PUBLIC HEARING ON

BILL 16-250, “SCHOOL MODERNIZATION FINANCING ACT OF 2005” (TITLE III OF COMMITTEE ON EDUCATION, LIBRARIES, AND RECREATION COMMITTEE PRINT)

Before the

Committee on Finance and Revenue
Council of the District of Columbia

The Honorable Jack Evans, Chairman

January 9, 2006, 11:00 a.m.
Council Chambers
John A. Wilson Building

Testimony of
Dr. Fitzroy Lee
Director of Revenue Estimation
Office of Revenue Analysis

Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia

Good morning, Chairman Evans and members of the committee. I am Dr. Fitzroy Lee, Director of Revenue Estimation for the Office of Revenue Analysis. I am pleased to present testimony on Title III of Bill 16-250, the "School Modernization Financing Act of 2005," as reported by the Committee on Education, Libraries and Recreation on December 5, 2005.

As this committee is aware, Chief Financial Officer Natwar M. Gandhi testified on the introduced version of this bill at a joint hearing held by this committee and the Committee on Education, Libraries and Recreation on July 5, 2005. In my testimony today, I would like to focus on the financial and administrative implications of the financing mechanisms proposed in Title III of Bill 16-250 and their impacts on the District's budget.

The original version of the bill would have relied on D.C. Lottery proceeds to pay debt service on bonds to finance the costs of modernizing, renovating or constructing public school facilities in the District. In contrast, the new proposals in Title III would use other District funding sources to accomplish these objectives.

Specifically, the bill makes three tax changes to raise revenue for school modernization projects. First, it would increase the tax on commercial property (Class 2) from $1.85 to $1.87 for each $100 of assessed value. This would raise $16.4 million in the first full fiscal year (FY 2007) and $248.7 million over the 10-year period of FY 2007 through FY 2016.

Second, the bill would increase the cigarette tax from $1.00 per pack to $1.50 per pack. This proposal would generate $8.1 million in additional revenue in FY 2007 and $68.0 million over the 10-year period.

Third, we understand from discussions with the committee that the legislation intends to freeze Tax Parity income tax rates at their current levels, e.g., there would be no further reduction in the 8.7 percent tax rate on incomes above $40,000. This change would generate $63.9 million in additional revenues in FY 2007 and a total of $638.7 million over the 10-year period of FY 2007 through FY 2016. We note, however, that the bill as currently drafted would not accomplish this and would need further technical revision.

In total, these tax changes would provide $88.4 million in tax revenues in the first year and $955.5 million over the 10-year period. In addition, the bill requires that up to $250 million of the FY 2005 budget surplus shall be deposited in the new Public School Capital Improvement Fund. Presumably, this would be a one-time deposit. Depositing the full amount early in calendar year 2006 could create cash management pressures in the short term, and we would need to make sure that there are sufficient funds to cover other bills and debt service due during that period.

The bill also provides that, for the next 10 years, $10 million of any revised revenue estimate that exceeds the annual revenue estimate in an approved budget and financial plan after FY 2007 shall be appropriated for the Public School Capital Improvement Fund annually. This could result in providing $100 million for the fund over the 10-year period, but the actual amount would depend on economic conditions and the availability of excess revenue in any given year.

These tax changes would generate significant sums for improving and modernizing the District's schools. There are operational and administrative matters that would need to be addressed if the Council approves the bill in its present form. Public outreach would be necessary to inform taxpayers of the new tax rates for commercial properties and cigarette taxes, as well as the nullification of the income tax rate reductions. The District's Integrated Tax System would also need to be re-programmed to identify properly these tax payments as they are paid and entered into the District's computerized tax database. We estimate the additional operational costs for the Office of Tax and Revenue (OTR) to effectively implement and administer the taxes under the proposed bill to be $75,000 on an annual basis.

Finally, although we do not have a proposal in writing, we understand that this committee may consider an alternative proposal to use the first $100 million of sales taxes collected by the District each fiscal year for public school modernization. While this approach would avoid most of the tax administration and implementation problems we highlighted with respect to the current proposal, if General Fund revenues are decreased by $100 million each year, there are two choices: either another revenue source must be found to fill this gap, or program spending would need to be curtailed. With the current expenditure budget and revenue forecast, funds are not sufficient in the FY 2007 – FY 2009 budget and financial plan to support this legislative proposal.

Assuming that economic conditions remain stable and that the $100 million would be available for modernization, there remain some issues that would need to be addressed, particularly with respect to how such a proposal would affect the

District's ability to pay its bills in the early part of the year. For example, any tax revenue diverted to schools modernization at the beginning of the fiscal year, without an offsetting increase in taxes or other revenue, would negatively impact the District's cash position. In fact, in order to meet its cash flow needs, the District has issued $250 million of Tax Revenue Anticipation Notes during the first quarter of the fiscal year for the last three years.

As you are aware, real property taxes, one of the District's major sources of annual revenue, are due on March 31 and September 15 each year (the 6^{th} and 12^{th} months of the fiscal year). Thus, the Office of the Chief Financial Officer would recommend that any tax revenue diverted to schools modernization occur after April 1. Committing tax revenues to schools modernization after receipt of real property taxes in March would mitigate the effect of this legislation on the District's cash position.

In addition, any tax revenue devoted to schools modernization must be net of funds dedicated to pay debt service for which the District is already obligated. That is, once a tax is collected, it must be determined how much of the revenue, if any, has existing debt service obligations. Therefore, the alternative proposal must take into account the fact that District law already requires OTR to deposit in special accounts in the General Fund certain amounts from its sales tax collections for specific uses.

For example, under D.C. Official Code section 47-2002.02, the District's 10% sales tax on food or drink prepared for immediate consumption includes a 1% tax earmarked for the Washington Convention Center Authority ("WCCA"). District law also requires that all of the ballpark sales tax collected by OTR under D.C.

Code section 47-2002.05 be deposited in the Ballpark Revenue Fund, except for the 1% to the WCCA. In addition, the Convention Center bonds and certain Tax Increment Financing bonds pledge a portion of District sales taxes for debt service. Thus, the alternative proposal should provide that the $100 million in sales taxes dedicated to school modernization should come out of that portion of OTR sales tax collections that remain after the sales taxes dedicated to the Ballpark Revenue Fund, the WCCA, and any other uses under existing law have been paid into their respective funds.

After setting aside any tax revenue needed to satisfy debt obligations, the remaining tax revenue would be available for school modernization expenditures. The amounts of sales taxes pledged to debt service is not particularly large, but must be considered in the mechanics of pledging sales tax revenues for schools modernization.

This concludes my testimony. I will be glad to answer any questions you may have.

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