from redemption of stock to pay taxes imposed at death

Internal Revenue Code Section: 303
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1950

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	too small	too small	too small	too small
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: When a shareholder in a closely-held business dies, a partial redemption of the stock (selling the stock back to the corporation) is treated as a sale or exchange of an asset eligible for long-term capital gain treatment, rather than as dividend income. The treatment of the redemption as a capital gain means that there is a “step up” in basis: the stock is valued for purposes of federal income tax as of the date that it was transferred to the decedent’s heir or heirs, rather than the value at the initial time of purchase by the decedent. As a result, there will be little or no federal tax due on the redemption (depending on the exact timing of the redemption).²⁵

In order to qualify for this tax benefit, at least 35 percent of the decedent’s estate must consist of the stock of the corporation. The benefits of the exclusion cannot exceed the estate taxes and expenses (funeral and administrative) that are incurred by the estate.

PURPOSE: According to the Congressional Research Service, this provision was adopted due to “congressional concern that estate taxes would force some estates to liquidate their holdings in a family business. There was further concern that outsiders could join the business, and the proceeds from any stock sales used to pay taxes would be taxable income under the income tax.”²⁶

IMPACT: Family businesses benefit from this provision, because it creates an incentive to sell stock back to the business in order to pay estate taxes. CRS observes that only a small percentage of businesses (approximately 3.5 percent) are subject to the estate tax, so a small number of wealthy families stand to benefit from the exclusion.²⁷ CRS adds that, “There are no special provisions in the tax code, however, for favorable tax treatment of other needy redemptions, such

²⁵ There could be some tax liability if the stock appreciates between the time it is bequeathed to the heir or heirs and the time it is sold back to the closely-held business.

²⁶ U.S. Senate, Committee on the Budget, p. 519.

²⁷ U.S. Senate, Committee on the Budget, Tax Expenditures: Compendium of Background Material on Individual Provisions, Senate Print 112-45, prepared by the Congressional Research Service (December 2012), p. 536.

as to pay for medical expenses. To take advantage of this provision the decedent's estate does not need to show that the estate lacks sufficient liquid assets to pay taxes and expenses. Furthermore, the proceeds of the redemption do not have to be used to pay taxes or expenses."²⁸

²⁸ U.S. Senate, Committee on the Budget, p. 519.

Income Tax
Exclusions

6. Gain on like-kind exchanges

Internal Revenue Code Section: 1031
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1921

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$11,645	\$11,960	\$12,274	\$12,799
Personal Income Tax Loss	\$5,868	\$5,967	\$6,166	\$6,365
Total	\$17,513	\$17,927	\$18,440	\$19,164

DESCRIPTION: When business or investment property is exchanged for property of a “like kind,” no gain or loss is recognized on the exchange and therefore no tax is paid on any appreciation in the property’s value at the time of the exchange. This exclusion contrasts to the general rule that any sale or exchange of money or property is a taxable event²⁹.

PURPOSE: According to the Congressional Research Service, the rationale for allowing these tax-free exchanges is “that the investment in the new property is merely a continuation of the investment in the old.”³⁰

IMPACT: CRS states that, “The like-kind exchange rules have been liberally interpreted by the courts to allow tax-free exchanges of property of the same general type but of very different quality and use. All real estate, in particular is considered ‘like-kind’... The provision is very popular with real estate interests, some of whom specialize in arranging property exchanges. It is useful primarily to persons who wish to alter their real estate holdings without paying tax on their appreciated gain. Stocks and financial instruments are generally not eligible for this provision, so it is not useful for rearranging financial portfolios.”³¹

In addition, the exclusion serves to “simplify transactions and make it less costly for businesses and investors to replace property. Taxpayers gain further benefit from the loose definition of ‘like-kind,’ because they can also switch their property holdings to types they prefer without tax consequences. This might be justified as reducing the inevitable bias a tax on capital gains causes against selling property, but it is difficult to argue for restricting the relief primarily to those taxpayers engaged in sophisticated real estate transactions.”³² The “like-kind” rule creates an economic distortion by encouraging investment in land and buildings even when real estate might not represent the most productive use of capital. A *New York Times* article stated that, “Because

²⁹ U.S. Senate, Committee on the Budget, p. 419.

³⁰ Ibid, p. 420.

³¹ Ibid, pp. 419-420.

³² Ibid, p. 421.

it allows farmers to avoid capital gains taxes on land swaps, the tax break provides an incentive to sell farmland coveted by developers and buy property in less desirable and more remote areas.”³³

³³ David Kocieniewski, “Major Companies Push the Limits of a Tax Break,” *The New York Times*, January 6, 2013.

Income Tax Exclusions

7. Imputed interest

Internal Revenue Code Sections: 163(e), 483, 1274 and 1274A
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1964

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	\$387	\$452	\$452	\$452
Total	\$387	\$452	\$452	\$452

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: For debt instruments that do not bear a market rate of interest, the Internal Revenue Service assigns or “imputes” a market rate to estimate interest payments for tax purposes. The imputed interest must be included as income to the recipient and is deducted by the payer. There are several exceptions to this general rule, covering debt associated with the sale of property when the total sales price is no more than \$250,000; the sale of farms or small businesses by individuals when the sales price is no more than \$1 million; and the sale of a personal residence. An interest rate greater than 9 percent may not be assigned to debt instruments given in exchange for real property for amounts less than an inflation-adjusted maximum (currently \$4.6 million or \$3.3 million, depending on the debt instrument used).

The tax expenditure is the revenue loss caused by the exceptions to the imputed interest rule listed above. A common example of this exemption is a low-interest, no-interest, or “gift” loan involved in the sale of property between family members.

PURPOSE: The purpose of the exclusion is to reduce the tax burden on the sales of homes, small businesses, and farms, and to allow buyers to finance the purchase of property that would otherwise be unaffordable under prevailing market rates and conditions. Essentially, the exclusion allows a limited set of transactions to take place without restrictions on seller financing. The restrictions on the exclusion are intended to prevent the tax avoidance that may result if the seller charges an artificially high sales price (to shift income toward tax-favored capital gains) and an artificially low interest rate (to shift income out of taxable interest payments).

IMPACT: Sellers of residences, small businesses, and farms who would have to pay tax on interest they do not charge, and otherwise will not receive, benefit from this provision. The exceptions to the imputed interest rules are generally directed at “seller take-back” financing, in which the seller of the property receives a debt instrument (note, mortgage) in return for the property. This financing mechanism allows the sellers to shift taxable income between tax years and thus delay the payment of taxes.³⁴ The imputed interest rules have been less important since the Tax Reform Act of 1986 took effect, because tighter depreciation rules limited the arbitrage opportunities from seller-financed transactions.³⁵

³⁴ U.S. Senate, Committee on the Budget, p. 460.

³⁵ Ibid.

Income Tax
Exclusions

8. Interest on small-issue qualified private-activity bonds

Internal Revenue Code Sections: 103, 141, 144, and 146
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1968

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$134	\$134	\$134	\$134
Personal Income Tax Loss	\$381	\$381	\$381	\$381
Total	\$515	\$515	\$515	\$515

DESCRIPTION: Interest income on state and local bonds that are used to finance loans of \$1 million or less for the construction of private manufacturing facilities is tax-exempt. These bonds, which are known as “small-issue industrial development bonds” (IDBs) are classified as private-activity bonds rather than governmental bonds because a substantial portion of the benefits accrues to private individuals or businesses.

The \$1 million loan limit for a single project may be raised to \$10 million if the aggregate amount of related capital expenditures (including those financed by tax-exempt bond proceeds) made over a six-year period is not expected to exceed \$10 million. Total borrowing for any borrower is limited to \$40 million. The small-issue IDBs are also subject to caps on the volume of private-activity bonds that each state can issue.

State and local governments initially faced no restrictions on the use of tax-exempt bonds for economic development. Congress first imposed limits on the amount of the bond issuance and the size of the projects supported in 1968.

PURPOSE: The Congressional Research Service notes that small-issue IDBs are supported by Congress as a way to promote investment in manufacturing and jobs.³⁶ Because the interest on the bonds is tax-exempt, buyers are willing to accept lower interest rates for the small-issue IDBs than they would for taxable securities, which in return reduce the cost of financing for the manufacturers.

IMPACT: CRS states that, “since interest on the bonds is tax exempt, purchasers are willing to accept lower before-tax rates of interest than on taxable securities. These low rates allow issuers to offer loans to manufacturing businesses at reduced interest rates”.³⁷ However, any increase in investment, jobs, and tax base obtained by communities from their use of these bonds likely is offset by the loss of jobs and tax base elsewhere in the economy. National benefit could arise from relocating jobs and tax base to achieve social or distributional objectives. The use of the bonds, however, is not targeted to specific geographic areas that satisfy explicit federal criteria

³⁶ U.S. Senate, Committee on the Budget, p. 481.

³⁷ Ibid, p. 480.

such as median income or unemployment ...”³⁸ CRS also points out that, “With a greater supply of public bonds, the interest rate on bonds necessarily increases to lure investors. In addition, expanding the availability of tax-exempt bonds also increases the assets available to individuals and corporations to shelter their income from taxation.”³⁹

³⁸ U.S. Senate, Committee on the Budget, *Tax Expenditures: Compendium of Background Material on Individual Provisions*, Senate Print 112-45, prepared by the Congressional Research Service (December 2012), p. 501.

³⁹ *Ibid*, pp. 501-502.

Income Tax
Exclusions

9. Magazine, paperback and record returns

Internal Revenue Code Section: 458
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1978

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	too small	too small	too small	too small
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Generally, if a buyer returns goods to the seller, the seller’s income is reduced in the year in which the items are returned. This tax expenditure involves an exemption from this rule for publishers and distributors of magazines, paperbacks, and records (records include discs, tapes, and similar objects that contain pre-recorded sounds).

Publishers and distributors may elect to exclude from corporate or personal taxable income any goods sold during a tax year that are returned shortly after the close of the tax year. Specifically, magazines must be returned within two months and 15 days after the end of the tax year, and paperbacks and records must be returned within four months and 15 days. This allows publishers and distributors to sell more copies to wholesalers and retailers than they expect will be sold to consumers.

PURPOSE: The purpose of the exclusion is to avoid taxing publishers and distributors of magazines, paperbacks, and records on accrued income when goods that are sold in one year are returned after the close of the year.

IMPACT: Publishers and distributors of magazines, paperbacks and records benefit from this provision. The Congressional Research Service notes that, “The special tax treatment granted to publishers and distributors of magazines, paperbacks, and records is not available to producers and distributors of other goods. On the other hand, publishers and distributors of magazines, paperbacks, and records often sell more copies to wholesalers and retailers than they expect will be sold to consumers.”⁴⁰ CRS also states that the exclusion “mainly benefits large publishers and distributors.”⁴¹ In 1984, the U.S. Treasury Department’s tax reform report to President Reagan recommended repealing the exclusion as an unnecessary subsidy.⁴²

⁴⁰ U.S. Senate, Committee on the Budget, Tax Expenditures: Compendium of Background Material on Individual Provisions, Senate Print 113-32, prepared by the Congressional Research Service (December 2014), p. 468.

⁴¹ U.S. Senate, Committee on the Budget, p. 468.

⁴² U.S. Department of the Treasury, Tax Reform for Fairness, Simplicity, and Economic Growth, Volume 1, Overview, p. 150.

Income Tax
Exclusions

10. Small business stock gains

Internal Revenue Code Section: 1202
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1993

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$905	\$905	\$996	\$996
Total	\$905	\$905	\$996	\$996

DESCRIPTION: Individuals and non-corporate business taxpayers are allowed to exclude from gross income a portion of the gain from the sale or exchange of qualified small business stock. The exclusion is 50 percent for qualified stock issued after August 10, 1993, but temporary provisions increased the exclusion to 75 percent for stock acquired from February 18, 2009, to September 27, 2010; and to 100 percent for stock acquired from September 28, 2010, to December 31, 2013. The exclusion is 50 percent for stock acquired after 2014. Because the gain on the sale of small business stock is ordinarily 28 percent, a 50 percent exclusion yields an effective tax rate of 14 percent. This provision expired at the end of 2013 but was extended through 2014 at a cost less than \$50 million.

Qualified small business stock must be acquired by a non-corporate taxpayer at the time of original issue and held for at least five years. The stock must be issued by a C corporation that has no more than \$50 million in gross assets and employs at least 80 percent of its assets during the five-year holding period. In addition, the corporation must be a “specialized small business investment company” in any line of business except for health care, law, engineering, architecture, food service, lodging, farming, insurance, finance, or mining.

The exclusion is considered a preference item for the purpose of computing the alternative minimum tax (AMT). Since 2014, the share of excluded gain that is added to AMT taxable income rises to 42 percent while the 7 percent exclusion expired at the end of 2013 but may be extended.

PURPOSE: The Congressional Research Service states that the exclusion is “intended to facilitate the formation and growth of small firms involved in developing new manufacturing technologies and organized as C corporations by increasing their access to capital. It does this by giving investors ... a robust incentive to acquire a sizable equity stake in such firms.”⁴³

IMPACT: CRS posits that, “Most of the benefits ... are captured by small business owners and high-income individuals with relatively high tolerances for risk.”⁴⁴ The tax expenditure from the exclusion arises from the difference between the effective capital gains tax rate that applies to

⁴³ U.S. Senate, Committee on the Budget, p. 515.

⁴⁴ Ibid, p. 513.

sales or exchanges of QSBS and the maximum effective capital gains tax rate, under both the regular income tax and the AMT, on the sale or exchange of other capital assets.”⁴⁵ Nevertheless, the tax expenditure may have less impact on access to capital than it once did, because alternative investments are now much attractive due to the reduction in long-term capital gains rates, which range from 0 to 15 percent depending on an individual’s tax bracket. CRS adds that, “There is limited evidence to support the view that the provision has had its intended effect of increasing the flow of equity capital to eligible firms ... there is a lack of research assessing the provision’s impact on the cash flow, capital structure or investment behavior of firms issuing the stock.”⁴⁶

⁴⁵ U.S. Senate, Committee on the Budget, p. 513.

⁴⁶ *Ibid*, p. 516.

Income Tax
Exclusions

11. Discharge of certain student loan debt

Internal Revenue and U.S. Code Sections: 108(f), 20 U.S.C. 1087ee(a)(5) and 42 U.S.C. 2541-1(g)(3)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1984

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$192	\$192	\$192	\$192
Total	\$192	\$192	\$192	\$192

DESCRIPTION: In general, canceled or forgiven debt, or debt that is repaid on a borrower’s behalf, is considered taxable income. However, federal law allows exclusion for the discharge of student loan debt by the federal, state, or local governments; public benefit corporations that operate a state, county, or municipal hospital; and qualified educational institutions for an individual who agrees to work in a certain type of occupation for a specified period of time.

Programs covered by the exclusion include loan forgiveness for teachers and public service employees under the federal direct student loan program, loan forgiveness for teachers under federal guaranteed loan programs, and loan cancellation for public service employees under the federal Perkins Loan program. Also eligible for the exclusion are loan payments made on behalf of health professionals who work in shortage areas under the National Health Service Corps Loan Repayment Program or state programs eligible for Public Health Service Act funding, as well as loan payments or forgiveness offered by state programs that recruit health care professionals to underserved or shortage areas. Finally, certain law school loan repayment programs made by non-federal lenders are also covered.

PURPOSE: The purpose of the exclusion is to encourage individuals to work in certain high-priority occupations (such as public health or education) or in certain locations (such as health professional shortage areas) by providing student loan forgiveness as an incentive.

IMPACT: Individuals with student loans forgiven under the program benefit from this provision. The industries and geographic areas targeted for the incentive may also benefit. The Congressional Research Service states that, “The value to an individual of excluding the discharge of student loan indebtedness from gross income depends on that individual’s marginal tax rate in the tax year in which the benefit is realized ... In many instances, borrowers employed in these types of professions will be in lower tax brackets than if they had taken higher-paying jobs elsewhere.”⁴⁷ CRS also points out that the impact of loan forgiveness programs and the tax exclusion for discharged student loan debt on occupational choices is not known.⁴⁸

⁴⁷ U.S. Senate, Committee on the Budget, p. 680.

⁴⁸ Ibid, p. 679.

Income Tax
Exclusions

12. Earnings of Coverdell education savings accounts

Internal Revenue Code Section: 530
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1998

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$96	\$96	\$96	\$96
Total	\$96	\$96	\$96	\$96

DESCRIPTION: A taxpayer may establish a Coverdell education savings account (ESA) to pay for the qualified education expenses of a named beneficiary.⁴⁹ Qualified expenses include tuition, fees, books, supplies, and room and board for elementary, secondary, and higher education. There are two tax advantages to a Coverdell: 1) the earnings can grow tax-free annually until they are withdrawn, and 2) distributions or withdrawals from a Coverdell are tax-free, if they are used to pay for qualified expenses. Annual contributions to a particular beneficiary cannot exceed \$2,000 and cannot be made after the beneficiary reaches age 18 unless he or she has special needs. The annual contribution is not deductible, but any earnings on the contributions are tax-free until they are distributed.

The maximum allowable contribution is reduced for taxpayers with annual incomes over \$95,000 and is phased out completely at an annual income level of \$110,000 (the comparable thresholds are \$190,000 and \$210,000 for a joint return). The portion of the distribution attributed to principal is not taxed, but the earnings may be taxed depending on the amount of qualified higher education expenses that the beneficiary has incurred. A 6 percent tax is imposed if total contributions exceed the annual per-beneficiary limit. In addition, “funds withdrawn from one Coverdell ESA in a 12-month period and rolled over to another ESA on behalf of the same beneficiary or a relative of the beneficiary are excluded from the annual contribution limit and are not taxable”.⁵⁰

A contributor may fund multiple accounts for the same beneficiary (subject to the overall \$2,000 annual limit) and a student may be the designated beneficiary of multiple accounts. With the exception of accounts for special needs beneficiaries, Coverdell ESA balances must be fully distributed by the time beneficiaries reach the age of 30.

PURPOSE: According to the Congressional Research Service, “These benefits reflect congressional concern that families are having increasing difficulty paying for college. They also reflect an intention to subsidize middle-income families that otherwise do not qualify for much

⁴⁹ The program is named after the late Senator Paul Coverdell of Georgia, who was the chief sponsor of the authorizing legislation. Coverdell ESAs were previously known as “Education IRAs.”

⁵⁰ U.S. Senate, Committee on the Budget, p. 632.

need-based federal student aid.”⁵¹ The federal law that expended eligible expenses to those incurred in connection with enrollment in public and private K-12 schools was intended to encourage families to exercise school choice to provide alternatives to the traditional public school.

IMPACT: CRS points out that, “Families that have the wherewithal to save are more likely to benefit. Whether families will save additional sums might be doubted. Tax benefits for Coverdell ESAs are not related to the student’s cost of attendance or other family resources, as is most federal student aid for higher education. Higher-income families also are more likely than lower-income families to establish accounts for their children’s K-12 education expenses.”⁵²

⁵¹ U.S. Senate, Committee on the Budget, p. 634.

⁵² *Ibid*, p. 646.

Income Tax
Exclusions

13. Earnings of qualified tuition programs

Internal Revenue Code Section: 529
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1997

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$865	\$1,154	\$1,346	\$1,442
Total	\$865	\$1,154	\$1,346	\$1,442

DESCRIPTION: Qualified Tuition Programs (QTPs), also known as “529 plans” for their section number in the tax code, are tax-advantaged investment used to pay for higher education. These earnings usually grow tax-free, if they are used to pay for qualified education expenses. There are two types of QTPs that allow people to pay in advance or save for college expenses for designated beneficiaries: (1) prepaid tuition plans, and (2) college savings plans. Prepaid tuition plans allow account owners to make tuition payments for beneficiaries at current prices, thereby providing a hedge against inflation. College savings plans allow account owners to save and invest money on a tax-favored basis that can be used to pay for higher education expenses (tuition and fees, books, supplies, room and board).

The District of Columbia sponsors a college savings plan, but does not offer a prepaid tuition plan. Nevertheless, it is possible to participate in a prepaid tuition plan outside of one’s current state of residence. Only states can sponsor college savings accounts, but both states and institutions of higher education offer prepaid tuition plans.

Contributors can fund multiple QTP accounts for the same beneficiary in different states, and an individual may be the beneficiary of accounts established by different contributors. Sponsors can establish their own restrictions, and the specifics of each plan vary from state to state. One difference between QTPs and Coverdell education savings accounts (see tax expenditure #12 on the previous page) is that there are no income restrictions or annual contribution limits for QTPs. Individuals can contribute to QTPs and Coverdell plans during the same year.

Contributions to QTPs are taxable, but the earnings on contributions as well as the distributions are free from federal income tax. Taxpayers must reduce their QTP exclusion by the amount of any other tax-free educational assistance. Non-qualifying distributions are subject to a 10 percent penalty, and the earnings share of a non-qualifying distribution is subject to federal income tax.

PURPOSE: The purpose of the exclusion is to help families save for higher education.

IMPACT: The Congressional Research Service states that the benefits of QTPs are more likely to benefit higher-income families because those tax payers are subject to higher taxes, and have the resources to save for college.⁵³ Urban Institute researchers have questioned whether the plans

⁵³ U.S. Senate, Committee on the Budget, p. 646.

have an impact on college savings because higher-income families have the resources to set aside funding for higher education without the tax incentives.⁵⁴

⁵⁴ Elaine Maag and Katie Fitzpatrick, “Federal Financial Aid for Higher Education: Programs and Prospects,” Urban Institute discussion paper issued January 2004 (available at www.urban.org), pp. 24-25.

Income Tax
Exclusions

14. Employer-provided education assistance

Internal Revenue Code Section: 127
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1978

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$915	\$915	\$991	\$991
Total	\$915	\$915	\$991	\$991

DESCRIPTION: An employee may exclude from income certain amounts paid by an employer for education assistance, including tuition, fees, and books. The maximum exclusion is \$5,250 per year. There are 3 main requirements of educational assistance plan for the exclusion to be applicable. First, the educational assistance must be provided pursuant to a written qualified educational assistance program. Second, the Plan may not discriminate in favor of highly compensated employees. Third, no more than 5 percent of the total amount paid out during the year may be paid to or for employees who are shareholders or owners of at least 5 percent or more of the business.⁵⁵ Any excess is part of an employee’s gross income and is subject both to income and payroll taxes. The exclusion applies whether the employer pays the expenses, reimburses the employee for expenses, or provides instruction directly. The coursework does not have to be job-related, but classes involving sports, games, or hobbies are eligible only if they are job-related.

PURPOSE: The purpose of the exclusion is to encourage employers to offer education assistance to their employees.

IMPACT: The Congressional Research Service states that, “The exclusion allows certain employees, who otherwise might be unable to do so, to continue their education. The value of the exclusion is dependent upon the amount of educational expenses furnished and the marginal tax rate.”⁵⁶ CRS adds that, “The availability of employer educational assistance encourages employer investment in human capital, which may be inadequate in a market economy because of spillover effects (i.e., the benefits of the investment extend beyond the individuals undertaking additional education and the employers for whom they work).”⁵⁷ The following groups of employees are much more likely to receive employer-provided educational assistance than other workers: employees in management, professional, and related jobs; full-time employees; employees who belong to labor unions; employees whose wages are in the top half of the earnings distribution; and employees at firms with 100 or more employees.⁵⁸

⁵⁵ U.S. Senate, Committee on the Budget, p. 693.

⁵⁶ Ibid, p. 694.

⁵⁷ Ibid, p. 695.

⁵⁸ Ibid, p. 694.

President Bush’s Advisory Panel on Federal Tax Reform recommended repealing this exclusion (as well as several other exclusions for fringe benefits) because, “The favorable tax treatment of fringe benefits results in an uneven distribution of the tax burden as workers who receive the same amount of total compensation pay different amounts of tax depending on the mix of cash wages and fringe benefits.”⁵⁹

⁵⁹ The President’s Advisory Panel on Federal Tax Reform, Simple, Fair, and Pro-Growth: Proposals to Fix America’s Tax System (November 2005), p. 85.

Income Tax
Exclusions

15. Employer-provided tuition reduction

Internal Revenue Code Section: 117(d)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1984

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$229	\$229	\$229	\$229
Total	\$229	\$229	\$229	\$229

DESCRIPTION: Tuition reductions for employees of educational institutions may be excluded from federal taxable income if the reductions do not represent payment for services. The exclusion also applies to tuition reductions for an employee’s spouse and dependent children. CRS states that “for individuals receiving a tuition reduction for education, the exclusion applies to both the employee of the eligible educational institution receiving the tuition reduction, as well as their spouses and dependent children”.⁶⁰

PURPOSE: The Congressional Research Service states that, “Language regarding tuition reductions was added by the Deficit Reduction Act of 1984 as part of legislation codifying and establishing boundaries for tax-free fringe benefits; similar provisions had existed in regulations since 1956.”⁶¹

IMPACT: CRS notes that, “The exclusion of tuition reductions lowers the net cost of education for employees of educational institutions ... Tuition reductions are provided by education institutions to employees as a fringe benefit, which may reduce costs of labor and turnover. In addition, tuition reductions for graduate students providing research and teaching services for the educational institution also contribute to reducing the education institution’s labor costs. Both employees and graduate students may view the reduced tuition as a benefit of their employment that encourages education. The exclusion may serve to in effect pass some of the education institutions’ labor costs on to other taxpayers.”⁶²

⁶⁰ U.S. Senate, Committee on the Budget, p. 655.

⁶¹ Ibid, p. 656.

⁶² Ibid.

Income Tax
Exclusions

16. Interest on education savings bonds

Internal Revenue Code Section: 135
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1988

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	too small	too small	too small	too small
Total	too small	too small	too small	too small

Note: “too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Part or all of the interest earned on U.S. Series EE or Series I savings bonds can be excluded from taxable income if the bonds are used to finance higher education expenses for the taxpayer, the taxpayer’s spouse, or the taxpayer’s dependents. The bonds must have been issued after 1989, and the owner must have been at least 24 years old at the time of issuance. The proceeds must be used for qualified higher education expenses (which generally cover tuition and fees, but not room and board) in the same year that they are redeemed.

The tax exemption is phased out for taxpayers with AGI between \$115,751 and \$145,749 if married filing jointly (\$77,200 and \$92,199 for other taxpayers) in tax year 2015.⁶³ Taxpayers with incomes above those levels did not qualify for any exclusion.

PURPOSE: The purpose of the exclusion is to encourage lower- and middle-income families to save for their children’s college education.

IMPACT: The Congressional Research Service states that, “Education savings bonds provide lower- and middle-income families with a tax-favored way to save for higher education that is convenient and often familiar. The benefits are greater for families who live in states and localities with high income taxes because the interest income from Series EE and Series I Bonds is exempt from state and local income taxes.”⁶⁴

Several restrictions limit the value of education savings bonds as a college savings vehicle. CRS observes that, “Since the interest exclusion for Education Savings Bonds can be limited when the bonds are redeemed, families intending to use them for college expenses must predict their income eligibility far in advance. They must also anticipate the future costs of tuition and fees

⁶³ U.S. Department of the Treasury Office of Tax Analysis, Tax Expenditures Fiscal Year 2017 (November, 2015).

⁶⁴ U.S. Senate, Committee on the Budget, Tax Expenditures: Compendium of Background Material on Individual Provisions, Senate Print 111-58, prepared by the Congressional Research Service (December 2010), p. 626.

and whether their children might receive scholarships ... In these respects, the bonds may not be as attractive an investment as some other education savings vehicles.⁶⁵

⁶⁵ U.S. Senate, Committee on the Budget, p. 627.

Income Tax
Exclusions

17. Interest on state and local private-activity bonds issued to finance education facilities

Internal Revenue Code Sections: 103, 141,142(k), 145, 146, and 501(c)(3)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1968

(Dollars in thousands)	FY 2016	FY 2017	FY 2017	FY 2019
Corporate Income Tax Loss	\$1,340	\$1,340	\$1,474	\$1,474
Personal Income Tax Loss	\$3,302	\$3,556	\$3,683	\$3,937
Total	\$4,641	\$4,895	\$5,156	\$5,410

DESCRIPTION: Interest income on state and local bonds used to finance the construction of non-profit educational facilities (such as classrooms and dormitories) and qualified public educational facilities is tax-exempt. These bonds are classified as private-activity bonds, rather than governmental bonds, because a substantial portion of the benefits accrues to individuals or private organizations instead of the general public.

Bonds issued for non-profit educational facilities are not subject to the state volume cap on private-activity bonds, but there is a cap of \$150 million on the amount of bonds any non-profit institution can have outstanding. Public colleges and universities can also issue tax-exempt bonds to finance facilities that are owned by private, for-profit corporations, provided that the school has a public-private agreement with the local education authority. Tax-exempt bonds issued for qualified public education facilities are subject to a separate state-by-state cap equal to \$10 per capita or \$5 million per year, whichever is greater⁶⁶.

PURPOSE: The purpose of the education private-activity bonds is to support the construction or substantial rehabilitation of educational facilities by subsidizing low-interest loans. Investors purchase the bonds at low interest rates because the income from them is tax-free.

IMPACT: The tax-exempt bonds benefit educational institutions by helping them finance facilities at reduced interest rates. Some benefits of the tax exemption also flow to bondholders. According to the Congressional Budget Office and the Joint Committee on Taxation, education facility bonds accounted for 17 percent of total state and local private-activity bond issuance from 1991 to 2007, growing 11 percent annually during that period.⁶⁷

⁶⁶ U.S. Senate, Committee on the Budget, Tax Expenditures: Compendium of Background Material on Individual Provisions, Senate Print 113-32, prepared by the Congressional Research Service (December 2014), p. 662.

⁶⁷ Congressional Budget Office and the Joint Committee on Taxation, Subsidizing Infrastructure Investment with Tax-Preferred Bonds (Washington, D.C.: Congressional Budget Office and Joint Committee on Taxation, 2009), pp. 19-23.

The Congressional Research Service observes that non-profit universities may be “using their tax-exempt status to subsidize goods and services for groups that might receive more critical scrutiny if they were subsidized by direct federal expenditure.”⁶⁸ Furthermore, “As one of many categories of tax-exempt bonds, nonprofit educational facilities and public education bonds have increased the financing costs of bonds issued for more traditional public capital stock. In addition, this class of tax-exempt bonds has increased the supply of assets that individuals and corporations can use to shelter income from taxation.”⁶⁹

⁶⁸U.S. Senate, Committee on the Budget, Tax Expenditures: Compendium of Background Material on Individual Provisions, Senate Print 112-45, prepared by the Congressional Research Service (December 2012), p. 673.

⁶⁹ Ibid.

Income Tax
Exclusions

18. Interest on state and local private-activity student loan bonds

Internal Revenue Code Sections: 103, 141, 144(b), and 146
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1965 (general exclusion for state and local bonds was enacted in 1913, but student loan bonds were not offered until enactment of the Higher Education Act of 1965)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$268	\$268	\$268	\$268
Personal Income Tax Loss	\$508	\$508	\$635	\$635
Total	\$776	\$776	\$903	\$903

DESCRIPTION: Student loan bonds, which are issued by state and local governments to finance student loans at below-market rates, represent another type of tax-exempt, private-activity bond. These bonds are subject to a state’s annual volume cap on private-activity bonds, and therefore must compete for tax-exempt financing with all other private-activity bonds that are subject to the cap. The tax expenditure represents the revenue loss from the exclusion of interest on the bonds.

In addition, this tax expenditure includes the revenue loss from federal government loan programs (such as Stafford, PLUS, and Consolidation loans) that were carried out through private lenders and financed in part by tax-exempt debt. As of July 1, 2010, the federal government is providing loans directly instead of operating through private lenders. Nevertheless, there is an ongoing revenue loss from loans that have already been issued.

PURPOSE: The purpose of the private-activity bonds is to increase access to higher education by subsidizing low-interest loans. Investors purchase the bonds at below-market interest rates because the income from them is tax-free.

IMPACT: Students benefit from the exclusion, which may also generate spillover benefits to society from a more educated citizenry. The lower interest rate on the bonds may increase the availability of student loans by lowering the cost of government borrowing, but it does not reduce the interest rate charged to students, which is set by federal law. Students present a high credit risk due to their uncertain earning prospects, meaning that the private sector may not supply a sufficient amount of capital for higher education due to the risk. Subsidies can help correct this market failure.⁷⁰

The Congressional Research Service points out that other federal programs, such as subsidized direct loans, may be sufficient to address the market failure. Tax-exempt financing also involves potential costs. CRS states that, “As one of many categories of tax-exempt private-activity bonds, bonds issued for student loans have increased the financing costs of bonds issued for

⁷⁰ U.S. Senate, Committee on the Budget, Tax Expenditures: Compendium of Background Material on Individual Provisions, Senate Print 113-32, prepared by the Congressional Research Service (December 2014) p. 652.

public capital stock, and have increased the supply of assets available to individuals and corporations to shelter their income from taxation.”⁷¹

⁷¹ U.S. Senate, Committee on the Budget, p. 652.

Income Tax
Exclusions

19. Scholarship and fellowship income

Internal Revenue Code Section: 117
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1954

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$2,788	\$2,884	\$3,076	\$3,269
Total	\$2,788	\$2,884	\$3,076	\$3,269

DESCRIPTION: Scholarships and fellowships are excluded from personal taxable income to the extent that they cover tuition and course-related expenses of students enrolled in primary, secondary, or higher education. The exclusion covers awards based on financial need (such as Pell Grants) as well as those based on academic achievement or merit (such as National Merit Scholarships). Eligible educational institutions must maintain a regular teaching staff and curriculum, and have a regularly enrolled student body attending classes where the school carries out its instructional activities.

PURPOSE: This exclusion was originally enacted to clarify the status of education grants. Until this provision was enacted in 1954, scholarships and fellowships were included in gross income unless it could be proven that the money was a gift. The Congressional Research Service observes that the present rationale for the exclusion, in light of the expansion of need-based grants, “rests upon the hardship that taxation would impose. If the exclusion were abolished, awards could arguably be increased to cover students’ additional tax liability, but the likely effect would be that fewer students would get assistance.”⁷²

IMPACT: CRS states that, “The exclusion reduces the net cost of education for students who receive financial aid in the form of scholarships or fellowships. The potential benefit is greatest for students at schools where higher tuition charges increase the amount of scholarship or fellowship assistance that might be excluded.”⁷³ As a result, students attending private colleges and universities may claim a disproportionate share of the benefits.

CRS adds that, “The exclusion provides greater benefits to taxpayers with higher marginal tax rates. While students themselves generally have low (or even zero) marginal rates, they often are members of families subject to higher rates. Determining what ought to be the proper taxing unit for college students complicates assessment of the exclusion.”⁷⁴

⁷² U.S. Senate, Committee on the Budget, p. 659.

⁷³ Ibid, p. 658.

⁷⁴ Ibid, p. 659.

Income Tax
Exclusions

20. Cafeteria plan benefits

Internal Revenue Code Section: 125
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1974

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$27,524	\$28,668	\$30,041	\$30,650
Total	\$27,524	\$28,668	\$30,041	\$30,650

DESCRIPTION: Cafeteria plans are employer-sponsored benefit packages that offer employees a choice between cash and qualified benefits, such as accident and health coverage, group-term life insurance, dependent care assistance, and adoption assistance. The employee pays no tax on the value of the benefits but pays tax if he or she chooses cash instead.

Most flexible spending accounts (FSAs), which reimburse employees for specific expenses up to a maximum amount, are governed by cafeteria plan rules because they involve a choice between cash wages and non-taxable benefits. FSAs allow employees to make pre-tax contributions for reimbursement of health and/or dependent care expenses, but these accounts have a “use or lose” rule. Starting in 2013, contributions to health care FSAs are capped at \$2,500.

In 2012, 20 percent of employees had access to a flexible benefits plan, 37 percent had access to a dependent care plan, and 40 percent had access to a health care reimbursement plan. Employees of firms with more than 500 employees were more likely to have access to these plans.⁷⁵

Additionally, CRS states that “[A]n important benefit that can be provided via cafeteria plans is the employee’s share of health insurance premiums, including cases where the employee pays the entire premium. Insurance bought from the individual exchanges established under the Patient Protection and Affordable Care act of 2010, which began in 2014, is not eligible for tax benefits under cafeteria plans⁷⁶.

PURPOSE: The purpose of the exclusion is to promote the adoption and use of flexible benefit packages that allow employees to choose the benefits they most need.

IMPACT: The Congressional Research Service points out that, “As with other tax exclusions, the tax benefits are greater for taxpayers with higher incomes. Higher income taxpayers may be more likely to choose nontaxable benefits (particularly health care benefits) instead of cash, which would be taxable. Lower income taxpayers may be more likely to choose cash, which they may value more highly and for which the tax rates would be comparatively low.”⁷⁷

⁷⁵ U.S. Senate, Committee on the Budget, p. 721.

⁷⁶ Ibid.

⁷⁷ Ibid.

CRS further states that, “Ability to fine-tune benefits increases the efficient use of resources and may help some employees better balance competing demands of family and work.”⁷⁸ Still, the exclusion may impair horizontal equity because, “(T)he favored tax treatment of cafeteria plans leads to different tax burdens for individuals with the same economic income.”⁷⁹

⁷⁸ U.S. Senate, Committee on the Budget, p. 723.

⁷⁹ *Ibid.*

Income Tax
Exclusions

21. Employee awards

Internal Revenue Code Sections: 74(c) and 274(j)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$229	\$229	\$229	\$305
Total	\$229	\$229	\$229	\$305

DESCRIPTION: Certain awards of tangible personal property given to employees for length of service or for safety practices are excluded from personal taxable income, departing from the standard treatment of prizes and awards as taxable income. The amount of the exclusion is limited to \$400 per employee but can rise to \$1,600 if it is part of a qualified employee achievement award plan that does not discriminate in favor of highly compensated employees. The employer is also allowed to deduct the cost from its taxable income. If the cost of the award to the employer and the fair market value of the award exceed the limits stated above, the employee must include the extra amount in his or her gross income.

There are several other restrictions designed to ensure that the awards do not constitute disguised compensation. Length of service awards cannot be granted to an employee in the first five years of service, or to an employee who received a length of service award in any of the prior four years of service. Awards for safety achievement cannot be awarded to a manager, administrator, clerical employee, or other professional employee. In addition, safety awards cannot be granted to more than 10 percent of employees in any year.

PURPOSE: The purpose of the exclusion is to clarify the tax treatment of employee awards and to encourage longevity in employment as well as safety practices on the job.

IMPACT: Employees who receive length-of-service or safety awards and employers who save costs related to training and time lost to injuries benefit from this provision. The Congressional Research Service points out that, “The exclusion recognizes a traditional business practice which may have social benefits. The combination on the limitation of the exclusion as to eligibility for qualifying awards, and the dollar amount of the exclusion not being increased since 1986, keep the exclusion from becoming a vehicle for significant tax avoidance. However, the lack of an increase in the exclusion effectively reduces the tax-free portion of some awards.”⁸⁰

⁸⁰ U.S. Senate, Committee on the Budget, p. 707.

Income Tax
Exclusions

22. Employee stock ownership plans

Internal Revenue Code Sections: 401(a)(28), 404(a)(9), 404(k), 415(c)(6), 1042,
4975(e)(7), 4978, and 4979A
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1974

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$76	\$76	\$76	\$76
Personal Income Tax Loss	\$1,206	\$1,287	\$1,287	\$1,367
Total	\$1,283	\$1,363	\$1,363	\$1,444

DESCRIPTION: An employee stock ownership plan (ESOP) is a defined-contribution retirement plan that invests in the stock of a sponsoring employer. ESOPs are unique among employee benefit plans in their ability to borrow money to buy stock. An ESOP can be leveraged (that is, borrowed money is used to buy stock) or unleveraged (where stock is acquired through direct employer contributions of cash or stock). ESOPs involve several tax expenditures and must meet the minimum requirements to qualify for the tax advantages.

First, employer contributions may be deducted from corporate taxable income as a business expense. An employer may also deduct dividends paid on stock held by an ESOP if the dividends are paid to plan participants. Second, employees are not taxed on employer contributions or the earnings on invested funds until they are distributed. Third, a stockholder in a closely-held company may defer recognition of the gain from the sale of stock to an ESOP if, after the sale, the ESOP owns at least 30 percent of the company’s stock and the seller reinvests the proceeds from the sale of stock in a U.S. company.

PURPOSE: The Congressional Research Service states that, “The tax incentives for ESOPs are intended to broaden stock ownership, provide employees with a source of retirement income, and grant employers a tax-favored means of financing.”⁸¹

IMPACT: ESOP tax incentives encourage personal savings through employee ownership of stock in a qualified employee benefit plan. Some evidence suggests that among firms with ESOPs, there is a greater increase in productivity if employees are involved in corporate decision-making.⁸² Employers and employees of participating companies benefit from the tax-favored status of ESOPs. Although most ESOPs are sponsored by private companies, the majority of ESOP participants are employed by public companies.⁸³

⁸¹ U.S. Senate, Committee on the Budget, p. 699.

⁸² Ibid, p. 701.

⁸³ Ibid, p. 699.

CRS observes that, “These plans are believed to motivate employees by more closely aligning their financial interests with the financial interests of their employers. The distribution of stock ownership in ESOP firms is broader than the distribution of stock ownership in the general population.”⁸⁴ Nevertheless, “(T)he requirement that ESOPs invest primarily in the stock of the sponsoring employer is consistent with the goal of corporate financing, but it may not be consistent with the goal of providing employees with retirement income. The cost of such a lack of diversification was demonstrated with the failure of Enron and other firms whose employees’ retirement plans were heavily invested in company stock.”⁸⁵

⁸⁴ U.S. Senate, Committee on the Budget, p. 700.

⁸⁵ *Ibid*, p. 701.

Income Tax
Exclusions

23. Employer-paid meals and lodging (other than military)

Internal Revenue Code Sections: 119 and 132(e)(2)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1918

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$1,601	\$1,677	\$1,754	\$1,830
Total	\$1,601	\$1,677	\$1,754	\$1,830

DESCRIPTION: Employees can exclude from personal taxable income the fair market value of meals provided by employers if the meals are furnished on the employer’s business premises and for the convenience of the employer. The fair market value of lodging provided by an employer can also be excluded from personal taxable income, if the lodging is furnished on business premises for the convenience of the employer, and if the employee is required to accept the lodging as a condition of employment (as when an apartment manager must live on the premises). The exclusion does not apply to cases in which an employee is reimbursed by the employer for amounts spent on meals and lodging.

In addition, the fair market value of meals provided to an employee at a subsidized eating facility operated by the employer is excluded from taxable income.

PURPOSE: The purpose of the exclusion is to eliminate the record-keeping and administrative burdens, and to recognize that the fair market value of employer-provided meals and lodging may be difficult to measure.

IMPACT: The Congressional Research Service states that, “The exclusion subsidizes employment in those occupations or sectors in which the provision of meals and/or lodging is common. Both the employees and their employers benefit from the tax exclusion. Under normal market circumstances, more people are employed in these positions than would otherwise be the case and they receive higher compensation (after tax). Their employers receive their services at lower cost. Both sides of the transaction benefit because the loss is imposed on the U.S. Treasury in the form of lower tax collections.”⁸⁶

⁸⁶ U.S. Senate, Committee on the Budget, p. 710.

Income Tax
Exclusions

24. Housing allowance for ministers

Internal Revenue Code Section: 107 and 265
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1921

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$610	\$610	\$610	\$610
Total	\$610	\$610	\$610	\$610

DESCRIPTION: Ministers (defined as being “a duly ordained, commissioned, or licensed minister of a church”⁸⁷) can exclude from personal taxable income the fair rental value of a church-owned or church-rented home furnished as part of their compensation, or a cash housing allowance paid as part of their compensation. The housing allowance used to pay expenses in providing a home include rent, mortgage interest, utilities, repairs, and other expenses directly relating to providing a home. The church must officially designate the allowance as being for housing before paying it to the minister, and the allowance cannot exceed the fair rental value of the minister’s home. In addition, ministers who receive cash housing allowances may also claim them as tax deductions on their individual income tax returns if they are used to pay mortgage interest and real estate taxes on their residences although they are still subject to social security payroll taxes.

PURPOSE: The Revenue Act of 1921 authorized only the exclusion for church-provided housing. Although there was no stated rationale for the exclusion, the Congressional Research Service notes that, “Congress may have intended to recognize clergy as an economically deprived group due to their relatively low incomes.”⁸⁸ Congress added the exclusion for cash housing allowances in 1954, possibly to provide equal treatment among clergy members receiving different types of housing assistance from their churches. In clarifying the tax treatment of housing assistance to clergy members in the “Clergy Housing Allowance Clarification Act of 2002” (P.L. 107-181), Congress stated its desire to “minimize government intrusion into internal church operations and the relationship between a church and its clergy.”⁸⁹

IMPACT: Ministers who receive a housing allowance or who live in a church-provided home benefit from this provision. Although, the special exclusion, ministers receiving such housing allowances pay less than other taxpayers with the same or smaller economic income. CRS observes that, “The tax-free parsonage allowances encourage some congregations to structure maximum amounts of tax-free housing allowances into their minister’s pay and may thereby distort the compensation package. The provision is inconsistent with economic principles of horizontal and vertical equity. Since all taxpayers may not exclude amounts they pay for housing

⁸⁷ U.S. Senate, Committee on the Budget, p. 725.

⁸⁸ Ibid, p. 726.

⁸⁹ Ibid, p. 727.

from taxable income, the provision violates horizontal equity principles ... Ministers with higher incomes receive a greater subsidy than lower-income ministers because those with higher incomes pay taxes at higher marginal tax rates. The disproportionate benefit of the tax exclusion to individuals with higher incomes reduces the progressivity of the tax system, which is viewed as a reduction in equity.”⁹⁰ In addition, some ministers are able to claim the tax benefits twice by deducting mortgage interest payments that were made with cash housing allowances that are excluded from taxable income.

⁹⁰ U.S. Senate, Committee on the Budget, p. 728.

Income Tax
Exclusions

25. Miscellaneous fringe benefits

Internal Revenue Code Sections: 117(d) and 132
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1984

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$5,871	\$5,947	\$6,100	\$6,252
Total	\$5,871	\$5,947	\$6,100	\$6,252

DESCRIPTION: Certain non-cash fringe benefits qualify for an exclusion from an employee’s gross income. These benefits include services provided at no additional cost (such as free stand-by flights for airline employees), employee discounts, working condition fringe benefits, certain tuition reductions, and *de minimis* fringe benefits (such as providing coffee to employees or allowing them occasional personal use of an office copy machine).

The benefits also may be provided to spouses, and dependent children of employees; retired and disabled former employees; and widows or widowers of former employees.

PURPOSE: The Congressional Research Service states that, “Congress recognized that in many industries employees receive either free or discounted goods and services that the employer sells to the general public. In many cases, these practices had been long established and generally had been treated by employers, employees, and the Internal Revenue Service as not giving rise to taxable income.”⁹¹ CRS further points out that, “Employees clearly receive a benefit from the availability of free or discounted goods or services, but the benefit may not be as great as the full amount of the discount. Employers may have valid business reasons, other than simply providing compensation, for encouraging employees to use the products they sell to the public ... As with other fringe benefits, placing a value on the benefit in these cases is difficult.”⁹²

IMPACT: Both employers and employees benefit from this exclusion, which subsidizes employment in those businesses and industries in which ancillary fringe benefits are feasible and commonly offered. CRS states that, “Under normal market circumstances, more people are employed in these businesses and industries than they would otherwise be, and they receive higher compensation (after tax). Their employers receive their services at lower cost. Both sides of the transaction benefit because the loss is imposed on the U.S. Treasury in the form of lower tax collections.”⁹³ In addition, “Because the exclusion applies to practices which are common and may be feasible only in some businesses and industries, it creates inequities in tax treatment among different employees and employers.”⁹⁴

⁹¹ U.S. Senate, Committee on the Budget, p. 742.

⁹² Ibid.

⁹³ Ibid pp. 742-743.

⁹⁴ Ibid, p. 743.

Income Tax
Exclusions

26. Spread on acquisition of stock under incentive stock option plans and employee stock purchase plans

Internal Revenue Code Sections: 422 and 423
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1981

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	-\$965	-\$965	-\$885	-\$885
Personal Income Tax Loss	\$327	\$246	\$246	\$246
Total	-\$638	-\$720	-\$639	-\$639

DESCRIPTION: Employees may be granted stock options under an incentive stock option plan (which is capped at \$100,000 annually per employee, and can be confined to officers or highly-paid employees) or an employee stock purchase plan (which is capped at \$25,000 annually per employee, and must be offered to all full-time employees with at least two years of service). These plans allow employees to exercise the stock options within a specified time frame.

Generally, a stock option or purchase plan allows an employee to buy the stock for less than the current market price. At the time the employee exercises an option, the stock is transferred from the company to the employee, but the difference in value between the market value and the option prices (also known as the spread) is not considered taxable income. The value of this tax expenditure stems from the deferral of the tax until the employee sells the stock. If the stock is held one year from purchase and two years from the granting of the option, the gain is also taxed at the lower long-term capital gain rate.

The employer is not allowed a tax deduction for granting a stock option, but if the stock is not held for the required amount of time the employee is taxed at ordinary income tax rates (rather than lower capital gain rates) and the employer is allowed a deduction.

PURPOSE: According to the Congressional Research Service, the deferral of tax for qualified stock options was re-instituted by the Economic Recovery Tax Act of 1981 “with the justification that encouraging the management of a business to have a proprietary interest in its successful operation would provide an important incentive to expand and improve the profit position of the companies involved.”⁹⁵ The deferral of taxable gains had been allowed between 1964 and 1976.

IMPACT: The ownership of company stock is thought by many to assure that the company’s employees, officers, and directors share the interests of the company’s stakeholders. CRS describes the complex effects of this provision as follows: “Taxpayers with above average or high incomes are the primary beneficiaries of these tax advantages. Because employers (usually corporations) cannot deduct the cost of stock options eligible for the lower tax rate on long-term capital gains, employers pay higher income taxes. The prevailing view of tax economists is that

⁹⁵ U.S. Senate, Committee on the Budget, p. 715.

the corporate income tax falls primarily on shareholders. Because most corporate stock is owned by high income households, these households bear the incidence of this aspect of stock options. These conflicting effects on incidence mean that the overall incidence of qualified stock options is uncertain.”⁹⁶

CRS also observes that, “Paying for the services of employees, officers, and directors by the use of stock options has several advantages for the companies. Start-up companies often use the method because it does not involve the immediate cash outlays that paying salaries involves; in effect a stock option is a promise of a future payment, contingent on increases in the value of the company’s stock. It also makes the employees’ pay dependent on the performance of the company’s stock, giving them extra incentive to try to improve the company’s (or at least the stock’s) performance.”⁹⁷

⁹⁶ U.S. Senate, Committee on the Budget, p. 714.

⁹⁷ *Ibid*, pp. 715-716.

Income Tax
Exclusions

27. Voluntary employees’ beneficiary association income

Internal Revenue Code Sections: 419, 419A, 501(a), 501(c)(9) and 4976
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1928

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$2,440	\$2,516	\$2,516	\$2,592
Total	\$2,440	\$2,516	\$2,516	\$2,592

DESCRIPTION: A voluntary employees’ beneficiary association (VEBA) provides life, sickness, accident, and other insurance, as well as fringe benefits, to active or retired employees, their dependents, and their beneficiaries. The income earned by a VEBA is generally exempt from federal income taxes,⁹⁸ but when the benefits are distributed to individuals, the income is taxable unless there is a specific statutory exclusion. Accident and health benefits are excludable from income, but severance and vacation pay are not.

Most VEBAs are organized as trusts to be legally separate from their employers. VEBAs must meet a number of general requirements. Most importantly, they must be associations of employees who share a common employment-related bond, such as membership in a collective bargaining unit. In addition, membership in a VEBA must be voluntary and the association must be controlled by its members, by an independent trustee such as a bank, or by trustees or fiduciaries at least some of whom are designated by the members or on behalf of the members. Substantially all of the organization’s operations must further the provision of life, sickness, accident, and other welfare benefits to employees and their families, and benefit plans (other than collectively-bargained plans) must not discriminate in favor of highly-compensated individuals.

PURPOSE: The Congressional Research Service states that, “Perhaps VEBAs were seen as providing welfare benefits that served a public interest and normally were exempt from taxation.”⁹⁹

IMPACT: CRS points out that, “A VEBA may provide a valuable option for both employers and employees by providing tax-free contributions for employers and benefits to employees. In addition, the irrevocable trust fund associated with a VEBA helps protect the benefits ...”¹⁰⁰ In the case of bankruptcy, the presence of a VEBA with accumulated assets for payment of retiree health benefits offers retirees a measure of protection.

⁹⁸ Income earned by a VEBA to pre-fund retiree health benefits is normally subject to tax, but an important exception applies to VEBAs that are established through collective bargaining.

⁹⁹ Ibid, p. 736.

¹⁰⁰ U.S. Senate, Committee on the Budget, p. 738.

Income Tax
Exclusions

28. Interest on state and local private-activity bonds issued to support energy facilities

Internal Revenue Code Sections: 103, 141, 142(f), and 146
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1980

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	too small	too small	too small	too small
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Each state receives a certain amount of authority to issue tax-exempt private activity bonds, which are securities issued by a state or local government to finance qualified projects by a private user. Qualified projects, which include the construction of certain private energy production facilities such as electric energy or gas, are expected to have a public benefit.

Energy facility bonds are subject to the annual volume cap for state private activity bonds and generally, only facilities operating as of January 1, 1997, are eligible for tax-exempt financing.

PURPOSE: The purpose of the tax preference is to encourage private entities to invest in energy infrastructure. The use of the bonds is to reduce the operating cost of electricity-generating facilities for a limited number of entities. Without the tax preference, local electricity generation might not have been viable economically. Investors purchase the bonds at low interest rates because the income from them is tax-free.

IMPACT: The beneficiaries of the tax exemption are bondholders. Energy production companies as well as residential and commercial users of energy benefit from this provision. The Congressional Budget Office and the Joint Committee on Taxation estimate that energy facilities accounted for only 2 percent of total state and local private-activity bond issuance from 1991 to 2007.¹⁰¹

The Congressional Research Service states that, “Even if a case can be made for a federal subsidy of energy production facilities based on underinvestment at the state and local level, it is important to recognize the potential costs. As one of many categories of tax-exempt private-activity bonds, those issued for energy production facilities increase the financing cost of bonds issued for other public capital. With a greater supply of public bonds, the interest rate on the bonds necessarily increases to lure investors. In addition, expanding the availability of tax-exempt bonds increases the range of assets available to individuals and corporations to shelter their income from taxation.”¹⁰²

¹⁰¹ Congressional Budget Office and Joint Committee on Taxation, p. 19.

¹⁰² U.S. Senate, Committee on the Budget, p. 144.

Income Tax
Exclusions

29. Accrued interest on savings bonds

Internal Revenue Code Section: 454(c)
Federal Law Sunset Date: None for general deduction
Year Enacted in Federal Law: 1951

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$839	\$839	\$839	\$839
Total	\$839	\$839	\$839	\$839

DESCRIPTION: Owners of U.S. Treasury Series E, EE, and I savings bonds have the option to include the interest in their taxable income as it accrues, or to defer taxation on the interest until the bond is redeemed. The estimated revenue loss from this tax expenditure represents the difference between the tax that would be due on the interest upon accrual and the tax that is paid using the deferral option.

PURPOSE: The exclusion of accrued interest is intended to encourage people to buy U.S. savings bonds. The Congressional Research Service points out that, “The deferral of tax on interest income on savings bonds provides two advantages. First, payment of tax on the interest is deferred, delivering the equivalent of an interest-free loan of the amount of the tax. Second, the taxpayer often is in a lower income bracket when the bonds are redeemed. This is particularly common when the bonds are purchased while the owner is working and redeemed after the owner retires.”¹⁰³

IMPACT: Savings bonds appeal to small savers because the bonds are available in small denominations, are easy to purchase, and serve as a safe investment. In addition, higher-income individuals cannot devote much of their savings to the bonds because of annual purchase limits.¹⁰⁴

CRS adds that, “The savings bond program was established to provide small savers with a convenient and safe debt instrument and to lower the cost of borrowing to the taxpayer. The option to defer taxes on interest increases sales of bonds. But there is no empirical study that has determined whether or not the cost savings from increased bond sales more than offset the loss in tax revenue from the accrual.”¹⁰⁵

¹⁰³ U.S. Senate, Committee on the Budget, p. 1018.

¹⁰⁴ Annual cash purchases of both EE and I bonds are limited to \$5,000 per-person for each type of bond (for a total of \$10,000 per year).

¹⁰⁵ U.S. Senate, Committee on the Budget, p. 1019.

Income Tax
Exclusions

30. Allocation of interest expenses attributable to tax-exempt bond interest by financial institutions (bonds interest for private nonprofit educational facilities)

Internal Revenue Code Sections: 141, 265(a), 265(b), and 291(e)
 Federal Law Sunset Date: None (but only applies to bonds issued in 2009 and 2010)
 Year Enacted in Federal Law: 2009

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$508	\$508	\$508	\$508
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$508	\$508	\$508	\$508

DESCRIPTION: Banks and other financial institutions are allowed to deduct their interest payments to depositors as a cost of doing business, thereby reducing their tax liability. Nevertheless, banks have to reduce their interest deduction if they invest in tax-exempt bonds. Generally, banks and financial institutions must reduce their interest deduction by the same percentage that tax-exempt bonds make up of total assets (i.e., if tax-exempt bonds are 10 percent of the bank’s portfolio, then the interest deduction must be reduced by 10 percent). The reason for this rule is to prevent banks from claiming two tax preferences for the same investment.

There are two important qualifications to this general rule. First, individuals and non-financial institutions with tax-exempt bond investments that comprise less than 2 percent of their investment portfolio are not required to reduce their interest expense deduction. Second, banks are required to reduce their interest deduction for investments in tax-exempt bonds by 20 percent if the bonds are offered by small issuers and are not private-activity bonds.

This tax expenditure captures the revenue loss from two temporary expansions of the interest deduction offset rules allowed for the purchase of bonds issued in 2009 and 2010. First, banks and other financial institutions were allowed to shelter an amount equal to 2 percent of the bonds issued during those years from the offset to their interest deduction. Second, the definition of “small issuer” was changed to include municipalities issuing up to \$30 million in bonds per year, rather than \$10 million for bonds issued in 2009 and 2010.

PURPOSE: According to the Congressional Research Service, the rationale for the expanded interest deduction for banks and financial institutions investing in tax-exempt bond is “to encourage public investment infrastructure generally and to assist state and local governments issue debt.”¹⁰⁶

IMPACT: CRS states that, “The temporary elimination of the requirement that banks and financial institutions reduce their interest expense deduction for tax-exempt bond holdings will

¹⁰⁶ U.S. Senate, Committee on the Budget, p. 602.

likely increase demand for these bonds and confer some interest cost savings to issuers. The magnitude of the interest cost saving is unclear and the effectiveness of the provision is uncertain. The increased complexity of the tax code, however, would likely reduce the effectiveness and economic efficiency of the provision.”¹⁰⁷

Additionally, CRS states that “the broader pool of potential investors (principally financial institutions) for these bonds will likely increase the demand for the bonds and push down interest rates. Lower interest costs will encourage more of this type of financing.”¹⁰⁸

¹⁰⁷ U.S. Senate, Committee on the Budget, pp. 602-603.

¹⁰⁸ *Ibid*, p. 602.

Income Tax
Exclusions

31. Interest on public-purpose state and local government bonds

Internal Revenue Code Sections: 103, 141, and 146
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1913

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$8,937	\$9,210	\$9,393	\$9,666
Personal Income Tax Loss	\$22,476	\$23,081	\$25,155	\$25,847
Total	\$31,412	\$32,291	\$34,548	\$35,513

DESCRIPTION: The interest on state or local bonds that are used to build capital facilities that are owned and operated by government entities and serve the general public interest (such as schools, highways, and bridges) are excluded from federal taxable income. These bonds can be issued in unlimited amounts, although state governments do have a variety of self-imposed debt limits.

D.C. policymakers had eliminated the exclusion of interest on out-of-state bonds acquired after December 31, 2012, from the District of Columbia personal income tax. This action meant that the District had “decoupled” from the federal exclusion for state and local bond interest, except for bonds issued by the District. Nevertheless, policymakers reversed this decision as part of D.C. Act 20-157, the “Fiscal Year 2014 Budget Support Act of 2013,” and all interest on public-purpose state and local bonds will continue to be excluded from D.C. taxes.

PURPOSE: According to the Congressional Research Service, the exclusion was based on the belief that state and local interest income was constitutionally protected from federal taxation. In 1988, the U.S. Supreme Court ruled in *South Carolina v. Baker* that federal taxation of state and local interest income was not barred by the Constitution, but the exclusion has remained in place. CRS states that, “(M)any believe the exemption for governmental bonds is still justified on economic grounds, principally as a means of encouraging state and local governments to invest in public capital.”¹⁰⁹

IMPACT: State and local governments benefit from the exclusion because it allows them to offer lower interest rates by increasing the effective rate of return enjoyed by the bondholder. In effect, the federal government subsidizes a state or local government’s interest cost by providing the exclusion. The expenditure also encourages state and local taxpayers to provide public services that also benefit residents of other local states or localities.

The impact of this tax expenditure can be measured by (1) how much additional public capital investment occurs because of this tax provision and by (2) the distributional effects across issuers and tax payers. The impact on public capital investment is mixed because the broad range of public projects financed with tax-exempt bonds diminishes the target efficiency of the public subsidy. Purchasers of state and local bonds also benefit from the exclusion, but the distribution

¹⁰⁹ U.S. Senate, Committee on the Budget, p. 1008.

of benefits depends on the interest-rate spread between taxable bonds and the tax-exempt municipal bonds, the percentage of the tax-exempt bond issues purchased by individuals of different income levels, and the range of marginal tax rates. Higher-income taxpayers are more likely to benefit because they are more likely to own bonds and can gain a windfall from the interest-rate spread due to their higher marginal tax rates. Nevertheless, researchers at the Tax Policy Center have pointed out that low- and moderate-income individuals may gain a significant benefit if the state and local programs supported by municipal bonds (such as school construction) provide roughly equal benefits on a per-capita basis.¹¹⁰

The windfall for higher-income taxpayers is illustrated by the following example. Assume that taxable bonds are paying 7 percent interest and that tax-exempt municipal bonds are paying 5 percent, there is a 2.0 percentage-point interest rate subsidy to the issuer. For someone facing a 25 percent marginal tax rate, the effective return on the taxable bond will be 5.25 percent (7 percent minus the .25 tax), a better deal than the tax-exempt rate of 5 percent. For someone facing a 40 percent marginal tax rate, the effective rate on the taxable bond will be 4.2 percent (7 percent minus the .40 tax), making the tax-exempt bond's 5 percent return a better deal. In fact, the 5 percent interest rate exceeds the amount that the higher-income taxpayer would demand (4.2 percent) to buy a tax-exempt bond rather than a taxable bond. Internal Revenue Service data from 2012 show that 73.8 percent of tax-exempt interest income was earned by tax filers with adjusted gross income of more than \$100,000.¹¹¹

The windfall for higher-income taxpayers also means that tax-exempt bonds are inefficient: the government loses more revenue by subsidizing tax-exempt bonds than it would cost to provide direct grants to subsidize the same amount of borrowing by state and local governments. According to the Congressional Budget Office and the Joint Committee on Taxation, research suggests that only 80 percent of the tax expenditure from tax-exempt bonds actually translates into lower borrowing costs for state and local governments; the other 20 percent represents a "deadweight loss."¹¹²

The federal subsidy of state and local borrowing for capital investment may generate spillover benefits for nearby states or localities; for example, a modernized wastewater treatment plant may reduce pollution in nearby rivers and lakes. At the same time, some question the subsidy for promoting capital investment at the expense of labor and argue that there is no evidence that state and public governments underprovide capital facilities. Finally, the subsidizing of state and local bonds decreases federal control of the budget because the revenue loss results from the decisions of state and local officials.¹¹³

¹¹⁰ Harvey Galper, Joseph Rosenberg, Kim Rueben, and Eric Toder, "Who Benefits from Tax-Exempt Bonds?: An Application of the Theory of Tax Incidence," working paper of the Tax Policy Center, September 27, 2013, pp. 14-18.

¹¹¹ U.S. Senate, Committee on the Budget, p. 1007.

¹¹² Congressional Budget Office and the Joint Committee on Taxation, p. 34.

¹¹³ U.S. Senate, Committee on the Budget, p. 1009.

Income Tax
Exclusions

32. Employer contributions for medical care, medical insurance premiums, and long-term care insurance premiums

Internal Revenue Code Sections: 105, 106, and 125
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1918

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$108,174	\$113,891	\$120,059	\$127,431
Total	\$108,174	\$113,891	\$120,059	\$127,431

DESCRIPTION: Employer payments for accident insurance, health insurance, long-term care insurance premiums¹¹⁴, and other employee medical expenses are not included in an employee’s personal taxable income. The exclusion applies to health benefits provided to the employee’s family members.

The exclusion also applies to flexible spending accounts (FSAs), which allow employees to choose a benefit amount at the start of a year and to use the account to pay for medical expenses not covered by employer-provided health insurance. FSAs are funded through wage and salary reductions, or through employer contributions, both of which are exempt from federal income and payroll taxes.

These exclusions have no limit on the amount of employer contributions that may be excluded although generous reimbursements paid to highly compensated employees under self-insured medical plans that fail to satisfy specified non-discrimination requirements must be excluded in the employees’ taxable income.

PURPOSE: The exclusion of employer-provided health insurance from taxable income is part of a longstanding policy of excluding fringe benefits from taxation. The legislative history of section 106 indicates that the exclusion was intended to remove differences between the tax treatment of employer contributions to group and non-group or individual health insurance plans.¹¹⁵ The exclusion subsidizes the provision of health care to employees through employer-provided group health insurance.

IMPACT: The Congressional Research Service states that, “The tax exclusion for employer contributions to employee health plans benefits only those taxpayers who participate in employer-

¹¹⁴ Before January 1, 2015, the District of Columbia allowed long-term care insurance premiums to be subtracted from federal adjusted gross income; however, based on the taxpayer’s age, certain amounts of these expenses may still be deductible as itemized medical expenses.

¹¹⁵ U.S. Senate, Committee on the Budget, p. 860

sponsored plans. Beneficiaries include current employees as well as retirees.”¹¹⁶ In 2012, 58.5 percent of the U.S. population received health insurance coverage through employers, according to the Employee Benefits Research Institute.¹¹⁷ CRS adds that, “Although the tax exclusion benefits a majority of working Americans, it provides greater benefits to higher-income taxpayers than to lower-income ones. Highly paid employees tend to receive more generous employer-paid health insurance coverage than their lowly paid counterparts. And highly paid employees fall in higher tax brackets” that increase the value of the exclusion.¹¹⁸

Those who are least likely to receive employer-provided health insurance include workers under age 25, workers in firms with fewer than 25 employees, part-time workers, low-wage workers, and workers in the construction, business and personal service, entertainment, and wholesale and retail trade industries.¹¹⁹

Experts also points out that the health care exclusion imposes significant efficiency costs on society. Employees covered by employer-provided health plans receive greater tax subsidy than individuals that purchase health insurance in the individual market, have no health insurance, pay out of pocket for medical expenses, and claim the medical-expense itemized income tax deduction. The subsidy consequently gives employees an incentive to seek compensation in the form of non-taxable health benefits rather than in taxable wages. As a result, employees may consume more health insurance than they need. As stated by CRS, “Most health economists think the unlimited exclusion for employer-provided health insurance has distorted the markets for both health insurance and health care. Generous health plans encourage subscribers to use health services that are not cost-effective, putting upward pressure on health care costs.”¹²⁰

Nevertheless, CRS points out that, “The exclusion does have some social benefits. Owing to the pooling of risk that employment-based group health insurance provides, one can argue that the exclusion makes it possible for many employees to purchase health insurance plans that simply would not be available on the same terms or at the same cost in the individual market.”¹²¹

¹¹⁶ Ibid, p. 858.

¹¹⁷ U.S. Senate, Committee on the Budget, p. 858.

¹¹⁸ Ibid.

¹¹⁹ Ibid.

¹²⁰ Ibid, p. 861.

¹²¹ Ibid.

Income Tax
Exclusions

33. Interest on state and local private-activity bonds issued to finance non-profit hospital construction

Internal Revenue Code Sections: 103, 141, 145(b), 145(c), 146, and 501(c)(3).
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$638	\$638	\$638	\$638
Personal Income Tax Loss	\$1,556	\$1,729	\$1,729	\$1,815
Total	\$2,194	\$2,367	\$2,367	\$2,454

DESCRIPTION: Interest income on state and local bonds used to finance the construction of non-profit hospitals and nursing homes is tax-exempt. These bonds are classified as private-activity bonds, rather than governmental bonds, because a substantial portion of the benefits accrues to individuals or private organizations instead of the general public. Non-profit hospital bonds are not subject to state volume caps on private-activity bonds. The non-profit hospital bonds are not subject to the state private activity bond annual volume cap. According to the U.S. Internal Revenue Service, \$8.95 billion of qualified hospital bonds were issued in 2011.¹²²

PURPOSE: The purpose of the bonds is to provide low-cost financing of hospitals and nursing homes owned by non-profit organizations. Investors purchase the bonds at low interest rates because the income from them is tax-free.

IMPACT: Private, non-profit hospitals and the communities they serve benefit from this provision. Some of the benefits of the tax exemption also flow to bondholders. According to the Congressional Budget Office and the Joint Committee on Taxation, state and local private-activity bonds are particularly important in the health care sector because the private sector provides almost all (more than 90 percent) of the total investment in hospitals and other health-care facilities.¹²³

The Congressional Research Service observes that, “Questions have ... been raised about whether nonprofit hospitals fulfill their charitable purpose and if they deserve continued access to tax-exempt bond finance. Even if a case can be made for this federal subsidy for nonprofit organizations, it is important to recognize the potential costs. As one of many categories of tax-exempt private-activity bonds, bonds for nonprofit organizations increase the financing cost of bonds issued for other public capital. With a greater supply of public bonds, the interest rate on the bonds necessarily increases to attract investors. In addition, expanding the availability of tax-

¹²² U.S. Senate, Committee on the Budget, p. 818.

¹²³ Congressional Budget Office and Joint Committee on Taxation, pp. 2-3.

exempt bonds increases the assets available to individuals and corporations to shelter their income from taxation.”¹²⁴

¹²⁴ U.S. Senate, Committee on the Budget, p. 819.

Income Tax
Exclusions

34. Medical care and TriCare medical insurance for military dependents, retirees, retiree dependents, and veterans

Internal Revenue Code Sections: 112 and 134
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$1,136	\$1,178	\$1,220	\$1,220
Total	\$1,136	\$1,178	\$1,220	\$1,220

DESCRIPTION: Active-duty military personnel receive a variety of benefits (such as medical and dental care) or cash in-lieu of such benefits that are excluded from taxation. In addition, the following groups are also eligible for medical and dental care benefits without being subject to taxation: dependents of active-duty personnel; retired military personnel and their dependents; veterans; survivors of deceased veterans; and reservists who have served on active duty since September 11, 2001, and joined the Selected Reserve.

Military dependents and retirees are allowed to receive medical care in military facilities and from military doctors, if there is sufficient spare capacity. These individuals can also be treated by civilian health-care providers working under contract with the Department of Defense through the TriCare program. TriCare provides medical care through a health maintenance organization, a preferred provider organization, a fee-for-service option, or Tricare for Life for elderly beneficiaries.

PURPOSE: The Congressional Research Service notes that this exclusion has evolved over time through a series of legislative, administrative, and legal actions. Thus, the rationale has not been clear-cut. CRS adds that, “Even if there was no specific statutory exclusion for the health benefits received by military personnel and their dependents, a case for excluding them could be made on the basis of sections 105 and 106 of the Internal Revenue Code. These sections exclude from the taxable income of employees any employer-provided health benefits they receive.”¹²⁵

IMPACT: Higher-income individuals gain a disproportionate share of the benefits of the exclusion because they face higher marginal tax rates that increase the savings from each dollar excluded. Although the tax exclusion of health benefits may create inefficiencies by encouraging individuals to purchase more health care than they would if they bore the full cost, direct care provided in military facilities may be difficult to value for tax purposes. In addition, the exclusion of medical care for service members’ dependents and military retirees might hamper military recruitment and retention. Others have argued that limiting the tax exclusion can be

¹²⁵ U.S. Senate, Committee on the Budget, p. 868.

coupled with an increase in military pay to prevent adverse impacts on the retention of active duty military personnel with dependents and high enough incomes to incur tax.¹²⁶

¹²⁶ U.S. Senate, Committee on the Budget, pp. 868-869.

Income Tax
Exclusions

35. Medicare Part A – hospital insurance benefits

Internal Revenue Code Section: None (Exclusion was authorized by IRS Revenue Ruling 70-341, 1970-2 C.B.31)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1970

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$15,306	\$16,059	\$17,063	\$17,899
Total	\$15,306	\$16,059	\$17,063	\$17,899

DESCRIPTION: Part A of Medicare pays most of the cost of in-patient hospital care and as much as 100 days per year of skilled nursing facility care, home health care, and hospice care for individuals who are 65 or older, or who are disabled. In 2014, 54 million aged and disabled persons were enrolled in Part A. Part A is financed primarily by a payroll tax on the earnings of current workers, which is split evenly between the employer and the employee.¹²⁷ The revenue from the payroll tax is credited to a trust fund where payments are then made to healthcare providers for current medical beneficiaries. The expected lifetime value of Part A benefits under current law generally exceeds the amount of payroll tax contributions by current beneficiaries. This difference, when multiplied by an individual’s marginal tax rate, represents a tax expenditure. The employer’s share of the payroll tax is also excluded from an employee’s taxable income.

PURPOSE: This exclusion has never been established by statute; rather, it was adopted by an Internal Revenue Service ruling in 1970. The rationale for the ruling was that, “(T)he benefits under Part A of Medicare may be excluded from gross income because they are in the nature of disbursements intended to achieve the social welfare objectives of the federal government. The ruling also stated that Medicare Part A benefits had the same legal status as monthly Social Security payments to an individual,”¹²⁸ which were not subject to federal income tax at the time.

IMPACT: The Congressional Research Service states that, “The exclusion of the value of Part A benefits lowers the tax burden of Part A beneficiaries. Without that exclusion, some workers might postpone their retirements, which would increase labor force participation in the economy.”¹²⁹ Nevertheless, CRS adds that, “Those who favor curtailing this subsidy, as a means of increasing federal revenue or reducing use of hospital care, would find it difficult to do so in an

¹²⁷ The payroll tax is 2.9 percent on earnings up to \$200,000 for single filers and \$250,000 for joint filers. The tax increases to 3.8 percent on earnings above those thresholds. Since 2013, an additional 0.9 percent payroll tax has been levied on wages over \$200,000 for single workers and over \$250,000 for married couples.

¹²⁸ U.S. Senate, Committee on the Budget, p. 890.

¹²⁹ Ibid, p. 891.

equitable manner for two reasons. First, Medicare benefits receive the same tax treatment as most other health insurance benefits: they are untaxed. Second, taxing the value of the health care benefits actually received would affect most strongly people who suffer problems that are costly to treat. Many of these individuals are elderly and living on relatively small fixed incomes. Moreover, changing longstanding practices that would reduce the value of social insurance benefits would complicate retirement planning for those near or in retirement.”¹³⁰

Moreover, the dynamics of this tax subsidy will change in the future. The amount by which Medicare Part A benefits exceed payroll tax contributions will decrease for future retirees because the contribution period will cover more of their work years (early beneficiaries after Medicare was established in 1965 contributed for very little of their working lives). “In addition,” CRS states, “the absence of a cap on worker earnings subject to the Medicare (Part A) payroll tax means that today’s high-wage earners contribute more during their working years and consequently receive a smaller (and possibly negative) subsidy once they begin to receive Part A benefits.”¹³¹

¹³⁰ U.S. Senate, Committee on the Budget, p. 892.

¹³¹ *Ibid.*

Income Tax
Exclusions

36. Medicare Part B – supplementary medical benefits

Internal Revenue Code Section: None (Exclusion was authorized by IRS Revenue Ruling 70-341, 1970-2 C.B. 31)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1970

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$10,790	\$11,375	\$11,961	\$12,588
Total	\$10,790	\$11,375	\$11,961	\$12,588

DESCRIPTION: Part B of Medicare covers certain physician services, outpatient services, and durable medical equipment for people who are over the age of 65 or disabled. Participation in the program is voluntary, unlike Medicare Part A. Premiums cover 25 percent of the cost of Medicare Part B for most beneficiaries, but since 2007 upper-income participants pay a larger share. Regular appropriations cover the rest of the program’s costs. The portion of the program’s costs paid by general government revenue is not included in the personal taxable income of recipients and therefore represents a tax expenditure equal to the marginal tax rate of enrollees multiplied by the amount of the exclusion.

PURPOSE: The exclusion has never been established by statute; instead, it was authorized by an Internal Revenue Service ruling in 1970. The IRS determined that Part B benefits (whether funded by premiums or general appropriations) could be excluded from taxable income because they have the same status under the tax code as benefits received through other accident and health insurance for personal injuries or sickness.¹³² According to the Congressional Research Service, “This exclusion is supported by the same rationale used by the IRS to justify the exclusion of Medicare Part A benefits from the gross income of beneficiaries.”¹³³

IMPACT: CRS states that, “While the tax subsidy for Part B reduces the after-tax cost of medical insurance for retirees, the addition of an income-related premium has partially reduced the tax subsidy for higher-income beneficiaries. The lower after-tax cost of part B medical insurance might encourage some to switch from employer-provided health to publicly provided Part B coverage by retiring earlier than they otherwise would have, thus reducing labor force participation.”¹³⁴ An alternative policy proposed is the addition of the value of the subsidy to taxable income and directing the revenues to the Medicare AMI trust fund. Individuals can then deduct the recaptured subsidy in the same manner that he or she can deduct other health insurance premiums paid out of pocket. CRS further points out that, “Attempts to recapture the subsidy

¹³² U.S. Senate, Committee on the Budget, pp. 896-897.

¹³³ Ibid, p. 897.

¹³⁴ Ibid.

from lower and middle income beneficiaries may impose an added tax burden on those who have little flexibility in their budgets to absorb higher taxes.”¹³⁵

¹³⁵ U.S. Senate, Committee on the Budget, p. 898.

Income Tax
Exclusions

37. Medicare Part D – prescription drug benefits

Internal Revenue Code Section: None (Exclusion was authorized by IRS Revenue Ruling 70-341, 1970-2 C.B. 31)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 2003

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$3,764	\$3,847	\$3,889	\$3,973
Total	\$3,764	\$3,847	\$3,889	\$3,973

DESCRIPTION: Part D of the Medicare program subsidizes the cost of prescription drugs for individuals eligible for Medicare. Participation in Part D is voluntary, except for those who are eligible both for Medicare and Medicaid, and certain other low-income Medicare beneficiaries who must enroll or are automatically enrolled in a prescription drug plan. Part D benefits are offered through stand-alone private prescription drug programs as well as “Medicare Advantage” plans, such as health maintenance organizations, that provide all Medicare benefits including prescription drugs. Enrollees pay monthly premiums that vary by plan and region.

Beneficiary premiums defray 14 percent of Part D program costs, while general revenues (73 percent) and state contributions (13 percent) finance the rest.¹³⁶ Higher income enrollees pay higher premiums and individuals with modified adjusted gross income (MAGI) greater than \$85,000 for single and \$175,000 for joint filers are subject to higher premium amount. Beneficiaries with incomes below 150 percent of the poverty line and modest assets can receive low-income subsidies to help pay premiums, cost-sharing, and other out-of-pocket expenses¹³⁷. The subsidies provided by the Medicare program are excluded from the taxable income of enrollees creating a tax expenditure equal to the subsidy (the difference between the value of the benefits received and the premiums that enrollees pay) multiplied by the marginal tax rates faced by enrollees.

PURPOSE: The purpose of the exclusion is to “expand access to outpatient prescription drugs among the Medicare population, restrain their spending on drugs, and contain program costs through heavy reliance on private competition and enrollee choice.”¹³⁸ The exclusion reduces the after-tax cost to enrollees of using prescription drugs making drugs more affordable thereby expanding access to such drugs among the elderly. Although the exclusion of Medicare benefits from taxable income has never been established by statute, it has been implemented through a regulatory rulings issued by the Internal Revenue Service in 1970. When Part D was created by the “Medicare Prescription Drug, Improvement, and Modernization Act of 2003” (P.L. 108-173), the same exclusion was therefore applicable.

¹³⁶ U.S. Senate, Committee on the Budget, p. 900.

¹³⁷ Ibid, pp. 900-901.

¹³⁸ Ibid, pp. 901-902.

IMPACT: Senior citizens enrolled in Medicare Part D benefit from the exclusion. The Congressional Research Service notes that, “Part D has made progress towards some of its main objectives. About 70 percent of Medicare beneficiaries were enrollees in a Part D plan and the share of those without drug coverage, including those in employer or other plans, has fallen about 12 percent. Some evidence suggests that expanded drug coverage reduced hospitalization rates and non-drug medical spending for Medical beneficiaries who previously had trouble affording drugs.”¹³⁹

¹³⁹ U.S. Senate, Committee on the Budget, p. 902.

Income Tax
Exclusions

38. Capital gain on sale of principal residence

Internal Revenue Code Section: 121
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1997

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$34,683	\$36,596	\$38,510	\$40,662
Total	\$34,683	\$36,596	\$38,510	\$40,662

DESCRIPTION: Homeowners may exclude from personal taxable income up to \$250,000 (single taxpayers) or \$500,000 (married taxpayers filing jointly) of capital gains realized on the sale or exchange of their principal residence. To qualify, the taxpayer must have owned and occupied the home for at least two of the previous five years. The exclusion applies only to the portion of the property associated with the residence, not to portions of the property used in business activity. The exclusion cannot be used more than once every two years.

PURPOSE: Capital gains arising from the sale of an individual’s principal residence have long received preferential tax treatment, in order to promote homeownership by reducing its after-tax cost. Previously, homeowners were allowed to defer the tax on capital gains from the sale of their principal residence if the proceeds of the sale were used to buy another home of equal or greater value. In addition, homeowners aged 55 and older were allowed a one-time exclusion of a gain up to \$125,000 from the sale of their principal residence. In 1997, Congress modified these provisions to reduce their complexity by allowing all taxpayers to exclude \$250,000 (single) or \$500,000 (married filing jointly) of capital gains from the sale of their principal residence.

IMPACT: The Congressional Research Service states that, “Excluding the capital gains on the sale of principal residences from tax primarily benefits middle- and upper-income taxpayers. At the same time, however, this provision avoids putting an additional tax burden on taxpayers, regardless of their income levels, who have to sell their homes because of changes in family status, employment, or health. It also provides tax benefits to elderly taxpayers who sell their homes and move to less expensive housing during their retirement years. This provision simplifies income tax administration and record keeping.”¹⁴⁰

With regard to the efficiency impact, CRS states that the exclusion “gives homeownership a competitive advantage over other types of investments, since the capital gains from investments in other assets are generally taxed when the assets are sold. Moreover, when combined with other provisions in the tax code such as the deductibility of home mortgage interest, homeownership is an especially attractive investment. As a result, savings are diverted out of other forms of investment and into housing.”¹⁴¹ Alternatively, the exclusion on the sale of a principal residence is justifiable because the tax law does not allow the deduction of personal capital losses, because

¹⁴⁰ U.S. Senate, Committee on the Budget, pp. 353-354.

¹⁴¹ Ibid, p. 355.

much of the profit from the sale of a personal residence can represent only inflationary gains and the motivation of such purchase is not profit-based. Additionally, “Taxing the gain on the sale of a principal residence might also interfere with labor mobility.”¹⁴²

¹⁴² U.S. Senate, Committee on the Budget, p. 355.

Income Tax
Exclusions

39. Interest on state and local private-activity bonds issued to finance housing

Internal Revenue Code Sections: 103, 141, 142, 143, and 146
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1980

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$365	\$365	\$365	\$365
Personal Income Tax Loss	\$778	\$864	\$951	\$951
Total	\$1,143	\$1,229	\$1,316	\$1,316

DESCRIPTION: Interest income on state and local bonds used to finance the construction of owner-occupied housing (mortgage revenue bonds, or MRBs), rental housing, and veterans’ housing for low and moderate-income families is tax-exempt. These bonds are classified as private-activity bonds, rather than governmental bonds, because a substantial portion of the benefits accrues to individuals or private organizations instead of the general public. Housing construction bonds are subject to state volume caps on private-activity bonds and therefore must compete with other authorized private activities for bond financing.

PURPOSE: The purpose of the bonds is to increase the incidence of homeownership as well as finance low-interest mortgages for low- and moderate-income homebuyers, along with multi-family housing for low-income renters. Investors purchase the housing bonds at low interest rates because the income is tax-free. The interest savings should allow issuers to offer housing for sale or rent at a lower cost.

IMPACT: With regard to homeownership, the Congressional Research Service notes that, “Income, tenure status, and house-price-targeting provisions imposed on MRBs make them more likely to achieve the goal of increased homeownership than many other housing tax subsidies that make no targeting effort, such as is the case for the mortgage-interest deduction. Nonetheless, it has been suggested that most of the mortgage revenue bond subsidy goes to families that would have been homeowners even if the subsidy were not available.”¹⁴³ Regarding rental housing, CRS states that the bonds promote “equitable treatment for families unable to take advantage of the substantial tax incentives available to those able to invest in owner-occupied housing.”¹⁴⁴

More generally, private-activity bonds impose costs because they “increase the financing cost of bonds issued for other public capital. With a greater supply of public bonds, the interest rate on the bonds necessarily increases to lure investors. In addition, expanding the availability of tax-

¹⁴³ U.S. Senate, Committee on the Budget, p. 360.

¹⁴⁴ Ibid, p. 385.

exempt bonds increases the assets available to individuals and corporations to shelter their income from taxation.”¹⁴⁵

¹⁴⁵ U.S. Senate, Committee on the Budget, p. 360.

Income Tax
Exclusions

40. Compensatory damages for physical injury or sickness

Internal Revenue Code Section: 104(a)(2) - 104(a)(5)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1918

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$1,279	\$1,279	\$1,279	\$1,279
Total	\$1,279	\$1,279	\$1,279	\$1,279

DESCRIPTION: Damages paid through a court award or a settlement to compensate for physical injury or illness is excluded from the recipient’s taxable income. The exclusion applies both to lump-sum payments and periodic payments, but does not apply to punitive damages except in certain states where only punitive damage awards are allowed. In addition, the exclusion does not apply to compensation for discrimination or emotional distress.

PURPOSE: According to the Congressional Research Service, the exclusion “is based on the reasoning that these payments are compensating for a loss.”¹⁴⁶ Noting that the interest component of periodic payments would normally be taxable, CRS adds that, “An argument for the full exclusion of periodic payments was to avoid circumstances where individuals used up their lump-sum payments and might then require public assistance.”¹⁴⁷

IMPACT: CRS states that, “The exclusion benefits individuals who receive cash compensation for injuries and illness. It parallels the treatment of workers’ compensation which covers on-the-job injuries. It especially benefits higher-income individuals whose payments would typically be larger, reflecting larger lifetime earnings, and subject to higher tax rates. By restricting tax benefits to compensatory rather than punitive damages, the provision encourages plaintiffs to settle out of court so that the damages can be characterized as compensatory.”¹⁴⁸

¹⁴⁶ U.S. Senate, Committee on the Budget, p. 916.

¹⁴⁷ Ibid.

¹⁴⁸ Ibid, pp. 918-919

Income Tax
Exclusions

41. Disaster mitigation payments

Internal Revenue Code Section: 139
Federal Law Sunset Date: None
Year Enacted in Federal Law: 2005

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	too small	too small	too small	too small
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Disaster mitigation payments under the Robert T. Stafford Disaster Relief and Emergency Insurance Act or the National Flood Insurance Act are excluded from taxable income. Disaster mitigation grants cover a variety of expenditures such as securing items to reduce potential damage from earthquakes, putting houses on stilts to reduce flood damage, and securing roofs and windows from wind damage.

PURPOSE: According to the Congressional Research Service, the Internal Revenue Service ruled in 2004 that disaster mitigation payments would be taxable, in the absence of a specific exemption in the law. Previously, individuals had not paid taxes on the payments. Congress responded by establishing an explicit statutory exclusion. CRS states that, “The tax legislation was in response to that ruling and reflected the general view that individuals and businesses should not be discouraged from mitigation activities due to tax treatment of these payments.”¹⁴⁹

IMPACT: CRS observes that, “The tax exemption is most beneficial for higher-income individuals who have higher marginal tax rates. Even individuals with relatively low incomes could be subject to tax, however, since the mitigation payments can be large when used for major construction projects (such as putting houses in flood plains on stilts). These individuals might not have enough income to pay taxes on these grants and taxation might cause them not to participate in the program.”¹⁵⁰

The fairness and efficiency issues surrounding the exclusion are complex. CRS states that, “An argument can be made that individuals should be responsible for undertaking their own measures to reduce disaster costs since those expenditures would benefit them ... Disaster mitigation expenditures for individuals and businesses can also have benefits that spill over to the community at large, and an individual would not take these benefits into account when making an investment decision.”¹⁵¹

¹⁴⁹ U.S. Senate, Committee on the Budget, p. 906.

¹⁵⁰ Ibid.

¹⁵¹ Ibid, pp. 906-907.

Income Tax
Exclusions

42. Employer contributions for premiums on accident and disability insurance

Internal Revenue Code Sections: 105 and 106
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1954

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$3,159	\$3,310	\$3,460	\$3,611
Total	\$3,159	\$3,310	\$3,460	\$3,611

DESCRIPTION: Employer payments for employee accident and disability insurance premiums are not included in an individual’s personal taxable income.

PURPOSE: According to the Congressional Research Service, in 1954 Congress exempted accident and health benefits from taxation “in an attempt to equalize the tax treatment of benefits through an insurance plan and benefits provided in other ways.”¹⁵² This action reversed a 1943 Internal Revenue Service ruling that employer payments to employees due to injury or sickness were subject to taxation.

IMPACT: Higher-income individuals benefit more from this exclusion since their marginal tax rates are higher and because they are more likely to receive insurance benefits from their employers. Also, lower income individuals would benefit less since they may have difficulty protecting themselves from income loss due to accident or disability. CRS points out that due to the exclusion, “(T)he employer’s cost is less than he would have to pay in wages that are taxable, to confer the same benefit on the employee because the value of this insurance coverage is not taxed. Employers are thus encouraged to buy such insurance for employees.”¹⁵³

The exclusion may impair both horizontal and vertical equity. In arguing for repeal of the exclusion, President Bush’s Advisory Panel on Federal Tax Reform stated that, “Employees who have these employer-provided fringe benefits receive better tax treatment than employees who pay for these expenses out of pocket. Among workers for whom the benefit is available, more of the benefits go to high-income taxpayers, even though they are paid for with higher tax rates for everyone.”¹⁵⁴ According to the Bureau of Labor Statistics’ National Compensation Survey, 37 percent of workers had access to short-term disability benefits, 34 percent had access to long-term disability benefits, and 97 percent of workers take up disability benefits.¹⁵⁵ Nevertheless, CRS

¹⁵² U.S. Senate, Committee on the Budget, p. 978.

¹⁵³ Ibid, p. 977.

¹⁵⁴ The President’s Advisory Panel on Federal Tax Reform, p. 85.

¹⁵⁵ U.S. Senate, Committee on the Budget, pp. 978.

adds that “[W]hether this exclusion is the most efficient method of encouraging purchases of prudent levels of insurance coverage is unclear”.¹⁵⁶

¹⁵⁶ U.S. Senate, Committee on the Budget, p. 979.

Income Tax
Exclusions

43. Employer contributions for premiums on group-term life insurance

Internal Revenue Code Section: 79
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1920

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$2,407	\$2,482	\$2,482	\$2,558
Total	\$2,407	\$2,482	\$2,482	\$2,558

DESCRIPTION: Employer payments for employee life insurance (up to \$50,000 in coverage) and death benefits are not included in an individual’s taxable income. In order to qualify for the exclusion, the insurance plan must meet certain requirements including non-discrimination provisions intended to ensure that benefits are spread widely and equitably among employees.

PURPOSE: The exclusion was originally authorized, without any limitation on the amount of coverage, by a legal opinion issued in 1920. The \$50,000 limit on the amount that can be excluded was enacted in 1964, based on the view that it “would encourage the purchase of group life insurance and assist in keeping the family unit intact upon death of the breadwinner.”¹⁵⁷

IMPACT: The Congressional Research Service states that, “Encouraging individuals to purchase more life insurance may be justified by concerns that many individuals would fail to buy prudent amounts of life insurance on their own, which could expose surviving family members to financial vulnerabilities. Subsidizing life insurance coverage may help provide a minimum standard of living for surviving dependent individuals.”¹⁵⁸ Employers may also benefit from the exclusion, because it allows them to provide this form of compensation at a lower cost than the earnings employees would need to buy the same amount of insurance on their own. On the other hand, self-employed individuals or those who work for an employer without such plan do not benefit from this tax subsidy for life insurance coverage.

Consequently, there is uneven access to the benefit, giving rise to horizontal and vertical equity concerns. CRS observes that, “Aside from administrative convenience, the rationale for providing insurance subsidies to employees, but not to the self-employed or those who are not employed is not obvious. As with many other fringe benefits, higher-income individuals probably receive more benefits from this exclusion because their marginal tax rates are higher and because they are more likely to receive group life insurance benefits from their employers. Lower-income individuals, whose surviving dependents are probably more financially vulnerable,

¹⁵⁷ U.S. Senate, Committee on the Budget, p. 973.

¹⁵⁸ Ibid, p. 973.

probably benefit less from this exclusion.”¹⁵⁹ President Bush’s Advisory Panel on Federal Tax Reform once called for repeal of the exclusion based on similar concerns.¹⁶⁰

¹⁵⁹ U.S. Senate, Committee on the Budget, p. 973.

¹⁶⁰ The President’s Advisory Panel on Federal Tax Reform, p. 85.

Income Tax
Exclusions

44. Employer pension contributions and earnings plans

Internal Revenue Code Sections: 401-407, 410-418e, and 457
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1921

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$112,386	\$129,763	\$152,481	\$171,212
Total	\$112,386	\$129,763	\$152,481	\$171,212

DESCRIPTION: Employer contributions to qualified pension, profit-sharing, stock-bonus, and annuity plans are not included in the employee’s personal taxable income in the year of contribution. Earnings on these contributions are also tax-free. Withdrawals are included in taxable income.

Tax-favored pension plans like Keogh plans are allowed for sole proprietors and partners. They account for only a relatively small portion of the cost (\$6,996, \$8,049, \$11,660, and \$13,315 thousand in FY2016-FY2019).

There are two major types of pension plans: (1) defined-benefit plans, which guarantee employees a certain benefit level on retirement, and (2) defined-contribution plans, which provide a pension that depends on the employee’s contributions and the earnings on those contributions. Employer contributions to both types of plans are excluded from taxable income. The estimated revenue impact of this tax expenditure is the revenue that the government does not collect on pension contributions and earnings, offset by the taxes paid on pension withdrawals.

PURPOSE: CRS notes that “The major economic justification for the favorable tax treatment of pension plans is that they arguably increase savings and increase retirement income security. The effects of these plans on savings and overall retirement income security are, however, subject to some uncertainty.”¹⁶¹ The Congressional Research Service observes that, “Since individuals cannot directly control their contributions to plans in many cases (defined-benefit plans), or are subject to a ceiling on contributions, the tax incentives to save may not be very powerful ... At the same time, pension plans may force saving and retirement income on employees who otherwise would have total savings less than their pension-plan savings.”¹⁶²

IMPACT: CRS states that, “The employees who benefit from this provision consist of taxpayers whose employment is covered by a plan and whose service has been sufficiently continuous for them to qualify for benefits in a company or union-administered plan.”¹⁶³ Nevertheless, CRS

¹⁶¹ U.S. Senate, Committee on the Budget, p. 953.

¹⁶² Ibid, pp. 953-954.

¹⁶³ Ibid, p. 950.

points out that the benefits are likely to accrue disproportionately to high-income households because employees with higher salaries are more likely to receive pension benefits, and the dollar contributions made on behalf of higher-income employees are larger. In addition, higher-income taxpayers derive a larger benefit because their marginal tax rate is higher, increasing the value of the exclusion. Workers are also more likely to be covered by pensions if they work in certain industries, if they are employed by large firms, or if they are unionized.¹⁶⁴

¹⁶⁴ U.S. Senate, Committee on the Budget, pp. 950-951.

Income Tax
Exclusions

45. Income of trusts to finance supplemental unemployment benefits

Internal Revenue Code Section: 501(c)(17)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1960

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$15	\$23	\$30	\$30
Total	\$15	\$23	\$30	\$30

DESCRIPTION: The investment income from a supplemental unemployment benefit trust may be exempt from taxation if it is established by an employer, employees, or both, solely to provide supplemental unemployment compensation when an involuntary loss of employment arises from a reduction in force, discontinuation of a plant or operation, temporary layoff, or other similar circumstance.

The trust must be set forth in a written plan that ensures it does not discriminate in favor of officers, shareholders, supervisors, or highly compensated employees. Benefits must be determined according to objective standards.

Supplemental unemployment trusts were first established in the auto industry in 1955. If an employee leaves a company voluntarily or is discharged for misconduct, he or she is not eligible for a benefit. The employee has no vested interest in the amounts paid into the fund on his or her behalf.

PURPOSE: The purpose of the exclusion is to encourage the creation of supplemental unemployment benefit trusts and to increase income support for laid-off workers.

IMPACT: Employers who sponsor a supplemental unemployment benefit trust and the employees who participate in the plans benefit from this provision. The exclusion may have a negative effect on economic efficiency, because the tax-free treatment of investment income encourages provision of supplemental unemployment benefits when other benefits might be more valuable in the absence of the tax preference.

Income Tax
Exclusions

46. Investment income on life insurance and annuity contracts

Internal Revenue Code Sections: 72, 101, 7702, 7702A
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$3,533	\$3,533	\$3,659	\$3,659
Personal Income Tax Loss	\$34,563	\$35,281	\$36,237	\$37,194
Total	\$38,095	\$38,813	\$39,896	\$40,853

DESCRIPTION: The investment income on life insurance contracts, commonly known as “inside build-up,” is typically not included in personal or corporate taxable income as it accrues, or when it is received by beneficiaries upon the death of the insured individual. Moreover, amounts paid as dividends or withdrawn as cash are taxed only when they exceed total premiums paid for the policy, thus allowing tax-free investment income to pay part of the cost of the insurance protection. The investment income that accumulates as part of an annuity policy is also free from taxation, but annuities are taxed on their investment component when paid.

Life insurance policies must follow rules designed to limit the tax-free accumulation of income. If investment income grows faster than is needed to fund the promised benefits, that income will be attributed to the owner of the policy and is subject to current taxation.

PURPOSE: The non-taxable status of life insurance inside build-up, the exclusion of death benefits, and the tax deferral on annuity investment income all date back to the creation of the federal income tax in 1913. The Congressional Research Service suggests that Congress may have decided to exclude death benefits “because they were believed to be comparable to bequests, which also were excluded from the tax base.”¹⁶⁵ CRS also notes that the other exclusions “were, in part, based on the general tax principle of constructive receipt. Policyholders, in this view, did not own the interest income because to receive that interest income they would have to give up the insurance protection or the annuity guarantees.”¹⁶⁶ Congress has taken necessary steps to limit tax-free inside build-up in certain cases and restricted the favorable treatment of inside build-up to ‘traditional’ life insurance policies from a broader category of ‘investment-oriented- products.

IMPACT: The exclusion allows taxpayers to save for retirement in a tax-deferred environment without restrictions on the amount that can be invested. Encouraging families to buy more life insurance can reduce financial vulnerabilities in case of a loss in the family. However, whether the exclusion induces families to buy prudent levels of life insurance is unclear.¹⁶⁷ CRS states that, “These provisions ... offer preferential treatment for the purchase of life insurance coverage and for savings held in life insurance policies and annuity contracts. Middle-income taxpayers,

¹⁶⁵ U.S. Senate, Committee on the Budget, pp. 304.

¹⁶⁶ Ibid, p. 305.

¹⁶⁷ Ibid, pp. 305-306.

who make up the bulk of the life insurance market, may reap most of this provision's benefits. Many higher-income taxpayers, once their life insurance requirements are satisfied, generally obtain better after-tax yields from tax-exempt state and local obligations or tax-deferred capital gains."¹⁶⁸

The exclusion may create efficiency costs for society because, "This exemption of inside build-up distorts investors' decisions by encouraging them to choose life insurance over competing savings vehicles such as bank accounts, mutual funds, or bonds. The result could be overinvestment in life insurance and excessive levels of life insurance protection relative to what would occur if life insurance products competed on a level playing field with other investment opportunities."¹⁶⁹

President Bush's Advisory Panel on Federal Tax Reform recommended repealing this exclusion (as well as several other exclusions for fringe benefits) because, "The favorable tax treatment of fringe benefits results in an uneven distribution of the tax burden as workers who receive the same amount of total compensation pay different amounts of tax depending on the mix of cash wages and fringe benefits."¹⁷⁰

¹⁶⁸ U.S. Senate, Committee on the Budget, p. 304.

¹⁶⁹ *Ibid*, pp. 308-306.

¹⁷⁰ President's Advisory Panel on Federal Tax Reform, p. 85.

Income Tax
Exclusions

47. Public assistance cash benefits

Internal Revenue Code Section: N.A. (this exclusion was established through a series of IRS rulings dating back to 1933)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: N.A. (this exclusion was established through a series of IRS rulings dating back to 1933)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$3,684	\$3,772	\$3,684	\$3,684
Total	\$3,684	\$3,772	\$3,684	\$3,684

DESCRIPTION: Under the general welfare exclusion, public assistance benefits in the form of cash payments or in-kind benefits (goods or services), whether provided free or partly subsidized, are not included in the personal taxable income of the recipient. Examples include cash benefits provided by the Temporary Assistance to Needy Families and the Supplemental Security Income program for the aged, blind, and disabled, and in-kind benefits provided by Medicaid and the Supplemental Nutrition Assistance Program (Food Stamps). A payment would qualify under the general welfare exclusion if payments: (1) are made to individuals under the government program; (2) are for the promotion of general welfare that is based on need; and (3) not represent compensation for services.

It should be noted that the estimates shown above reflect only the forgone revenue from public assistance cash benefits because it is difficult to determine the value of in-kind benefits to recipients.

PURPOSE: The exclusion is not specifically authorized by law; instead, the exclusion has been established by a series of Internal Revenue Service rulings. The Congressional Research Service states that, “Revenue rulings generally exclude government transfer payments from income because they have been considered to have the nature of ‘gifts’ in aid of the general welfare. While no specific rationale has been advanced for this exclusion, the reasoning may be that Congress did not intend to tax with one hand what it gives with the other.”¹⁷¹

IMPACT: CRS notes that, “Exclusion of public assistance cash payments from taxation gives no benefit to the poorest recipients and has little impact on the incomes of many. This is because welfare payments are relatively low and many recipients have little if any non-transfer cash income ... If family cash welfare payments were made taxable, most recipients would still owe no tax.”¹⁷² Nevertheless, some families with relatively large amounts of cash benefits, as well as those who worked for part of the year and received cash assistance for part of the year, would pay tax if public assistance benefits were taxable; these families therefore benefit from the exclusion.

¹⁷¹ U.S. Senate, Committee on the Budget, p. 927.

¹⁷² Ibid, p. 926.

The exclusion violates the principle of horizontal equity because people with identical incomes will face a different tax liability if they receive different amounts of public assistance cash benefits. On the other hand, the exclusion promotes the social goal of protecting a minimum level of income for all individuals.

Income Tax
Exclusions

48. Traditional and Roth IRA earnings and distributions

Internal Revenue Code Sections: 219, 408 and 408A
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1997

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$7,803	\$8,427	\$9,051	\$9,715
Total	\$7,803	\$8,427	\$9,051	\$9,715

DESCRIPTION: There are two types of Individual Retirement Accounts (IRAs) that offer tax benefits: the Roth IRA and the traditional IRA. Contributions to a Roth IRA are taxable, but the earnings, as well as qualified distributions made more than five years after the establishment of the IRA, are tax-free. The pattern of benefits for a traditional IRA is the opposite: some contributions to a traditional IRA are tax-deductible for taxpayers below specified income levels, and the earnings on contributions are tax-free, but the qualified distributions are taxable. Participation in IRAs is approximately evenly split between Roth IRAs and traditional IRAs.¹⁷³

Qualified distributions to a Roth IRA are those made after age 59½, upon the death or disability of the individual, or for first-time homebuyer expenses. An individual may contribute up to \$5,500 to a Roth IRA (\$6,500 for an individual above the age of 50) or an amount equal to earned income, whichever is less, but eligibility is conditioned on income.

Qualified distributions to a traditional IRA must start before age 70½ and individuals are allowed to roll over employer retirement account balances into individual IRAs. The allowable contribution was phased out for single filers with income between \$60,000 and \$70,000, and for joint filers with income between \$96,000 and \$116,000, during tax year 2014.

The above expenditure reflects the net effect from traditional and Roth IRAs. It reflects the forgone taxes from the deduction of IRA contributions by some taxpayers, the forgone taxes from not taxing IRA earnings, and the revenue gain from the taxation of IRA distributions (traditional IRAs distributions are taxed).

PURPOSE: The purpose of the exclusion is to provide an incentive for taxpayers to save for retirement, and in particular to provide a savings incentive for workers who do not have employer-provided pension plans.

IMPACT: Taxpayers who save for retirement through an IRA benefit from this provision. The Congressional Research Service notes that, “IRAs tend to be less focused on higher-income levels than some types of capital tax subsidies, in part because they are capped at a dollar amount. Their benefits do tend, nevertheless, to accrue more heavily to the upper half of the income distribution.

¹⁷³ Urban-Brookings Tax Policy Center, The Tax Policy Briefing Book: A Citizens’ Guide for the 2008 Election and Beyond, p. II-3-1, available at www.taxpolicycenter.org.

This effect occurs in part because of the low participation rates at lower income levels. Further, the lower marginal tax rates at lower income levels make the tax benefits less valuable.”¹⁷⁴

It is not clear whether IRAs and other tax-favored retirement plans actually increase savings. CRS notes that “Another economic justification for IRAs is that they arguably increase savings and increase retirement security. The effects of these plans on savings and overall retirement income are, however, subject to some uncertainty.”¹⁷⁵ In fact, William Gale and Benjamin Harris of the Urban-Brookings Tax Policy Center point out that, “Savings incentives do not raise private saving to the extent that households finance their contributions by shifting their existing assets into a tax-favored account, or by shifting current-period saving that would have occurred even in the absence of the incentive, or by increasing their debt.”¹⁷⁶

¹⁷⁴ U.S. Senate, Committee on the Budget, pp. 961.

¹⁷⁵ U.S. Senate, Committee on the Budget, pp. 963.

¹⁷⁶ William Gale and Benjamin Harris, “Savings and Retirement: How Does Tax-Favored Retirement Saving Affect National Saving?” in The Tax Policy Briefing Book: A Citizens’ Guide for the 2008 Election and Beyond, pp. II-3-13 – II-3-14, available at www.taxpolicycenter.org.

Income Tax
Exclusions

49. Social Security and Railroad Retirement benefits

Internal Revenue Code Section: 86
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1938

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$12,623	\$13,356	\$14,089	\$14,918
Total	\$12,623	\$13,356	\$14,089	\$14,918

DESCRIPTION: A portion of Social Security and Railroad Retirement Board benefits are not subject to federal income tax. By local law, the District of Columbia has extended the tax exemption to the full amount of benefits (see tax expenditures #120-#123 in this report). This description and the estimate of forgone revenue shown above pertain only to the benefits that are exempt due to the District’s conformity to the federal income tax rules.

The amount of Social Security benefits and “Tier 1” Railroad Retirement benefits (which are equivalent to Social Security benefits) subject to federal taxation depends on the amount of “provisional income” above certain thresholds. Provisional income is adjusted gross income plus one-half of Social Security benefits and otherwise tax-exempt interest income, such as tax-exempt bonds.

Taxpayers with provisional income under \$25,000 (single) or \$32,000 (married filing jointly) pay no tax on their Social Security or Railroad Retirement benefits.

If provisional income is above the tax-exempt thresholds but below \$34,000 (single) or \$44,000 (joint) then the amount of benefits subject to tax is the lesser of: (1) 50 percent of benefits, or (2) 50 percent of income above the tax-exempt thresholds. If the provisional income is between the \$25,000 threshold (\$32,000 for a married couple) and a second-level threshold of \$34,000 (\$44,000 for a married couple), the amount of benefits subject to tax is the lesser of : (1) 50 percent of benefits; or (2) 50 percent of provisional income in excess of the first threshold.

If provisional income exceeds \$34,000 (single) or \$44,000 (joint), then the amount of benefits subject to tax is the lesser of: (1) 85 percent of benefits, or (2) 85 percent of income above the second threshold, plus the smaller of (a) \$4,500 for single filers or \$6,000 for joint filers, or (b) 50 percent of benefits. For married people filing separately, taxable benefits are the lesser of 85 percent of benefits or 85 percent of provisional income. The income thresholds described above are not indexed for inflation.

The proceeds from taxation of Social Security and Railroad Retirement benefits at the 50 percent level are credited to the Social Security Trust Fund and the National Railroad Retirement Investment Trust. The proceeds of the taxation of benefits at the 85 percent level are credited to the Medicare Hospital Insurance Trust Fund.

PURPOSE: The purpose of the exclusion is to treat Social Security and Railroad Retirement benefits more like other pension income, thereby enhancing horizontal equity. Social Security and Railroad Retirement benefits were tax-free until 1984, unlike other pension benefits which are fully taxable except for the proportion of projected lifetime benefits that can be attributed to the worker's contributions. The Social Security amendments of 1983 (P.L. 98-21) made 50 percent of benefits above threshold amounts taxable, and the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66) created the second level in which 85 percent of benefits above the threshold are subject to taxation.

The Congressional Research Service points out that the exemption level as well as the progressive rates for the taxing of benefits reflect the social welfare goals of Social Security, which differs from a regular pension program in basing its benefits on work history and providing additional benefits to people with lower earnings.¹⁷⁷

IMPACT: CRS observes that, "Under the current two-level structure, all Social Security beneficiaries have some untaxed benefits. The Congressional Budget Office estimates that more than 70 percent of benefits are untaxed. Taxes are imposed on at least half of the benefits for middle and upper income beneficiaries, while lower income beneficiaries have no benefits taxed."¹⁷⁸

President Bush's Advisory Panel on Federal Tax Reform criticized the two-tiered structure for the taxation of Social Security and railroad retirement benefits for being overly complicated and permitting "bracket creep," which means that more and more recipients cross the income thresholds each year due to inflation and are required to pay more tax.¹⁷⁹

¹⁷⁷ U.S. Senate, Committee on the Budget, pp. 992-993.

¹⁷⁸ *Ibid*, p. 993.

¹⁷⁹ The President's Advisory Panel on Federal Tax Reform, p. 88.

Income Tax
Exclusions

50. Survivor annuities paid to families of public safety officers

Internal Revenue Code Section: 101(h)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1997

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	too small	too small	too small	too small
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: The surviving spouse or child of a public safety officer killed in the line of duty can exclude from gross income a survivor annuity payment under a government pension plan. The annuity must be attributable to the individual’s service as a public safety officer.

PURPOSE: According to the Congressional Research Service, “Congress believed that surviving spouses of public safety officers killed in the line of duty should be subject to the same rules as survivors of military service personnel killed in combat.”¹⁸⁰

IMPACT: Surviving family members of officers killed in the line of duty benefit from this provision. The annual revenue loss from this provision has been less than \$50 million since its enactment in 1997.

¹⁸⁰ U.S. Senate, Committee on the Budget, pp. 987-988.

Income Tax
Exclusions

51. Workers’ compensation benefits

Internal Revenue Code Section: 104(a)(1)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1918

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$3,761	\$3,836	\$3,912	\$3,987
Total	\$3,761	\$3,836	\$3,912	\$3,987

DESCRIPTION: Workers’ compensation benefits (both medical and non-medical benefits) granted to employees in the case of work-related injury, and to survivors in case of an employee’s work-related death, are not taxable. Employers finance the benefits through insurance or self-insurance, and their costs are deductible as a business expense. Benefits are paid regardless of who was at fault, and workers’ compensation is treated as the exclusive remedy for work-related injury or death. Workers’ compensation programs are administered by the states.

PURPOSE: The Congressional Research Service states that no rationale for the exclusion is found in the legislative history (the provision was enacted in 1918), “But it has been maintained that workers’ compensation should not be taxed because it is in lieu of court-awarded damages for work-related injury or death that, before enactment of workers’ compensation laws ... would have been payable under tort law for personal injury or sickness and not taxed.”¹⁸¹

IMPACT: CRS states that, “The exclusion from taxation of employer contributions for worker’s compensation medical benefits provides a tax benefit to any worker covered by the worker’s compensation program, not just those actually receiving benefits in a particular year.”¹⁸²

A possible unintended consequence of the tax expenditure is that it “reduces the employer’s cost of compensating employees for accidents on the job and can be viewed as blunting financial incentives to maintain safe workplaces.”¹⁸³

¹⁸¹ U.S. Senate, Committee on the Budget, p. 834.

¹⁸² Ibid, p. 833.

¹⁸³ Ibid, p. 834.

Income Tax
Exclusions

52. Active income of controlled foreign corporations

Internal Revenue Code Sections: 11, 882, and 951-964
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1909

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$107,509	\$112,544	\$116,592	\$121,627
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$107,509	\$112,544	\$116,592	\$121,627

DESCRIPTION: When a U.S. firm earns income through a foreign subsidiary, the income is exempt from U.S. corporate taxes as long as it remains in the hands of the foreign subsidiary. Therefore, federal taxes are deferred until the income is repatriated to the U.S. parent firm as dividends or other income. This deferral represents a tax expenditure.

When the foreign income is repatriated, the U.S. parent corporation can credit foreign taxes paid by the subsidiary against U.S. taxes owed on the repatriated income. If a U.S. firm invests in a country or countries with low tax rates, the tax benefit from the deferral can be particularly large.

PURPOSE: The purpose of this tax deferral is to encourage the purchase and operation of foreign subsidiaries by U.S. firms, thereby increasing U.S. firms’ penetration of foreign markets and enhancing the firms’ global competitiveness. Proponents also contend that the tax deferral boosts U.S. exports.

IMPACT: U.S. multinational firms with foreign operations in low-tax countries benefit from this provision because they can shield more of their income from taxation. The Congressional Research Service observes that, “(E)conomic theory suggests that a tax incentive such as deferral does not promote the efficient allocation of investment. Rather, capital is allocated most efficiently – and world economic welfare is maximized – when taxes are neutral and do not distort the distribution of investment between the United States and abroad. Economic theory also holds that while world welfare may be maximized by neutral taxes, the economic welfare of the United States would be maximized by a policy that goes beyond neutrality and poses a disincentive for U.S. investment abroad.”¹⁸⁴

CRS also points out that deferral probably benefits U.S. capital and foreign labor, but may reduce world economic efficiency by distorting the allocation of capital. CRS states that, “Because the U.S. capital-labor ratio is therefore probably lower than it otherwise would be and U.S. labor has less capital with which to work, deferral likely reduces the general U.S. wage level.”¹⁸⁵

¹⁸⁴ U.S. Senate, Committee on the Budget, pp. 51-52.

¹⁸⁵ Ibid, p. 50.

Income Tax
Exclusions

53. Allowances for federal employees working abroad

Internal Revenue Code Section: 912
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1943

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$7,854	\$8,211	\$8,211	\$8,568
Total	\$7,854	\$8,211	\$8,211	\$8,568

DESCRIPTION: U.S. federal civilian employees working abroad are allowed to exclude from personal taxable income certain special allowances that are provided to offset the costs of living abroad, such as the costs of housing, education, and travel. Like other U.S. citizens, federal employees who work abroad are subject to U.S. taxes and can credit any foreign taxes paid against their U.S. taxes.

PURPOSE: The purpose of this exclusion is to offset the extra costs of working abroad (such as maintaining a home in the U.S. and in the foreign country) and to encourage employees to accept assignments abroad.

IMPACT: Federal civilian employees working abroad benefit from this provision. The tax expenditure can be seen as promoting equity by making sure that federal employees working abroad are not taxed on allowances that serve as reimbursement for employment expenses. At the same time, the exclusion may also encourage federal agencies to provide more compensation in the form of generous special allowance than would otherwise be the case, thereby undermining efficiency.

Income Tax
Exclusions

54. Income earned abroad by U.S. citizens

Internal Revenue Code Section: 911
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1926

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$5,855	\$6,294	\$6,660	\$7,026
Total	\$5,855	\$6,294	\$6,660	\$7,026

DESCRIPTION: U.S. citizens who live abroad (except for U.S. government employees, who benefit from a separate exclusion described under tax expenditure #53) were allowed to exclude up to \$99,200 in earned income from personal taxable income in 2014. The limit on excludable income is adjusted annually for inflation. A taxpayer must meet foreign residence tests to receive the exclusion. Taxpayers may also exclude a certain amount of foreign housing expenses from taxable income.¹⁸⁶ The combined income and housing exclusion cannot exceed the taxpayer’s total foreign earned income for that year, including the value of a housing allowance.

PURPOSE: The purpose of this exclusion is to compensate U.S. citizens working abroad for the costs of living overseas and the taxes they pay to the foreign country where they live. When the exclusion was originally adopted in 1926, proponents argued that it “would bolster U.S. trade performance, since it would provide tax relief to U.S. expatriates engaged in trade promotion.”¹⁸⁷ The history of the exclusion shows a continuing attempt by policymakers to find a balance between the provision’s perceived beneficial effects on U.S. trade and economic performance and perceptions of tax equity.

IMPACT: U.S. citizens who live and work abroad benefit from this provision. The Congressional Research Service points out that, “The impact of the exclusions on Americans working abroad depends partly on whether their foreign taxes are higher or lower than their U.S. taxes (before taking the exclusion into account). For expatriates who pay high foreign taxes, the exclusion holds little importance, because they can use the foreign tax credit to offset their U.S. tax liability ... For expatriates who pay little or no foreign taxes, however, the exclusion can reduce or eliminate their U.S. tax liability.”¹⁸⁸

¹⁸⁶ The housing exclusion is equal to the amount by which housing costs exceed 16 percent of the earned income exclusion, but cannot exceed 30 percent of the maximum earned income exclusion (which was \$99,200 in 2014). In addition, the Treasury Department has the authority to raise the maximum housing exclusion above these levels in high-cost cities.

¹⁸⁷ U.S. Senate, Committee on the Budget, p. 33.

¹⁸⁸ Ibid, p. 32.

Additionally, CRS notes that “data suggest that U.S. citizens who work abroad have higher real incomes, on average, than people working in the United States. If that is true, where it does reduce taxes, the exclusion reduces the progressivity of the income tax.”¹⁸⁹

The uniform allowable income exclusion also may exceed the additional costs of living in some countries, while failing to compensation for the additional costs in higher-cost countries.

Employers also benefit because the exclusion subsidizes the transfer of employees to positions overseas; without the exclusion, employers might have to reimburse employees for the taxes paid on their housing and other expenses of living abroad.

¹⁸⁹ U.S. Senate, Committee on the Budget, p. 32.

Income Tax
Exclusions

55. Inventory property sales source rule exception

Internal Revenue Code Sections: 861, 862, 863, and 865
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1921

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$1,678	\$1,777	\$1,777	\$1,777
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$1,678	\$1,777	\$1,777	\$1,777

DESCRIPTION: This provision allows firms to exclude certain export income from the corporate income tax by allocating the income from sales of inventory property to foreign rather than U.S. sources. If the inventory is both manufactured and sold by a firm, it can exempt up to 50 percent of the combined income from U.S. taxes. If the firm earns income only from the sale of the inventory, it can exempt all of the income from U.S. taxes.

This rule on the taxation of inventory property can enable a firm to escape U.S. corporation tax entirely (not just on the portion of income that is attributable to the manufacture or sale of inventory property) because it increases the amount of foreign tax paid, which can be credited against U.S. taxes. Many firms have “excess credits” from prior foreign-source income, so they can reduce their U.S. taxable income by increasing the amount of their income that is attributed to foreign sources. The tax treatment of inventory property represents a tax expenditure because income from other types of property, such as personal property, cannot be allocated to foreign countries in this way.

PURPOSE: The purpose of the exclusion is to assist U.S. businesses that are engaged in international trade. The Tax Reform Act of 1986 provided that income from the sale of personal property was generally to be attributed to the home country where the seller resides. Nevertheless, Congress was concerned that this rule would create difficulties for U.S. export firms, and therefore made the exemption for inventory property.¹⁹⁰

IMPACT: Businesses that export goods to other countries are the intended beneficiaries of this provision. Still, the Congressional Research Service notes that, “In the long run ... the burden of the corporate income tax (and the benefit from corporate tax exemptions) probably spreads beyond corporate stockholders to owners of capital in general. Thus, the source-rule benefit is probably shared by U.S. capital in general, and therefore probably disproportionately benefits upper-income individuals. To the extent that the rule results in lower prices for U.S. exports, a part of the benefit probably accrues to foreign consumers of U.S. products.”¹⁹¹

The Congressional Budget Office points out that while this rule “may increase the volume of U.S. trade, it is not expected to improve the U.S. trade balance... the provision could actually expand

¹⁹⁰ U.S. Senate, Committee on the Budget, p. 57.

¹⁹¹ Ibid, p. 56.

the U.S. trade deficit by generating inflows of foreign capital and their accompanying exchange rates effects.”¹⁹² This rule “allows domestic export income that is not subject to foreign taxes to be exempted from U.S. taxes as well, so the income escapes corporate taxation altogether.”¹⁹³

¹⁹² U.S. Senate, Committee on the Budget, p. 57.

¹⁹³ Congressional Budget Office, *Options for Reducing the Deficit: 2014 to 2023*, November 2013, pp. 164-165.

Income Tax
Exclusions

56. Benefits and allowances for armed forces personnel

Internal Revenue Code Sections: 112 and 134
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1925

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$2,522	\$2,690	\$2,858	\$2,942
Total	\$2,522	\$2,690	\$2,858	\$2,942

DESCRIPTION: Military personnel receive a variety of in-kind benefits that are not taxed. These include medical and dental benefits, group life insurance, professional education and dependent education, moving and storage, premiums for survivor and retirement protection plans, subsistence allowances, uniform allowances, housing allowances, overseas cost-of-living allowances, evacuation allowances, family separation allowances, travel for consecutive overseas tours, emergency assistance, family counseling, defense counsel, burial and death services, certain combat-zone compensation and combat-related benefits, and travel of dependents to a burial site. Any cash payments given in lieu of the benefits are also excluded from taxable income.

In addition, payments made to families when members of the armed forces die on active duty or while traveling to or from active duty are excluded from taxation.¹⁹⁴

PURPOSE: CRS states that “The principle of exemption of armed forces benefits and allowance evolved from the precedent set by *Jones v. United States*, through subsequent statues, regulations, or long standing practices.”¹⁹⁵ The rationale of the exclusion is to reduce tax burdens of military personnel during wartime (as in the use of combat pay provisions); other allowances were based on the belief that certain types of benefits are intrinsic elements in the military structure.

IMPACT: Military service members and their families benefit from the exclusion. The Congressional Research Service states that, “Some see the provision of compensation in a tax-exempt form as an unfair substitute for additional taxable compensation. The tax benefits that flow from an exclusion do provide the greatest benefits to high- rather than low-income military personnel.”¹⁹⁶ The value of the exclusion therefore reduces the progressivity of the income tax system. The exclusion may also harm efficiency by encouraging the Defense Department to provide members of the armed forces with a greater share of non-cash benefits than they would prefer. Nevertheless, CRS states that “elimination of the tax exclusions could also lead service

¹⁹⁴ Families of a deceased member of the armed forces receive a \$100,000 death gratuity payment.

¹⁹⁵ U.S. Senate, Committee on the Budget, p. 17.

¹⁹⁶ *Ibid*, p. 18.

members to think that their benefits were being cut, or provide an excuse in the “simplification” process to actually cut benefits, affecting recruiting and retention negatively.”¹⁹⁷

¹⁹⁷ U.S. Senate, Committee on the Budget, p. 18.

Income Tax
Exclusions

57. Combat pay

Internal Revenue Code Section: 112
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1918

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$588	\$630	\$672	\$672
Total	\$588	\$630	\$672	\$672

DESCRIPTION: Pay received by active members of the U.S. Armed Forces is excluded from gross income during any month in which the member served in a combat zone or was hospitalized as the result of an injury or illness incurred while serving in a combat zone. For commissioned officers, the exclusion is limited to the maximum compensation for active enlisted military personnel. For hospitalized service members, the exclusion is limited to two years after he or she ended service in the combat zone.

PURPOSE: The Congressional Research Service states that, “Generally, compensation paid to active military personnel in a combat zone is increased to reflect the hazards inherent to duty in a combat zone. Excluding combat pay from taxation may reflect general public recognition of such military service.”¹⁹⁸

IMPACT: The exclusion of combat pay significantly reduces (for commissioned officers) or eliminates (for enlisted personnel) tax liability of active military personnel serving in a combat zone.

¹⁹⁸ U.S. Senate, Committee on the Budget, p. 30.

Income Tax
Exclusions

58. Military disability benefits

Internal Revenue Code Section: 104(a)(4), 104(a)(5), and 104(b)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$126	\$126	\$126	\$126
Total	\$126	\$126	\$126	\$126

DESCRIPTION: Service members who become physically unfit to perform military duties can be retired on military disability under certain conditions. Individuals who were members of the armed forces on or before September 24, 1975, may be eligible for the exclusion of disability pay from personal taxable income. The amount of military disability pay for these individuals is based on either of two methods: the percentage-of-disability method, or the years-of-service method. Under the percentage-of-disability method, the pension equals the percentage of disability multiplied by the terminal monthly basic pay. Under the years-of-service method, terminal monthly basic pay is multiplied by the number of service years times 2.5. Only the portion that would have been paid under the percentage-of-disability method is excluded from gross income.

Individuals who joined the armed forces after September 24, 1975, may exclude military disability payments equivalent to disability payments they could have received from the U.S. Department of Veterans Affairs. Otherwise, their disability payments may be excluded only if the disability is directly attributable to a combat-related injury.

Under the Victims of Terrorism Tax Relief Act of 2001, any civilian or member of the military whose disability is attributable to terrorism or military action anywhere in the world may exclude disability income from gross income.

PURPOSE: The purpose of the exclusion is to compensate veterans for economic hardship created by injury or illness. According to the Congressional Research Service, blanket exclusion for military disability pay was enacted in 1942, based partly on the view that military disability pay was similar to workers’ compensation, which was excluded from the federal income tax. In 1976, Congress tightened the exclusion due to concern about abuses by “armed forces personnel who were classified as disabled shortly before becoming eligible for retirement in order to obtain tax-exempt treatment for their pension benefits.”¹⁹⁹ However, those who joined the military on or before September 24, 1975, were allowed to continue under the prior rules.

IMPACT: Military veterans who are retired on disability benefit from this exclusion. CRS observes that, “Disability pension payments that are exempt from tax provide more net income

¹⁹⁹ U.S. Senate, Committee on the Budget, p. 22.

than taxable pension benefits at the same level. The tax benefit of the provision increases as the marginal tax rate increases, and is greater for higher-income individuals.”²⁰⁰

²⁰⁰ U.S. Senate, Committee on the Budget, p. 22.

Income Tax Exclusions

59. Contributions in aid of construction for water and sewer utilities

Internal Revenue Code Sections: 118(c) and 118(d)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1996

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	too small	too small	too small	too small

Note: "Too small" means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Contributions in aid of construction received by regulated water and sewage disposal utilities are not included in the utilities' gross income if the contributions are spent for the construction of new facilities within two years. Contributions in aid of construction are charges paid by utility customers, usually builders or developers, to cover the cost of expanding, improving, or replacing water or sewage disposal facilities in order to serve housing subdivisions, industrial plants, and manufacturing parks. Contributions that are an advance of funds and require repayment are also excluded from the utilities' income. Connection fees charged to customers for installing lines cannot be excluded from income unless the lines will serve multiple customers. This tax expenditure allows the utility to treat the contribution as a tax-free addition to its capital rather than treating it as taxable income. The total DC expenditure for FY 2015-2019 is estimated to be \$197,446.

PURPOSE: The purpose of the exclusion is to encourage modernization of water and sewage facilities. The Tax Reform Act of 1986 repealed a similar subsidy that applied not only to water and sewage facilities, but also to utilities that provided steam, electricity, and gas. Congress reinstated the subsidy for water and sewage facilities in 1996 based on concern that the repeal had inhibited community development and the modernization of water and sewage plants.²⁰¹

IMPACT: Builders and developers benefit from the tax expenditure because the required contribution is smaller if the utility does not have to pay taxes on the amount. Nevertheless, the Congressional Research Service notes that the ultimate beneficiaries are unclear because, "To the extent that the lower charges to builders and developers for contributions in aid of construction are passed on to ultimate consumers through lower prices, the benefit from this special tax treatment accrues to consumers. If some of the subsidy is retained by the builders and developers because competitive prices do not require it to be passed forward in lower prices, then the special tax treatment also benefits the owners of these firms."²⁰² CRS adds that, "Absent a public policy justification, such subsidies distort prices and undermine economic efficiency."²⁰³

²⁰¹ U.S. Senate, Committee on the Budget, pp. 238-239.

²⁰² Ibid, p. 238.

²⁰³ Ibid, p. 239.

Income Tax
Exclusions

60. Earnings of certain environmental settlement funds

Internal Revenue Code Section: 468B
Federal Law Sunset Date: None
Year Enacted in Federal Law: 2005

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Hazardous waste site cleanup is sometimes funded by environmental settlement funds, which serve the same purpose as an escrow account. These funds are established in consent decrees between the U.S. Environmental Protection Agency (EPA) and the parties responsible for contaminating a site, under the jurisdiction of a federal district court. This provision allows businesses that contribute to certain environmental settlement funds to exclude the earnings on those contributions from taxable income. In effect, the provision lowers the after-tax cost to a business of reaching a settlement with the EPA to clean up hazardous wastes identified through the “Superfund” program.

PURPOSE: The purpose of the exclusion is to give parties deemed responsible for hazardous waste sites an incentive to enter into an agreement with the EPA to clean up the sites.

IMPACT: Businesses that establish environmental settlement funds during the eligible period benefit from this provision. The Congressional Research Service states that, “The tax expenditure tied to the provision lies in the fund income that escapes taxation.”²⁰⁴

There may also be a broader public benefit because the exclusion should encourage those responsible for hazardous wastes to act more quickly to remediate the sites at their own expense, which also saves tax dollars that would otherwise be needed to perform the remediation.

²⁰⁴ U.S. Senate, Committee on the Budget, p. 254.

Income Tax Exclusions

61. Energy conservation subsidies provided by public utilities

Internal Revenue Code Section: 136
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1992

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	too small	too small	too small	too small
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Residential energy customers can exclude from personal taxable income any subsidy they receive from a public utility for purchasing or installing an energy conservation device. If an energy conservation expenditure qualifies for this exclusion, the taxpayer may not claim any other tax benefits for the same expenditure.

PURPOSE: The purpose of the exclusion is to encourage residential customers to participate in conservation programs sponsored by public utilities. These programs would enhance the energy efficiency of dwelling units and encourage energy conservation in residential buildings.

IMPACT: Homeowners who participate in conservation programs and install energy-saving devices benefit from this provision. The Congressional Research Service points out that this tax preference “might be justified on the grounds of conservation, if consumption of energy resulted in negative effects on society, such as pollution. In general, however, it would be more efficient to directly tax energy fuels than to subsidize a particular method of achieving conservation. From an economic perspective, allowing special tax benefits for certain types of investment or consumption results in a misallocation of resources.”²⁰⁵

CRS also notes that complex incentives are at play in the case of rental housing. Both the tenant and landlord lack a strong financial incentive to invest in energy conservation equipment because the benefits may not accrue entirely to the party paying the cost. Tenants may not occupy a rental property long enough to reap the benefits of energy conservation measures, whereas landlords may not have sufficient control over the behavior of renters to be sure that the investment in energy conservation will pay off. As a result, “These market failures may lead to underinvestment in conservation measures in rental housing and provide the economic rationale for this provision.” Nevertheless, the exclusion is available both to owners who occupy their homes and those who rent them out.²⁰⁶

²⁰⁵ U.S. Senate, Committee on the Budget, p. 132.

²⁰⁶ Ibid, p. 133.

Income Tax
Exclusions

62. Interest on state and local private-activity bonds issued to finance water, sewer, and hazardous-waste facilities

Internal Revenue Code Sections: 103, 141, 142, and 146.
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1968

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$134	\$134	\$134	\$134
Personal Income Tax Loss	\$381	\$381	\$508	\$635
Total	\$515	\$515	\$642	\$769

DESCRIPTION: Interest income on state and local bonds used to finance the construction of sewage facilities, facilities used to supply water, and facilities that dispose of hazardous waste is tax-exempt. The bonds are classified as private-activity bonds, rather than governmental bonds, if a substantial portion of the benefits accrues to private organizations instead of the general public. The private-activity bonds issued for these facilities are subject to a state annual volume cap, which was the greater of \$100 per capita or \$296.8 million in 2014.

In order to qualify for tax-exempt bond financing, water-supply facilities must serve the general public, and must be operated by a governmental unit or have their rates established or approved by a government regulator. The portion of a hazardous waste facility that can be financed with tax-exempt bonds cannot exceed the portion of the facility to be used by entities other than the owner or operator of the facility.

PURPOSE: The purpose of the tax expenditure is to encourage investment. It provides low-cost financing of water, sewer, and hazardous-waste facilities. Investors purchase the bonds at low interest rates because the income from them is tax-free.

IMPACT: The Congressional Research Service suggests that tax-exempt financing of water, sewer, and hazardous waste facilities has general public benefits because the subsidy helps correct a market failure that may lead to underinvestment. The benefits of the facilities to the environment and public health cross state and local borders, but state and local governments may not recognize the spillover benefits when setting spending levels. CRS adds that, “there are significant costs, real and perceived, associated with siting an unwanted hazardous waste facility. The federal subsidy through this tax expenditure may encourage increased investment as well as spread the cost to more potential beneficiaries, federal taxpayers.”²⁰⁷

CRS also cautions that, “As one of many categories of tax-exempt private-activity bonds, bonds for these facilities increase the financing cost of bonds issued for other public capital. With a greater supply of public bonds, the interest rate on the bonds necessarily increases to attract

²⁰⁷ U.S. Senate, Committee on the Budget, p. 592.

investors. In addition, expanding the availability of tax-exempt bonds increases the assets available to individuals and corporations to shelter their income from taxation.²⁰⁸

²⁰⁸ U.S. Senate, Committee on the Budget, p. 593.

Income Tax
Exclusions

63. Employer-provided adoption assistance

Internal Revenue Code Sections: 23 and 137
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1996

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$305	\$305	\$381	\$381
Total	\$305	\$305	\$381	\$381

DESCRIPTION: Benefits that a taxpayer receives through an employer-sponsored adoption assistance program are excluded from personal taxable income. The employer-sponsored benefits must be provided according to a written plan, and qualified expenses that are eligible for deduction include reasonable and necessary adoption fees, court costs, attorney fees, and traveling expenses. In the case of a special-needs adoption, expenses such as construction, renovations, or alterations may qualify for the exclusion.

For tax year 2014, the maximum exclusion was \$13,190 per child. The deduction was phased out for taxpayers with modified adjusted gross income between \$197,880 and \$237,880; at higher income levels, there is no benefit. The maximum deduction, and the income levels over which the benefits are phased out, are indexed for inflation.

Qualified adoption expenses that are claimed under this exclusion cannot also be claimed for the federal adoption tax credit (and vice-versa). The exclusion also does not cover any expenses paid by a federal, state, or local grant.

PURPOSE: The purpose of the exclusion is to encourage and facilitate adoption, especially children of special needs, by reducing the associated financial costs. CRS states that “the credit and income tax are designed to provide tax relief to moderate income families for the costs associated with adoptions and to encourage families to seek adoptable children”.²⁰⁹

IMPACT: The exclusion primarily benefits middle-income families because it is phased out for wealthy taxpayers. There may also be more general benefits to society by helping children find permanent adoptive homes. The Congressional Research Service also points out that the federal government administers a direct assistance program for people adopting children with special needs, and that there has been an ongoing debate about whether adoption assistance (whether targeted to children with special needs or all children) should be administered through direct-expenditure programs or through the tax system.²¹⁰

²⁰⁹ U.S. Senate, Committee on the Budget, p. 779.

²¹⁰ Ibid, p. 780.

Income Tax
Exclusions

64. Child and dependent care and employer-provided dependent care

Internal Revenue Code Sections: 21 and 129
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1981

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$3,660	\$3,660	\$3,660	\$3,736
Total	\$3,660	\$3,660	\$3,660	\$3,736

DESCRIPTION: Employer payments for dependent care through a dependent-care assistance program are not included in an individual’s personal taxable income. The maximum annual exclusion is \$3,000 for one dependent and \$6,000 for two or more dependents, and may not exceed the lesser of the employee’s earned income or the earned income of the employee’s spouse. To qualify, the employer assistance must be provided through a plan that meets certain conditions, such as eligibility requirements that do not discriminate in favor of highly-compensated employees, shareholders, or owners.

Qualifying dependent-care expenses include household services, day care centers, and other similar types of non-institutional care. Dependents must be under the age of 13, except for a physically or mentally incapacitated spouse or dependent who lives with the taxpayer for more than half of the year. Day care centers must comply with state and local laws and regulations for the exclusion of payments to be allowable. Payments to relatives are allowable only if the relatives are not dependents of the taxpayer, or a child of the taxpayer under age 19.

A tax payer may also claim a nonrefundable tax credit for certain expenses to care for a dependent child, disabled dependent or disabled spouse. To qualify for the credit, the expenses incurred must be to enable the tax payer to work.

PURPOSE: The rationale for the tax credit is that child care is a work related cost. The provision was intended to recognize the similarity of child care expenses to employee business expenses and provide limited benefits. The Congressional Research Service states that the exclusion was “intended to provide an incentive for employers to become more involved in the provision of dependent care services for their employees.”²¹¹ There is also the desire to reduce welfare cost.

IMPACT: CRS notes that the exclusion “provides an incentive for employers to provide, and employees to receive, compensation in the form of dependent-care assistance rather than cash ... As is the case with all deductions and exclusions, this benefit is related to the taxpayer’s marginal tax rate and, thus, provides a greater benefit to taxpayers in high tax brackets than those in low tax brackets.”²¹² Nevertheless, the \$6,000 limit on the exclusion restricts the benefit for upper-income families.

²¹¹ U.S. Senate, Committee on the Budget, p. 766.

²¹² Ibid, p. 765.

CRS further observes that, “The income tax exclusion violates the economic principle of horizontal equity, in that all taxpayers with similar incomes and work-related child care expenses are not treated equally. Only taxpayers whose employers have a qualified child care assistance program may exclude from income taxes a portion of their work-related child care expenses.”²¹³ The horizontal equity problem is one reason why President Bush’s Advisory Panel on Federal Tax Reform called for repeal of the exclusion.²¹⁴

On the other hand, CRS states that, “the availability of dependent care can reduce employee absenteeism and unproductive work time. The tax exclusion may also encourage full participation of women in the work force as the lower after-tax cost of child care may not only affect labor force participation but hours of work ... Those employers that may gain most by the provision of dependent-care services are those whose employees are predominantly female, younger, and whose industries have high personnel turnover.”²¹⁵

²¹³ U.S. Senate, Committee on the Budget, p. 768.

²¹⁴ The President’s Advisory Panel on Federal Tax Reform, p. 85.

²¹⁵ U.S. Senate, Committee on the Budget, p. 769.

Income Tax
Exclusions

65. Foster care payments

Internal Revenue Code Section: 131
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1982

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$451	\$451	\$451	\$451
Total	\$451	\$451	\$451	\$451

DESCRIPTION: Payments made by a state, local, or qualified foster-care placement agency to a provider who cares for a foster child in the home are excluded from the personal taxable income of the provider. The exclusion applies both to reimbursements for the general cost of caring for a foster child as well as additional payments provided for the care of a child with physical, mental, or emotional handicaps (the latter are referred to as “difficulty of care” payments).

The exclusion does not cover foster care payments made for more than 5 children aged 19 or older under the standard reimbursement rates or the “difficulty of care” reimbursement rates, nor does it cover payments for more than 10 children under the age of 19 who are eligible for “difficulty of care” rates.

PURPOSE: According to the Congressional Research Service, the exclusion of qualified foster care payments “was made to relieve foster care providers from the detailed record-keeping requirements of prior law,”²¹⁶ which disallowed any exclusion in excess of the actual expenses paid in caring for a foster child. “Congress feared that detailed and complex record-keeping requirements might deter families from accepting foster children or from claiming the full tax exclusion to which they were entitled.”²¹⁷

IMPACT: CRS observes that, “It is generally conceded that the tax law treatment of foster care payments provides administrative convenience for the Internal Revenue Service, and prevents unnecessary accounting and record-keeping burdens for foster care providers. The trade-off is that to the extent foster care providers receive payments over actual expenses incurred, monies which should be taxable as income are provided an exemption from individual income and payroll taxes.”²¹⁸ Children in foster care may benefit from the exclusion because the reduction in the administrative burden may encourage more people to become foster parents, and there may be a broader social benefit from encouraging the placement of children in foster care.

²¹⁶ U.S. Senate, Committee on the Budget, p. 785.

²¹⁷ Ibid.

²¹⁸ Ibid.

Income Tax
Exclusions

66. Employer-provided transportation assistance

Internal Revenue Code Section: 132(f)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1984 (parking benefits) and 1992 (transit benefits)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$3,965	\$4,193	\$4,346	\$4,498
Total	\$3,965	\$4,193	\$4,346	\$4,498

DESCRIPTION: Taxpayers are allowed to exclude up to \$255 per month for employer-paid parking in 2016, as well as an additional \$255 per-month for employer-provided transit passes or van-pool benefits.²¹⁹ A “transit pass” means any pass, token, fare card, voucher, or similar item that entitles an individual to transportation in a mass-transit system or through a commuter highway vehicle (van pool). The maximum monthly exclusions for employer-provided parking and transit assistance are adjusted annually for inflation.

In addition, bicycle commuters may exclude as much as \$20 multiplied by the number of qualified bicycle commuting months during the year. Nevertheless, the exclusion for bicycle commuting expenses is not allowable if the employee does not receive mass transit or parking benefits from his or her employer. The \$20 cap per month is not adjusted for inflation.

Employees can use pre-tax dollars, at their employer’s discretion, to pay for parking or mass transit benefits. The pre-tax option is not available for bicycle commuting benefits, which must be paid directly by the employer.

PURPOSE: The exclusion is part of a general policy of excluding employer-provided benefits from taxable income. The exclusion is capped to place a limit on the ability of employers and employees to shift compensation from taxable wages to non-taxable fringe benefits.

IMPACT: The Congressional Research Service states that, “The subsidy benefits both employees, through higher compensation, and their employers, who may face lower wage costs.”²²⁰

With regard to mass transit, CRS observes that, “Subsidies for mass transit and vanpools encourage the use of mass transportation and may reduce congestion and pollution. Some studies have found that transportation benefit programs can spur non-users of public transportation to become occasional users, and occasional users to become more regular users ... All commuters in an area may enjoy spillover benefits from reduced traffic congestion such as lower transportation

²¹⁹ U.S. Department of the Treasury, Internal Revenue Service, Employer’s Tax Guide to Fringe Benefits – For Use in 2016 (Publication 15-B, issued December 23, 2015), p. 19.

²²⁰ U.S. Senate, Committee on the Budget, p. 558.

costs, shorter waiting times in traffic, and improved air quality.”²²¹ Nevertheless, “Businesses and workers located where mass transportation alternatives are lacking gain little benefit from this provision.”²²²

With regard to parking, CRS points out that, “Subsidies or favorable tax treatment of parking may encourage more employees to drive to work, which may increase traffic congestion and air pollution. One study found that when employees in California firms became able to opt for a cash benefit instead of employer-provided parking benefits, the proportion of employees driving to work fell significantly. Subsidized employee parking may also make finding parking spaces harder, which can affect quality of life in residential neighborhoods near work areas and the flow of customers for retail businesses.”²²³

²²¹ U.S. Senate, Committee on the Budget, pp. 560-561.

²²² *Ibid*, p. 560.

²²³ *Ibid*, p. 561.

Income Tax
Exclusions

67. Interest on state and local private-activity bonds issued to finance airport, dock, and mass commuting facilities

Internal Revenue Code Sections: 103, 141, 142, and 146
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1968

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$402	\$402	\$402	\$402
Personal Income Tax Loss	\$889	\$889	\$889	\$1,016
Total	\$1,291	\$1,291	\$1,291	\$1,418

DESCRIPTION: Each state receives a certain amount of authority to issue tax-exempt private activity bonds, which are securities issued by a state or local government to finance qualified projects by a private user. These qualified projects, which include the construction of airports, docks, wharves, and mass commuting facilities, are expected to have a public benefit.

Although private-activity mass commuting facility bonds are subject to annual volume caps on private-activity bonds (the cap was \$100 per capita or \$296.8 million, whichever is greater, for each state in 2014), bonds issued for airports, docks, and wharves are not subject to the caps.

PURPOSE: The purpose of the bonds is to promote the construction of airport, dock, wharf, and mass-transit infrastructure by subsidizing low interest rates, thereby lowering the cost of the facilities and supporting commerce. Investors purchase the bonds at low interest rates because the income from them is tax-free.

IMPACT: The owners of airport, dock, wharf, and mass-transit infrastructure, as well as the businesses and residents who use these facilities, benefit from this provision. There may also be spillover benefits from such investment. According to the Congressional Research Service, “Economic theory suggests that to the extent these facilities provide social benefits that extend beyond the boundaries of the state or local government, the facilities might be underprovided due to the reluctance of state and local taxpayers to finance benefits for nonresidents.”²²⁴

CRS also identifies potential costs of these private activity bonds, stating that, “As one of many categories of tax-exempt private-activity bonds, those issued for airports, docks, wharves, and mass commuting facilities increase the financing cost of bonds issued for other public capital. With a greater supply of public bonds, the interest rate on the bonds necessarily increases to lure investors. In addition, expanding the availability of tax-exempt bonds increases the assets available to individuals and corporations to shelter their income from taxation.”²²⁵

²²⁴ U.S. Senate, Committee on the Budget, p. 571.

²²⁵ Ibid.

Income Tax
Exclusions

68. Interest on state and local private-activity bonds issued to finance highway projects and rail-truck transfer facilities

Internal Revenue Code Sections: 103, 141, 142(m), and 146
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 2005

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	\$134	\$134
Personal Income Tax Loss	\$127	\$127	\$127	\$127
Total	\$127	\$127	\$261	\$261

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: States are authorized to issue tax-exempt private activity bonds, which are securities issued by a state or local government to finance qualified projects by a private user. These qualified projects, which include highway projects and surface freight transfer facilities (truck to rail, or rail to truck) that receive federal aid, are expected to have a public benefit even though a substantial portion of the benefits will accrue to private individuals or businesses.

These bonds are not subject to the federally-imposed annual state volume caps on private-activity bonds, but there is a national limitation of \$15 billion on the aggregate value of the bonds, which are allocated by the U.S. Secretary of Transportation.

PURPOSE: According to the Congressional Research Service, in 2005 Congress authorized state and local governments to issue tax-exempt bonds to finance highways and surface freight-transfer facilities “to enhance the efficiency of the nation’s long-distance freight transport infrastructure. With more efficient intermodal facilities, proponents suggest that long-distance truck traffic will shift from government-financed interstate highways to privately-owned long-distance rail transport.”²²⁶ The bonds promote construction of highways and surface freight-transfer facilities by subsidizing low interest rates, thereby lowering the cost of the facilities and supporting commerce. Investors buy the bonds at low interest rates because the income earned is tax-free.

IMPACT: Private businesses should benefit from the construction of a more efficient system of long-distance freight transportation, but there may be spillover benefits to society as well in the form of economic development. CRS notes that, “The facilities may be underprovided because state and local taxpayers may be unwilling to finance benefits for nonresidents.”²²⁷ At the same time, CRS points out that expanding tax-exempt private-activity bond issuance raises the financing cost of bonds issued for other public capital. “With a greater supply of public bonds, the interest rate on the bonds necessarily increases to lure investors,” CRS states. “In addition,

²²⁶ U.S. Senate, Committee on the Budget, p. 546.

²²⁷ Ibid, p. 547.

expanding the availability of tax-exempt bonds increases the assets available to individuals and corporations to shelter their income from taxation.”²²⁸

²²⁸ U.S. Senate, Committee on the Budget, p. 547.

Income Tax
Exclusions

69. G.I. bill education benefits

U.S. Code Section: U.S. Code Title 38, Section 5301 (not codified in the Internal Revenue Code)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1917

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$715	\$775	\$830	\$876
Total	\$715	\$775	\$830	\$876

DESCRIPTION: Higher education benefits that veterans receive under the G.I. bill are excluded from the personal taxable income of recipients (as are all benefits provided by the U.S. Department of Veterans Affairs).

Veterans who served on active duty for at least three years after September 11, 2001, and received an honorable discharge, are eligible for payment of full tuition and fees at all in-state public schools, as well as tuition and fees up to \$19,200 per academic year at private or foreign schools. These veterans can also receive an annual stipend of up to \$1,000 for books and supplies. Veterans who served for less than three years can qualify for partial benefits, depending on their length of service.

Veterans who entered active duty before September 11, 2001, are eligible for up to 36 months of education benefits, with the amount of benefits depending on length of service and other factors.

If a veteran receives another education-related tax benefit, such as the Hope Credit or Lifetime Learning Credit, he or she must reduce the value of the other benefit by the amount of any G.I. bill payment made on his or her behalf.

PURPOSE: The purpose of the exclusion is to recognize the service and the sacrifices that veterans made for our country, and to help them prepare for civilian employment.

IMPACT: Veterans receiving education benefits under the G.I. bill benefit from this provision. The tax savings will have greater value for veterans with higher incomes because they are in higher marginal tax brackets. The U.S. military benefits as well, because the benefits provided under the G.I. bill serve as a valuable recruitment tool.

Income Tax
Exclusions

70. Veterans’ benefits and services

U.S. Code Section: U.S. Code Title 38, Section 5301 (not codified in the Internal Revenue Code)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1917

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$4,064	\$3,979	\$3,894	\$4,275
Total	\$4,064	\$3,979	\$3,894	\$4,275

DESCRIPTION: All cash payments provided by the U.S. Department of Veterans Affairs are excluded from the personal taxable income of recipients. The payments include veterans’ death benefits, disability compensation, interest on state and local government qualified private activity bonds for veteran housing, and pension payments.

In addition, surviving spouses and parents of service members are eligible for dependency and indemnity compensation payments if the service member died on active duty; died due to a service-connected illness or condition; or was totally disabled for 10 or more years before death due to a non-service-connected illness or condition (this period is reduced to five years if the veteran was totally disabled upon leaving military service). These benefits are also exempt from taxation.

PURPOSE: The purpose of the exclusion is to recognize the service performed by veterans and the sacrifices they made for our country, and to provide income support to elderly veterans and those with disabilities.

IMPACT: Individuals receiving veterans’ benefits and their families benefit from this provision. The Congressional Research Service observes that, “The exclusion of veterans’ benefits alters the distribution of payments and favors higher-income individuals”²²⁹ because they face higher marginal tax rates. CRS adds that, “The rating schedule for veterans disability compensation was intended to reflect the average impact of the disability on the average worker. However, because the rating is not directly rated to the impact of the disability on the veteran’s actual or potential earnings, the tax-exempt status of disability compensation payments may reflect a tax exemption for an inaccurate estimate of the veteran’s lost earnings because of the disability.”²³⁰

Some analysts have contended that benefits could be focused on veterans who are most impaired if those with disability ratings less than 30 percent were made ineligible for disability compensation. Although 44.8 percent of veterans receiving disability compensation had a

²²⁹ U.S. Senate, Committee on the Budget, p. 1001.

²³⁰ Ibid.

combined rating of 30 percent or less, their disability compensation payments accounted for only 9.7 percent of all disability compensation payments for veterans in FY 2013.²³¹

²³¹ U.S. Senate, Committee on the Budget, p. 1002.

**Income Tax
Adjustments**

71. Interest on student loans

Internal Revenue Code Section: 221
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1997

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$2,019	\$2,115	\$2,211	\$2,307
Total	\$2,019	\$2,115	\$2,211	\$2,307

DESCRIPTION: Taxpayers may deduct up to \$2,500 in annual interest paid on qualified higher education loans (the maximum deduction is not adjusted for inflation). The deduction is phased out as income levels rise; in tax year 2014, the phase-out ranges were from modified adjusted gross incomes of \$65,000 to \$80,000 for single filers and \$130,000 to \$160,000 for joint filers. The deduction can be taken without itemizing (known as an adjustment or an above-the-line deduction).

A qualified education loan represents indebtedness incurred solely to pay for qualified higher education expenses, such as tuition, fees, and room and board, on behalf of a taxpayer, or his or her spouse or dependents. The student must have been enrolled on at least a half-time basis in a program leading to a degree, certificate, or credential at an institution eligible to participate in U.S. Department of Education student aid programs, or at a hospital or health care facility that offers internship or residency programs leading to a certificate or degree.

Interest on loans from relatives or qualified employer plans may not be deducted. The qualifying expenses eligible for deduction must be reduced by the amount of any scholarship or other payment that is excluded from the federal income tax. The deduction is not allowed for individuals who can be claimed as a dependent by another taxpayer.

PURPOSE: According to the Congressional Research Service, the interest deduction “was authorized ... as one of a number of benefits intended to make postsecondary education more affordable for middle-income families who are unlikely to qualify for much need-based federal student aid. The interest deduction is seen as a way to help taxpayers repay education loan debt, which has risen substantially in recent years.”²³²

IMPACT: In 2013, 37,330 District tax filers claimed the federal student loan adjustment. Tax filers with federal adjusted gross income of less than \$50,000 comprised 53 percent of the claimants and accounted for 57 percent of the total amount deducted,²³³ reflecting the phasing out

²³² U.S. Senate, Committee on the Budget, p. 627.

²³³ These data are from the Internal Revenue Service’s Statistics of Income Tax Stats, “Tax Year 2013: Historic Table 2,” available at www.irs.gov/taxstats/index.html.

of the benefit at income levels from \$65,000 to \$80,000 (for individual returns) and \$130,000 to \$160,000 (for joint returns).

Researchers from the Urban Institute have pointed out that, “Units that receive the student loan interest deduction differ from units receiving the other tax benefits because benefits accrue to former students who have loans rather than current students and their families.”²³⁴

CRS also discusses the incentives created by the deduction as follows: “The tax deduction can be justified both as a way of encouraging persons to undertake additional education and as a means of easing repayment burdens when graduates begin full-time employment. Whether the deduction will affect enrollment decisions is unknown; it might only change the way families finance college costs. The deduction may allow some graduates to accept public service jobs that pay low salaries, although their tax savings would not be large. The deduction has been criticized for providing a subsidy to all borrowers (aside from those with higher income), even those with little debt, and for doing little to help borrowers who have large loans. It is unlikely to reduce loan defaults, which generally are related to low income and unemployment.”²³⁵

²³⁴ Leonard Burman, Elaine Maag, Peter Orszag, Jeffrey Rohaly, and John O’Hare, “The Distributional Consequences of Federal Assistance for Higher Education: The Intersection of Tax and Spending Programs,” Discussion Paper No. 26 of the Urban-Brookings Tax Policy Center, August 2005, p. 8.

²³⁵ U.S. Senate, Committee on the Budget, pp. 627-628.

**Income Tax
Adjustments**

72. Contributions to health savings accounts

Internal Revenue Code Section: 223
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 2003

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$878	\$1,004	\$1,171	\$1,380
Total	\$878	\$1,004	\$1,171	\$1,380

DESCRIPTION: Health savings accounts (HSAs) provide a tax-advantaged vehicle for people to pay for unreimbursed medical expenses, such as deductibles and co-payments, which are not covered by insurance. Eligible individuals can establish and fund an HSA if they have qualifying high-deductible health insurance (at least \$1,250 for single coverage and \$2,500 for family coverage in 2014). The minimum deductible levels do not apply to preventive care. Furthermore, qualifying health care plans cannot have limits on out-of-pocket expenditures that exceed \$6,350 for single coverage and \$12,700 for family coverage in 2014. The goal is to make individuals more conscious of health-care costs while protecting them from catastrophic costs.

For 2014, the annual contribution limit to an HSA was \$3,300 for single coverage and \$6,550 for family coverage. Individuals who are at least 55 years old but not yet enrolled in Medicare can contribute an additional \$1,000 per year. Individuals may deduct their HSA contributions from gross income in calculating their taxable income. An employer can also contribute to an HSA on an employee’s behalf, and such contributions are not taxable to the employee or to the employer. HSA account earnings are tax-exempt and unused balances may accumulate without limit.

Withdrawals from HSAs are exempt from federal income taxes if they are used for qualified medical expenses. HSA withdrawals that are not used for qualified medical expenses are subject to a 20 percent penalty and must be included in the gross income of the account owner in determining federal tax liability.

PURPOSE: According to the Congressional Research Service, HSAs were created to (1) slow the growth of health care costs by reducing reliance on insurance and making individuals more aware of the costs of health care, and (2) help individuals finance future health care costs by building up savings²³⁶. CRS notes that, “Taxpayers can carry their HSAs with them when they change jobs, which, in theory, may help maintain continuity of health care if their new employer offers different or perhaps no health insurance coverage.”²³⁷

²³⁶ U.S. Senate, Committee on the Budget, p. 812.

²³⁷ Ibid.

IMPACT: A national estimate prepared by the U.S. Government Accountability Office indicated that the average adjusted gross income for an HSA participant was almost \$139,000 in 2005, compared to \$57,000 for all other filers.²³⁸

CRS observes that, “HSAs allow individuals to insure against large or catastrophic expenses while covering routine and minor costs out of their own pocket. Properly designed, they may encourage more prudent health care use and the accumulation of funds for medical emergencies. For these outcomes to occur, however, individuals will have to put money into their accounts regularly (especially if their employer does not) and to refrain from spending it for things other than health care.”²³⁹ In addition, it is not clear if individual consumers of health care have the expertise necessary to judge whether they can reduce their usage of health care or purchase lower-cost services without harming their health, which is necessary for this market-based approach to work.

At the same time, HSAs could fracture the health care market. CRS states that “If HSAs primarily attract young, healthy individuals, premiums for plans without high deductibles are likely to rise since they would disproportionately cover the older and less healthy individuals ... If this process continued unchecked, eventually people who need insurance the most would be unable to afford it.”²⁴⁰

People who finance more of their own health-care costs stand to benefit from HSAs, because they otherwise enjoy a smaller subsidy from the exclusion of employer-provided health care. If an employer-provided health plan switches to a higher deductible, employees would lose out in the absence of an HSA. As CRS states, “HSAs restore this benefit as long as the account is used for health care expenses.”²⁴¹

²³⁸ U.S. Government Accountability Office, Health Savings Accounts: Participation Increased and Was More Common among Individuals with Higher Incomes, GAO-08-474R, April 30, 2008, p. 6.

²³⁹ U.S. Senate, Committee on the Budget, p. 812.

²⁴⁰ *Ibid*, p. 813.

²⁴¹ *Ibid*, p. 814.

**Income Tax
Adjustments**

73. Health insurance premiums and long-term care insurance premiums paid by the self-employed

Internal Revenue Code Section: 162(l)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$2,926	\$3,098	\$2,754	\$2,754
Total	\$2,926	\$3,098	\$2,754	\$2,754

DESCRIPTION: Self-employed individuals may deduct amounts paid for health insurance covering themselves, their spouses, or their dependents. In addition, self-employed individuals may also reduce their taxable personal income by the amounts paid for qualified long-term care insurance, subject to annual limits ranging from \$370 for individuals age 40 and under to \$4,660 for individuals over age 70 in 2014 (the limits are indexed for inflation). The deduction is taken “above the line,” which means that it can be used regardless of whether the taxpayer itemizes deductions on his or her tax return.

For the purpose of this deduction, a self-employed individual is defined as a sole proprietor, working partner in a partnership, or employee of an S corporation who owns more than 2 percent of the corporation’s stock. The following limitations apply: (1) the deduction cannot exceed a taxpayer’s net earned income from the trade or business in which the health insurance plan was established, minus deductions for 50 percent of the self-employment tax and any contributions to a qualified pension plan, and (2) the deduction cannot be taken for any month when a self-employed person is eligible to participate in a health insurance plan offered by an employer or a spouse’s employer. If a self-employed person claims an itemized deduction for medical expenses, those expenses must be reduced by the amount of this deduction.

PURPOSE: According to the Congressional Research Service, the purpose of the deduction is (1) to provide the self-employed with a tax benefit comparable to the exclusion for employer-provided health benefits, and (2) to improve access to health care by the self-employed.²⁴²

IMPACT: CRS states that, “The deduction lowers the after-tax cost of health insurance purchased by the self-employed by a factor equal to a self-employed individual’s marginal income tax rate. Individuals who purchase health insurance coverage in the non-group market but are not self-employed receive no such tax benefit. There is some evidence that the deduction has contributed to a significant increase in health insurance coverage among the self-employed and their immediate families. As one would expect, the gains appear to have been concentrated in higher-income households.”²⁴³

²⁴² U.S. Senate, Committee on the Budget, p. 846.

²⁴³ Ibid.

That pattern is evident in the District. In 2013, 9,340 District tax filers claimed the federal adjustment for medical insurance premiums paid by the self-employed. Filers with federal adjusted gross income of \$200,000 or more represented about 35 percent of the claimants and accounted for more than half (58 percent) of the amount deducted.²⁴⁴

CRS also describes some of the efficiency losses to society that may result from the deduction, stating that, “(A) 100-percent deduction is likely to encourage higher-income self-employed individuals to purchase health insurance coverage than they otherwise would. That overconsumption leads to wasteful or inefficient use of health care. To reduce the likelihood of such an outcome, some favor capping the deduction at an amount commensurate with a standardized health benefits package, adjusted for regional variations in health care costs.”²⁴⁵

²⁴⁴ These data are from the Internal Revenue Service’s Statistics of Income Tax Stats, “Tax Year 2013: Historic Table 2,” available at www.irs.gov/taxstats/index.html.

²⁴⁵ U.S. Senate, Committee on the Budget, p. 847.

**Income Tax
Adjustments**

74. Contributions to self-employment retirement plans

Internal Revenue Code Sections: 401-407, 410-418E, and 457
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1962

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$64,043	\$70,372	\$77,135	\$84,606
Total	\$64,043	\$70,372	\$77,135	\$84,606

DESCRIPTION: Self-employed taxpayers who contribute to their own retirement accounts may deduct those contributions from their personal taxable income, up to certain limits. The deduction is taken “above the line,” which means that it can be used regardless of whether the taxpayer itemizes deductions on his or her tax return.

Taxes on the earnings of the retirement accounts are deferred until the funds are distributed during retirement. The withdrawals from the plans are included in personal taxable income. Therefore, the value of the tax expenditure equals the revenue that the government does not collect on the retirement contributions and earnings, offset by the taxes paid on the pensions by those who are currently drawing down the benefits.

One type of self-employment retirement plan is a “simplified employee pension” (SEP). A self-employed taxpayer is allowed to deduct SEP contributions of as much as 25 percent of self-employment income (net of any SEP contribution) or \$53,000 for 2015 and 2016 (whichever is less). There are other retirement plan options for the self-employed, including 401(k) plans, other defined contribution plans, and defined benefit plans²⁴⁶.

PURPOSE: The purpose of the adjustment is to encourage the self-employed to save for retirement.

IMPACT: In 2013, 5,820 District tax filers claimed this adjustment. The benefits were strongly concentrated among upper-income households. Tax filers with federal adjusted gross income of \$200,000 or more represented the majority (62 percent) of the claimants and accounted for 83 percent of the total amount deducted.²⁴⁷

The adjustment lowers the after-tax cost of retirement contributions made by the self-employed by a percentage equal to a self-employed individual’s marginal income tax rate, which disproportionately benefits high-income households. The tax-favored treatment of some retirement contributions as well as the earnings on those contributions may encourage individuals

²⁴⁶ The information about retirements for self-employed people is retrieved from <https://www.irs.gov/Retirement-Plans/Retirement-Plans-for-Self-Employed-People>

²⁴⁷ These data are from the Internal Revenue Service’s Statistics of Income Tax Stats, “Tax Year 2013: Historic Table 2,” available at www.irs.gov/taxstats/index.html.

to shift their savings from taxable accounts to tax-advantaged accounts without increasing total savings. At the same time, the adjustment also promotes equity among self-employed individuals and individuals who work at public or private-sector organizations.

**Income Tax
Adjustments**

**75. Employee contributions to traditional Individual Retirement
Accounts**

Internal Revenue Code Sections: 219 and 408
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1974

(Dollars in thousands)	FY 2016	FY 2017	FY 2017	FY 2018
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$6,359	\$6,404	\$6,506	\$6,823
Total	\$6,359	\$6,404	\$6,506	\$6,823

DESCRIPTION: There are two types of Individual Retirement Accounts (IRAs) that offer tax benefits: the traditional IRA and the Roth IRA. Contributions to a traditional IRA are tax-free for those meeting income requirements, and the earnings on the contributions are tax-free, regardless of income. The deduction is taken “above the line,” which means that it can be used regardless of whether the taxpayer itemizes deductions on his or her tax return. Qualified distributions from traditional IRAs are taxable. The pattern is reversed for a Roth IRA; the contributions are taxable, while earnings and qualified distributions are tax-free. Participation in IRAs is approximately evenly split between traditional IRAs and Roth IRAs.²⁴⁸

Qualified distributions to a traditional IRA are those made after age 59½, upon the death or disability of the individual, or for first-time homebuyer expenses. An individual may contribute up to \$5,500 to a traditional IRA (\$6,500 for an individual above the age of 50) or an amount equal to earned income, whichever is less, but the tax benefits are limited based on income if a taxpayer is covered by an employer-provided pension plan.

For taxpayers covered by a pension plan, the full deduction was allowed for tax year 2015 if adjusted gross income was less than \$61,000 for a single person or \$98,000 for a married couple filing jointly. The deduction was phased out over the \$61,000 to \$71,000 range for single filers and the \$98,000 to \$118,000 range for joint filers. A taxpayer who is not covered by a pension plan and whose spouse is also not covered is eligible to deduct the full amount of his or her contribution to a traditional IRA, regardless of income.

The estimated value of the tax expenditure reflects the loss of revenue from the exclusion of traditional IRA contributions and earnings, offset by the tax paid on withdrawals from the IRAs.

PURPOSE: The purpose of the exclusion is to provide an incentive for taxpayers to save for retirement, and in particular to provide a savings incentive for workers who do not have employer-provided pension plans.

²⁴⁸ Urban-Brookings Tax Policy Center, The Tax Policy Briefing Book: A Citizens’ Guide for the 2008 Election and Beyond, p. II-3-1, available at www.taxpolicycenter.org.

IMPACT: Taxpayers who save for retirement through a traditional IRA benefit from this provision. However, it is not known whether IRAs benefit society or increase overall levels of saving. It is possible that individuals simply shift existing savings into IRAs because of the tax incentive.

Paul Burham and Larry Ozanne of the Congressional Budget Office state that, “Empirical studies have not been able to resolve the uncertainty about how IRAs affect saving, although many attempts have been made. The evidence for the full population is contradictory, but a limited consensus suggests that IRAs increased saving for nonelderly and less-wealthy families.”²⁴⁹

The Congressional Research Service points out that, “IRAs tend to be less focused on higher-income levels than some types of capital tax subsidies, in part because they are capped at a dollar amount. Their benefits do tend, nevertheless, to accrue more heavily to the upper half of the income distribution. This effect occurs in part because of the low participation rates at lower income levels. Further, the lower marginal tax rates at lower income levels make the tax benefits less valuable.”²⁵⁰

In 2013, 9,350 District tax filers claimed this deduction. All of the claimants had federal adjusted gross income of less than \$75,000, and accounted for the entire amount deducted.²⁵¹

²⁴⁹ Paul Burnham and Larry Ozanne, “Individual Retirement Accounts,” in *The Encyclopedia of Taxation and Tax Policy*, Second Edition, Joseph Cordes, Robert Ebel, and Jane Gravelle, eds. (Washington, D.C.: The Urban Institute Press, 2005), p. 199.

²⁵⁰ U.S. Senate, Committee on the Budget, p. 961.

²⁵¹ These data are from the Internal Revenue Service’s Statistics of Income Tax Stats, “Tax Year 2013: Historic Table 2,” available at www.irs.gov/taxstats/index.html.

**Income Tax
Adjustments**

76. Overnight travel expenses of National Guard and Reserve members

Internal Revenue Code Sections: 62(a)(2)(E) and 162(p)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 2003

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$42	\$42	\$42	\$42
Total	\$42	\$42	\$42	\$42

DESCRIPTION: A deduction from federal gross income is allowed for all unreimbursed overnight travel, meals, and lodging expenses of National Guard and Reserve members. This deduction can be taken without itemizing (known as an adjustment or above-the-line deduction).

To qualify, members must have traveled more than 100 miles away from home and stayed overnight as part of an activity while on official duty. No deduction is permitted for commuting expenses to and from drill meetings and the amount of expenses may not exceed the general federal government per-diem rate applicable to that locale.

PURPOSE: The purpose of the adjustment is to reimburse members of the National Guard and Reserve for expenses incurred in the line of duty. The Congressional Research Service states that, “In enacting the new deduction, Congress identified the increasing role that Reserve and National Guard members fulfill in defending the nation and a heavy reliance on service personnel to participate in national defense. Congress noted that more than 157,000 reservists and National Guard were on active duty status – most assisting in Operation Iraqi Freedom at the time of enactment.”²⁵²

IMPACT: National Guard and Reserve members benefit from this provision. CRS notes that, “The tax deduction can be justified as a way of providing support to reservists and as a means of easing travel expense burdens.”²⁵³ In addition, “By providing military compensation in a form not subject to tax, the benefits have greater value for members of the armed services with high income than for those with low income.”²⁵⁴

²⁵² U.S. Senate, Committee on the Budget, p. 26.

²⁵³ Ibid, p. 27.

²⁵⁴ Ibid, p. 26.

Income Tax
Deductions

77. Accelerated depreciation of buildings other than rental housing

Internal Revenue Code Sections: 167 and 168
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1954

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$197	\$197	\$197	\$197
Personal Income Tax Loss	\$187	\$187	\$187	\$187
Total	\$385	\$385	\$385	\$385

DESCRIPTION: This provision allows for accelerated depreciation of buildings as a deduction from personal and corporate income tax. The standard method to calculate depreciation is the straight-line method used under the alternative minimum tax, in which equal amounts are deducted over 40 years. The accelerated method allows buildings used for purposes besides rental housing to be depreciated over 39 years.

Also included in this tax expenditure are accelerated depreciation rules for qualified leasehold improvements, qualified restaurant property, and qualified retail improvements (which have a 15-year depreciation period) and for certain motorsports racetrack property (which has a seven-year depreciation period). The special rules for qualified leasehold improvements, restaurant property, retail improvements, and motorsports racetrack property expired on December 31, 2013, but they have been extended repeatedly in the past and Congress could reinstate them.

The revenue impact of this tax expenditure represents the difference between the tax that would be due under the 40-year period and the tax that is required under accelerated depreciation.

PURPOSE: The purpose of the deduction is to promote investment in buildings. In addition, accelerated depreciation helps to offset any understatement of depreciation that results from use of a historical cost basis to calculate depreciation, which does not account for inflation.

IMPACT: Owners of buildings that are used in a trade or business benefit from this provision. The Congressional Research Service states that, “The direct benefits of accelerated depreciation accrue to owners of buildings, and particularly to corporations ... Benefits to capital income tend to concentrate in the higher-income classes.”²⁵⁵

CRS adds that, “Evidence suggests that the rate of economic decline of rental structures is much slower than the rates allowed under current law, and this provision causes a lower effective tax rate on such investments than would otherwise be the case. This treatment in turn tends to increase investment in nonresidential structures relative to other assets, although there is considerable debate about how responsive these investments are to tax subsidies.”²⁵⁶

²⁵⁵ U.S. Senate, Committee on the Budget, p. 425.

²⁵⁶ Ibid, p. 427.

**Income Tax
Deductions**

78. Accelerated depreciation of equipment

Internal Revenue Code Sections: 167 and 168
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1954

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$5,372	\$5,372	\$5,372	\$5,372
Personal Income Tax Loss	\$2,081	\$2,081	\$2,081	\$2,081
Total	\$7,453	\$7,453	\$7,453	\$7,453

DESCRIPTION: This provision allows for accelerated depreciation of equipment as a deduction from personal and corporate income tax. The standard method to calculate depreciation is the straight-line method in which equal amounts are deducted in each period. Equipment is currently divided into six categories that are depreciated over 3, 5, 7, 10, 15, and 20 years, respectively. Accelerated depreciation allows for faster write-offs than the straight-line method, using methods such as “double declining balance depreciation,” which permits taxpayers to apply twice the straight-line depreciation rate to each year’s remaining undepreciated balance.

In addition, Congress and the President have periodically authorized “bonus depreciation,” which allows a certain percentage of the cost of machinery and equipment to be deducted immediately. Bonus depreciation was in effect under federal law, allowing a 100 percent deduction for equipment placed into service from September 9, 2010, through the end of 2011, and permitting 50 percent expensing through the end of 2013. Nevertheless, in 2008 the District of Columbia “decoupled” from the federal bonus depreciation rules (but not from the regular accelerated depreciation rules described in the first paragraph), meaning that taxpayers could not include the bonus provisions when calculating their District taxes – and will not be able to do so in the future if bonus depreciation is reauthorized.²⁵⁷

Taxpayers who are eligible for another type of accelerated expensing of the cost of business property (known as the “Section 179 allowance”) must calculate their section 179 deduction first and then calculate any additional depreciation from the remaining basis.

PURPOSE: The purpose of this deduction is to promote investment in business machinery and equipment. Proponents of accelerated depreciation contend that the value of machinery and equipment declines faster in the early years, and that depreciation should follow the same pattern.

IMPACT: Owners of machinery and equipment used in a trade or business benefit from this provision. The Congressional Research Service states that, “The direct benefits of accelerated depreciation accrue to owners of assets and particularly to corporations ... Benefits to capital income tend to concentrate in the higher-income classes.”²⁵⁸

²⁵⁷ The statutory provision requiring decoupling was included in D.C. Law 17-219, the “Fiscal Year 2009 Budget Support Act of 2008,” which took effect on August 16, 2008. See Title VII-L of the Act.

²⁵⁸ U.S. Senate, Committee on the Budget, p. 433.

CRS adds that, “Evidence suggests that the rate of economic decline of equipment is much slower than the rates allowed under current law, and this provision causes a lower effective tax rate on such investments than would otherwise be the case. The effects of these benefits on investment in equipment are uncertain, although more studies find equipment somewhat more responsive to tax changes than they do structures. Equipment did not, however, appear to be very responsive to the temporary expensing provisions adopted in 2002 and expanded in 2003.”²⁵⁹ Another risk is that subsidies for machinery and equipment may encourage the substitution of capital for labor, dampening employment growth.

The Center on Budget and Policy Priorities has urged states to decouple from the federal rules for bonus depreciation, arguing that a substantial portion of the benefits flow to multi-state corporations, which may spend the additional money out-of-state or simply increase their own profit. CBPP also points out that the bonus depreciation provisions include no requirement or incentive for a firm to buy machinery or equipment in state.²⁶⁰

²⁵⁹ U.S. Senate, Committee on the Budget, pp. 434-435.

²⁶⁰ Ashali Singham and Nicholas Johnson, “States Can Avert New Revenue Loss and Protect Their Economies by Decoupling from Federal Expensing Provision,” report issued by the Center on Budget and Policy Priorities, April 14, 2011, p. 2.

Income Tax
Deductions

79. Small life insurance company taxable income

Internal Revenue Code Section: 806
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1984

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Life insurance companies with gross assets of less than \$500 million may take a special deduction on taxable insurance income of as much as \$15 million. Specifically, a small life insurance company may deduct 60 percent of the first \$3 million of taxable income. For life insurance companies with taxable income between \$3 million and \$15 million, the deduction equals \$1.8 million minus 15 percent of the taxable income above \$3 million. The deduction phases out as a company’s taxable insurance income (before the deduction) increases from \$3 million to \$15 million.

PURPOSE: Although the purpose of the deduction is not clear from the legislative history, it may have been intended to extend a policy of giving tax-favored treatment to small life insurance companies that dates back to the early 20th century.²⁶¹ Policymakers may also have been motivated by a desire to help small businesses and expand competition in the insurance market.

IMPACT: Small life insurance companies benefit from the deduction. The Congressional Research Service points out that a company eligible for the maximum deduction of \$1.8 million (60 percent of the first \$3 million in taxable income) is in effect taxed at a 13.6 percent rate instead of the regular 34 percent corporate rate. CRS adds that, “Determining how benefits for the small life insurance company deduction are distributed is difficult because ownership of these companies may be widely dispersed, either among shareholders in stock companies or policyholders in mutual companies. Competitive pressures may force companies to pass some of these benefits on to life insurance policyholders via lower premiums.”²⁶²

Nevertheless, CRS notes that the deduction violates economic principles and creates costs for society as a whole. First, “The principle of taxing on the ability to pay, often put forth as a requisite of an equitable and fair tax system, does not justify reducing taxes on business income for firms below a certain size.”²⁶³ In addition, “Imposing lower tax rates on smaller firms distorts the efficient allocation of resources, since it offers a cost advantage based on size and not

²⁶¹ U.S. Senate, Committee on the Budget, p. 312.

²⁶² Ibid.

²⁶³ Ibid, p. 313.

economic performance. This tax reduction serves no simplification purpose, since it requires an additional set of computations and some complex rules to prevent abuses.”²⁶⁴

²⁶⁴ U.S. Senate, Committee on the Budget, p. 313.

**Income Tax
Deductions**

80. Amortization of business start-up costs

Internal Revenue Code Section: 195
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1980

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	\$108	\$108
Personal Income Tax Loss	too small	too small	too small	\$103
Total	too small	too small	\$108	\$211

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: This provision allows a taxpayer to deduct from personal or corporate taxable income eligible start-up expenditures of up to \$5,000 and to amortize any remaining amount over 15 years. The deduction must be reduced on a dollar-for-dollar basis when the costs exceed \$50,000. Therefore, no deduction is allowable for a taxpayer with \$70,000 or more of qualified start-up expenditures.

Such expenditures must satisfy two requirements in order to be deducted. First, the expenditures must be paid in connection with creating or investigating a trade or business before the taxpayer begins an active business. Second, the expenditures must reflect costs that would be deductible for an active business.

PURPOSE: The Congressional Research Service states that the deduction is intended to “encourage the formation of new firms that do not require substantial start-up costs by allowing a large share of the costs to be deducted in the tax year when they begin to operate.”²⁶⁵

IMPACT: New businesses that incur start-up costs benefit from this provision. As CRS points out, “Benefits to capital income tend to concentrate in the higher income classes.”²⁶⁶ CRS also observes that there are tax administration benefits both to start-up businesses and the IRS, stating that, “In theory, business start-up costs should be written off over the life of the business on the grounds that they are a capital expense. Such a view, however, does pose the difficult challenge of determining the useful life of a business at its outset. Section 195 has two notable advantages as a means of addressing this challenge. First, it makes costly and drawn-out legal disputes involving business taxpayers and the IRS over the tax treatment of start-up costs less likely. Second, it does so at a relatively small revenue cost.”²⁶⁷

²⁶⁵ U.S. Senate, Committee on the Budget, p. 449.

²⁶⁶ Ibid, p. 448.

²⁶⁷ Ibid, pp 449-450.

Income Tax
Deductions

81. Completed contract rules

Internal Revenue Code Section: 460
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$973	\$973	\$1,081	\$1,081
Personal Income Tax Loss	\$103	\$103	\$103	\$103
Total	\$1,076	\$1,076	\$1,184	\$1,184

DESCRIPTION: Some taxpayers with construction or manufacturing contracts extending for more than one tax year are allowed to use the completed contract method of accounting. Under this method, income and costs pertaining to the contract are reported when the contract is completed; however, some indirect costs may be deducted from corporate and personal taxable income in the year paid or incurred. This policy has been likened to giving taxpayers an interest-free loan because the speeding up of deductions temporarily provides them with more money.

This deduction is limited to home construction contracts and to other real estate construction contracts if they are in effect for less than two years and the contractor’s gross receipts for the previous three years have averaged \$10 million or less. The tax expenditure is the revenue loss that results from deferring tax on the contracts covered by the rule, relative to the normal tax treatment of such contracts (which is to capitalize indirect costs and report them at the same time that the income from the contract is reported).

PURPOSE: The purpose of the deduction is to recognize the uncertainties involved in certain contracts, which make it difficult to determine profit or loss until the contract is completed. IRS rules authorized the completed contract method of accounting in 1918, but the use of this method has since been restricted due to concern about perceived abuses by large contractors who were using accrual accounting in their own financial statements (which showed that they could estimate the profit or loss before the contract was completed).

IMPACT: The Congressional Research Service states that, “Use of the completed contract rules allows the deferral of taxes through mismatching income and deductions because they allow some costs to be deducted from other income in the year incurred, even though the costs actually relate to the income that will not be reported until the contract’s completion, and because economic income accrues to the contractor each year he works on the contract but is not taxed until the year the contract is completed. Tax deferral is the equivalent of an interest-free loan from the Government on the amount of the deferred taxes.”²⁶⁸ Although the deduction has minor economic impact because it is now restricted to a very small segment of the construction industry, CRS notes that it “adds some tax advantage to an already heavily-favored” construction sector.²⁶⁹

²⁶⁸ U.S. Senate, Committee on the Budget, p. 472.

²⁶⁹ Ibid, p. 474.

Income Tax
Deductions

82. Exception from passive loss rules for \$25,000 of rental real estate loss

Internal Revenue Code Section: 469(i)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$5,713	\$6,050	\$6,386	\$6,717
Total	\$5,713	\$6,050	\$6,386	\$6,717

DESCRIPTION: Taxpayers who own rental property and meet specific requirements can deduct up to \$25,000 in passive losses from their ordinary income. Passive gains and losses generally arise from ventures such as limited or general partnerships, or other investment-oriented ventures, in which the taxpayer does not actively participate.

Although passive-loss rules usually prohibit deducting rental property losses from income, this tax expenditure involves an exception to those rules. To qualify for the deduction, the taxpayer must play an active role in the rental process, own a stake of at least 10 percent in the property, and have an adjusted gross income of less than \$100,000 for a full deduction or \$150,000 for a partial deduction. Taxpayers with adjusted gross income of more than \$150,000 cannot receive a deduction.

PURPOSE: The limitations on passive-loss deductions were adopted in the Tax Reform Act of 1986 in order to reduce opportunities for tax sheltering. Many taxpayers had used passive losses in real estate ventures, oil and gas operations, and farming businesses to offset wage, salary, and active investment income. However, a partial exception for passive losses from rental real estate was offered because, “Congress believed that a limited measure of relief ... was appropriate in the case of certain moderate-income investors in rental real estate, who otherwise might experience cash flow difficulties with respect to investments that in many cases were designed to provide financial security, rather than to shelter a substantial amount of other income.”²⁷⁰

IMPACT: Certain owners of rental real estate benefit from this provision. This exception to the passive-loss rules may create economic distortions and efficiency losses. By extending a tax preference to rental real estate investment, this provision may encourage overinvestment in the real estate sector at the expense of other investments that would otherwise be more productive. Although upper-income households are more likely to own rental properties, the income restrictions curtail the benefits for high-income individuals.

²⁷⁰ U.S. Congress, Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986, JCS-10-87 (Washington, D.C.: U.S. Government Printing Office, 1987), p. 230.

Income Tax
Deductions

83. Expensing of depreciable small business property (Section 179 expensing allowance)

Internal Revenue Code Section: 179
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1958

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$1,081	\$865	\$865	\$649
Personal Income Tax Loss	\$2,973	\$1,333	\$1,230	\$1,025
Total	\$4,054	\$2,198	\$2,095	\$1,674

DESCRIPTION: In general, the cost of business property must be deducted from personal and corporate income as it depreciates over its useful life. Section 179 expensing allows certain businesses to deduct the full purchase price of qualified equipment, provided that the amount deducted cannot exceed taxable income from the trade or business in which the property is used. Qualified equipment generally includes new and used machinery, equipment, and off-the-shelf computer software purchased for use in a trade or business. With several exceptions, real property such as buildings and their structural components do not qualify for the deduction.

In recent years, section 179 expensing has been broadened for fixed time periods by federal laws such as the Economic Stimulus Act of 2008 and the American Recovery and Re-Investment Act of 2009. Most recently, the American Taxpayer Relief Act of 2012 set the maximum deduction under section 179 as \$500,000 for 2012 and 2013 and set an annual investment limit of \$2 million. For each dollar of qualifying property that a taxpayer places in service above \$2 million, the maximum deduction under section 179 was reduced by one dollar. After tax year 2013, the limit on expensing dropped back to \$25,000, with an annual investment limit of \$200,000.

In 2008, the District of Columbia decoupled from the increases to Section 179 expensing, meaning that individuals and firms were not able to apply the higher expensing levels in calculating their D.C. taxes.²⁷¹ The expensing limitation for D.C. taxes equals the lesser of \$25,000 (or \$40,000 for a qualified high technology company) or the actual cost of the business property during the year it was placed in service. If Congress restores higher section 179 levels, the estimated revenue loss to the District from this tax expenditure will not reflect the increased amounts.

Taxpayers who are eligible for other types of accelerated depreciation must calculate their section 179 deduction first and then apply any other deductions to the remaining basis.

Accelerated depreciation of any type of property does not change the cumulative amount of depreciation allowed. Therefore, this provision allows a taxpayer to deduct more in the first year of the investment and less in the later years of the capital life-cycle.

²⁷¹ The statutory provision requiring decoupling was included in D.C. Law 17-219, the “Fiscal Year 2009 Budget Support Act of 2008,” which took effect on August 16, 2008. See Title VII-L of the Act.

PURPOSE: The expensing allowance, which has been modified and expanded many times since its initial enactment in 1958, was intended “to reduce the tax burden on small firms, give them an incentive to invest more, and simplify their tax accounting,” according to the Congressional Research Service.²⁷²

IMPACT: CRS states that, “In the absence of section 179, the cost of qualified assets would have to be recovered over longer periods. Thus, the provision greatly accelerates the depreciation of relatively small purchases of those assets. This effect has significant implications for business investment. All other things being equal, expensing boosts the cash flow of firms able to take advantage of it, as the present value of taxes owed on the stream of income earned by a depreciable asset is smaller under expensing than other depreciation schedules.”²⁷³ The lower cost of capital and the resulting increase in cash flow are in turn intended to stimulate the economy by spurring capital investment and employment.

CRS also points out that, “(B)ecause the allowance has a phase-out threshold, its benefits are confined to firms that are relatively small in asset, employment, or revenue size. Benefits to capital income tend to concentrate in the higher income classes.”²⁷⁴

With regard to efficiency, CRS states that, “Some argue that investment by smaller firms should be supported by government subsidies because they create more jobs and develop and commercialize more new technologies than larger firms. The evidence on this issue is inconclusive. In addition, economic analysis offers no clear justification for targeting investment tax subsidies at such firms. In theory, taxing the returns to investments made by all firms at the same effective tax rate does less harm to social welfare than granting preferential tax treatment to the returns earned by many small firms.”²⁷⁵

Another risk is that subsidies for machinery and equipment may encourage the substitution of capital for labor, dampening employment growth.

²⁷² U.S. Senate, Committee on the Budget, p. 441.

²⁷³ *Ibid*, pp. 440-441.

²⁷⁴ *Ibid*, p. 441.

²⁷⁵ *Ibid*, pp. 443-444.

**Income Tax
Deductions**

84. Expensing of magazine circulation expenditures

Internal Revenue Code Section: 173
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1950

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	\$94	too small	too small	too small
Total	\$94	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: This provision allows publishers of periodicals, newspaper, and magazines to deduct expenditures to establish, maintain, or increase circulation in the year that the expenditures are made. The revenue impact of this tax expenditure is the difference between the current deduction of costs and the recovery that would have been allowed if these expenses were capitalized and deducted over time.

The expenditures that are eligible for deduction do not include purchases of land and depreciable property, or the expansion of circulation through the purchase of another publisher or its list of subscribers.

PURPOSE: According to the Congressional Research Service, “Congress wanted to eliminate some of the difficulties associated with distinguishing between expenditures to maintain circulation, which had been treated as currently deductible, and those to establish or develop new circulation, which had to be capitalized.”²⁷⁶ There had been numerous disputes between publishers and the IRS, dating back to the late 1920s, about how to make this distinction.

IMPACT: Publishers of newspapers, magazines, and periodicals benefit from this provision, but the IRS also benefits from the administrative simplification that results. CRS states that, “Section 173 provides a significant tax benefit for publishers in that it allows them to expense the acquisition of an asset ... that seems to yield returns in more years than one. At the same time, it simplifies tax compliance and accounting for them and tax administration for the IRS. Without such treatment, it would be necessary for the IRS or Congress to clarify how to distinguish between expenditures for establishing or expanding circulation and expenditures for maintaining circulation.”²⁷⁷

CRS adds that, “Like many other business tax expenditures, the benefit tends to accrue to high-income individuals.”²⁷⁸

²⁷⁶ U.S. Senate, Committee on the Budget, p. 464.

²⁷⁷ Ibid, pp. 464-465.

²⁷⁸ Ibid, p. 464.

Income Tax
Deductions

85. Gain on non-dealer installment sales

Internal Revenue Code Sections: 453 and 453A(b)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$5,725	\$5,641	\$5,641	\$5,641
Personal Income Tax Loss	\$1,357	\$1,117	\$958	\$958
Total	\$7,082	\$6,759	\$6,599	\$6,599

DESCRIPTION: People who do not deal regularly in selling property (non-dealers) are allowed to report some sales of property for personal and corporate tax purposes under a special method of accounting called the installment method. This method allows the taxpayer to pro-rate the gross profit from the sale over a period in which payments are received. The taxpayer gets the advantage of deferring some of the taxes to future years, rather than paying the taxes in full. The tax expenditure is the difference between what the tax liability would be under year-of-sale reporting and tax liability under installment reporting.

Non-dealers must pay interest to the government on the deferred taxes attributable to the portion of the installment sales that arise during and remain outstanding at the end of the tax year in excess of \$5 million. A transaction with a sales price of less than \$150,000 does not count toward the \$5 million threshold. Because the interest payments offset some of the value of the tax deferral, the tax expenditure reflects only the revenue loss from transactions that give rise to interest-free deferrals.

PURPOSE: The purpose of the deduction is to match the timing of tax payments to the timing of the cash flow generated by the sale of the property. The Congressional Research Service points out that, “It has usually been considered unfair, or at least impractical, to attempt to collect the tax when the cash flow is not available, and some form of installment sale reporting has been permitted since at least the Revenue Act of 1921.”²⁷⁹

IMPACT: Infrequent sellers of property who sell on an installment basis benefit from this provision. CRS notes that, “The deferral of taxation permitted under the installment sale rules essentially furnishes the taxpayer an interest-free loan equal to the amount of tax on the gain that is deferred.” CRS adds that, “(T)he primary benefit probably flows to sellers of farms, small businesses, and small real estate investments.”²⁸⁰

A fair method of taxing such property sales is difficult to structure. CRS states that, “The installment sales rules have always been pulled between two competing goals: taxes should not be avoidable by the way a deal is structured, but they should not be imposed when the money to pay

²⁷⁹ U.S. Senate, Committee on the Budget, p. 416.

²⁸⁰ Ibid.

them is not available. Allowing people to postpone taxes by taking a note instead of cash in a sale leaves obvious room for tax avoidance ... After having tried many different ways of balancing these goals, lawmakers have settled on a compromise that denies the advantage to taxpayers who would seldom have trouble raising the cash to pay their taxes (retailers, dealers in property, investors with large amounts of sales) and permits its use to small, non-dealer transactions (with 'small' rather generously defined).²⁸¹

²⁸¹ U.S. Senate, Committee on the Budget, p. 417.

Income Tax
Deductions

86. Life insurance company reserves

Internal Revenue Code Sections: 803(a)(2), 805(a)(2), and 807
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1984

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$3,159	\$3,258	\$3,258	\$3,258
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$3,159	\$3,258	\$3,258	\$3,258

DESCRIPTION: Life insurance companies can deduct net additions to their reserves and must add net subtractions to their reserves when calculating income, subject to certain requirements set forth in section 807 of the Internal Revenue Code. The ability to deduct the net additions to reserves may allow life insurance companies to defer paying some taxes, thus reducing their tax burden by allowing them to offset current income with future expenses. In most years, insurance companies increase their reserves.

PURPOSE: The purpose of the deduction is to make tax rules consistent with standard industry accounting practices. In the insurance industry, it is common practice to use some form of reserve accounting in estimating net income.

Insurance companies have been allowed to deduct any additions to their reserves required by law since the corporate income tax was adopted in 1909. Before Congress adopted the Deficit Reduction Act of 1984 (P.L. 98-369), reserves were required by state law. Because Congress concluded that state rules allowed for a significant overstatement of deductions, it established federal rules for allowable reserves in the Deficit Reduction Act of 1984.

IMPACT: The Congressional Research Service observes that, “When life insurance companies can deduct additions to the reserve accounts when computing taxable income, they can purchase assets using tax-free (or tax-deferred) income. Reserve accounting shelters both premium and investment income from tax because amounts added to reserves include both premium income and the investment income earned by the invested assets.”²⁸²

The benefits from the deduction may extend beyond the life insurance companies. CRS points out that, “Competition in the life insurance market could compel companies to pass along corporate tax reductions to policyholders. Thus, this tax expenditure may benefit life insurance consumers as well as shareholders of private stock insurance companies. For mutual life insurance companies, policyholders may benefit either through lower insurance premiums, better service, or higher policyholder dividends.”²⁸³

²⁸² U.S. Senate, Committee on the Budget, p. 316.

²⁸³ Ibid, pp. 316-317.

Income Tax
Deductions

87. Loss from sale of small business corporation stock

Internal Revenue Code Section: 1244
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1958

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$51	\$51	\$51	\$51
Total	\$51	\$51	\$51	\$51

DESCRIPTION: Taxpayers may deduct a loss on the sale or exchange of qualifying small business corporation stock as an ordinary loss, rather than a capital loss. The deduction as an ordinary loss is more valuable because ordinary income is taxed at a higher rate than capital income. The estimates above by the Department of Treasury are based on FY 2016 revenue changes. The FY 2017 expenditure estimates are not available because the projected revenue changes are unavailable for estimation.

A small business corporation is defined as having not more than \$1 million in money and other property received for its stock. For any taxable year, the aggregate amount that a taxpayer may treat as an ordinary loss from the sale or exchange of small business corporation stock may not exceed \$50,000 for single filers or \$100,000 for joint filers. This write-off is much greater than the \$3,000 deduction allowed for losses from the sale or exchange of other corporate stock.

PURPOSE: The purpose of the deduction is to encourage investment in small businesses. Because small businesses are often unproven and have a high failure rate, the deduction may encourage entrepreneurs to invest in small businesses by offering them some protection against investment losses.

IMPACT: Individuals with losses from small business corporation stock benefit from this provision, as do the small businesses that benefit from greater investment. Nevertheless, there may be an efficiency loss associated with the deduction, because it channels resources (in the form of tax relief) to businesses based on their size rather than on their productivity and ability to respond to market forces.

Income Tax
Deductions

88. Property and casualty insurance company reserves

Internal Revenue Code Section: 832(b)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$395	\$395	\$395	\$494
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$395	\$395	\$395	\$494

DESCRIPTION: A property and casualty insurance company’s taxable income during a tax year is its underwriting income (i.e., premiums minus incurred losses and expenses) plus investment income and certain other income items minus allowable deductions. Additions to loss reserves held to pay future claims can also be deducted from taxable income under certain conditions.

The Tax Reform Act of 1986 imposed a 15 percent pro-ration provision, due to Congressional concern that the use of tax-exempt investments to finance additions to loss reserves needed to be regulated. Therefore, the allowable deduction for additions to loss reserves was reduced by 15 percent of the sum of (1) the insurer’s tax-exempt interest, (2) the deductible portion of dividends received (with special rules for dividends from affiliates), and (3) the increase in the cash value of life insurance, endowment or annuity contracts for the taxable year. Even with the 15 percent reduction, property and casualty insurance companies are still able to shield a considerable amount of income from taxation.

PURPOSE: The Congressional Research Service states that Congress adopted this provision because members concluded it was “not appropriate to fund loss reserves on a fully deductible basis out of income which may be, in whole or in part, exempt from tax. The amount of the reserves that is deductible should be reduced by a portion of such tax-exempt income to reflect the fact that reserves are generally funded in part from tax-exempt interest or from wholly or partially deductible dividends.”²⁸⁴

IMPACT: CRS observes that, “The 15 percent pro-ration provision allows property and casualty insurance companies to fund a substantial portion of their deductible reserves with tax-exempt or tax-deferred income. Life insurance companies, banks and brokerage firms, and other financial intermediaries, face more stringent proration rules that prevent or reduce the use of tax-exempt or tax-deferred investments to fund currently deductible reserves or deductible interest expense. Allowing property and casualty insurance companies an advantageous tax status, based on the ability to use tax-exempt income to reduce tax liabilities, may allow those insurers to attract economic resources from other sectors of the economy, thus creating economic inefficiencies.” Nevertheless, “A more stringent allocation rule could reduce insurance companies’ demand for

²⁸⁴ U.S. Senate, Committee on the Budget, p. 334.

tax-exempt bonds issued by state and local governments, which could raise financing costs for those governments.”²⁸⁵

²⁸⁵ U.S. Senate, Committee on the Budget, pp. 334-335.

Income Tax
Deductions

89. Research and development expenditures

Internal Revenue Code Section: 59(e) and 174
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1954

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$5,134	\$5,627	\$5,923	\$5,923
Personal Income Tax Loss	\$94	\$94	\$94	\$94
Total	\$5,227	\$5,721	\$6,017	\$6,017

DESCRIPTION: The Internal Revenue Code (IRC) offers several provisions that allow immediate expensing or accelerated depreciation of research and development (R&D) expenditures for the purposes of computing corporate and personal taxable income. This policy stands in contrast to the tax treatment of other investments with long-term benefits, in which the expenditures would be depreciated over the useful life of the asset.

In particular, section 174 of the IRC allows C corporations to deduct qualifying research expenditures as a current expense, or to amortize these expenditures over 60 months beginning in the month when the corporation first realizes benefits from the expenditures. Section 59 provides another exception for all companies (pass-through entities as well as corporations) by allowing a firm to amortize eligible research expenses over 10 years, starting in the tax year in which the expenses are paid or incurred.

Expenditures for the acquisition or improvement of land and depreciable property used in connection with research do not qualify for the research and development deductions. In addition, a deduction claimed under section 174 must be reduced by the amount of any federal research tax credit claimed under section 41 of the IRC.

PURPOSE: The purpose of the deductions is to encourage investment in R&D, and to avoid the difficulty of determining the useful life of any asset created through the research and development process. Many economists contend that society as a whole will underinvest in R&D because private organizations and individuals do not account for the spillover benefits to society when they make decisions to pursue R&D. Therefore, it may be appropriate for the government to encourage greater expenditure on R&D in order to realize its full benefits.

IMPACT: Firms with qualified research and development expenditures benefit from this provision. The Congressional Research Service states that, “The main beneficiaries of the (R&D deduction) are larger manufacturing corporations primarily engaged in developing, producing, and selling technically advanced products. They tend to invest more in R&D as a percentage of gross revenues than most other firms.”²⁸⁶ Nevertheless, there may be broader benefits to society

²⁸⁶ U.S. Senate, Committee on the Budget, p. 86.

because the deductions can reduce the market failure that occurs when firms ignore the spillover benefits of research and development when making their investment decisions.

CRS adds that, “Critics of federal tax incentives for innovation maintain that the main flaw with section 174 is that it does not target its inventive effect at R&D investments that are likely to generate social returns that far exceed the private returns.”²⁸⁷

²⁸⁷ U.S. Senate, Committee on the Budget, p. 87.

Income Tax
Deductions

90. Amortization of certified pollution control facilities

Internal Revenue Code Sections: 169(d)(5)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 2005

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$395	\$296	\$296	\$296
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$395	\$296	\$296	\$296

DESCRIPTION: Coal-fired electric generation plants that invested in pollution control equipment placed in service after April 11, 2005, are eligible to amortize the costs over a seven-year period. This rule applies only to plants that began operation on or after January 1, 1976.

Plants that began operating before January 1, 1976, are eligible for five-year amortization if the pollution control equipment has a useful life of 15 years or less.

Both sets of rules (those applying to pre-1976 plants and to post-1975 plants) represent a tax expenditure because they allow for faster depreciation than the 15- or 20-year period (depending on the type of equipment) that would ordinarily be allowed under the modified accelerated cost recovery system, which sets the standard rules for depreciation.

Qualifying pollution control equipment refers to any technology, such as a scrubber system, that is installed by a qualifying facility to reduce the air emissions of any pollutant regulated by the U.S. Environmental Protection Agency under the Clean Air Act.

PURPOSE: According to the Congressional Research Service, the accelerated depreciation for pollution control equipment “targets electric utilities, a major source of air pollution ... The incentive will facilitate utilities in meeting a new suite of EPA mandates to reduce emissions of sulfur dioxide (SO₂), nitrous oxide (NO₂), and mercury (Hg).”²⁸⁸

IMPACT: CRS observes that, “Because of the time value of money, the earlier deduction is worth more in present value terms, which reduces the cost of capital and the effective tax rates on the investment returns. This should provide an incentive for power plant companies ... to invest in pollution control equipment.”²⁸⁹ At the same time, CRS notes a possible perverse consequence of this subsidy, stating that, “The Clean Air Act’s ‘New Source Review’ provisions require the installation of state-of-the-art pollution-control equipment whenever an air-polluting plant is built or when a ‘major modification’ is made on an existing plant. By creating a more favorable (in

²⁸⁸ U.S. Senate, Committee on the Budget, pp. 218-219.

²⁸⁹ Ibid, p. 218.

some cases much more favorable) regulatory environment for existing facilities than new ones, grandfathering creates an incentive to keep old, grandfathered facilities up and running.”²⁹⁰

²⁹⁰ U.S. Senate, Committee on the Budget, p. 219.

**Income Tax
Deductions**

91. Depreciation recovery periods for specific energy property

Internal Revenue Code Sections: 168(e)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$889	\$790	\$691	\$691
Personal Income Tax Loss	too small	too small	too small	too small
Total	\$889	\$790	\$691	\$691

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Federal law allows more rapid depreciation of certain types of tangible energy property than would otherwise be allowed under the modified accelerated cost recovery system, which sets the standard rules for depreciation. The accelerated depreciation of specific types of energy property, described in the next paragraph, represents tax expenditure.

The recovery period for certain renewable energy equipment, including solar, wind, geothermal, fuel cell, combined heat and power, and microturbine property is five years. Renewable energy generation property that is part of a “small electric power facility” and certain biomass property are also depreciated over five years. Natural gas gathering lines are subject to seven-year depreciation if the original use began after April 11, 2005. A qualified smart meter or smart electric grid system has a recovery period of 10 years. Finally, certain electric transmission property and natural gas distribution lines placed in service after April 11, 2005, are depreciated over 15 years.

PURPOSE: According to the Congressional Research Service, a detailed legislative history for these provisions is lacking, but the rationale was “presumably to encourage alternative energy sources that are less polluting than conventional fuels.”²⁹¹

IMPACT: Commercial property owners who purchase the energy property listed above benefit from the tax subsidy, but there may be efficiency costs to society. CRS points out that, “Economic theory suggests that capital investments should be treated equally to maximize economic efficiency. Permanent investment subsidies, such as accelerated depreciation, may distort the allocation of capital in the long run, possibly reducing overall efficiency in the allocation of resources.”²⁹² Nevertheless, externalities such as the pollution associated with conventional fossil fuels may justify a tax subsidy for alternative energy sources. CRS also observes that, “Economic efficiency is better enhanced by taxing energy sources that negative external externalities, rather than subsidizing renewable alternatives.”²⁹³

²⁹¹ U.S. Senate, Committee on the Budget, p. 117.

²⁹² Ibid.

²⁹³ Ibid, p. 118.

**Income Tax
Deductions**

92. Blue Cross and Blue Shield companies

Internal Revenue Code Sections: 833
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$407	\$407	\$407	\$508
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$407	\$407	\$407	\$508

DESCRIPTION: Blue Cross and Blue Shield and other smaller health insurance providers which operated on August 16, 1986, as well as other non-profit health insurers that meet certain community service and medical loss ratio standards, qualify for special tax treatment. A medical loss ratio (MLR) equals total health benefits paid divided by premium income, and is used as an indicator of profitability and administrative efficiency.

This deduction has two main features. First, Blue Cross/Blue Shield and other eligible health insurers are allowed to fully deduct unearned premiums,²⁹⁴ unlike other property and casualty insurance companies (which is how Blue Cross/Blue Shield and the other insurers are classified under tax law). Second, Blue Cross/Blue Shield and the other insurers may deduct 25 percent of the year’s health-related claims and expenses minus their accumulated surplus at the beginning of the year. The special deductions apply only to net taxable income for the year and cannot be used in alternative minimum tax calculations. The Patient Protection and Affordable Care Act of 2010 now requires the insurers to maintain an MLR of 85 percent in order to claim the deduction.

PURPOSE: In the Tax Reform Act of 1986, Congress repealed a tax exemption that Blue Cross/Blue Shield had enjoyed since the 1930s, after finding that the company was engaged in inherently commercial activities and that its tax-exempt status provided an unfair competitive advantage. At the same time, Congress enacted the special deduction to recognize the role of Blue Cross/Blue Shield and other health insurers in providing insurance to high-risk, small groups,²⁹⁵ which is more risky and expensive.

IMPACT: Although the preferential tax treatment presumably benefits Blue Cross/Blue Shield, the other insurers, and the people who receive the insurance, the Congressional Research Service notes that the insurers have moved away from their traditional role of covering smaller, high-risk

²⁹⁴ An unearned premium refers to an insurance premium that has been collected in advance by an insurance company, but must be returned to the client if the coverage ends before the term covered by the insurance is complete (if the client exercises an option to cancel, for example).

²⁹⁵ U.S. Senate, Committee on the Budget, pp. 320-321.

groups. As a result, “Some have argued that these tax preferences have benefited their managers and their affiliated hospitals and physicians more than their communities.”²⁹⁶

²⁹⁶ U.S. Senate, Committee on the Budget, p. 321.

Income Tax
Deductions

93. Medical and dental care expenses

Internal Revenue Code Section: 213
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$7,586	\$7,791	\$8,337	\$9,363
Total	\$7,586	\$7,791	\$8,337	\$9,363

DESCRIPTION: Taxpayers who itemize their deductions can deduct from their taxable personal income any medical and dental expenses in excess of a certain percentage of adjusted gross income (AGI). For taxpayers under age 65, that threshold rose from 7.5 percent to 10 percent of AGI in 2013. For taxpayers age 65 or over, the threshold remains at 7.5 percent of AGI but will increase to 10 percent in 2017. The deduction includes amounts that are paid for health insurance, and covers the medical expenses of the taxpayer, his or her spouse, and dependents.

There are rules that govern the medical expenses eligible for deduction which include amounts paid by the taxpayer and his family for the following purposes:

1. health insurance premiums, diagnosis, treatment, mitigation, or prevention of disease, or for the purpose of affecting any structure or function of the body, including dental care;
2. prescription drugs and insulin, transportation primarily for and essential to medical care, and lodging away from home for and essential to medical care, up to \$50 per night for each individual.

There are limits on deductions for long-term care insurance. The limits depend on the age of the insured person, and are adjusted annually for inflation: in 2014, they will range from \$370 for individuals age 40 and under to \$4,660 for individuals over age 70.

PURPOSE: CRS states that the deduction “is intended to assist taxpayers who have high out of pocket medical expenses relative to their taxable income.”²⁹⁷ The purpose of the deduction is to compensate for large medical bills that are viewed as involuntary and therefore reduce an individual’s ability to pay taxes. Still, the Congressional Research Service observes that, “(T)he deduction is not limited to strictly involuntary expenses. It also covers some costs of preventive care, rest cures, and other discretionary expenses.”²⁹⁸

IMPACT: CRS states that low- to middle-income households claim a large share of the benefits of the deduction because, “Lower-income taxpayers have relatively low rates of health insurance

²⁹⁷ U.S. Senate, Committee on the Budget, p. 854.

²⁹⁸ Ibid, p. 851.

coverage, because they cannot afford health insurance coverage or coverage is not offered by their employers. As a result, many of these taxpayers are forced to pay out of pocket for the health care they and their immediate families receive. In addition, medical spending constitutes a larger fraction of household budgets among low-income taxpayers than it does among high-income taxpayers, making it easier for low-income taxpayers to exceed the ... AGI threshold.”²⁹⁹

CRS also observes that the deduction does not establish horizontal equity among those who receive employer-sponsored health care and those who pay for health care costs out of pocket because, “Employer-paid health care is excluded from income and payroll taxes, whereas the cost of health insurance bought in the non-group market can be deducted from taxable income only to the extent it exceeds 7.5 or 10 percent of AGI.”³⁰⁰

²⁹⁹ U.S. Senate, Committee on the Budget, p. 851.

³⁰⁰ *Ibid*, p. 855.

Income Tax
Deductions

94. Accelerated depreciation of rental housing

Internal Revenue Code Sections: 167 and 168
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1954

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$450	\$450	\$450	\$450
Personal Income Tax Loss	\$4,264	\$4,157	\$4,157	\$4,050
Total	\$4,713	\$4,607	\$4,607	\$4,500

DESCRIPTION: Rental housing that was placed in service after 1986 benefits from accelerated depreciation that is calculated on a straight-line basis over 27.5 years. This tax expenditure measures the revenue loss due to the rental housing deductions in excess of those allowed under the 40-year straight-line depreciation allowed under the alternative minimum tax.

Rental housing that was placed in service before 1986 continues to depreciate according to the method in effect when it came on the market, which may allow the property to depreciate faster than under a straight-line method.

PURPOSE: Depreciation policy was developed through administrative rulings prior to 1954. The purpose of accelerated depreciation is to promote investment in rental housing by effectively deferring taxes paid on such investment.

IMPACT: The Congressional Research Service states that, “The direct benefits of accelerated depreciation accrue to owners of rental housing. Benefits to capital income tend to concentrate in the higher-income classes.”³⁰¹

With regard to the economic impact of accelerated depreciation, CRS notes that, “Evidence suggests that the rate of economic decline of residential structures is much slower than the rates allowed under current law, and this provision causes a lower effective tax rate on such investments than would otherwise be the case. This treatment in turn tends to increase investment in rental housing relative to other assets, although there is considerable debate about how responsive these investments are to tax subsidies.”³⁰²

In addition, “Much of the previous concern about the role of accelerated depreciation in encouraging tax shelters in rental housing has faded because the current depreciation provisions are less rapid than those previously in place, and because there is a restriction on the deduction of passive losses.”³⁰³

³⁰¹ U.S. Senate, Committee on the Budget, p. 368.

³⁰² Ibid, pp. 369-370.

³⁰³ Ibid, p. 370.

Income Tax
Deductions

95. Mortgage interest on owner-occupied residences

Internal Revenue Code Section: 163(h)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$62,047	\$67,929	\$74,053	\$77,679
Total	\$62,047	\$67,929	\$74,053	\$77,679

DESCRIPTION: Taxpayers may take an itemized deduction for interest paid on debt secured by a principal or second residence. Although some restrictions apply, most taxpayers can deduct the full amount of their mortgage interest. Mortgage interest is deductible on up to \$1 million of debt used to buy, build, or improve a principal or second residence, plus home equity indebtedness of up to \$100,000. The sum of the acquisition indebtedness and home equity debt cannot exceed the fair market value of the home.

The deduction is considered a tax expenditure because homeowners are allowed to deduct their mortgage interest even though the implicit rental income from the home (the money they could earn by renting to someone else) is not subject to tax. There were no limits on the home mortgage interest deduction until the current restrictions were enacted in 1986 and 1987.

PURPOSE: The home mortgage interest deduction was part of a larger deduction for all interest paid that was established when the personal income tax was first enacted in 1913. The Congressional Research Service states that, “There is no evidence in the legislative history that the interest deduction was intended to encourage home ownership or to stimulate the housing industry at that time.”³⁰⁴

Proponents of the deduction contend that it encourages homeownership, which in turn is seen as a way to encourage neighborhood stability and civic responsibility by giving people a stronger stake in their communities.

IMPACT: In 2013, 78,590 District tax filers claimed the mortgage interest deduction. Taxpayers with federal adjusted gross income of \$100,000 or more comprised 54 percent of the beneficiaries and claimed 67 percent of the total amount deducted.³⁰⁵ CRS reports that the households with annual income of \$100,000 or more also claimed the bulk (82 percent) of the benefits nationwide.³⁰⁶ Higher-income households can afford to spend more on housing and can qualify to borrow more.

³⁰⁴ U.S. Senate, Committee on the Budget, p. 339.

³⁰⁵ These data are from the Internal Revenue Service’s Statistics of Income Tax Stats, “Tax Year 2013: Historic Table 2,” available at www.irs.gov/taxstats/index.html.

³⁰⁶ U.S. Senate, Committee on the Budget, p. 340.

Urban Institute researchers also point out that the mortgage interest deduction “is not a cost-effective tool for increasing homeownership because its main beneficiaries are not individuals on the margin between renting and owning. The deduction is available only to itemizing taxpayers and its value rises with an individual’s tax rate.”³⁰⁷ As a result, eliminating the deduction would reduce after-tax income by the largest percentage for those in the 80th to 99th percentiles of the income distribution (those in the top 1 percent would not lose as much because their mortgage costs are lower as a percentage of income).³⁰⁸

With regard to economic efficiency, CRS states that, “The preferential tax treatment of owner-occupied housing relative to other assets is also criticized for encouraging households to invest more in housing and less in other assets that might contribute more to increasing the Nation’s productivity and output.”³⁰⁹ Nor is the deduction necessarily effective in promoting homeownership. According to CRS, “(T)he rate of homeownership in the United States is not significantly higher than in countries such as Canada that do not provide a mortgage interest deduction under their income tax. The value of the U.S. deduction may be at least partly capitalized into higher prices at the middle and upper end of the market.”³¹⁰

The home mortgage interest deduction also impairs horizontal and vertical equity. Renters do not receive a comparable tax benefit. Landlords may deduct mortgage interest paid for rental properties, but must pay tax on the rental income (homeowners don’t pay any tax on the imputed rental value of their homes). Finally, many elderly individuals do not have home mortgages (they own their homes outright) and therefore do not benefit from the mortgage interest deduction.³¹¹

³⁰⁷ Eric Toder, Margery Austin Turner, Katherine Lim, and Liza Getsinger, “Reforming the Mortgage Interest Deduction,” April 2010 (available at www.urban.org), p. 3.

³⁰⁸ Toder, Turner, Lim, and Getsinger, p. 16.

³⁰⁹ U.S. Senate, Committee on the Budget, p. 340.

³¹⁰ *Ibid.*

³¹¹ Richard Green, “Mortgage Interest Deduction,” in *The Encyclopedia of Taxation and Tax Policy*, Joseph Cordes, Robert Ebel, and Jane Gravelle, eds. Washington, D.C.: The Urban Institute Press, 2005), p. 260.

Income Tax
Deductions

96. State and local property taxes on owner-occupied residences

Internal Revenue Code Section: 164
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$17,520	\$18,631	\$19,792	\$20,852
Total	\$17,520	\$18,631	\$19,792	\$20,852

DESCRIPTION: Taxpayers may take an itemized deduction for real estate taxes paid on an owner-occupied residence.

PURPOSE: When the U.S. personal income tax was first enacted in 1913, all federal, state, and local taxes were deductible, based on the premise that tax payments reduce disposable income and therefore should not be included in a measure of the taxpayer’s ability to pay. Today, proponents argue that the deduction promotes fiscal federalism by helping state and local governments raise revenue to support public services.

IMPACT: In 2013, 85,260 District tax filers claimed the deduction for property taxes paid. Taxpayers with federal adjusted gross income of \$100,000 or more comprised 55 percent of the claimants and accounted for 75 percent of the total amount deducted.³¹²

As stated by the Congressional Research Service, “Like all personal deductions, the property tax deduction provides uneven tax savings per dollar of deduction. The tax savings are higher for those with higher marginal tax rates, and those homeowners who do not itemize deductions receive no direct tax savings on property taxes paid. Higher-income groups are more likely to itemize property taxes and to receive larger average benefits per itemizing return. Consequently, the tax expenditure benefits of the property tax are concentrated in the upper-income groups.”³¹³

CRS adds that the deduction “is not an economically efficient way to provide federal aid to state and local governments in general, or to target aid on particular needs, compared with direct aid. The deduction works indirectly to increase taxpayers’ willingness to support higher state and local taxes by reducing the net price of those taxes and increasing their income after federal taxes.”³¹⁴ A counter-argument is that state and local governments may underinvest in infrastructure or services that spill over beyond their borders; the deduction for state and local taxes may help correct that underinvestment.

³¹² These data are from the Internal Revenue Service’s Statistics of Income Tax Stats, “Tax Year 2013: Historic Table 2,” available at www.irs.gov/taxstats/index.html.

³¹³ U.S. Senate, Committee on the Budget, p. 344.

³¹⁴ Ibid, pp. 345-346.

A possible unintended consequence is that, “(T)he value of the property tax deduction may be capitalized to some degree into higher prices for the type of housing bought by taxpayers who can itemize.”³¹⁵ Like the mortgage interest deduction, the property tax deduction may also impair horizontal and vertical equity. Renters cannot deduct their rent payments from the federal income tax. Landlords are able to deduct the property taxes on their rental properties but must pay tax on the rental income (homeowners don’t pay any tax on the imputed rental value of their homes).

President Bush’ Advisory Panel on Federal Tax Reform called for repeal of deductions for state and local taxes, arguing that, “(T)hese expenditures should be treated like any other nondeductible personal expense, such as food or clothing, and that the cost of these services should be borne by those who want them – not by every taxpayer in the country ... As with many other tax benefits, the state and local tax deduction requires higher tax rates for everyone, but the benefits of the deduction are not shared equally among taxpayers.”³¹⁶

³¹⁵ U.S. Senate, Committee on the Budget, p. 346.

³¹⁶ The President’s Advisory Panel on Federal Tax Reform, pp. 83-84.

Income Tax
Deductions

97. Casualty and theft losses

Internal Revenue Code Section: 165(c)(3), 165(e), 165(h) - 165(k)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$303	\$303	\$303	\$364
Total	\$303	\$303	\$303	\$364

DESCRIPTION: Taxpayers who itemize deductions may subtract from taxable income their non-business casualty and theft losses that are not reimbursed through insurance, subject to the following limitations: (1) total losses during the tax year must exceed 10 percent of adjusted gross income, and (2) losses must exceed \$100 per event in order to be counted. Eligible losses include those arising from fire, storm, shipwreck or other casualty, or from theft and the cause of the loss must be a sudden, unexpected, an unusual event. Congress has removed the 10 percent of AGI threshold and the \$100 per-event threshold for calamities such as Hurricanes Katrina, Wilma, and Rita.

PURPOSE: CRS states that “The deduction was intended to be for extraordinary, nonrecurring losses which go beyond the average or usual losses incurred by most taxpayers in day-to-day living.”³¹⁷ The \$100 floor per-event, which was established in 1964, was intended to reduce the number of small and often improper claims, reduce the costs of record-keeping and audits, and focus the deduction on extraordinary losses.³¹⁸

IMPACT: As stated by the Congressional Research Service, “The deduction grants some financial assistance to taxpayers who suffer substantial casualties and itemize deductions. It shifts part of the loss from the property owner to the general taxpayer and thus serves as a form of government coinsurance. Use of the deduction is low for all income groups.”³¹⁹

The benefits may be tilted toward more affluent taxpayers because a dollar of deductible losses is worth more to those with higher marginal tax rates,” and because the deduction is available only to those who itemize.

Finally, the deduction may protect people who failed to purchase insurance at the expense of those who did. CRS further points out that, “It similarly discriminates against people who take preventive measures to protect their property but cannot deduct their expenses. No distinction is

³¹⁷ U.S. Senate, Committee on the Budget, p. 946.

³¹⁸ Ibid.

³¹⁹ Ibid, p. 945.

made between loss items considered basic to maintaining the taxpayer's household and livelihood versus highly discretionary personal consumption.³²⁰

³²⁰ U.S. Senate, Committee on the Budget, p. 947.

Income Tax
Deductions

98. Deduction of foreign taxes instead of a credit

Internal Revenue Code Sections: 901
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$232	\$232	\$232	\$232
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$232	\$232	\$232	\$232

DESCRIPTION: Taxpayers may elect to claim a deduction against taxable income or a credit against taxes due for any taxes paid on income that was earned abroad. Generally, the credit is more advantageous than the deduction because the credit reduces taxes on a dollar-for-dollar basis, whereas the deduction only reduces the amount of income subject to taxation. Nevertheless, if the taxpayer has reached the foreign tax credit limit, then he or she will benefit from claiming the deduction, which also represents a tax expenditure.

PURPOSE: According to the Congressional Research Service, the rationale for this almost 100-year-old deduction might have been “to recognize foreign taxes, like state taxes, as a possible cost associated with earning income. As such, the provision would help correct for mismeasurement of adjusted gross income and be justified on ability to pay or horizontal equity arguments.”³²¹

IMPACT: The deduction benefits those taxpayers who are either unable to claim the foreign tax credit or who have reached the foreign tax credit limit. CRS points out that, the deduction “results in the foreign return net of foreign tax equaling the domestic before-tax return and a nationally efficient allocation of capital. While this maximizes the income or output in the domestic market, it also alters the division of income between capital and labor, shifting income towards labor and away from capital. Because national neutrality distorts the location of investment, it produces an inefficient ‘deadweight’ reduction in world economic welfare.”³²²

³²¹ U.S. Senate, Committee on the Budget, p. 66.

³²² Ibid.

**Income Tax
Deductions**

99. Charitable contributions

Internal Revenue Code Sections: 170 and 642(c)
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1917 (individuals) and 1935 (corporations)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$1,670	\$1,670	\$1,670	\$1,670
Personal Income Tax Loss	\$46,134	\$47,612	\$49,196	\$50,885
Total	\$47,805	\$49,283	\$50,866	\$52,555

DESCRIPTION: Subject to certain limitations, charitable contributions may be deducted by individuals, corporations, estates, and trusts. The contributions must be made to religious, educational, or scientific institutions; public charities; non-profit hospitals; and federal, state, or local governments. Only individuals who itemize their deductions can claim this deduction.

Individuals may deduct charitable contributions of as much as 50 percent of gross income (30 percent for gifts of capital gain property). Corporations may deduct charitable contributions up to 15 percent of adjusted taxable income.³²³ Contributions made in the form of property are subject to different rules depending on the type of donor, recipient, and purpose.

PURPOSE: According to the Congressional Research Service, the deduction was originally established for individual taxpayers during World War I in response to concern that high wartime tax rates would curtail charitable contributions.³²⁴ The deduction was extended to corporations in 1935. Proponents argue that the deduction for private donations reduces demand for government services, and that the services provided by voluntary, non-profit organizations may be more efficient and better tailored to people’s needs than public services.

IMPACT: In 2013, 108,530 District tax filers claimed this deduction. Those with federal adjusted gross income (AGI) of less than \$100,000 comprised 52 percent of the claimants, but accounted for only 26 percent of the total amount deducted. Those with federal AGI of \$200,000 or more comprised only 19 percent of claimants, but accounted for 59 percent of the total amount deducted.³²⁵

³²³ The District departs from federal practice on this issue, which is to cap charitable contributions for corporations at 10 percent of taxable income, rather than 15 percent as in the District. See D.C. Official Code § 47-1803.03(a)(8).

³²⁴ U.S. Senate, Committee on the Budget, p. 686.

³²⁵ These data are from the Internal Revenue Service’s Statistics of Income Tax Stats, “Tax Year 2013: Historic Table 2,” available at www.irs.gov/taxstats/index.html.

The unavailability of the deduction to taxpayers who claim the standard deduction is one reason why the benefits of the charitable contribution deduction are tilted to higher-income individuals. In addition, the higher marginal tax rates faced by higher-income taxpayers mean that each dollar they deduct translates into a larger reduction in tax. To make the deduction more equitable, President Bush's Advisory Panel on Federal Tax Reform proposed making it available to all taxpayers who contribute more than 1 percent of their income to charity, regardless of whether they itemize their deductions.³²⁶

CRS states that households at the lower end of the income scale are more likely to claim deductions for donating to religious institutions, whereas higher-income households are more likely to claim deductions for giving to hospitals, the arts, and educational institutions.³²⁷

Society may benefit from the deduction because it supports activities, such as education and scientific innovation, which can have large spillover effects. Jon Bakija of Williams College and Bradley Heim of the U.S. Treasury Department found that the estimated permanent price elasticity of charitable giving is about -0.7 and is higher for high-income individuals. As a result, they conclude there is "fairly robust evidence that charitable giving is fairly responsive to persistent changes in tax incentives."³²⁸ On the other hand, CRS notes that the deduction may allow "wealthy taxpayers to indulge special interests and hobbies. To the extent that charitable giving is independent of tax considerations, federal revenues are lost without having provided any additional incentive for charitable gifts. It is generally argued that the charitable contribution deduction is difficult to administer and that taxpayers have difficulty complying with it because of complexity."³²⁹

William Randolph of the U.S. Treasury Department points out that a deduction may not be the most effective way to promote charitable giving because, "An efficient subsidy would vary with the amount of external benefits, whereas the tax subsidy rate provided by a charitable deduction varies only with the giver's tax rate ... Some argue that a tax credit would be a fairer and more efficient form of subsidy because the subsidy rate would not depend as much on the giver's level of income."³³⁰ Moreover, researchers at the Center on Philanthropy at Indiana University have found that economic growth plays a more important role in spurring charitable giving than do changes in tax rates or preferences.³³¹

³²⁶ President's Advisory Panel on Federal Tax Reform, pp. 75-76.

³²⁷ U.S. Senate, Committee on the Budget, p. 685.

³²⁸ Jon Bakija and Bradley Heim, "How Does Charitable Giving Respond to Incentives and Income? Dynamic Panel Estimates Accounting for Predictable Changes in Taxation," National Bureau of Economic Research Working Paper 14237, August 2008, p. 41.

³²⁹ U.S. Senate, Committee on the Budget, p. 827.

³³⁰ William Randolph, "Charitable Deductions," in *The Encyclopedia of Taxation and Tax Policy*, Joseph Cordes, Robert Ebel, and Jane Gravelle, eds. Washington, D.C.: The Urban Institute Press, 2005), p. 52.

³³¹ The Center on Philanthropy at Indiana University, "How Changes in Tax Rates Might Affect Itemized Charitable Deductions" (March 2009), research paper available at www.philanthropy.iupui.edu.

Income Tax
Deductions

100. Costs of removing architectural and transportation barriers to the disabled and elderly

Internal Revenue Code Section: 190
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1976

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	too small	too small	too small	too small
Personal Income Tax Loss	too small	too small	too small	too small
Total	too small	too small	too small	too small

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: Business taxpayers may deduct up to \$15,000 in annual expenses for the removal of physical barriers to the elderly or persons with disabilities in qualified facilities or public transportation vehicles that the taxpayer owns or leases. The tax expenditure associated with this deduction reflects the additional tax savings from the deduction, relative to the regular depreciation rules that would otherwise apply.

Costs associated with constructing a new facility, vehicle, or undertaking a complete renovation of an existing facility to make it more accessible to the elderly or persons with disabilities, do not qualify for the deduction. In the case of a partnership, the \$15,000 limit applies separately to the partnership and its individual members.

PURPOSE: According to the Congressional Research Service, the “likely goal” of the deduction “was to engage the private sector in expanding employment opportunities and improving access to goods and services for the elderly and disabled. Supporters of the provision have long contended that without it, most firms would be unlikely to remove physical barriers to the elderly and disabled from their facilities and transport systems.”³³²

IMPACT: CRS states that, “Like all accelerated depreciation allowances, the provision defer a portion of the tax on any income earned by firms making the requisite improvements. In effect, the provision increases the present value of the depreciation allowances a firm may claim for making the eligible investment.”³³³

CRS questions the impact of the deduction because, “It is not even clear from the business tax data published by the Internal Revenue Service to what extent firms have taken advantage of the section 190 expensing allowance. The efficacy of the allowance ... has not been empirically examined. Because the allowance covers only a fraction of the expenses a firm incurs in accommodating the needs of disabled employees, it can be argued that its incentive effect is too

³³² U.S. Senate, Committee on the Budget, p. 507.

³³³ Ibid, p. 508.

small to have much of an impact on employment levels for the disabled.”³³⁴

³³⁴ U.S. Senate, Committee on the Budget, p. 508.

Income Tax
Special Rules

101. 60-40 rule for gain or loss from section 1256 contracts

Internal Revenue Code Section: 1256
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1981

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$105	\$105	\$105	\$105
Personal Income Tax Loss	\$995	\$995	\$995	\$995
Total	\$1,099	\$1,099	\$1,099	\$1,099

Note: “Too small” means that the nationwide federal revenue impact was estimated as \$50 million or less.

DESCRIPTION: A “section 1256 contract” is any regulated futures contract, foreign currency contract, non-equity option, dealer equity option, or dealer securities futures contract that is traded on a qualified board of exchange with a “mark-to-market” accounting system. Under a mark-to-market system, gains and losses must be reported on an annual basis for tax purposes.

A tax expenditure arises under section 1256 contracts because the capital gain or loss from applicable contracts are treated as consisting of 60 percent long-term and 40 percent short-term gain or loss, regardless of how long the contract is held. The “60-40 rule” removes the one-year holding period requirement for long-term capital gains tax treatment, allowing some gains to be taxed at a lower rate.

The “60-40 rule” does not apply to hedging transactions, which are transactions done by a business in its normal operation with the primary purpose of reducing risks, or to limited partnerships.

PURPOSE: According to the Congressional Research Service, “Using mark-to-market overcomes the tax sheltering impact of certain commodity futures trading strategies and to harmonize the tax treatment of commodities futures contracts with the realities of the marketplace.”³³⁵

IMPACT: The mark-to-market accounting for section 1256 contracts eliminates the deferral that would result under usual tax rules that recognize gains only when they are realized, rather than when they accrued. At the same time, this accounting method removes the one-year holding requirement for long-term capital gains treatment, conferring a benefit to the owners of these assets. According to CRS, this special rule “often results in lower taxes for traders.”³³⁶

³³⁵ U.S. Senate, Committee on the Budget, p. 538.

³³⁶ Ibid.

Income Tax
Special Rules

102. Interest rate and discounting period assumptions for reserves of property and casualty insurance companies

Internal Revenue Code Sections: 831, 832(b), and 846
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$2,728	\$2,728	\$2,728	\$2,728
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$2,728	\$2,728	\$2,728	\$2,728

DESCRIPTION: Property and casualty insurance companies may gain a tax advantage from the rules for calculating the present value of future losses. A present value is the current equivalent value of a given cash flow, and is calculated using interest rates or discount factors and information about the timing of income and losses. Most businesses calculate taxable income by deducting expenses when the business becomes liable for paying them. However, property and casualty companies pay out a significant portion of losses years after premiums were collected. Therefore, it is necessary to discount losses in future years to prevent the insurer from gaining a tax advantage from deferring loss payments.

Each year, the U.S. Treasury Department specifies discount factors for various lines of property and casualty insurance that are used to compute present value of future losses for tax purposes. If Treasury uses long-term market interest rates, that will tend to overstate the present value of losses paid in the near future while underestimating the present value of losses paid further into the future. A tax expenditure arises if the net present value of losses calculated by insurers for tax purposes is greater than the true net present value of the losses.

PURPOSE: According to the Congressional Research Service, “Requiring most property and casualty companies to calculate the present value of future losses ... with discount rates specified by the Treasury may simplify the tax liability calculation and may help ensure uniform tax treatment of property and casualty companies.”³³⁷

IMPACT: CRS states that, “Determining the distribution of benefits ... is difficult because ownership of most property and casualty insurance companies is widely dispersed, either among shareholders in stock companies or policyholders in mutual companies.”³³⁸ In addition, “Allowing property and casualty insurance companies an advantageous tax status, based on the potential mismatch between simple tax rules and actual financial management practices, may

³³⁷ U.S. Senate, Committee on the Budget, p. 329.

³³⁸ Ibid.

allow those insurers to attract economic resources from other sectors of the economy, thus creating economic inefficiencies.”³³⁹

³³⁹ U.S. Senate, Committee on the Budget, pp. 329-330.

Income Tax
Special Rules

103. Inventory accounting

Internal Revenue Code Sections: 475, 491-492
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1938

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$1,783	\$1,783	\$1,783	\$1,888
Personal Income Tax Loss	\$298	\$298	\$298	\$298
Total	\$2,082	\$2,082	\$2,082	\$2,187

DESCRIPTION: Businesses that sell goods generally must maintain inventory records to determine the cost of the goods sold. Businesses can account for inventory on an item-by-item basis, but may also use rules such as first-in, first-out (FIFO) accounting, which assumes that the most recent item sold is the earliest one that was purchased, and last-in, first-out (LIFO) accounting, which assumes that the most recent item sold is the last one purchased. Under FIFO, firms may choose the lower of cost or market (LCM) method, which allows them to deduct losses on goods that have fallen in value below their original cost while in inventory. LIFO can only be used if it is also used for financial reporting, although it is not allowable for securities dealers.

Basic FIFO is seen as the standard method of accounting for costs by matching the order of purchase with the order of sale. The use of the LCM method under FIFO, as well as LIFO more generally, are considered tax expenditures because they provide more favorable tax treatment than basic FIFO. LIFO allows a firm to exclude the appreciation in value of inventory when prices are rising, whereas LCM allows a firm to recognize losses when inventory drops in value.

PURPOSE: According to the Congressional Research Service, LIFO was originally adopted “to allow a standard accounting practice.”³⁴⁰ Because price inflation was very low, LIFO originally had a very minor impact. CRS also notes that LCM was “considered a conservative accounting practice which reflected the loss in value of inventories.”³⁴¹ President Obama’s FY 2010 and FY 2011 budget requests included a proposal to repeal both LIFO and LCM.

IMPACT: One study found that LIFO is most heavily used by the chemical, furniture, general merchandise, and metal industries, while another study concluded that it is most often used by the petroleum industry and by motor vehicle, food and beverage, and general merchandise retailers.³⁴² LIFO allows firms to lower their tax burden by reducing the difference between the sales price and the cost of inventory, and may even encourage firms expecting a high tax bill to

³⁴⁰ U.S. Senate, Committee on the Budget, p. 523.

³⁴¹ Ibid.

³⁴² Ibid, p. 522.

purchase more inventories before the year ends to reduce taxable income. Small firms may benefit by using LCM for both tax and financial purposes.³⁴³

³⁴³ U.S. Senate, Committee on the Budget, pp. 523-524.

Income Tax
Special Rules

104. Special alternative tax on small property and casualty insurance companies

Internal Revenue Code Sections: 321(a), 501(c)(15), 832, and 834
 Federal Law Sunset Date: None
 Year Enacted in Federal Law: 1954

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$108	\$108	\$108	\$108
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$108	\$108	\$108	\$108

DESCRIPTION: Insurance companies that are not classified as life insurance companies (mostly property and casualty insurance companies) enjoy tax-exempt status if their annual gross receipts are \$600,000 or less and if premiums account for 50 percent or less of their gross receipts. Mutual insurance companies may enjoy tax-exempt status if their annual gross receipts are \$150,000 or less, and if more than 35 percent of the receipts consist of premiums.

Slightly larger insurance companies that are not classified as life insurance companies may elect to be taxed only on their taxable investment income, provided that net written premiums and direct written premiums each do not exceed \$1.2 million.

PURPOSE: Small insurance companies have enjoyed tax advantages for more than a century, dating back to a time when tax-exempt fraternal organizations provided life insurance to about 30 percent of the population. The Congressional Research Service states that, “These provisions may have been included to encourage formation of small insurance companies to serve specific groups of individuals or firms that could not easily obtain insurance through existing insurers.”³⁴⁴

IMPACT: Due to this provision, “Some very small non-life insurance companies are exempted from taxation entirely, while slightly larger non-life insurance companies may choose a potentially advantageous tax status instead of being taxed at the regular corporate tax rate of 35 percent.”³⁴⁵ It is difficult to determine how the benefits of the deduction are distributed because, “(O)wnership of some of these companies may be widely dispersed. Competitive pressures may force companies to pass some of these benefits on to insurance policyholders via lower premiums. In other cases, a set of companies may set up a ‘captive’ or ‘minicaptive’ insurance company, which provides insurance policies in exchange for premiums. In these cases, stakeholders in the parent companies benefit from the tax exemption.”³⁴⁶

³⁴⁴ U.S. Senate, Committee on the Budget, p. 324.

³⁴⁵ Ibid.

³⁴⁶ Ibid.

CRS notes that the deduction violates economic principles and creates costs for society as a whole. First, “The principle of basing taxes on the ability to pay, often put forth as a requisite of an equitable and fair tax system, does not justify reducing taxes on business income for firms below a certain size.” In addition, “Imposing lower tax rates on smaller firms distorts the efficient allocation of resources, since it offers a cost advantage based on size and not economic performance. This tax reduction serves no simplification purpose, since it requires an additional set of computations and some complex rules to prevent abuses.”³⁴⁷

³⁴⁷ U.S. Senate, Committee on the Budget, p. 325.

Income Tax
Special Rules

105. Apportionment of research and development expenses for determining foreign tax credits

Internal Revenue Code Sections: 861-863 and 904 (also see IRS Regulation 1.861-17)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1977

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$197	\$197	\$197	\$197
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$197	\$197	\$197	\$197

DESCRIPTION: This tax expenditure arises from a complicated set of rules governing the allocation of research and development (R&D) expenses by multinational corporations. These rules allow some corporations to claim larger foreign tax credits that can be used to offset U.S. corporate tax liability.

When foreign-source income is repatriated to the U.S. in the form of dividends, royalties, or other income, the U.S. parent corporation can claim a credit against its U.S. tax liability for any foreign taxes the subsidiary has paid on that income, in order to avoid double taxation of the income. The credit cannot exceed the U.S. tax due on the foreign-source income. Multinational corporations must allocate deductible expenses between foreign and domestic income, but this is difficult in the case of R&D because of its long-term nature.

IRS regulations require U.S.-based multinational corporations to allocate a portion of R&D expenditures to foreign countries even if the research was performed entirely in the U.S. Because most foreign governments do not allow a tax deduction for R&D, the required allocation of R&D expenses to these countries raises the amount of foreign tax paid and therefore increases foreign tax credits against U.S. taxable income.³⁴⁸

PURPOSE: According to the Congressional Research Service, the relevant IRS regulations were “guided by the notion that if R&D conducted in the United States often contributes to the development of goods and services sold in foreign markets, then the accurate measurement of foreign income for U.S. multinational companies requires that part of their domestic R&D expenses be deducted from foreign income.”³⁴⁹

IMPACT: The effects of the R&D apportionment rules are unclear. Supporters of the regulations contend that allocating all R&D expenses to U.S. income would be equivalent to allowing a double deduction in cases where foreign countries provide a deduction. Critics argue that the

³⁴⁸ U.S. Senate, Committee on the Budget, pp. 37-40.

³⁴⁹ Ibid, p. 40.

regulations discourage R&D and encourage U.S. companies to transfer some of their R&D to foreign locations with higher tax rates.³⁵⁰

³⁵⁰ U.S. Senate, Committee on the Budget, pp. 42-44.

Income Tax
Special Rules

106. Interest-charge domestic international sales corporations

Internal Revenue Code Sections: 991-997
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Loss	\$592	\$592	\$691	\$691
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$592	\$592	\$691	\$691

DESCRIPTION: An “Interest-Charge Domestic Sales Corporation” (IC-DISC) is a domestic corporation, usually formed as a tax-exempt subsidiary of another corporation or trust, that exports U.S. products. The parent company pays the IC-DISC a tax-deductible commission for its qualified export sales. Because the IC-DISC is tax-exempt, distributions to IC-DISC shareholders are taxed only once at the lower individual dividend and capital gains tax rates. As a result, the shareholders enjoy a preferred after-tax return which represents a tax expenditure.

IC-DISC shareholders may also defer up to \$10 million in income that is attributable to qualified export sales. An interest charge is imposed on shareholders, however, based on the distribution that would have occurred without the deferral. The \$10 million deferral limit was intended to limit the benefit of IC-DISC activity to smaller businesses.

PURPOSE: According to the Congressional Research Service, “IC-DISC was intended to increase U.S. exports and provide an incentive for U.S. firms to operate domestically rather than abroad. Additionally, IC-DISC ... was adopted as a way to partially offset export subsidies offered by foreign countries.”³⁵¹

IMPACT: IC-DISC reduces the effective tax rate on export income and the benefit accrues to the owners of export firms as well as IC-DISC shareholders. Although IC-DISCs are intended to boost the U.S. economy by increasing exports and discouraging U.S. corporations from establishing subsidiaries in other countries, CRS highlights a number of negative consequences. For example, “With flexible exchange rates, an increase in U.S. exports resulting from IC-DISC likely causes an appreciation of the U.S. dollar relative to foreign currencies. In response, U.S. citizens could be expected to increase their consumption of imported goods, possibly at the expense of domestically produced substitutes. As a result, no improvement in the balance of trade occurs and domestic employment could decrease.”³⁵²

CRS also points to “inefficiencies that IC-DISC may introduce into the allocation of productive economic resources within the U.S. economy, as only domestic exporters may benefit from the subsidy. Additionally, because the tax benefit is related to the production of exported goods and

³⁵¹ U.S. Senate, Committee on the Budget, p. 72.

³⁵² Ibid, p. 73.

services, domestic consumers receive no direct consumption benefit. Foreign consumers, on the other hand, benefit from lower-priced goods.”³⁵³

³⁵³ U.S. Senate, Committee on the Budget, p. 73.

PART II: LOCAL TAX EXPENDITURES

**INCOME TAX
(LOCAL BUSINESS AND PERSONAL INCOME TAX)**

Income Tax Exemptions

107. Additional personal exemption for the blind

District of Columbia Code: D.C. Official Code § 47-1806.02(d)
 Sunset Date: None
 Year Enacted: 1987

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$90	\$90	\$93	\$96
Total	\$90	\$90	\$93	\$96

DESCRIPTION: All District of Columbia taxpayers may claim a personal exemption, which equals \$1,775 for tax year 2015. An additional exemption of equal value (\$1,775) is available for a blind taxpayer, and for the blind spouse or domestic partner of a taxpayer, if the spouse or partner has no gross income during the taxable year and is not the dependent of another taxpayer.

The personal exemption available to all taxpayers is not considered a tax expenditure because it can be seen as part of the normal tax structure that helps determine the zero-tax bracket. By contrast, the personal exemption for the blind is considered a tax expenditure because it departs from the standard rule.

The District provides a larger additional exemption for the blind than Maryland (\$1,000) or Virginia (\$800).³⁵⁴ The federal government provides an additional standard deduction for the blind equal to \$1,550 for single filers and \$1,250 for married individuals (tax year 2015).

D.C. law provides that the value of the exemption shall be adjusted annually to reflect increases in the cost of living. The annual cost-of-living adjustment is rounded down to the next lowest multiple of \$50.³⁵⁵

In December 2013 the D.C. Tax Revision Commission, an expert advisory panel chaired by former Mayor Anthony Williams, recommended increasing the D.C. personal exemption to the federal level (currently \$3,900) and then phasing out the exemption beginning at an income level of \$150,000 for single filers and \$200,000 for joint filers. This change would make the income tax more progressive and offset some of the revenue loss from increasing both the personal exemption and the standard deduction.³⁵⁶

³⁵⁴ Information is available on the Virginia department of taxation website, and the 2015 Maryland state and local tax forms and instructions.

³⁵⁵ In other words, if the cost-of-living adjustment resulted in an increase of \$25, it would be rounded down to zero; if it resulted in an increase of \$75, it would be rounded down to \$50. The cost-of-living adjustment is made using the Consumer Price Index for the Washington-Baltimore Metropolitan Statistical Area for all urban consumers, published by the U.S. Department of Labor. See D.C. Official Code § 47-1801.04(11)(A) and § 47-1806.02(i).

³⁵⁶ See www.dctaxrevisioncommission.org.

PURPOSE: The purpose of this provision is to reduce the tax burden of taxpayers who are blind or who have blind spouses or domestic partners, based on the assumption that someone who is blind faces additional expenses that make it harder to maintain an adequate standard of living.

IMPACT: Taxpayers who are legally blind, or have a legally blind spouse or domestic partner, benefit from this provision. In tax year 2013, 766 individuals claimed the exemption and tax filers with income at or below \$50,000 accounted for 61 percent of the total amount exempted (see table below).

The additional personal exemption for the blind violates the principle of horizontal equity. As stated by the Congressional Budget Office in discussing the additional federal deduction for the blind, “(N)o analogous relief is provided to deaf people or to those with other disabilities who confront other, similar, expenses.”³⁵⁷ Moreover, the additional personal exemption does not benefit blind people who have no tax liability before taking the exemption.

Additional personal exemption for the blind -- 2013				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	23	3%	\$39	3%
\$1 to \$25,000	276	36%	\$462	36%
\$25,001 to \$50,000	169	22%	\$283	22%
\$50,001 to \$75,000	97	13%	\$162	13%
\$75,001 to \$100,000	59	8%	\$99	8%
\$100,001 to \$150,000	68	9%	\$114	9%
\$150,001 to \$200,000	29	4%	\$49	4%
Over \$200,000	45	6%	\$75	6%
Total	766	100%	\$1,283	100%

³⁵⁷ Congressional Budget Office, *Budget Options*, Vol. 2 (August 2009), p. 198.

Income Tax Exemptions

108. Additional personal exemption for the elderly

District of Columbia Code: D.C. Official Code § 47-1806.02(e)
 Sunset Date: None
 Year Enacted: 1987

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$5,139	\$5,139	\$5,283	\$5,428
Total	\$5,139	\$5,139	\$5,283	\$5,428

DESCRIPTION: All District of Columbia taxpayers may claim a personal exemption, which equals \$1,775 for tax year 2015. An additional exemption of equal value (\$1,775) is available for an elderly taxpayer (someone who reached age 65 before the end of the taxable year), and another exemption is available for the elderly spouse or domestic partner of the taxpayer, if the spouse or partner has no gross income during the taxable year and is not the dependent of another taxpayer.

The personal exemption available to all taxpayers is not considered a tax expenditure because it can be seen as part of the normal tax structure that helps determine the zero-tax bracket. By contrast, the personal exemption for the elderly is considered a tax expenditure because it departs from the standard rule.

The District provides a larger additional exemption for the elderly than Maryland (\$1,000) or Virginia (\$800).³⁵⁸ The federal government provides an additional standard deduction for the elderly equal to \$1,550 for single filers and \$1,250 for married individuals (tax year 2015)³⁵⁹.

D.C. law provides that the value of the exemption shall be adjusted annually to reflect increases in the cost of living. The annual cost-of-living adjustment is rounded down to the next lowest multiple of \$50.³⁶⁰

In December 2013 the D.C. Tax Revision Commission, an expert advisory panel chaired by former Mayor Anthony Williams, recommended increasing the D.C. personal exemption to the

³⁵⁸ Information is available on the Virginia department of taxation website, and the 2015 Maryland state and local tax forms and instructions.

³⁵⁹ Table 20-1 Standard deduction chart retrieved from https://www.irs.gov/publications/p17/ch20.html#en_US_2015_publink1000283783

³⁶⁰ In other words, if the cost-of-living adjustment resulted in an increase of \$25, it would be rounded down to zero; if it resulted in an increase of \$75, it would be rounded down to \$50. The cost-of-living adjustment is made using the Consumer Price Index for the Washington-Baltimore Metropolitan Statistical Area for all urban consumers, published by the U.S. Department of Labor. See D.C. Official Code § 47-1801.04(11)(A) and § 47-1806.02(i).

federal level (currently \$3,900) and then phasing out the exemption beginning at an income level of \$150,000 for single filers and \$200,000 for joint filers. This change would make the income tax more progressive and offset some of the revenue loss from increasing both the personal exemption and the standard deduction.³⁶¹

PURPOSE: The purpose of this provision is to reduce the tax burden of elderly taxpayers and their families. The additional exemption reflects the assumption that the elderly face additional expenses, such as medical bills, that make it harder to maintain an adequate standard of living. In addition, some argue that the exemption is appropriate because many senior citizens have fixed incomes.

IMPACT: Elderly taxpayers, as well as taxpayers with an elderly spouse or domestic partner, benefit from this provision. During tax year 2013, 43,516 senior citizens claimed the exemption and those with income at or below \$50,000 accounted for 52 percent of the total amount exempted (see table below).

The additional personal exemption for the elderly violates the principle of horizontal equity. Non-elderly taxpayers with the same economic income do not receive an equivalent exemption. In discussing the additional federal standard deduction for the elderly, the Congressional Budget Office points out that the poverty rate among the elderly is now the lowest of all age groups.³⁶²

Additional personal exemption for the elderly -- 2013				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	1,390	3%	\$2,328	3%
\$1 to \$25,000	11,242	26%	\$18,830	26%
\$25,001 to \$50,000	10,217	23%	\$17,113	23%
\$50,001 to \$75,000	5,839	13%	\$9,780	13%
\$75,001 to \$100,000	3,866	9%	\$6,476	9%
\$100,001 to \$150,000	4,131	9%	\$6,919	9%
\$150,001 to \$200,000	2,249	5%	\$3,767	5%
\$200,001 to \$500,000	3,587	8%	\$6,008	8%
Over \$500,000	995	2%	\$1,667	2%
Total	43,516	100%	\$72,889	100%

³⁶¹ See www.dctaxrevisioncommission.org.

³⁶² Congressional Budget Office, *Budget Options*, Vol. 2, p. 198.

Income Tax
Exemptions

109. Investment funds exemption from unincorporated business franchise tax

District of Columbia Code: D.C. Official Code § 47-1808.01(6)
 Sunset Date: None
 Year Enacted: 2014

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$4,620	\$4,851	\$5,094	\$5,348
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$4,620	\$4,851	\$5,094	\$5,348

DESCRIPTION: The District cannot tax non-residents’ income, whether earned directly or via pass-through entities. Prior to 2015, investment funds operating a stock “trading” business in the District were treated as an unincorporated business and therefore, subject to the unincorporated business franchise tax (UBFT) of 9.975 percent. However, UBFT does not apply to trade or business in which more than 80 percent of gross income is derived from personal services actually rendered by the individuals or partners, without capital as a material income-producing factor. This exempts professional firms, including doctors, lawyers, engineers, and accountants. This changed with the Tax Revision Commission Recommendations Clarification Act of 2014. The Act exempts trades and businesses that trade their own stocks, securities and commodities from filing unincorporated business franchise taxes.

The exemption stems from the argument of whether or not an investment partnership is treated as being engaged in a trade or business. An investment partnership, being treated as a business, will apportion its investment income as “business income” among the states where the investment partnership has apportionment factors, and the nonresident partners might be taxed in those states on their distributive shares of the apportioned business income of the investment partnership. On the other hand, an investment partnership not treated as being engaged in a trade or business, will have its income pass through to the partners as nonbusiness income and be taxed only in the partner’s state of residence or commercial domicile³⁶³.

Virginia and Maryland offer similar exemptions to ‘pass-through’ entities that are established solely to invest in intangible personal property, such as stocks and bonds, and have no employees, and no real or tangible property. These pass-through entities are not considered to be carrying on a trade or business. Corporations and non-residents in Virginia are not required to file a Virginia income tax return solely because of income from an investment pass-through entity. In Maryland non-resident members, and partnerships whose activities and assets are limited to investment in stocks, bonds, futures, options or debt obligations other than debt instruments directly secured by real or tangible personal property are not subject to the nonresident member tax merely because

³⁶³ John A. Biek, “State Income Tax Exemptions for Nonresident Partners in Investment Partnerships” May-June 2009, available at <http://www.ngelaw.com/files/Publication/28ece83b-1d2c-4c41-9186-1ee61fac8a1e/Presentation/PublicationAttachment/cd94486d-1a7b-41d1-b908-1caeadd4047d/JPTE.6666.Biek.pdf>.

the investment decisions, trading orders, research and the like are conducted by a general partner from a Maryland location.

PURPOSE: The purpose of this provision is to encourage new industries, and thereby expand the District's economy and employment base.

IMPACT: According to DC Tax Revision Commission, the tax imposed on investment funds operating a stock trading business in the District “amounts to a 9.975 percent tax on capital gains, dividends, and interest—and represents a liability that would not be imposed on funds in other states. The UBFT effectively precludes investment funds from “trading” stocks or securities in the District”³⁶⁴. The DC Tax Revision Commission recommended that the “District adopt such a ‘trading safe harbor’ that would generally exempt investment funds from the UBFT. This step, which would apply only to intangible property and not real property, could position the District to attract a vibrant new industry, spurring growth and diversifying the economy”³⁶⁵.

³⁶⁴ Final Report of the D.C. Tax Revision Commission. May 2014, p. 18, available at http://media.wix.com/ugd/ddda66_eb2ae0d8b86a4c9c86eae90501c36aa.pdf.

³⁶⁵ Final Report of the D.C. Tax Revision Commission. May 2014, p. 18, available at http://media.wix.com/ugd/ddda66_eb2ae0d8b86a4c9c86eae90501c36aa.pdf

Income Tax
Subtractions

110. Qualified high-technology companies: depreciable business assets

District of Columbia Code: D.C. Official Code § 47-1803.03(a)(18)
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	no estimate	no estimate	no estimate	no estimate
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: Qualified high-technology companies benefit from more generous rules regarding the franchise tax deduction for personal property expenses. Whereas other businesses can subtract the lesser of \$25,000 or the actual cost of the property for the year the property is placed in service, a qualified high-technology company can subtract the lesser of \$40,000 or the actual cost of the property for the year the property is placed in service.

A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies. The expensing rules are part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the “New E-conomy Transformation Act of 2000.”³⁶⁶

Although Maryland does not offer a comparable deduction, the state provides several types of financial assistance to information and technology firms, including the Maryland Venture Fund, a state-funded seed and early-stage equity fund that has invested 60 percent of its resources in technology companies; the Challenge Investment Program, which helps “seed-stage” companies defray some of the initial costs involved in bringing new products to market; and the Enterprise Investment Fund Program, which makes direct equity investments in emerging technology companies.³⁶⁷ In addition, Maryland provides tax credits for those who invest at least \$25,000 in qualified Maryland biotechnology companies.

Virginia permits technology businesses to exempt from taxable income the long-term capital gains arising from investment in a qualified technology business, which must have gross revenues of \$3 million or less in the most recent year, have its principal office in Virginia, and conduct its business primarily, or do substantially all of its production, in Virginia. The exemption applies to investments made between April 1, 2010, and June 30, 2015. Virginia also offers a Qualified

³⁶⁶ The other incentives, which include a reduced corporate tax rate, employment credits, property tax abatements, sales tax exemptions, and personal property tax exemptions, are discussed elsewhere in this section.

³⁶⁷ Maryland Department of Business and Economic Development, Business in Maryland: Information & Technology, available at www.choosemaryland.org.

Equity and Subordinated Debt Investments Credit to corporate and individual taxpayers who invest in a pre-qualified small business venture that is primarily engaged in certain technology fields. Finally, Arlington County uses authority provided by state law to reduce business and professional license tax rates to qualifying firms with 100 or more employees located in designated “technology zones.”

PURPOSE: The purpose of this provision is to encourage the growth of high-technology companies in the District of Columbia and thereby expand the District’s economy and employment base.

IMPACT: High-technology companies in the District of Columbia benefit from this provision. There is no estimate of the forgone revenue because the subtraction is reported on the same line on the business tax forms as other subtractions; therefore, relevant data were unavailable.

The accelerated depreciation for high-technology companies means that amounts available for deduction in later years will be smaller; nevertheless, the companies benefit because the enhanced deduction gives them resources immediately that they can put to productive use. The provision violates the principle of horizontal equity because companies in other industries with similar levels of income and personal property expenses cannot subtract the same amount.

**Income Tax
Subtractions**

111. College savings plan contributions

District of Columbia Code: D.C. Official Code § 47-4501 - § 47-4512
 Sunset Date: None
 Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$1,163	\$1,163	\$1,163	\$1,163
Total	\$1,163	\$1,163	\$1,163	\$1,163

DESCRIPTION: The District of Columbia College Savings Plan allows residents to create college savings accounts to benefit from incentives for qualified tuition programs provided by section 529 of the U.S. Internal Revenue Code. Contributions to a college savings account must be spent on “qualified higher education expenses,” which include tuition, fees, books, supplies, and equipment.³⁶⁸ Anyone can open a college savings account on behalf of a particular child. At the end of FY 2014, the D.C. plan had 17,386 accounts with an average balance of \$20,046. Fueled by strong performance in the financial markets and solid sales efforts, assets of the DC College Savings Plan rose to \$348.5 million as of September 30, 2014, from \$285.3 million at the end of FY 2013. This represents an increase of 22%³⁶⁹

The earnings in a college savings account are exempt from federal income tax, as is the distribution of funds in the account to pay for qualified higher education expenses. The District of Columbia conforms to those federal rules when applying the local income tax (see tax expenditure #13, “Earnings of qualified tuition programs”).

The District of Columbia also allows account owners to take a local income tax deduction of as much as \$4,000 each year for single filers, or \$8,000 for joint filers. If the account owner contributes more than the maximum amount in a tax year, the excess amount may be carried forward, subject to the annual limit, for five years. The estimate of forgone revenue shown above reflects the loss resulting from the local income tax deduction.

College savings plans are offered in 49 states, 34 of which offer state tax deductions or credits to those who contribute to the plans, in addition to the federal tax incentives.³⁷⁰ In Maryland, a taxpayer can deduct up to \$2,500 in annual account contributions *per* child, while in Virginia a taxpayer can deduct up to \$4,000 in annual account contributions *per* child. Both states also allow residents to exclude the earnings on their 529 account investments from state income tax.

³⁶⁸ See Section 529(c)(3) of the Internal Revenue Code for the statutory definition of “qualified higher education expenses.”

³⁶⁹ D.C. 529 College Savings Plan, Fiscal Year 2014 Annual Report, available at www.dccollegesavings.com.

³⁷⁰ College Savings Plans Network, compare plans by state, available at <http://plans.collegesavings.org/planComparisonState.aspx>

PURPOSE: The purpose of this provision is to increase access to higher education by helping individuals and families save for higher education on a tax-favored basis.

IMPACT: Families and others who pay for higher education benefit from the subtraction, as do the students whose educations are financed, at least in part, by the tax-favored college savings accounts. Moreover, there may be a general benefit to society from having a more educated citizenry and productive workforce.

During tax year 2013 (the last year for which data were collected), 2,404 tax filers claimed this subtraction. As shown in the table below, tax filers with annual income above \$100,000 accounted for 85 percent of the total amount subtracted.

Higher-income families stand to benefit more from college savings plans because they have the resources to save for college and face higher marginal tax rates that increase the value of tax deductions and exclusions. Urban Institute researchers have questioned whether the plans have an impact on college savings because higher-income families would likely set aside funding for higher education even without the tax incentives.³⁷¹

College Savings Program - 2008				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	11	0.5%	\$43	0.4%
\$1 to \$25,000	84	3%	\$207	2%
\$25,001 to \$50,000	141	6%	\$313	3%
\$50,001 to \$75,000	168	7%	\$475	4%
\$75,001 to \$100,000	202	8%	\$621	6%
\$100,001 to \$150,000	425	18%	\$1,560	15%
\$150,001 to \$200,000	364	15%	\$1,606	15%
\$200,001 to \$500,000	788	33%	\$4,443	41%
Over \$500,000	221	9%	\$1,462	14%
Total	2,404	100%	\$10,731	100%

³⁷¹ Maag and Fitzpatrick, pp. 24-25.

**Income Tax
Subtractions**

112. Public school teacher expenses

District of Columbia Code: D.C. Official Code § 47-1803.03(b-2)
 Sunset Date: None
 Year Enacted: 2007

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$122	\$122	\$122	\$122
Total	\$122	\$122	\$122	\$122

DESCRIPTION: An individual who has served as a classroom teacher in a traditional public school or a public charter school for an entire tax year may subtract the following expenses from District of Columbia gross income: (1) the amount paid for basic classroom materials and supplies needed for teaching, up to \$500 per year, and (2) the amount paid as tuition and fees for post-graduate education, professional development, or licensing and certification requirements, up to \$1,500 per year. If the taxpayer claimed a deduction for classroom materials and supplies, or tuition and fees on his or her federal income tax return, then those expenses may not be claimed as a deduction from District of Columbia gross income.

Maryland offers public school classroom teachers a non-refundable annual tuition tax credit of up to \$1,500 for courses necessary to achieve or maintain advanced teacher certification. To receive the credit, the teacher must complete the course with a grade of “B” or better, have a satisfactory performance evaluation, and not have been reimbursed by his or her school system for the tuition paid. Virginia allows a licensed primary or secondary school teacher to deduct 20 percent of unreimbursed tuition costs paid to attend continuing education courses required as a condition of employment, provided that these expenses were not deducted from federal gross income.

PURPOSE: The purpose of the subtraction is to defray the costs that teachers often absorb for classroom supplies, materials, and professional development, and to enhance the public schools’ ability to recruit and retain highly qualified teachers.

IMPACT: Classroom teachers are the direct beneficiaries of the subtraction, but there may be spillover benefits for society if the provision helps public schools in the District of Columbia schools attract and retain skilled teachers. On the other hand, the subtraction may violate the principle of horizontal equity because other professionals such as child welfare workers do not receive a similar deduction. Decision-makers might also consider whether it makes more sense to pursue the policy goals through direct spending for school supplies and professional development, rather than through a tax provision.

During tax year 2013 (the last year for which data were collected), 2,338 tax filers claimed the subtraction, which is squarely focused on middle-income earners. As shown in the table below, in 2008, tax filers with incomes between \$25,000 and \$75,000 accounted for 56 percent of the total amount deducted.

Public School Teacher Expenses - 2008				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	26	1%	\$14	1%
\$1 to \$25,000	385	16%	\$199	14%
\$25,001 to \$50,000	800	34%	\$398	28%
\$50,001 to \$75,000	535	23%	\$398	28%
\$75,001 to \$100,000	234	10%	\$238	17%
\$100,001 to \$150,000	223	10%	\$107	8%
\$150,001 to \$200,000	83	4%	\$40	3%
Over \$200,000	52	2%	\$27	2%
Total	2,338	100%	\$1,420	100%

Income Tax
Subtractions

113. Health insurance premiums paid for a same-sex spouse or domestic partner (business income tax)

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(W)
Sunset Date: None
Year Enacted: 1992

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$376	\$397	\$419	\$442
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$376	\$397	\$419	\$442

DESCRIPTION: A corporation, unincorporated business, or partnership in the District of Columbia can deduct from gross income all health insurance premiums paid on behalf of an employee’s family members or a domestic partner, provided that the benefits are offered to all full-time employees who are D.C. residents. Prior to 2013, the federal government did not allow any deductions on behalf of domestic partners, so such deductions were based only in D.C. law. The 2013 ruling by the federal government does not apply to registered domestic partnerships, civil unions or similar formal relationships recognized under state law.

D.C. law defines a “domestic partner” as a person with whom an individual maintains a committed relationship characterized by mutual caring and sharing of a mutual residence; who is at least 18 years of age and competent to contract; who is the sole domestic partner of the other person; and is not married.³⁷² A domestic partner can be of the same sex or the opposite sex.

Neither Maryland nor Virginia offers employers a similar tax deduction for domestic partners.

PURPOSE: The purpose of this provision is to make the tax treatment of health insurance benefits more equitable by providing businesses with the same deduction from D.C. business taxes that they receive for providing health benefits to other family members of an employee.

IMPACT: Businesses that pay health insurance premiums on behalf of domestic partners benefit from this provision. Domestic partners also benefit indirectly because the provision lowers the price to businesses of providing health benefits to domestic partners and therefore may increase the availability and affordability of the benefits.

³⁷² See D.C. Official Code § 32-701(3).

Income Tax
Subtractions

114. Health insurance premiums paid for a same-sex spouse or domestic partner (personal income tax)

District of Columbia Code: D.C. Official Code § 47-1803.03(a)(15) and § 46-401(b)
 Sunset Date: None
 Year Enacted: 2006

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Corporate Income Tax Impact	\$0	\$0	\$0	\$0
Personal Income Tax Impact	\$93	\$97	\$101	\$105
Total	\$93	\$97	\$101	\$105

DESCRIPTION: An individual taxpayer may subtract from gross income the amount of any health insurance premium paid by his or her employer for a domestic partner.

Individuals can also exclude from gross personal income the health insurance premiums that employers pay for themselves and other family members, but that exclusion is provided in federal law, to which the District conforms (see tax expenditure #32, “Employer contributions for medical care, medical insurance premiums and long-term care insurance premiums”). The federal government now allows any tax deductions or exclusions on behalf of domestic partners, but the tax deductions or exclusions do not apply to registered domestic partnerships, civil unions or similar formal relationships recognized under state law. The 2013 ruling by the federal government does not apply to registered domestic partnerships, civil unions or similar formal relationships recognized under state law. The estimated revenue loss shown above reflects the cost of providing the D.C. personal income tax deduction for health insurance premiums paid for a domestic partner.

D.C. law defines a “domestic partner” as a person with whom an individual maintains a committed relationship characterized by mutual caring and sharing of a mutual residence; who is at least 18 years of age and competent to contract; who is the sole domestic partner of the other person; and is not married.³⁷³ A domestic partner can be of the same sex or the opposite sex.

Neither Maryland nor Virginia offers individuals a similar tax deduction for domestic partners.

PURPOSE: The purpose of the subtraction is to promote tax equity for domestic partners, and to expand their access to health insurance. The health insurance premiums paid by employers on behalf of spouses are not counted in District of Columbia gross income as a result of federal conformity; this provision offers the same treatment to domestic partners. The provision also makes health insurance more affordable to domestic partners.³⁷⁴

³⁷³ See D.C. Official Code § 32-701(3).

³⁷⁴ Council of the District of Columbia, Committee on Finance and Revenue, Report on Bill 16-495, the “Domestic Partner Health Care Benefits Tax Exemption Act of 2005,” October 12, 2005.

IMPACT: Domestic partners and their families benefit from the subtraction. During tax year 2009 (the last year for which data were collected), 267 tax filers claimed the subtraction. Tax filers with incomes over \$75,000 accounted for 50 percent of the total amount deducted, as shown in the table below. It is estimated that the number of claimants has dropped since 2009 because same-sex marriage is now legal in the District of Columbia, reducing the appeal of domestic partner benefits for same-sex couples, and the federal government recognize domestic partners for tax purposes.

The deduction for health insurance premium costs may lead employees to seek – and employers to provide -- more of their compensation in terms of health benefits than they would otherwise offer, creating an efficiency loss.

Health Insurance Premiums Paid for a Same-Sex Spouse or Domestic Partner -- 2009				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	3	1%	\$7,289	1%
\$1 to \$25,000	33	12%	\$93,346	14%
\$25,001 to \$50,000	64	24%	\$88,752	14%
\$50,001 to \$75,000	47	18%	\$140,916	22%
75,001 to \$100,000	35	13%	\$89,807	14%
\$100,001 to \$150,000	39	15%	\$109,066	17%
\$150,001 to \$200,000	17	6%	\$39,845	6%
\$200,001 to \$500,000	26	10%	\$75,237	11%
Over \$500,000	3	1%	\$10,684	2%
Total	267	100%	\$654,942	100%

**Income Tax
Subtractions**

115. Health professional loan repayments

District of Columbia Code: D.C. Official Code § 7-751.11
 Sunset Date: None
 Year Enacted: 2006

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$76	\$76	\$76	\$76
Total	\$76	\$76	\$76	\$76

DESCRIPTION: The District of Columbia Health Professional Recruitment Program was established to serve as a recruitment tool for health professionals in the District. Subject to the availability of funds, the program repays the outstanding principal, interest, and related expenses for government or commercial loans obtained by an individual for tuition, fees, and reasonable educational expenses incurred while obtaining a health professional degree. The loan repayments made by the District government are taxable under the federal income tax, but are not considered income for purposes of District of Columbia income tax.

In return for the loan repayment, the health professional must work for at least two years and a maximum of four years at a non-profit facility located in a “health professional shortage area” or “medically underserved area” in the District of Columbia designated by the U.S. Department of Health and Human Services. The non-profit facility must offer primary care, mental health, or dental services to District of Columbia residents regardless of their ability to pay.

Physicians, dentists, and nurses are among the health professionals who are eligible to apply for the program. Selection is based on professional qualifications and relevant experience, professional achievements, and other indicators of competency. The Department of Health administers the program.

In 2012, Maryland policymakers enacted legislation to establish “Health Enterprise Zones” where residents experience measurable health disparities and poor health outcomes. A health care practitioner who provides primary care, behavioral health services, or dental health services in a designated zone may apply to the Department of Health and Mental Hygiene (DHMH) for a state income tax credit if he or she (1) demonstrates competency in cultural, linguistic, and health literacy, (2) accepts and provides care for Medicaid and uninsured patients, and (3) meets any other criteria set by DHMH. A practitioner in a Health Enterprise Zone may also apply for a refundable \$10,000 credit against the state income tax for hiring workers who help provide health-care services in the zone. These tax credits are budgeted, so they are subject to the availability of funds and provided on a first-come, first-served basis.

Virginia loan repayment program through the Virginia Department of Health-Office of Minority Health and Health Equity (VDH-OMHHE) provides non-taxed incentives to qualified medical, dental, behavioral health and pharmaceutical (pharmacists) professionals in return for a minimum of two (2) years of service at an eligible practice site in one of the federally designated Health Professional Shortage Areas (HPSAs) in a qualified field of practice in Virginia. Virginia State

Loan Repayment Program VA-SLRP requires a dollar for dollar match from the community/practice site. The maximum award for a four (4) year commitment is \$140,000 and shall be for a qualifying educational loan. Prioritizing applications for VA-SLRP is done on a first come first serve basis with priority given to renewals. All approvals are based on availability of funds. The participant shall meet and fulfill all requirements listed below in order to be eligible for the VA-SLRP³⁷⁵.

PURPOSE: The purpose of this provision is to “recruit community-based providers to our neediest neighborhoods by creating an incentive for those health professionals who choose to work where a health care shortage exists.”³⁷⁶

IMPACT: Health professionals who agree to work in health professional shortage or medically underserved areas in the District of Columbia benefit from this provision. Low-income residents who receive health care from non-profit entities in the targeted areas should also benefit from this provision.

During tax year 2009 (the latest year for which data are available), 80 tax filers claimed the subtraction. The number of claimants increased to 100 in FY 2013. As shown in the table below, tax filers with incomes at or below \$75,000 accounted for 72 percent of the total amount subtracted, reflecting the lower salaries that health professionals receive at non-profit facilities in medically underserved areas.

Health Professional Loan Repayments -- 2009				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	2	3%	\$5,646	1%
\$1 to \$25,000	16	20%	\$130,156	25%
\$25,001 to \$50,000	25	31%	\$97,626	19%
\$50,001 to \$75,000	20	25%	\$136,954	27%
\$75,001 to \$100,000	6	8%	\$75,036	15%
\$100,001 to \$150,000	6	8%	\$46,107	9%
\$150,001 to \$200,000	3	4%	\$14,700	3%
Over \$200,000	2	3%	\$10,007	2%
Total	80	100%	\$516,232	100%

³⁷⁵ Virginia Loan Repayment Programs available at <https://www.vdh.virginia.gov/OMHHE/primarycare/incentives/loanrepayment/>

³⁷⁶ Council of the District of Columbia, Committee on Health, Report on Bill 16-420, the “District of Columbia Health Professional Recruitment Program Act of 2005,” October 14, 2005, p. 1.

**Income Tax
Subtractions**

116. Housing relocation and assistance payments

District of Columbia Code: D.C. Official Code § 42-2851.05, § 42-3403.05, and 47-1803.02(a)(2)(R)
 Sunset Date: None
 Year Enacted: 1980 (rental housing conversion) and 2002 (federal housing assistance programs)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	minimal	minimal	minimal	minimal
Total	minimal	minimal	minimal	minimal

DESCRIPTION: The “Rental Housing Conversion and Sale Act of 1980” (D.C. Law 3-86) requires an owner who converts rental housing into a condominium or cooperative to provide a relocation payment to each tenant who does not purchase a unit or share, or enter into a lease of at least five years. In addition, the Department of Housing and Community Development (DHCD) must provide a housing relocation payment of up to \$1,000 as well as housing assistance payments for three years to each low-income tenant who does not purchase a unit or share in a condominium or cooperative conversion. The formula for determining the housing assistance payment is set forth in § 42-3403.04 of the D.C. Official Code. Housing relocation and assistance payments are excluded from D.C. income tax.

In addition, the “Housing Act of 2002” (D.C. Law 14-114) authorizes the Mayor to provide relocation services to the tenants of a building that discontinues its participation in a federal housing assistance program. The relocation services include not only information about available housing and relevant assistance programs, but also relocation payments of as much as \$500 per tenant. The relocation payments are excluded from D.C. income tax.

PURPOSE: The purpose of the exclusions for housing relocation and assistance payments is to protect tenants, particularly low-income tenants, who are displaced by a landlord’s decision to convert rental housing into owner-occupied housing or to cease participating in a federal housing assistance program.

IMPACT: Tenants receiving housing relocation and assistance payments are the intended beneficiaries of this provision. Although DHCD advertises the availability of the housing relocation and assistance payments to tenants who are displaced by a rental housing conversion, no one has applied in about five years. Because of the small scale of the housing relocation and assistance program, the revenue loss for fiscal years 2016 through 2019 is estimated as “minimal” (less than \$50,000 per year).

Income Tax
Subtractions

117. D.C. and federal government survivor benefits

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(N)
 Sunset Date: None
 Year Enacted: 1987

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$4,522	\$4,717	\$4,915	\$5,128
Total	\$4,522	\$4,717	\$4,915	\$5,128

DESCRIPTION: Taxpayers may exclude from their District of Columbia taxable income the amount of any survivor benefits they received from the D.C. government or federal government if they are 62 years of age or older by the end of the tax year. Neither Maryland nor Virginia provides any income exclusion for survivor benefits.

This provision does not affect Social Security survivor benefits, which are excluded from taxation under another provision of D. C. law (see tax expenditure # 122, “Social Security benefits for survivors and dependents”).

PURPOSE: The purpose of the exclusion is to promote income security among elderly survivors of D.C. government or federal government workers by shielding their benefits from taxation.

IMPACT: Individuals over the age of 62 who receive survivor benefits from the D.C. government or federal government benefit from this provision. In 2013, 2,361 tax filers claimed this subtraction. Tax filers with income at or below \$50,000 accounted for the bulk (79 percent) of the total subtractions, as shown in the table on the next page.

The exclusion of federal and D.C. government survivor benefits violates the principle of horizontal equity, because those with private-sector survivors’ benefits do not receive the same exclusion.

D.C. and Federal Government Survivor Benefits -- 2013				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	366	16%	\$7,309	16%
\$1 to \$25,000	956	40%	\$17,800	39%
\$25,001 to \$50,000	612	26%	\$11,098	24%
\$50,001 to \$75,000	203	9%	\$3,792	8%
\$75,001 to \$100,000	93	4%	\$2,201	5%
\$100,001 to \$150,000	65	3%	\$1,505	3%
\$150,001 to \$200,000	30	1%	\$682	1%
\$200,001 to \$500,000	30	1%	\$852	2%
Over \$500,000	6	0.3%	\$278	1%
Total	2,361	100%	\$45,516	100%

Income Tax
Subtractions

118. Disability payments for the permanently and totally disabled

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(M)
 Sunset Date: None
 Year Enacted: 1985

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$95	\$99	\$103	\$108
Total	\$95	\$99	\$103	\$108

DESCRIPTION: Taxpayers may exclude from adjusted gross income up to \$5,200 in disability payments, provided that (1) they were permanently and totally disabled when they retired, (2) they had not reached the age required to retire under their employer’s regular (non-disability) retirement program as of the first day of the taxable year, and (3) their other income was less than \$15,000.

This provision does not apply to Social Security disability benefits, which are excluded from taxation under another provision of D.C. law (see tax expenditure #123, “Social Security benefits for the disabled”).

Virginia allows permanently and totally disabled taxpayers to exclude up to \$20,000 in disability plan income. Virginia taxpayers who claim the state’s age deduction for those over the age of 62 are not eligible for the exclusion. Maryland does not have a similar tax provision.

PURPOSE: The purpose of the subtraction is to maintain in D.C. law a provision of the U.S. Internal Revenue Code that was abolished by the Social Security Amendments of 1983, thereby preserving in local law a tax benefit to certain individuals with disability income.³⁷⁷

IMPACT: Permanently and totally disabled individuals who receive disability payments, are not eligible for their employer’s regular retirement plan, and meet the income standards benefit from this provision. Since tax year 2008 (the last year for which data were collected), about 126 taxpayers have claimed the subtraction.

Because of the income limit, the subtraction assists only low-income individuals and households. Moreover, the real value of the benefit has declined over time because the amount that can be excluded (\$5,200) as well as the limitation on other income (\$15,000) have not been adjusted for inflation or income growth.

³⁷⁷ Specifically, the federal government replaced disability income exclusion with a new credit for the permanently and totally disabled. Because a credit is not automatically mirrored in the D.C. income tax system, D.C. policymakers apparently decided to retain the disability income exclusion in local law.

**Income Tax
Subtractions**

119. Income of persons with a permanent and total disability

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(V)
 Sunset Date: None
 Year Enacted: 2005

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$604	\$630	\$656	\$684
Total	\$604	\$630	\$656	\$684

DESCRIPTION: A taxpayer who has been determined to have a permanent and total disability by the U.S. Social Security Administration may exclude up to \$10,000 from District of Columbia gross income if he or she (1) is receiving Supplemental Security Income or Social Security Disability, railroad retirement disability, or federal or District of Columbia government disability payments, and (2) has a household adjusted gross income of less than \$100,000.

Neither Maryland nor Virginia offers a similar exclusion, although Virginia allows permanently and totally disabled taxpayers to exclude up to \$20,000 in disability plan income.

PURPOSE: The purpose of this exclusion is to provide income support to people who cannot work due to a permanent and total disability.

IMPACT: People with a permanent and total disability benefit from this provision. During tax year 2008 (the last year for which data were collected), 680 tax filers claimed this subtraction. Since 2008 about 680 tax filers have continued to claim the subtraction. As shown in the table below, the benefits accrue almost entirely to low-to-moderate income taxpayers: tax filers with income of \$50,000 or less accounted for 90 percent of the total amount subtracted.

Income for people with a permanent and total disability -- 2008				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	136	20%	\$1,154	21%
\$1 to \$25,000	308	45%	\$2,566	46%
\$25,001 to \$50,000	159	23%	\$1,285	23%
\$50,001 to \$75,000	61	9%	\$475	9%
Over \$75,000	16	2%	\$89	2%
Total	680	100%	\$5,569	100%

Income Tax
Subtractions

120. Social security and railroad retirement benefits

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(L)
Sunset Date: None
Year Enacted: 1985

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$27,819	\$29,018	\$30,239	\$31,546
Total	\$27,819	\$29,018	\$30,239	\$31,546

DESCRIPTION: The District of Columbia exempts all railroad retirement benefits from the local income tax, a policy that goes beyond the federal policy of exempting a portion of railroad retirement benefits from the federal income tax (see tax expenditure #49, “Social Security and Railroad Retirement benefits”). Maryland and Virginia also exempt all railroad retirement benefits from the income tax. The estimate of forgone revenue shown above represents the incremental revenue loss resulting from the District’s decision to exempt the railroad retirement benefits that are subject to federal taxation.

Under the federal income tax, the portion of railroad retirement benefits that railroad workers would receive if they were instead covered by Social Security is taxed on the same basis as Social Security benefits. Specifically, up to 50 percent of Social Security benefits are taxable for taxpayers with income between \$25,000 and \$34,000 (single filers) or \$32,000 and \$44,000 (joint filers). Above those income ranges (\$34,000 for a single filer and \$44,000 for joint filers), up to 85 percent of Social Security benefits are subject to federal income tax.

In addition, non-Social Security equivalent benefits provided to railroad retirees, such as supplemental annuity benefits, are subject to federal income tax regardless of any other income that the retiree receives.

PURPOSE: The purpose of the subtraction is to help protect railroad retirement benefits as a source of income support, and to ensure equitable tax treatment of railroad retirement and Social Security benefits. Under D.C. law, all Social Security benefits are also exempt from the local income tax (see tax expenditure #121, “Social Security benefits for retired workers”).

IMPACT: Individuals receiving railroad retirement payments benefit from this subtraction. According to the Railroad Retirement Board, in the District of Columbia there are approximately 500 current beneficiaries of the railroad retirement program, who receive average benefits of \$597 per month.³⁷⁸ Because D.C. taxpayers report their railroad retirement and Social Security income on the same line of the income tax form, there are no data on the railroad retirement subtraction by income level.

³⁷⁸ U.S. Railroad Retirement Board, “Annual Railroad Retirement Act & Railroad Unemployment Insurance Act Data, Table B27: Retirement and Survivor Benefits in Current-Payment Status on September 30, 2014, by Class and State (amounts in thousands),” available at www.rrb.gov.

**Income Tax
Subtractions**

121. Social Security benefits for retired workers

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(L)
 Sunset Date: None
 Year Enacted: 1985

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	included in #120	included in #120	included in #120	included in #120
Total	included in #120	included in #120	included in #120	included in #120

DESCRIPTION: The District exempts all Social Security benefits from taxation, a policy that is more generous than the federal treatment of Social Security benefits (see tax expenditure #49, “Social Security and Railroad Retirement Benefits”). Under federal law, up to 50 percent of Social Security benefits are taxable for taxpayers with “provisional income” between \$25,000 and \$34,000 (single filers) or \$32,000 and \$44,000 (joint filers). Above those income ranges (\$34,000 for a single filer and \$44,000 for joint filers), up to 85 percent of Social Security benefits are subject to federal income tax.³⁷⁹

The estimate of forgone revenue represents the incremental revenue loss resulting from the District’s decision to exempt the Social Security benefits of retired workers that are subject to federal taxation. There are 30 other states that provide a full exemption of Social Security benefits from taxation, including Maryland and Virginia.³⁸⁰

PURPOSE: The purpose of the subtraction is to shield Social Security benefits from taxation and ensure that Social Security provides adequate income support to the elderly during their retirement.

IMPACT: Retired Social Security recipients benefit from this provision. Because D.C. taxpayers report railroad retirement and all types of Social Security income (for retirees, survivors and dependents, and the disabled) on the same line of the income tax form, there are no data on the subtraction for Social Security retirement benefits by income level.

The table on the following page shows the aggregate distribution of Social Security *and* railroad retirement subtractions by income group. Nevertheless, because almost two-thirds of the Social Security recipients in the District are retirees and the number of railroad retirement beneficiaries in the District is small (approximately 500), the distribution suggests that taxpayers with incomes of \$100,000 or less claim the bulk of the benefits of the subtraction. As of December 2014, there

³⁷⁹ Provisional income consists of federal adjusted gross income, tax-exempt interest, some foreign-source income, and one-half of Social Security benefits.

³⁸⁰ Wisconsin Legislative Fiscal Bureau, Individual Income Tax Provisions in the States pp. 3, 33, 56.

were 52,477 retired workers, 1,902 spouses of retired workers, and 770 children of retired workers receiving Social Security benefits in the District of Columbia.³⁸¹

The table below shows that 21,796 tax filers claimed the subtraction for Social Security or Railroad Retirement benefits in 2013. The number is lower than the numbers of recipients cited in the previous paragraph because those figures include all household members rather than tax filing units.

Social Security and Railroad Retirement Benefits -- 2013				
Income Category (AGI)	Number	Share	Amount (\$ in '000s)	Share
Breakeven or Loss	244	1%	\$2,379	1%
\$1 to \$25,000	3527	16%	\$15,207	5%
\$25,001 to \$50,000	6666	31%	\$62,283	22%
\$50,001 to \$75,000	3521	16%	\$49,399	17%
75,001 to \$100,000	2141	10%	\$35,228	12%
\$100,001 to \$150,000	2286	10%	\$43,144	15%
\$150,001 to \$200,000	1187	5%	\$25,198	9%
\$200,001 to \$500,000	1779	8%	\$43,552	15%
Over \$500,000	445	2%	\$12,076	4%
Total	21,796	100%	\$288,466	100%

Note: The table shows the income levels of Social Security beneficiaries (old-age, survivors and dependents, and disability benefits) as well as Railroad Retirement beneficiaries in 2013. Approximately two-thirds of these beneficiaries are Social Security old-age (retired worker) beneficiaries.

³⁸¹ U.S. Social Security Administration, *OASDI Beneficiaries by State and County, 2014*, SSA Publication No. 13-11954, released August 2015, p. 2.

Income Tax
Subtractions

122. Social Security benefits for survivors and dependents

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(L)
 Sunset Date: None
 Year Enacted: 1985

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	included in #120	included in #120	included in #120	included in #120
Total	included in #120	included in #120	included in #120	included in #120

DESCRIPTION: The District exempts all Social Security benefits from taxation, a policy that is more generous than the federal treatment of Social Security benefits. Under federal law, up to 50 percent of Social Security benefits are taxable for taxpayers with “provisional income” between \$25,000 and \$34,000 (single filers) or \$32,000 and \$44,000 (joint filers). Above those income ranges (\$34,000 for a single filer and \$44,000 for joint filers), up to 85 percent of Social Security benefits are subject to federal income tax.³⁸²

The estimate of forgone revenue represents the incremental revenue loss resulting from the District’s decision to exempt the Social Security benefits of survivors and dependents that are subject to federal taxation.

There are 30 other states that provide a full exemption of Social Security benefits from taxation, including Maryland and Virginia.³⁸³

PURPOSE: The purpose of the exclusion is to shield Social Security benefits from taxation and ensure that Social Security provides adequate income support to dependents and survivors.

IMPACT: Survivors and dependents who receive Social Security benefit from this provision. As of December 2014, there were 7,399 survivors receiving Social Security benefits in the District of Columbia.³⁸⁴

Because D.C. taxpayers report railroad retirement and all types of Social Security income (for retirees, survivors and dependents, and the disabled) on the same line of the income tax form, there are no data on the subtraction for Social Security survivors’ and dependents’ benefits by income level.

³⁸² Provisional income consists of federal adjusted gross income, tax-exempt interest, some foreign-source income, and one-half of Social Security benefits.

³⁸³ Wisconsin Legislative Fiscal Bureau, pp. 3, 33, 56.

³⁸⁴ U.S. Social Security Administration, OASDI Beneficiaries by State and County, 2014, Table 3, p. 4.

Income Tax
Subtractions

123. Social Security benefits for the disabled

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(L)
 Sunset Date: None
 Year Enacted: 1985

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	included in #120	included in #120	included in #120	included in #120
Total	included in #120	included in #120	included in #120	included in #120

DESCRIPTION: The District exempts all Social Security benefits from taxation, a policy that is more generous than the federal treatment of Social Security benefits. Under federal law, up to 50 percent of Social Security benefits are taxable for taxpayers with “provisional income” between \$25,000 and \$34,000 (single filers) or \$32,000 and \$44,000 (joint filers). Above those income ranges (\$34,000 for a single filer and \$44,000 for joint filers), up to 85 percent of Social Security benefits are subject to federal income tax.³⁸⁵

The estimate of forgone revenue represents the incremental revenue loss resulting from the District’s decision to exempt the Social Security disability benefits that are subject to federal taxation.

There are 30 other states that provide a full exemption of Social Security benefits from taxation, including Maryland and Virginia.³⁸⁶

PURPOSE: The purpose of the exclusion is to shield Social Security benefits from taxation and ensure that Social Security provides adequate income support to people with disabilities.

IMPACT: Social Security recipients with disabilities benefit from this provision. As of December 2014, there were 15,189 disabled workers, 11 spouses of disabled workers, and 592 children of disabled workers receiving Social Security benefits in the District of Columbia.³⁸⁷

Because D.C. taxpayers report railroad retirement and all types of Social Security income (for retirees, survivors and dependents, and the disabled) on the same line of the income tax form, there are no data on the subtraction for Social Security disability benefits by income level.

³⁸⁵ Provisional income consists of federal adjusted gross income, tax-exempt interest, some foreign-source income, and one-half of Social Security benefits.

³⁸⁶ Wisconsin Legislative Fiscal Bureau, pp. 3, 33, 56.

³⁸⁷ U.S. Social Security Administration, OASDI Beneficiaries by State and County, 2014, Table 3, p. 4.

**Income Tax
Subtractions**

124. Rental assistance to police officers

District of Columbia Code: D.C. Official Code § 42-2902
 Sunset Date: None
 Year Enacted: 1993

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	minimal	minimal	minimal	minimal
Total	minimal	minimal	minimal	minimal

Note: “Minimal” means that the forgone revenue is estimated as less than \$50,000 per year, although precise data are lacking.

DESCRIPTION: Metropolitan Police Department (MPD) officers are eligible to receive discounted rent from public and private housing providers in the District of Columbia. The D.C. Housing Authority (DCHA) is also required by law to offer public housing units at a discounted rent to MPD officers, with priority given to officers who already live in the District. The discounted rent received by officers is not counted as income in calculating District of Columbia income tax liability.

An officer who receives discounted rent must notify the Chief of Police of the terms of the discount and provide a copy of the lease or written agreement detailing the terms of the housing rental.

A review did not identify similar provisions offered in Maryland or Virginia.

PURPOSE: The purpose of this provision is to encourage MPD officers to live in the District of Columbia, particularly in public housing, and thereby promote safety and security in the communities where they live. The report on the legislation by the Council’s Committee on Housing stated that, “Effective community policing requires a police presence in our community ... Police officers who live in our community serve as a positive role model for our children, build a closer rapport with our residents, and their mere presence increases public safety.”³⁸⁸

IMPACT: MPD officers, and the communities where they reside, are the intended beneficiaries of this provision. According to DCHA, three MPD officers lived at DCHA properties and received discounted rent in 2013. DCHA has not returned requests for an updated number and no data were available on the number of officers receiving the benefit at private properties. The estimated revenue loss is minimal (less than \$50,000 per year) because of the low utilization of this provision.

³⁸⁸ Council of the District of Columbia, Committee on Housing, Report on Bill 10-325, the “District of Columbia Metropolitan Police Housing Assistance Program and Community Safety Act of 1993,” July 20, 1993, p. 2.

Income Tax
Subtractions

125. Compensatory damages awarded in a discrimination case

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(U) and § 47-1806.10
Sunset Date: None
Year Enacted: 2002

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$34	\$35	\$37	\$38
Total	\$34	\$35	\$37	\$38

DESCRIPTION: A taxpayer may exclude from District of Columbia gross income a court award intended to compensate him or her for the pain and suffering associated with unlawful employment discrimination. The exclusion does not apply to back pay, front pay (future wages), or punitive damages.³⁸⁹ A review did not identify similar provisions offered in Maryland or Virginia.

PURPOSE: The purpose of the subtraction is to preserve the full value of the awards that are intended to compensate individuals for the pain and suffering associated with unlawful employment discrimination.

IMPACT: Individuals who have won an employment discrimination suit or received a monetary settlement of an employment discrimination claim benefit from this provision. Since tax year 2008 (the last year for which data were collected), 36 tax filers who were distributed fairly evenly across the income scale, claimed the subtraction.

³⁸⁹ D.C. law provides that damages pertaining to back pay and front pay are to be averaged over the period of back and future wages involved. This spreading of back pay and front pay protects the taxpayers from having to pay a large lump sum in taxes in one year, and avoids the perverse result in which a taxpayer could be pushed into a higher tax bracket due to the award of back pay and front pay.

**Income Tax
Subtractions**

126. Poverty lawyer loan assistance

District of Columbia Code: D.C. Official Code § 47-1803.02(a)(2)(X)
 Sunset Date: None
 Year Enacted: 2007

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$44	\$44	\$44	\$44
Total	\$44	\$44	\$44	\$44

DESCRIPTION: Loans that are awarded and subsequently forgiven through the District of Columbia Poverty Lawyer Loan Assistance Repayment Program (LRAP) can be excluded from District of Columbia gross income.

LRAP is intended to encourage law students and attorneys to practice in areas of civil law deemed to serve the public interest. Participants, who practice law in the designated areas, live in the District of Columbia, have an individual annual adjusted gross income of less than \$81,955 or a joint annual adjusted gross income of less than \$184,955,³⁹⁰ and exhaust all other loan assistance opportunities, can receive loans to repay the debt incurred while obtaining a law degree. The loans are forgiven when the participant completes his or her service obligation. The maximum amount of loan repayment assistance is \$1,000 per month and \$60,000 per participant.

The District of Columbia Bar Foundation administers LRAP on behalf of the Deputy Mayor for Public Safety and Justice, who oversees the program. The Bar Foundation determines which areas of legal practice qualify for LRAP. According to the Bar Foundation, LRAP provided \$332,905 in loan repayment assistance awards to 72 civil legal aid lawyers who represent low-income DC residents in FY2015. Additionally, the average participant in 2015 owed \$144,059 in educational debt, \$142,933 in law school or bar study debt only, and had a salary of \$55,950. The average LRAP award in 2015 was \$5,927.³⁹¹

PURPOSE: The purpose of this subtraction is to encourage attorneys to enter public-interest work and thereby expand access to legal services for low-income residents.

IMPACT: LRAP participants benefit from this provision, as do the organizations and clients who receive legal services from the participants. Since tax year 2008 (the last year for which data were available), about 44 tax filers claimed the subtraction. Organizations that have employed program participants include the Legal Aid Society of the District of Columbia, Legal Counsel for the Elderly, Washington Legal Clinic for the Homeless, and the Whitman-Walker Health Legal Services Program.

³⁹⁰ The income ceiling will be increased by 3 percent on October 1 of each year. The next increase will take effect on October 1, 2016. See D.C. Official Code § 4-1704.03(4).

³⁹¹ These data are from www.dcbfoundation.org.

Income Tax

Credits

127. Qualified high-technology companies: business income tax exemption and reduction

District of Columbia Code: D.C. Official Code § 47-1817.06

Sunset Date: None

Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$16,891	\$17,651	\$18,446	\$19,276
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$16,891	\$17,651	\$18,446	\$19,276

Note: The estimated revenue loss shown in the table above covers *all* of the business tax credits available to qualified high-technology companies (QHTCs) because they are combined into one sum in the District's tax database. In other words, the revenue loss applies to this tax expenditure as well as #127 - #131.

DESCRIPTION: High-technology companies are eligible for a credit that eliminates business franchise taxes for five years and thereafter reduces the rate to 6 percent. The general tax rate for the corporation and the unincorporated business franchise taxes is 9.2 percent.

For a business that was certified as a qualified high-technology company (QHTC) before January 1, 2012, the five-year tax exemption begins when the company commenced business in the District of Columbia. For a business that was certified as a QHTC on or after January 1, 2012, the five-year tax exemption is applicable from the date that the company has taxable income. The total amount of exemptions that a QHTC may receive shall not exceed \$15 million.

A high-technology company is considered "qualified" if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies. The business tax credits are part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the "New E-conomy Transformation Act of 2000."³⁹²

Neither Maryland nor Virginia offers a comparable business tax reduction, but each state offers an array of incentives to technology firms which are described under tax expenditure #110, "Qualified high-technology companies: depreciable business assets."

PURPOSE: The purpose of the credit is to encourage high-technology firms to locate, expand, and stay in the District of Columbia, thereby strengthening the employment and economic base.

³⁹² The other incentives, which include special depreciation rules, employment credits, property tax abatements, sales tax exemptions, and personal property tax exemptions, are discussed elsewhere in this section.

IMPACT: Qualified high-technology companies benefit from the tax credit, although there could also be spillover benefits in terms of greater employment and business activity. In tax year 2013, 136 companies qualified for the credit in the amount of \$27,953,118. The credit violates the principle of horizontal equity because firms in other industries do not receive similar tax relief.

The estimated revenue loss shown in the table on the previous page covers *all* of the business tax credits available to qualified high-technology companies (QHTCs) because they are combined into one sum in the District's tax database. In other words, the revenue loss applies to this tax expenditure as well as tax expenditures #127 - #131, which are described on the following pages. Nevertheless, the bulk of the revenue loss derives from the business income tax exemption and reduction, which is much more broad-based than the other business tax expenditures for QHTCs.

A study was conducted by Yi Geng , a fiscal analyst, with the Office of Revenue Analysis (ORA) on the impact of QHTCs on the District's economy. The study showed that the QHTC credit has a significant impact on payroll growth for QHTC companies staying in DC. The study additionally found that on the one hand, the District's tax law regarding the QHTC credit does not stipulate that a company must continue to do business in the District after the credit has been allowed, so that a significant number of companies certified as QHTC in one year ceased doing business in the District in the following years in the tracking period. On the other hand, for those certified QHTC companies that stayed in DC and continued to do business in the District, their DC payrolls grew much faster than their nationwide payrolls, while for comparable non-QHTC companies their DC payroll growth was slower than the nationwide payroll growth.

Income Tax
Credits

128. Qualified high-technology companies: employee relocation incentives

District of Columbia Code: D.C. Official Code § 47-1817.02
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	included in #127	included in #127	included in #127	included in #127
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	included in #127	included in #127	included in #127	included in #127

DESCRIPTION: A qualified high-technology company³⁹³ is authorized to claim business tax credits for the relocation costs paid to, or on behalf of, a qualified employee³⁹⁴ to reimburse actual moving expenses, to assist in financing the purchase of a home, or pay for the required security deposit or lease payments for the first year of a lease. The credit may not exceed \$5,000 per taxable year for each employee relocated to the District from another state, or \$7,500 per taxable year for each employee relocated to the District from another state if the employee also relocates his or her principal residence into the District.

A company may not claim the credit until it has relocated at least two qualified employees and employed them for at least six months in the District. The credit is not available for employees who work less than 35 hours per week, and the company may not claim the credit if it has claimed a deduction for the relocation costs. If the amount of the credit exceeds the amount otherwise due, a company may carry forward the unused amount of the credit for 10 years.

The employment relocation credits are part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the “New E-economy Transformation Act of 2000.”³⁹⁵ Neither Maryland nor Virginia offers relocation credits, but each state offers an array of incentives to

³⁹³ A qualified high-technology company must(1) have two or more employees in the District, and (2) derive at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies.

³⁹⁴ A qualified employee is someone who is employed in the District of Columbia by a high-technology company.

³⁹⁵ The other incentives, which include increased expensing of capital assets, a reduced corporate tax rate, property tax abatements, sales tax exemptions, and personal property tax exemptions, are discussed elsewhere in this section.

technology firms which are described under tax expenditure #110, “Qualified high-technology companies: depreciable business assets.”

PURPOSE: The purpose of the credit is to encourage high-technology companies to relocate, expand, and stay in the District of Columbia by ensuring that they can relocate key employees. In turn, the growth of the high-technology industry is intended to strengthen the District’s economic and employment base.

IMPACT: High-technology companies, and their employees who relocate to the District of Columbia, benefit from this provision. There may also be spillover benefits in terms of greater employment and business activity. However, the credit violates the principle of horizontal equity because firms in other industries with equivalent levels of income are not eligible for similar tax relief.

There is no separate estimate of forgone revenue for this credit because QHTC credits are combined into one sum in the tax database. The bulk of the credits reflect the preferential business tax rates offered to QHTCs (see tax expenditure #127).

Income Tax
Credits

129. Qualified high-technology companies: employment incentives

District of Columbia Code: D.C. Official Code § 47-1817.03
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	included in #127	included in #127	included in #127	included in #127
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	included in #127	included in #127	included in #127	included in #127

DESCRIPTION: A qualified high technology company is allowed a credit against its business tax liability equal to 10 percent of the wages paid during the first 24 calendar months of employment to a qualified employee hired after December 31, 2000. The credit for each qualified employee may not exceed \$5,000 per taxable year. If the credit exceeds the amount of tax otherwise due from a high-technology company, the unused amount of the credit may be carried forward for 10 years.

A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies. A qualified employee is a person who is employed in the District of Columbia by a qualified high-technology company.

The employment credits are part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the “New E-conomy Transformation Act of 2000.”³⁹⁶

Maryland offers a job creation tax credit for firms that create at least 60 new jobs (25 in a “priority funding area”), as well as tax credits for hiring people with disabilities, but these incentives are not specific to the high-technology sector (or any other sector). Virginia provides a major business facility tax credit for firms that create at least 50 new jobs (25 new jobs for firms in economically distressed areas or enterprise zones) relative to a base year, as well as a green job creation tax credit and a clean fuel vehicle job creation tax credit, but once again, the incentives are not targeted at the high-technology sector.

PURPOSE: The purpose of the credit is to encourage the growth of high-technology industries and high-technology employment in the District of Columbia, and thereby strengthen the District’s economic base.

³⁹⁶ The other incentives, which include increased expensing of capital assets, a reduced corporate tax rate, property tax abatements, sales tax exemptions, and personal property tax exemptions, are discussed elsewhere in this section.

IMPACT: High-technology companies in the District of Columbia benefit from this provision. There may also be spillover benefits in terms of greater employment and business activity. However, the credit violates the principle of horizontal equity because firms in other industries with equivalent levels of income are not eligible for similar tax relief.

There is no separate estimate of forgone revenue for this credit because QHTC credits are combined into one sum in the tax database. The bulk of the credits reflect the preferential business tax rates offered to QHTCs (see tax expenditure #127).

Income Tax
Credits

130. Qualified high-technology companies: incentives to employ disadvantaged workers

District of Columbia Code: D.C. Official Code § 47-1817.05
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	included in #127	included in #127	included in #127	included in #127
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	included in #127	included in #127	included in #127	included in #127

DESCRIPTION: A qualified high technology company may take credits against its franchise tax liability equal to 50 percent of the wages paid to a qualified disadvantaged employee during the first 24 calendar months of employment. The credit may not exceed \$15,000 in a taxable year for each disadvantaged employee, and the credit is not allowable if the company accords the qualified employee lesser benefits or rights than it accords other employees in similar jobs. If the amount of the allowable credit exceeds the tax otherwise due, the company may carry forward the unused amount of the credit for 10 years.

A qualified disadvantaged employee refers to a District of Columbia resident who is receiving benefits from the Temporary Assistance to Needy Families (TANF) program; was a recipient of TANF in the period immediately preceding employment; was released from incarceration within 24 months of being hired by a qualified high-technology company; or qualifies for the Welfare-to-Work Tax Credit or the Work Opportunity Tax Credit under the U.S. Internal Revenue Code³⁹⁷.

A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies. The employment credits are part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the “New E-conomy Transformation Act of 2000.”³⁹⁸

Maryland offers tax credits to employers who hire people with disabilities, but this incentive is not specific to the high-technology sector (or to any other sector). Virginia provides a tax credit

³⁹⁷ D.C. Official Code § 47-1817.04.

³⁹⁸ The other incentives, which include increased expensing of capital assets, a reduced corporate tax rate, property tax abatements, sales tax exemptions, and personal property tax exemptions, are discussed elsewhere in this section.

of up to \$750 for hiring TANF recipients (for businesses with 100 employees or less), but once again the incentive is not limited to the high-technology sector. As of 2014 however, no taxpayers claimed the Credit for Certain Employers Hiring Recipients of Temporary Assistance for Needy Families (“TANF”) in Virginia during the past 5 years³⁹⁹.

PURPOSE: The purpose of the credit is to encourage high-technology companies to employ and retain disadvantaged workers.

IMPACT: Disadvantaged workers in the District of Columbia benefit from this tax credit, as do high-technology companies that employ the workers. However, the credit violates the principle of horizontal equity because firms in other industries with equivalent levels of income are not eligible for similar tax relief.

There is no separate estimate of forgone revenue for this credit because QHTC credits are combined into one sum in the tax database. The bulk of the credits reflect the preferential business tax rates offered to QHTCs (see tax expenditure #127).

³⁹⁹ Commonwealth of Virginia Department of Taxation, Jan. 10, 2014 available at [http://leg2.state.va.us/dls/h&sdocs.nsf/fc86c2b17a1cf388852570f9006f1299/30471ad3a974078885257b34006188e9/\\$FILE/RD53.pdf](http://leg2.state.va.us/dls/h&sdocs.nsf/fc86c2b17a1cf388852570f9006f1299/30471ad3a974078885257b34006188e9/$FILE/RD53.pdf).

Income Tax
Credits

131. Qualified high-technology companies: incentives to retrain disadvantaged workers

District of Columbia Code: D.C. Official Code § 47-1817.04
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	included in #127	included in #127	included in #127	included in #127
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	included in #127	included in #127	included in #127	included in #127

DESCRIPTION: A qualified high technology company may take a credit against its franchise tax liability for the expenditures paid or incurred during the taxable year for retraining a qualified disadvantaged employee. The credit cannot exceed \$20,000 for each qualified disadvantaged worker during the first 18 months of employment. If the credit exceeds the amount of tax otherwise due from the company, the unused amount of the credit may be carried forward for 10 years, or can be taken as a refundable credit in an amount up to 50 percent of the credit.

A qualified disadvantaged employee retraining expenditures which are eligible for the tax credit include tuition, costs, or fees for credit or noncredit courses leading to academic degrees or certification of professional, technical, or administrative skills taken at District-based accredited colleges or universities or the cost for formal enrollment in training programs offered by nonprofit training providers (including community or faith-based organizations certified for the provision of training or job-readiness preparation at skill levels suitable for immediate performance of entry-level jobs), in demand among technology companies and information and telecommunications companies.

A qualified disadvantaged employee refers to a District of Columbia resident who is receiving benefits from the Temporary Assistance to Needy Families (TANF) program; was a recipient of TANF in the period immediately preceding employment; was released from incarceration within 24 months of being hired by a qualified high-technology company; or qualifies for the Welfare-to-Work Tax Credit or the Work Opportunity Tax Credit under the U.S. Internal Revenue Code.

A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies. The retraining credits are

part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the “New E-conomy Transformation Act of 2000.”⁴⁰⁰

Virginia provides a non-refundable worker retraining tax credit of up to 30% of all classroom training costs but is limited to up to \$200 annual credit per student if the course work is incurred at a private school or \$300 per qualified employee with retraining in a STEM or STEAM discipline.⁴⁰¹ The worker retraining tax credit is not targeted at the high-technology sector or at disadvantaged workers. Maryland does not provide tax incentives for worker retraining.

PURPOSE: The purpose of the credit is to encourage high-technology companies to invest in the skills of disadvantaged workers and thereby to help disadvantaged workers attain better jobs with higher wages and more potential for advancement within the high-technology sector.

IMPACT: Disadvantaged workers in the District of Columbia benefit from this tax credit, as do high-technology companies that employ the workers. However, the credit violates the principle of horizontal equity because firms in other industries with equivalent levels of income (and training costs) are not eligible for similar tax relief.

There is no separate estimate of forgone revenue for this credit because QHTC credits are combined into one sum in the tax database. The bulk of the credits reflect the preferential business tax rates offered to QHTCs (see tax expenditure #127).

⁴⁰⁰ The other incentives, which include increased expensing of capital assets, a reduced corporate tax rate, property tax abatements, sales tax exemptions, and personal property tax exemptions, are discussed elsewhere in this section.

⁴⁰¹ For classes taken at a private school, Virginia limits the annual credit to \$200 per student (\$300 per student if the student is undergoing training in science, technology, engineering, or mathematics).

Income Tax
Credits

132. First-time home purchase for D.C. government employees

District of Columbia Code: D.C. Official Code § 42-2506
 Sunset Date: March, 2015
 Year Enacted: 2000

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$180	\$144	\$108	\$72
Total	\$180	\$144	\$108	\$72

DESCRIPTION: District government employees and public charter school employees, as well as individuals who have accepted an offer to serve as a District of Columbia police officer, firefighter, emergency medical technician, public school teacher, or public charter school teacher, are eligible for a \$2,000 income tax credit in the year that they buy a home in the District and the following four years. To receive the credit, the individual must be a first-time homebuyer in the District and remain a District of Columbia resident. Any portion of the credit that is not used in a tax year cannot be carried forward, carried back, or refunded.

When first-time homebuyer credits were first authorized in 2000, only police officers were eligible, but the law was amended in 2007 to include the other groups of employees listed above. A review did not identify any similar homeownership benefits for government employees in Maryland or Virginia.

In December 2013 the D.C. Tax Revision Commission, an expert advisory panel chaired by former Mayor Anthony Williams, recommended repealing the first-time homebuyer credit for D.C. government employees. The Commission contended that repealing this tax expenditure (and several others) would promote horizontal equity and that tax relief targeted to particular activities or groups would be less necessary if the Commission’s proposal to increase the standard deduction and personal exemption were adopted.⁴⁰²

D.C law 21-36 and 20-155 repealed the law for home purchases with a closing date of after March 30, 2015. District government employees that took advantage of the benefit prior to March 2015 will continue to benefit from the tax credit program provided that the employee remains eligible for the tax credit.

PURPOSE: The purpose of the credit is to aid in the recruitment and retention of highly qualified employees (particularly teachers, police officers, firefighters, and emergency medical technicians); to strengthen the District of Columbia’s economic and tax base; and to encourage employees to live in the District and become engaged in its civic and neighborhood life.

⁴⁰² See www.dctaxrevisioncommission.org.

IMPACT: District government employees, as well as individuals who have accepted an offer to serve as a District of Columbia police officer, firefighter, and emergency medical technician, or teacher, benefit from this tax credit. As noted above, there may also be spillover benefits for District of Columbia neighborhoods and the District economy. Although the credit could aid in efforts to recruit highly-qualified employees, the forgone revenue could also have been used to increase employee pay or benefits. The credit violates the principle of horizontal equity because only some groups of new homebuyers are eligible.

During tax year 2013, 98 tax filers claimed the credit. As shown in the table below, the benefits were concentrated on middle-income households. Tax filers with incomes from \$25,001 to \$75,000 claimed 68 percent of the benefits.

First Time Home Purchase for D.C. Government Employees -- 2013				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	1	1%	\$2	1%
\$1 to \$25,000	4	4%	\$8	4%
\$25,001 to \$50,000	28	29%	\$54	28%
\$50,001 to \$75,000	39	40%	\$78	40%
\$75,001 to \$100,000	10	10%	\$20	10%
\$100,001 to \$150,000	11	11%	\$22	11%
\$150,001 to \$200,000	4	4%	\$8	4%
Over \$200,000	1	1%	\$2	1%
Total	98	100%	\$194	100%

Income Tax
Credits

133. Lower-income, long-term homeownership

District of Columbia Code: D.C. Official Code § 47-1806.09 - § 47-1806.09f
 Sunset Date: None
 Year Enacted: 2002

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$4	\$4	\$4	\$4
Total	\$4	\$4	\$4	\$4

DESCRIPTION: The District offers a lower-income, long-term homeowner credit to residents with a household income equal to or less than 50 percent of the area median income who own an eligible residence (one that receives the homestead deduction) as a principal place of residence and have resided in that home for at least seven consecutive years. Eligible homeowners get a credit on their District of Columbia income tax equal to the difference between the current real property tax bill and 105 percent of their real property tax bill in the prior year.

The credit is refundable, meaning that the taxpayer can get a check for any amount by which the credit exceeds his or her income tax liability. Because household income determines eligibility, this means that the income of anyone who shares the housing – even someone who is unrelated to the taxpayer – counts toward the 50 percent median income cap. To claim the credit, taxpayers must fill out Schedule L, the “Lower Income Long-Term Homeowner Credit.”

In tax year 2015, the household income limits ranged from \$38,250 for a single-person household to \$72,100 for a household of eight people or more.

A review did not identify any tax relief provisions targeted at long-term homeowners in Maryland or Virginia.

PURPOSE: The purpose of the credit is to protect lower-income, long-term homeowners in the District of Columbia from rapid increases in real property taxes that could force them to sell their homes and possibly to leave the District.

IMPACT: Lower-income, long-term homeowners in the District of Columbia benefit from this provision. In tax year 2013, 70 tax filers claimed the credit. The credit violates the principle of horizontal equity because lower-income homeowners who have not resided in the same home as a principal place of residence for seven years do not qualify for similar tax relief.

Income Tax**Credits****134. Property tax circuit breaker**

District of Columbia Code: D.C. Official Code § 47-1806.06
 Sunset Date: None
 Year Enacted: 1977

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$15,477	\$16,373	\$17,320	\$18,322
Total	\$15,477	\$16,373	\$17,320	\$18,322

DESCRIPTION: The District’s property tax circuit breaker program (also known as “Schedule H”) has been revised substantially, effective in tax year 2014. The program allows low-income homeowners and renters to claim a property tax credit that is applied to the taxpayer’s income tax liability. To qualify, the taxpayer must have been a D.C. resident throughout the taxable year. The credit is refundable; if the amount of the credit exceeds tax liability, the taxpayer receives the excess amount in the form of a refund.

The annual income eligibility threshold is \$50,000 per tax filing unit (the limit is \$60,000 for persons over the age of 70), and is adjusted annually for inflation based on the consumer price index. The decision not to use household income to determine eligibility is important because taxpayers will no longer have to count the income of anyone who shares their housing – even someone who is unrelated – when applying for the program. Using the income of the tax filing unit (a single person or a family, in essence) expands eligibility and also reduces the administrative complexity of the program.

For homeowners, the credit equals the amount by which a homeowner’s property tax bill exceeds a set percentage of household income (the relevant percentage varies with income), up to a maximum amount of \$1,000. The maximum credit is adjusted annually for inflation.

For renters, an imputed property tax payment is used to calculate his or her credit. The imputed tax payment is 20 percent of total rent payments. The renter receives a credit equal to the amount by which his or her imputed property tax payment exceeds a percentage of household income, up to a maximum amount of \$1,000. The maximum credit is also adjusted annually for inflation.

The program is known as a “circuit breaker” because it stops tax liability from increasing once it reaches a certain percentage of income. According to the Institute on Taxation and Economic Policy, all but 16 states offered a circuit breaker program in 2011.⁴⁰³ In many states, the circuit breaker is available only to the elderly.

⁴⁰³ Informing the Debate Over Tax Policy Nationwide “Property Tax Circuit Breakers”, Institute on Taxation and Economic Policy (September 2011), p. 1.

Maryland also offers a circuit breaker program. Homeowners with household income up to \$60,000 can claim a credit on taxes that result from the first \$300,000 in assessed value. Renters can also qualify for a credit of up to \$750 based on the assumption that 15 percent of their rent is used to pay property tax. Virginia does not have a circuit-breaker program.

PURPOSE: The purpose of the credit is to enhance income security for residents whose property taxes are high relative to their income, such as elderly residents on fixed incomes. Although the tax relief is provided through the income tax system, it is based on the amount by which an individual or family's property tax bill exceeds a specified percentage of income.

IMPACT: Low- to moderate-income individuals and families who own or rent a home in the District of Columbia that serves as their primary place of residence are the main beneficiaries of this credit. During tax year 2013, 6,876 tax filers claimed the credit, but that number will rise substantially as the eligibility expands and the maximum credit rises, beginning in tax year 2014. As shown in the table, the credit has been targeted at low-income residents: 100 percent of the credits were claimed by tax filers with incomes below \$20,000 in 2013.

Property tax circuit breaker - 2013				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	906	13%	\$582	14%
\$1 to \$5,000	1,122	16%	\$684	17%
\$5,001 to \$10,000	1,475	21%	\$868	22%
\$10,001 to \$15,000	1,777	26%	\$1,021	25%
\$15,001 to \$20,000	1,596	23%	\$860	21%
Total	6,876	100%	\$4,015	100%

Income Tax
Credits

135. Earned income tax credit

District of Columbia Code: D.C. Official Code § 47-1806.04(f)
Sunset Date: None
Year Enacted: 2000

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$65,096	\$66,543	\$67,751	\$68,930
Total	\$65,096	\$66,543	\$67,751	\$68,930

DESCRIPTION: An individual who receives a federal earned income tax credit (EITC) is eligible for a District of Columbia EITC equal to 40 percent of the federal credit. The credit is refundable, meaning that if the taxpayer’s credit exceeds his or her D.C. income tax liability, he or she receives the balance in the form of a refund.

Working families with children who have annual incomes below \$39,131 to \$53,267 (depending on marital status and number of children) generally are eligible for the federal EITC and investment income of \$3,400 or less for the year. In addition, low-income workers without children who have incomes below \$14,820 (\$20,330 for a married couple) can receive a very small federal EITC.⁴⁰⁴ In the District however, the amount of the credit allowable to a low-income worker without a child must not exceed the credit percentage of the earned income amount, over the phase-out percentage of 8.48% of the adjusted gross income (or, if greater, the earned income) for the taxable year that exceeds the phase out amount of \$ 17,235, increased annually by the cost-of-living adjustment⁴⁰⁵. The EITC has a phase-in range where the credit increases along with earnings, then hits a plateau where the credit remains constant, and then has a phase-out range where the credit falls to zero. The maximum credit amounts for FY 2015 are: 6,242 with three or more qualifying children, \$5,548 with two qualifying children, \$3,359 with one qualifying child, and \$503 with no qualifying children.

The American Recovery and Reinvestment Act (ARRA) of 2009 also revised the federal EITC by providing a larger subsidy for families with three or more children and increasing benefits for married couples in order to reduce a “marriage penalty.” Although the ARRA expansions were originally adopted only for 2009 and 2010, Congress extended the provisions through the end of tax year 2017. Those changes are mirrored in the D.C. EITC.

The D.C. EITC is additionally available to non-custodial parents between the ages of 18 and 30 who are in compliance with a court order for child support payments. Because these taxpayers

⁴⁰⁴ 2015 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates, available at <https://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit/EITC-Income-Limits-Maximum-Credit-Amounts>.

⁴⁰⁵ D.C. government extended the earned income tax credit to include single workers at the recommendation of the D.C Tax revision Commission (May 2014) available at <http://www.dctaxrevisioncommission.org/>.

are not eligible for the federal EITC, they must fill out an additional form (Schedule N, “Non-Custodial Parent EITC Claim”) to claim the D.C. EITC. Taxpayers cannot claim both the D.C. EITC and the low-income credit (see tax expenditure #136 for a description of the low-income credit).

The majority of states (23 of 41) with a broad-based income tax also offer their own EITCs, including Maryland and Virginia. The District’s 40 percent refundable EITC is the most generous in the nation.⁴⁰⁶ Maryland offers taxpayers the choice of a 25 percent refundable EITC or a 50 percent non-refundable EITC. In April 2014 the Maryland legislature passed a bill to increase the state EITC to 28 percent of the federal credit over four years, which the governor signed into law. The Maryland refundable EITC schedule is as follows: 25.5 percent in 2015, 26 percent in 2016, 27 percent in 2017 and 28 percent thereafter. Virginia provides a 20 percent non-refundable EITC.

Montgomery County, Maryland, is one of several localities to offer an EITC. Although Montgomery County’s EITC was originally designed to equal the taxpayer’s state EITC, the percentage was reduced due to budget shortfalls and is set at 95 percent for tax year 2014. The county EITC is scheduled to return to 100 percent of the state EITC in tax year 2015.

PURPOSE: The purpose of the credit is to promote self-sufficiency among low-income workers, thereby reducing poverty and welfare dependency.

IMPACT: Low-income individuals and families benefit from the credit. During tax year 2013, 58,493 tax filers claimed the D.C. EITC. Tax filers with income between \$10,000 and \$20,000 received 51 percent of the total share of the credit, as shown in the table below. This is consistent with the structure of the credit, which reaches its maximum at an annual income of \$9,880 for families with one child and \$13,870 for families with two or more children in 2015.

Researchers have found that the EITC leads to significant increases in employment among single mothers while not reducing labor supply among those who were already in the labor market.⁴⁰⁷ One estimate is that the EITC lifted 2.5 million children out of poverty nationwide in 2005, more than any other government program.⁴⁰⁸ Proponents also note that the EITC is easy to administer; no additional bureaucracy is needed to deliver benefits. The Center on Budget and Policy Priorities notes that, “States with EITCs report very low administrative costs with the credit – typically less than 1 percent – which means that nearly every dollar a state spends on the EITC goes to the working families in need of help.”⁴⁰⁹

⁴⁰⁶Erica Williams and Michael Leachman, “States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Economy,” Center on Budget and Policy Priorities, January 30, 2014, pp. 4-5.

⁴⁰⁷ Nada Eissa and Hilary Hoynes, “Redistribution and Tax Expenditures: The Earned Income Tax Credit,” *National Tax Journal* (64)(2, Part 2), June 2011, p. 704.

⁴⁰⁸ Ibid, p. 690.

⁴⁰⁹ Center on Budget and Policy Priorities, “Policy Basics: State Earned Income Tax Credits,” January 2, 2014, p. 2.

Earned Income Tax Credit - 2013				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	894	2%	\$264	0.4%
\$1 to \$10,000	17647	30%	\$10,444	18%
\$10,001 to \$20,000	20982	36%	\$30,253	51%
\$20,001 to \$30,000	11126	19%	\$13,671	23%
\$30,001 to \$40,000	6687	11%	\$3,899	7%
Greater than \$40,000	1157	2%	\$324	1%
Total	58,493	100%	\$58,855	100%

Income Tax
Credits

136. Low-income credit

District of Columbia Code: D.C. Official Code § 47-1806.04(e)
Sunset Date: None
Year Enacted: 1987

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2017
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$1,880	\$1,880	\$1,880	\$1,880
Total	\$1,880	\$1,880	\$1,880	\$1,880

DESCRIPTION: A taxpayer qualifies for a low-income credit if he or she meets the following requirements: (1) the taxpayer files a federal tax return and his or her federal tax before credits and payments is zero, (2) the taxpayer’s federal adjusted gross income is less than the sum of his or her federal personal exemptions and federal standard deduction, and (3) the taxpayer’s amount of taxable income on the form D-40 is more than zero.

For tax year 2015, the credit ranged from \$91 to \$1,392, depending on the taxpayer’s filing status and number of personal exemptions. The credit is non-refundable, which means that the credit reduces the amount of D.C. tax that is owed, but does not result in a tax refund if the credit exceeds the amount of income tax liability. Taxpayers cannot claim both the D.C. earned income tax credit and the low-income credit (see tax expenditure # 135 for a description of the earned income tax credit).

Maryland provides a non-refundable “poverty-level credit” to taxpayers with earned income and Maryland adjusted gross income below the federal poverty standards. The credit equals the lesser of the state income tax paid or 5 percent of the taxpayer’s earned income. Similarly, Virginia offers a non-refundable “credit for low-income individuals” for taxpayers with Virginia adjusted gross income that falls below the federal poverty level. The credit cannot exceed \$300 for each person claimed as a personal exemption on the Virginia tax return, and taxpayers who claim certain other exemptions or deductions, such as the additional personal exemption for the blind or elderly, are not eligible for the low-income credit.

In December 2013 the D.C. Tax Revision Commission, an expert advisory panel chaired by former Mayor Anthony Williams, recommended repealing the low-income credit because it would not be necessary if the Commission’s proposal to increase the standard deduction and personal exemption were adopted.⁴¹⁰

PURPOSE: The purpose of the low-income credit is to eliminate income tax liability for poor households. This goal is achieved by making the District’s income tax threshold equal to the federal income tax threshold. The “tax threshold” is defined as “the point at which a taxpayer

⁴¹⁰ See www.dctaxrevisioncommission.org.

begins to owe income tax after allowance of the standard deduction and all personal exemptions to which the taxpayer is entitled, but before application of any itemized deductions or credits.”⁴¹¹

IMPACT: D.C. taxpayers who do not have any federal tax liability benefit from this credit. During tax year 2013, 10,719 tax filers claimed the credit. Tax filers with income between \$5,000 and \$15,000 claimed 56 percent of the total credits, as shown in the table below.

The credit is particularly likely to benefit low-income individuals and families who cannot qualify for the EITC because they have little or no earnings (such as retirees). In addition, the low-income credit may particularly benefit low-income childless adults, who receive much smaller EITC benefits than families with children.

Low Income Credit - 2013				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	111	1%	\$39	2%
\$1 to \$5,000	933	9%	\$75	4%
\$5,001 to \$10,000	6,145	57%	\$715	38%
\$10,001 to \$15,000	1,653	15%	\$338	18%
\$15,001 to \$20,000	1,183	11%	\$397	21%
Greater than \$20,000	694	6%	\$316	17%
Total	10,719	100%	\$1,880	100%

⁴¹¹ See D.C. Official Code § 47-1806.4(e)(1).

Income Tax

Credits

137. Farm to food donations (personal income tax)

District of Columbia Code: D.C. Official Code § 47-1806.14

Sunset Date: None

Year Enacted: 2015

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	no estimate	no estimate	no estimate	no estimate
Total	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: A taxpayer can claim a nonrefundable tax credit per year for food commodity donations. Food commodity includes vegetables, fruits, grains, mushrooms, honey, herbs, nuts, seeds, or rootstock grown in the District by urban farming or a community garden. The donated food must not be damaged, out-of-condition, nor of a condition that would be considered unfit for human consumption under District or federal law or regulations.

The credit can equal 50% of the value of the contribution and must not exceed \$ 2,500 per taxpayer per tax year. In the case that the tax credit exceeds a taxpayer's tax liability, the excess amount of the tax credit can be carried forward consecutively for up to 5 tax years. A taxpayer claiming the tax credit must provide adequate documentation supporting the tax credit claim preapproved by the Chief Financial Officer.

Neither Maryland nor Virginia offer tax incentives for food commodities donated to shelters and food banks. Virginia currently has a bill in the legislative session that would create a tax credit equal to 30 percent of the fair market value of such donations (not to exceed \$5,000) for farmers who donate to food banks. If the bill is passed, the credit would become available July, 2016 and would last through 2020.⁴¹²

PURPOSE: The intent of this tax expenditure is to encourage urban farming, improve access to fresh and healthy food in the District, and the productive use of District property.

IMPACT: Food banks and shelters will benefit from the increased food donations received from individuals due to the credit. Additionally, citizens that receive food from the shelters benefit because they have increased access to healthier food choices.

⁴¹² Farm Bureau of Virginia, available at https://vafarmbureau.org/News-Video/News-Headlines/articleType/ArticleView/articleId/2060/Bill_would_create_tax_credit_for_farmers_who_donate_to_food_banks.

Income Tax
Credits

138. Farm to food donations (business income tax)

District of Columbia Code: D.C. Official Code §47-1807.12 and §47-1808.12
Sunset Date: None
Year Enacted: 2015

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	no estimate	no estimate	no estimate	no estimate
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: A business can claim a nonrefundable tax credit per year for food commodity donations. Food commodity includes vegetables, fruits, grains, mushrooms, honey, herbs, nuts, seeds, or rootstock grown in the District by urban farming or a community garden. The donated food must not be damaged, out-of-condition, nor of a condition that would be considered unfit for human consumption under District or federal law or regulations.

The credit can equal 50% of the value of the contribution and must not exceed \$ 5,000 per taxpayer per tax year. In the case that the tax credit exceeds a taxpayer's tax liability, the excess amount of the tax credit can be carried forward consecutively for up to 5 tax years. A taxpayer claiming the tax credit must provide adequate documentation supporting the tax credit claim preapproved by the Chief Financial Officer.

Neither Maryland nor Virginia offer tax incentives for food commodities donated to shelters and food banks. Virginia currently has a bill in the legislative session that would create a tax credit equal to 30 percent of the fair market value of such donations (not to exceed \$5,000) for farmers who donate to food banks. If the bill is passed, the credit would become available July, 2016 and would last through 2020.⁴¹³

PURPOSE: The intent of this tax expenditure is to encourage urban farming, improve access to fresh and healthy food in the District, and the productive use of District property.

IMPACT: Food banks and shelters will benefit from the increased food donations received from individuals due to the credit. Additionally, citizens that receive food from the shelters benefit because they have increased access to healthier food choices.

⁴¹³ Farm Bureau of Virginia, available at https://vafarmbureau.org/News-Video/News-Headlines/articleType/ArticleView/articleId/2060/Bill_would_create_tax_credit_for_farmers_who_donate_to_food_banks.

Income Tax
Credits

139. Child and dependent care

District of Columbia Code: D.C. Official Code § 47-1806.04(c)
 Sunset Date: None
 Year Enacted: 1977

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$12,078	\$12,078	\$12,078	\$12,078
Total	\$12,078	\$12,078	\$12,078	\$12,078

DESCRIPTION: An individual who receives a federal child and dependent care tax credit, as authorized by section 21 of the U.S. Internal Revenue Code (26 U.S.C. § 21), is eligible for a District of Columbia income tax credit equal to 32 percent of the federal credit. The credit is not refundable (it cannot exceed the amount of the individual’s tax liability).

The U.S. Internal Revenue Code limits the credit to care provided for a dependent child under the age of 13, or a spouse or certain other dependents who are incapable of self-care. The care must have been provided in order that the taxpayer, and his or her spouse if the taxpayer is married, can work or look for work. The individual receiving the care must have lived with the taxpayer for at least half of the year. The value of the federal credit ranges from 20 percent to 35 percent (declining as income rises) of dependent care expenses of up to \$3,000 for one qualifying individual and \$6,000 for two or more qualifying individuals.

The expenses qualifying for the credit must be reduced by the amount of any employer-provided dependent care benefits that the taxpayer excluded from his or her gross income.

Maryland offers a child and dependent care tax credit similar to the District’s: single filers with income up to \$20,500 and joint filers with income up to \$41,000 receive credits equal to 32.5 percent of the federal credit which are phased out near the top of the eligibility scale. The Maryland credit is gradually phased out over income ranges of \$20,501 to \$25,000 (single filers) and \$41,001 to \$50,000 (joint filers). Maryland also allows single filers to deduct up to \$3,000 and joint filers to deduct up to \$6,000 in actual child and dependent care expenses.⁴¹⁴ Virginia does not provide a child and dependent care credit, but allows taxpayers who qualify for the federal credit to deduct up to \$3,000 in care expenses for one dependent and up to \$6,000 for two or more dependents.

PURPOSE: The purpose of the credit is to assist families in paying for child and dependent care so that a parent or caretaker may work or look for work.

⁴¹⁴ The Maryland credit does not affect a taxpayer’s eligibility for or amount of the state tax subtraction for child-care costs.

IMPACT: Individuals and families eligible for the federal child and dependent care tax credit benefit from the D.C. credit. During tax year 2013, 16,844 tax filers claimed the credit. Urban Institute researchers have noted that, “Because the credit is nonrefundable, under current law the high credit rates remain elusive. Those for whom the highest credit rates apply rarely owe taxes, and as a result they rarely receive any benefit from this provision.”⁴¹⁵ The same pattern would apply to the District’s credit because it follows the federal rules.

Child and Dependent Care Credit - 2013				
Income Category (AGI)	Number	Share	Amount (\$ in 000s)	Share
Breakeven or Loss	22	0.1%	\$14	0.1%
\$1 to \$5,000	107	1%	\$64	0.5%
\$5,001 to \$10,000	294	2%	\$190	2%
\$10,001 to \$15,000	675	4%	\$700	6%
\$15,001 to \$20,000	1149	7%	\$1,134	9%
Greater than \$20,000	14597	87%	\$9,977	83%
Total	16,844	100%	\$12,078	100%

⁴¹⁵ Elaine Maag, Stephanie Rennane, and C. Eugene Steuerle, “A Reference Manual for Child Tax Benefits,” Urban-Brookings Tax Policy Center, Discussion Paper No. 32, April 2011, p. 13.

Income Tax
Credits

**140. Alternative fuel vehicle conversion and infrastructure credit
(personal income tax)**

District of Columbia Code: D.C. Official Code § 47-1806.13 and § 47-1806.12
Sunset Date: None
Year Enacted: 2015

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$661	\$842	\$1,078	\$1,078
Total	\$661	\$842	\$1,078	\$1,078

DESCRIPTION: An individual can claim a nonrefundable credit in the amount of 50% of the equipment and labor costs directly attributable to the purchase and installation of alternative fuel storage and dispensing or charging equipment on a qualified alternative fuel vehicle refueling property or in a qualified private residence. The maximum credit that can be claimed is \$ 1,000 per vehicle charging station for a qualified private residence, and \$10,000 per qualified alternative fuel vehicle refueling property or vehicle charging station for a qualified alternative fuel vehicle refueling property.

The equipment and labor cost to claim the credit cannot include any land purchases (or land access) to be used as a qualified alternative fuel vehicle refueling property, purchase of an existing qualified alternative fuel vehicle refueling property, or construction or purchase of any structure. The credit claimed cannot exceed the taxpayer's tax liability for the year. If the amount of the tax credit exceeds the tax liability, the excess amount of the credit can be rolled over for up to 2 tax years

A nonrefundable tax credit of 50% of the labor costs directly attributable to the cost of converting a motor vehicle licensed in the District that operates on petroleum diesel or petroleum derived gasoline to a motor vehicle that operates on an alternative fuel can be claimed by a tax filer with a maximum credit of \$19,000 per vehicle.

Alternative fuel is fuel used to power a motor vehicle that include at least 85% ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, biodiesel (not kerosene), electricity provided by a vehicle-charging station, or hydrogen.⁴¹⁶ The tax credit is available until December 31, 2026.

Federal Income Tax Credits exist for the installation of alternative fuel systems. The infrastructure development provision was part of the 2005 Energy Policy Act and provides a 30% federal income tax credit, up to \$30,000 per property, to install alternative fuel dispensing systems.

⁴¹⁶ § 47-1806.12

Maryland has an electric vehicle supply equipment rebate program for EVSE purchase and installation of 50% of cost up to \$900. The qualified EVSEs must be placed in service on or after July 1, 2014, but before June 30, 2017. Individuals are limited to one (1) rebate. Virginia currently does not have any incentives.

PURPOSE: The legislation aims to radically transform the fuel options available in the District with initiatives that would facilitate a rapid advance in the diversity of fuel sources available in the District.

IMPACT: DC residents will benefit from the credit as the tax expenditure will transform the available fuel options for District residents, allowing them to choose cleaner, greener options for fueling their vehicles.

Income Tax

Credits

**141. Alternative fuel vehicle conversion and infrastructure credit
(business income tax)**

District of Columbia Code: D.C. Official Code § 47-1807.10 and § 47-1807.11
 Sunset Date: None
 Year Enacted: 2015

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	no estimate	no estimate	no estimate	no estimate
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: A corporation can claim a nonrefundable credit in the amount of 50% of the equipment and labor costs directly attributable to the purchase and installation of alternative fuel storage and dispensing or charging equipment on a qualified alternative fuel vehicle refueling property or in a qualified private residence.

The equipment and labor cost to claim the credit cannot include any land purchases (or land access) to be used as a qualified alternative fuel vehicle refueling property, purchase of an existing qualified alternative fuel vehicle refueling property, or construction or purchase of any structure. The credit claimed cannot exceed the taxpayer's tax liability for the year. If the amount of the tax credit exceeds the tax liability, the excess amount of the credit can be rolled over for up to 2 tax years

A nonrefundable tax credit of 50% of the labor costs directly attributable to the cost of converting a motor vehicle licensed in the District that operates on petroleum diesel or petroleum derived gasoline to a motor vehicle that operates on an alternative fuel can be claimed by a tax filer with a maximum credit of \$19,000 per vehicle.

Alternative fuel is fuel used to power a motor vehicle that include at least 85% ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, biodiesel (not kerosene), electricity provided by a vehicle-charging station, or hydrogen. The tax credit is available until December 31, 2026.

Maryland has an electric vehicle supply equipment rebate program for EVSE purchase and installation of 50% of cost up to \$900. The qualified EVSEs must be placed in service on or after July 1, 2014, but before June 30, 2017. Individuals are limited to one (1) rebate. Virginia currently does not have any incentives.

PURPOSE: The legislation aims to radically transform the fuel options available in the District with initiatives that would facilitate a rapid advance in the diversity of fuel sources available in the District.

IMPACT: DC residents will benefit from the credit as the tax expenditure will transform the available fuel options for District residents, allowing them to choose cleaner, greener options for fueling their vehicles.

REAL PROPERTY TAX

**Real Property Tax
Abatements**

142. New or improved buildings used by high-technology companies

District of Columbia Code: D.C. Official Code § 47-811.03
 Sunset Date: None
 Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$37	\$37	0	0

DESCRIPTION: Two types of non-residential or mixed-use buildings are eligible for a freeze on property taxes for a five-year period, if more than 50 percent of the tenants are qualified high-technology companies, or at least 50 percent of the aggregate square footage is leased to a qualified high-technology company using the premises as an office or retail space.

First, new buildings which received their initial certificate of occupancy after December 31, 2000, are eligible for the property tax freeze. In addition, existing buildings that were improved in order to adapt or convert the property for use by a qualified high-technology company are also eligible for the tax abatement.

A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies. The property tax abatements are part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the “New E-conomy Transformation Act of 2000.”⁴¹⁷

During tax year 2015, one property in the District of Columbia received the tax abatement for leasing space to a QHTC, and the Office of Tax and Revenue reports that the abatement on that property will last through the end of tax year 2016 (FY2017). The revenue loss estimated for FY 2016 to 2019 is based on the assumption only the one property will receive this abatement.

Prince George’s County offers a real property tax credit for businesses that are involved primarily in high-technology manufacturing, fabrication, assembling, or research and development, and have (1) made at least a \$500,000 investment in 5,000 square feet or more of real property that is newly constructed or substantially renovated, and (2) create at least 10 new full-time positions over a period of three years. The credit offsets the property tax arising from any increase in the firm’s real property assessment in the first year and is then phased out over the next four years.

PURPOSE: The purpose of the abatement is to ensure that high-technology companies have adequate space and to protect property owners against sharp increases in their tax liability that

⁴¹⁷ The other incentives, which include increased expensing of capital assets, a reduced corporate tax rate, employment credits, sales tax exemptions, and personal property tax exemptions, are discussed elsewhere in this section.

may accompany the development or conversion of space for use by high-technology companies. More generally, the tax abatement is intended to encourage the growth of high-technology companies in the District of Columbia and thereby expand the District's economy and employment base.

IMPACT: High-technology companies in the District of Columbia, as well as the property owners who lease space to high-technology companies, are the intended beneficiaries of this provision. The abatement violates the principle of horizontal equity because property owners renting to tenants that are not qualified high-technology companies are not eligible for similar tax relief.

**Real Property Tax
Abatements**

143. Non-profit organizations locating in designated neighborhoods

District of Columbia Code: D.C. Official Code § 47-857.11 - § 47-857.16
 Sunset Date: None
 Year Enacted: 2010

(Dollars in thousands)	FY 2017	FY 2018	FY 2018	FY 2019
Revenue Loss	\$153	\$153	\$153	\$153

DESCRIPTION: Non-profit organizations,⁴¹⁸ as well as property owners who lease office space to non-profits, can qualify for real property tax abatements for a period of 10 years if they are located in an “eligible non-profit zone.” The authorizing statute defines five non-profit zones and allows the Mayor to designate additional zones, which must be approved by act of the Council.

Eligible non-profits or property owners can receive a real property tax abatement of \$8 per square foot for 10 consecutive years if they: (1) purchase or lease 5,000 square feet of office space, (2) occupy at least 75 percent of the space, (3) purchase or lease the space at the market rate, and net of any real estate taxes, (4) do not receive any other real property tax abatement or tax-increment financing for the office space, and (5) occupy the new space by September 30, 2013, if located in the Capitol Riverfront, Mount Vernon Triangle, or NOMA zones, or by September 30, 2016, if located in the Anacostia zone, the Minnesota-Benning zone, or a zone designated by the Mayor.

Eligible non-profits or property owners cannot claim the abatement for more than 100,000 square feet of office space, and the annual abatement cannot exceed their real property tax liability. The total annual abatement is capped at \$500,000, and the total abatement for each zone over 10 years is capped as follows: \$600,000 for the Anacostia zone, \$2.6 million for the Capitol Riverfront zone, \$800,000 in zones designated by the Mayor; \$600,000 in the Minnesota-Benning zone, \$1.2 million in the Mount Vernon Triangle zone, and \$2.6 million in the NOMA zone. Non-profits must apply to the Mayor and receive a certification of eligibility in order to claim an abatement.

PURPOSE: The purpose of the abatement is “to provide an incentive for (non-profits) to locate their offices in emerging commercial neighborhoods of the District of Columbia.”⁴¹⁹

IMPACT: Eligible non-profits and property owners who lease space to the non-profits benefit from the abatements. Two non-profits, the American Iron and Steel Institute at 25 Massachusetts Avenue, N.W., and Case Western Reserve, at 820 First Street, N.E., have been approved for the abatements,⁴²⁰ but there are no plans to approve additional abatements at this time.

⁴¹⁸ For purposes of this program, eligible non-profit organizations are those that are exempt from federal income tax under sections 501(c)(3), (4), and (6) of the U.S. Internal Revenue Code.

⁴¹⁹ See Title 10-B, Section 6300.1 of the D.C. Municipal Regulations.

⁴²⁰ Although the Office of Revenue Analysis normally does not provide tax information about specific individuals or organizations, D.C. Official Code § 47-1001 allows disclosure of tax-exempt properties.

**Real Property Tax
Abatements**

144. New residential developments

District of Columbia Code: D.C. Official Code § 47-857.01 - § 47-857.10
 Sunset Date: None
 Year Enacted: 2002

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$1,540	\$1,346	\$1,134	\$520

DESCRIPTION: The Mayor is authorized to grant up to \$8 million annually in real property tax abatements for new residential developments. The tax abatement for any eligible property expires at the end of the 10th tax year after the tax year in which a certificate of occupancy is issued for the property. An eligible property must be improved by new structures or undergo rehabilitation, and have 10 or more units devoted to residential use.

The \$8 million annual limit is divided among projects in three areas: (1) \$2.5 million in tax abatements for new housing projects and new mixed-income housing projects downtown, (2) \$2 million in tax abatements for new housing projects and new mixed-income housing projects in Housing Priority Area A (“Mount Vernon Square North”), and (3) \$3.5 million in tax abatements for new, mixed-income housing projects in other parts of the District of Columbia, which includes a set-aside of up to \$500,000 for real property located in square 2910.⁴²¹

Recipients of the tax abatements include the “Mass Court Apartments” at 300 Massachusetts Avenue, N.W., the “Meridian at Gallery Place” apartments at 450 Massachusetts Avenue, N.W., the “Quincy Court” condominium at 1117 10th Street, N.W., and “The Residences at Georgia Avenue” at 4100 Georgia Avenue, N.W.

The amount of tax relief varies according to the location of the property and other factors, such as the type of construction and the percentage of affordable housing units. The rules governing the program are set forth in Title 10-B, Chapter 59 of the D.C. Municipal Regulations. The Office of the Deputy Mayor for Planning and Economic Development administers the program.

A property that receives a tax abatement for vacant rental housing (see tax expenditure #224) or receives tax-increment financing is not eligible for the new residential development abatements.

PURPOSE: The regulations state that the program’s purpose is “to provide tax abatements as incentives for the production of new housing downtown and for the production of affordable, mixed-income housing in high-cost areas of the District of Columbia.”⁴²²

⁴²¹ Square 2910 is bounded by Kansas Avenue, Upshur Street, Georgia Avenue, and Taylor Street in Northwest D.C.

⁴²² See Title 10-B, Section 5900 of the D.C. Municipal Regulations.

IMPACT: The tax abatements are intended to deliver broad-based benefits by promoting the growth of mixed-income communities with commercial and residential uses, thereby strengthening the District’s economic and tax base.⁴²³ In particular, the downtown and Mount Vernon Square North areas are targeted beneficiaries of the program. During FY 2014, 16 properties received abatements through this program.

The revenue loss declines during the FY 2016-2019 period because some properties are reaching the end of the 10-year eligibility period. The abatements violate the principle of horizontal equity because similar developments in other parts of the city do not qualify for equivalent tax relief.

⁴²³ This summary draws on the Council of the District of Columbia, Committee on Finance and Revenue, “Committee Report on Bill 14-183, the ‘HomeStart Financial Incentives Act of 2001,’” dated November 13, 2001.

**Real Property Tax
Abatements**

145. NoMA residential developments

District of Columbia Code: D.C. Official Code § 47-859.01 - § 47-859.05
 Sunset Date: None
 Year Enacted: 2009

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$5,000	\$5,000	\$5,000	\$5,000

DESCRIPTION: The Mayor is authorized to grant up to \$5 million annually and \$50 million in total real property tax abatements for new residential developments in the North of Massachusetts Avenue (NoMA) neighborhood of Wards 5 and 6. The tax abatement for any eligible property expires at the end of the 10th tax year after the tax year in which a certificate of occupancy is issued for the property. An eligible property must be improved by new structures or undergo rehabilitation, and have 10 or more units devoted to residential use.

The tax abatement is set at \$1.50 per residential floor-area ratio square foot, multiplied by the total square footage as certified by the project architect and the Mayor. The rules governing the program are set forth in Title 10-B, Chapter 62 of the D.C. Municipal Regulations. The Deputy Mayor for Planning and Economic Development administers the program.

A property that claims a tax abatement for vacant rental housing (see tax expenditure #224) or receives tax-increment financing is not eligible for the NoMA abatements.

PURPOSE: The purpose of the abatements is to encourage new multi-family residential development in the NoMA neighborhood. Noting that residential development had slowed considerably due to a weakening economy and credit crunch, the Council’s Committee on Finance and Revenue stated in its report on the authorizing legislation that, “The tax abatement bill would give an incentive to new builders to break ground and create new residential development in the NoMA area. The tax incentives contained in the bill are modeled after the successful Housing Act of 2002.”⁴²⁴ (see tax expenditure #144, “New residential developments”).

IMPACT: Housing developers and residents of the new housing developments stand to benefit from the tax abatements, which are also intended to have broader benefits by strengthening the District’s economic and tax base. The abatements violate the principle of horizontal equity because similar developments in other parts of the city do not qualify for equivalent tax relief.

Nine developments receive this abatement (See table on following page). The revenue loss from the tax abatements will be constant until the first projects to receive the abatement reach their 10th year and after that the projected revenue loss will decrease.

⁴²⁴ Council of the District of Columbia, Committee on Finance and Revenue, Report on Bill 18-18, the “NoMA Residential Development Tax Abatement Act of 2009,” March 16, 2009, p. 2.

Table 1: Recipients of the NoMA Tax Abatement

Name of Development	Address	# of Units	Date confirmed	Total Tax Abated \$	Annual Tax Abatement \$
The Loree Grand	250 K St NE	212	09/2010	3,568,050	356,805
CS Residential 1	130 M St NE	440	03/2011	6,454,875	645,488
Archstone North Capitol Hill 1	1160 First St NE	469	05/2013	7,878,090	787,809
NoMA West Residential 1, LLC	150, 151, 200, 201, 251 Q Street NE	603	02/2014	8,432,580	843,258
CS Residential 2	140 M St NE	203	02/2014	2,581,785	258,179
NoMA West Residential, LLC	60 L St NE	321	02/2014	4,599,705	459,971
77H	77 H St NE	303	02/2014	4,241,850	424,185
Washington Gateway	100 Florida Ave NE	400	02/2015	5,153,265	515,327
Archstone North Capitol Hill 2	55 M St NE	436	Not yet confirmed as of 5/24/16	<u>7,089,800</u>	<u>708,980</u>
				50,000,000	5,000,002

Source: Information obtained from DMPED, May 24, 2016.

**Real Property Tax
Abatements**

146. Urban farming and food security

District of Columbia Code: D.C. Official Code § 42-868
Sunset Date: None
Year Enacted: 2014

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$341	\$289	\$286	\$284

DESCRIPTION: If a landowner uses, leases or allows it to be used by an unrelated party, for an agricultural purposes, 90 percent of the real property tax on the land value of the relevant portion of the real property can be abated for each real property tax year that the real property is actually used for an agricultural use. The land must produce a food commodity or put to another season-appropriate agricultural-related use (like providing cover cropping, a bee hive, or growing seedlings in a greenhouse).

Food commodity means vegetables, fruits, grains, mushrooms, honey, herbs, nuts, seeds, or rootstock grown in the District by urban farming, or by a community garden, that are intended to be used as food in its perishable state and are approved by regulatory authorities.

PURPOSE: The intent of this tax expenditure is to encourage urban farming, improve access to fresh and healthy food in the District, and the productive use of District property.

IMPACT: Property owners will benefit from the provision. Residents will also benefit from the provision because of the increase in healthy foods available in the District.

Real Property Tax Exemptions

147. Development of a qualified supermarket, restaurant or retail store

District of Columbia Code: D.C. Official Code § 47-1002(23)
 Sunset Date: None
 Year Enacted: 1988

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$6,140	\$6,263	\$6,389	\$6,516

DESCRIPTION: A qualified supermarket, restaurant or retail store is eligible for a real property tax exemption for 10 consecutive years beginning with the tax year in which a certificate of occupancy was issued for the development. Qualified supermarkets, restaurants, and retail stores must be located in census tracts where more than half of the households have incomes below 60 percent of the area median, as determined by the U.S. Department of Housing and Urban Development. The property must continue to be used for the original purpose in order to maintain the exemption.

If the real property is not owned by the supermarket, restaurant, or retail store, the owner of the property can qualify for the real property tax exemption (also valid for 10 years) if the owner leases the land or structure to the supermarket at a fair-market rent that is reduced by the amount of the tax exemption. The authorizing statute also provides that a qualifying supermarket, restaurant, or retail store that leases real property which is part of a larger development can receive a rebate from the D.C. government for its pro-rata share of the property tax paid, if the owner of the property has already paid the tax.

However, the authorizing statute provides that any new exemptions for a qualified restaurant, or retail store beginning on or after October 1, 2010, shall not be granted “until the fiscal effect of any such new exemptions is included in an approved budget and financial plan.”⁴²⁵

PURPOSE: The purpose of this exemption is to encourage the construction and operation of supermarkets, restaurants and retail stores in lower-income areas of the city.

IMPACT: Individuals and organizations that are constructing and operating supermarkets, restaurants, and retail stores in the target areas benefit from this provision, as do residents of these areas. Presently, 18 supermarkets and one restaurant claim the exemption⁴²⁶. The exemption violates the principle of horizontal equity because other businesses locating in the target areas do not receive a similar exemption. The estimates of forgone revenue shown above are based on past experience suggesting that an additional three supermarkets will qualify each year.

⁴²⁵ See D.C. Official Code § 47-3802(b)(1), as amended by D.C. Law 20-61, the “Fiscal Year 2014 Budget Support Act of 2013,” effective December 24, 2013.

⁴²⁶ Unified Economic Development Budget Report: Fiscal Year 2015 Year-End, March 2016, Appendix III.

Real Property Tax Exemptions

148. High-technology commercial real estate database and service providers

District of Columbia Code: D.C. Official Code § 47-4630
 Sunset Date: None
 Year Enacted: 2010

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$700	\$700	\$700	\$585

DESCRIPTION: Real property that is leased and occupied by a high-technology commercial real estate database and service provider qualifies for a 10-year exemption from the real property tax, subject to certain conditions. The real property must be located in an enterprise zone or a low- or moderate-income area, must have been occupied by December 31, 2010, and must continue to be occupied by the high-technology database and service provider. In addition, (1) the lease for the real property must last at least 10 years, (2) the tenant must employ a minimum of 250 employees in the District of Columbia, (3) the tenant must enter into an agreement with the Department of Small and Local Business Development about small and local business participation in any design, buildout, or improvement of the real property, and (4) the real property owner must pass the exemption through to the high-technology database and service provider.

To claim the exemption, the firm had to certify to the Department of Employment Services that it increased the number of new employees residing in the District of Columbia by at least 100, relative to a baseline employment level as of January 5, 2010. The firm must maintain employment at greater than the baseline level throughout the term of the abatement. The value of the exemption is capped at \$700,000 annually and at \$6,185,000 over 10 years.

PURPOSE: According to the Committee on Finance and Revenue report on the authorizing legislation, “The purpose of this legislation is to encourage business relocation into the District. The legislation will enable the attraction of a niche technology industry to the District.”⁴²⁷ The Office of the Deputy Mayor for Planning and Economic Development also expressed the view that the provision would increase employment, business activity, and tax revenue.⁴²⁸

IMPACT: The CoStar Group, which leases space at 1331 L Street, N.W., benefited from a \$700,000 exemption in tax years 2011, 2012, and 2013. Because the authorizing statute provides that the property must have been occupied by December 31, 2010, there will be no additional beneficiaries.

⁴²⁷ Council of the District of Columbia, Committee on Finance and Revenue, Report on Bill 18-476, the “High Technology Commercial Real Estate Database and Service Providers Tax Abatement Act of 2008,” November 24, 2009, p. 1.

⁴²⁸ Ibid, p. 3.

Real Property Tax Exemptions

149. Educational institutions

District of Columbia Code: D.C. Official Code § 47-1002(10)
Sunset Date: None
Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$124,128	\$124,748	\$125,372	\$125,999

DESCRIPTION: Buildings belonging to and operated by schools, colleges, or universities “which are not organized or operated for private gain, and which embrace the generally recognized relationship of teacher and student,” are exempt from real property taxation.

Exempting educational institutions from the real property tax is standard practice throughout the United States. Both Virginia and Maryland exempt educational institutions from real property taxation.

PURPOSE: The exemption supports a general policy of providing property tax exemptions to non-profit organizations that provide religious, charitable, social, scientific, literary, educational, or cultural benefits to the general public.

IMPACT: Educational institutions benefit directly from the exemption, which is also expected to provide broader societal benefits such as a better-informed citizenry and a more productive workforce. During tax year 2015, 472 properties received the educational institutions exemption.

Educational institutions account for 7.0 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴²⁹ The tax exemptions given to certain properties shift the burden of paying for public services to taxable properties and may result in those properties paying a higher property tax rate.

⁴²⁹ In tax year 2015, tax-exempt property of educational institutions was valued at almost \$6.6 billion. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax Exemptions

150. Libraries

District of Columbia Code: D.C. Official Code § 47-1002(7)
Sunset Date: None
Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$425	\$427	\$429	\$431

DESCRIPTION: Library buildings that belong to and are operated by organizations that are not organized or operated for private gain, and are open to the public generally, are exempt from real property taxation.

It is not clear whether private, non-profit libraries in other states are exempt from real property taxation. Libraries may qualify for real property exemptions granted to educational institutions or to art and cultural organizations, depending on the specific definitions of those categories in each state and how the statutory language has been interpreted.

PURPOSE: The exemption supports a general policy of providing property tax exemptions to non-profit organizations that provide religious, charitable, social, scientific, literary, educational, or cultural benefits to the general public.

IMPACT: Libraries benefit from the exemption, but there may be a wider social benefit because the libraries are open to the public and thereby provide opportunities for learning and enrichment to the general populace. Presently, the Folger Shakespeare Library is the only library that qualifies for this exemption.

Real Property Tax Exemptions

151. Embassies, chanceries, and associated properties of foreign governments

District of Columbia Code: D.C. Official Code § 47-1002(3)
 Sunset Date: None
 Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$49,298	\$49,544	\$49,792	\$50,041

DESCRIPTION: Property belonging to foreign governments and used for diplomatic purposes is exempt from real property taxation in the District of Columbia. To claim the exemption, a foreign government must send a diplomatic note to the U.S. Department of State’s Office of Foreign Missions, which submits the request for property tax exemption to the D.C. government along with a “Foreign Government Information Request Form” that is completed by the foreign government.⁴³⁰

Exempting embassies and chanceries from real property taxation is standard practice, but such property is concentrated in D.C. and New York City. Neighboring jurisdictions such as Montgomery County, Arlington County, and Fairfax County exempt the property of foreign governments from the real property tax.

PURPOSE: The purpose of the exemption is to uphold a principle of international law that foreign governments are entitled to a tax exemption for real property owned by the foreign government and used by its diplomatic mission. Any portion of the property that is not used for diplomatic or consular purposes is not exempt from the District’s real property tax.

IMPACT: Foreign governments that own embassies, chanceries, and associated properties in the District of Columbia benefit from this exemption. During tax year 2015, 600 properties received the exemption for embassies, chanceries, and associated properties of foreign governments. These properties account for 3.5 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴³¹

⁴³⁰ U.S. Department of State, Office of Foreign Missions, “Diplomatic Note 06-01,” dated April 12, 2006.

⁴³¹ In tax year 2015, tax-exempt property of foreign governments was valued at \$3.3 billion. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax Exemptions

152. Federal government property

District of Columbia Code: D.C. Official Code § 47-1002(1)
 Sunset Date: None
 Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$876,621	\$881,004	\$885,409	\$889,836

DESCRIPTION: Property belonging to the United States is exempt from real property taxation in the District of Columbia, “unless the taxation of same has been authorized by Congress.”⁴³²

PURPOSE: This exemption recognizes the federal government’s immunity from taxation by states or municipalities. This immunity has been established in numerous court decisions, beginning with *McCulloch v. Maryland*, 17 U.S. 316 in 1819, and has been reinforced in other cases including *Clallam County v. United States*, 263 U.S. 341 in 1923; *Cleveland v. United States*, 323 U.S. 329, 333 in 1945; *United States v. Mississippi Tax Commission*, 412 U.S. 363 in 1973; and *United States v. Mississippi Tax Commission*, 421 U.S. 599 in 1975.

IMPACT: The United States government benefits from this exemption. During tax year 2015, 2,783 properties received the federal government exemption. These properties account for 51.1 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴³³

⁴³² See D.C. Official Code § 47-1002(1).

⁴³³ In tax year 2015, tax-exempt property of the U.S. government was valued at \$47.5 billion. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax Exemptions

153. District of Columbia government property

District of Columbia Code: D.C. Official Code § 47-1002(2)
Sunset Date: None
Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$215,928	\$221,758	\$229,741	\$237,323

DESCRIPTION: “Property belonging to the District of Columbia and used for governmental purposes (as determined by the Mayor), unless otherwise provided by law” is exempt from taxation in the District of Columbia.⁴³⁴

PURPOSE: This exemption recognizes the District government’s exemption from its own property tax.

IMPACT: The District of Columbia benefits from this exemption. During tax year 2015, 2,481 properties received the District government exemption. These properties account for 14.4 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴³⁵

⁴³⁴ See D.C. Official Code § 47-1002(2).

⁴³⁵ In tax year 2015, tax-exempt property of the D.C. government was valued at \$13.4 billion. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax Exemptions

154. Miscellaneous properties

District of Columbia Code: Title 47 of the D.C. Official Code, Chapters 10 and 46
 Sunset Date: Varies⁴³⁶
 Year Enacted: Multiple years

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$122,654	\$123,267	\$123,884	\$124,503

DESCRIPTION: This tax expenditure includes (1) properties that qualify for a tax exemption based on multiple categories, and (2) individual properties that were granted statutory exemptions but did not fall into any of the other categories of tax-exempt property, such as non-profit educational institutions, non-profit hospitals, and charitable organizations. Real property exemptions for individual properties are found in Chapter 10 (“Property Exempt from Taxation”) and Chapter 46 (“Special Tax Incentives”) of Title 47 (“Taxation, Licensing, Permits, Assessments, and Fees”) of the D.C. Official Code.

An example of property that would qualify as exempt based on multiple categories is land owned by the Washington Metropolitan Area Transit Authority (which is tax-exempt) that is the site of a tax-exempt affordable housing development.

PURPOSE: The purpose of the exemptions is to reflect special circumstances that were determined to justify a real property tax exemption by the D.C. Council or the U.S. Congress.

IMPACT: The property owners who benefit from these tax exemptions represent a diverse array of organizations and commercial enterprises. During tax year 2015, 2,138 tax-exempt properties fell into the miscellaneous category. These properties account for 9.4 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴³⁷ The tax exemptions given to certain properties shift the burden of paying for public services to taxable properties and may result in those properties paying a higher property tax rate.

Examples of organizations that have been awarded individual tax exemptions include the National Geographic Society, the Brookings Institution, the American Chemical Society, the National Society of the Colonial Dames of America, the Young Men’s Christian Association, the National Education Association, the Woolly Mammoth Theatre Company, the Rosedale Conservatory, the Capitol Hill Community Garden Land Trust, the Heurich House Foundation, the Brentwood Retail Center, and the OTO Hotel at Constitution Square.

⁴³⁶ Some of the individual properties have sunset dates for their tax exemptions, but the more common restriction is that the exemption is valid so long as the property continues to be used for the same purpose as when the exemption was granted.

⁴³⁷ In tax year 2015, tax-exempt miscellaneous properties were valued at \$8.7 billion. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Several international organizations with tax-exempt property fall into this category, including the World Bank, International Monetary Fund, and the Inter-American Development Bank.

Real Property Tax Exemptions

155. Hospital buildings

District of Columbia Code: D.C. Official Code § 47-1002(9)
 Sunset Date: None
 Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$15,216	\$15,292	\$15,368	\$15,445

DESCRIPTION: Hospital buildings that belong to and are operated by organizations “which are not organized or operated for private gain” are exempt from real property taxation.⁴³⁸

Exempting non-profit hospitals from the real property tax is standard practice throughout the United States. Both Virginia and Maryland exempt non-profit hospitals from real property taxation, but Maryland’s exemption is limited to 100 acres of real property.

PURPOSE: The exemption supports a general policy of providing property tax exemptions to non-profit organizations that provide religious, charitable, social, scientific, literary, educational, or cultural benefits to the general public.

IMPACT: Non-profit hospitals benefit from the exemption, but the general public is also intended to benefit from this subsidy to hospital care. During tax year 2015, 11 properties received the hospital building exemption.

Hospitals account for 0.9 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴³⁹ The tax exemptions given to certain properties shift the burden of paying for public services to taxable properties and may result in those properties paying a higher property tax rate.

⁴³⁸ See D.C. Official Code § 47-1002(9).

⁴³⁹ In tax year 2015, tax-exempt property of hospitals was valued at \$857 million. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax Exemptions

156. Historic property

District of Columbia Code: D.C. Official Code § 47-842 - § 47-844
 Sunset Date: None
 Year Enacted: 1974

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$9	\$9	\$9	\$10

DESCRIPTION: The D.C. Council is authorized to grant tax relief to the owners of buildings that have been designated as historic by the Historic Preservation Review Board.⁴⁴⁰ The tax relief is provided through agreements between the D.C. government and the property owners lasting at least 20 years, in order to assure the continued maintenance of the historic buildings.

The authorizing statute provides that the agreements “shall, as a condition for tax relief, require reasonable assurance that such buildings will be used and properly maintained and such other conditions as the Council finds to be necessary to encourage the preservation of historic buildings.”⁴⁴¹ The D.C. government can seek recovery of back taxes, with interest, if the conditions for the exemption are not fulfilled.

Montgomery County provides a Historic Preservation Tax Credit against the real property tax, equal to 25 percent of the amount expended by the taxpayer for restoring or preserving a historic property. Both Maryland and Virginia offer state historic preservation tax credits against other taxes (personal income, corporate income, and insurance premiums taxes in both states, and the bank franchise tax in Virginia).

PURPOSE: The purpose of this provision is to protect historic buildings and landmarks in the District of Columbia; preserve the city’s historic, aesthetic, and cultural heritage; foster civic pride; and enhance the city’s attractiveness to visitors, thereby promoting economic development.

IMPACT: The owners of historic buildings receive the direct benefits of the tax relief, but there may be a broader benefit to D.C. residents from the preservation of the city’s cultural and social history, as well as neighborhood beautification and improvement.

In recent years, two properties have received partial tax exemptions due to their historical status, but one of the properties (the Washington Club at 15 Dupont Circle, N.W.) was recently sold and is to be renovated as a luxury apartment building. Therefore, the revenue loss estimate is based on the assumption that only the other property (the Potomac Boat Club at 3530 K Street, N.W.) will receive the exemption during the FY 2016-2019 period.⁴⁴²

⁴⁴⁰ Although the statute cites the Joint Committee on Landmarks of the National Capital as the designating authority, the Joint Committee was replaced by the Historic Preservation Review Board in 1978.

⁴⁴¹ See D.C. Official Code § 47-844.

⁴⁴² The Potomac Boat Club’s exemption extends through FY 2021.

Real Property Tax Exemptions

157. Homestead deduction

District of Columbia Code: D.C. Official Code § 47-850
 Sunset Date: None
 Year Enacted: 1978

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$58,443	\$59,027	\$59,617	\$60,213

DESCRIPTION: Taxpayers who live in their own home in the District of Columbia may take a homestead deduction that reduces the taxable value of their home. The homestead deduction is \$71,700 for tax year 2016. Annual cost-of-living adjustments to the homestead deduction were suspended for several years due to the budget crisis that resulted from the economic recession, but the adjustments resumed on October 1, 2012.

To qualify for the homestead deduction, a taxpayer must file an application with the Office of Tax and Revenue. Only homes with five or fewer dwelling units, including the unit occupied by the owner, are eligible. Taxpayers may not claim the deduction for more than one home.

Although neighboring jurisdictions in Maryland and Virginia provide a variety of property tax reductions to homeowners, they do not offer a provision similar to the District’s homestead deduction. Maryland offers a “circuit breaker” program that allows credits against a homeowner’s property tax bill if property taxes exceed a certain percentage of gross income.⁴⁴³ The Virginia Constitution authorizes localities to grant real property tax exemptions or deferrals to the elderly and disabled homeowners (subject to conditions established in statute by the Virginia General Assembly, but Virginia law does not allow a homestead exemption similar to the District’s). The Virginia Constitution also mandates that localities grant a real property tax exemption to veteran homeowners who are permanently and totally disabled, or to the surviving spouse of the veteran.

PURPOSE: The purpose of the homestead deduction is to encourage individuals to own and occupy homes in the District of Columbia and to provide tax relief to resident homeowners.

IMPACT: District of Columbia residents who own their home benefit from this provision. In tax year 2014, 95,819 owner-occupied residential properties received the homestead exemption. Mark Haveman and Terri Sexton point out that, “Exemptions and credits for specified dollar amounts will result in a greater percentage tax reduction for owners of low-value homes, while exemptions and credits for a percentage of value will provide a greater dollar savings to owners of high-value homes.”⁴⁴⁴

⁴⁴³ This credit is somewhat similar to the District’s “Schedule H” program, but in Maryland the credit is offered against the property tax bill.

⁴⁴⁴ Mark Haveman and Terri Sexton, “Property Tax Assessment Limits: Lessons from Thirty Years of Experience” Policy Focus Report PF018 of the Lincoln Institute of Land Policy, 2008, p. 33.

Real Property Tax Exemptions

158. Lower-income homeownership households and cooperative housing associations

District of Columbia Code: D.C. Official Code § 47-3503
 Sunset Date: None
 Year Enacted: 1983

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$9,761	\$9,809	\$9,858	\$9,908

DESCRIPTION: Certain property transferred to a “qualifying lower income homeownership household” is exempt from real property taxation. A qualifying lower-income homeownership household must meet two requirements: (1) household income can be no greater than 120 percent of the lower-income guidelines established for the Washington metropolitan area by the U.S. Department of Housing and Urban Development (HUD), and (2) the household must own the property in fee simple or receive at least a 5 percent qualified ownership interest as part of a shared equity financing agreement. The fair market value of the property being transferred cannot exceed 80 percent of the median sale price for homes in the District of Columbia.

As of March 28, 2016, the household income limits ranged from \$58,980 for a one-person household to \$111,120 for a household with eight or more people. The current limit on the purchase price of the home is \$408,000.

In addition, if there is a shared equity financing agreement in place, the renting household must receive a “credit against rent” that is equal to the value of the property tax exemption multiplied by the percentage of the household’s qualified ownership interest.

The real property tax exemption is valid until the end of the fifth tax year following the year in which the property was transferred. During the five-year period, the owner must continue to occupy the property. If the property is owned by a cooperative housing association, it must continue to rent at least 50 percent of the units to households that meet the income standard for a qualifying lower income homeownership household and benefit from the “credit against rent” requirement throughout the five-year period.

PURPOSE: The authorizing statute states that, “The purpose of this act is to expand homeownership opportunities for lower-income families to the maximum extent possible at the lowest possible cost to the District of Columbia.”⁴⁴⁵

IMPACT: Households with annual income no greater than 120 percent of the lower-income guidelines established for the Washington metropolitan area benefit from this exemption. There may be spillover benefits for society if homeownership leads to neighborhood improvement and stability by giving people a greater stake in their communities.

⁴⁴⁵ See D.C. Official Code § 47-3501(7).

**Real Property Tax
Exemptions**

159. Multi-family and single-family rental and cooperative housing for low- and moderate-income persons

District of Columbia Code: D.C. Official Code § 47-1002(20)
Sunset Date: None
Year Enacted: 1978

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$1,085	\$1,090	\$1,095	\$1,101

DESCRIPTION: Multi-family and single-family rental and cooperative housing, as well as individual condominium units, are exempt from the real property tax if they are rented to low- and moderate-income persons and qualify for at least one of the following federal programs: (1) the mortgage interest subsidy program for owners of rental housing projects for lower-income families, (2) the “Section 8” housing voucher program, (3) the rent supplement program for needy tenants, (4) the mortgage insurance program for moderate-income and displaced families, and (5) the supportive housing direct loan program for the low-income elderly.

PURPOSE: The purpose of this provision is to increase and maintain the stock of affordable housing in the District of Columbia.

IMPACT: Owners of housing that is rented to low- and moderate-income families benefit from this provision, as do their tenants.

Real Property Tax Exemptions

160. Nonprofit housing associations

District of Columbia Code: D.C. Official Code § 47-3505
 Sunset Date: None
 Year Enacted: 1983

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$10,845	\$10,899	\$10,954	\$11,008

DESCRIPTION: Property transferred to a qualifying non-profit housing association⁴⁴⁶ is exempt from the real property tax through the end of the third year in which the property was transferred, provided that the association certifies its intent to transfer the property to (1) a qualifying lower-income ownership household, (2) a multi-family housing property where at least 35 percent of the households are qualifying lower income ownership households, or (3) a cooperative housing association where at least 50 percent of the units are occupied by qualifying lower income ownership households and receive a “credit against rent.”⁴⁴⁷

A qualifying lower-income homeownership household must meet two requirements: (1) household income can be no greater than 120 percent of the lower-income guidelines established for the Washington metropolitan area by the U.S. Department of Housing and Urban Development (HUD), and (2) the household must own the property in fee simple or receive at least a 5 percent qualified ownership interest as part of a shared equity financing agreement. As of March 28, 2016, the household income limits ranged from \$58,980 for a one-person household to \$111,120 for a household with eight or more people.

Maryland exempts property owned by a non-profit housing corporation from the state real property tax.

PURPOSE: The authorizing statute states that, “The purpose of this act is to expand homeownership opportunities for lower-income families to the maximum extent possible at the lowest possible cost to the District of Columbia.”

IMPACT: Non-profit housing associations and the lower-income residents they assist in attaining homeownership benefit from this provision. There may be spillover benefits for society if homeownership leads to neighborhood improvement and stability by giving people a greater stake in their communities.

⁴⁴⁶ Specifically, an eligible non-profit housing association is one that is exempt from federal income tax under sections 501(c)(3) or 501(c)(4) of the U.S. Internal Revenue Code.

⁴⁴⁷ The credit against rent is equal to the value of the property tax exemption multiplied by the percentage of the household’s qualified ownership interest.

Real Property Tax Exemptions

161. Nonprofit affordable housing developers

District of Columbia Code: D.C. Official Code § 47-1005.02
 Sunset Date: None
 Year Enacted: 2012

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$400	\$500	\$550	\$600

DESCRIPTION: Non-profit affordable housing developers are allowed to maintain their real property tax exemption during the time that a project is under the restrictions of the federal low-income housing tax credit (LIHTC) program. The reason this exemption is necessary is because property developed through the LIHTC program is usually transferred to a private, for-profit subsidiary of the developer. Without this exemption, the non-profit organization would have to pay tax on property it is developing as affordable housing.

The LIHTC program was established by Congress in 1986 to provide the private market with an incentive to invest in affordable rental housing. Federal housing tax credits are awarded by state housing finance agencies to developers of qualified projects, who usually sell the credits to investors to raise capital or equity for their projects.⁴⁴⁸ The credit purchaser must be part of the property ownership entity; this transfer is usually accomplished by creating a limited partnership or limited liability company.

This approach reduces the debt that the developer would otherwise incur and thereby makes it possible for an affordable housing project to offer lower rents. If the project maintains compliance with LIHTC program requirements, investors receive a dollar-for-dollar credit against their federal tax liability for a 10-year period. Projects eligible for housing tax credits must meet low-income occupancy requirements.⁴⁴⁹

PURPOSE: The purpose of the exemption is to ensure that non-profit developers of affordable housing do not become subject to real property taxation when they participate in the LIHTC program.

IMPACT: The exemption supports the operations of a program that the D.C. Housing Finance Agency (which awards LIHTC credits in the District of Columbia) describes as one of the two primary long-term financing programs used to develop affordable multi-family rental housing projects.⁴⁵⁰

⁴⁴⁸ The developer typically sells the credit in order to raise up-front cash for the affordable housing project.

⁴⁴⁹ Developers are required to set aside at least 20 percent of their units for households with incomes at or below 50 percent of the area median, or at least 40 percent of their units for households at or below 60 percent of the area median (adjusted for family size).

⁴⁵⁰ See www.dchfa.org.

**Real Property Tax
Exemptions**

162. Correctional Treatment Facility

District of Columbia Code: D.C. Official Code § 47-1002(25)
Sunset Date: None
Year Enacted: 1997

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$3,523	\$3,629	\$3,738	\$3,850

DESCRIPTION: The Correctional Treatment Facility (CTF), located on Lot 804 of Square 1112, (1901 E Street, S.E.) is exempt from real property taxation as long as the facility on that site is used as a correctional facility housing inmates in the custody of the Department of Corrections (DOC).

The CTF, which houses all of DOC’s female and juvenile prisoners as well as some male prisoners who are a medium-security risk or lower, is owned and managed by the Corrections Corporation of America, which purchased the facility from the D.C. government in 1997 under a sale/leaseback arrangement that lasts for 20 years.

PURPOSE: The purpose of this provision is to maintain the tax-exempt status of the CTF following the change from government to private ownership.

IMPACT: The operators of the CTF benefit from this provision, which was offered as part of a larger agreement in which the D.C. government received up-front revenue from the sale of the CTF.

Real Property Tax Exemptions

163. Art galleries

District of Columbia Code: D.C. Official Code § 47-1002(6)
Sunset Date: None
Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$2,423	\$2,435	\$2,447	\$2,459

DESCRIPTION: Art gallery buildings belonging to and operated by “organizations which are not organized or operated for private gain” are exempt from real property taxation, provided that they are open to the public generally and do not charge admission more than two days per week.

Non-profit art and cultural organizations are exempt from real property taxation in Maryland and not in Virginia.

PURPOSE: The exemption supports a general policy of providing property tax exemptions to non-profit organizations that provide religious, charitable, scientific, literary, educational, or cultural benefits to the general public.

IMPACT: Art galleries benefit from the exemption, but there may be a wider social benefit because the galleries are open to the public and provide general cultural enrichment. At the same time, the tax exemptions given to certain properties shift the burden of paying for public services to taxable properties and may result in those properties paying a higher property tax rate.

Galleries or museums that benefit from this exemption include Decatur House, the Hillwood Estate, the Kreeger Museum, the Phillips Collection, and the National Museum for Women in the Arts. Many other galleries or museums are exempt through other provisions of the property tax code; for example, some are located on federal property and others have been exempted from real property taxation by a special act of Congress.

Real Property Tax Exemptions

164. Cemeteries

District of Columbia Code: D.C. Official Code § 47-1002(12)
Sunset Date: None
Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$6,358	\$6,389	\$6,421	\$6,453

DESCRIPTION: Cemeteries dedicated to and used solely for burial purposes and not organized or operated for private gain, including buildings and structures reasonably necessary and usual to the operation of a cemetery, are exempt from real property taxation.

Real property tax exemptions for non-profit cemeteries are standard nationwide. Both Maryland and Virginia exempt non-profit cemeteries from real property taxation.

PURPOSE: The exemption supports a general policy of providing property tax exemptions to non-profit organizations that provide religious, charitable, scientific, literary, educational, or social benefits to the general public.

IMPACT: Non-profit cemeteries benefit from the exemption, but there may be a wider social benefit as well.

During tax year 2015, 24 cemetery properties received this exemption. Cemeteries account for 0.4 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴⁵¹

⁴⁵¹ In tax year 2015, tax-exempt property of cemeteries was valued at \$353 million. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax Exemptions

165. Charitable organizations

District of Columbia Code: D.C. Official Code § 47-1002(8)
 Sunset Date: None
 Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$16,324	\$16,406	\$16,488	\$16,570

DESCRIPTION: Buildings belonging to and operated by institutions “which are not organized or operated for private gain,” and are used “for purposes of public charity principally in the District of Columbia,”⁴⁵² are exempt from real property taxation.

Real property exemptions for charitable organizations represent standard practice throughout the United States. Maryland and Virginia exempt charitable organizations from the real property tax.

PURPOSE: The exemption supports a general policy of providing property tax exemptions to non-profit organizations that provide religious, charitable, scientific, literary, educational, or cultural benefits to the general public.

IMPACT: Charitable organizations benefit directly from the exemption, which is also expected to provide broader societal benefits by encouraging the voluntary provision of social services. During tax year 2014, 468 properties received the charitable use exemption.

Some experts have pointed out that the exemption may be poorly targeted, because it favors charitable non-profits that own real estate, and may encourage some non-profits to invest more in real property than is optimal from the standpoint of maximizing social welfare (for example, the investment in real estate could come at the expense of an organization’s charitable mission itself).

Property owned by charitable organizations accounts for 1.2 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴⁵³ The tax exemptions given to certain properties shift the burden of paying for public services to taxable properties and may result in those properties paying a higher property tax rate.

⁴⁵² See D.C. Official Code § 47-1002(8).

⁴⁵³ In tax year 2015, tax-exempt property of charitable organizations was valued at \$1.1 billion. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax Exemptions

166. Churches, synagogues, and mosques

District of Columbia Code: D.C. Official Code § 47-1002(13)
 Sunset Date: None
 Year Enacted: 1942

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$67,350	\$67,686	\$68,025	\$68,365

DESCRIPTION: Churches, including buildings and structures reasonably necessary and usual in the performance of the activities of the church, are exempt from real property taxation. A church building is defined as a building “primarily and regularly used by its congregation for public religious worship.”⁴⁵⁴

In addition, the following types of property belonging to religious orders or societies are exempt from real property taxation: buildings belonging to religious corporations or societies primarily and regularly used for religious worship, study, training, and missionary activities; pastoral residences owned by a church and actually occupied by the church’s pastor, rector, minister, or rabbi (with a limit of one pastoral residence for any church or congregation); and Episcopal residences owned by a church and used exclusively as the residence of a bishop of the church.

Real property tax exemptions for churches, synagogues, mosques, and other places of religious worship are standard nationwide. Both Maryland and Virginia exempt churches, synagogues, and mosques from real property taxation.

PURPOSE: The exemption reflects a general policy of providing property tax exemptions to non-profit organizations that provide religious, charitable, scientific, literary, educational, or cultural benefits to the general public. More specifically, the exemption is intended to promote the free exercise of religion and respect the separation of church and state.

IMPACT: Churches, synagogues, mosques, and other places of worship benefit from the exemption, but the exemption is also intended to benefit society more broadly by promoting the free exercise of religion and the separation of church and state. During tax year 2015, there were 1,158 tax-exempt church properties. Property owned by churches, synagogues, and mosques accounts for 4.1 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴⁵⁵

⁴⁵⁴ See D.C. Official Code § 47-1002(13).

⁴⁵⁵ In tax year 2015, tax-exempt property of churches, synagogues, and mosques was valued at \$3.8 billion. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax Exemptions

167. Washington Metropolitan Area Transit Authority properties

District of Columbia Code: D.C. Official Code § 9-1107.01
 Sunset Date: None
 Year Enacted: 1966

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$9,732	\$9,781	\$9,830	\$9,879

DESCRIPTION: The Washington Metropolitan Area Transit Authority Compact establishes the rules that govern the operation and administration of the regional mass transit system, commonly known as “Metro.” The District of Columbia, the State of Maryland, and the Commonwealth of Virginia are signatories to the Compact. Article XVI (“General Provisions”), Section 78 of the Compact, exempts the Washington Metropolitan Area Transit Authority (WMATA) and its Board from all taxes or assessments on any property that WMATA owns or controls.

PURPOSE: As stated in the Compact, WMATA’s mission “is in all respects for the benefit of the people of the signatory states and is for a public purpose.”⁴⁵⁶ WMATA’s exemption from all taxes or assessments on its property helps WMATA fulfill its mission of improving transportation throughout the region, and extends to this regional organization the tax exemption that is provided to federal and local government property.

IMPACT: Residents of the Washington metropolitan area benefit from this tax exemption, as do the businesses and visitors who also rely on the Metro system, because the exemption allows WMATA to devote more of its resources to serving the public. Nevertheless, the tax exemption may reduce the costs of keeping land undeveloped.

During tax year 2015, there were 393 tax-exempt WMATA properties in the District of Columbia. These properties account for 0.6 percent of the total assessed value of tax-exempt property in the District of Columbia.⁴⁵⁷

WMATA has engaged in joint developments on its property, which augment the local tax base. For example, Metro sold land adjacent to the Georgia Avenue-Petworth Metrorail station that was developed as housing and retail space.

⁴⁵⁶ See Article XVI, Section 70 of the Washington Metropolitan Area Transit Authority Compact.

⁴⁵⁷ In tax year 2015, tax-exempt property of WMATA properties was valued at \$546 million. The total value of tax-exempt property in the District of Columbia was valued at \$93 billion.

Real Property Tax
Credits

168. First-time homebuyer credit for D.C. government employees

District of Columbia Code: D.C. Official Code § 42-2506
Sunset Date: 2015
Year Enacted: 2000

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$104	\$61	\$27	\$14

DESCRIPTION: District of Columbia government employees; employees of District of Columbia public charter schools; and individuals who have accepted an offer to be a District of Columbia police officer, firefighter, emergency medical technician, public school teacher, or public charter school teacher are eligible for property-tax credits if they are first-time homebuyers in the District of Columbia.

When first-time homebuyer credits were first authorized in 2000, only police officers were eligible, but the law was amended in 2007 to include the other groups of employees listed above.

The property-tax credit phases out over five years. In the first year, the credit equals 80 percent of property tax liability; in the second year, 60 percent; in the third year, 40 percent; and in the fourth and fifth years, 20 percent. The Fiscal Year 2016 Budget Support Act of 2015 repealed the credit so that only homes purchased before March 30, 2015 are eligible.

PURPOSE: The purpose of the credit is to provide a tool to recruit and retain qualified employees (particularly teachers, police officers, firefighters, and emergency medical technicians); to strengthen the economic and tax base; and to encourage employees to live in the District of Columbia and become engaged in its civic and neighborhood life.

IMPACT: District government employees, as well as individuals who have accepted an offer to serve as a District of Columbia police officer, firefighter, emergency medical technician, or teacher benefit from this tax credit. As noted above, there may also be spillover benefits for District of Columbia neighborhoods and the District economy. However, the credit violates the principle of horizontal equity because only some groups of new homebuyers are eligible. In addition, employees may prefer to receive compensation in the form of wages and salary, which they can use to buy the goods and services that they most need.

According to the Office of Tax and Revenue there were 65 claimants in 2011, 82 claimants in 2012, then rising to 143 claimants in 2013 and 140 claimants in 2014. The credits will be phasing out over the next five years for those who purchased a home before March 2015, with all credits claimed by 2020.

Real Property Tax
Credits

169. Assessment increase cap

District of Columbia Code: D.C. Official Code § 47-864
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$23,138	\$23,832	\$24,547	\$25,284

DESCRIPTION: Homeowners who qualify for a homestead deduction (those who occupy a home in the District of Columbia as their principal residence) are also eligible for an annual assessment cap credit. This credit limits the taxable assessed value of the individual’s home to a 10 percent increase from the prior tax year.

If during the prior tax year the property was sold, its value was increased due to a change in its zoning classification, or the assessment of the property was clearly erroneous due to an error in calculation or measurement of improvements, then the taxpayer does not qualify for the assessment increase cap. In addition, the statute provides that the taxable assessment of a property eligible for a homestead deduction shall not fall below 40 percent of the current tax year’s assessed value.

For the state property tax, Maryland also imposes a 10 percent cap on the annual increase in the taxable assessed value of an owner-occupied home. The 10 percent cap also applies to local property taxes in Maryland, but local governments can adopt a cap lower than 10 percent. Virginia law limits the property tax growth in each locality to a 1 percent annual increase, excluding increases in property tax values that result from new construction or improvements, but localities may exceed the 1 percent cap after holding a public hearing on the issue (there is no state property tax in Virginia).

PURPOSE: The purpose of the cap is to protect resident homeowners from sharp growth in property values and assessments. In the early to middle part of the past decade, the value of residential real property soared in the District of Columbia. Assessed values often rose by more than 20 percent annually and sometimes more than doubled in a single year. From fiscal year 2002 to fiscal year 2007, the assessed value of residential real property in the District almost tripled from \$24.9 billion to \$73.1 billion.⁴⁵⁸ The cap was intended to protect resident homeowners from these rapid increases in real property tax liability, and was also designed to smooth the transition from triennial assessments to annual assessments.

IMPACT: Homeowners who have a principal residence in the District of Columbia benefit from the assessment increase cap. In tax year 2015, 51,638 owner-occupied households enjoyed lower taxes due to the cap. Since FY 2010, the estimated revenue loss from the cap and the number of beneficiaries has dropped as growth in assessed value has moderated.

⁴⁵⁸ Government of the District of Columbia, Office of the Chief Financial Officer, CAFR 2008: Comprehensive Annual Financial Report, Year Ended September 30, 2008 (January 2009), p. 160.

Due to the variation in rates of property value growth in different neighborhoods, the assessment increase cap can create equity problems. Some taxpayers will pay real property tax based on the full assessed value, while others who live in rapidly appreciating areas that benefit from the cap will not.

In a paper prepared for the D.C. Tax Revision Commission, University of Georgia professor David Sjoquist found that owners of more expensive houses typically have a smaller percentage reduction in taxable value due to the assessment cap.⁴⁵⁹ In addition, the cap creates inequities in the taxable percentage of assessed value by neighborhood.⁴⁶⁰

Professor Sjoquist also found that senior citizens benefit more from the assessment cap (their taxable value is lower as a percentage of assessed value) than non-seniors, possibly because senior citizens stay in their homes longer.⁴⁶¹ He also estimated that a 10 percent reduction in a homeowner's tax bill due to the D.C. assessment cap reduces the probability that the owner will move by 2.26 percent. The reduction in mobility is attributed to the sharp rise in property taxes that an owner might face in a new home, which is assessed at market value after being purchased.⁴⁶²

⁴⁵⁹ David Sjoquist, "The Residential Property Tax Credit: An Analysis of the District of Columbia's Assessment Limitation," report prepared for the D.C. Tax Revision Commission, May 2013, pp. 28-30.

⁴⁶⁰ *Ibid*, pp. 32-37.

⁴⁶¹ *Ibid*, p. 38.

⁴⁶² *Ibid*, pp. 40-43.

Real Property Tax
Credits

170. Credit for senior citizens and persons with disabilities

District of Columbia Code: D.C. Official Code § 47-863
 Sunset Date: None
 Year Enacted: 1986

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$27,155	\$27,290	\$27,427	\$27,564

DESCRIPTION: Senior citizens (age 65 or older) and persons with disabilities qualify for a 50 percent reduction in real property tax liability on a home that they own and occupy in the District of Columbia, provided that their household adjusted gross income is less than \$127,600 and have at least 50% ownership in the property. The maximum is adjusted for changes in the Consumer Price Index.

Taxpayers must file an application with the Office of Tax and Revenue in order to qualify. A senior citizen or person with a disability must own at least 50 percent of the property or cooperative unit, which must be the taxpayer’s principal place of residence.

Montgomery County offers a real property Senior Tax Credit that is equal to 50 percent of a taxpayer’s combined State Homeowners’ Tax Credit and the County Supplement to that credit (individuals must be 65 years of age or older). As authorized by Virginia law, the city of Alexandria as well as Arlington and Fairfax counties provide full or partial real property tax exemptions, to low- and moderate-income senior citizens and those who are permanently and totally disabled. The amount of the exemption depends on household gross income but the maximum income levels are lower in Virginia,⁴⁶³ and there is also an asset limit for eligible households.

PURPOSE: The purpose of the credit is to protect senior citizens and people with disabilities, who often live on fixed incomes, from real property tax liabilities that may be difficult or impossible for them to pay. In 2012, when the Council raised the maximum household income from \$100,000 to \$125,000, proponents pointed out that senior citizens and persons with disabilities of modest income might otherwise be ineligible because *household* income (including income of those who are not senior citizens or do not have a disability) is measured.⁴⁶⁴

IMPACT: The beneficiaries of this provision are senior citizens and people with disabilities who live in their own homes in the District of Columbia and have household adjusted gross income less than \$127,600. In tax year 2015, 19,166 properties qualified for the credit. The credit violates the principle of horizontal equity because other homeowners with adjusted gross income of less than \$127,600 do not receive the same relief.

⁴⁶³ The maximum income levels in Alexandria City and Fairfax County are \$72,000; in Arlington County, the maximum income is \$99,472.

⁴⁶⁴ Council of the District of Columbia, Committee on Finance and Revenue, “Report on Bill 19-512, the ‘Age-in-Place and Equitable Senior Citizen Real Property Act of 2012’,” dated March 1, 2012, p. 3.

Real Property Tax
Credits

171. Condominium and cooperative trash collection

District of Columbia Code: D.C. Official Code § 47-872 (condominiums) and § 47-873 (cooperatives)
Sunset Date: None
Year Enacted: 1990

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$6,206	\$6,361	\$6,520	\$6,683

DESCRIPTION: Owners of condominium units and cooperative dwelling units may qualify for a trash collection credit against their real property tax liability if they pay for garbage collection instead of receiving city garbage service. The credit, which is \$107 for tax year 2015, is adjusted annually for inflation.

In order to qualify for the credit, the property must be occupied by the owner and used for non-transient residential purposes. In addition, the property must be located in a condominium or cooperative housing building with more than four dwelling units.

PURPOSE: The purpose of the credit is to help defray the costs of garbage collection for real property owners who do not receive trash collection services from the D.C. government.

IMPACT: Condominium or cooperative housing owners who pay for garbage collection benefit from this credit. In tax year 2015, about 58,000 homeowners received this credit.

**Real Property Tax
Rebate**

172. Qualified high technology companies: interior renovation tax rebate

District of Columbia Code: D.C. Official Code § 47-4665
 Sunset Date: None
 Year Enacted: 2015

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$3,000	\$3,000	\$3,000

DESCRIPTION: A qualified high technology company that enters into a lease over 50,000 square feet for a minimum of 12 year term in the District will receive tax abatements for improvements made to the leased space. The qualified high technology company can receive up to 50 percent of the value of the improvements as a tax abatement, which may be spread over 5 years. The amount of the rebate in any given year cannot exceed \$1 million or the total tax liability for that year. The total of all rebates granted cannot exceed \$3,000,000 per fiscal year or \$15,000,000 over five years.

A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies.

PURPOSE: The purpose of the rebate is to encourage the growth of high-technology industries in the District of Columbia, and thereby strengthen the District’s economic base.

IMPACT: High-technology companies in the District of Columbia benefit from this provision. However, the rebate violates the principle of horizontal equity because firms in other industries are not eligible for similar tax relief.

**Real Property Tax
Rebate**

173. Public charter school tax rebate

District of Columbia Code: D.C. Official Code § 47-867
 Sunset Date: None
 Year Enacted: 2005

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$1,173	\$1,205	\$1,248	\$1,289

DESCRIPTION: A public charter school that leases a school facility from an entity that is subject to the District’s real property tax is entitled to a rebate equal to the school’s pro-rata share of the lessor’s tax on the property, provided that the school is liable under its lease for that share of the tax, and the lessor paid the tax.

Public charter schools must apply for the rebate by filing Form FP-305 with the Office of Tax and Revenue.

PURPOSE: The purpose of the rebate is to put public charter schools that lease their facilities on an equal footing with other public schools that own their facilities and are exempt from taxation on the real property.

IMPACT: Public charter schools that lease their school buildings benefit from this provision. During tax year 2014, 38 rebates were issued. At the time of publication, 13 rebates had been given for tax year 2015, but more were expected to be requested in 2016.

During the 2014-2015 school year there were 63 public charter schools with 112 campuses that enrolled 37,684 students.⁴⁶⁵ The D.C. Public Charter School Board approved applications for four new charter schools in 2015.⁴⁶⁶

⁴⁶⁵ District of Columbia Public Charter School Board, Annual Report 2015, p. 1.

⁴⁶⁶ Ibid.

Real Property Tax
Deferrals

174. Low-income homeowners

District of Columbia Code: D.C. Official Code § 47-845.02
Sunset Date: None
Year Enacted: 2005

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$6	\$6	\$6	\$6

DESCRIPTION: A taxpayer who occupies a home or condominium in the District of Columbia as his or her principal place of residence can defer any real property tax in excess of his or her real property tax for the prior year, if the taxpayer has a household adjusted gross income of less than \$50,000. Real property tax deferred in accordance with this provision bears interest at the rate of 6 percent annually (this was decreased from 8 percent beginning in 2015). The amount of real property tax deferred, including the interest on amounts deferred in prior years, cannot exceed 25 percent of the assessed value of the property in the current tax year.

To qualify for the deferral, the taxpayer must file an application with the Office of Tax and Revenue. Senior citizens (those who are 65 or older) must undergo home equity conversion mortgage counseling in order to qualify for the deferral.

Montgomery County also allows certain homeowners to defer paying the amount by which their real property tax liability exceeds the amount due the prior year. To qualify, the household must have had gross income of \$120,000 or less the previous year, and at least one of the owners must have lived in the home as his or her principal place of residence for the prior five years. Interest on the deferred taxes accrues at a rate set annually by the county. In addition to the District of Columbia, 26 states have some type of property tax deferral program in place.⁴⁶⁷

PURPOSE: The purpose of the deferral is to protect low- and moderate-income property owners from sharp increases in real property tax liability that may outpace the growth of their incomes.

IMPACT: Homeowners with annual household adjusted gross income less than \$50,000 are the intended beneficiaries of this provision. In tax year 2015, there were 10 claimants in this program. While the interest rate was recently reduced from 8 percent to 6 percent, it still may discourage use of the deferral, particularly during a period of low interest rates. It is also possible that the deferral could lead to more financial hardship for low-income homeowners by compounding their debt. Research by the American Association of Retired Persons (AARP) has found that participation rates in property tax deferral programs are generally very low (less than 1 percent).⁴⁶⁸

⁴⁶⁷ David Baer, “Property Tax Relief Programs and Property Tax Burdens,” American Association of Retired Persons, August 19, 2008, p. 22, available at www.taxadmin.org.

⁴⁶⁸ Baer, pp. 22-25.

Real Property Tax
Deferrals

175. Low-income, senior-citizen homeowners

District of Columbia Code: D.C. Official Code § 47-845.03
 Sunset Date: None
 Year Enacted: 2005

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$109	\$112	\$116	\$119

DESCRIPTION: A taxpayer who is 65 years of age or older, occupies a home or condominium in the District of Columbia as his or her principal place of residence, and has a household adjusted gross income of less than \$50,000 can defer any real property tax owed in a given tax year. The deferred taxes bear interest at the rate charged by the U.S. Internal Revenue Service on underpayments of federal income taxes, but will not exceed 6 percent per year (the interest rate was 8 percent prior to 2015). The amount of tax deferred, plus interest accrued on the taxes deferred in previous years, is limited to 25 percent of the assessed value of the property in the current tax year. The Budget Support Act of 2015 amended the deferral so that if the homeowner is 75 years of age or older, has less than \$12,500 of household interest and dividend income, and has owned a residence in the District for at least the immediately preceding 25 years, no interest shall bear for taxes.

Several additional requirements apply. The homeowner must live in a home with no more than five dwelling units, and the senior citizen or citizens must own at least 50 percent of the house or condominium. The homeowner must also undergo home equity conversion mortgage counseling and file an application with the Office of Tax and Revenue to qualify for the deferral. This tax deferral differs from the deferral available for low-income homeowners described on the previous page (see tax expenditure #174, “Low-income homeowners”) by covering the *entire* property tax bill, rather than just the yearly increase in property tax liability.

The City of Alexandria and Arlington County allow tax deferrals for senior citizens and persons with disabilities. To qualify for a property tax deferral in Alexandria, the taxpayer’s household gross income was limited to \$72,000 in 2016 and assets (excluding the home and surrounding two acres) may not exceed \$430,000. In Arlington County, senior citizens and people with disabilities may receive a property tax deferral only if they meet income limits (which vary based on household size) and have assets that are less than \$540,000.

Montgomery County also allows certain homeowners (whether elderly or not) to defer paying the amount by which their real property tax liability exceeds the amount due the prior year. To qualify, the household must have had gross income of \$120,000 or less the previous year, and at least one of the owners must have lived in the home as his or her principal place of residence for the prior five years. Interest on the deferred taxes accrues at a rate set annually by the county. In addition to the District of Columbia, 26 states offer some type of property tax deferral program.⁴⁶⁹

⁴⁶⁹ *Significant Features of the Property Tax*. Lincoln Institute of Land Policy and George Washington Institute of Public Policy. (Residential Property Tax Relief Programs, Accessed May 4, 2016.)

PURPOSE: The purpose of the tax deferral is to protect low- and moderate-income senior citizens from real property tax burdens that they cannot afford. This provision recognizes that many senior citizens are “house-rich” but “cash-poor,” because many senior citizens live on fixed incomes that may not keep pace with the assessed value of homes.

IMPACT: Senior citizen homeowners with annual household adjusted gross income less than \$50,000 benefit are the intended beneficiaries of this provision. Due to the recent change in eligibility requirements and interest rates, there has been an increased participation and 300 seniors received a deferral in tax year 2015. Research by the American Association of Retired Persons (AARP) has found that participation rates in property tax deferral programs are generally very low (less than 1 percent).⁴⁷⁰

The deferral violates the principle of horizontal equity because non-elderly homeowners with household adjusted gross income of less than \$50,000 do not receive similar tax relief (the deferral option for low-income homeowners is more limited). The deferral might also compound the financial difficulties of low-income senior citizens by encouraging the buildup of debt.

⁴⁷⁰ David Baer, “Property Tax Relief Programs and Property Tax Burdens,” American Association of Retired Persons, August 19, 2008, p. 22-25, available at www.taxadmin.org.

DEED RECORDATION AND TRANSFER TAX

Deed Recordation and Transfer Tax Exemptions

176. Educational institutions

District of Columbia Code: D.C. Official Code § 42-1102(3) for the deed recordation tax
D.C. Official Code § 47-902(3) for the transfer tax
Sunset Date: None
Year Enacted: 1962 (deed recordation tax) and 1980 (transfer tax)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$1,424	\$1,467	\$1,511	\$1,556

DESCRIPTION: Organizations that are exempt from real property taxation in the District of Columbia pursuant to D.C. Official Code § 47-1002 are also exempt from the deed recordation tax and transfer taxes. Educational institutions are among the groups covered under § 47-1002 that qualify for this blanket exemption.

PURPOSE: The purpose of the exemption is to extend the real property tax exemption for educational institutions to the other two taxes related to real property: the deed recordation tax and the transfer tax. As a result, there is uniform treatment under the real property, deed recordation, and transfer taxes for educational institutions.

IMPACT: Educational institutions benefit from this exemption, which would also be expected to have spillover benefits for their employees and students. Moreover, there could be broader benefits to society because education promotes a better-trained workforce and a more informed citizenry.

Deed Transfer Tax
Exemptions

177. Bona-fide gifts to the District of Columbia

District of Columbia Code: D.C. Official Code § 47-902(24)
 Sunset Date: None
 Year Enacted: 2011

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: Real property that is transferred to the District of Columbia as a “bona fide gift,” at the request of the D.C. government and without any consideration for the transfer, is exempt from the real property transfer tax.⁴⁷¹

PURPOSE: The enactment of this provision was motivated by the transfer of property from PEPCO to the D.C. government in 2008. The property was conveyed as a gift so that the D.C. government could complete a portion of the Metropolitan Branch Pedestrian and Bicycle Trail.⁴⁷²

IMPACT: The D.C. government and donors of property are the intended beneficiaries of this exemption. The transfer from PEPCO is the only gift of property to the D.C. government known to have occurred in recent years. A more common way of transferring private land to the District involves the exchange of privately-owned land for a publicly-owned parcel.

⁴⁷¹ The transfer tax on real property is based on consideration paid for the transfer, but when there is no consideration, the tax is based on the fair market value of the property conveyed.

⁴⁷² PEPCO was reimbursed by the D.C. government for the \$47,850 transfer tax PEPCO paid on transferring the property.

Deed Recordation and Transfer Tax Exemptions

178. Embassies, chanceries, and associated properties of foreign governments

District of Columbia Code: D.C. Official Code § 42-1102(3) for the deed recordation tax
 D.C. Official Code § 47-902(3) for the transfer tax
 Sunset Date: None
 Year Enacted: 1962 (deed recordation tax) and 1980 (transfer tax)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$538	\$554	\$570	\$588

DESCRIPTION: Organizations that are exempt from real property taxation in the District of Columbia pursuant to D.C. Official Code § 47-1002 are also exempt from the deed recordation and transfer taxes. Foreign governments are among the groups covered under § 47-1002 that qualify for this blanket exemption, which applies to the embassies and other properties that foreign governments use for diplomatic purposes.

PURPOSE: The purpose of the exemption is to uphold a principle of international law that foreign governments are entitled to exemption from taxation of real property owned by the foreign government and used by its diplomatic mission. Any portion of the property that is not used for diplomatic or consular purposes is not exempt from the District’s deed recordation or transfer tax. The exemption also ensures that there is uniform treatment under the real property, deed recordation, and transfer taxes for properties purchased by foreign governments for diplomatic uses.

IMPACT: Foreign governments that buy or sell embassies, chanceries, and associated properties in the District of Columbia benefit from this exemption.

Deed Recordation and Transfer Tax Exemptions

179. Federal government and District of Columbia government

District of Columbia Code: D.C. Official Code § 42-1102(2) for the deed recordation tax
 D.C. Official Code § 47-902 (2) for the transfer tax
 Sunset Date: None
 Year Enacted: 1962 (deed recordation tax) and 1980 (transfer tax)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$2,376	\$2,447	\$2,520	\$2,596

DESCRIPTION: Property acquired by the United States government is exempt from the deed recordation and transfer taxes, unless taxation of the property has been specifically authorized by the U.S. Congress.

PURPOSE: This exemption recognizes the fact that the federal government is immune from taxation by the states or municipalities. This immunity has been established in numerous court decisions, beginning with *McCulloch v. Maryland*, 17 U.S. 316 in 1819, and has been reinforced in other cases including *Clallam County v. United States*, 263 U.S. 341 in 1923; *Cleveland v. United States*, 323 U.S. 329, 333 in 1945; *United States v. Mississippi Tax Commission*, 412 U.S. 363 in 1973; and *United States v. Mississippi Tax Commission*, 421 U.S. 599 in 1975.

IMPACT: The United States and District of Columbia governments benefit from this exemption. Currently, 83 percent of this estimate represents D.C. government tax expenditures.

Deed Recordation and Transfer Tax Exemptions

180. Other properties exempt from real property taxation

District of Columbia Code: D.C. Official Code § 42-1102(4) for the deed recordation tax
 D.C. Official Code § 47-902(3) for the transfer tax
 Sunset Date: None
 Year Enacted: 1962 (deed recordation tax) and 1980 (transfer tax)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$1,389	\$1,431	\$1,474	\$1,518

DESCRIPTION: Properties exempted from the real property tax by D.C. Official Code § 47-1002 also receive a blanket exemption from the deed recordation and transfer taxes.⁴⁷³ In addition to some major types of tax-exempt properties that are specifically exempted by statute from the deed recordation and transfer tax (churches, educational institutions, embassies, and charitable organizations), there are a number of other institutions that also receive the deed recordation and transfer tax exemptions through this blanket exemption. These institutions, which are included in the estimate of forgone revenue shown above, include non-profit hospitals, libraries, art galleries, and cemeteries.

PURPOSE: The purpose of this exemption is to promote equitable treatment for non-profit institutions under the real property tax, the deed recordation tax, and the transfer tax. In addition, the exemption recognizes and encourages the public benefits provided by many non-profit entities such as hospitals and libraries.

IMPACT: The owners of non-profit hospitals, libraries, art galleries, cemeteries, and other organizations that are exempt from real property taxation in the District of Columbia benefit from this parallel exemption from the deed recordation and transfer taxes.

⁴⁷³ There are two narrow exceptions to this rule. D.C. law provides that the following tax-exempt properties do not receive corresponding exemptions from the deed recordation and transfer taxes: (1) property for which payments in lieu of taxes (PILOTs) are being made pursuant to a PILOT agreement, and (2) land in the Capper/Carrollsborg PILOT area that is not otherwise exempt from real property taxation.

Deed Recordation Tax Exemptions

181. Special act of Congress

District of Columbia Code: D.C. Official Code § 42-1102(4)
Sunset Date: None
Year Enacted: 1962

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: A deed to property acquired by an institution, organization, corporation, or association entitled to an exemption from real property by a special act of Congress is exempt from the deed recordation tax, provided that the property is acquired “solely for a purpose or purposes for which such special exemption was granted.”⁴⁷⁴

A similar exemption applicable to the transfer tax was repealed by D.C. Law 14-282, the “Tax Clarity and Recorder of Deeds Act of 2002,” which took effect on April 4, 2003.⁴⁷⁵

PURPOSE: The purpose of this exemption is to extend the deed recordation tax exemption to properties that have been exempted from real property taxation in the District of Columbia by a special act of Congress. Exempting the properties from both taxes promotes uniformity and equity in property taxation.

IMPACT: Owners of property that qualifies for a real property tax exemption in the District of Columbia by a special act of Congress benefit from this exemption. Examples of past recipients include properties owned by the Daughters of American Revolution, the National Education Association, the American Veterans of World War II, the American Association of University Women, and Woodrow Wilson House.

⁴⁷⁴ See D.C. Official Code § 42-1102(4).

⁴⁷⁵ See section 11(o)(4) of this legislation.

Deed Recordation and Transfer Tax Exemptions

182. Cooperative housing associations

District of Columbia Code: D.C. Official Code § 42-1102(14), § 47-3503(a)(2), and § 47-3503(a)(3) for deed recordation tax
 D.C. Official Code § 47-902(11) and § 47-3503(b)(2) for transfer tax
 Sunset Date: None
 Year Enacted: 1983

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$527	\$543	\$559	\$576

DESCRIPTION: A property acquired by a cooperative housing association is exempt from the deed recordation and transfer taxes if at least 50 percent of the units are occupied by households with an annual income no greater than 120 percent of the lower-income guidelines established by the U.S. Department of Housing and Urban Development (HUD) for the Washington metropolitan area.

For the D.C. area, the FY 2016 HUD household income limits ranged from \$58,980 for a one-person household to \$111,120 for a household with eight or more people. The current limit on the purchase price of the home is \$408,000.

The cooperative housing association must receive a credit against the purchase price of the property equal to the total transfer tax that would have been due without the exemption. This provision is necessary because the transfer tax is usually paid by the seller of the property.

PURPOSE: The authorizing statute states that, “The purpose of this act is to expand homeownership opportunities for lower-income families to the maximum extent possible at the lowest possible cost to the District of Columbia.”⁴⁷⁶ The statute further states that, “Expansion of homeownership opportunities for lower income families is beneficial to the public peace, health, safety and general welfare.”⁴⁷⁷

IMPACT: Cooperative housing associations with at least 50 percent of units occupied by lower-income households benefit from this provision.

⁴⁷⁶ See D.C. Official Code § 47-3501(7).

⁴⁷⁷ See D.C. Official Code § 47-3501(6).

Deed Transfer Tax Exemptions

183. Inclusionary zoning program

District of Columbia Code: D.C. Official Code § 47-902(23)
 Sunset Date: None
 Year Enacted: 2007

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$23	\$23	\$36	\$36

DESCRIPTION: Transfers of property to a qualifying low- or moderate-income household pursuant to the Inclusionary Zoning (IZ) program are exempt from the transfer tax on real property. IZ requires an affordable housing set-aside in new developments of 10 or more units, or a substantial rehabilitation that expands an existing building’s floor-area ratio (FAR) by 50 percent or more and adds 10 or more units, in exchange for an increase in density. There are exemptions for certain zones and historic districts and some housing construction projects have been exempt due to geographic location, because they received development approvals before the effective date of IZ, or because they were subject to housing affordability requirements as a planned unit development or through other D.C. government programs.⁴⁷⁸

IZ is targeted at households earning less than 50 percent of area median income (AMI), and between 50 percent and 80 percent of AMI, depending on the zoning and the type of construction. The amount of the affordable housing set-aside (which ranges between 8 and 10 percent of the residential space) also varies depending on the zoning and construction type. Affordable units offered through the IZ program have rental or sales price caps that are tied to AMI. In return for providing affordable units, developers receive a 20 percent bonus density.

After housing is built in accordance with the IZ program, the developer or owner of the affordable unit issues a notice of availability to the Department of Housing and Community Development (DHCD), which then holds a lottery to select an eligible household for each unit. Prospective renters and buyers have to submit information about their income and household size, a declaration of eligibility, a mortgage pre-qualification (if applicable), and any other documents required by the Mayor.

PURPOSE: The purpose of the exemption is to further the IZ program’s goals of producing affordable housing for residents, creating mixed-income neighborhoods, and increasing homeownership opportunities for low- and moderate-income households.

IMPACT: Low- and moderate-income households are the intended beneficiaries of this provision. According to DHCD, 54 IZ units had been produced as of March 2016. In total, 24 units have been sold, six of those in FY15. The FY16 and FY17 estimates are based on the number of current projects under construction and due to be completed by 2017, taking past sales rates into account. The FY18 and FY19 projections are based on expected new construction, as well as continued sales of units completed in in prior years.

⁴⁷⁸ Department of Housing and Community Development, “Inclusionary Zoning Annual and 5.5 Year Report,” April 24, 2013. pp. 5-6.

Deed Recordation and Transfer Tax Exemptions

184. Lower-income homeownership households

District of Columbia Code: D.C. Official Code § 42-1102(12), § 47-3503(a)(1), and § 47-3503(a)(3) for deed recordation tax
 D.C. Official Code § 47-902(9) and § 47-3503(b)(1) for transfer tax
 Sunset Date: None
 Year Enacted: 1983

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: Property that is transferred to a “qualifying lower-income homeownership household” is exempt from the deed recordation and transfer taxes. A qualifying lower-income homeownership household must meet two requirements: (1) household income can be no greater than 120 percent of the lower-income guidelines established for the Washington metropolitan area by the U.S. Department of Housing and Urban Development (HUD), and (2) the household must own the property in fee simple or receive at least a 5 percent qualified ownership interest as part of a shared equity financing agreement. The lower-income household must occupy the unit that qualifies for the deed recordation and transfer tax exemption. The fair market value of the property being transferred cannot exceed 80 percent of the median sale price for homes in the District of Columbia.

As of March 28, 2016, the household income limits ranged from \$58,980 for a one-person household to \$111,120 for a household with eight or more people. The current limit on the purchase price of the home is \$408,000.

The lower-income purchaser or the persons acquiring qualified ownership interests under a shared equity financing agreement must receive a credit against the purchase price of the property equal to the total transfer tax that would have been due without the exemption. This provision is necessary because the transfer tax is usually paid by the seller.

PURPOSE: The authorizing statute states that, “The purpose of this act is to expand homeownership opportunities for lower-income families to the maximum extent possible at the lowest possible cost to the District of Columbia.”⁴⁷⁹ The statute further states that, “Expansion of homeownership opportunities for lower income families is beneficial to the public peace, health, safety and general welfare.”⁴⁸⁰

IMPACT: Families with an annual income no greater than 120 percent of the low-income guidelines set by HUD for the Washington metropolitan area benefit from this tax expenditure, provided that they meet the other eligibility criteria described above.

⁴⁷⁹ See D.C. Official Code § 47-3501(7).

⁴⁸⁰ See D.C. Official Code § 47-3501(6).

Deed Recordation and Transfer Tax Exemptions

185. Nonprofit housing associations

District of Columbia Code: D.C. Official Code § 42-1102(13) and § 47-3505(c) (deed recordation tax)
 D.C. Official Code § 47-902(10) and § 47-3505(b) (transfer tax)
 Sunset Date: None
 Year Enacted: 1983

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$160	\$161	\$166	\$169

DESCRIPTION: Property that is transferred to a “qualifying nonprofit housing organization”⁴⁸¹ is exempt from the deed recordation and transfer taxes if the organization certifies its intent to do the following within the next 36 months: (1) transfer the property to a household with annual income no greater than 120 percent of the lower-income guidelines established by the U.S. Department of Housing and Urban Development for the Washington metropolitan area, (2) transfer at least 35 percent of the units in a multi-family property to households meeting the lower-income standard described above, or (3) transfer the property to a cooperative housing association that will make at least 50 percent of the units available to households meeting the lower-income standard.

As of March 28, 2016, the household income limits ranged from \$58,980 for a one-person household to \$111,120 for a household with eight or more people. The current limit on the purchase price of the home is \$408,000.

An additional requirement for the transfer tax exemption is that the non-profit housing association must receive a credit against the purchase price of the property in an amount equal to the transfer tax that would have been due without the exemption. This provision is necessary because the transfer tax is usually paid by the seller.

PURPOSE: The authorizing statute states that, “The purpose of this act is to expand homeownership opportunities for lower income families to the maximum extent possible at the lowest possible direct cost to the District of Columbia.”⁴⁸² The statute further states that, “Additional support for nonprofit housing organizations ... through property tax abatements and other incentives can serve to expand homeownership for lower income families at little or no additional cost to the District of Columbia.”⁴⁸³

IMPACT: Nonprofit housing associations and the lower-income households they serve benefit from this provision.

⁴⁸¹ A “qualifying nonprofit housing association” has been approved by the U.S. Internal Revenue Service as exempt from federal income taxation under section 501(c)(3) or 501(c)(4) of the Internal Revenue Code.

⁴⁸² See D.C. Official Code § 47-3501(7).

⁴⁸³ See D.C. Official Code § 47-3501(5).

Deed Recordation Tax Exemptions

186. Nonprofit affordable housing developers

District of Columbia Code: D.C. Official Code § 42-1102(32) and § 47-902(25)
 Sunset Date: None
 Year Enacted: 2012

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$156	\$159	\$164	\$167

DESCRIPTION: Non-profit affordable housing developers are granted an exemption from the deed recordation tax if the property is under the restrictions of the federal low-income housing tax credit (LIHTC) program. The reason this exemption is necessary is because property developed through the LIHTC program is usually transferred to a private, for-profit subsidiary of the developer. Without this exemption, the non-profit organization would have to pay the deed recordation tax on property it is developing as affordable housing.

The LIHTC program was established by Congress in 1986 to provide the private market with an incentive to invest in affordable rental housing. Federal housing tax credits are awarded by state housing finance agencies to developers of qualified projects, who usually sell the credits to investors to raise capital or equity for their projects.⁴⁸⁴ The credit purchaser must be part of the property ownership entity; this transfer is usually accomplished by creating a limited partnership or limited liability company.

This approach reduces the debt that the developer would otherwise incur and thereby makes it possible for an affordable housing project to offer lower rents. If the project maintains compliance with LIHTC program requirements, investors receive a dollar-for-dollar credit against their federal tax liability for a 10-year period. Projects eligible for housing tax credits must meet low-income occupancy requirements.⁴⁸⁵

PURPOSE: The purpose of the exemption is to ensure that non-profit developers of affordable housing do not become subject to the deed recordation tax because of their participation in the LIHTC program.

IMPACT: The exemption supports the operations of a program that the D.C. Housing Finance Agency (which awards LIHTC credits in the District of Columbia) describes as one of the two primary long-term financing programs used to develop affordable multi-family rental housing projects.⁴⁸⁶

⁴⁸⁴ The developer typically sells the credit in order to raise up-front cash for the affordable housing project.

⁴⁸⁵ Developers are required to set aside at least 20 percent of their units for households with incomes at or below 50 percent of the area median, or at least 40 percent of their units for households at or below 60 percent of the area median (adjusted for family size).

⁴⁸⁶ See www.dchfa.org.

Deed Recordation and Transfer Tax Exemptions

187. Resident management corporations

District of Columbia Code: D.C. Official Code § 42-1102(20) and § 47-3506.01(b)(1) for recordation tax
 D.C. Official Code § 47-902(15) and § 47-3506.01(b)(2) for transfer tax
 Sunset Date: None
 Year Enacted: 1992

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: Public housing that is transferred to a qualifying resident management corporation is exempt from the deed recordation and transfer taxes. A resident management corporation is a non-profit corporation in which public housing residents are the sole voting members.

PURPOSE: The purpose of the exemption is to expand the opportunities of low-income families who live in a public housing project to become owners of the housing. Resident ownership is also expected to help stabilize neighborhoods by giving residents a greater stake in the safety and upkeep of the community.

IMPACT: Resident management corporations and the individuals they serve are the intended beneficiaries of this provision. According to the D.C. Housing Authority, the Kenilworth-Parkside project is the only property that has been transferred to a resident management corporation (this transfer took place in 1992). Presently, no exemptions are projected for the FY 2016 through FY 2019 period.

Deed Recordation and Transfer Tax Exemptions

188. Deeds to property transferred to a named beneficiary of a revocable transfer on death

District of Columbia Code: D.C. Official Code § 42-1102(34) and § 19-604
Sunset Date: None
Year Enacted: 2015

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: Deeds to property transferred to a named beneficiary of a revocable transfer on death deed by reason of the death of the grantor of the revocable transfer on death deed. The provision was part of the Residential Real Property Equity and Transparency Act of 2014.

PURPOSE: The purpose of the provision is unclear but was included as part of the real property tax overhaul in the Residential Real Property Equity and Transparency Act of 2014.

IMPACT: The tax exemption prevents the double payment of deed tax on the transfer of a property that is revocable.

Deed Recordation and Transfer Tax Exemptions

189. Security interest instrument

District of Columbia Code: D.C. Official Code § 42-1102(33) and § 47-340.01
 Sunset Date: None
 Year Enacted: 2015

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: A security interest instrument executed by a borrower in connection with a loan under the Industrial Revenue Bond Forward Commitment Program is entitled to an exemption provided that a certification from the Mayor that the security interest instrument is entitled to this exemption accompanies the security interest instrument at the time it is presented for recordation. The provision helps to minimize risk related to these transactions by helping to indemnify the District.

PURPOSE: The purpose of the exemption is to memorialize and document the current practice related to these IRB transactions.

IMPACT: The majority of entities that take advantage of IRB’s are tax-exempt, and therefore not subject to recordation tax under current law. There are a few commercial and nonprofit entities that are not exempt from real property taxes and would be subject to recordation tax; however, they are not taxed because the District’s practice has been to exempt these instruments, regardless of the underlying tax status of the entity, from recordation.

The practice has been to exempt these transactions from recordation taxes because the security instruments are unified deeds of trust and therefore involve the financial interest of both the borrowing entity and the District Government. The District’s financial interest is a small share of the total bond issuance.

Deed Recordation and Transfer Tax Exemptions

190. Charitable organizations

District of Columbia Code: D.C. Official Code § 42-1102(3) for the deed recordation tax
D.C. Official Code § 47-902 (3) for the transfer tax
Sunset Date: None
Year Enacted: 1962 (deed recordation tax) and 1980 (transfer tax)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$401	\$413	\$425	\$438

DESCRIPTION: Organizations that are exempt from real property taxation in the District of Columbia pursuant to D.C. Official Code § 47-1002 are also exempt from the deed recordation tax and transfer taxes. Charitable entities are among the groups covered by § 47-1002 that qualify for this blanket exemption.

PURPOSE: The purpose of the exemption is to extend the real property tax exemption for charitable entities to the other two taxes on real property: the deed recordation tax and the transfer tax. As a result, there is uniform treatment under the real property, deed recordation, and transfer taxes for charitable organizations.

IMPACT: Charitable entities benefit from this exemption, which might also have spillover benefits for the people who receive goods or services from the charitable organizations.

Deed Recordation and Transfer Tax Exemptions

191. Churches, synagogues, and mosques

District of Columbia Code: D.C. Official Code § 42-1102(3) for the deed recordation tax
D.C. Official Code § 47-902(3) for the transfer tax
Sunset Date: None
Year Enacted: 1962 (deed recordation tax) and 1980 (transfer tax)

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: Organizations that are exempt from real property taxation in the District of Columbia pursuant to D.C. Official Code § 47-1002 are also exempt from the deed recordation tax and transfer taxes. Churches, synagogues, and mosques are among the groups covered under § 47-1002 that qualify for this blanket exemption.

PURPOSE: The purpose of the exemption is to extend the real property tax exemption for places of worship to the two other taxes related to real property: the deed recordation tax and the transfer tax. As a result, there is uniform treatment under the real property, deed recordation, and transfer taxes for churches, synagogues, mosques, and other places of worship.

IMPACT: Churches, synagogues, mosques, and other places of worship benefit from this exemption when their property is sold.

Deed Recordation and Transfer Tax Exemptions

192. Tax-exempt entities subject to a long-term lease

District of Columbia Code: D.C. Official Code § 42-1102(27) for the deed recordation tax
D.C. Official Code § 47-902(21) for the transfer tax
Sunset Date: None
Year Enacted: 2003

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: A property is exempt from the deed recordation and transfer taxes if it is subject to a lease or ground rent for a term of at least 30 years, and if the lessor would have been exempt from real property taxation under D.C. Official Code § 47-1002 if it had owned the property outright.

PURPOSE: This exemption was created to provide equitable treatment under the deed recordation and transfer taxes for properties that are under the control of organizations that are exempt from the real property tax. This provision extends the exemption these entities receive when they acquire a property in fee simple to the conveyance of property that is subject to a lease or ground rent of at least 30 years.

IMPACT: Organizations that are exempt from the real property tax and assume control of a property through a lease of 30 years or more benefit from this provision. It was impossible to estimate the revenue loss from this exemption because deed recordation and transfer tax exemptions are not categorized in a way that identifies tax-exempt entities subject to a long-term lease.

SALES TAX

Sales Tax
Exemptions

193. Energy products used in manufacturing

District of Columbia Code: D.C. Official Code § 47-2005(11) and (11A)
Sunset Date: None
Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$5,102	\$5,316	\$5,529	\$5,734

DESCRIPTION: Gross receipts from the sale of natural or artificial gas, oil, electricity, solid fuel, or steam are exempt from the sales tax when these energy products are used for (1) manufacturing, assembling, processing, or refining, or (2) preparing or refrigerating goods when used in a restaurant, including a hotel restaurant.

The exemption for energy used to produce goods in a restaurant took effect on January 1, 2010. The rest of the exemption for energy used in manufacturing dates back to 1949, when the District’s sales tax was first established.

Similar exemptions are common in many states, but they are sometimes provided under broader sales tax exemptions. For example, Virginia exempts manufacturing and agricultural businesses from paying sales taxes on their purchases of materials, machinery, and equipment, based on the principle that these inputs are included in the value of goods that are taxed at the retail level.

PURPOSE: The purpose of the exemption is to recognize that energy products used in manufacturing are ordinary and necessary expenses in the production process rather than outputs offered for retail sale. The sales tax is intended to be a consumption tax rather than a tax on intermediate goods and services that are consumed or directly used in production.

IMPACT: Manufacturing businesses and restaurants benefit from the exemption. Nevertheless, the exemption creates questions of horizontal equity because many service industries use energy products as inputs but do not receive a sales tax exemption for the costs of natural or artificial gas, oil, electricity, solid fuel, or steam that they use.

Sales Tax Exemptions

194. Internet access service

District of Columbia Code: D.C. Official Code § 47-2001(n)(2)(F)
 Sunset Date: None
 Year Enacted: 1999

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$7,674	\$7,997	\$8,316	\$8,624

DESCRIPTION: Gross receipts from sales of Internet access service are exempt from the sales tax. “Internet access service” is defined as a service that “enables users to access content, information, electronic mail, or other services offered over the Internet and may also include access to proprietary content, information, and other services as part of a package of Internet access services offered to customers.”⁴⁸⁷

Internet access service does not include (1) the sales of data processing and information services that do not involve content, information, electronic mail, or other services offered over the Internet, or (2) telecommunication services. The exemption also does not cover online purchases.

State and local taxation of Internet access has been barred by the 1998 Internet Tax Freedom Act approved by Congress. The federal Act became permanent law on February 24, 2016, in the Trade Facilitation and Trade Enforcement Act of 2015.

PURPOSE: Proponents of the tax exemption for Internet access contend that the exemption will stimulate the continued growth of a technology that has very positive economic and social impacts.

IMPACT: Individuals or firms selling Internet access service benefit from this exemption, as do their customers. Nevertheless, sales tax exemptions of this nature may create economic inefficiencies (by favoring the consumption of some items rather than others based on the tax, rather than the value of the product) and raise issues of horizontal equity. For example, some experts argue that it is inequitable to tax the computer hardware that provides Internet access but not the Internet access itself.

⁴⁸⁷ See D.C. Official Code § 47-2001(n)(2)(F).

Sales Tax Exemptions

195. Materials used in development of a qualified supermarket

District of Columbia Code: D.C. Official Code § 47-2005(28)
Sunset Date: None
Year Enacted: 2000

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$992	\$1,034	\$1,075	\$1,115

DESCRIPTION: Gross receipts from the “sales of building materials related to the development of a qualified supermarket”⁴⁸⁸ are exempt from the sales tax. A qualified supermarket is located in a census tract where more than half of the households have incomes below 60 percent of the area median, as determined by the U.S. Department of Housing and Urban Development.

PURPOSE: The purpose of the exemption is to encourage the construction and operation of supermarkets in underserved areas of the city.

IMPACT: Individuals and organizations that are constructing and operating supermarkets in the target areas benefit from this provision. Consumers are also intended beneficiaries of this exemption because it is designed to provide an incentive for supermarkets to locate in areas that lack them. The exemption violates the principle of horizontal equity because other businesses locating in the target areas do not receive an exemption on the purchase of building materials.

The estimate of forgone revenue shown above is based on an assumption that three qualified supermarkets will be constructed each year.

⁴⁸⁸ See D.C. Official Code § 47-2005(28).

Sales Tax Exemptions

196. Professional and personal services

District of Columbia Code: D.C. Official Code § 47-2001(n)(2)(B)
 Sunset Date: None
 Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$304,379	\$317,163	\$329,850	\$342,054

DESCRIPTION: Gross receipts from sales of professional, insurance, or personal services are exempt from the sales tax. Examples of the sales that are exempt include accounting and bookkeeping, architectural, consulting, dental, engineering, legal, and physician services.

The Tax Revision Commission Implementation Amendment Act of 2014 (BSA Subtitle (VII) (B)) expanded the sales tax base to include some services not previously taxed in the District of Columbia. These include bottled water delivery services and other direct selling establishments, carpet and upholstery cleaning services, fitness and recreational sports centers, and other personal care services such as tanning, car washes, bowling centers and billiard parlors.

Maryland and Virginia provide similar exemptions to professional, insurance, and personal services. Only four states (Hawaii, New Mexico, South Dakota, and Washington State) tax a broad set of professional services including accounting and bookkeeping, architectural, dentist, engineering, legal, and medical services.⁴⁸⁹

PURPOSE: This exemption is part of most state tax systems because the sales tax originated as a levy on purchases of tangible personal property by both individuals and businesses, rather than a tax on all consumption. Even as the service economy has grown, policymakers have usually continued to exempt professional, insurance, or personal services from the sales tax.

IMPACT: Firms providing professional, insurance, or personal services benefit from this exemption, as do the consumer of these services. Nevertheless, many experts have pointed out that the substantial growth of services as a percentage of the economy means that a large share of consumption expenditures is not taxed, and that tax rates on tangible goods may therefore be higher than they otherwise would be.⁴⁹⁰ Moreover, the exemption violates the principle of horizontal equity because two taxpayers with equal levels of consumption will pay different amounts of sales tax if one consumes more professional services than the other.

⁴⁸⁹ William Fox, “Sales Taxes in the District of Columbia,” paper prepared for the D.C. Tax Revision Commission, May 2013, p. 8.

⁴⁹⁰ See for example Virginia Joint Legislative Audit and Review Commission, Review of the Effectiveness of Virginia Tax Preferences, report to the Governor and General Assembly of Virginia (January 2012), pp. 20-22.

Sales Tax Exemptions

197. Qualified high-technology companies: certain sales and technology sales

District of Columbia Code: D.C. Official Code § 47-2001(n)(2)(G) and § 47-2005(31)
 Sunset Date: None
 Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$3,399	\$3,535	\$3,676	\$3,823

DESCRIPTION: The gross receipts from certain sales of intangible property or services, which are otherwise taxable, are exempt from the sales tax if the sale is made by a qualified high technology company within the District of Columbia. The list of tax-exempt products and services includes website design, maintenance, hosting, or operation; Internet-related consulting, advertising, or promotion services; graphic design; banner advertising; subscription services; and Internet website design and maintenance services. This exemption does not apply to telecommunication service providers. Further, certain ‘technology sales’ are also exempt, including “computer software or hardware, and visualization and human interface technology equipment, including operating and applications software, computers, terminals, display devices, printers, cable, fiber, storage media, networking hardware, peripherals, and modems when purchased for use in connection with the operation of the Qualified High Technology Company.”⁴⁹¹

A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies.

This sales tax exemption is part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the “New E-economy Transformation Act of 2000.”⁴⁹² Maryland and Virginia do not provide similar exemptions, but Virginia offers a sales tax exemption for purchases of computer servers and other types of equipment used by large data centers (those with a new capital investment of \$150 million or more). Data centers must also meet job creation and wage targets in order to qualify for Virginia’s sales tax exemption.

PURPOSE: The purpose of the exemption is to encourage the growth of high-technology companies in the District of Columbia and thereby expand the District’s economy and employment base.

⁴⁹¹ See D.C. Official Code § 47-2005(31).

⁴⁹² The other incentives, which include a reduced corporate tax rate, increased expensing of capital assets, employment credits, property tax abatements, and personal property tax exemptions, are discussed elsewhere in this section.

IMPACT: High-technology companies in the District of Columbia benefit from this provision. The exemption violates the principle of horizontal equity because companies in other industries do not receive similar treatment (nor do companies that sell similar products but do not meet the definition of a qualified high-technology company).

Note: this report previously identified foregone revenue from these two provisions separately; however, recent changes in the granularity of administrative tax data on QHTCs made available to the Office of Revenue Analysis preclude the presentation of more detailed information at this time.

Sales Tax
Exemptions

198. Transportation and communication services

District of Columbia Code: D.C. Official Code § 47-2001(n)(2)(A)
Sunset Date: None
Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$54,618	\$56,912	\$59,188	\$61,378

DESCRIPTION: Gross receipts from sales of transportation and communication services are exempt from the sales tax. The exemption does not include the sales of data processing services, information services, or local telephone service.

Maryland and Virginia provide similar exemptions for transportation and communication services.

PURPOSE: This exemption was included in the original establishment of the D.C. sales tax in 1949, likely because the sales tax originated as a levy on purchases of tangible personal property by both individuals and businesses, rather than taxes on all consumption. Even as the service economy has grown, policymakers continue to exempt most services from the sales tax.

IMPACT: Firms providing transportation and communication services benefit from this exemption. The exemption violates the principle of horizontal equity because firms in other industries do not receive similar treatment.

Sales Tax Exemptions

199. Federal and D.C. governments

District of Columbia Code: D.C. Official Code § 47-2005(1)
 Sunset Date: None
 Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$225,696	\$235,175	\$244,582	\$253,631

DESCRIPTION: Gross receipts from sales to the United States government, the District of Columbia government, or any instrumentalities of either government, are exempt from the sales tax, except for sales to national banks and federal savings and loan associations.

Maryland and Virginia also exempt the state and its political subdivisions (such as counties, cities, townships) from the sales tax, in addition to the federal government exemption.

PURPOSE: The exemption for sales to the U.S. government recognizes the federal government’s immunity from taxation by the states or municipalities. This immunity has been established in numerous court decisions, beginning with *McCulloch v. Maryland*, 17 U.S. 316 in 1819, and has been reinforced in other cases including *Clallam County v. United States*, 263 U.S. 341 in 1923; *Cleveland v. United States*, 323 U.S. 329, 333 in 1945; *United States v. Mississippi Tax Commission*, 412 U.S. 363 in 1973; and *United States v. Mississippi Tax Commission*, 421 U.S. 599 in 1975.

The sales tax exemption for the District government eliminates a cost that would ultimately be borne by D.C. taxpayers, and can be justified on the grounds that the local government is usually an intermediate consumer of goods and services rather than the end user.

IMPACT: The federal government and the District of Columbia government benefit from this exemption.

Sales Tax Exemptions

200. Medicines, pharmaceuticals, and medical devices

District of Columbia Code: D.C. Official Code § 47-2005(14) and (15)
 Sunset Date: None
 Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$18,945	\$19,741	\$20,531	\$21,290

DESCRIPTION: Gross receipts from sales of medicines, pharmaceuticals, drugs, and medical devices are exempt from the sales tax. Both Maryland and Virginia exempt medicine, pharmaceuticals, and medical supplies from the sales tax, which is also a standard practice nationwide.⁴⁹³ However, D.C., Maryland, and Virginia are among only 15 states that also exempt non-prescription drugs; one state charges a preferential rate of 1 percent.⁴⁹⁴

PURPOSE: The purpose of the exemption is to make the sales tax more equitable by exempting necessities that absorb a relatively large share of the income of low-income households, and to avoid adding to the expense of potentially life-saving medicines, drugs, and medical devices. In addition, the exemption protects the elderly and people in poor health, who spend more for medical care, drugs, and medical products.

IMPACT: The sellers and purchasers of medicines, pharmaceuticals, drugs, and medical devices benefit from this exemption, as do consumers – particularly those with high medical costs such as the elderly and individuals with chronic conditions. Nevertheless, the exemption may not be well targeted at helping low-income individuals and families because it is available to all taxpayers. Data on consumer expenditures show that out-of-pocket expenditures on drugs and medical care rise along with income.⁴⁹⁵

Nevertheless, Virginia’s Joint Legislative Audit and Review Commission (JLARC) concluded that the sales tax exemption for medicine and other health products provides significant benefits to the elderly. In examining the impact of the exemption in Virginia, JLARC stated that, “(A)verage out-of-pocket reductions in tax liability to households with at least one member 65 or older was \$66 in 2008, which was above the statewide average (\$38) for all households. Their savings were enough to enable them to purchase a year-and-a-half’s worth of prescription drugs

⁴⁹³ John Due and John Mikesell, “Retail Sales Tax, State and Local” in *The Encyclopedia of Taxation and Tax Policy*, Second Edition, Joseph Cordes, Robert Ebel, and Jane Gravelle, eds. (Washington, D.C.: The Urban Institute Press, 2005), p. 337.

⁴⁹⁴ Federation of Tax Administrators, “State Sales Tax Rates and Food & Drug Exemptions,” available at www.taxadmin.org.

⁴⁹⁵ Virginia Joint Legislative Audit and Review Commission, p. 33.

for common conditions such as arthritis or diabetes, according to prices under a major retailer's discount prescription drug program."⁴⁹⁶

In a paper prepared for the D.C. Tax Revision Commission, University of Tennessee professor William Fox contended that the case for exempting non-prescription drugs is "weak relative to many other types of consumption and the exemption could be eliminated."⁴⁹⁷

⁴⁹⁶ Virginia Joint Legislative Audit and Review Commission, pp. 33-34.

⁴⁹⁷ Professor William Fox, "Sales Taxes in the District of Columbia," paper prepared for the D.C. Tax Revision Commission, May 2013, p. 7.

Sales Tax Exemptions

201. Groceries

District of Columbia Code: D.C. Official Code § 47-2001(n)(2)(E)
 Sunset Date: None
 Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$68,457	\$71,332	\$74,185	\$76,930

DESCRIPTION: Gross receipts from sales of food or drinks that are defined as eligible foods under the federal Supplemental Nutrition Assistance Program (SNAP, which was formerly known as the “Food Stamp” program) are exempt from sales tax, except sales of food or drink for immediate consumption or the sale of soft drinks.⁴⁹⁸ Snack food is exempt from the sales tax, due to a statutory change that the District adopted in 2001.⁴⁹⁹

Maryland exempts groceries from the sales tax, while in Virginia groceries are subject to a sales tax of 2.5 percent instead of the 6.0 rate imposed in Northern Virginia.⁵⁰⁰ Virginia is one of only 13 states to impose the sales tax on food: seven of these states apply the general rate, while six charge a lower rate.⁵⁰¹ Several states that tax food also provide a rebate or tax credit to protect low-income households.

PURPOSE: The purpose of the exemption is to make the sales tax more equitable by exempting necessities that absorb a large share of the income of low-income households.

IMPACT: All residents benefit from the exemption of groceries from the sales tax, but the exemption is particularly important for low-income individuals and families. Some have observed that the benefit for low-income families is smaller than one might expect, because federal law bars sales taxation of food purchased through the SNAP program.

Some experts further contend that sales tax exemptions and reductions for food are poorly targeted because they do not depend on income. Virginia’s Joint Legislative Audit and Review Commission reported that households earning more than \$70,000 accounted for 44 percent of Virginia households in 2008, but claimed 58 percent of the reduction in tax liability from the

⁴⁹⁸ Food prepared for immediate consumption is taxed at a 10 percent rate, compared to the 5.75 percent general sales tax rate.

⁴⁹⁹ This change was part of D.C. Law 13-305, the “Tax Clarity Act of 2000,” effective June 9, 2001.

⁵⁰⁰ Virginia’s sales tax became more complicated due to legislation enacted in 2013. The base rate for the general sales tax is now 5.3 percent, but in the Northern Virginia and Hampton Roads areas, a 0.7 percent add-on raises the total tax to 6 percent. The regional add-on generates revenue for transportation projects.

⁵⁰¹ Federation of Tax Administrators, “State Sales Tax Rates and Food & Drug Exemptions,” available at www.taxadmin.org.

partial sales tax exemption for food. At the same time, households earning less than \$20,000 comprised 14 percent of Virginia households, but received only 7 percent of the total benefit from the lower tax rate.⁵⁰² In a report prepared for the D.C. Tax Revision Commission, University of Tennessee professor William Fox stated that, “Food could be taxed and low-income households compensated with credits against the personal income tax or a smart card could be provided to low-income households to use as payment of sales tax on food purchases.”⁵⁰³

⁵⁰² Virginia Joint Legislative Audit and Review Commission, p. 33.

⁵⁰³ William Fox, “Sales Taxes in the District of Columbia,” paper prepared for the D.C. Tax Revision Commission, May 2013, p. 7.

Sales Tax Exemptions

202. Materials used in war memorials

District of Columbia Code: D.C. Official Code § 47-2005(16)
 Sunset Date: None
 Year Enacted: 1957

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	minimal

DESCRIPTION: Gross receipts from the “sales of material to be incorporated permanently in any war memorial authorized by Congress to be erected on public grounds of the United States” are exempt from the sales tax.⁵⁰⁴

PURPOSE: The purpose of the exemption is to facilitate the construction of war memorials on public grounds in the District of Columbia.

IMPACT: The exemption benefits the U.S. government by providing a sales tax exemption for materials used in the construction for war memorials that are authorized by Congress and built on federally-owned land. There is no projected revenue loss from this exemption during the FY 2016 through FY 2018 period because there are no war memorials planned for construction during that time frame.

At the time of this writing, the World War I Centennial Commission was in the process of selecting a design for a World War I Memorial to be built at Pershing Park in Washington, D.C. According to the National Capital Planning Commission, the ground is expected to be broken for this memorial sometime in 2018. However, because no further information could be obtained, it is assumed that the sales tax revenue losses of exempted materials used in that year will be minimal, or less than \$50,000.

The World War II Memorial, dedicated in 2004, was the most recent war memorial constructed in Washington, D.C.

⁵⁰⁴ See D.C. Official Code § 47-2005(16).

Sales Tax Exemptions

203. Nonprofit (501(c)(4)) organizations

District of Columbia Code: D.C. Official Code § 47-2005(22)
 Sunset Date: None
 Year Enacted: 1987

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$37,890	\$39,482	\$41,061	\$42,580

DESCRIPTION: Gross receipts from sales to an organization that is exempt from federal corporate income tax under section 501(c)(4) of the Internal Revenue Code are exempt from District of Columbia sales taxation. Organizations covered by section 501(c)(4) include “civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.”⁵⁰⁵

Maryland and Virginia exempt non-profit organizations from the sales tax, as do all but five states with a broad-based sales tax.⁵⁰⁶

PURPOSE: The purpose of the exemption is to support the activities of non-profit organizations that promote social welfare.

IMPACT: Organizations that are tax-exempt under section 501(c)(4) of the Internal Revenue Code, and the people those organizations serve, benefit from this exemption. Still, sales tax exemptions for particular organizations narrow the tax base and may result in a higher sales tax rate for non-exempt individuals and organizations. Another consideration is that tax benefits for non-profits give them an advantage in direct competition with for-profit firms.⁵⁰⁷

In a recent study, the Virginia Joint Legislative Audit and Review Commission (JLARC) found that the rate of increase in non-profit activity (as measured by per-capita expenditures) did not change significantly after 2004, when statutory changes broadened the number of non-profits eligible for Virginia’s sales tax exemption. In fact, JLARC found that many charitable non-profits operating in Virginia did not use the exemption. Nevertheless, JLARC concluded that the exemption helps organizations that meet important needs such as emergency medical services, food, and housing assistance, and that the non-profits which provide the services reduce the state’s burden of directly providing or funding the services.⁵⁰⁸

⁵⁰⁵ See 26 U.S.C. 501(c)(4)(A).

⁵⁰⁶ Virginia Joint Legislative Audit and Review Commission, p. 62.

⁵⁰⁷ William Fox, “Sales Taxes in the District of Columbia,” paper prepared for the D.C. Tax Revision Commission, May 2013, p. 9.

⁵⁰⁸ Virginia Joint Legislative Audit and Review Commission, pp. 58-61.

Sales Tax Exemptions

204. Semi-public institutions

District of Columbia Code: D.C. Official Code § 47-2005(3)
 Sunset Date: None
 Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$57,412	\$59,823	\$62,216	\$64,518

DESCRIPTION: Gross receipts from sales to semi-public institutions are exempt from the sales tax if (1) the institution obtains a certificate from the Mayor stating that the institution is entitled to the sales tax exemption, (2) the vendor keeps a record of each sale, (3) the institution is located in the District of Columbia, and (4) the property or services purchased are for use or consumption, or both, in maintaining and operating the institution for the purpose for which it was established, or for honoring the institution or its members.

A semi-public institution is defined as “any corporation, and any community chest, fund, or foundation, organized exclusively for religious, scientific, charitable, or educational purposes, including hospitals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.”⁵⁰⁹

Maryland and Virginia exempt non-profit organizations from the sales tax, as do all but five states with a broad-based sales tax.⁵¹⁰

PURPOSE: The purpose of the exemption is to support the mission of private, non-profit institutions that provide religious, educational, social, philanthropic and other services that have important public benefits. The exemption recognizes and encourages the public benefits provided by many non-profit entities such as hospitals and libraries.

IMPACT: Semi-public (non-profit) institutions, and the people they serve, benefit from this exemption. Still, sales tax exemptions for particular organizations narrow the tax base and may result in a higher sales tax rate for non-exempt individuals and organizations. Another consideration is that tax benefits for non-profits give them an advantage in direct competition with for-profit firms.⁵¹¹

In a recent study, the Virginia Joint Legislative Audit and Review Commission (JLARC) found that the rate of increase in non-profit activity (as measured by per-capita expenditures) did not

⁵⁰⁹ See D.C. Official Code § 47-2001(r).

⁵¹⁰ Virginia Joint Legislative Audit and Review Commission, p. 62.

⁵¹¹ William Fox, “Sales Taxes in the District of Columbia,” paper prepared for the D.C. Tax Revision Commission, May 2013, p. 9.

change significantly after 2004, when statutory changes broadened the number of non-profits eligible for Virginia's sales tax exemption. In fact, JLARC found that many charitable non-profits operating in Virginia did not use the exemption. Nevertheless, JLARC concluded that the exemption helps organizations that meet important needs such as emergency medical services, food, and housing assistance, and that the non-profits which provide the services reduce the state's burden of directly providing or funding the services.⁵¹²

⁵¹² Virginia Joint Legislative Audit and Review Commission, pp. 58-61.

Sales Tax Exemptions

205. Miscellaneous

District of Columbia Code: D.C. Official Code § 47-2005
 Sunset Date: None
 Year Enacted: 1949 and subsequent years

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: D.C. law includes a number of sales-tax exemptions that are relatively small in scope. These miscellaneous exemptions cover gross receipts from (1) sales of materials and services to the printing clerks of the U.S. House of Representatives, and sales of materials and services by the printing clerks, (2) casual and isolated sales by a vendor who is not regularly engaged in the business of retail sales, (3) sales of food, beverages, and other goods made for use in the U.S. House of Representatives cloakrooms, and sales of food, beverages, and other goods made by anyone involved in operating the cloakrooms, (4) sales of food or beverages on a train, airline, or other form of transportation operating in interstate commerce, (5) food or drink that is delivered and sold without profit by a non-profit volunteer organization to persons who are confined to their homes, (6) sales of food or drink made by a senior citizen residence to the residents, guests, and employees of the senior residence, (7) sales of vessels that are subject to Article 29 of the Police Regulations, (8) sales of residential cable television services and commodities,⁵¹³ (9) sales of printing services and tangible personal property to a publisher that prints and distributes its own newspaper in the District of Columbia free of charge, (10) sales of two-way land mobile radios used for taxicab dispatch and communication, (11) sales of material or equipment used in the construction, repair, or alteration of real property, provided that the materials are temporarily stored in the District of Columbia for not longer than 90 days in order to transport the property outside the District for use solely outside the District, and (12) sales by the U.S. government or the District government.

Sales tax exemptions for infrequent or isolated transactions are common in other states.

PURPOSE: The miscellaneous exemptions serve a variety of purposes, including (1) avoiding an administrative burden on those who sell goods or services infrequently or incidentally, (2) preventing double-taxation for certain goods or services subject to other taxes when they are sold, (3) exempting goods or carriers that are passing through the District through interstate commerce or transportation, and (4) promoting the purchase of certain items.

IMPACT: Various groups of vendors and consumers benefit from these exemptions, as described above. There may also be a benefit to the Office of Tax and Revenue, because the cost of collecting sales tax on incidental or unusual transactions might exceed the amount of revenue generated. There is no estimate of the forgone revenue for these provisions, because most of the individual items are very small and difficult to estimate.

⁵¹³ These sales are subject to a gross receipts tax.

Sales Tax
Exemptions

206. Public utility companies

District of Columbia Code: D.C. Official Code § 47-2005(5)
Sunset Date: None
Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$83,945	\$87,470	\$90,969	\$94,335

DESCRIPTION: Gross receipts from sales to a utility or a public-service company are exempt from the sales tax, provided that (1) the sales are for use or consumption in furnishing a service or commodity, and (2) the charges from furnishing the service or commodity are subject to a gross receipts tax or mileage tax in the District of Columbia. Both Maryland and Virginia provide similar exemptions.

PURPOSE: The purpose of the exemption is to protect utilities and public-service companies from double taxation. Because utilities and public-service companies are subject to a gross receipts tax, the value of the purchases made to provide utility service are already included in the base of the gross receipts tax.

IMPACT: Utility and public-service companies benefit from this exemption, as do their customers who would presumably bear some of the burden of the tax through higher rates.

**Sales Tax
Exemptions**

207. State and local governments

District of Columbia Code: D.C. Official Code § 47-2005(2)
Sunset Date: None
Year Enacted: 1949

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	minimal	minimal	minimal	minimal

Note: "Minimal" means that the forgone revenue is estimated as less than \$50,000 per year, although precise data are lacking.

DESCRIPTION: Gross receipts from sales to a state or any of its political subdivisions (counties, cities, townships) are exempt from the sales tax, provided that the state grants a similar exemption to the District of Columbia. The term "state" refers to the states, territories, and possessions of the United States.

PURPOSE: The purpose of the exemption is to recognize that purchases made by state and local governments are not meant for final consumption, but rather as inputs to the provision of goods and services by those governments.

IMPACT: State and local governments benefit from the exemption, as do the taxpayers in those jurisdictions. The District of Columbia also benefits indirectly, because the District will not receive an exemption from the sales tax in other jurisdictions if it does not provide a reciprocal exemption.

**Sales Tax
Exemptions**

208. Valet parking services

District of Columbia Code: D.C. Official Code § 47-2001 (n)(1)(L)(iv-I)
Sunset Date: None
Year Enacted: 2002

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$256	\$268	\$281	\$292

DESCRIPTION: Gross receipts from sales of valet parking services are exempt from the sales tax.

PURPOSE: The District’s sales tax generally includes “the sale of or charge for the service of parking, storing, or keeping motor vehicles or trailers.”⁵¹⁴ Nevertheless, the District had never levied the tax on valet parking services, and policymakers decided to codify the sales tax exemption for valet parking services.⁵¹⁵

IMPACT: Valet parking providers and their customers benefit from this exemption. The exemption creates a horizontal inequity, because other forms of parking are not exempt from taxation.

During fiscal year 2015, the District Department of Transportation reported that 61 valet parking permits were in effect. The estimated revenue loss from the exemption for fiscal years 2016 through 2019 is based on assumptions about the number of days each valet parking establishment is open and the money collected per day.

⁵¹⁴ See D.C. Official Code § 47-2001(n)(1)(L).

⁵¹⁵ Office of the Chief Financial Officer, “Fiscal Impact Statement: ‘Fiscal Year 2003 Budget Support Act of 2002,’” June 4, 2002, p. 7.

INSURANCE PREMIUMS TAX

Insurance Premium Tax

Credit

209. Certified capital investment by insurance companies

District of Columbia Code: D.C. Official Code § 31-5233

Sunset Date: None

Year Enacted: 2004

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$1,902	\$4,722	\$0	\$0

DESCRIPTION: Insurance companies that invest in a certified capital company (CAPCO) can receive insurance premium tax credits equal to the amount of the insurance company’s total debt and equity investment in the CAPCO. By allowing insurance companies to claim premium tax credits, the District generates a pool of investment capital.

CAPCOs must apply for certification from the Department of Insurance, Securities, and Banking (DISB), and must demonstrate that they meet statutory requirements for equity capitalization, venture capital experience, and other criteria. DISB has certified three CAPCOs.

The CAPCOs are required to invest the insurance company funds in qualified small businesses that are headquartered and conduct their principal business operations in the District, or that certify in an affidavit that they will relocate their headquarters and principal business operations to the District within 90 days after receiving an initial investment from a CAPCO. At least 25 percent of the employees of a qualified small business must live in the District, and at least 75 percent of their employees must work in the District. Qualified small businesses must also certify in an affidavit that they are unable to obtain conventional financing.

Amendments to the CAPCO statute enacted in 2010⁵¹⁶ created four tiers of qualified businesses, based on their primary line of business and the location of their headquarters. The size of the credit earned by a CAPCO will depend on the tier of business; for example, each dollar invested in a Tier One business will yield a credit of \$1.25. The amendments also require CAPCOs to invest all of their certified capital within 10 years of being awarded insurance premium tax credits. If a CAPCO fails to make the full investment within 10 years, it is barred from using its certified capital to pay its management fees.

In any tax year, an insurance company may not claim insurance premium tax credits that exceed 25 percent of its premium tax liability, but the unused premium tax credits can be carried forward indefinitely until they are utilized. There is an aggregate limit of \$50 million on the premium tax credits that may be granted and a \$12.5 million limit per year. Tax year 2009 was the first year that insurance companies could claim the credit.

CAPCO programs have been adopted in eight other states, but not in Maryland or Virginia.⁵¹⁷

⁵¹⁶ D.C. Law 18-181, the “Certified Capital Companies Improvement Amendment Act of 2010,” took effect on May 27, 2010.

⁵¹⁷ This information is from www.capcoprogram.com.

PURPOSE: The purpose of the credit is to encourage private capital investment in new or expanding small businesses in the District of Columbia. More generally, the CAPCO program is intended to strengthen and expand the District’s economic and tax base.

IMPACT: The impact of the CAPCO program has been the subject of some dispute. The D.C. Auditor concluded in a 2009 report that the CAPCO program was ineffective, having created only 31 jobs over four years, and recommended termination of the program.⁵¹⁸ Professor Stephen Fuller of George Mason University offered a more optimistic assessment that same year, contending that CAPCO “has achieved its initial goals ... in spite of a declining economic environment and the collapse of the conventional capital markets.” Fuller credited the program with supporting early-stage businesses and helping those businesses to attract additional capital.⁵¹⁹

In a report issued in 2010, the Council’s Committee on Public Services and Consumer Affairs concluded that the program suffered from “misaligned incentives” and offered “little in the way of risk protection for the District government” from poor investment decisions by the CAPCOs.⁵²⁰ While approving amendments designed to strengthen the program, the Committee stated that, “(U)nder no circumstances should the duration of the CAPCO program be extended through the allocation of any additional premium tax credits beyond those allocated pursuant to the original act.”⁵²¹

According to the Department of Insurance, Securities, and Banking, \$47.3 million in CAPCO tax credits had been claimed by the end of March of 2016. The estimate of foregone revenue in the table above assumes that all of the remaining \$6.6 million balance will be claimed in FY2016 and FY2017.

⁵¹⁸ Office of the District of Columbia Auditor, “Certified Capital Companies Program,” March 12, 2009, available at www.dcauditor.org.

⁵¹⁹ Stephen Fuller, “D.C. CAPCO: Progress Report and Assessment,” prepared for The D.C. Coalition for Capital, April 3, 2009.

⁵²⁰ Council of the District of Columbia, Committee on Public Services and Consumer Affairs, Report on Bill 18-402, the “Certified Capital Companies Improvement Amendment Act of 2010,” February 24, 2010, pp. 3-4.

⁵²¹ *Ibid*, pp. 6-7.

PERSONAL PROPERTY TAX

Personal Property Tax
Exemptions

210. Digital audio radio satellite companies

District of Columbia Code: D.C. Official Code § 47-1508(a)(8)
Sunset Date: None
Year Enacted: 2000

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: The personal property of a digital audio radio satellite service company with a license granted by the Federal Communications Commission is exempt from the personal property tax, provided that the company is subject to a gross receipts tax.

PURPOSE: The purpose of the exemption is to prevent double taxation.

IMPACT: Digital audio radio satellite companies benefit from this exemption. The Office of Revenue Analysis (ORA) cannot estimate the revenue forgone from the exemption, because there is only one provider of digital radio service located in the District of Columbia. ORA follows the policy of the U.S. Internal Revenue Service which states that, “No statistical tabulation may be released with cells containing data from fewer than three returns,” in order to protect the confidentiality of individual tax records.⁵²²

⁵²² U.S. Internal Revenue Service, Publication 1075, “Tax Information Security Guidelines for Federal, State, and Local Agencies and Entities” (January 2014), p. 116.

Personal Property Tax Exemptions

211. Qualified high-technology companies

District of Columbia Code: D.C. Official Code § 47-1508(a)(10)
 Sunset Date: None
 Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$108	\$112	\$115	\$119

DESCRIPTION: The personal property of a “qualified high technology company” is exempt from personal property taxation for the 10 years beginning in the year of purchase. The exemption applies to personal property purchased after December 31, 2000. In addition, qualified personal property leased to a qualified high technology company under a lease-purchase or security-purchase agreement is also exempt from personal property tax for a period not to exceed 10 years.⁵²³

A high-technology company is considered “qualified” if it (1) has two or more employees in the District, and (2) derives at least 51 percent of gross revenues earned in the District from technology-related goods and services such as Internet-related services and sales; information and communication technologies, equipment and systems that involve advanced computer software and hardware; and advanced materials and processing technologies.

The personal property tax exemption is part of a package of incentives for high-technology firms authorized by D.C. Law 13-256, the “New E-conomy Transformation Act of 2000.”⁵²⁴

PURPOSE: The purpose of this exemption is to encourage the growth of high-technology companies in the District of Columbia and thereby expand the District’s economy and employment base.

IMPACT: High-technology companies in the District of Columbia benefit from this provision. The exemption violates the principle of horizontal equity because businesses in other industries do not receive the same treatment.

⁵²³ The property is not exempt from the personal property tax if it is leased to a qualified high-technology company under an operating lease.

⁵²⁴ The other incentives, which include a reduced corporate tax rate, increased expensing of capital assets, employment credits, property tax abatements, and sales tax exemptions, are discussed elsewhere in this section.

Personal Property Tax Exemptions

212. Qualified supermarkets

District of Columbia Code: D.C. Official Code § 47-1508(a)(9)
 Sunset Date: None
 Year Enacted: 2000

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$319	\$322	\$332	\$343

DESCRIPTION: The personal property of a “qualified supermarket” is exempt from personal property taxation for 10 years, subject to several conditions. First, the real property where the personal property is located must continue to be used as a supermarket. Second, if the supermarket leases the real property where it is located, the owner of the property must reduce the rent charged to the supermarket by the amount of any real property tax exemption it receives for being the site of a qualified supermarket. Third, the supermarket must meet its requirements under the “First Source” program, which requires private organizations receiving D.C. government aid to give priority to D.C. residents in filling new jobs.⁵²⁵

A “qualified supermarket” is a supermarket located in a census tract where more than half of the households have incomes below 60 percent of the area median, as determined by the U.S. Department of Housing and Urban Development.

PURPOSE: The purpose of the exemption is to encourage the construction and operation of supermarkets in underserved areas of the city.

IMPACT: Individuals and organizations that are constructing and operating supermarkets in the target areas benefit from this provision. By extension, residents of these areas benefit by gaining greater access to a wider range of food in their neighborhood. The exemption violates the principle of horizontal equity because other businesses that locate in the same areas do not receive similar treatment, nor do supermarkets located outside of the eligible areas.

⁵²⁵ Specifically, the beneficiaries of D.C. government aid are expected to hire D.C. residents for at least 51 percent of their new jobs.

Personal Property Tax Exemptions

213. Cogeneration systems

District of Columbia Code: D.C. Official Code § 47-1508(a)(12)
 Sunset Date: None
 Year Enacted: 2013

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$1,370	\$1,370	\$1,370

DESCRIPTION: Cogeneration systems, which are defined as systems that produce both electric energy and steam or forms of useful energy (such as heat) that are used for industrial, commercial, heating, or cooling purposes, are exempt from the personal property tax beginning on October 1, 2016.

PURPOSE: The purpose of the exemption is to encourage the development of cogeneration systems and thereby promote more efficient forms of energy use. Although traditional power sources are only 33 percent efficient, meaning that they waste approximately two-thirds of the energy they produce, cogeneration systems have an efficiency rate of 60 to 80 percent.⁵²⁶

IMPACT: The exemption is expected to benefit a cogeneration project planned for a large development on the Southwest waterfront, which is set for a phased delivery beginning in 2016. Proponents argue that cogeneration systems are not financially viable without the personal property tax exemption, especially in light of the significant capital investment that the systems require.

Nevertheless, a “Tax Abatement Financial Analysis” (TAFAs) issued by the Chief Financial Officer found that, “(C)ogeneration exemptions are ... unlikely to be necessary, as cogeneration systems generally provide a reasonable return on investment .” The TAFAs pointed out that the long-term energy savings resulting from cogeneration can justify the initial up-front capital investment.⁵²⁷

⁵²⁶ Council of the District of Columbia, “Report on Bill 19-749, the ‘Energy Innovation and Savings Amendment Act of 2012,’” dated October 4, 2012, pp. 2, 6-7.

⁵²⁷ Office of the Chief Financial Officer, “Tax Abatement Financial Analysis: ‘Energy Innovation and Savings Amendment Act of 2012,’” dated June 29, 2012, pp. 1-2.

Personal Property Tax Exemptions

214. Non-profit organizations

District of Columbia Code: D.C. Official Code § 47-1508(a)(1)
Sunset Date: None
Year Enacted: 1902

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$6	\$6	\$6	\$6

DESCRIPTION: The personal property of any non-profit organization organized exclusively for religious, scientific, charitable, or educational purposes, including hospitals, is exempt from personal property taxation, provided that that the organization obtains a letter from the Chief Financial Officer stating that it is entitled to the exemption. Any personal property used for activities that generate unrelated business income subject to tax under section 511 of the U.S. Internal Revenue Code of 1986 is not exempt from the personal property tax.

PURPOSE: The exemption supports a general policy of providing tax exemptions to non-profit organizations that provide religious, scientific, charitable, educational, or cultural benefits to the general public.

IMPACT: Non-profit organizations organized exclusively for religious, scientific, charitable, educational, or cultural purposes benefit from this exemption. By narrowing the tax base, it is possible that this and similar exemptions increase the tax rate on entities that must pay the tax.

Personal Property Tax Exemptions

215. Motor vehicles and trailers

District of Columbia Code: D.C. Official Code § 47-1508(a)(3)
 Sunset Date: None
 Year Enacted: 1954

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$2,831	\$2,859	\$2,888	\$2,914

DESCRIPTION: Any motor vehicle or trailer registered in the District of Columbia is exempt from personal property taxation, except that special equipment mounted on a motor vehicle or trailer and not used for the transportation of persons or property is taxed as tangible personal property. The District’s personal property tax applies only to business property, so the motor vehicles owned by District residents for their personal use would not be taxed even if this exemption were not in place.

PURPOSE: The reason for the exemption is not known, but many states do not include motor vehicles in their personal property tax.⁵²⁸ Motor vehicles are exempt from the personal property tax in Maryland, but personal and commercial motor vehicles in Virginia are subject to the personal property tax.⁵²⁹

IMPACT: Owners of commercial motor vehicles and trailers benefit from this exemption. As of March 2016, there were 19,207 commercial vehicles registered in the District of Columbia, according to the D.C. Department of Motor Vehicles. The exemption violates the principle of economic neutrality because firms’ personal property tax liability could vary depending on the type of property owned, even if they have the same level of income or assets.

⁵²⁸ John Bowman, “Personal Property Taxation” in District of Columbia Tax Revision Commission, *Taxing Simply, Taxing Fairly: Full Report* (1998), Chapter H, p. 204.

⁵²⁹ In Virginia, each city or county sets its own personal property tax rate and the state subsidizes some personal property tax relief for non-commercial motor vehicles.

Personal Property Tax
Exemptions

216. Public utility and toll telecommunications providers

District of Columbia Code: D.C. Official Code § 47-1508(a)(3A)
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$10	\$10	\$10	\$10

DESCRIPTION: The personal property of any company that is subject to a public utility tax or the toll telecommunications tax is exempt from the personal property tax.

PURPOSE: The purpose of the exemption is to prevent double taxation.

IMPACT: Companies that are subject to the public utility tax or the toll telecommunications tax benefit from this exemption.

Personal Property Tax Exemptions

217. Wireless telecommunication companies

District of Columbia Code: D.C. Official Code § 47-1508(a)(7)
 Sunset Date: None
 Year Enacted: 1998

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	minimal	minimal	minimal	minimal

Note: “Minimal” means that the forgone revenue is estimated as less than \$50,000 per year, although precise data are lacking.

DESCRIPTION: The personal property of a wireless telecommunication company is exempt from personal property taxation, except for office equipment or office furniture. This exemption includes resellers that purchase telecommunications services from another telecommunications service provider, and then resell or integrate the purchased services into a mobile telecommunication service. The exemption is valid whether or not the wireless company uses the property to provide a service which is subject to the toll telecommunications tax.

PURPOSE: The purpose of the exemption is to provide wireless telecommunication companies with a personal property tax exemption equivalent to the exemption provided to other telecommunication companies.

IMPACT: Wireless telecommunication companies benefit from the exemption. Nevertheless, the number of firms that claim the exemption and the associated reduction in tax are unknown because the wireless telecommunication companies do not have to file a form with the Office of Tax and Revenue to be eligible.

The estimated revenue loss is “minimal” (less than \$50,000 per year) because U.S. Census Bureau data show that wireless telecommunication companies are typically small (approximately 30 employees).⁵³⁰ D.C. law exempts the first \$225,000 of taxable personal property from the tax, and most wireless telecommunication companies might therefore be exempt, due to their size, even without this blanket exemption. The majority of D.C. businesses have no personal property tax liability as a result of the \$225,000 exemption.

The exemption violates the principle of horizontal equity because other firms with similar amounts or stocks of personal property do not receive similar treatment.

⁵³⁰ Specifically, the 2007 Economic Census reported that there were 31 wireless telecommunication companies in the District of Columbia with 925 employees, an average of 29.8 employees per firm.

LOCAL TAX EXPENDITURES (unknown if used)

Income Tax
Credits

218. Paid leave for organ or bone marrow donors

District of Columbia Code: D.C. Official Code § 47-1807.08 and § 47-1808.08
 Sunset Date: None
 Year Enacted: 2006

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	no estimate	no estimate	no estimate	no estimate
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	no estimate	no estimate	no estimate	no estimate

DESCRIPTION: A business that provides its employees with a paid leave of absence to serve as organ or bone marrow donors may claim a non-refundable credit equal to 25 percent of the regular salary paid during the leave of absence, not to exceed 30 days for an organ donation and seven days for a bone marrow donation.

To qualify for the credit, the leave provided by the business must be in addition to any medical, personal, or other paid leave provided to the employee. In addition, the credit does not apply if the employee is eligible for leave under the U.S. Family and Medical Leave Act of 1993. The credit does not reduce the minimum tax liability for a business, and the business also cannot deduct the salary paid to the employee during any period for which the paid leave is in effect.

Neither Maryland nor Virginia offers employer incentives to encourage organ or bone-marrow donations. However, Virginia allows organ and tissue donors to take personal income tax deductions of up to \$5,000 (10,000 for joint filers) or the actual amount paid, whichever is less, for unreimbursed medical expenses that have not been claimed as a medical deduction on the taxpayer’s federal income taxes. In addition, Virginia allows taxpayers to deduct from their taxable income the fee paid for an initial screening to become a bone-marrow donor, provided that the individual was not reimbursed for the fee and did not claim a deduction for the fee on his or her federal return. Maryland provides up to 30 days (in any 12-month period) of paid leave to state employees for organ donation.

PURPOSE: The purpose of the credit is to increase the number of private employers who allow their employees paid leave to serve as organ and bone marrow donors.

IMPACT: Employers who provide their employees with paid leave to serve as organ or bone marrow donors are the intended beneficiaries of this provision, which should also generate indirect benefits by expanding the number of organ or bone marrow donors. There were no claimants of this credit in tax year 2013.

The revenue loss for FY 2016-FY 2019 cannot be estimated, because ORA follows the policy of the U.S. Internal Revenue Service providing that, “No statistical tabulation may be released

outside the agency with cells containing data from fewer than three returns.”⁵³¹ This policy is intended to protect the confidentiality of individual tax records.

⁵³¹ U.S. Internal Revenue Service, Publication 1075, “Tax Information Security Guidelines for Federal, State, and Local Agencies and Entities” (January 2014), p. 116.

Income Tax
Credits

219. Employer-assisted home purchases

District of Columbia Code: D.C. Official Code § 47-1807.07 and § 47-1808.07
 Sunset Date: None
 Year Enacted: 2002

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	minimal	minimal	minimal	minimal
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	minimal	minimal	minimal	minimal

Note: “Minimal” means that the forgone revenue is estimated as less than \$50,000 per year, although precise data are lacking.

DESCRIPTION: A business in the District of Columbia with at least one employee may receive a tax credit equal to one-half of the amount of homeownership assistance provided to its employees during the taxable year, provided that (1) the credit received for each employee shall not exceed \$2,500, (2) the assistance is provided through a certified employer-assisted home purchase program, (3) the assistance is used for the purchase of a qualified residential real property, and (4) the eligible employee is a new homebuyer (someone who did not own a principal place of residence in the District in the prior 12 months).

To be eligible, an employee must have a household income less than or equal to 120 percent of the area median income.

PURPOSE: The purpose of the credit is to leverage private-sector assistance for new homeownership in the District of Columbia among low- to moderate-income individuals and families. By providing a tax credit equal to 50 percent of the housing assistance provided by a business, up to \$2,500 annually for each year, the District has in effect created a matching incentive for employer-assisted home purchases.

IMPACT: Low- to moderate-income taxpayers who are eligible for an employer-assisted home purchase program benefit from this tax credit. There may also be spillover benefits in terms of a stronger tax base for the District, increased demand for housing, and more stable neighborhoods.

The revenue loss from the credit is difficult to estimate because the District’s business tax forms do not include a separate line for employer-assisted home purchases. Instead, the credit is combined with other credits into a single line on the tax forms. Nevertheless, the estimated revenue loss for FY 2016 to FY 2019 is characterized as “minimal” for several reasons. First, two-thirds of D.C. corporate franchise taxpayers (73.1 percent in tax year 2012) and unincorporated business taxpayers (74.2 percent in tax year 2012) pay the minimum tax and cannot benefit from the credits. In addition, the D.C. Association of Realtors indicated that usage of the credits had been modest for the previous publication of this report.

**UNUSED LOCAL TAX EXPENDITURES
(no one is taking them)**

Income Tax
Credits

220. Economic development zone incentives for businesses

District of Columbia Code: D.C. Official Code § 6-1501, § 6-1502, § 6-1504, and § 47-1807.06
 Sunset Date: None
 Year Enacted: 1988

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$0	\$0	\$0	\$0

DESCRIPTION: D.C. law designates three economic development zones that are eligible for tax and other development incentives: the Alabama Avenue zone, the D.C. Village zone, and the Anacostia zone. The Mayor may also designate additional economic development zones (subject to Council approval), based on evidence of economic distress such as high levels of poverty, high levels of unemployment, low income, population loss, and other criteria set forth in the law.

A business entity that is located within an economic development zone is eligible for corporate franchise tax credits or unincorporated business franchise tax credits if (1) the business has signed a “First Source” agreement with the D.C. government pledging that 51 percent of new hires shall be D.C. residents, and (2) the business is subject to the D.C. franchise tax.

The available credits include (1) a credit equal to 50 percent of wages paid to low-income workers who are D.C. residents, up to a maximum of \$7,500 per employee per year, (2) a credit equal to 50 percent of the workers’ compensation premiums paid on behalf of workers who are D.C. residents, and (3) a rent credit for businesses that rent space to a non-profit child care center. The value of the rent credit is equal to the difference between the fair market value for the space and the actual rent charged to the child care center. If the rent credit exceeds the tax liability of a business, it can carry the credit backward or forward for up to five years.

The Mayor must submit and the Council must approve a resolution that qualifies the business for the incentives. The resolution must identify the business, specify the types of incentives to be granted, and estimate the annual dollar value of each franchise tax credit.

In 1997, the federal government established an enterprise zone in the District of Columbia, which provided businesses operating in the zone with federal wage tax credits, expensing and capital gains tax benefits, and tax-exempt bond financing. The authorization for the federal enterprise zone expired on December 31, 2011.

Maryland provides income tax credits for each new worker hired by a business in any of 29 enterprise zones and also allows localities to offer real property tax credits for a portion of any

property improvements made by a business in an enterprise zone.⁵³² Businesses that locate in the Baltimore City or Prince George's County zones are eligible for larger property and income tax credits, as well as personal property tax credits. Virginia replaced its enterprise zone tax credits with a grant program.

PURPOSE: The purpose of the incentives is to promote economic development in neighborhoods in economic distress, and to increase the employment of low-income D.C. residents.

IMPACT: Businesses located in an economic development zone are eligible to benefit from these incentives, as are low-income residents. Nevertheless, only two incentive packages have been approved since the economic development zones were created, and neither package included business tax incentives (both packages included real property tax incentives).

⁵³² The income tax credits are \$1,000 for each new worker but the credit rises to \$6,000 over three years if the worker is "economically disadvantaged." The real property tax credits equal 80 percent of the increased tax liability resulting from property improvements for the first five years, and are then phased out over the next five years.

**Real Property Tax
Abatements**

221. Improvements to low-income housing

District of Columbia Code: D.C. Official Code § 47-866
 Sunset Date: None
 Year Enacted: 2002

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: If the owner of an eligible housing accommodation makes improvements of at least \$10,000 per housing unit in a 24-month period, the owner is eligible for a tax abatement equal to the increase in real property tax liability for each of the subsequent five years, relative to a base year before the improvements were completed.

To qualify, the owner must offer at least 25 percent of the units at rents that are affordable to households with income below 50 percent of the area median. In addition, the owner must maintain the property as low-income housing throughout the five-year period, and is not eligible for the abatement if he or she has recovered the costs of renovation through another program.

The total abatements provided through this tax provision are capped at \$1 million annually. To receive the benefit, the property owner must submit an application to the Mayor at least 30 days before the physical improvements begin and receive certification from the Mayor after the improvements are completed. The Mayor must also determine that the improvements are unlikely to be made without the tax abatement. In Mayor’s Order 2009-202, dated November 25, 2009, Mayor Fenty designated the Department of Housing and Community Development (DHCD) as the agency responsible for administering this tax abatement program.⁵³³

PURPOSE: The purpose of the abatements is to preserve and upgrade the supply of affordable housing by encouraging owners to rehabilitate their housing units and making the abatements contingent on the affordability of the housing to low-income individuals and families.

IMPACT: The owners of affordable-housing accommodations who improve their housing are the intended beneficiaries of this provision, along with the low-income residents who live in the housing units. Nevertheless, DHCD has not received any applications for the abatement.

⁵³³ Mayor’s Order 2009-202, entitled “Delegation of Authority – Tax Abatements under Section 291 of the Housing Act of 2002,” was published in the D.C. Register, Vol. 56, No. 49, p. 9222, December 4, 2009.

**Real Property Tax
Abatements**

222. Preservation of section 8 housing in qualified areas

District of Columbia Code: D.C. Official Code § 47-865
 Sunset Date: None
 Year Enacted: 2002

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: If the owner of a housing accommodation who receives subsidies through a project-based housing assistance program (“Section 8” program) of the U.S. Department of Housing and Urban Development (HUD) renews or extends the HUD contract with substantially the same conditions for at least five years, the owner is eligible for a tax abatement. To qualify, the housing must be located in an area where the average rent for one-bedroom and two-bedroom apartments exceeds the fair-market rent (as defined by HUD) by 25 percent or more.

If the contract is renewed for five years, the owner qualifies for a tax abatement for each of the five years equal to 75 percent of any increment to his or her real property tax liability compared to a base year immediately prior to the first year of the abatement. If the contract is renewed for 10 years, the owner qualifies for a tax abatement for each year equal to 100 percent of the increment to his or her real property tax liability compared to the base year.

The Department of Housing and Community Development administers this tax abatement.⁵³⁴

PURPOSE: The purpose of the abatement is to preserve affordable housing by encouraging landlords to continue participating in federal housing programs for low-income households. The abatements are limited to areas where the average rents exceed the fair-market rent by 25 percent in order to target the benefits where they are most needed.⁵³⁵

IMPACT: The owners of housing accommodations in qualified areas who renew their contracts with HUD to provide section 8 housing are the intended beneficiaries of this provision, along with residents of federally-subsidized housing located in the qualified areas. However, there are presently no participants in this abatement program. Only one property owner has claimed the abatement for preserving section 8 housing, but that abatement has expired.

⁵³⁴ See Mayor’s Order 2009-202, entitled “Delegation of Authority – Tax Abatements under Section 291 of the Housing Act of 2002,” *D.C. Register*, Vol. 56, No. 49, p. 9222, December 4, 2009.

⁵³⁵ This summary draws on the Council of the District of Columbia, Committee on Finance and Revenue, “Committee Report on Bill 14-183, the ‘HomeStart Financial Incentives Act of 2001,” dated November 13, 2001. The tax abatements for preservation of section 8 housing originated in Bill 14-183, which became Law 14-114, the “Housing Act of 2002,” effective April 19, 2002.

**Real Property Tax
Abatements**

223. Single-room-occupancy housing

District of Columbia Code: D.C. Official Code § 42-3508.06
 Sunset Date: None
 Year Enacted: 1994

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: The Mayor is authorized to provide tax abatements, as well as deferral or forgiveness of water and sewer fees and other indebtedness to the District government, to encourage the development of single-room-occupancy housing for low- and moderate-income tenants. These incentives would be granted following negotiations and the signing of a written agreement between the Mayor and housing providers who are developing or operating single-room-occupancy housing accommodations.

The written agreement may establish a formula for abating property tax liability for the relevant property or properties. The abatement applies for a period of no longer than 10 years, beginning during the first year that the newly constructed or rehabilitated single-room-occupancy housing becomes available for occupancy.

To qualify for the incentives, a housing provider must demonstrate to the satisfaction of the Mayor that the single-room-occupancy housing (1) is affordable to low- and moderate-income tenants and that the rent is reduced by the benefits received, (2) complies with the District's zoning regulations, (3) includes at least 95 square feet of space and a clothing storage unit, (4) provides toilet and shower or bathing facilities on each floor, (5) includes common day room, kitchen, and laundry facilities, (6) provides a 24-hour manual or electronic security system, and (7) is supervised by a manager who resides on the premises.

PURPOSE: The purpose of the incentives is to encourage the development of single-room-occupancy housing for low- and moderate-income tenants.

IMPACT: Organizations that develop or operate single-room-occupancy housing for low- and moderate-income tenants are the intended beneficiaries of this provision, along with the low- and moderate-income tenants who need affordable housing. Nevertheless, there is no evidence that the incentives have been used.

**Real Property Tax
Abatements**

224. Vacant rental housing

District of Columbia Code: D.C. Official Code § 42-3508.02
Sunset Date: None
Year Enacted: 1985

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: An owner of newly constructed rental housing accommodations is eligible for tax abatements equal to 80 percent of tax liability during the first year the housing becomes available for rental. In each succeeding year, the tax abatement would be reduced by 16 percentage points until the property is fully taxable.

When vacant rental accommodations that have been rehabilitated become available for rental, the owner of the property also becomes eligible for an 80 percent reduction of the increased tax liability that results from the rehabilitation. In each succeeding year, the tax abatement would be reduced by 16 percentage points until the full value of the property is taxable. In addition, the Mayor may defer or forgive any indebtedness owed to the District, or forgive any outstanding tax liens when a vacant rental accommodation is being rehabilitated in accordance with this program.

A project eligible for a tax abatement or forgiveness of any indebtedness or tax lien through this program must be certified by the Mayor as being “in the best interest of the District and ... consistent with the District’s rental property needs in terms of its location, type, and variety of sizes or rental units.” A property is not eligible for this program if the property receives tax incentives for new residential development in targeted neighborhoods (see tax expenditures #144 and #145).

PURPOSE: The purpose of the abatement is to expand the supply of safe and affordable rental housing for low- to moderate-income residents of the District of Columbia.

IMPACT: Renters as well as the owners of newly constructed or rehabilitated rental housing are the intended beneficiaries of this tax incentive. Nevertheless, there is no evidence that any abatements have been awarded through this program in recent years.

Real Property Tax Exemptions

225. Resident management corporations

District of Columbia Code: D.C. Official Code § 47-1002(24)
Sunset Date: None
Year Enacted: 1992

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: Public housing that is transferred to a qualifying resident management corporation is exempt from the real property tax through the end of the 10th tax year following the year in which the property is transferred. A resident management corporation is a non-profit corporation in which public housing residents are the sole voting members.

PURPOSE: The purpose of the exemption is to give low-income families living in a public housing project the opportunity to become owners of the public housing. Once residents become owners, they are expected to have a stronger stake in the maintenance of the property and the quality of life in the community.

IMPACT: Resident management corporations and the individuals they serve are the intended beneficiaries of this provision. According to the D.C. Housing Authority, the Kenilworth-Parkside project is the only property that has been transferred to a resident management corporation.

Because the Kenilworth-Parkside Resident Management Corporation assumed control in 1992, that property is now taxable. There are presently no beneficiaries and no exemptions are projected for the FY 2016 through FY 2019 period.

Real Property Tax
Multiple

226. Economic development zone incentives

District of Columbia Code: D.C. Official Code § 6-1501 - § 6-1503
 Sunset Date: None
 Year Enacted: 1988

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: D.C. law designates three economic development zones that are eligible for tax and other development incentives: the Alabama Avenue zone, the D.C. Village zone, and the Anacostia zone. The Mayor may also designate additional economic development zones, subject to Council approval by resolution. The designation of additional zones must be based on evidence of economic distress such as high levels of poverty, high levels of unemployment, low income, population loss, and other criteria set forth in the authorizing statute.

The real property incentives include property tax reductions that are gradually phased out over five years (the reduction is 80 percent the first year, and is then reduced by 16 percent each year until reaching zero in year six); the deferral or forgiveness of any property tax owed on the property; and the forgiveness of costs or fees associated with a nuisance property infraction. To qualify, a property owner in an eligible zone must have constructed or substantially rehabilitated the property after October 20, 1988, and must comply with zoning regulations.

The Mayor must submit and the Council must approve a resolution that qualifies the property for the incentives. The resolution must identify the real property and its owner; specify each tax or charge to be reduced, deferred, or forgiven; and state the dollar amount of each tax incentive.

Montgomery County offers enterprise zone real property tax credits to businesses that locate in designated areas of downtown Silver Spring, Takoma Park/Long Branch, and Wheaton. The credits start at 80 percent of the increase in real property liability, relative to a base year, and are phased out over 10 years. Prince George’s County offers revitalization tax credits for construction or renovation of commercial and residential structures. The credits equal 100 percent of the increased assessment value relative to a base year, and are then phased out in 20 percent annual increments. Virginia replaced its enterprise zone tax credits with a grant program.

PURPOSE: The purpose of the incentives is to encourage commercial, industrial and residential development, and thereby to create jobs, increase homeownership, and stabilize neighborhoods marked by high poverty and unemployment rates, low income levels, population loss, and other indicators of economic distress.

IMPACT: Owners of newly constructed or improved real property in an economic development zone are the intended beneficiaries of the incentives. However, only two incentive packages have been approved since the zones were created, and neither is in effect today. There are no proposals pending to use the economic development zone incentives.

Real Property Tax
Multiple

227. Homeowners in enterprise zones

District of Columbia Code: D.C. Official Code § 47-858.01 - § 47-858.05
 Sunset Date: None
 Year Enacted: 2002

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: The D.C. government provides real property tax abatements for homeowners in an enterprise zone who substantially rehabilitate their home. Census tracts with poverty rates of 20 percent or more qualify as enterprise zones.

To qualify for the abatements, a property owner must have a household income less than 120 percent of the area median income. In order to receive a tax abatement, an owner must receive certification from the Mayor that the property and rehabilitation meet the requirements of the law.

The tax abatement is measured as a percentage of the amount by which the homeowner’s tax liability for the property increased after the substantial rehabilitation. During the year in which the rehabilitation is completed, and the following three years, the taxpayer can deduct 100 percent of the increased tax liability. In the fourth year, the taxpayer can deduct 75 percent; in the fifth year, 50 percent; and in the sixth year, 25 percent. In the seventh year after the rehabilitation is completed, the property is fully taxable.

PURPOSE: The purpose of the abatement is to promote the revitalization of neighborhoods classified as enterprise zones, to attract new residents to the District of Columbia, and to strengthen the District’s tax base.

IMPACT: Low- to moderate-income owners of homes in enterprise zones are the intended beneficiaries of these provisions, which are also expected to create spillover benefits for neighborhoods with poverty rates of 20 percent or more. Presently, there are no beneficiaries of these tax abatements and none are projected for the FY 2016 to FY 2019 period.

Personal Property Tax Exemptions

228. Solar energy systems

District of Columbia Code: D.C. Official Code § 47-1508(a)(11)
 Sunset Date: None
 Year Enacted: 2013

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: Solar energy systems are exempt from the personal property tax. “Solar energy” is defined as “radiant energy, direct, diffuse, or reflected, received from the sun at wavelengths suitable for conversion into thermal, chemical, or electrical energy, that is collected generated, or stored for use at a later time.”⁵³⁶

The section of D.C. Code authorizing this exemption states that “Systems using exclusively solar energy as defined in § 34-1431(14)); provided, that, notwithstanding any other provision of law, the CFO shall transfer \$120,000 from the certified revenues deposited in the Renewable Energy Development Fund established by § 34-1436 to the unrestricted fund balance of the General Fund of the District of Columbia and shall recognize the \$120,000 as local funds revenue in fiscal year 2013 and in each subsequent fiscal year.” As of yet, this transfer has not occurred as there is no indication that the exemption has been taken.

PURPOSE: The purpose of the exemption is to encourage the installation of large, commercial solar energy systems and thereby help the District to achieve its target of using at least 2.5 percent of energy from solar sources by 2023.⁵³⁷

IMPACT: Proponents argue that solar energy systems are not financially viable without the personal property tax exemption, especially in light of the significant capital investment that the systems require. Nevertheless, a “Tax Abatement Financial Analysis” issued by the Chief Financial Officer found that, “Because District renewable energy portfolio standards, along with Federal renewable energy incentives currently in place, are sufficient to make investment in solar systems a profitable investment ... solar energy exemptions are not generally necessary in order for solar power systems to be developed in the District.”⁵³⁸

Neither the Office of Tax and Revenue nor the Department of Energy and Environment had records of any entities having taken this exemption.

⁵³⁶ See D.C. Official Code § 34-1431(14).

⁵³⁷ See Council of the District of Columbia, “Report on Bill 19-749, the ‘Energy Innovation and Savings Amendment Act of 2012,’” dated October 24, 2012, pp. 2, 5-6.

⁵³⁸ Office of the Chief Financial Officer, “Tax Abatement Financial Analysis: ‘Energy Innovation and Savings Amendment Act of 2012,’” dated June 29, 2012, p. 1.

Personal Property Tax
Exemptions

229. Works of art lent to the National Gallery of Art by non-residents

District of Columbia Code: D.C. Official Code § 47-1508(a)(2)
 Sunset Date: None
 Year Enacted: 1950

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: Works of art owned by an individual who is not a resident or a citizen of the United States are exempt from the personal property tax, provided that the works of art are lent to the National Gallery of Art solely for exhibition without charge to the general public.

PURPOSE: The U.S. Congress established the exemption in order to facilitate a National Gallery of Art exhibition of the paintings of oil magnate Calouste Gulbenkian, who was considered to have one of the best private art collections in the world. Mr. Gulbenkian was unwilling to lend his paintings to the National Gallery without assurances that they would be exempt from federal and District of Columbia taxation, particularly if he were to pass away while the paintings were on loan.⁵³⁹ Therefore, on September 1, 1950, Congress enacted P.L. 81-749, which established that works of art owned by a non-resident of the United States who is not a citizen of the U.S., and lent for exhibition by the National Gallery of Art, are exempt from the federal estate tax and from the D.C. inheritance and personal property taxes.⁵⁴⁰

The exhibit, “European Paintings from the Gulbenkian Collection,” was open to the public from October 8, 1950, to May 31, 1951. Included were works by Ghirlandaio, Rubens, Van Dyck, Rembrandt, Fragonard, Gainsborough, Corot, Manet, Monet, Degas, and Renoir.

IMPACT: There is no evidence that the exemption has been used in any cases besides the Gulbenkian exhibit.

⁵³⁹ U.S. House of Representatives, Committee on Ways and Means, 81st Congress, Report to Accompany House J. Res. 497 (Report No. 2724), July 24, 1950, pp. 1-2.

⁵⁴⁰ The relevant provision of the inheritance tax was repealed when the inheritance tax law was rewritten in 1987.

**UNUSED LOCAL TAX EXPENDITURES
(implementing regulations not yet written)**

Income Tax
Subtractions

230. Environmental savings account contributions and earnings

District of Columbia Code: D.C. Official Code § 8-637.03
 Sunset Date: None
 Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$0	\$0	\$0	\$0

DESCRIPTION: An individual, partnership, corporation, trust, or government agency may establish an environmental savings account (ESA) in order to accumulate funds for the cleanup or redevelopment of brownfields, which are defined as “abandoned, idled property or industrial property where expansion or redevelopment is complicated by actual or perceived environmental contamination.”⁵⁴¹ Funds deposited in an ESA, and the interest earned on the funds, are exempt from District of Columbia income tax. Any funds that are withdrawn and not used for the cleanup and redevelopment of a contaminated property will be subject to the income tax and a 10 percent penalty.

A review did not identify similar income tax incentives offered by Maryland or Virginia, but Maryland authorizes local governments to provide property tax credits equal to 50 to 70 percent of the increase in property taxes for property owners who participate in the state’s Voluntary Cleanup Program. The tax credits may be granted for five years, or 10 years if the property is in an enterprise zone. Montgomery County and Baltimore City are among the jurisdictions that offer the property tax credits.

PURPOSE: The purpose of the subsidy is to provide incentives for individuals and organizations to clean up brownfields voluntarily, which would in turn reduce public health risks and promote economic development by encouraging the reuse of contaminated properties.

IMPACT: Owners of property that is contaminated by hazardous substances may benefit from this provision. The subtraction would be claimed on a line of the tax form that includes other subtractions; therefore, there are no data on use of the provision or associated revenue loss. However, according to officials in the D.C. Department of the Environment, the accounts are not being used as there are no implementing regulations.

⁵⁴¹ See D.C. Official Code § 8-631.02(2).

Income Tax
Credits

231. Brownfield revitalization and cleanup

District of Columbia Code: D.C. Official Code § 8-637.01
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Business Income Tax Loss	\$0	\$0	\$0	\$0
Personal Income Tax Loss	\$0	\$0	\$0	\$0
Total	\$0	\$0	\$0	\$0

DESCRIPTION: The Mayor is authorized to submit proposed rules to the Council to establish business franchise tax credits for businesses that clean up and redevelop “brownfields,” which are defined as “abandoned, idled property or industrial property where expansion or redevelopment is complicated by actual or perceived environmental contamination.”⁵⁴² The total credits awarded to a business would be capped at 100 percent of the costs of cleaning up and 25 percent of the costs of developing the brownfield.

A review did not identify similar business tax incentives offered by Maryland or Virginia, but Maryland authorizes local governments to provide property tax credits equal to 50 to 70 percent of the increase in property taxes for property owners who participate in the state’s Voluntary Cleanup Program. The tax credits may be granted for five years, or 10 years if the property is in an enterprise zone. Montgomery County and Baltimore City are among the jurisdictions that offer the property tax credits.

PURPOSE: The intent of this tax expenditure is to provide incentives for businesses to clean up brownfields voluntarily, which would in turn reduce public health risks and promote economic development by encouraging the reuse of contaminated properties.

IMPACT: Businesses that own contaminated property are the intended beneficiaries of this provision, which is also designed to have spillover benefits to society by reducing environmental risks and contaminants while promoting the redevelopment of brownfields. Nevertheless, the credits have not been offered because implementing regulations have not been proposed.⁵⁴³

⁵⁴² See D.C. Official Code § 8-631.02(2).

⁵⁴³ If the Mayor proposed regulations, the Council would have 45 days to review the rules (excluding Saturdays, Sundays, legal holidays, and periods of Council recess), and if the Council did not act within this period, the rules would be deemed approved.

Real Property Tax
Credits

232. Brownfield revitalization and cleanup

District of Columbia Code: D.C. Official Code § 8-637.01
Sunset Date: None
Year Enacted: 2001

(Dollars in thousands)	FY 2016	FY 2017	FY 2018	FY 2019
Revenue Loss	\$0	\$0	\$0	\$0

DESCRIPTION: The Mayor is authorized to submit proposed rules to the Council to establish real property tax credits for property owners who clean up and redevelop “brownfields,” which are defined as “abandoned, idled property or industrial property where expansion or redevelopment is complicated by actual or perceived environmental contamination.”⁵⁴⁴ The total credits awarded to a property owner would be capped at 100 percent of the costs of cleanup and 25 percent of the costs for development of the contaminated property.

Maryland authorizes local governments to provide property tax credits equal to 50 to 70 percent of the increase in property taxes for property owners who participate in the state’s Voluntary Cleanup Program. The tax credits may be granted for five years, or 10 years if the property is in an enterprise zone. Montgomery County and Baltimore City are among the jurisdictions that offer the property tax credits.

PURPOSE: The purpose of this tax expenditure is to provide incentives for property owners to clean up brownfields voluntarily, which would in turn reduce public health risks and promote economic development by encouraging the reuse of contaminated properties.

IMPACT: The owners of contaminated property are the intended beneficiaries of this provision, which is also designed to have spillover the benefits for the public by reducing environmental risks and contaminants while promoting the redevelopment of brownfields. Nevertheless, the credits have not been offered because the implementing regulations have not been proposed.⁵⁴⁵

⁵⁴⁴ See D.C. Official Code § 8-631.02(2).

⁵⁴⁵ If the Mayor proposed regulations, the Council would have 45 days to review the rules (excluding Saturdays, Sundays, legal holidays, and periods of Council recess), and if the Council did not act within this period, the rules would be deemed approved.